

Phibro Animal Health Corporation

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- Erin Wright: Good afternoon and good morning, everybody. My name is Erin Wright. I'm the healthcare technology and distribution analyst at Credit Suisse. Welcome to the second day of our annual healthcare conference here in Scottsdale. With us today we have Phibro Animal Health. With us, we have Jack Bendheim, Chairman, President and CEO of the company, as well as Richard Johnson, the CFO. We're going to be doing a fireside chat and we'll get started here in just a second. We'll also be hosting a breakout session in room 4 as well, following this. Feel free to send me any questions via email if you do have any that you'd also like to ask. Thank you.
- So, just to kind of get started, can you give us an update on kind of what's transpired in the most recent quarter in terms of any sort of seasonal anomalies, any sort of update kind of from an MFA perspective, focusing more, I guess, on the animal health component?
- Richard Johnson: We had a -- in our animal health business, we had about 3% growth in the quarter, and that was a very strong growth in our faster growing product categories of nutritional specialties and vaccines. They offset some continued shrinkage, as we expected, and as we called out, in our US sales of certain antibiotic products. So, overall, I think it was a quarter as we expected. There wasn't any particular seasonality or other factors behind it, just a good development of the business.
- Erin Wright: And can you speak to where we stand now in terms of your exposure to medicinal feed additive and the associated risk from VFD?
- Richard Johnson: Right. We said on a trailing 12 basis at September we have \$18 million in sales of those products in the United States. So, that's come down over the last two years from the high 30s down to 18. We said there's probably one more quarter of a negative overlap and then we expect that business to more or less stabilize at whatever that new level is going to be.
- Jack Bendheim: Right. But, also, we stressed on the call, we stressed that through that drop we've grown our business. We've grown our business with the same customers with the new offerings we have of vaccines and nutritional specialties. We continue to see that grow. You know, new adapters, our customers sort of adapt, in the US, to the world of not using a lot of antibiotics, and that's a positive trend in the US and generally we see strong business around the world.

- Erin Wright: And I guess on the back of that, just taking a step back, but thinking about sort of the market, where we stand now, how our current utilization trends, maybe excluding some of those factors with the current antibiotic trends. How are current utilization trends across VC scripts here in the US as well as overseas? What are some key highlights in terms of certain geographies?
- Jack Bendheim: The highlights are that overall, both in the US and ex-US, our customers are doing well. There is increased -- you know, economies are growing and strong around the world, and we see increasing demand for protein in all markets. The advantage and unusual part of our business in the US is that a significant part of our customers' business is exported. So, I mean, this week they're talking about signing a big agreement in China by importing over \$4 billion of food. Our customers' products are fitting into that category. It's all about inexpensive protein, high quality, good quality. The US is a player as well as our customers in Brazil and in Australia and South Africa, etc., etc. So, it's the economy that's driving it, it's new people coming into the economy, it's the growth of protein, and we're seeing that around the world.
- Erin Wright: And are you seeing the offset to an increase, I guess you mentioned, your customers adapting sort of to this new market. Are you seeing an uptick in ionophores utilization and some other categories, like the vaccines, for instance? Is that really starting to -- like, what inning do you think we're in, in terms of that?
- Jack Bendheim: That's very granular, so let me back up and tell whoever is here, and whoever is listening, that ionophores is a category of antibiotics. Ionophores is a category of antibiotics that are not used in human health and control certain cocci diseases in chickens and also in pigs, and has certain other applications in cattle. It's a very, very big category of antibiotic use. So, it depends on the nomenclature game. It's in a world where you want to grow animals not using any antibiotics, then you can't use ionophores, either. That is an extreme in the US; it's not the case around the world. So, we're seeing, as countries shift into more controlled production, very, very heavily, we're seeing that in China now, moving very rapidly. The customers will continue to use the products that work well for them and keep the animals healthy. Ionophores is part of that game.
- Erin Wright: And then thinking about OmniGen. Where do we stand in terms of market share, I guess in the US and then also opportunities in other geographies?
- Jack Bendheim: So, OmniGen is our trade name for one of our nutritional products that allows dairy producers, a lot of people who have cows that produce milk, to fight off diseases. It works on the immune factors in these cows. So, our position in the US is about the same, how we view our percentage of market share. But we also are seeing good growth in Europe. We're starting to see growth in China and in other markets, in Mexico and Brazil. So, we are seeing growth in that product line, and it's a great product. And beyond that -- behind that, we have a whole suite of other nutritional specialties for the dairy market, and that's been a strong suite for us and will continue to be.
- Erin Wright: And dairy fundamentals right now, is it improving?
- Jack Bendheim: Lousy in the US. A happy farmer and a sad farmer is about \$0.10 to \$0.15 a hundredweight, so it's not a huge shift, but right now they're not happy. But things can change and they get their amount of cows in line and they can be happy. So, five months ago they were very happy, now they're not that happy.

- Erin Wright: And then switching to the poultry nutritional specialty product that is a more recent launch for you. How is traction with that product? What is the competitive landscape? Is it a developed one in that space?
- Jack Bendheim: So, there is not a developed one. When you move away from using antibiotics and move to nutritional specialties, you open up to many people saying, well, my product is a great product, but we already -- on our product line, and we have a few products there, we're talking about hundreds of millions of birds we have experience with. Lots and lots of data, and we see strong increased demand for the product, because it really works. And it allows, again, the farmer, the grower who wants to move away from using ionophores as well as other antibiotics. It gives them the ability to get the growth and the control of the environment. It works well for them.
- Erin Wright: And how material is that to contributing kind of to your business? Is it material yet or still in embryonic sort of stages?
- Jack Bendheim: We're packed to sell.
- Erin Wright: Okay.
- Jack Bendheim: And we are seeing nice growth with it. It's becoming a material part of the business and continues to grow. We have very, very high expectations for this product line and adjacent product lines we have for poultry.
- Richard Johnson: And much of the growth we've seen the last 18, 24 months has been driven by that -- within the nutritional specialty category. Much of that growth has been driven by this introduction into poultry.
- Jack Bendheim: And what could help kind of accelerate that further? Like, what sort of internal marketing programs and education do you kind of, I guess, employ when you look at that sort of market?
- Jack Bendheim: That's a good point. As we sort of went over on the call the other day, we've increased spending on SG&A. It looks like \$10 million this year over last year. And most of that money is about improving and expanding our sales force, looking at new products, looking technically, running tests, seeing how these products work. So, it's an education. The antibiotics that have come off the market have been on the market for 30 years, two generations of farmers. That's what they knew how to do. So, it's a bit of a new age, and people want to see what they're putting into their animals, is it going to work for them. So, what worked in the state of Arkansas might not work in Maine. It definitely might not work in Sao Paulo region in Brazil. So, you've got to do all this work all the time, and that's -- but we're getting good adoption of these products.
- Erin Wright: And then switching to vaccines, what are some of the key product lines that are really driving growth across that segment that has been a nice growth?
- Jack Bendheim: Well, we're both in poultry. Poultry is the biggest driver out of our Israeli plant, and in the US we have two lines. We have a line that is for salmonella and a line for pigs mostly involved with PRRS and some other diseases. So, around the world we are expanding our footprint and acceptance of some of our key product lines for control of various diseases in poultry, that is coming out of Israel. And in the US, I think we've had

good growth on the poultry side. The warmer weather is not producing enough sick pigs, it affects the business.

Erin Wright: And so how, thinking about the speed of new product lines and heading into sort of the next quarter and into next year, sort of, how should we be thinking about seasonal shifts or patterns to kind of help us kind of forecast from a modeling perspective?

Jack Bendheim: I think we still view, that we'll have growth of vaccines still in double digits?

Richard Johnson: Sure. It will be -- they're relatively small categories, so quarter in, quarter out, you can get some shifts that might give you a bigger percentage or a smaller percentage. But, right, for the year, our guidance, and we're still very comfortable with that. That is, we'll get double-digit growth on both vaccines and nutritional specialties. We'll see some decline in the MFA category due to -- we're going to continue to have a negative overlap through December, probably, on the US sales of certain antibiotics, but overall we expect -- I forget what the guidance said -- I think it was 3% sales growth. And that's still our best expectation.

Erin Wright: And on for the MFA business, how much of it is still sort of the underlying regulatory factors versus consumer-driven pressures on antibiotics?

Jack Bendheim: In the US it's all consumer pressure. The regulatory shift has had some effect in some markets, when there are not enough vets and you can't follow the VFD. I mean, that more affects the cattle people. We're not very big in that category in the US. But overall, around the world, we still see the movement of small farms to larger farms, the overall demands, I said earlier, for protein is very, very strong, especially in Asia and Southeast Asia. So, we see -- we're quite optimistic about the overall product line, including ionophores, including some of these non-medically important -- nonhuman medically important antibiotics around the world.

Erin Wright: And then acquisitions have contributed some to growth. Have you fully lapped contributions from acquisitions at this point?

Richard Johnson: Right, right. We fully lapped that really back in January. We've got a new small Argentine business that we purchased in September, so that will contribute marginally to growth.

Erin Wright: What is that business?

Jack Bendheim: We acquired -- you know, Argentina is one of the biggest producer in the world of cattle. For political reasons they went out of the market; now that shifted with a new regime in Argentina. So, we acquired a small company that has some product lines and has decent penetration into the feedlot business in Argentina. And now, it just happened, we're looking to introduce some of our products into there, and we expect some very, very decent growth in that market.

Erin Wright: So, there is some cross-selling opportunities?

Jack Bendheim: Exactly.

Richard Johnson: It's really a platform for us to have a bigger entry; use their organization and get our products into the cattle segment.

Erin Wright: But primarily beef?

Richard Johnson: Beef, right.

Erin Wright: And in Brazil, particularly South America, any sort of change in the regulatory environment there?

Jack Bendheim: Not that we see. Brazil economically did not do well last year. It's coming back this year. Our business has come back nicely from last year. I mean, there's lots of noise in Brazil, but the whole market is getting stronger and we continue to see good market penetration. So, we're optimistic about Brazil.

Erin Wright: And is that still primarily more on the beef side?

Jack Bendheim: Brazil is everything. It still is a very, very strong poultry market. They are the largest exporters in the world of poultry. But obviously they raise more cattle than any other country in the world, most of it is on range. We have some unique presentations for that market and we continue to see growth in that business, and we will continue to see growth in that business out for the next 10 years.

Erin Wright: Is there any sort of update on Mecadox?

Jack Bendheim: There is no real update other than we've submitted to the FDA, data that we produced that shows the product is safe and effective as it always was. They are reviewing that data right now and we are continuing selling the product.

Erin Wright: Do you have any sort of update on, like, timeline, or it's up to them or is it --

Jack Bendheim: You asked me to give you a timeline on a US government agency, I won't go there.

Richard Johnson: There is no required formal timeline. It's completely at their discretion.

Jack Bendheim: That's a better answer, correct?

Erin Wright: Thank you. Opportunities in aquaculture? Is that at all on the horizon in terms of kind of some sort of, maybe more meaningful or material contribution there?

Jack Bendheim: So, this year we'll do a lot more than we did last year. Still not meaningful, but the world and us and all the competitors are focusing on aquaculture. There are huge opportunities. It's a market where it's poorly regulated but it is becoming more regulated and, again, and more and more measured. So, when that happens, products that we have, that our competitors have, people start looking more seriously. So, I think aquaculture will be a growth market for us and our competitors over the next five years. But it's going to ramp up slowly.

Erin Wright: And what part of regulatory development do you anticipate or what is being sort of discussed?

Jack Bendheim: Well, the regulations are there, but this is a segment of food that really has boomed in the last, say, 10 years, right? If we were sitting here 10 years ago and we were talking about sushi restaurants, we would hardly see them, right? Today it's like Starbucks. So, the demand for fish around the world is growing very, very rapidly. The fish are being

produced but on farms, not in the sea. We've effectively pretty much fished the sea. But now when you come in with a product against certain diseases, you need brand-new approval. To get a drug approved in a new species is 10, 15 years. So, there are products but the regulatory path, which is there, is very slow. On the other hand, most of the products that we have and our competitors have, have been used in poultry and in swine and in cattle, way before the agencies got developed. So, everyone was grandfathered in, so that's the biggest problem here. But we and our competitors, we're all moving on this.

Erin Wright: And \$18 million you mentioned on a trailing 12-month basis going back to the beginning a little bit with the MFA segment. What is that number potentially kind of next year?

Richard Johnson: We haven't -- I think if you look, and I just say we saw a decline of roughly \$4 million in the September quarter, so it would be reasonable to think that there is probably another number of that magnitude. So, we're probably down into the lower teens, and that is plus/minus where we think it will stabilize.

Erin Wright: Okay. And that should help from a visibility standpoint across your business, I would assume?

Jack Bendheim: Well, we won't be battling --

Richard Johnson: We won't be battling that negative overlap, sure.

Erin Wright: And then from an M&A perspective you have done some certain deals, like, the one in Argentina, the -- some of the vaccine deals. I guess what's in your -- how much flexibility do you have, but also what's kind of out there in the pipeline at the moment?

Jack Bendheim: We have nothing in the pipeline, but we're actively looking for opportunities. I mean, it's a space that has become very expensive. There have been a bunch of acquisitions that have been done at very high multiples. We take our shareholders' money very seriously, so we look to buy opportunistically and not bet the farm. So, we'll be doing more acquisitions like we did in Argentina, then looking to do a giant acquisition.

Richard Johnson: And it's also why we're spending more money internally, because we see a lot of opportunities with our -- both our current product portfolio, either taking some of those products and moving them across into other species and also taking them to more geographies. And typically many of the products start in the United States and then we'll look to go to other markets. And then we're developing, looking to develop new products, also. So, that's the other side of business development versus M&A.

Erin Wright: Are there any particular geographies that seem compelling to you that you are not in?

Jack Bendheim: I think we want to be in all the markets that grow lots of animals. So, we don't need to be in every country in the world, but we need to be in the countries that have the ability, I mean, have the land, have the water, have the technical ability. So, there are a few countries left and there are some opportunities for us going forward that way.

Erin Wright: And then do you think that there is sort of a derivative impact at all for you just in light of kind of Lilly, their discussion on potentially spinning out their animal health business? Would there be any sort of increased visibility that maybe you would see some sort of derivative impact from?

Jack Bendheim: Well, I think we've seen in the past, there is -- we're not in the companion animal business. All of our competitors are. So, within any sale or any combination typically in terms of, let's say Lilly. If Lilly decides to sell their business to one of the major competitors, there will be parts of those businesses because of FTC or European commissioner will come out and I think we will be an obvious buyer, potentially obvious buyer. So, with the announcement of Lilly was a little bit of a surprise and I think will keep all the M&A guys busy for a while.

Erin Wright: And then any questions from the audience at all?

Unidentified Participant: Hi. Could you talk about some of your segments outside of your core animal health, what your long-term view or strategy is on performance products or mineral nutrition?

Jack Bendheim: So, mineral nutrition I would say is core to us. Even though the margins are smaller, it's a great steady business, great cash flow business, and it's just a US business, but it puts us in front of every customer every day. We have a very significant market share and we do a great job. And it's a great way to put products in front of the customer. So, that's the biggest non-core, but it's core.

The performance product business is a business we've been in for a long time. Some of those products were sold by my grandfather in 1915. So, we get no prize for longevity, and we are looking to divest and sell off, and we have over time. The business is smaller today than it was five years ago. So, over time we'll get out of those businesses.

Erin Wright: You can't divest those in like one fell swoop, right? It's --

Jack Bendheim: It's a combination. It's not clear. It's not one market and not one customer base. It's pretty diverse, so I think we'll just -- we'll run it out.

Erin Wright: And in the mineral nutrition business from time to time you see some fluctuations of access from a commodity perspective to different types of materials, so can you give us an update there on if there is any sort of shift in that business that we should be thinking about in terms of access to products?

Jack Bendheim: Again, the core of that business is the mineral side of the one-a-day vitamin, one-a-day vitamin and mineral. If you're looking at minerals on a daily basis, if you're doing it or if you're not, you're getting it food, you're getting the zinc, the manganese, your copper, magnesium, etc., etc. So, that's what we're doing for the cattle. We're providing that part of the minerals they need. The sources are global, so there is no shortage ever of you can't get zinc and you can't get copper. Prices fluctuate because they're commodities. It's very transparent. Our customers see it as we see it. So, if prices go up, prices go up in our product lines; if prices go down, prices go down in our product line. The margin stays relatively the same.

Richard Johnson: I think if you just look at the history of our financial history of that business. Top line has been pretty nominal growth, but we've grown the bottom line meaningfully. We've grown the bottom line from \$11 million or \$12 million up to, I think, \$17 million last year. So, that just -- we make some money on the volumes and regardless of whether the commodity prices are up and down. We really have, I'll say, almost no exposure to commodity pricing because of the nature of the business.

Erin Wright: What sort of underlying growth rate should we entertain over just the longer term?

Richard Johnson: It's basically US animal growth, so -- but we're building the business in various ways, so I think that bottom line can grow faster than that. You know, we've grown the bottom line probably mid-single digits on average over the last few years.

Erin Wright: I think I've asked you this before, but -- you don't anticipate kind of delving into a companion animal line just a little bit, but I would think multiples are somewhat high there as well. But what would be the synergies if you did?

Jack Bendheim: The multiples are extremely high there, so BI doesn't need to worry, we're not going to come after them. But we are spending money and looking. We hired some people with very good track records, and we're looking to find within that very broad companion animal business maybe some niche products that we can develop. So, I don't see real synergies other than our manufacturing base, but I wouldn't be surprised if we come out here next year to the conference and we'll be talking about that we've launched one or two products.

Erin Wright: And is there just any sort of, just sort of the evolution of the MFA market? Is there, just speaking kind of the manufacturing a little bit, is there anything you can do from a rationalization of cost-cutting perspective just given sort of the ongoing dynamic there?

Jack Bendheim: Well, the dynamic there is quite interesting because while we see demand falling in the USA for consumer pressure reasons, a much bigger factor for all of us is, and I mentioned before, but changes in China. In China they raise 400 million pigs a year; in the US we raise about 90 million. But in China they raise 400 million pigs and they raise it on farms that sometimes had two or three pigs. It's a major cause of concern for the Chinese government in terms of quality of the animals as well as the environmental. Coming off this last congress of a few weeks ago, Xi mentioned and committed to returning blue sky to China within five years. And immediately what's going on, they're closing very rapidly these small farms, moving them together to large farms. But you get to larger farms, our product -- they start measuring, our products become very important, because they want healthier animals, they want healthier meat, they want a better environment. But we're going to see very, very rapid growth in a lot of these products, not in the USA, but we're going to see it there. Indonesia is going -- 350 million people and they predict a 25% growth in poultry production in the next four years.

So, all of these things pull for various products, whether it's vaccine, nutritional, antibiotics, and I think, I mean, I've sat here for a while in this seat here -- not here, but back there, and I've never been as optimistic as I am now about growth for this industry. I think we're going to go in a great time. It's a great business and it's a recurring and sustaining business.

Erin Wright: Excellent. Thank you. We're going to move over to the breakout.

Jack Bendheim: All right. Thank you.

Richard Johnson: Thanks.