August 28, 2019

Phibro Animal Health Corporation (PAHC)

Q4 June 2019 Earnings Call

CORPORATE PARTICIPANTS

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

Richard G. Johnson Phibro Animal Health Corporation - CFO

CONFERENCE CALL PARTICIPANTS

David Michael Westenberg Guggenheim Securities, LLC, Research Division - Analyst

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

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

Kevin Kedra G. Research, LLC - Research Analyst

Michael Leonidovich Ryskin BofA Merrill Lynch, Research Division - Associate

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Phibro Fourth Quarter Financial Results Conference Call. (Operator Instructions) As a reminder, this conference may be recorded.

I would now like to turn the conference over to Richard Johnson, Chief Financial Officer. You may begin.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Thank you, operator, and good morning, everyone, and welcome to the earnings call of Phibro Animal Health. On our call today, we'll be discussing our fourth quarter and full year ended June 2019 results. On the call today are Jack Bendheim, our Chief Executive Officer; and myself, Richard Johnson, Chief Financial Officer. We'll provide an overview of our fourth quarter and annual results, and we'll also discuss our expectations for the new fiscal year, then we'll open the line for your questions.

Before we begin, let me remind you of some standard things. Our earnings press release and financial tables can be found on the Investors section of our website at pahc.com. We're also providing a simultaneous webcast of this morning's call, which can be accessed on the website as well. Today's presentation slides and a replay and transcript of the call will also be available on the website later today.

Our remarks today will include forward-looking statements, and actual results could differ materially from those projections. For a list and description of certain factors that could cause results to differ, I refer you to the Forward-Looking Statements section in our earnings press release.

Our remarks today will also include references to certain financial measures which were not prepared in accordance with generally accepted accounting principles or U.S. GAAP. I refer you to the non-GAAP financial information section in our earnings press release for a discussion of these measures. Reconciliations of these non-GAAP financial measures to the most directly comparable U.S. GAAP measures are included in the financial tables that accompany the earnings press release.

In addition -- before we get into the numbers, we want to remind everyone that we present our results on a GAAP basis and on an adjusted basis. We present adjusted results that exclude acquisition-related items, unusual, nonoperational or nonrecurring items, including stock-based compensation and restructuring costs, other income and expense that we report separately in the consolidated P&L, and income tax effects related to any pretax adjustments as well as excluding unusual or nonrecurring income tax items.

And now before I get into the financials, let me introduce Jack Bendheim with some introductory comments. Jack?

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

Thank you, Dick, and thank you, everyone, who is joining us this morning.

For both the last completed quarter and our guidance for our new fiscal year, there are really two themes, one external and one internal, that are strongly dictating our financial performance. The external ones is, obviously, African Swine Fever, or ASF, and the internal one is our strategic decision not to pull back the reins of our strategic investments despite the financial and operational impact caused by ASF.

Let me talk a little about these two themes. As we detailed in our press release, we expect roughly a $40 million sales decline in our China business due to ASF in the coming fiscal year. From a glass half full point of view, I note that our projected impact is roughly the same as that publicly discussed by some of our larger competitors, and this speaks to the reality that despite the fact that we have a smaller bundle and less geographic scope, when it comes to head-to-head battles, we are more than able to hold our own. We as a company take great pride in the business we have built in China. And while it's clear the ASF impact will be with us for longer than just this fiscal year, we know that once the dust fully settles, e will be positioned to once again gain a significant share of that market.

On the other hand, a $40 million sales headwind is much more significant to a company of our size than it is to some of our competitors, and we don't have the offsets to fully counteract its impact.

One of the levers we obviously do have relates to spending. We have taken some focused measures relating to our headcount and our manufacturing base. Still, as you saw from our release, our spending in the coming year is expected to increase roughly $30 million and about half relates to discretionary project spending. I am truly excited about several of the projects we are working on, and I expect to begin seeing results of some of them by the end of this fiscal year.

As we have demonstrated in China, when we have the products and services to offer our customers, we can be very competitive and garner our fair share or more, and I'm highly confident that the investments we are making will yield such projects. I'd like to touch on a few of these investments.

As the world moves away from using antibiotics for growth promotion, it is clear to us that the most logical manner to fill the continuing need is through products that benefit the microbiome. Earlier this year, we've launched Provia Prime, our first Phibro-created direct-fed microbial blend for poultry. The early results are already extremely encouraging. Our acquisition of Osprey allows us to be fully basic in this area and will be the linchpin of a whole suite of microbial products we anticipate in producing across multiple species in the coming years.

We know that Osprey products and processes are extremely productive and competitive because in choosing to work with Osprey and Provia Prime, we tested their products against many others in the industry. Our microbial products are reported as part of our nutritional specialties unit, and it's within nutritional specialties that we have the bulk of our dairy-focused products as well.

For too long, we have watched the economics of our dairy customers erode, and while milk numbers are looking up a bit, we have concluded that we need to offer even better products and value to these customers. I'm excited about the category revamp we will be launching around January and believe we have the ingredients through a disruptive suite of products that will not only return this category to one of sustained growth, but will in relatively short order eclipse the peak sales we had in this market a few years ago.

On the pet side, we are now in multiple test markets with our initial product, Rejensa, a supplemental joint care chew that helps support canine joint health. Our focus today has been working through an exclusive distributor with a veterinary-only product. We are carefully seeking to balance our fixed versus variable spending here and are definitely seeking to avoid creating a huge marketing spend on the promise of a product before we're actually able to prove that it meets consumer needs. Initial results in our trial markets have met expectations, and we continue to trial and roll out to new markets. I anticipate being able to provide some additional color later this year.

On the vaccine side, we have a number of impactful investments, some of which we anticipate yielding near-term results. We are, as we speak, beginning to trial in the U.S. poultry market an automated vaccination delivery system known as pHi-Tech. Our patented pHi-Tech system brings two advantages to the market: first, it helps to ensure vaccination injection accuracy, taking a largely manual process and bringing automation to it; secondly, the move to automation allows for the capture of significant amounts of data and enables real-time oversight to optimize management of the vaccination process.

We seem to have tapped an unrecognized and unmet need in the industry. Although our solution replaces what appears on the surface to be an extremely inexpensive status quo, the interest and reception of the industry has been huge in the U.S. and several international markets. If we're able to fully execute here, the results will be substantial from both an industry and financial point of view.

We are also ramping up our pre-commercialization spend at our Sligo Ireland vaccine facility. We anticipate having our first product to sell out of Sligo in mid-2021. We have strong confidence in our ability to be successful here because while the facility is new, we already manufacture the same vaccines in other locations. Once open, Sligo will give us an increased access to European and other key markets for our poultry vaccine.

Finally, circling back to ASF. We are spending significant time and resources on developing a vaccine for this devastating virus. We've made a lot of progress in the last few months and believe we have a unique approach. We're under no illusions here about the likelihood of success. The virus is an extremely difficult one to defeat, and there are several competitive institutions with greater resources that are also seeking to create a vaccine. Still, we're cautiously optimistic about this effort as we believe the solution to ASF is likely not to be a single winner take all and, therefore, the unique approach we are taking may very well complement other approaches being taken.

Additionally, the value of the vaccine alone or in combination is tremendous. The Chinese pork industry is about $130 billion annually. And while obviously only a portion of this figure will be retained by the successful ASF vaccine manufacturer, the potential revenue here is staggering, and we believe the reward to risk inherent in our continued investment is fairly self-evident.

Even with this opportunity, I firmly wish for our customers and for ourselves that ASF would never have occurred. Unfortunately, that is not the situation we find ourselves in and, as a result, the underlying progress our company has made and continues to make is somewhat obscured from view.

Hopefully, some of the reasons why we remain heavily bullish on our future have come across on this call and I look forward to discussing any questions you may have following Dick's review of our fourth quarter and guidance of fiscal 2020. Dick?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Thanks, Jack. Now let's start by reviewing the results for our June 2019 quarter.

Our consolidated sales for the quarter were $204 million, a 4% decline compared to the same quarter last year. Our Animal Health sales declined due to African Swine Fever in China and due to lower Mineral Nutrition sales on reduced selling price and product mix. Growth in Performance Products was a partially offset.

Our reported net income was $8.8 million - that was a $13.3 million decline due to the lower sales and also increased SG&A expenses, including the pretax restructuring costs of $6.3 million that we recorded for both the termination of a manufacturing agreement as well as employee separation costs.

For the quarter, diluted earnings per share on a GAAP basis was $0.22 - that was $0.33 below the same quarter last year. I'll discuss adjusted results on the next page of the webcast.

So looking at selected line items from the P&L, I'll get into the detail of net sales in more detail at the individual segment level.

In total, adjusted gross profit declined $2.2 million, or 3%, compared to the prior year. The gross profit decline was roughly in line with the overall sales decrease. Animal Health gross profit declined in proportion with sales. Mineral Nutrition gross profit was comparable to the prior year, despite the lower revenues. Performance Products gross profit improved due to sales growth, but it was partially offset by unfavorable product mix.

On the SG&A line, adjusted SG&A increased $4.6 million, or 11%, driven by strategic investments in key development projects to position ourselves for future growth.

Our adjusted net interest expense increased $600,000 on higher variable interest rates and higher debt levels, and that all came down to adjusted diluted EPS of $0.33 a share, compared with $0.46 last year, a $0.13, or 28%, decline.

So now looking more closely at the Animal Health business. Net sales for the quarter were $132 million. Sales declined $5.7 million, or 4%, compared to the prior year. The sales decline was principally due to lower demand in China due to African Swine Fever. Sales of MFAs and other were down $5.8 million or 6%. On the positive side, we saw continued volume growth in Latin America and increased penetration in other Asia Pacific countries for MFAs and other.

Nutritional specialties net sales were $28.6 million, an increase of $300,000, or 1%. Encouraging volume growth in international dairy offset continued negative domestic dairy conditions and continued reduced demand from some poultry customers.

Our vaccines net sales of $17.2 million declined $200,000, or 1%, compared to last year. Good growth in Asia Pacific and Eastern European regions was largely offset by the October 2018 loss of a domestic distribution arrangement and the continued turbulent economic conditions in certain international countries.

At the bottom line, adjusted EBITDA of $31.2 million decreased $5.7 million, or 15%, due to a decline in gross profit and increased SG&A cost. Gross profit declined driven by the lower sales volume, partially offset by favorable manufacturing cost for our vaccines. SG&A increased as we continued to make strategic investments in product research and development.

Now turning to our other segments. Mineral Nutrition net sales were $56 million in the quarter - that was a decrease of $4.3 million, or 7%. The decrease was due to product mix and lower average selling prices. Just a reminder - our selling prices are correlated with movement of underlying raw material costs. We did see increased unit volumes, which were a partial offset.

Mineral Nutrition adjusted EBITDA was $3.8 million, which was even with the prior year despite reduced sales. We continue to see progress in returning to improved levels of profitability, despite a highly competitive pricing environment.

Performance Products net sales of $15.9 million increased $2.1 million on growth in personal care ingredients and adjusted EBITDA increased $200,000.

Our corporate or unallocated expenses were $9.8 million in the quarter - that was a $1.1 million increase over last year. The increase was primarily due to increased business development costs. Other factors included increased public company costs, and we did see a benefit from reduced costs of variable compensation.

And now because it's the end of our full fiscal year, I'll do one page on our full year financial results - just talking through those briefly.

Net sales for the full year were $828 million and increased $8 million, or 1%. Animal Health sales were comparable with the prior year. Mineral Nutrition declined slightly while Performance Products grew almost $9 million.

In Animal Health, we saw sales growth in the MFAs and other category, driven by international volume growth, particularly in the Asia Pacific and Latin America regions, partially offset by lower domestic demand. While the Asia Pacific region reported strong sales growth for the full year, sales reduced demand related to African Swine Fever.

In the nutritional specialties category, sales declined 8% year-on-year primarily due to the continued negative dairy industry and some reduced demand from poultry customers.

The vaccine product group declined 5% year-on-year due to the turbulent economic conditions in certain international countries and the loss of a domestic distribution arrangement. We did see volume growth in other international markets that partially offset those reductions.

As I said earlier, Mineral Nutrition sales were down just slightly from the prior year, and on the positive side, Performance Products sales grew 17%, albeit off of a smaller base, on sales growth of personal care ingredients and other industrial products.

Our adjusted gross profit for the full year was $270 million - that was a decline of $3.8 million, or 1%, driven by declines in the Animal Health and Mineral Nutrition businesses. Adjusted SG&A increased $7.5 million, or 5%, as we continued to increase investments in business and product development to position ourselves for future growth. As I said earlier, other factors included increased public company costs offset in part by a reduction in variable compensation.

For the full year, adjusted EBITDA totaled $118 million - that was an $11 million, or 8%, decline from the year earlier, and adjusted EPS came in at $1.53 per share, down $0.21, or 12%, compared to the prior year.

And looking briefly at our capitalization on Page 10. Our gross leverage ratio, which is gross debt to adjusted EBITDA, our gross leverage ratio was 2.8x at June 30. We had $82 million of cash and short-term investments on the balance sheet at year-end. And for the year, we recorded a $7 million source of cash before changes in short-term investments and financing activities.

And now turning to guidance on Page 11. On Page 11, we've shown you just the highlight line items of our guidance for our fiscal 2020.I'll get into more detail on each of these line items in the next few pages, but just to review them briefly, we expect consolidated sales of between $833 million and $863 million - that's 1% to 4% overall sales growth. The Animal Health business will drive the sales growth of the total company, with sales in that business expected to be between $537 million and $557 million - that's an increase of 1% to 5%.

Adjusted EBITDA is expected to be between $103 million and $107 million - that's a decline from the prior year. We'll discuss in more detail our spending on future growth initiatives that are weighing down profitability.

Adjusted diluted EPS will decline somewhat in line with EBITDA, and there are a couple of other factors we'll discuss in a few minutes. It's expected to be between $1.08 and $1.15 per share, also a decline from the prior year.

So looking at Page 12. There are 2 major initiatives we're really focused on in our new fiscal year. One is Animal Health sales growth. We're looking for substantial sales growth out of our current portfolio as well as growth from new product introductions. We're looking for the benefit of the recent Osprey Biotechnics acquisition, and that will, we expect, offset the significant decline we're going to see from our reduced sales in China due to African Swine Fever. And second, we are expecting and planning to increase operating expenses as we continue to spend for strategic growth initiatives. And in addition, there will be a reset of variable compensation. In other words, we're just putting the bonus plan back to more normal levels, and that would be expected to also increase expense.

So if we look at Page 13, this chart shows you the breakdown of where we expect the Animal Health sales growth to come from. We expect our current and new product sales to grow between 5% and 8%. We expect the acquisition and related products to contribute $20 million to $22 million to our sales in 2020 and that's 4% growth.

On the other hand, we see a $40 million hit to our sales from the decline in business in China due to African Swine Fever. That's all in the MFA category. So net-net, all of those pluses and minuses, we expect a growth between $5 million and $25 million in sales - that's 1% to 5% growth overall.

Giving you a little more color on Animal Health sales growth, looking at Page 14. In the nutritional specialties area in our dairy focus, as Jack talked about, we are repositioning key products with a launch planned for midyear. In addition, we're seeing accelerated international growth of this portfolio of products and that will be a significant contributor to our growth overall.

In the poultry segment, we see ongoing growth of our current products as well as the recent launch of Provia Prime. Provia Prime is a direct-fed microbial. It's one of the major reasons we got to know Osprey Biotechnics and eventually came to the point of acquiring that business. It's a gut health product for poultry. Osprey Biotechnics will add to our sales growth for the year. Osprey is a developer, manufacturer, marketer of microbial products and bio products. It serves a variety of applications. We see it fitting very nicely into our overall business.

On the vaccine side, most of our vaccines are for poultry and swine. The recent launch of a new product, a poultry vaccine that's used in the hatchery, MB-1, is expected to give us good sales growth. In addition, we will be moving beyond some negative overlaps both on the loss of a distribution arrangement, which happened in October of last year, as well as some downturns in certain international countries.

In the MFA category, excluding China, we expect volume growth. We expect volume growth in both swine and poultry, in part reflecting our expectations for increased global protein production driven by a supply shortfall in China.

In China, we expect volumes to be negligible as our customers consume their existing purchases, and they will be cautious in placing new orders due to recent regulatory developments.

On Page 16, turning to our operating expenses, our SG&A, selling, general and administrative. We expect those expenses to increase by $28 million to $33 million - that's a 16% to 19% increase. As Jack said, approximately half of that increase is investment in major strategic initiatives to support future growth.

Just briefly touching on many of the same points, building out our vaccine production facility in Ireland, investing in development of a potential vaccine for African Swine Fever, the commercial introduction of our innovative automated vaccination delivery system, all of these will require significant spending in fiscal '20.

Continuing on, we will continue to invest in developing additional data to support the introduction and penetration of current and newly launched nutritional specialty products. And on the companion animal side, we have ongoing product development and market investigation for various products, including our first product launch, Rejensa, a supplemental joint care chew that helps support canine joint health.

The costs of our base organization are stable, and the guidance reflects the effects of recent and anticipated restructuring actions. A reset of variable compensation is expected to contribute approximately 3 percentage points of the overall SG&A increase. And the recent acquisition will also contribute an additional approximately 3 percentage points of the overall SG&A increase.

Adjusted EBITDA, as we talked earlier, is expected to be between $103 million and $107 million, and adjusted net income is expected to be between $44 million and $46 million. The decline year-on-year is due to the decline in adjusted EBITDA. In addition, there is increased depreciation expense and increased interest expense in the current year compared to the prior year.

Net interest expense is expected to increase due to higher borrowing levels. We funded the Osprey acquisition of $55 million by borrowings from our credit facilities. We expect approximately $45 million of capital expenditures during the current fiscal year, and we expect working capital to grow somewhat to support the sales growth. In total, we would expect net debt to increase between $70 million and $80 million over the course of our current fiscal year.

Just other technical items on Page 19. We'd expect the effective income tax rate to be similar to the prior year. And on an adjusted earnings per share basis, we expect shares outstanding to be essentially unchanged from the prior year.

Importantly, on quarterly trends, we expect the full year decline in adjusted EBITDA will occur entirely in the first half of our fiscal year, as we will see the declines in some of the business happened earlier in our year, while the new sales initiatives will become meaningful in the second half of our year.

So with that, operator, that concludes our prepared remarks. So you would open it up for questions, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from David Risinger of Morgan Stanley.

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

I have a couple of questions first for Jack and then I'll follow up with a few questions for Dick. So I've heard a little bit of buzz that ASF may be spreading somewhat to Eastern Europe, but I'm not sure if that is true. Can you talk about that, including any potential risk to your European business? And then second, with respect to your vaccine business, obviously, it faced some pressures, including some different dynamics, but could you just help us understand the competitive landscape to your vaccine business and whether there are any new competitors that are pressuring sales? Or is it other factors that have driven the recent declines?

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

Thank you, David. So to the first question, I mean, African Swine Fever has been out there for over 100 years, and it's been in Europe a long time, as a matter of fact, a lot longer. I mean there've been outbreaks in Spain, and there've been outbreaks in Eastern Europe. And the Chinese claim that it spread to China from Kazakhstan, I mean, from way Eastern Europe. So it's been out there. The difference is that the way it's been handled up to now is with very, very good biosecurity. And pretty much Western Europe, Eastern Europe has managed this disease with good biosecurity. And for that matter, it's also spread through Vietnam and now in the Philippines and other markets in Eastern Europe. Again, it's still about somewhat contained.

In China, for whatever reasons, it's much more difficult to have good biosecurity and, subsequently, we've seen the devastating effect it had there. So we're talking in China about over 50% of the pigs having disappeared. And you understand something, David, which is it's not like every pig has gotten sick, right, but what happens is, it is such a virulent disease that if it hits a farm, over 90 -- 98% of the pigs die and then that same farmer is quite reluctant to put new pigs back on -- back in the barn because the virus stays around. So once it happens, no one is putting new pigs back on. So I mean the Chinese say that they've killed around a few million pigs, but as the reality is, they were talking about -- of a standing pork population between 360 million and 400 million that over 200 million have disappeared. So it's so much more devastating in China than we see in the rest of the world. Plus, China itself accounts -- all of their pigs -- accounts for over 50% of all the pigs in the whole world. And that's why when everyone talks about African Swine Fever, they talk mostly about China.

To your second question, we don't sell MFAs in Europe. So the fact that it is popping up here and there in Europe has no effect on our business. And finally, we see the same competitors we've seen in our poultry vaccine business. And as you recall, what we've said at a few times that the reason for the drop in our sales is we lost the distribution of someone's product in the United States last October, and on an annual basis, we will have annualized that in a few months.

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

That's extremely helpful. And then could you shed a little bit more color on China? So what were the China total sales last fiscal year that just ended fiscal '19? And could you just explain a little bit more what the MFA risk is? You obviously quantified, I believe, the total sales decline of $40 million in China in 2020. But how much of that is due to the new regulatory initiative relative to ASF?

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

So I mean our sales in China have been about $40 million, and we expect basically the business to -- at least for the coming fiscal year, it's not in our numbers, because there is inventory in the market and because of the great decline in the amount of pigs available to consume that inventory, we think it matches up. And it dovetails into -- to us what is surprising that the Chinese are still looking to change their regulatory status and to go as well to therapeutic claims and not leave them what they have. This makes it more difficult to raise pigs in wherever they still have the ability to raise pigs. But our distributors in China want to wait for new regulations to come out and want to make sure that they have the right labels on their products. So between the inventory, changed regulations and, as we said in our statement, because it's difficult to get pigs to be tested, to move pigs around and have them tested, it's going to take us maybe a year or maybe up to 2 years to get the new therapeutic claims. So it all runs around the same numbers. So we have no anticipation of sales for that market. We think it's going to take -- I just saw something this morning in some of the press the people think it can take 4 to 5 years for the Chinese to restock, and that is with some assumption on good biosecurity and some potential vaccine which right now no one has. So this is going to be a long time. But what -- the reality is, in terms of – from our business point of view and I think even you are looking out around the world, is there is still a demand for protein in China, and it's going to shift around the world and might not be satisfied by pork, but be satisfied by chicken grown in China and chicken imported and pork imported and cattle imported and increase in fish industry in China. So this is going to affect the whole world with some big and small ramifications.

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

That's extremely helpful. And if I may, just pivoting to Dick. Dick, could you just talk about the outlook for cash flow from operations in fiscal '20 relative to the $47 million in cash flow from operations that you booked in fiscal '19? And then if you have any comment on dividend prospects.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Dividend prospects are unchanged. We expect the dividend to continue at its current level. No discussions of any change in the dividend. I have to do some quick back calculating...

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

Yes, if you want to circle back on the cash flow...

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes, let me come back to you on that. I just don't have the schedule in front of me.

Operator

And our next question comes from Erin Wright of Crédit Suisse.

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

Do you foresee any sort of turnaround or stabilization in the dairy market at this point, particularly in the U.S. or domestic market? And has there been any sort of major shift in the competitive landscape there when it comes to your OmniGen product?

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

Well, what we're seeing is that -- and what we've seen is approximately 9.3 million dairy cows that exist -- still exist, and they were there 4, 5 years ago and they are today. And the big shift has been in the dairy economics on the farm. So there are very, very few small 100, 200 cow dairy farms left in the United States, and there has been an increase and still increasing farms over 5,000 cows. And that has posed, as we told in the past, some challenges to us because our business in OmniGen was really built on these smaller farms, and the product change that I mentioned sort of at the opening of this conversation is we've readjusted and reformulated OmniGen to where we feel we will have increased the value to where this is presented to some of the larger farms. So we're very optimistic that with those changes, we will get back market share and even grow the business.

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

Okay. That's helpful. And then can you quantify a little bit for us the microbial market for you over time and how big that could be and how a product such as Provia Prime is positioned in this market and when should the contribution be more material and what Osprey also adds for you there?

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

I mean that is a great question. So the microbials have been around for a very, very long time and -- but not used that much in the animal industry. And the reason one used that much is we had some really very effective product of antibiotic. But antibiotics now are out as we all know. I mean the -- and as the producers look around for products that make sense, the products that will affect sort of the gut of the animal at reasonable cost and still fit into some of what we'd call natural, there is nothing better than taking product that sort of originated from the dirt and extracting and developing ranges of microbial products. And that's where -- so the potential is huge. I mean the potential in the markets are in the near-term tens of millions, long terms greater than that. And as we've said earlier, Osprey is very well positioned. They have great technicians, great plans, domestically located and fits all the various points. One of the things we were attracted to was the fact it was owned by a woman. That was important to us as we perhaps had to look at what we should be doing domestically. So I hit all the points, and we think we're going to do great with the company.

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

Okay. That's great. And then just one last one. I guess I was just curious, given some of the further consideration that we've seen across the larger animal health manufacturers, do you think that you could benefit from any sort of disruption, sales force defections or product line divestitures at all?

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

Initially, some of that could depend on how the FTC looks at this acquisition coming up. And if there's any forced divestitures, obviously, we will look. And beyond that, there's always opportunity in disruptions. And I think if there will be opportunities, we will surely look and see if we can gain by them. But on the face of it, I think it's a great acquisition for Elanco, and it doesn't do that much for us.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Just before the next call, circling back to David's question, the numbers we've put out would imply cash flow from operations of between $40 million and $50 million next year, David, that's roughly right in the same range as we have this year.

Operator

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

Kevin Kedra - G. Research, LLC - Research Analyst

Maybe first one for Dick for the clarification on the comments about the EBITDA decline being somewhat -- or entirely captured within the first half of the year. It sounded like a lot of that was a function of the movement of revenues, but given the increase in SG&A, is that going to be kind of stable throughout the year? Or are we going to see that SG&A increase also front-loaded in the first half of the year and thus leading to that EBITDA decline?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Well, the spending we talked about on all of the various initiatives, that's give or take going to happen evenly across the fiscal year. So we will have higher operating expenses sort of coming right out of the gate at the beginning of this new fiscal year. And then you're right, the revenue -- we'll see more of a hit to revenue in the first half of our year, and that's why we're going to see -- really all of the year-over-year decline hitting us in the first half of the year.

Kevin Kedra - G. Research, LLC - Research Analyst

All right. And then assuming you might be able to quantify a bit more about how much you're spending on the African Swine Fever vaccine, and the spending on that program you talked about it being maybe a 3- to 5-year program, is that something we should expect to be -- that spending to be consistent over the next several years? Is there lumpiness there? Just wanted to kind of think big picture about that program.

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

So we've sort of put a bunch of things together. I think the spending will be heavily this year, past with the next year. If we are successful in developing a vaccine, what takes long is then the testing -- the approvals on the testing. What's unusual about our approach to this vaccine is that there's always 2 things that's putting any product out into the marketplace. One is safety. Obviously, safety is the most important. And efficacy, historically, was done by the market, but now it's also regulators want to see the efficacy of a product. What's unusual about our approach to this vaccine is we're not incorporating the African Swine Fever virus into it. So our putting out a vaccine that won't spread the virus. So it's not a safety issue, it's obviously on efficacy because our approach is sort of different. We're just looking to the protein side.

So we take 3 to 5 years because everyone says 3 to 5 years and then no vaccine, especially when there's greater demand. I don't know. It could be faster if we show the regulators that we have a product that can work, that can slow down this virus and have an effect. And as I said earlier, it's such a huge market and, basically, one has to vaccinate every pig because you want to basically protect every pig from the potential. So if we just see initially that this thing only looks like it's going to work 50%, 50% of $135 billion is, what, I don't know, $60 billion, $65 billion market you're saving. So the potential is huge, especially with our approach because, again, we are working -- looking -- it's a little bit different; as a matter of fact, it's very different. But we made some very, very interesting successful steps so far.

Operator

And our next question comes from Michael Ryskin of Bank of America Merrill Lynch.

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

First, I wanted to start with something we talked about a lot in the past, and it's the expectation that as ASF is sort of ravaging China and all of Southeast Asia and the supply in those markets goes down, you expect a little bit of a rebound in Latin America and Brazil in terms of the production of swine and now that could have set some of your revenue losses in China specifically. Didn't spend as much time on the call, although you kind of hinted at it. I wanted to get a better sense if you have any updated expectations on that in terms of timing or magnitude, probably not the next couple of months, but is there something that could factor into your rebound in the second half of the year in terms of fiscal 3Q, fiscal 4Q pickup?

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

So as I said in answer, I think, to Erin's question, there is a protein shortage in China, and I think it will be filled, obviously, if there is pork available. That would be number one. The places you can add relatively easily pork production is in South America, mostly Brazil. You can do some growth in the United States. The U.S. is caught up in the trade wars, and that side is difficult. But none of this will get anywhere close to the amount of pork protein that's missing. So we do expect to see in our business around the world both in the U.S. and in South America because this tends to be, I think, fungible. Everywhere anyone's raising protein, so whether you are fishing or you are doing poultry or pork or cattle, all these – the prices are moving up rapidly. In one of the articles I've read this morning, it said, in the last 3 days, the price of pork in China jumped 9%. So all these things will have an effect. And yes, as they have effect and people put on more increased production as people raise heavier weight, as people look to get better yields, all these things will benefit our business, and yes it's somewhat factored in. It's hard to take a big plug number, but it is factored in for us and, I'm sure, all of our competitors as well.

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

Okay. And then on the comments on SG&A increase year-over-year, the reinvestment back into the business, you highlighted that about half or $15 million is discretionary. Going beyond the comments on ASF you just talked through, is this sort of the new spend going forward? Or is this a little bit of fiscal year 2020 we have to adjust to the market so we're going to ramp up then, but then in the out years, you can see that number sort of return back to fiscal year '18, fiscal year '19 levels?

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

I think to answer that, it is how wisely we spend our money, and you are trusting us and we're trusting ourselves spend it wisely. So we think these various projects we're working on will give us great returns, every single one of them. If we do that, then hopefully we'll bring those products to market, we'll make more money, and we'll find new things to spend money on. That will be the great way to grow this business, and you will be very happy with us, and we will be happy with ourselves. So on the other hand, if we are completely unsuccessful, and we don't know what the hell we're doing, then we're going to stop.

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

All right. Appreciate it. One last one if I can squeeze it in. Again, a follow-up on an earlier comment on Elanco-Bayer acquisition, and I want to focus on your balance sheet and your optionality to do some tuck-in M&A. You talked through your leverage, and we know about the Osprey deal, but still I know you were very active -- or you tried to get involved when Boehringer Ingelheim and Merial were doing their asset swap and some assets came up for sale. What's your ability to sort of leverage up now? And is that still a focus for you going into this year? Or is the focus more on the internal operations and getting the initiatives you've outlined [at fixing it all]?

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

I have my attorney at this table, and he frowns at me. But someone told me I should take a look at the WeWork IPO to look at leverage. So I don't know today. We're dealing in a crazy world out there, and Dick put up on the screen that I think we are...

Richard G. Johnson - Phibro Animal Health Corporation - CFO

With Osprey, we'll be a little north of 3x leverage.

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

Right. Normally, if I am sitting opposite you, you would ask me do I sleep well at night with such high leverage. But the fact it means that there's a lot of money out there. And one can do -- for the right acquisition, I think money is available.

Operator

(Operator Instructions) Our next question comes from David Westenberg of Guggenheim Securities.

David Michael Westenberg - Guggenheim Securities, LLC, Research Division - Analyst

So can you remind us again on your companion animal strategy, if you are going to maybe be adding any headcount there, if there is any spending on companion animal that accounts for some of that $30 million in additional SG&A spend? And then if companion animal opportunities do become successful, is there opportunities to maybe change that thought in terms of investment there?

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

Good question. Our approach to companion animals is that we've said this in the beginning, we started with a clean slate. We're not looking to add sales force. We're not looking to work in that direction. I think we're looking to bring products, unique products to the market that maybe or not going to be as large factors as what some of these giant companies are doing. And as they consolidate, obviously, the interest of them carrying smaller products reduces. So we think these are some unmet needs, and right now our strategy, as we said, was to work exclusively with one distributor and using that distributor's sales force as we go ahead, and we talk and try to grow these products. So right now we've launched one, we're looking to do more. But we're not looking to spend a ton of money in our own SG&A. The money we're spending on is on research and on...

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Development.

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

Development.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

It's not on organization, it's not the sales force.

David Michael Westenberg - Guggenheim Securities, LLC, Research Division - Analyst

Okay. And then just a quick bookkeeping kind of question. You get a little bit on the accretion on Osprey. I know we can do a little bit of the math with $20 million and 3% increase in SG&A due to that. But can you maybe run us through maybe on the EPS level or maybe give us the COGS kind of work their way through that math?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes, I think we've told you what we're going to tell you. The pieces -- it's a nicely profitable business. It more than covers the increased interest expense from making the acquisition. So it's accretive after covering all incremental costs.

Operator

And this does conclude our question-and-answer session. I would now like to turn the call back over to Richard Johnson for closing remarks.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

All right, everyone. Well, we thank you for your interest in the discussion this morning. We will talk to you again when we put out our first quarter results. Until then, thanks, and take care. Bye now.

Operator

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