

Phibro Animal Health Corporation

PAHC - BUY - Still Positive Post In-Line F2Q15 Because Margin Expansion Story Continues to Play Out

February 10, 2015

- **Conclusion:** Post F2Q15 results, we remain positive on PAHC because sales growth (driven by volume) and margin expansion continue to be robust. Therefore, the sustainability of PAHC's earnings growth is still underappreciated, in our view. We expect upwards consensus earnings revisions to drive PAHC's stock higher because: 1) Global trends over the next several decades support the need for PAHC's products, and 2) PAHC is a leader in high-growth sectors of Animal Health.
- **F2Q15 positives that support our thesis:** 1) Entry into the swine vaccine market through agreement with MJ Biologics includes commercialized and pipeline drugs. 2) Animal Health net sales grew 10%, primarily from volume; MFAs grew 9%; Nutritional specialty products grew 27%; Vaccines declined 8%. 3) Gross profit increased 10%, to 29.7%; majority of improvement came from Animal Health. Animal Health gross profit increased \$5.3MM, with about \$4.3MM due to volume growth and product mix and \$1.3MM due to higher average selling prices. 4) Continue to see good volume demand worldwide.
- PAHC reported F2Q15 EPS of \$0.35, in-line with consensus and \$0.05 better than our estimate. Our Variance Analysis table has details. Management reaffirmed its '15 EPS guidance of \$1.60 at the midpoint of the ranges (consensus was \$1.60 and we were \$1.57). We updated our model for F2Q15 results and this did not change our F'15 EPS estimate.
- **Potential Catalysts.** 1) Increasing market share and geographic expansion of existing products, '15+; 2) New product approvals and launches, '15+; 3) Gross margin and operating margin expansion, '15+; 4) Debt paydown reduces interest expense, '15+; 5) Tuck-in acquisitions, '15+.

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PAHC BUY

EARNINGS RELEASE

Investment Thesis: Growth

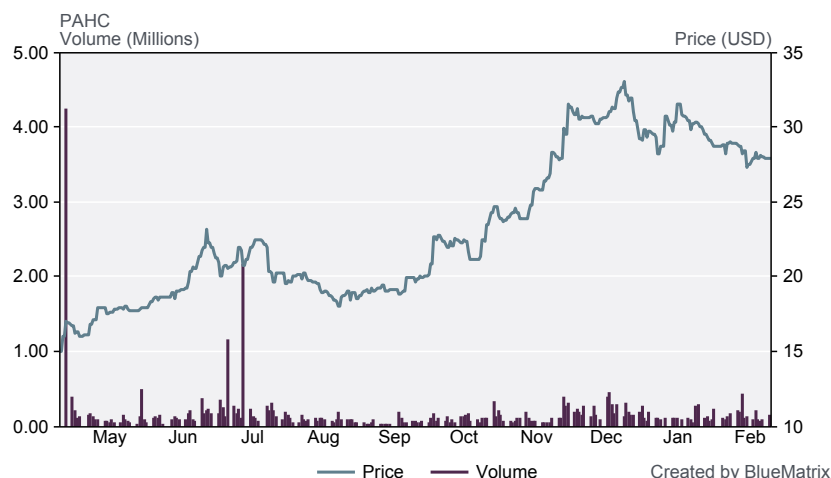
SHARE PRICE	\$28.04
PRICE TARGET	\$35.00

Revenue (\$M) (FY Jun)	1Q	2Q	3Q	4Q	FY
2014	162.2	172.7	173.3	183.7	691.9
2015	187.5	188.7	192.8E	198.0E	767.0E
Prior	—	175.3	185.8E	190.4E	739.0E
2016	—	—	—	—	798.0E

Adjusted EPS (\$)	1Q	2Q	3Q	4Q	FY
2014	0.30	0.35	0.36	0.22	1.22
P/E					23.0x
2015	0.51	0.35	0.34E	0.36E	1.57E
Prior	—	0.30	0.37E	0.39E	—
P/E					17.9x
2016	—	—	—	—	1.76E
P/E					15.9x

Market Data & Valuation Multiples

52-Week Range	\$15.00 - \$33.89
Shares Out (M)	17.5
Market Cap (M)	\$1,093
ADV (3 mo; 000)	175



SCENARIO	VALUATION	INVESTMENT THESIS
Bull Case	F2015E EPS: \$1.90 12-Month Bull Case Scenario: \$45 Upside/Downside Potential: 60%	<ul style="list-style-type: none"> • 5-year sales and EPS CAGRs of 10% and 20%, respectively • 600 bps of operating margin expansion from F'13A to F'19E • Business development
Base Case	F2015E EPS: \$1.57 12-Month Base Case Scenario: \$35 Upside/Downside Potential: 25%	<ul style="list-style-type: none"> • 5-year sales and EPS CAGRs of 6% and 11%, respectively • 547 bps of operating margin expansion from F'13A to F'19E • No additional business development
Bear Case	F2015E EPS: \$1.45 12-Month Bear Case Scenario: \$25 Upside/Downside Potential: -11%	<ul style="list-style-type: none"> • 5-year sales and EPS CAGRs of 3% and 7%, respectively • 500 bps of operating margin expansion from F'13A to F'19E • No additional business development

Source: Guggenheim Securities, LLC

VALUATION METHODOLOGY AND RISKS

We use a DCF analysis to get to our 12-month price target of \$35. We use a WACC of 12% and an exit multiple of 13x forward EBIT to arrive at our price target. This compares favorably to other Animal Health companies, which trade on average at a forward EV/EBIT of 16x. This compares favorably to similar companies that have been acquired at a historical EV/EBITDA of 11x, which means the EV/EBIT would likely be even higher. Risks to our valuation include: 1) regulatory restrictions on the use of antibacterials in food-producing animals; 2) increased competition from larger and better capitalized companies in the industry; 3) adverse weather conditions and the availability of natural resources; 4) lack of new product launches and/or existing products fail to gain market share.

PHIBRO VARIANCE ANALYSIS

	Actual F2Q15 Amount	Guggenheim Estimate F2Q15 Amount	Variance	Comments
Total Revenue	188.7	175.3	13.3	Driven by volume growth in Animal Health, and, price and volume in Mineral Nutrition.
COGS	132.6	119.6	13.0	
Gross Profit	56.1	55.8	0.3	
SG&A and R&D	35.2	38.0	(2.8)	
Other Operating Expenses	0.0	0.0	-	
Operating Income	20.8	17.8	3.1	
Non Operating Items	-3.5	-3.2	(0.3)	
Pre-Tax Income	17.3	14.5	2.8	
Taxes	3.2	2.6	0.6	
Tax Rate	18.5%	18.0%	0.5%	
Net Income	14.1	11.9	2.2	
Averages Shares	39.8	39.7	0.2	
Operating EPS	\$0.35	\$0.30	\$0.05	
Margin Analysis				
Revenues	100.0%	100.0%		
COGS	70.3%	68.2%		
Gross Margin	29.7%	31.8%		
SG&A and R&D	18.7%	21.7%		
Net Income	7.5%	6.8%		

Source: Guggenheim Securities, LLC and Company reports

CATALYST CALENDAR

Date	Driver	Upcoming Event
Calendar 2015+		
2015	Carbadox	Codex could adopt language curtailing its use
2015	Teaneck, NJ	FDA re-inspects facility, issued 483s last time
Late 2016	U.S. Animal Health Antibiotics	FDA wants sponsors to complete process for label changes relating to new GFI213

Source: Guggenheim Securities, LLC and Company reports

FINANCIAL MODEL

(\$ in MM, except per share amounts)	Phibro F2015	Midpoint	Guggenheim F2015
	Guidance		Estimate
Net Sales	\$739 to \$759	\$749	\$767
Net Sales Growth	7% to 10%	8.5%	10.1%
Adjusted EBITDA	\$103 to \$107	\$105	\$109
Adjusted EBITDA Growth	14% to 18%	16.0%	8.8%
Adjusted diluted EPS ⁽¹⁾	\$1.57 to \$1.62	\$1.60	\$1.57
Diluted Average Shares Outstanding	39.6		39.8
Capex	\$25		\$25

Source: Guggenheim Securities, LLC and Company Reports

(1) Cash taxes of \$10MM to \$12MM. Running slightly below 20% tax rate for the year.

Phibro Animal Health - Quarterly Margin Analysis 2009-2021E

	2009	2010	2011	2012	2013	2014	1Q15A	2Q15A	3Q15E	4Q15E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
COGS	75.7%	74.0%	76.3%	74.9%	72.6%	69.5%	67.8%	70.3%	68.9%	68.6%	68.9%	67.2%	66.5%	65.9%	65.3%	64.7%	64.2%
Gross Margin	24.3%	26.0%	23.7%	25.1%	27.4%	30.5%	32.2%	29.7%	31.1%	31.4%	31.1%	32.8%	33.5%	34.1%	34.7%	35.3%	35.8%
SG&A and R&D	15.1%	16.4%	16.4%	17.1%	18.1%	19.2%	18.2%	18.7%	20.7%	20.8%	19.6%	20.1%	20.0%	20.0%	19.9%	19.3%	18.8%
Oper. Inc.	9.3%	9.7%	7.3%	8.0%	9.3%	11.4%	14.0%	11.0%	10.4%	10.6%	11.5%	12.7%	13.5%	14.2%	14.8%	15.9%	17.0%
Operating Expenses	15.1%	16.4%	16.4%	17.1%	18.1%	19.2%	18.2%	18.7%	20.7%	20.8%	19.6%	20.1%	20.0%	20.0%	19.9%	19.3%	18.8%
Non-Oper. Items	-5.8%	-5.8%	-5.5%	-5.4%	-5.5%	-2.0%	-1.9%	-1.9%	-1.7%	-1.6%	-1.8%	-1.8%	-1.7%	-1.4%	-1.1%	-1.0%	-0.9%
Pretax Income	3.4%	3.9%	1.8%	2.6%	3.9%	9.4%	12.1%	9.2%	8.7%	9.0%	9.7%	10.9%	11.8%	12.8%	13.7%	14.9%	16.1%
Adjusted Net Income	2.7%	3.8%	1.2%	1.5%	2.8%	7.6%	10.8%	7.5%	7.1%	7.3%	8.1%	8.8%	9.5%	9.0%	9.6%	10.5%	11.3%

Source: Guggenheim Securities, LLC and Company Reports

Phibro Animal Health - Quarterly Revenue Model 2011-2021E

(\$ in Millions)															
(Year Ended June 30)	2011	2012	2013	2014	1Q15A	2Q15A	3Q15E	4Q15E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
MFAs & Other	273.3	290.5	303.7	326.8	80.8	87.4	88.0	90.8	347.0	373.0	401.0	431.0	463.4	498.1	535.5
Nutritional Specialties	43.1	47.7	52.3	67.5	19.5	20.8	21.0	21.7	83.0	90.0	96.8	104.0	111.8	120.2	129.2
Vaccines	28.8	36.9	28.9	41.4	16.9	10.6	11.3	12.2	51.0	57.0	61.3	65.9	70.8	76.1	81.8
Animal Health	345.2	375.2	384.9	435.7	117.2	118.8	120.3	124.7	481.0	520.0	559.0	600.9	646.0	694.4	746.5
Mineral Nutrition	209.3	210.1	203.2	205.4	55.4	58.7	58.5	58.4	231.0	206.0	208.1	210.1	212.2	214.4	216.5
Performance Products	63.9	68.8	65.0	55.8	14.8	11.2	14.0	15.0	55.0	65.0	65.3	65.7	66.0	66.3	66.6
Other New Products	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.0	15.0	20.0	25.0	30.0	35.0
Total Revenues	618.3	654.1	653.2	696.9	187.5	188.7	192.8	198.0	767.0	798.0	847.4	896.7	949.2	1005.1	1064.7
% Change															
MFAs & Other		6.3%	4.5%	7.6%	3.6%	9.2%	8.1%	3.9%	6.2%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Nutritional Specialties		10.7%	9.8%	29.0%	38.0%	26.6%	29.9%	4.3%	22.9%	8.4%	7.5%	7.5%	7.5%	7.5%	7.5%
Vaccines		28.1%	-21.9%	43.4%	86.2%	-7.7%	10.4%	15.1%	23.2%	11.8%	7.5%	7.5%	7.5%	7.5%	7.5%
Animal Health		8.7%	2.6%	13.2%	15.8%	10.0%	11.6%	5.0%	10.4%	8.1%	7.5%	7.5%	7.5%	7.5%	7.5%
Mineral Nutrition		0.4%	-3.3%	1.1%	20.0%	15.9%	17.2%	-0.6%	12.5%	-10.8%	1.0%	1.0%	1.0%	1.0%	1.0%
Performance Products		7.8%	-5.5%	-14.3%	-0.2%	-20.9%	-10.0%	33.7%	-1.4%	18.2%	0.5%	0.5%	0.5%	0.5%	0.5%
Other New Products		NM	NM	NM	NM	NM	NM	NM	NM	NM	114.3%	33.3%	25.0%	20.0%	16.7%
Total Revenues		5.8%	-0.1%	6.7%	15.6%	9.2%	11.3%	4.9%	10.1%	4.0%	6.2%	5.8%	5.9%	5.9%	5.9%

Source: Guggenheim Securities, LLC and Company Reports

Phibro Animal Health - Annual Revenue Model 2011-2021E

(\$ in Millions)																						
	Year End June 30,											2012/	2013/	2014/	2015E/	2016E/	2017E/	2018E/	2019E/	2020E/	2021E/	CAGR
	2011	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2011	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Base Business																						
MFAs & Other	273.3	290.5	303.7	326.8	347.0	373.0	401.0	431.0	463.4	498.1	535.5	6.3%	4.5%	7.6%	6.2%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Nutritional Specialties	43.1	47.7	52.3	67.5	83.0	90.0	96.8	104.0	111.8	120.2	129.2	10.7%	9.8%	29.0%	22.9%	8.4%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Vaccines	28.8	36.9	28.9	41.4	51.0	57.0	61.3	65.9	70.8	76.1	81.8	28.1%	-21.9%	43.4%	23.2%	11.8%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Total Animal Health	345.2	375.2	384.9	435.7	481.0	520.0	559.0	600.9	646.0	694.4	746.5	8.7%	2.6%	13.2%	10.4%	8.1%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Mineral Nutrition	209.3	210.1	203.2	205.4	231.0	206.0	208.1	210.1	212.2	214.4	216.5	0.4%	-3.3%	1.1%	12.5%	-10.8%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Performance Products	63.9	68.8	65.0	55.8	55.0	65.0	65.3	65.7	66.0	66.3	66.6	7.8%	-5.5%	-14.3%	-1.4%	18.2%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
Other New Products	0.0	0.0	0.0	0.0	0.0	7.0	15.0	20.0	25.0	30.0	35.0	NM	NM	NM	NM	NM	114.3%	33.3%	25.0%	20.0%	16.7%	NM
Total Revenues	618.3	654.1	653.2	696.9	767.0	798.0	847.4	896.7	949.2	1,005.1	1,064.7	5.8%	-0.1%	6.7%	10.1%	4.0%	6.2%	5.8%	5.9%	5.9%	5.9%	5.9%

Source: Guggenheim Securities, LLC and Company Reports

Phibro Animal Health - Cash Flow Analysis 2012-2021E

(\$ in Millions)										
(Year ended June 30)	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Cash flows provided by Operating Activities:										
Net Income	7.0	24.9	(3.1)	62.4	70.4	80.2	80.4	91.4	105.0	120.2
Depreciation and Amortization	17.5	19.0	21.5	21.5	21.5	21.5	21.5	21.5	21.5	21.5
Amortization of deferred financing costs, imputed interest & debt discount	1.7	1.9	1.4	-	-	-	-	-	-	-
Other	0.5	(10.6)	7.7	-	-	-	-	-	-	-
Net Changes in Working Capital	5.1	(34.8)	(28.2)	(19.8)	(8.6)	(15.3)	(15.7)	(16.9)	(15.1)	(16.1)
Net cash provided by Operating Activities	31.9	0.4	(0.7)	64.0	83.2	86.3	86.2	95.9	111.4	125.5
Cash flows from Investing Activities										
Purchases of PP&E	(14.8)	(19.9)	(19.8)	(25.0)	(25.0)	(25.0)	(25.0)	(25.0)	(25.0)	(25.0)
Net proceeds from sale of assets	0.6	1.3	-	-	-	-	-	-	-	-
Acquisitions, net of cash acquired	(3.4)	(18.7)	-	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)
Other	-	-	0.4	-	-	-	-	-	-	-
Net cash used in Investing Activities	(17.6)	(37.3)	(19.4)	(35.0)	(35.0)	(35.0)	(35.0)	(35.0)	(35.0)	(35.0)
Cash flows from Financing Activities										
(Repayment) or Issuance of long term debt	(8.2)	13.9	(80.1)	2.6	(54.0)	(30.0)	(35.0)	(40.0)	-	-
Cash dividends paid	-	(3.0)	(25.0)	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)
Other	-	-	109.7	-	12.0	10.0	-	-	-	-
Net cash (used in) provided by Financing Activities	(8.2)	10.9	4.6	(12.4)	(57.0)	(35.0)	(50.0)	(55.0)	(15.0)	(15.0)
Effect of exchange-rate on cash	(0.7)	(0.5)	-	-	-	-	-	-	-	-
Net (decrease) increase in cash and equivalents	5.3	(26.5)	(15.5)	16.6	(8.8)	16.3	1.2	5.9	61.4	75.5
Cash and equivalents at beginning of year	48.6	53.9	27.4	11.8	28.4	19.6	35.9	37.1	43.0	104.4
Cash and equivalents at end of year	53.9	27.4	11.8	28.4	19.6	35.9	37.1	43.0	104.4	179.9

Source: Guggenheim Securities, LLC and Company Reports

Phibro Animal Health - Balance Sheet Analysis 2012-2021E

(\$ in Millions)

(Year ended June 30)	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Assets										
Cash and Cash Equivalent	53.9	27.4	11.8	28.4	19.6	35.9	37.1	43.0	104.4	179.9
Accounts Receivable	99.1	99.1	113.9	125.5	132.8	143.4	154.3	166.2	176.0	186.4
Inventories	120.1	140.0	143.2	156.8	159.1	167.2	175.3	183.9	193.0	202.7
Other current assets	28.7	29.8	30.4	30.4	30.4	30.4	30.4	30.4	30.4	30.4
Total Current Assets	301.9	296.4	299.3	341.1	341.9	376.9	397.2	423.5	503.8	599.5
Plant, Property & Equipment	101.7	104.4	109.2	112.7	116.3	119.8	123.3	126.9	130.4	134.0
Intangible	15.0	35.2	29.8	29.8	29.8	29.8	29.8	29.8	29.8	29.8
Other assets	22.3	38.2	34.1	44.1	54.1	64.1	74.1	84.1	94.1	104.1
Total Other Assets	139.0	177.8	173.0	186.6	200.1	213.7	227.2	240.8	254.3	267.9
TOTAL ASSETS	440.9	474.1	472.3	527.7	542.1	590.6	624.4	664.3	758.1	867.3
Liabilities & Shareholder's Equity										
Current portion of long-term debt	5.4	0.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Accounts Payable	67.9	57.9	59.6	65.1	66.0	69.4	72.8	76.3	80.1	84.1
Accrued Expenses and other current liabilities	52.6	57.4	49.9	49.9	49.9	49.9	49.9	49.9	49.9	49.9
Total Current Liabilities	125.9	115.4	112.4	117.9	118.9	122.2	125.6	129.1	132.9	137.0
Long term debt	344.8	365.5	286.4	289.0	235.0	205.0	170.0	130.0	130.0	130.0
Other liabilities	58.5	62.1	58.3	58.3	58.3	58.3	58.3	58.3	58.3	58.3
Total Liabilities	529.1	543.1	457.2	465.2	412.2	385.5	353.9	317.5	321.2	325.3
Shareholders Equity	(88.2)	(68.9)	15.1	62.5	129.9	205.0	270.5	346.8	436.9	542.1
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	440.9	474.1	472.3	527.7	542.1	590.6	624.4	664.3	758.1	867.3

Source: Guggenheim Securities, LLC and Company Reports

ANALYST CERTIFICATION

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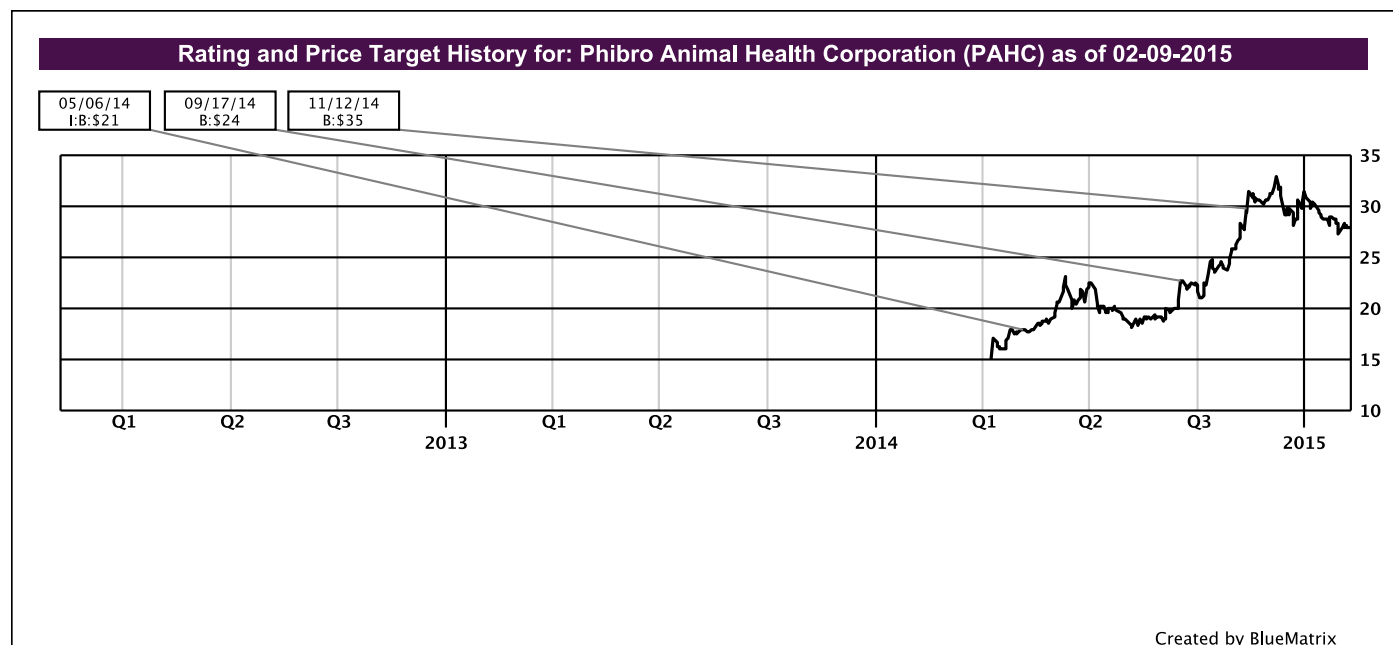
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Guggenheim Securities, LLC or its affiliates received compensation for investment banking services from Phibro Animal Health Corporation during the past 12 months.

Guggenheim Securities, LLC or its affiliates expect(s) to receive or intend(s) to seek compensation for investment banking services from Phibro Animal Health Corporation in the next 3 months.

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RATING DEFINITIONS

BUY (B) - Describes stocks that we expect to provide a total return (price appreciation plus yield) of 10% or more within a 12-month period.

NEUTRAL (N) - Describes stocks that we expect to provide a total return (price appreciation plus yield) of plus 10% or minus 10% within a 12-month period. No price target is assigned.

SELL (S) - Describes stocks that we expect to provide a total negative return (price appreciation plus yield) of 10% or more within a 12-month period.

NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Guggenheim Securities, LLC policies.

CS - Coverage Suspended. Guggenheim Securities, LLC has suspended coverage of this company.

NC - Not covered. Guggenheim Securities, LLC does not cover this company.

SECTOR: SPECIALTY PHARMACEUTICALS

February 10, 2015

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Rating Category	Count	Percent	IB Serv./ Past 12Mos.	
			Count	Percent
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Neutral	95	50.53%	3	3.16%
Sell	0	0.00%	0	0.00%

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