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Jun 09, 2020

Phibro Animal Health (PAHC)

$27.21 (As of 06/08/20)

Price Target (6-12 Months): **$29.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 05/04/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:B
	Value: B | Growth: B | Momentum: D	

Summary

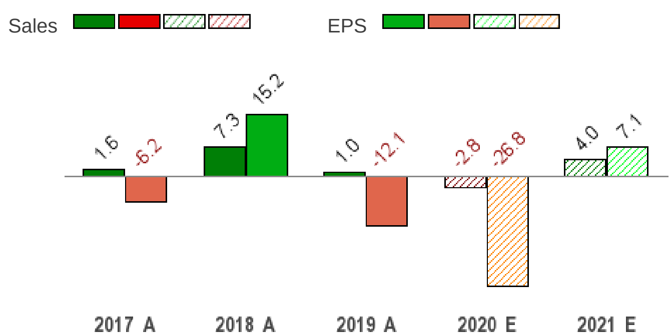
Phibro exited third-quarter fiscal 2020 with better-than-expected earnings. The uptick in revenues despite business disruptions stemming from the pandemic is encouraging. The robust growth in the key operating segment of Animal Health and strong volume growth in domestic poultry and dairy products contributed to the company's top line. The acquisition of Osprey Biotechnics and robust international demand for the company's poultry vaccines and adjuvant sales growth further instill investor optimism. Expansion of gross margin is encouraging as well. Phibro shares have outperformed the industry in the past six months. However, revenue decline in two of its core segments and contraction in adjusted operating margin are concerning. The withdrawal of fiscal 2020 guidance is another cause of worry.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$33.97 - $16.87**
20 Day Average Volume (sh)	**147,839**
Market Cap	**$1.1 B**
YTD Price Change	**9.6%**
Beta	**0.45**
Dividend / Div Yld	**$0.48 / 1.8%**
Industry	**Medical - Products**
Zacks Industry Rank	**Top 23% (59 out of 252)**
Last EPS Surprise	**8.6%**
Last Sales Surprise	**NA**
EPS F1 Est- 4 week change	**-3.6%**
Expected Report Date	**08/25/2020**
Earnings ESP	**0.0%**
P/E TTM	**21.9**
P/E F1	**24.3**
PEG F1	**5.5**
P/S TTM	**1.4**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021					837 E
2020	190 A	214 A	211 A		805 E
2019	200 A	218 A	206 A	204 A	828 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					$1.20 E
2020	$0.19 A	$0.34 A	$0.38 A	$0.22 E	$1.12 E
2019	$0.39 A	$0.41 A	$0.39 A	$0.33 A	$1.53 A

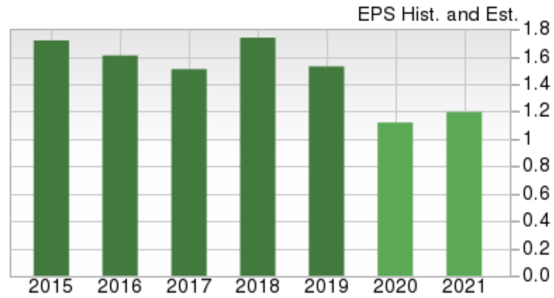
*Quarterly figures may not add up to annual.

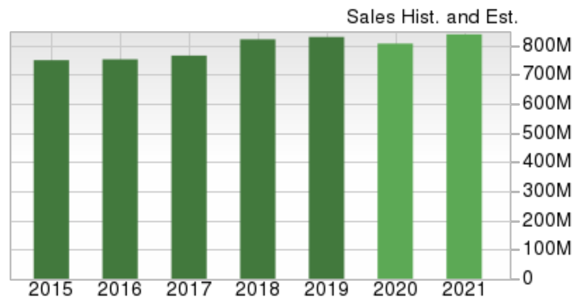
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/08/2020. The reports text is as of 06/09/2020.

Overview

Headquartered in New Jersey, Phibro Animal Health Corporation is a leading global diversified animal health and mineral nutrition company. The company provides a broad range of products for food animals including poultry, swine, beef and dairy cattle and aquaculture. In addition to animal health and mineral nutrition products, Phibro manufactures and markets specific ingredients for use in the personal care, automotive, industrial chemical and chemical catalyst industries. At present, Phibro sells over 1,200 products in more than 65 countries.

Currently, Phibro focuses on regions where the majority of livestock production is consolidated in large commercial farms such as the U.S., Brazil, China, Russia, Mexico, Australia, Turkey, Israel, Canada and Europe.





Business Segments

Animal Health (64.3% of total revenue in FY19) develops, manufactures and markets more than 550 product presentations including antibacterials, anticoccidials, nutritional specialty products and vaccines.

Mineral Nutrition (28.2% of total revenue in FY19) manufactures and markets more than 400 formulations and concentrations of trace minerals such as zinc, manganese, copper, iron and other compounds, with special focus on customers in North America.

Performance Products (6.4% of total revenue in FY19) manufactures and markets a number of specialty ingredients for use in the personal care, automotive, industrial chemical and chemical catalyst industries, predominantly in the U.S.

Reasons To Buy:

▲ **Share Price Performance**: Phibro has outperformed its industry for the past six months. The stock has gained 11.9% against the industry's 2.2% loss. Phibro exited third-quarter fiscal 2020 with better-than-expected earnings. The uptick in revenues despite business disruptions stemming from the pandemic is encouraging. The robust growth in the key operating segment of Animal Health and strong volume growth in domestic poultry and dairy products contributed to the company's top line. In the quarter that represented the early stage of global lockdown, core Animal health segment improved by 8%. Vaccines and nutritional specialties products continued to show double-digit growth.

Phibro's diversified product portfolio, the benefits of the recent MJ Biologics deal, and the company's significant presence in the emerging markets bolster our confidence in the stock.

Further, the acquisition of Osprey Biotechnics and robust international demand for the company's poultry vaccines and adjuvant sales growth further instill investor optimism. Expansion of gross margin is encouraging as well.

▲ **Animal Health Market Growth Continues**: Phibro Health is well positioned in the fastest growing food animal species segment of the animal health market with significant presence in poultry and swine. Going by a MarketWatch data, the global Animal Health Care market was valued at %45800 million in 2018 and will reach $66900 million by the end of 2025, growing at a CAGR of 4.9%. With such an optimistic trend prevailing in the market, Phibro's animal health business is doing well. We are also encouraged to note that, Phibro as a leading provider of Medicated Feed Additives (MFA) products, has the potential to best capture the huge and growing animal health market worldwide.

During the third quarter of fiscal 2020, Animal Health net sales grew 8% year over year despite the pandemic challenges and the lower sales in China that the company is facing since the beginning of the fiscal. The company witnessed increased demand from poultry and cattle customers in the United States and Latin America. This helped to largely offset lower volumes in China, due to the effects of African swine fever and a phased regulatory change that began Jan 1, 2020.

Within Animal Health, Nutritional specialty product sales rose 23% on increased organic volume in domestic poultry and dairy products. In addition, the recently-completed acquisition of Osprey Biotechnics accounted for approximately half of the year-over-year sales growth at the segment. Apart from this, net vaccine sales increased 28% year over year, driven by robust international demand for poultry vaccines as well as enhanced market penetration.

▲ **Diversified Product Portfolio**: With rise in scarcity of natural resources, demand for efficient production of animal food such as poultry, swine and cattle have increased. By 2050, the world will need to double food production to feed an estimated global population of 9.1 billion (as per United Nations World Population Database). Meeting this need requires cost-effective production of safe, high-quality animal protein.

Phibro's key animal health products, including MFAs and nutritional specialty products facilitate in enhancing animal nutrition. Phibro's leading product franchise, Stafac/V-Max/Eskalin, is approved in more than 30 countries for use in poultry and swine and is regarded as one of the leading MFA products for livestock. Similarly, the company's nutritional product offerings, such as OmniGen-AF, are used increasingly in the global dairy industry. The company also manufactures vaccines which protect animals from both viral and bacterial disease challenges.

On the other hand, Phibro's mineral nutrition products strengthen an animal's diet and helps maintain its optimal health. Management believes the diversity of species and product categories enhances the company's sales mix and lowers sales concentration risk.

Currently, the company is focused on expanding its footprint in the poultry, swine and cattle industries in both domestic and international markets. The complementary nature of its animal health and mineral nutrition portfolio provides Phibro with unique cross-selling opportunities that can help reach out to new customers or strengthen relationships with existing ones. We believe such a diverse portfolio will allow the company to comfortably address the distinct growing conditions of livestock in different regions of the world.

▲ **Potential in Emerging Markets**: Phibro's existing operations and established sales, marketing and distribution network in over 65 countries, provides it ample scope to take advantage of global growth opportunities. Outside the United States, Phibro's global footprint extends to key high-growth regions (countries where the livestock production growth rate is expected to be higher than the average growth rate) including Brazil and other countries in South America, China, India and Asia Pacific, Russia and former CIS countries, Mexico, Turkey, Australia, Canada and South Africa and other countries in Africa.

Phibro has continued to invest in the Far East Asia where huge growth is expected in poultry and dairy industries. Currently, the company is expanding its dairy business in the markets of Australia, Brazil and Mexico. We believe given the turmoil that is currently prevailing in the economies of Russia, Greece, Brazil and China, Phibro has performed quite well of late and bears the potential to continue the healthy performance, going ahead.

▲ **Prospering Vaccine Business**: Phibro is focusing on new developments along with incremental registrations and growing volumes of existing nutritional specialties and vaccine technologies. Last December, Phibro bought the assets of KoVax, an Israel-based developer and manufacturer of vaccines for the international aquaculture market. The buyout has widened Phibro's portfolio of aquaculture products.

Earlier, the company purchased MJ Biologic's swine vaccines in the United States. Further, Phibro had become the exclusive distributor of MJ Biologicals that works on research and development of animal health products. Both the firms are working on the joint development of certain animal vaccines. So far, the collaboration has helped expand Phibro's U.S. swine product offering to include specialized vaccines.

The company recently launched the pHi-Tech vaccination device. The initial trials have started delivering impressive results. The company has signed up its first customers for the trials and expects the product to contribute to its top line in the long term.

▲ **Stable Solvency Structure with Heavy Payout Load**: Phirbo Animal Health exited third-quarter fiscal 2020 with cash and cash equivalents of $82 million compared with $75 million at the end of the second quarter. Meanwhile, total debt came up to $367 million, a slight decline from the sequentially-last-reported figure of $373 million. Although, the reported quarter's total debt was much higher than the corresponding cash and cash equivalent level, the company has current-year-payable debt of $17 million on its balance sheet, much lower than the present level of cash in hand. This is good news in terms of the company's solvency position particularly during the year of global pandemic when it is majorly facing manufacturing and supply halt globally.

The quarter's total debt-to-capital stands at 65.3% a moderately leveraged balance sheet right now. It represents a sequential rise from 63.2% in the second quarter. On the other hand, the company's fiscal third-quarter interest coverage stands at 4.7%, a marginal fall from the sequentially-last quarter's figure of 4.9%.

Phirbo's capital deployment policy is based on the return of shareholders's money through dividends and share buybacks. The company's current payout ratio stands at a 0.39. Amid the pandemic-led economic crisis, if production and supply halt along with lockdowns continue through the next few months, the company might find paying its regular quarterly dividends to be over burdened.

Reasons To Sell:

Product Launches Get Postponed Due to Pandemic: With regards to various pipelines of the company's products and projects, Phirbo noted that, in the current situation, it is extremely difficult to launch new products. The company stated that, it is definitely noticing a pause in the uptake of OmniGen Pro, Provia Prime, Rejensa due to social distancing requirements and therefore had delayed the launch of pHi-Tech.

For the fiscal fourth quarter too, Phirbo is expecting soft demand for its products as well as projects an projects an increase in costs associated with the reduction of the risk of virus attack to the company's manufacturing employees.

Customer consolidation can adversely affect Phibro's revenues. Moreover, headwinds such as unfavorable currency movement and tough competitive scenario continue to pose threats.

Foreign Exchange Headwinds: Phibro conducts operations globally, which entails transactions in a variety of currencies. Although a portion of Phibro's revenues are denominated in various currencies, the selling prices of the majority of its products outside the United States are referenced in U.S. dollars. As a result, Phibro's revenues are not significantly directly affected by currency movements. However, the company is subject to currency risk to the extent that its costs are denominated in currencies other than those in which the company earns revenues. Notably, Phibro manufactures some of its major products in Brazil and Israel, where production costs are largely denominated in local currencies, while selling prices are largely set in U.S. dollars. As such, the company is exposed to changes in cost of goods sold resulting from currency movements and may not be able to adjust its selling prices to offset such movements. In fact, management in particular believes that the current strong U.S. dollar is affecting the company's export market.

Competitive Landscape: Phibro is engaged in highly competitive industries. With respect to its major products, it thus faces threat from a substantial number of global and regional competitors. Phibro's competitive position is based principally on its product registrations, customer service and support, breadth of product line, product quality, manufacturing technology, facility location, and product prices. Some of the company's principal competitors, with greater financial, R&D, production and other resources, include Bayer AG, Ceva Santé Animale, Boehringer Ingelheim International GMBH, Eli Lilly and Company (Elanco Animal Health), Huvepharma Inc., Lallemand Inc., Merck & Co., Inc. (Merck Animal Health and MSD Animal Health), Pharmgate LLC, Southeastern Minerals, Inc., Virbac and Zoetis Inc. Moreover, consolidation continues to rise in the animal health market, which might work in favor of Phibro's competitors. Thus, the company faces a tough competitive scenario in nearly all the markets wherein it operates.

Generic Pressure to Affect Growth: Phibro also faces competition from generic alternatives of some of its products. The company depends primarily on trade secrets to provide management with competitive advantages for many of its products. The protection afforded is limited by the availability of new competitive products or generic versions of existing products that can successfully compete with Phibro's products. As a result, Phibro faces competition from such new competitive products or lower-priced generic alternatives. These days, generic competitors are becoming more aggressive in terms of pricing, and generic products form a considerable proportion of overall animal health sales in certain regions. If animal health customers increase their use of new or existing generic products, it will adversely affect Phibro's financial health and operational performance.

Last Earnings Report

Phibro Q3 Earnings Top Estimates, Revenues Up Y/Y

Quarter Ending	03/2020
Report Date	May 07, 2020
Sales Surprise	NA
EPS Surprise	8.57%
Quarterly EPS	0.38
Annual EPS (TTM)	1.24

Phibro Animal Health reported adjusted earnings per share of 38 cents in the third quarter of fiscal 2020, reflecting a 2.6% fall from the year-ago 39 cents. The figure, however, beat the Zacks Consensus Estimate by 8.6%.

Meanwhile, without adjustments, GAAP earnings per share was 33 cents, down 10.8% from the year-ago count.

Net Sales

In the quarter under review, net sales totaled $210.7 million, up 2.4% year over year owing to strength in the company's Animal health business.

Segmental Sales Break-Up

During the third quarter, Animal Health net sales grew 8% to $139 million. Within this segment, sales of medicated feed additives (MFAs) and other declined $1.4 million, reflecting a 2% year-over-year decline. The higher demand from poultry and cattle customers in the United States and Latin America were offset by reduced volumes in China due to African Swine Fever and regulatory changes effective Jan 1, 2020.

Within Animal Health, nutritional specialty product sales rose 23% to $6.4 million on volume growth in domestic poultry and dairy products. The acquisition of Osprey Biotechnics also aided sales at the segment.

Apart from this, net vaccine sales totaled $4.8 million, showing an increase of 28% year over year, driven by robust international demand for the company's poultry vaccines and adjuvant sales growth.

Net sales at the Mineral Nutrition segment fell 7% year over year to $56.2 million owing to lower average selling prices. However, the decline was partially offset by higher overall unit volume.

Net sales at the Performance Products segment fell 2% to $15.6 million owing to lower volume of personal care products' ingredients.

Margins

Phibro's third-quarter gross profit rose 7.3% year over year to $69.5 million. Also, gross margin expanded 148 basis points (bps) to 32.9%.

Selling, general and administrative expenses in the reported quarter were $48.2 million, up 13.9% from the year-ago quarter.

Adjusted operating profit declined 5.3% year over year to $21.3 million and adjusted operating margin contracted 83 bps to 10.1% in the quarter under review.

Financial Update

The company ended the third quarter of fiscal 2020 with cash and short-term investments on hand of $82 million compared with $75 million at the end of second-quarter fiscal 2020.

Cumulative net cash provided by operating activities at the end of the third quarter was $55.5 million compared with the year-ago figure of $32.3 million.

Cumulative capital expenditure amounted to $24 million at the end of the third quarter, reflecting an increase from the year-ago $19.8 million.

FY20 Outlook

The animal production industry is facing business interruptions due to the coronavirus pandemic in the form of demand disruption and production impacts, including the ability to process animals. Further, pronounced price declines at the producer level for all proteins are hampering production levels.

Given the current economic uncertainties, Phibro is not able to estimate the overall impact on its operations and financial results in the near term. Accordingly, it withdrew all guidances for fiscal year 2020. Phibro, however, is anticipating a decline in product demand in the fourth quarter.

Valuation

Phibro shares are up 9.6% in the year-to-date period and down 9% in the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Medical sector are down 3.5% and up 0.2% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 0.7% and up 3.4%, respectively.

The S&P 500 index is up 0.2% in the year-to-date period and up 11.9% in the past year.

The stock is currently trading at 22.8X Forward 12-months earnings, which compares to 31.5X for the Zacks sub-industry, 23.3X for the Zacks sector and 23.4X for the S&P 500 index.

Over the past five years, the stock has traded as high as 28.1X and as low as 10.1X, with a 5-year median 19.5X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $29 price target reflects 24.3X forward 12-months earnings.

The table below shows summary valuation data for PAHC.

Valuation Multiples - PAHC

		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	22.82	31.47	23.31	23.35
	5-Year High	28.1	31.47	23.31	23.35
	5-Year Low	10.12	17.01	15.94	15.23
	5-Year Median	19.45	20.12	19.04	17.49
P/S F12M	Current	1.32	3.93	2.82	3.63
	5-Year High	2.53	3.93	3.74	3.63
	5-Year Low	0.85	2.88	2.21	2.53
	5-Year Median	1.49	3.28	2.91	3.02
P/B TTM	Current	5.64	2.97	4.32	4.41
	5-Year High	62.37	4.26	5.05	4.56
	5-Year Low	3.3	2.19	2.92	2.83
	5-Year Median	9.33	2.78	4.28	3.65

As of 06/08/2020

Industry Analysis **Zacks Industry Rank:** Top 23% (59 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
Eli Lilly and Company **(LLY)**	Outperform	1
Cardiovascular Systems, Inc. **(CSII)**	Neutral	3
Elanco Animal Health Incorporated **(ELAN)**	Neutral	3
IDEXX Laboratories, Inc. **(IDXX)**	Neutral	4
MerckCo., Inc. **(MRK)**	Neutral	3
Neogen Corporation **(NEOG)**	Neutral	3
Patterson Companies, Inc. **(PDCO)**	Neutral	4
Zoetis Inc. **(ZTS)**	Neutral	4

Industry Comparison Industry: Medical - Products

	PAHC	X Industry	S&P 500	LLY (Industry Peers)	MRK	ZTS
Zacks Recommendation (Long Term)	Neutral	-	-	Outperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	1	3	4
VGM Score	B	-	-	D	B	B
Market Cap	1.10 B	374.04 M	23.56 B	142.71 B	209.25 B	67.11 B
# of Analysts	3	3	14	6	7	12
Dividend Yield	1.76%	0.00%	1.8%	1.98%	2.94%	0.57%
Value Score	B	-	-	B	B	D
Cash/Price	0.07	0.10	0.06	0.01	0.04	0.03
EV/EBITDA	12.25	-0.15	13.19	23.84	14.78	29.26
PEG Ratio	5.66	4.08	3.18	1.79	2.29	5.03
Price/Book (P/B)	5.63	3.72	3.19	44.64	7.99	24.38
Price/Cash Flow (P/CF)	12.17	18.05	12.52	21.07	12.39	31.06
P/E (F1)	25.00	34.05	23.31	21.92	15.47	42.49
Price/Sales (P/S)	1.35	5.55	2.51	6.18	4.35	10.59
Earnings Yield	4.12%	0.09%	4.15%	4.56%	6.47%	2.36%
Debt/Equity	1.79	0.10	0.76	4.37	0.82	2.22
Cash Flow ($/share)	2.24	-0.01	7.01	7.08	6.69	4.55
Growth Score	B	-	-	D	D	B
Hist. EPS Growth (3-5 yrs)	-3.58%	12.07%	10.87%	16.98%	9.00%	20.59%
Proj. EPS Growth (F1/F0)	-26.80%	0.82%	-10.76%	12.72%	3.28%	-8.63%
Curr. Cash Flow Growth	-7.92%	5.43%	5.48%	-7.51%	5.54%	18.22%
Hist. Cash Flow Growth (3-5 yrs)	4.96%	7.71%	8.55%	9.27%	0.15%	16.87%
Current Ratio	2.72	2.73	1.29	1.11	1.11	2.77
Debt/Capital	64.17%	14.48%	44.75%	81.39%	45.14%	68.98%
Net Margin	4.48%	-27.05%	10.59%	23.97%	21.10%	25.41%
Return on Equity	24.23%	-9.21%	16.26%	194.18%	52.46%	67.72%
Sales/Assets	1.06	0.56	0.55	0.59	0.57	0.56
Proj. Sales Growth (F1/F0)	-2.72%	0.00%	-2.62%	7.23%	2.59%	-1.97%
Momentum Score	D	-	-	F	B	A
Daily Price Chg	-0.62%	0.72%	1.55%	0.00%	0.78%	0.21%
1 Week Price Chg	4.50%	0.17%	7.51%	-2.45%	1.91%	1.16%
4 Week Price Chg	19.55%	5.42%	15.61%	-5.89%	6.40%	11.80%
12 Week Price Chg	53.30%	42.93%	38.10%	15.33%	18.56%	32.01%
52 Week Price Chg	-9.00%	0.00%	3.66%	30.97%	0.51%	28.20%
20 Day Average Volume	147,839	242,625	2,648,536	3,597,354	10,040,113	1,994,428
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-3.57%	0.00%	0.00%	0.00%	0.09%	0.41%
(F1) EPS Est 12 week change	-8.47%	-12.93%	-15.97%	0.57%	-7.16%	-15.80%
(Q1) EPS Est Mthly Chg	-23.21%	0.00%	0.00%	0.00%	0.00%	-4.78%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Value Score	B
Growth Score	B
Momentum Score	D
VGM Score	B

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.