

Phibro Animal Health Corp.

Ticker: PAHC

Set to rule the roost

Initiating coverage with Outperform rating

\$23 target price (24% upside based on 5/25 close)

US\$725m mkt cap

May 29, 2014

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US Agriculture

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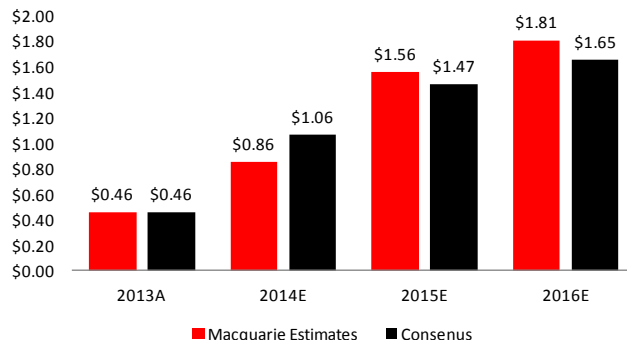
Please read Disclaimer on Page 15-17

Initiating coverage with Outperform rating, \$23 TP (24% upside)

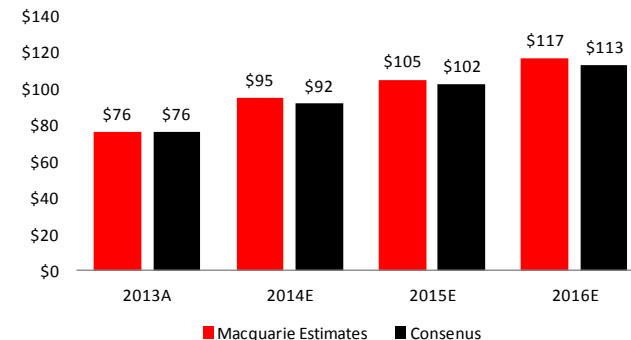
- Thematic drivers support an appealing industry growth outlook...
- Supported by a compelling return profile, a balance sheet bolstered by the recent IPO, a solid cash flow outlook supporting growth and disbursement objectives, combined with a modest valuation.

			Phibro - Sales, EBITDA & EPS (US\$m, except EPS)						
				Macquarie Estimates & Variance			Consensus Estimates		
<u>Company Name</u>	<u>Identifier</u>	<u>Rating</u>	<u>Metric</u>	<u>4Q14E</u>	<u>2015E</u>	<u>2016E</u>	<u>4Q14E</u>	<u>2015E</u>	<u>2016E</u>
Phibro	PAHC	Outperform	Sales	\$177.6	\$736.2	\$781.7	\$173.9	\$729.4	\$772.6
			EBITDA Est.	\$23.1	\$104.8	\$116.5	\$23.5	\$102.1	\$112.7
			EBITDA Margin	13.0%	14.2%	14.9%	13.5%	14.0%	14.6%
			EPS	\$0.32	\$1.56	\$1.81	\$0.28	\$1.47	\$1.65

Macquarie vs. Consensus - EPS



Macquarie vs. Consensus - EBITDA



Source: FactSet, Macquarie Capital (USA), May 2014

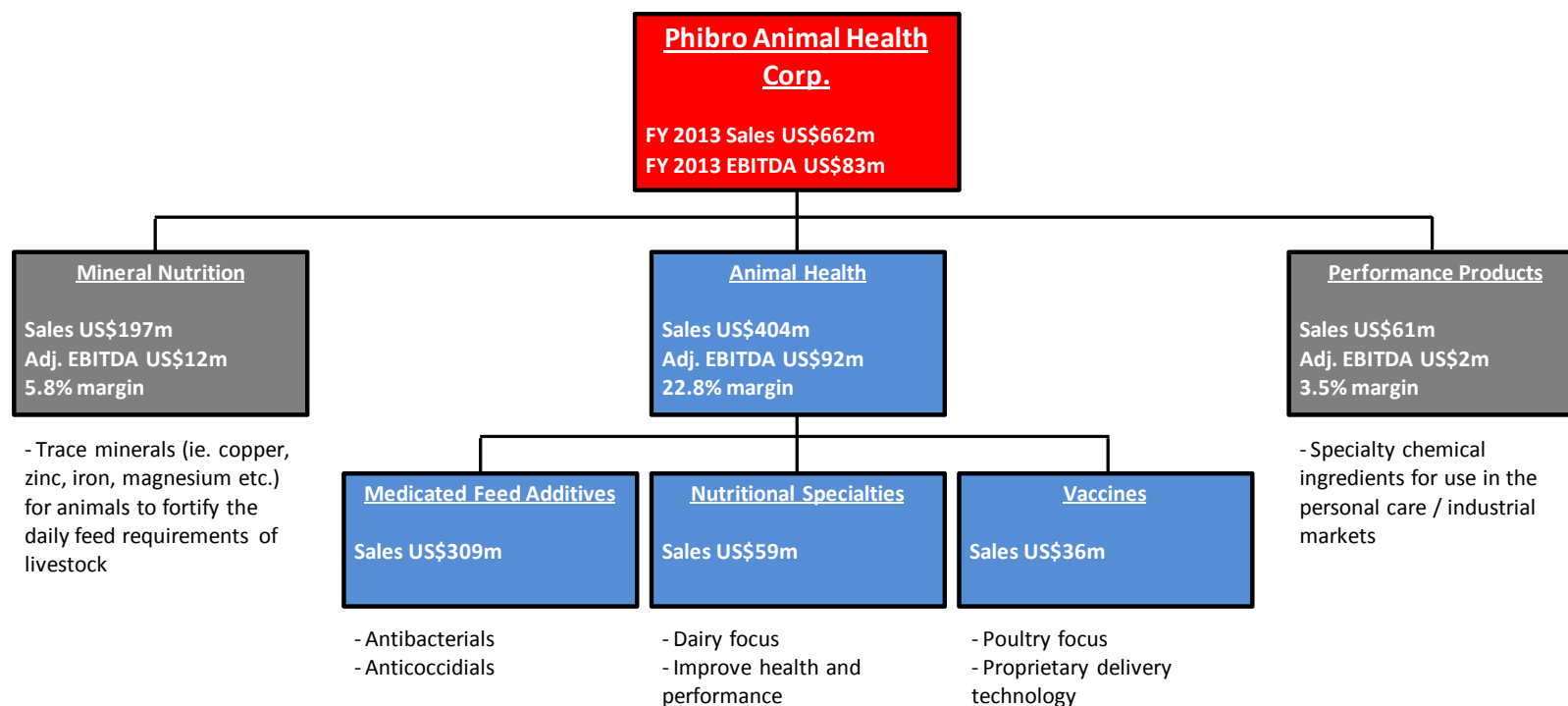
Industry Growth Drivers:

1. Population growth and rising incomes lead to greater food consumption
2. Limited natural resources
3. Food supply becoming global
4. Producer productivity pressure

Leads to large number of animals raised together...

...results in inevitable bacterial and disease pressures

Operational Overview



Global animal health medicines and vaccines market estimated at ~US\$22bn in 2012, with the livestock sector representing 60% of this, per Vetnosis estimates

All financials reflect FY ended Dec. 31, 2013

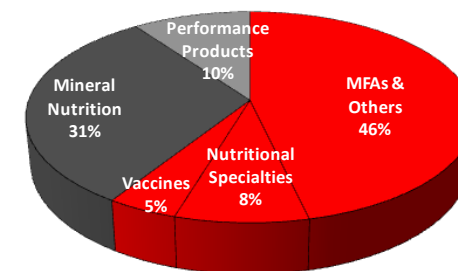
Source: Company Data, Macquarie Capital (USA), May 2014

Financial Overview – Sales Growth

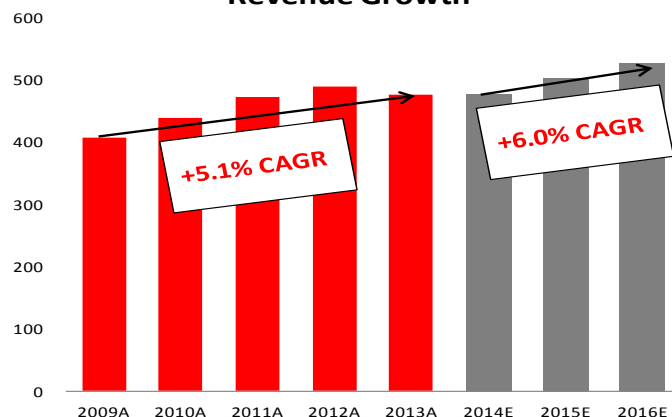
Leading position in high growth sub-sectors

- Per Vetnosis, animal health market is expected to grow at approx. 5.3% CAGR between 2012 and 2017.
- Phibro focused on fastest growing food animal species segment of animal health market - poultry and swine - projected to grow at 6.2% and 6.7% CAGR through 2017, per industry consultants.
- Phibro was the 3rd largest business in the MFA sector in 2012, as measured by sales.

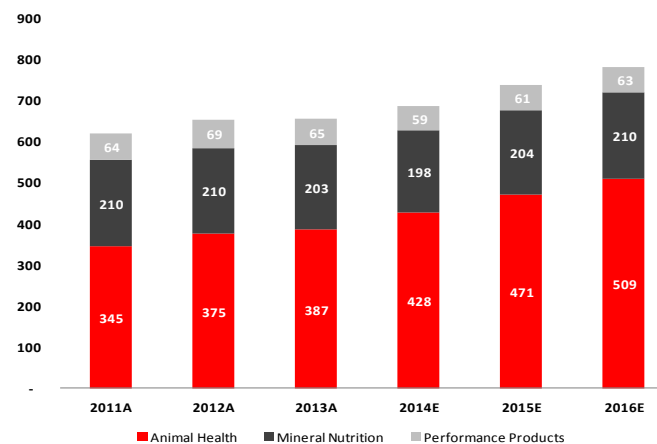
Sales Breakdown - 2013A
FY2013 US\$653m



Revenue Growth



Sales Breakdown (US\$m)



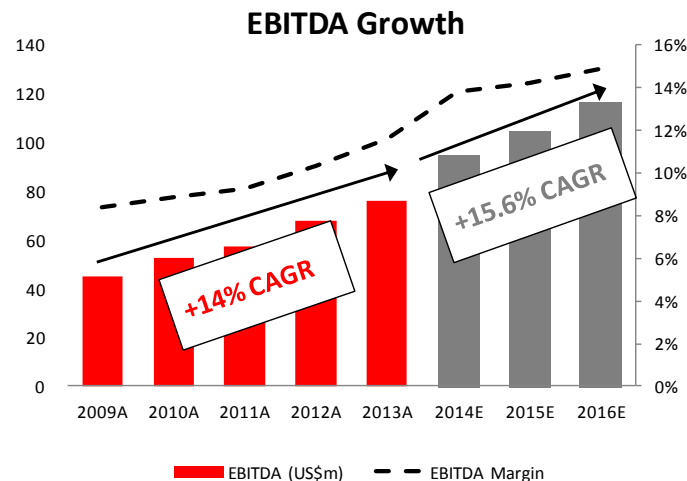
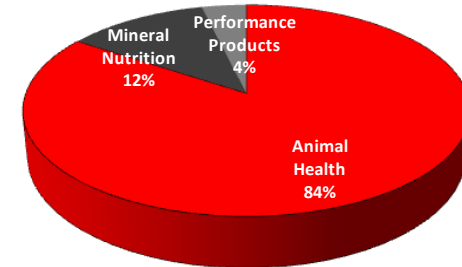
Source: Company Data, Macquarie Capital (USA), May 2014

Financial Overview – EBITDA growth

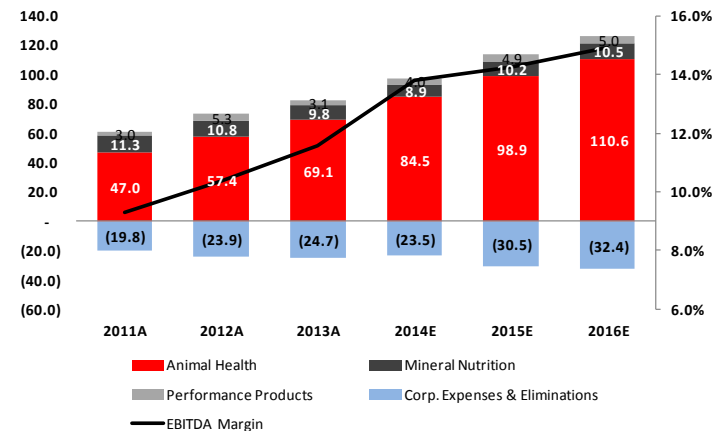
Animal Health segment driver of earnings growth

- Over the past three years, Phibro has grown earnings at a rate that meaningfully exceeds revenue growth.
- Earnings growth and margin expansion driven by the Animal Health segment
- Earnings growth and margin expansion based on improved penetration and product acceptance.
- We model continued margin expansion based on sales mix and improved manufacturing footprint.

EBITDA Breakdown - 2013A
FY2013 US\$98m



Adj. EBITDA Breakdown (US\$m)



Source: Company Data, Macquarie Capital (USA), May 2014

Company Highlights

Strong participation in key macro trends

- Products align with need for increased protein production
- Focused exclusively on food animals
- Global presence with infrastructure in high growth markets
- Sell >1,100 products in >65 countries to ~2,580 customers
- Phibro estimates OmniGen has achieved over 20% penetration of US dairy cow herd.

Products and capabilities to drive customers success

- Strong brand loyalty
- Diversified & complementary product portfolio
- Products economically important to end customers' success
- Nearly 40 years experience

Solid financial profile

- Historical revenue growth faster than industry

Numerous growth levers at hand

Expansions focused on emerging markets

- Protein demand growth strongest in emerging markets.
- Global presence selling >1,100 products in >65 countries to ~2,580 customers.

Poultry expansion offers attractive growth profile

- Epitopix tie-up looks attractive.
- Presents an opportunity to penetrate the attractive high growth poultry segment in the US.

OmniGen penetration offshore

- 20% penetration of US dairy cow herd, with room to improve.
- Next leg of growth is focused on Brazil and parts of Europe.
- China's industrialization of dairy production presents an opportunity.

CapEx program has boosted margin potential

- Greater capacity on lower manufacturing costs.
- Boosts Phibro's competitiveness in emerging markets.

Valuation

→ Our US\$23 target price represents 14.5x our 2015 EPS estimate...

→ ...our sum-of-the-parts analysis straddles with our US\$23 target

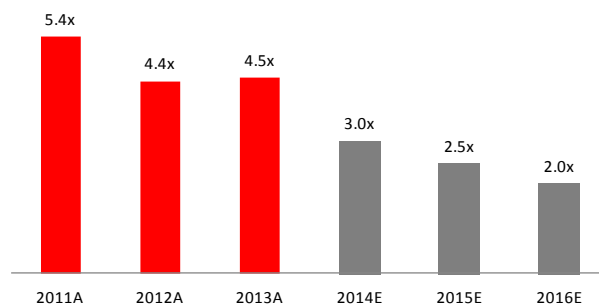


Operating Segment	Group Comparables	2015E EBITDA	2015 EV/EBITDA Multiple Avg	Implied Value	2015E EPS	2015 PE Avg.	Implied Value
Animal Health	LLY, ZTS (20% discount)	\$115	9.5x	\$1,092	\$1.70	14.6x	\$24.8
Mineral Nutrition	FMC DD	\$13	9.3x	\$118	\$0.19	14.0x	\$2.6
Performance Products	DD, DOW	\$5	8.3x	\$44	\$0.08	14.2x	\$1.1
Corp. Expenses & Eliminations		-\$28	4.0x	-\$111	-\$0.41	12.0x	-\$4.9
Sum		\$105		\$1,143	\$1.56	15x	
(minus) Net Debt				267			
Implied Equity Value				876			
Share count				39.4			
Share value				\$22			\$24

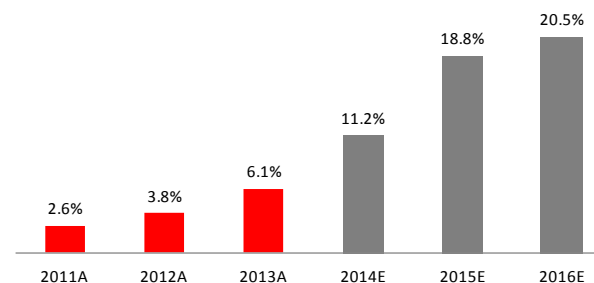
Source: Company Data, FactSet Macquarie Capital (USA), May 2014

Financial Metrics

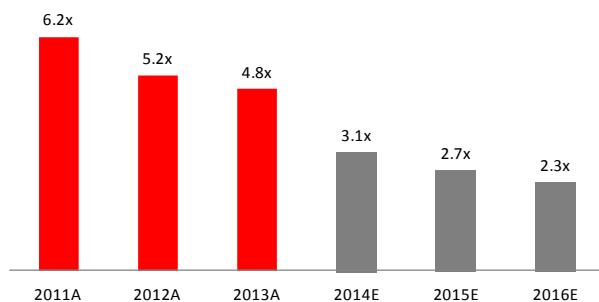
Net Debt/EBITDA



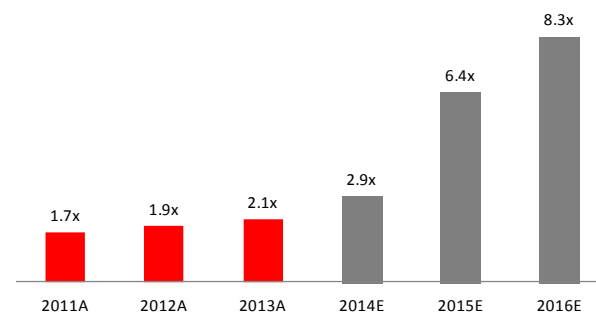
ROIC



Debt to EBITDA



EBITDA/Interest Expense



Source: Company Data, Macquarie Capital (USA), May 2014

Income Statement

(FY Dec. US\$m)	2009A	2010A	2011A	2012A	2013A	2014E	2015E	2016E
Total Segments	537.1	594.2	618.9	653.4	655.2	685.8	736.2	781.7
Net Sales	537.1	594.2	618.9	653.4	655.2	685.8	736.2	781.7
Cost of sales	407.5	439.5	473.1	488.9	475.9	477.0	500.9	523.8
Gross Profit	129.7	154.7	145.8	164.5	179.4	208.8	235.3	257.9
SG&A	84.6	101.9	104.9	114.5	122.4	134.9	151.8	164.2
R&D	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating Income (EBIT)	45.0	52.8	40.8	50.1	57.0	73.9	83.5	93.7
Interest Expense, Net	31.3	34.4	34.3	35.5	35.5	29.8	12.7	10.8
Other income (expenses)	(15.8)	1.2	4.6	2.2	3.7	(1.7)	6.0	6.0
Pretax Income	(2.1)	19.6	11.2	16.8	25.2	42.5	76.7	88.9
Income Taxes & Others	3.4	3.8	3.8	7.1	7.0	8.7	15.3	17.8
Minority Interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income	(5.5)	15.8	7.4	9.7	18.2	33.8	61.4	71.1
EPS Diluted - Adjusted	(\$0.14)	\$0.40	\$0.19	\$0.25	\$0.46	\$0.86	\$1.56	\$1.81
Shares Outstanding - Diluted	39.4	39.4	39.4	39.4	39.4	39.4	39.4	39.4
EPS - GAAP	(\$0.14)	\$0.40	\$0.19	\$0.25	\$0.46	\$0.86	\$1.56	\$1.81
One-time items	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income Statement Analysis								
Operating Margin	8.4%	8.9%	6.6%	7.7%	8.7%	10.8%	11.3%	12.0%
Gross Margin	24.1%	26.0%	23.6%	25.2%	27.4%	30.4%	32.0%	33.0%
Tax Rate	-160.6%	19.3%	34.1%	42.1%	27.8%	20.8%	20.0%	20.0%
Net Margin	-1.0%	2.7%	1.2%	1.5%	2.8%	4.9%	8.3%	9.1%
YoY % Change								
Revenue		10.6%	4.2%	5.6%	0.3%	4.7%	7.3%	6.2%
Operating Income		17.3%	(22.7%)	22.7%	13.7%	29.8%	12.9%	12.3%
Pretax Income		N/M	(43.0%)	50.1%	50.0%	68.8%	80.5%	15.9%
Net Income		N/M	(53.4%)	31.9%	87.1%	85.8%	81.7%	15.9%
Diluted EPS		N/M	(53.4%)	31.9%	87.1%	85.8%	81.7%	15.9%
Metrics								
Interest Coverage Ratio	1.4	1.5	1.2	1.4	1.6	2.5	6.6	8.7
D&A	0.0	0.0	16.7	17.6	18.9	20.7	21.4	22.8
EBITDA	45	53	58	68	76	95	105	117
YoY % Change		17.3%	8.9%	17.7%	12.1%	24.7%	10.8%	11.2%
EBITDA Margin	8.4%	8.9%	9.3%	10.4%	11.6%	13.8%	14.2%	14.9%
EBITDA Per Share	\$1.14	\$1.34	\$1.46	\$1.72	\$1.93	\$2.40	\$2.66	\$2.96

Source: Company Data, Macquarie Capital (USA), May 2014

Balance Sheet

(FY Dec. US\$m)	2011A	2012A	2013A	2014E	2015E	2016E
Assets						
Cash & ST Investments	48.6	53.9	27.4	14.1	24.4	49.8
Accounts Receivable, Net	97.7	99.0	99.0	107.2	113.3	120.3
Inventories	124.1	118.4	140.2	152.4	160.0	162.9
Other Current Assets	24.4	28.9	30.6	31.2	31.8	32.5
Total Current Assets	294.8	300.2	297.1	304.9	329.5	365.4
Property, Plant & Equipment, Net	109.2	100.3	104.8	103.7	102.7	100.2
Intangible Assets	12.9	15.0	35.2	35.9	36.6	37.3
Other Assets	18.2	22.0	37.8	37.8	37.8	37.8
Total Assets	435.1	437.5	474.9	482.2	506.6	540.7
Liabilities and Shareholder's Equity						
ST Debt & Current Portion Of Long-Term Debt	5.5	5.4	0.1	0.1	0.1	0.1
Accounts Payable & Accrued Liabilities	63.0	66.8	58.4	68.6	73.6	78.2
Income Tax Payable	0.0	0.0	0.0	0.0	0.0	0.0
Other Current Liabilities	47.8	52.6	57.2	60.1	63.1	66.2
Total Current Liabilities	116.3	124.8	115.7	128.7	136.8	144.5
Long-Term Debt, Net	352.5	344.8	365.5	281.1	272.3	263.6
Deferred Tax Liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Other Liabilities	36.1	56.2	62.0	68.2	69.6	71.0
Total Liabilities	504.9	525.7	543.3	478.0	478.7	479.0
Total Shareholders' Equity	-69.7	-88.2	-68.4	4.2	27.9	61.7
Total Liabilities & Shareholders' Equity	435.1	437.5	474.9	482.2	506.6	540.7
Ratios						
Current Ratio	2.5x	2.4x	2.6x	2.4x	2.4x	2.5x
Cash & Marketable Securities/Share	\$1.23	\$1.37	\$0.69	\$0.36	\$0.62	\$1.26
Receivables Turnover	6.3x	6.6x	6.6x	6.4x	6.5x	6.5x
Inventory Turnover	3.8x	5.4x	5.1x	4.5x	4.6x	4.8x
Working Capital Turnover	3.5x	3.7x	3.6x	3.9x	3.8x	3.5x
Asset Turnover	1.4x	1.5x	1.4x	1.4x	1.5x	1.4x
Payables Turnover	9.8x	10.1x	10.5x	10.0x	10.0x	10.0x
Net Debt/EBITDA	5.4x	4.4x	4.5x	2.8x	2.4x	1.8x
Book Value/Share	(1.77)	(2.24)	(1.74)	0.11	0.71	1.57
Debt to Equity	-5.1x	-4.0x	-5.3x	67.6x	9.8x	4.3x

Source: Company Data, Macquarie Capital (USA), May 2014

Cash Flow Statement

(FY Dec. US\$m)	2011A	2012A	2013A	2014E	2015E	2016E
Cash Flows From Operating Activities:						
Net Income (loss)	(15.0)	7.5	25.9	33.8	61.4	71.1
Depreciation & Amortization	16.7	17.6	18.9	20.7	21.4	22.8
Deferred Taxes & Investment Tax Credit	0.7	(2.4)	(11.9)	(0.6)	(0.6)	(0.7)
Other Funds	1.2	5.8	3.8	4.0	4.2	4.4
Changes in Working Capital	(7.4)	4.6	(35.7)	(4.1)	(7.3)	(3.9)
Accounts Receivable	(4.9)	(3.5)	(0.8)	(8.2)	(6.1)	(7.0)
Inventories	(8.1)	0.0	(25.2)	(12.2)	(7.6)	(2.8)
Accounts Payable	2.2	4.8	(6.7)	10.1	5.0	4.6
Other Assets/Liabilities	3.3	3.3	(3.0)	6.2	1.4	1.4
Operating Cash Flow	(3.9)	33.2	1.0	53.8	79.0	93.8
Cash Flows From Investing Activities:						
Capital Expenditure	(21.6)	(15.0)	(20.0)	(19.6)	(20.4)	(20.3)
Net Assets from Acquisitions	-	(3.4)	(18.7)	-	(10.0)	(10.0)
Sale of Fixed Assets & Businesses	2.2	0.6	1.3	1.5	1.7	2.0
Purchase/Sale of Investments	-	-	-	-	-	-
Other Funds	-	-	-	-	-	-
Cash flow from Investing:	(19.5)	(17.9)	(37.4)	(18.1)	(28.7)	(28.3)
Cash Flow From Financing Activities:						
Dividends Paid	(50.0)	-	(3.0)	(25.0)	(15.0)	(15.0)
Change in Capital Stock	-	-	-	54.0	-	-
Issuance/Reduction of Debt, Net	58.8	(9.3)	13.4	(78.0)	(25.0)	(25.0)
Other Funds	-	-	-	-	-	-
Cash Flow from Financing:	8.8	(9.3)	10.4	(49.0)	(40.0)	(40.0)
Miscellaneous Funds	0.5	(0.7)	(0.5)	-	-	-
Beginning Cash & Equivalents	62.7	48.6	53.9	27.4	14.1	24.4
Net Change in Cash	(14.1)	5.3	(26.5)	(13.3)	10.3	25.4
Ending Cash & Equivalents	48.6	53.9	27.4	14.1	24.4	49.8

Source: Company Data, Macquarie Capital (USA), May 2014

Investment Risks

Company	Investment Risks
Phibro	<ul style="list-style-type: none">An expansion of the regulatory restrictions on the use of antibacterials in food-producing animalsIncreased competition within participating marketsIrrational capacity additions among peersDisruptions in internal productionAdvances in veterinary medical practices and animal health technologies could negatively affect demand for Phibro products

Source: Company Data, Macquarie Capital (USA), May 2014

Important disclosures:**Recommendation definitions****Macquarie - Australia/New Zealand**

Outperform – return > 3% in excess of benchmark return

Neutral – return within 3% of benchmark return

Underperform – return > 3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%

Neutral – expected return from -10% to +10%

Underperform – expected <-10%

Macquarie First South - South Africa

Outperform – return > 10% in excess of benchmark return

Neutral – return within 10% of benchmark return

Underperform – return > 10% below benchmark return

Macquarie - Canada

Outperform – return > 5% in excess of benchmark return

Neutral – return within 5% of benchmark return

Underperform – return > 5% below benchmark return

Macquarie - USA

Outperform – return > 5% in excess of benchmark return

Neutral – return within 5% of benchmark return

Underperform – return > 5% below benchmark return

Volatility index definition*

This is calculated from the volatility of historic price movements.

Very high–highest risk – Stock should be expected to move up or down 60-100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40-60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30-40% in a year.

Low–medium – stock should be expected to move up or down at least 25-30% in a year.

Low – stock should be expected to move up or down at least 15-25% in a year.

* Applicable to Australian/NZ stocks only

Recommendation – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense

Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit /efpowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit /average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 March 2014

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.32%	60.23%	41.25%	40.21%	58.52%	48.74%	(for US coverage by MCUSA, 8.21% of stocks followed are investment banking clients)
Neutral	34.54%	24.97%	40.00%	53.19%	35.56%	32.77%	(for US coverage by MCUSA, 6.67% of stocks followed are investment banking clients)
Underperform	14.14%	14.80%	18.75%	6.60%	5.92%	18.49%	(for US coverage by MCUSA, 0.00% of stocks followed are investment banking clients)

Company Specific Disclosures:

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