Phibro Animal Health Corporation

September 10, 2019
04:05 PM EDT

David Risinger: Good afternoon, everyone. Thank you for joining the session with Phibro. I just need to refer you to disclaimers at www.morganstanley.com/researchdisclosures. It's very much my pleasure to welcome the leadership team of the company here today. Jack Bendheim is immediately to my left. He is the company's Chairman and CEO, and he has been with the company, I guess, since [1969]. So a very long time in the industry and has built the company and continues to grow the company globally over many years. Dick Johnson is the company's CFO. He's also been with Phibro a long time, since 2002. Dani Bendheim, at the end of the row here, is Executive Vice President of Corporate Strategy and has held a variety of operational and leadership roles since joining the company in 1997. Thanks for being here today, appreciate it.

So obviously, the financial guidance was disappointing to the Street and the company has faced sort of an unusual confluence of events in the recent past. I think the way that you've been building the company is still on the same path and on the same track that you have intended it to be.

So maybe you could just talk a little bit about the vision for the company, the path you see from here, and the opportunity to continue to build value.

Jack Bendheim: So the vision for the company is the same as we've had since our acquisition from Pfizer of their Medicated Feed Additives business in 2000. It was to grow the company in all the regions of the world that have protein growth, have production animals. Overall, to build the company in a way that we would be agnostic to species and type of culture, meaning if you want to grow your animal without antibiotics, that's fine. If you want to grow with, that's fine. If you have pigs, or chickens, or cattle, dairy cattle, fish, we want to have all those products and we want to be in the areas that are most likely the parts of the world, which are the best suited to raise these animals.

We continue to do that. We're in the animal health business and it's sort of in a strange way funny. One sees animals gets sick, but no one ever saw animals get so sick that they died. The African Swine Fever that we all have seen now so rapidly grow in China really was a shock to all of us. And to Phibro especially, we've done a great job in building our presence in China. And so it's a very nice business, very comparative with our competitors.

But there is, right now, no vaccine. There is no cure for this disease in China. And as you've read increasingly, there could be up to 70% of pigs missing in China. Put that in the right perspective. China raises and consumes about 800 million pigs a year. So take an easy number like 50%, that’s 400 million pigs a year that have disappeared. The United States, which is a great producer, produces 125 million pigs a year.

The amount of pigs that are missing in China are greater than the rest of the world's production totally. So the impact is huge. Obviously, the impact in China is catastrophic. The impact for protein producers around the world is potentially profitable and potentially great, but the price of all proteins will rise and again, hitting us the way it hit us was a bit of a shock. I mean we owned up to it. We've taken out China from our projections for this coming year. So we've dropped about $40 million in sales.

Notwithstanding that, with the small Osprey acquisition and with the general growth, we're still growing the business year-on-year.

David Risinger: Excellent. And in terms of going into a little bit more detail on Phibro and your competitive advantages in the marketplace, could you discuss some of those and if there are differences geographically that would be helpful as well.

Jack Bendheim: So I think Phibro, from its inception has been a nimble company. We don't have a very, very deep level of management levels. We are all acquainted with the business around the world and we're able to respond quickly to market changes. We're able to respond quickly to new ideas and I think it's sort of been proven by our entry ten years ago into the vaccine business. We've become an important player, especially in poultry vaccines and in swine vaccines in the United States. Taking a small position in nutritional specialties and today being, I would say of all the major animal health companies, the leader in nutritional specialties in both the United States and around the world.

So we continue to grow in the right areas and continue to maintain our business in the areas where we've done well. And I think that’s our competitive advantage.

David Risinger: Excellent. Maybe we could just pivot to a couple of financial questions, Dick. With respect to the outlook for 2020 that you provided, could you just recap that briefly and then talk about cash flow expectations, CapEx, et cetera

Dick Johnson: Well, we're forecasting EBITDA to be down year on year. Midpoint of the guidance is $105 million compared to $118 million this year. Jack mentioned that we're growing sales and we're growing gross profit very nicely. In fact, faster than sales. But we're continuing to move ahead substantially with growth investments, growth initiatives and that's driven up SG&A. So SG&A is up roughly $30 million year-over-year.

About half of that is these strategic initiatives. There's several in the vaccine area. We're building out a new production facility in Ireland that requires you to staff and bring the facility up to speed before you begin to have any sales out of the facility. We are spending on some very interesting technology, a potential vaccine for African Swine Fever. And we have a new injection device for vaccinating poultry initially, and then in the other species eventually, that we're spending on the infrastructure behind that device.

So putting a lot of money behind initiatives for the vaccines. We're putting money behind our companion animal initiative. We can talk more about that and also putting money behind other nutritional specialty products and really putting more data, more information to show our customers that the products make sense.

So that’s kind of a snapshot of our P&L. Cash flow wise, we'll see free cash flow of roughly a breakeven number. We're forecasting a pretty high -- we're forecasting a substantially higher than usual CapEx number for the year, $45 million. This year, we did about $30 million and a lot of that spending is the CapEx side of these vaccine initiatives that I talked about. I think that was both your questions.

David Risinger: That covers it well. And then looking beyond fiscal '20, obviously I'm not looking for guidance, but should we expect the CapEx fade or to stay at that level given the build outs that are occurring.

Dick Johnson: No, you look at our CapEx history, you'll see some ups and downs, but I wouldn't expect the CapEx to stay at the level. I'd expect it to come back down more into our historical average or trend.

David Risinger: Okay. Very good. While we're chatting, I think it would be helpful for you to talk a little bit about how different you see the fiscal second half relative to the fiscal first half.

Dick Johnson: Right. What we've said is most the EBITDA decline year-over-year, really all of the EBITDA decline year-over-year, will happen in the first half of the year. We're going to be continuing this spend pretty evenly over the course of the year and some of the new product initiatives that we have in our guidance for the full year will really begin to hit much more in the second half of the year. While at the same time, we will see this decline in our sales from the lost business, at least in the short run, from the China business that has to do with African Swine Fever.

David Risinger: Okay. Very good. Dani, I wanted to ask a little bit more, and Jack you could answer as well however you see fit, but I wanted to ask just for a little bit more perspective on the MFA business. Obviously, Phibro is a leader but if we exclude China, maybe you could just paint a picture of the size of your MFA business and the trends strategically, volume, pricing, et cetera.

Jack Bendheim: So the MFA business is a broad category. Within that, there is this concept of shared or dual use. So there are products, antibiotics, which there are no replacements for, let's say, other than vaccines, which are used to control various coccidiosis kinds of diseases. That business continues, it's tied to poultry and that business continues to grow.

The big change we've seen is the use of antibiotics for growth promotion or production uses only. And that has come to an end or within the next two, three years. So the only use of these antibiotics that have shared use will be through veterinary prescription, will be for therapeutic use. But the growth in the protein business around the world is not happening in countries that have good biosecurity like the U.S., like Europe. But we're seeing that heavy growth in the Far East. We're going to see big, big growth in Africa where eventually they'll get there but not for the foreseeable future. And they will need, as a tool, they will need the therapeutic use of antibiotics to control bacterial diseases.

So we see our antibiotic business growing, sort of 2%, 3%, 4% annually, shifting over to more therapeutic use. And the prices we said are basically based on the value we give. So the customers need to see value. We've often spoken about this, 3, 5, 10 to 1. And if they get the value that's how we set the prices. And there's always been competition. We have some unique antibiotics that we have no competition in the production of those products. We've been that way for 40 years and I see no reason that will change. So that's the prognosis.

David Risinger: Very good. I guess a better question for you, Dani, would be strategy and some of the recent transactions. So could you shed some light on the transactions that you've executed recently and how they'll add to your growth opportunities?

Dani Bendheim: Sure. The most recent transaction was the Osprey transaction and basically as a follow-up to your MFA question, when you remove antibiotics from growth promotion, the most logical replacement are direct fed microbials. These are products that currently in the U.S., the market estimates are kind of sketchy, but look to be about $150 million in the U.S. Globally, the numbers are much larger. You see number between $2 billion and $3 billion. They're used most heavily in aquaculture and we certainly see that as part of where we are going to be pivoting to with these products.

Phibro was coming out or has worked the last couple of years on a direct fed microbial product called Provia Prime for the U.S. poultry, or introduced initially to the U.S. poultry business. In doing so, we met with a number of different microbial companies out there, half a dozen or so. And ultimately, we decided to work with a company called Osprey to produce the majority of the strains that are in Provia Prime.

Based on that introduction and on working with them, when the opportunity came to purchase them, we were extremely interested. They wanted to work with us. I think the history of our acquisitions in the past have largely been on people and companies that we have a relationship with. They saw that and they liked what they saw, and the principals of Osprey are continuing to work with us.

We looked at them and said this a tremendous fit for us because we independently came to vet their products and their processes versus others and recognize that they are a leader. So we wanted to get basic in this area. And now, we are basic and we see ourselves growing our suite of products not just in poultry but also obviously, in aquaculture as well as throughout the other species.

David Risinger: And maybe you could talk about the timeline for building out that opportunity.

Dani Bendheim: I'd say for a new product you're probably looking at a year, but one of the advantages of, especially within the United States, of being basic here is we believe that there'll be a bespoke element or a custom element as well, where we can go to different poultry farms for instance and recognize the issues they uniquely are facing and come up with a Provia Prime, but with a twist for them for that particular farm within a matter of months.

So we look at this as having unique product for almost every customer, if they required that or if they sought that within the United States. It would take us a little bit longer to roll that out internationally. But those types of product changes could be very quick, more or less like an autogenous vaccine type response.

David Risinger: Very interesting. Thank you. Let me pause there and see if there are any questions from the audience. Yes, just one moment. If you could just wait for the mic.

Unidentified Audience Member: Thanks. I was just curious to get your take on broader industry consolidation. Something like the Elanco-Bayer deal. Does that change your world at all? Does that create opportunities for you? Do you think there will be more consolidation like that? Any kind of response you might have to something like that.

Jack Bendheim: I think the opportunities it will create will come out of antitrust, whether it's U.S. or overseas. If there's something that fits into our portfolio and the price is a decent price, I think we'd be interested. I think on the consolidation side, it more affects the companion animal business where we're just starting. It definitely affects people competing in the companion animal space, looking to the big-box stores, to Amazon, to Chewy, to that mode of operation. So I think that end of the business will get more competitive for all the four big players.

Unidentified Audience Member: And in terms of expansion opportunities in different sectors, aquaculture for example, plans, thoughts?

Jack Bendheim: So aquaculture has always been a big business. But it wasn’t viewed in a commercial way,e way it has been these last ten years. It poses a big problem because most of the registrations for -- so going back, looking at aquaculture there is no species that has as big a bacterial demand pressure as in fish, as in aquaculture, as especially in farmed fish. Maybe just think about it a second. When you have a pond and you put in a little shrimp, and they grow but there's no place to go, right, and there is no current.

So everything that comes in the front end is going to go out the back end. A lot of it is going to get eaten. The bacterial pressure in shrimp is so amazing and so high that it's not unusual, I mean I would say the average yield in Ecuador in Central America is under 50%. That means 50% of the juveniles are not making it. So it's a huge opportunity. Normally, in the rest of the world, we'd have antibiotics approved. But they weren't -- no one was looking at aquaculture as a commercial business until more recently.

So there are very few drugs that are approved and it's a great opportunity for nutritional specialties, for these directly fed microbials that Dani was referring to, also, which is why it's a $1 billion business overseas. A huge opportunity. And now, with the pressure that China is putting on the world in terms of less protein availability, I would say fish is one of the big areas that they're going to look to, to replace pork.

Dani Bendheim: Particularly for Phibro, we've been in the aquaculture -- we got into it a few years ago. This coming year, this coming fiscal year will be the first year we'll pass the $10 million mark in our sales. So we do -- it's taken us a little longer to get to where we'd like to be. We'd like to obviously get past that but we do see it as an opportunity and something that we're starting to work with.

Unidentified Audience Member: I was interested to understand if you have now a critical mass and a foundation to build from, where do you see that going?

Dani Bendheim: Yes, we are -- in different markets, we have -- in South America and in Southeastern Asia, we have people dedicated to the sales of these products. We don't give guidance as far as by species as far as how large we think it's going to be. We passed what we consider a threshold of $10 million, which kind of separates our minor versus our larger species and we look to expand from there.

David Risinger: Maybe we could pivot to dairy briefly. That market has been challenged. Could you just give us an update on sort of a look ahead.

Jack Bendheim: So that market has been challenged. Look ahead, again, strangely because of the protein shortages in China, I think we're going to be seeing around the world increased prices on milk protein. And because milk trade around the world is not liquid milk. It's powdered milk and you can ship that near and far as well as cheeses. So it's more positive. But the effect of the last five years in the U.S. industry has been the closure of small farms.

So where the average size farm numerically in the United States had 100 to 500 cows, effectively all those people are out of business. And the same amount of cows now all reside on farms with 5,000, 10,000 or more. The calculations of someone running a large farm is different than the calculations of someone running a small farm. And our business, specifically OmniGen, was geared towards these smaller farms. There were many of them and we had good market share.

As we said in the call the other day, we're going to reintroduce OmniGen. We have reformulated it. We're finishing up some testing that will be more suitable for the large farmer, for the large farms and we think we will regain lost sales plus grow the business. Because I think we'll have a very competitive offering.

David Risinger: What's the timing of that?

Jack Bendheim: We think we're going to launch it in January of the coming year.

David Risinger: Okay. That’s helpful. Thank you. And then I'm curious about how Phibro thinks about capitalizing on other competitors, what I would call very large product. So does Phibro consider pursuing branded generic versions of large products like Rumensin, for example, that does not have any sort of protection? Or is that just not where Phibro -- where management is taking the business?

Jack Bendheim: So we are not looking to go in the branded generic business. And sort of a follow-up question before you even ask it is our major product, which is still virginiamycin, is a product we've been making for 40 years. And there is no generics. Elanco faced generics in Rumensin for a long time, but it took a very long time to get registration in the United States.

So we're not battled by the same forces they were and it's not a strategy that we think would make sense for us.

David Risinger: Okay. Then with respect to your companion animal initiative, obviously that opens up a new market opportunity. Could you talk about that initial launch and how you envision potentially capitalizing on that and building upon that over time?

Dani Bendheim: Sure. We have publicly talked about two of the products we've licensed. The first product, which we've now started trialing is a product called Rejensa. It's a butylated glucosamine. We are trialing it in the Atlanta region as well as Southern California and Texas. The way we are going to market right now is we are working with one of the big three distributors. We've given them exclusivity but we've also worked with them that they are not just presenting the product, but they're actually detailing it. And the large distributors, obviously they have their own pressures and they are looking at different ways of getting into the market.

They detail equipment, but they traditionally have not detailed products such as this. This is a vet only product, though it's not a pharmaceutical product. It's a nutritional product. And anecdotally, the product is doing really well. There is a lot of -- we've created a lot of data behind the product. The product is -- glucosamine as a category is well understood and works very well. This has a unique feature relative to glucosamine that we think differentiates it and we're excited to see where it can go.

As my father said on the call a couple days ago, we look to give additional color later this year but our expectation is that if it continues to go as it's gone, we would look to launch it nationally.

David Risinger: And the second product?

Dani Bendheim: The second product, which actually was the first step that we licensed is a differentiated delivery system for Lyme vaccine. And that is not as far along. We're hoping to be able to introduce that I think in end of our fiscal '21, early fiscal '22 based on testing and obviously, there's still a few hurdles for that to get through.

David Risinger: Okay. Very good. I think we should close it out there. This has been very comprehensive. Really appreciate you taking the time to be here.

Jack Bendheim: Thank you, David. Thank you for inviting us.

David Risinger: Thank you.