

Equity Research

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Phibro Animal Health Corporation (PAHC-\$28.95)

Rating: BUY

Target Price: \$36.00

Phibro Acquires Distribution Rights to Swine Vaccines; Maintain BUY and \$36 PT

<u>REV</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
2014A	162.2A	172.7A	173.3A	183.7A
2015E	187.5A	182.4E	185.7E	197.9E
2016E	—	—	—	—
<u>EPS</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
2014A	0.12A	0.07A	0.36A	0.22A
2015E	0.51A	0.37E	0.38E	0.40E
2016E	—	—	—	—
<u>FY</u>	<u>2014A</u>	<u>2015E</u>	<u>2016E</u>	
REV	691.9A	753.3E	793.4E	
EPS	1.22A	1.67E	1.86E	
P/E	23.7x	17.3x	15.6x	

- **Swine vaccine agreement with privately held MJ Biologics is an attractive opportunity, in our view:** Phibro announced a deal with MJ Biologics (MJB), which provides Phibro with distribution rights to MJB's existing vaccine technologies as well as rights to additional vaccines that Phibro and MJB intend to develop in the future. MJB's vaccines are used in the swine industry for the treatment of a common infection, porcine reproductive and respiratory virus (PRRS), and are currently only sold in the U.S. The deal includes a \$5M upfront, a minimum \$10M closing payment due in January 2021 and a single-digit royalty on net sales to MJB. This deal is in-line with the company's strategy to do bolt-on deals, and management indicated it can do more deals this year with its \$20M cash balance. We reiterate our BUY and \$36 PT.
- **We estimate some small upside for Phibro sales and profit:** The distribution and collaboration agreement includes North American distribution rights to MJB's vaccines and any vaccines that the companies develop together. Phibro must make minimum base payments of \$0.2M per month and 50% of all gross margins over \$0.4M/month. Management would not disclose MJB's current sales or market share in North America and would not provide forecasts. However, if we conservatively estimate monthly operating expense of \$0.4M (which includes the \$0.2M monthly minimum) and utilize Phibro's historical animal health operating margins of ~18%, we would arrive at EBIT of ~\$1.05M, which could represent \$0.02 post-tax upside to our 2015 EPS estimates. We are not updating the model until after the February earnings call and hope to get guidance at that time.
- **International market expansion expected:** Phibro also gained exclusive development and distribution rights outside North America for MJB's vaccine products, allowing Phibro to expand sales to international markets. For example, the PRRS virus is present in China, but the MJB vaccine is not available there, which provides an opportunity to grow sales. While management indicated the product is small and there are several larger companies like Boehringer, Merck and Zoetis with competitive products in the space, we like that Phibro can build out this franchise with its international infrastructure.
- **No impact from Brazil's recent blackouts:** Management indicated that its Sao Paulo plant was not in the region that blacked out for a short period of time. Additionally, the facility has emergency back-up power supplies that would have limited any impact.

Current Statistics

Market Cap (\$Mil)	\$1,127.8	Free Float (%):	17.400
Avg. Daily Trading Volume (3 mo.):	157,218		
Shares Out (Mil):	17.443		

Valuation

We value Phibro using EV/EBITDA multiples, which incorporate the positive industry outlook, in our view. We apply a 15x multiple to our 2015 estimated EV/EBITDA (using EBITDA of \$112 million, above the company's \$107 million guidance) and divide this value by the company's 40 million shares to generate a \$36 price target. Industry leader, Zoetis, currently trades at approximately 17.3x its 2015 FactSet consensus EV/EBITDA, and we maintain Phibro's discount to this name while allowing for some slight multiple expansion.

We also check our assumptions using discounted cash flow analysis (DCF) applied to cash flows from FY:2015-20. We utilize a 9% weighted average cost of capital (WACC), which is slightly higher than that of Zoetis, and a 3% terminal growth rate, since we expect the animal health market to continue expanding along with the broader economy. This analysis generates a \$31 price target. The stock is now trading slightly below this range.

If we utilize comparable transactions like the recent Lilly acquisition of the Novartis Animal Health Business for 5x sales and think about a far smaller 2x sales multiple applied to FY:2015 Phibro sales (given Phibro's lower margins and livestock focus), we arrive at a hypothetical value of \$38 per share, which supports our BUY thesis and \$36 price target.

Risks

- (1) Any additional regulatory restrictions on antibacterial use in the U.S. or amongst international importers could decrease demand for Phibro's products.
- (2) Disruptive macroeconomic events such as wars, economic downturns that lead to reduced consumer spending, weather changes leading to droughts and increased feed prices, or currency weakness, could adversely impact Phibro's business.
- (3) Animal epidemics could temporarily reduce demand for Phibro's products.
- (4) Competition from other animal health companies or generic players could pressure Phibro.
- (5) Obsolescence of any of Phibro's antibacterials due to increased bacterial resistance could be a longer-term risk to the business.
- (6) 92.5% of share voting power is expected to reside with the Bendheim family, which may obstruct future takeover attempts.

Company Description

Phibro Animal Health Corporation is an international livestock focused animal health company that manufactures animal medicines and nutritional products utilized by large industrial meat producers. At this time, Phibro's products primarily focus on the poultry and swine segments of the livestock market but the company is also making inroads into peripheral areas such as dairy and aquaculture which could become more prominent in the future.

Companies Mentioned:

Eli Lilly and Company (LLY - NYSE): NC
Merck & Co., Inc. (MRK - NYSE): NC
Zoetis Inc. (ZTS - NYSE): NC
Boehringer Ingelheim (private)
MJ Biologics (private)

Disclosures Appendix

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Distribution of Ratings/Investment Banking Services (IB) as of 01/23/15

Rating	Cantor		IB Serv./Past 12 Mos.	
	Count	Percent	Count	Percent
BUY [B]	92	61.33	23	25.00
HOLD [H]	49	32.67	10	20.41
SELL [S]	9	6.00	1	11.11