

September 24, 2014

Phibro Animal Health Corp

Bumping estimates and raising PT

We bumped financial projections based upon slightly higher sales and a lower tax rate. We are raising our PT from \$19 to \$23 based upon higher EPS and terminal growth (raised from 1.5% to 2.0% on the heels of strong execution).

Bumping revenue and EPS. We raised revenue forecasts primarily due to improving Minerals segment (approx 30% of total co. F14 rev) performance. For F15E (June), we bumped revenue by 2% to \$746M. We also raised medium-term EPS due to an extended benefit from NOLs (\$28M of net operating loss carryforwards as of F14 end), which should keep the company's tax rate abnormally low for the next 2-3 years. We raise EPS as follows: F15E from \$1.48 to \$1.49 (guidance is \$1.46-1.51), F16E from \$1.65 to \$1.71 and F17E from \$1.55 to \$1.76.

So why are we Equal-weight Phibro shares? While Phibro is a strong company with durable animal health growth prospects, the stock's FCF yield (at 4% pre-dividend) is less compelling than its F15E P/E of 14.7x. And we note that the company's tax rate is likely to step up from 16% in F15E to 30% in F18E when Phibro's NOLs (\$28M as of June 30, 2014) are largely exhausted, resulting in modest medium-term EPS growth (from \$1.71 in F16E to \$1.80 in F18E).

On September 16th, Phibro delivered F4Q:14 revenue 5% above our estimate and EPS 12% above. Revenues were \$184M, 5% above our and cons' \$175M. EPS were \$0.22, 11% above our \$0.20 and 19% below cons' \$0.27. Animal Health, the company's key segment, delivered sales of \$114M, up 13% YOY, which was 3% above our forecast of \$111M. Total company gross margin of 29.6% was below our forecast of 32.5% due to product mix (\$6M of the \$9M revenue upside came from low-margin Mineral products). But this was offset by operating expenses at 18.9% of sales, which were below our 21.3%. Operating income was as expected at \$20M.

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Phibro Animal Health Corp (PAHC.O , PAHC US)

Specialty Pharmaceuticals / United States of America

Stock Rating**Equal-weight****Industry View****In-Line****Price target****\$23.00**

Shr price, close (Sep 23, 2014)

\$21.95

Mkt cap, curr (mm)

\$865

52-Week Range

\$23.74-15.10

Fiscal Year Ending	06/14	06/15e	06/16e	06/17e
ModelWare EPS (\$)	1.23	1.49	1.71	1.76
Prior ModelWare EPS (\$)	1.20	1.48	1.65	1.55
P/E	17.9	14.7	12.9	12.5
Consensus EPS (\$)	1.08	1.49	1.69	1.87
Div yld (%)	3.5	1.8	1.9	2.0

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

\$ = Consensus data is provided by Thomson Reuters Estimates

e = Morgan Stanley Research estimates

QUARTERLY MODELWARE EPS (\$)

Quarter	2014	2015e Prior	2015e Current	2016e Prior	2016e Current
Q1	0.30	0.39	0.39	0.41	0.43
Q2	0.35	0.37	0.39	0.45	0.45
Q3	0.36	0.37	0.36	0.42	0.41
Q4	0.22	0.35	0.34	0.37	0.42

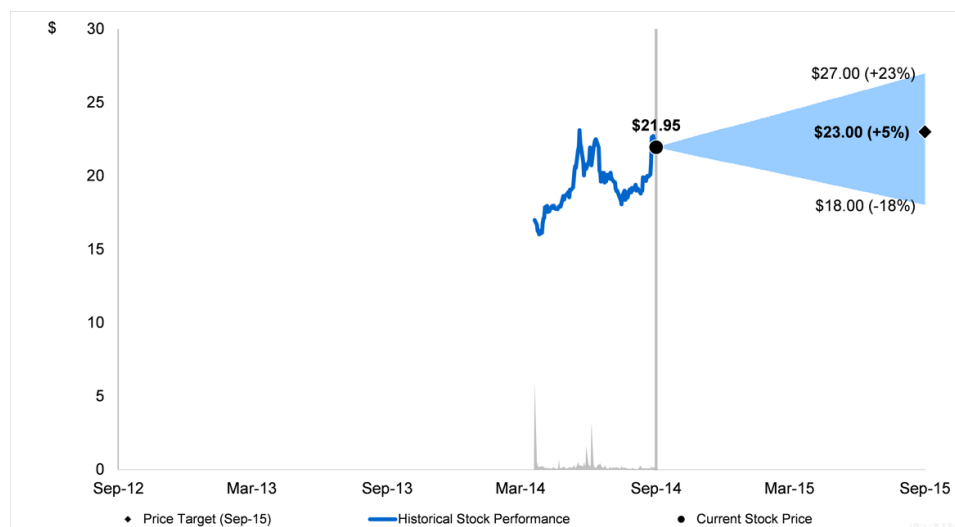
e = Morgan Stanley Research estimates

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Risk Reward

Risk-Reward View: We anticipate modest stock upside in our base case



Source: Morgans Stanley Research estimates, Thomson Reuters.

Price Target \$23

DCF: 7.6% WACC, 2.0% terminal growth beyond F2021E

Bull \$27

5% higher '15E EPS plus DCF flexed to assume LT rev growth ('14A-'21E) of 6% rather than 5%.

Financial results are above expectations, Phibro exits flattish Performance Products business. Market demand is greater than we project and Phibro delivers 2015 EPS 5% above forecast. Stock multiple expands as investors gain greater confidence in Phibro's ability to deliver as a public company. Phibro divests its Performance Products segment which is currently a modest drag on growth and is operating just above breakeven (contribution to rev 9% and EBITDA 2%).

Base \$23

DCF assumes 7.6% discount rate and 2% terminal growth

Phibro delivers accelerating revenue growth in F15 as expected. We project F15E (June) revenue growth of 8% and EBITDA growth of 11%. Management executes well and delivers strong Animal Health segment growth plus improvements in both Mineral Nutrition and Performance Products segment margins.

Bear \$18

5% lower '15E EPS, and DCF flexed to assume LT rev growth ('14A-'21E) of 4% rather than 5%

Certain business segments disappoint, causing downside to financial outlook. Weaker-than-expected demand causes F15 EPS to be 5% below forecast. Regulators surprisingly take negative action against key products. See risks section.

Investment Thesis

- Phibro offers an investment opportunity in growing global demand for animal protein consumption.
- Our \$23 PT represents 11x C15E EBITDA of \$106M; our DCF reflects 7.6% discount rate and 2% terminal growth; PT is rolled one-year forward to 2016E.
- We project 5% rev and 10% EPS CAGR from F14-21E.

Key Value Drivers

- Sept. quarter results in November.
- Potential small acquisitions (mgmt targets spending approx \$10M annually, but we exclude future deals from our model)

Risks to Achieving Price Target

- Upside risks to our price target include greater-than-anticipated livestock market growth; financial results upside; investor concerns about antibiotic use in livestock animals fades, driving stock multiple expansion; encouraging acquisitions and/or divestitures.
- Disappointing financial results; quarterly earnings volatility; regulatory/legal challenges; disease or weather disruptions to certain animal species demand; worse-than-expected impact of planned FDA removal of growth promotion claims for antibiotics over the next three years; manuf problems; potential insider stock sales after 180-day lockup expires around Oct 11.

DCF

Exhibit 1: Discounted Cash Flow

(\$M)	F2013A	F2014A	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
GAAP Net Income			59	59	61	71	78	85	93
+After-tax interest expense			11	11	10	9	8	7	6
+Depreciation and amortization			23	23	24	23	23	23	23
-Capital expenditure			(25)	(22)	(22)	(23)	(23)	(24)	(25)
Change in working capital			(9)	(19)	(9)	(26)	(10)	(31)	(22)
FCF			58	52	63	55	76	60	75
Dividends			16	17	17	18	19	20	21
FCF net of dividends			42	35	45	36	57	40	54

WACC	7.6%	Equity value per share							
Perpetuity	2.0%	Perpetuity							
			0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%
CF value ('15-'21E)	293	5.6%	\$29	\$32	\$36	\$40	\$47	\$56	\$69
TV	882	6.1%	\$25	\$28	\$31	\$35	\$39	\$46	\$55
Firm Value	1,175	6.6%	\$23	\$25	\$27	\$30	\$34	\$38	\$45
TV as % of firm value	75%	7.1%	\$20	\$22	\$24	\$26	\$29	\$33	\$37
F15E Debt	265	WACC 7.6%	\$18	\$20	\$22	\$23	\$26	\$29	\$32
F15E Cash	18	8.1%	\$17	\$18	\$19	\$21	\$23	\$25	\$28
Equity Value	928	8.6%	\$15	\$16	\$17	\$19	\$20	\$22	\$24
Shares	40	9.1%	\$14	\$15	\$16	\$17	\$18	\$20	\$22
CF value/share	\$7	9.6%	\$13	\$14	\$14	\$15	\$17	\$18	\$19
TV/share	\$22								
Net cash/share	(\$6)								
Price/share	\$23								

Source: Morgan Stanley Research

Financials

Exhibit 2: Income Statement, Margins & Valuation

Income Statement (\$M)	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
Net sales	653	692	746	790	826	867	909	948	985
COGS	470	480	511	532	550	571	595	618	641
Gross Profit	183	212	235	258	276	296	313	330	345
SG&A/R&D	122	137	151	163	173	182	191	198	204
EBITA	61	74	84	94	103	114	123	132	141
EBITDA	76	91	101	112	122	133	142	151	160
Other expenses (income)	36	13	13	13	13	12	11	10	8
Pre-tax Income	25	61	71	81	90	102	111	121	132
Taxes	7	12	12	14	21	31	33	36	40
Tax rate	27.8%	20.2%	16.5%	17.0%	23.0%	30.0%	30.0%	30.0%	30.0%
Net Income	18	48	59	68	70	71	78	85	93
EPS	\$0.59	\$1.23	\$1.49	\$1.71	\$1.76	\$1.80	\$1.97	\$2.15	\$2.34
Dil. Sh. Outstd.	31	39	40	40	40	40	40	40	40
% Growth YOY	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
Net Sales		6%	8%	6%	5%	5%	5%	4%	4%
COGS		2%	6%	4%	3%	4%	4%	4%	4%
Gross Profit		16%	11%	10%	7%	7%	6%	5%	5%
SG&A/R&D		13%	10%	8%	6%	5%	5%	4%	3%
EBITA		21%	13%	13%	9%	11%	8%	7%	7%
EBITDA		21%	10%	11%	8%	9%	6%	6%	6%
Net Income		164%	22%	15%	3%	2%	9%	9%	9%
Diluted EPS		109%	21%	15%	3%	2%	9%	9%	9%
Margin Analysis	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
Gross margin	28.0%	30.6%	31.5%	32.6%	33.4%	34.1%	34.5%	34.8%	35.0%
SG&A/R&D as % of Sales	18.7%	19.9%	20.3%	20.7%	20.9%	20.9%	21.0%	20.9%	20.7%
EBITA margin	9.3%	10.7%	11.2%	12.0%	12.5%	13.2%	13.5%	13.9%	14.3%
EBITDA margin	11.6%	13.2%	13.5%	14.2%	14.8%	15.3%	15.6%	15.9%	16.2%
Net Margin	2.8%	7.0%	7.9%	8.5%	8.4%	8.2%	8.6%	9.0%	9.4%
Gross Margin (bps change)		254	92	112	79	70	40	30	20
Operating Margin (bps change)		137	51	73	51	69	35	37	39
Valuation	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
Price/Earnings	NA	17.9x	15.2x	13.3x	12.9x	12.6x	11.5x	10.6x	9.7x
EV/EBITDA	NA	12.5x	11.2x	9.9x	8.8x	7.9x	7.0x	6.4x	5.8x
EV/Sales	NA	1.7x	1.5x	1.4x	1.3x	1.2x	1.1x	1.0x	0.9x
Dividend / Share	\$0.00	\$0.76	\$0.40	\$0.42	\$0.44	\$0.46	\$0.49	\$0.51	\$0.54
Dividend Yield	NA	3.5%	1.8%	1.8%	1.9%	2.0%	2.1%	2.2%	2.4%
FCF / Share	\$0.12	(0.25)	\$1.46	\$1.31	\$1.58	\$1.38	\$1.93	\$1.52	\$1.90
FCF Yield	NA	-1.1%	6.4%	5.8%	7.0%	6.1%	8.5%	6.7%	8.4%

Source: Morgan Stanley Research, Company Data

Exhibit 3: Balance Sheet & Cash Flow

Balance Sheet (\$M)	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
Cash and short-term investments	27	12	18	12	18	15	35	32	46
A/R	99	114	117	135	135	154	154	175	170
Inventory	140	143	157	151	168	166	187	188	225
Other current assets	30	30	30	30	30	30	30	30	30
PP&E	104	109	117	120	122	124	127	131	136
Other assets	73	64	59	55	52	49	46	43	40
TOTAL ASSETS	474	472	499	505	525	539	579	600	647
Total debt	366	289	265	235	205	175	145	110	75
A/P and Accrued liabilities	58	60	68	62	69	61	72	63	74
Other current liabilities	57	50	50	50	50	50	50	50	50
Other non-current liabilities	62	58	58	58	58	58	58	58	58
Total Liabilities	543	457	441	405	382	344	325	281	257
S/E	(69)	15	58	100	143	196	254	319	390
TOTAL LIABILITIES AND S/E	474	472	499	505	525	539	579	600	647
Cash Flow Statement (\$M)	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
Net income	25	(3)	59	59	61	71	78	85	93
Depreciation	15	17	18	19	20	20	20	20	20
Change in working capital	(35)	(28)	(9)	(19)	(9)	(26)	(10)	(31)	(22)
Other operating activities	(5)	13	5	4	4	3	3	3	3
CASH FROM OPERATIONS	0	(1)	72	63	75	69	91	77	94
Capex	(20)	(20)	(25)	(22)	(22)	(23)	(23)	(24)	(25)
Other investing activities (incl. M&A)	(17)	0	-	-	-	-	-	-	-
CASH FROM INVESTING	(37)	(19)	(25)	(22)	(22)	(23)	(23)	(24)	(25)
Cash dividends paid	(3)	(25)	(16)	(17)	(17)	(18)	(19)	(20)	(21)
Net change in debt	15	(80)	(25)	(30)	(30)	(30)	(30)	(35)	(35)
Other financing activities (incl. Share Repurchases)	(1)	110	-	-	-	-	-	-	-
CASH FROM FINANCING	11	5	(41)	(47)	(47)	(48)	(49)	(55)	(56)
Exchange rate effect	(0)	(0)	-	-	-	-	-	-	-
Net change in cash	(27)	(16)	6	(6)	6	(2)	19	(2)	13
Other Metrics	F2013	F2014	F2015E	F2016E	F2017E	F2018E	F2019E	F2020E	F2021E
LEVERAGE:									
Net Debt	338	278	247	223	187	160	110	78	29
Debt / EBITDA	4.8x	3.2x	2.6x	2.1x	1.7x	1.3x	1.0x	0.7x	0.5x
Net Debt / EBITDA	4.5x	3.0x	2.4x	2.0x	1.5x	1.2x	0.8x	0.5x	0.2x
PROFITABILITY:									
ROE	NM	NM	161.9%	85.9%	57.4%	42.1%	34.6%	29.7%	26.1%
RNOA	17%	17.2%	18.3%	19.7%	20.6%	21.7%	22.3%	22.6%	22.5%
LIQUIDITY:									
Current Ratio	2.0	2.7	2.2	2.3	2.4	2.6	2.6	2.9	3.0
Quick Ratio	1.0	1.4	1.1	1.3	1.2	1.4	1.4	1.6	1.6
OPERATIONAL EFFICIENCY:									
Days Receivable		56	57	58	60	61	62	63	64
Days Payable		45	46	45	43	41	41	40	39
Days Inventory		108	107	106	106	107	108	111	118

Source: Morgan Stanley Research, Company Data

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(as of August 31, 2014)

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	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY
Overweight/Buy	1078	34%	334	39%	31%
Equal-weight/Hold	1378	44%	413	48%	30%
Not-Rated/Hold	108	3%	21	2%	19%
Underweight/Sell	566	18%	93	11%	16%
TOTAL	3,130		861		

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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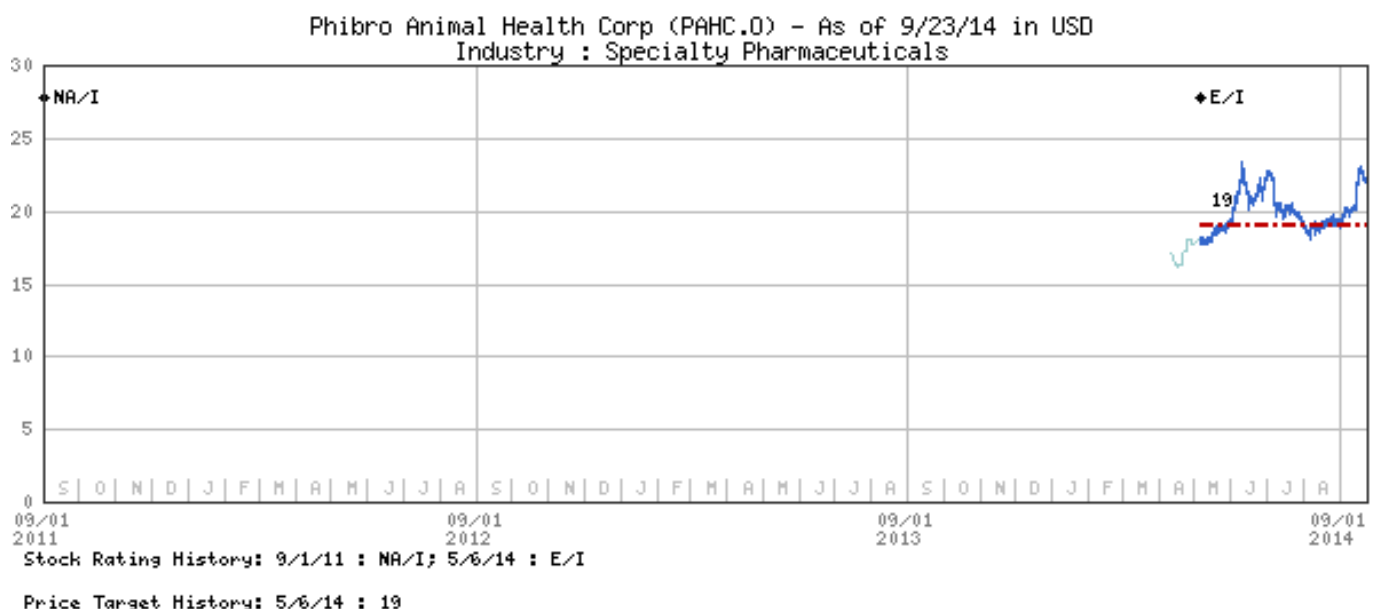
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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Stock Price, Price Target and Rating History (See Rating Definitions)



Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —

Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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INDUSTRY COVERAGE: Specialty Pharmaceuticals

COMPANY (TICKER)	RATING (AS OF)	PRICE* (09/23/2014)
Christopher Caponetti, CFA		
Endo Health Solutions Inc (ENDP.O)	++	\$65.95
Mallinckrodt Plc (MNK.N)	E (02/12/2014)	\$88.58
David Risinger		
Actavis Inc (ACT.N)	O (06/18/2014)	\$240.85
Alkermes Plc. (ALKS.O)	E (10/01/2013)	\$45.22
Allergan Inc. (AGN.N)	++	\$169.18
Mylan Inc. (MYL.O)	++	\$46.61
Perrigo Co. (PRGO.N)	E (07/11/2014)	\$149.42
Phibro Animal Health Corp (PAHC.O)	E (05/06/2014)	\$21.95
Teva Pharmaceutical Industries Ltd. (TEV.N)	E (03/14/2014)	\$52.38
Valeant Pharmaceuticals International (VRXN)	++	\$115.95
Zoetis Inc. (ZTS.N)	U (05/07/2014)	\$35.88

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* Historical prices are not split adjusted.

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