

**Phibro Animal Health**

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Mike Ryskin: Start the next session. Thank you for joining us. My name is Mike Ryskin, I'm on the Life Science Tools and Diagnostics team here at Bank of America/Merrill Lynch and also have the privilege of covering the animal health space and that's where our next presenters fall in. With us, we have Richard Johnson, CFO, and Jack Bendheim, Chairman and CEO of Phibro Animal Health Corp. Thank you for joining us, gentlemen. Appreciate you making the trip out here.

I guess just to start off, to get the ball rolling, you reported your most recent quarter a few weeks ago. There's some, you know a lot of moving pieces in the quarter, some positive, some negative. If you could sort of talk through, you know, high level, just a few minutes what were the biggest pieces in terms of dairy, African swine fever, you know, if you added business.

Jack Bendheim: Fine. So, we, we took down the guidance for the year about \$10 million. Our fiscal year ends in June, so our new year starts in July. And there was a bunch of headwinds, one is the continuation of the low price of dairy in the United States and around the world. And we think we came to a realization that the way we went to the market, the customer base has changed. So, historically and it's been for the last 15 years about 9 million dairy cows in the United States and people who had 300, 500 cows had the ability to make a living. That is no longer the case. I remember there was an article in the Times, I think last week, spoke about a family in Wisconsin that has been raising dairy for four generations and now has been forced to get out.

So, our presentation and the products are well known. We did a great job calling on the small dairies, but with this low price, the, the cows have shifted. Now they're on these big, big farms, 10,000 to 40,000 head. Where the analysis is done, very, it's very analytic and no one is really seeing the cows. I mean people see the cows but the owners don't see the cows. And if a cow drops off 1% or 2% in production, you know it very quickly and the cow ends up as hamburger very quickly. Not the case in the smaller farms.

So we've had to adjust and we are adjusting our presentation, just the way we go to the market. So we think starting sort of in January, we'll come out with a new presentation that will be behind us, but the reality is a lot of our customers had gone out of business and the business had declined. So that's on the dairy side.

African swine fever - now everyone's sorting of reading about how it has tremendously affected animal protein for the last six months. The first part of that in China as a producer of sort coming on, they went out and they slaughtered a lot of pigs, put on the market, so the price of protein in China and then eventually around the world, because the US was an exporter, declined. And that affected obviously pork. It also affected chicken. So business was sort of softer and now with the sort of, the going public announcement and again Rabobank as I said on the call has done a lot of great work on this.

There is potentially 50% of the pigs in China that are gone. Give you an idea of what that means. China raises and eats 700 million pigs a year. If 50% are gone, that's 350 million pigs out of the market. And the rest of the world, I mean US, Europe, everyone together raises around 350 million pigs. So we're at a protein crisis because we will not be able to make up the loss. I'm not going to sprinkle in and talk about trade wars cause that just sort of confuses the conversion. But, I think that gets straightened out.

But effectively, the price of protein now going forward is going to go up a lot. But for us, who have worked very hard for 20 years of selling into that market in China, our customers are out. So, we've taken for this quarter our sales down, projecting for the next year are going to be down 80%. We do have a chicken business in China. And what we expect, it's around the rest of the world, everyone is going to be ramping up as quickly as they can to produce the protein, where the protein might be swine, it could be chicken, it could be fish, it could be even dairy too in order to supply China, which is the second wealthiest country in the world and has this huge demand for protein.

Mike Ryskin:

Great, thanks. Actually I want to follow up on both of those points in a little bit more detail, cause I found your comments on the call to be very informative and sort of a new way of thinking about it. I'll start with the dairy markets. The changes that you talked about, just to be clear, the underlying cause of why you've seen this shift in terms of the, the producers, is that tied to the lower end, you know, end customer price of milk in recent years? And is there any opportunity for that to reverse down the road? I know you've changed your sort of near-term outlook, but is this in your mind permanent, done forever? Or you know sort of what's the likelihood of possibly, three, five years down the road that reverses? Then also, is this US phenomenon only or is this something you're seeing, you know, in Europe as well?

Jack Bendheim:

Um, so, the liquid dairy market, which is the historic market in the United States, was a very, very steady market. But when I go home in a couple of days and I open my refrigerator, I'm going to see almond milk. I'm going to see rice milk, right. And so, no matter how often I tell my wife that it's affecting our standard of living, I'm not successful. So--

Mike Ryskin:

I was going to say if anyone should be a proponent--

Jack Bendheim:

I am, but you know the kids are tired of hearing it, so the fact remains that the liquid milk business in the United States has dramatically changed. And I'm not sure how quickly it will change back. I mean, you know, we're all lacto intolerant. We're -- whatever, whatever we manage not to be, we are today. But -- and the larger producers, who can produce at the lower price level, so let me come back. So the old producers, it was all dairy. It was all milk. I mean Dick grew up on a farm in Wisconsin, 20, 30 cows. He came home from school, he had to milk it and he hated it, which is why he went to work as an accountant. You can imagine he had a -- what it will drive someone to become an accountant. And that's what his growing up around dairy farm in Wisconsin. So a lot of those businesses are gone. The newer, the bigger plants, they have their integrated. So they'll have liquid. They'll also produce their own cheeses. They'll have dry powder. It's much more capital and they can afford to do it. So that's a shift. I don't see that shift coming back.

All right, I think that's long, long term. I mean someone was telling me the other day, the small farm, the reason he's staying in business was he found a barista in Brooklyn who on the blackboard behind her puts milk directly from whatever Farmer Jones' farm and because of that he's actually gets a few extra bucks and he's staying in business. Well if that's what happens to the milk dairy industry in the United States, it's not long-term good. So, that's a big change. And again these bigger farms, integrated and they're doing well because then you can export. You can export dry powdered milk. You can export cheeses. You can develop a market directly yourself. Again, that we -- China was the case. It was growing. Now it's sort of out of the picture. But that will come back.

Mike Ryskin: Great. I appreciate that. On the second point, on the African swine fever, you know you mentioned the magnitude of the hit to China and the magnitude of the industry there. But also just thinking about your, the exposure Phibro, 40% poultry, 20% of revenue is dairy, so swine is somewhat a little bit down, down the stream. If you think about potential offsets down the road, because as you said, you know, all these people, they have to be fed somehow. So whether it is poultry, whether it is people restocking with swine down the road, whether it's other protein sources, right doesn't seem like there's -- it's something that people are talking about as a potential, you know, later 2019, maybe 2020. But it's something that's hard right now to put a magnitude on in terms of how much of that will be offset. How do you see that developing and I guess it's hard to frame this in the minds of a different, you know, prior outbreaks because of the magnitude, but are there any prior example you could sort of flag?

Jack Bendheim: Well this is nothing like any prior virus outbreak we've ever seen. For one reason, to date there has been no vaccine that's effective against African swine fever. The virus has been around for over 100 years and the only way it so far seems to be able to contain it is through very, very good biosecurity. And that is quite hard for the Chinese to do. So, they'll get there but this could be around for a long time.

Also I have to say that we're in the vaccine business and we're also looking, we have, we think, interesting approaches, too early to say a lot more than just that, but we're also looking to see if we can develop an African swine fever vaccine. So this is novel, but yes everybody in the world is going to see if they can put on more protein. I mean in the United States three months ago, the farmers are losing \$50 a pig, now they're making \$100 a pig. That's a great incentive to see if you can, if you can put a few more, a 1,000 more head depending on the size of your farm. And we'll see this here. We're seeing it in Brazil. We're seeing it around the world, that everyone is going to increase production and that's a business that we're in and the markets we're in. We'll get our fair share.

Mike Ryskin: But to truly offset it, I mean there are limitations in terms of just the global capacity of trade system to, you know, as you said, if there's 350 million pigs that aren't coming to market, I mean is it really possible to offset that from a production point of view? Is there capacity there?

Jack Bendheim: I don't believe so. I think this is -- I think this is a crisis. I mean if you -- if we wanted to get so involved in all the other trade noises, this is a huge crisis. This is a crisis for China. But if it is a crisis for China, it's also a crisis for the rest of the world. I mean this is, this is about food security. And they will do, I believe, whatever they have to do to provide food for their population, which means they're going to buy up whatever's available and that means poorer countries and poorer people won't want -- won't get

access. So there are lots of shifting pieces here, not all of them fully thought about yet.

But if I want to be, you know, mercenary, I think for Phibro on the smaller set, you know, we participate in China. It was a huge market in a very small way. We participate in these other markets in a larger way. So it doesn't take a lot for us to be able to fill the missing hole. It just takes some time, because you can't, you can't put on -- you can imagine if you're living in North Carolina and someone has a 10,000 pig farm nearby, and they go to the local town for permission to add another 10,000 pigs, you're not going to stand up and say that's a good idea. So, there's going to be some reasons that it's slow, but eventually it will happen.

Mike Ryskin: And the way I've been thinking about it is poultry should probably be the first one to sort of see a response followed by swine and other geographies then last by cattle, both in terms of the, you know, life cycle of the animals and also the cost of the protein. Is that a fair way to think about it?

Jack Bendheim: Are you starting to cover the protein industry? Yeah, absolutely. I mean chicken, chicken's the easiest, so we're going to see those guys move quicker and add more, you know, they can grow faster, then swine. Cattle is also one of taste. I mean I don't think the Chinese, you know, eat a lot of steak, so that will take a long time. Fish would be great, but they'll, they'll do it themselves, I mean they are already the largest grower of fish in the world. You know they'll convert another million acres, whatever they need to do.

Mike Ryskin: Got it. And I'm glad already you also touched on the point of biosecurity and specifically biosecurity in China. If we think about the potential for this to spread elsewhere in the world, as you've said, the virus has been around for a while. There have been outbreaks in wild hogs in Europe for some time, both in Eastern Europe and in Spain. There's currently an outbreak in Belgium, I believe. So how do you think about the risk of this spreading beyond China?

Jack Bendheim: People travel the world today. Everyone, you know I came in last night here to the airport. You see the world coming in and who knows where they came from and who knows what they're carrying. So, I think that's harder. We are, in the United States, we have the best biosecurity system. And if it ever happened here, we'll do a good job and I think that's so far that's the way to contain it. There's no way to cure it yet. So, again, let's hope it doesn't happen here, but it's out -- it's in Europe already as you said, in Spain and they managed to contain it.

Mike Ryskin: And one last point before I want to move off of ASF, just cause I don't want to spend the entire conversation there, is you mentioned, you know, you're obviously working on some potential solutions and probably everyone is. I saw some headlines just in the last couple days of a university in Europe claiming to have a live-attenuated viral vaccine specific to wild hogs. Just curious if you've seen anything on that or if any on these early potential, you know, news flashes are worth following or if you think it's still just snake oil?

Jack Bendheim: I don't want to say it's snake oil. When we come out with our announcement, you'll say the same thing about us. But I think what's unusual about this virus is that it is -- something is going on which is suppressing the immune system in the pig. So, just throwing a standard attenuated vaccine or anything similar like that, is just going to make

the pig sick and there's nothing that allows the, the immune system to respond. So if you don't work on the immune system, at least in our opinion, nothing is going to happen.

So you can do something in a lab, it all could look good, but when you get out. This is a viral virus. These pigs are dying within ten days. You've got to think about that. So, you know, sometimes you give a little bit of the snake oil and end up they'd be dead before you have a chance or whatever to work that's going to work. So, it's not, it's not simple. People, a lot of very smart people in China are working on this thing. The historic ways just don't seem to be working.

Mike Ryskin: Okay, all right. Curious if there's any questions from the audience. We want to keep it sort of open. Yeah--

Unidentified Audience Member: So if you're working on this vaccine, don't they have to be handled in a BSL4 laboratory? Do we have that here?

Jack Bendheim: So the answer is BSL3 is fine. The US is building a BSL4 out in Kansas. But it's a BSL3, which is a biosecurity level. In China, there are very, very few places that have it and we are working on -- I spent a week a month for the last 4 months in China looking and working with people to come up and I think we are close to having an agreement with a BSL3 lab. Because you can't take, you can't move the virus simply out of that country. And we think that's the best place to work. But it's a good point.

Mike Ryskin: I'll ask, just moving down the, the revenue build for a moment. You've talked in the last several quarters on, you know, further diversifying the business and you start talking about some of your developments and potential moving into companion animals. Didn't really get an update on that this quarter. I was wondering if there was anything you could add? As the timelines get a little closer, sort of you know what you're looking for -- looking at, what the focus is?

Jack Bendheim: So, so it's minor good news to report is we have and we've done -- we sold about \$83,000 of -- don't write it down, \$83,000 of product which is a joint supplement product. And the question is, when I see you again or the next call, if the customers have returned it, then we are not doing well in the companion animal business. If there's a reorder, then we're in the business. I think there are opportunities in that business. You know, we spoke on the phone a few months ago, a few quarters ago, about Lyme disease vaccine. We're looking at that. We've now launched this one product. I think we will have a bunch of products that we'll launch. I think there is space for us in the business. We don't have a -- we don't have a sales force, so we don't have to feed a sales force. We could look at this thing in novel ways and it's a huge market, as you know, as you follow. So I think, you know, I think our approach will be successful.

Mike Ryskin: So the sales you've had so far, is that -- that's not for the Lyme disease vaccine?

Jack Bendheim: No.

Mike Ryskin: What's the indication there?

Jack Bendheim: It's basically to help the animal's joint disease. It's in the nutritional side of the business, but we've seen in our own testing some good results. And so far, anecdotally, we've

heard good things reporting back from the vets, who have bought it from the distributor in terms of their customers being happy. But again, \$83,000 doesn't make a business.

Richard Johnson: Yeah, it's really a test marketing phase, right.

Mike Ryskin: Yep, that's great. And then you know going down the road, so you obviously want to keep investing in that. You talked -- you just mentioned the Lyme disease vaccine. Sort of where do you see the biggest opportunities there? And down the road, you know how big do you foresee getting into the segment? Is it still just sort of testing the waters or is it opportunity here to really diversify and this becomes one of your, you know, one of your many segments?

Jack Bendheim: There's actually a possibility this could become a real leg under the table. I mean our strategy here is that with the consolidation of companies in the animal health and companion animal business, that it's not easy for people out there, if someone has a good idea, whether it's a lab or a vet or somebody to go and get someone to pick up their product. You end up going to, to major animal health company, someone's going to say, we looked at that ten years ago. It's a bad idea. We're working on something else. Again we have a clean slate. We have an open mind. We have some very smart people, that's not me, but smart people working on this. And so I think there's a very, very good chance that you know we could have a business and this business could be, I don't know, within 5 years at least a \$100 million business. But again, we're just at \$83,000 of starting.

Mike Ryskin: And I think a few years ago, just thinking about the inorganic side of things, I believe it was when Sanofi and Merial Boehringer Ingelheim did the asset swap part of their US companion animal vaccines portfolio came up. And I think you were one for the bidders for that. So, getting to the point of, inorganic opportunities, obviously continue to see a lot of moves in animal health space with Elanco buying Aratana and then you know a lot of speculation of what Bayer's going to do. Are there inorganic opportunities in companion animal as well? Sort of how do you see the market?

Jack Bendheim: Pricing remains very, very high, which is why we've chosen the old-fashioned path of doing it ourselves and spending, spending money. You know we get hit, obviously, on earnings because we're spending operating income to do this. But we think it's the most logical approach in growing the business. And again we see opportunities, not that we wouldn't do an acquisition but we're just not ready to spend your money and -- just to do a, you know, 20 multiple acquisition.

Mike Ryskin: Yep.

Jack Bendheim: EBITDA.

Mike Ryskin: So then on the, on the internal side of things, on the operating leverage, some pressures in terms of mix, some pressures in terms of FX, but at the same time you're looking to continue to invest to grow the business longer term, both via you know sales force and R&D. So how do you balance those two in terms of investor returns and, and maintaining the, you know, the investment in the future growth of the company?

Jack Bendheim: That way we're opportunistic. We're spending money. Now we acquired a few years ago

from Elanco, a vaccine facility in Sligo, Ireland. We're spending money getting that up and working. So not CapEx, they're just hiring people to work on the regulatory side, to work on the construction plan side. I mean that will be an extension of our current vaccine production in Israel. It'll open up markets, logical markets that we should be selling but whatever reason we can't sell. So we'll have, you know, growth in that business. We're spending money, you spoke about, in companion. We're looking at some new products internally. Again, we're opportunistic. We're looking across the board and we're not betting on any homeruns, just betting on a lot of singles and doubles.

Mike Ryskin: Yep, and if I, you know, just thinking back to a few years ago, looking at sort of the progression in some of the things that have happened in the end markets, 2015, 2016, 2017, obviously there were pressures from the medicated feed additive side of the business in the US. Domestic sales were challenged, but then you had the, you know, very robust offsetting growth in nutritional specialties and in vaccines. As those were sort of the future growth drivers. Now, flash forward, nutritional specialties, as we discussed, just very challenging end market because of dairy. Is there another, you know, is there a way to shift that, to sort of -- is there another growth driver besides the companion animal side of things that we talked about that you could sort of point to, whether it's you know vaccines or, you know, you have a small business in agriculture, is there any particular area that sort of sticks out to you?

Jack Bendheim: So as we're starting to prepare budgets for next year, some of the growth areas is aquaculture, looking mostly to the Far East, is more nutritional specialties, both in poultry and in swine and back in dairy. We're growing our dairy business in Europe and in China. We have the vaccine. We've expanded our production in Israel. We've been -- had a difficult time. Turkey was one of our biggest markets and their FX has been insane, so eventually these things go to some level of stability. I would say this last year's been a perfect storm. I mean I -- what I haven't bring up is our, you know that Mississippi has been overflowing, so our costs are moving some goods to our plant in Quincy, it's a small thing. But, everything's happening, but that's what happens in life. It's like everything else. You know we're in a lot of different businesses, with a lot of different places. We've got a lot of really good people. And I think we deal with all of this stuff.

Mike Ryskin: All right. Any questions from the audience? All right, the -- some of the specific, you know, focusing on the nutritional specialties not on vaccines, a question that we get a lot from investors is, how much of it is sort of a portfolio approach versus one or two specific product drivers that were the growth drivers that are now being challenged? I mean you've called out some of these in the past, either you know both acquisitions and internally developed. So how should we think about product mix beyond the segment level, sort of on a product-by-product basis? And is there anything coming up in the pipeline? You know I know you probably don't want to talk about future products, projects too much but is there something that you're thinking of that could be a, you know, quote, unquote blockbuster, needle mover on its own?

Jack Bendheim: I don't think we'll have a blockbuster and that's just not our business and our strategy. But we have some really wonderful products, poultry products against various you know coccidiosis kind of diseases that is growing. So, our sales are growing and we're getting into Europe, Russia. Sales are growing in all these markets and as we get there, we grow and I think we see repeat business. So we see constant growth in some of our leading

products. We don't have a full suite of products, so our products really have to get out there. We've also launched a new way, let's call it a vaccine gun. We're trying to figure out a name other than a gun, but a vaccine device. We launched it at the poultry show this past February and we're going to start test marketing that and that has -- looks very, very interesting with some very good technology in the way it's produced as well, as well as the intelligence. The device potentially adds for the farmers -- he's able to see what they vaccinate and what their costs are, etc. etc. That'll be something new for us this coming year. So a lot of, you know, I've got a lot of single and doubles, but feeling very confident about the business.

Mike Ryskin: And if you -- again just going back to the first quarter results by some of your competitors, at least in the public markets, Zoetis had a very choppy quarter in the livestock markets for a number of different reasons. Merck called out some weakness in US livestock, even though it's a relatively very small part of their business overall. Elanco had some, some moving pieces here and there. Does that sort of give you an opportunity to gain share? I mean I think Zoetis specifically referenced that they, they face some challenging conditions in Brazil because of some price increases they saw. There was a little bit of distributor stock and destocking in the US. That's one of the feed additive stuff. Is that something you can, you can take advantage of or are the markets just too sticky beyond that and, you know, people are well entrenched in their ways?

Jack Bendheim: We have great competitors. They're all very smart and they all do a great job. We're all out there fighting with the same -- for the same customers sometimes with similar products. And I think we all get our fair share. So, if someone has a down quarter, it's really a down quarter because the animals are not available. And they're not available to us either. We're all going to do very well I believe in these coming years as all of our customers expand. And again it's hard to sit here. I don't want to come back to African swine fever, but I tend to do it. It's hard to imagine what this loss of protein, you know, it's going -- in the second wealthiest country in the world is going to mean. And it's going to mean that everyone is going to look to put on as much -- as many animals and keep those animals alive and healthy and gain weight to supply this, this missing protein. So I think business is going to -- for all of us in the production animal business, business is going to be very, very good for the next five years. I mean I don't want to look beyond five years but--

Mike Ryskin: And then, so on that point, I mean just thinking back to where everyone was three months ago in January, February -- by that point, the outbreak was very well known. It had obviously been, been closely followed in the news, but I think at that point most people were still seeing a potential hit much smaller than what we're talking about today, with the 50% you mentioned. And then again going back two or three weeks, it was being talked about as a 30 to 35% hit. So the number just keeps getting higher and higher and higher. So in terms of where we go from here and when will we know what the response will be in terms of poultry and whatever and the other markets ramping up, is this is a week-by-week monitor event? Is this a, you know, when will we know sort of how the next six months, year, two years shakes out?

Jack Bendheim: A year ago August, China announced they found one pig dead from African swine fever. All right and from that, as you can imagine, it's in China. Is that really true because then we started talking about 5%, 10%. It's under control. It's not under control. Again, Rabobank was reporting 30, 35%. I just got back from China a couple weeks ago, people

I'm talking to are talking about 50%. Who knows? And again you understand it's not, it's not 50% of the pigs who have this disease. What happens is, if you have a farm of 500 pigs and 1 has disease, you cull the other 499. And what has happened is when you do that, the farmer who raised those pigs, no one's reimbursing him or her. So they're not -- this is China, they're not going to put on more pigs. So that's what -- and that's what happened so quickly. You know China is not the most transparent country in the world but if any of you have Chinese friends or family who can get on We Chat, you will be surprised how open they are to this catastrophe. And there are pictures circulating on We Chat talking about some of the better neighborhoods and some cities where the shelves are empty. So, this is major and we'll have ramifications for a very, very long time.

Mike Ryskin: We've spoken internally to a few of our counterparts in China and also that are just involved in the global protein and ag markets and they've told us stories of -- first of all there's a lot of producers out there that in fear of getting one animal sick that they may have, you know, a bunch of animals that are 10%, 15% below market weight and they're not taking any chances of taking a loss and they're just liquidating and getting whatever money they can for now. So that speaks of a lot of protein that you talked about on the market that's sort of suppressing prices in the near term and then there's also some stories of some of the biggest producers in China that did get, you know, some outbreaks. Had to cull the entire herd. They took the expense to try to repopulate and then a month later got it again, because it was still in the soil and they didn't properly disinfect and had to liquidate a second time. And that just -- they used up all their capital and they're done.

Jack Bendheim: My guess is that by this time a month from now, the freezers will be empty. This will be daily on the news, in the Chinese news and it'll start affecting everybody and every business.

Mike Ryskin: Great. If there's no other questions from the audience, I think we're, we're coming up to the end of our time here. So I want to be -- I want to thank you so much for participating. Always--

Jack Bendheim: Thank you for inviting us.

Mike Ryskin: Appreciate the insights, great insights into the industry, Jack. Thank you.

Jack Bendheim: Thank you, Mike.

