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Neogen Corp. (NEOG)

Q4 2024 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Neogen Corporation Fourth Quarter 2024 Earnings Call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. [Operator Instructions] This call is being recorded on Tuesday, July 30, 2024.

I would now like to turn the conference over to Bill Waelke. Please go ahead.

Bill Waelke

Vice President-Investor Relations & Treasury, Neogen Corp.

Thank you for joining us this morning for the discussion of the fourth quarter of our 2024 fiscal year. I'll briefly cover the non-GAAP and forward-looking language before passing the call over to our CEO, John Adent, who will be followed by our CFO, Dave Naemura.

Before the market opened today, we published our fourth quarter results, as well as a presentation with both documents available in the Investor Relations section of our website. On our call this morning, we will refer to certain non-GAAP financial measures that we believe are useful in evaluating our performance. Reconciliations of historical non-GAAP financial measures are included in our earnings release and the presentation, slide 2 of which provides a reminder that our remarks will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act.

These forward-looking statements are subject to risks that could cause actual results to be materially different from those expressed in or implied by such forward-looking statements. These risks include, among others, matters that we have described in our most recent Annual Report on Form 10-K and in other filings we make with the SEC. We disclaim any obligation to update these forward-looking statements.

With that, I'll turn things over to John.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thanks, Bill. Good morning, everyone, and welcome to the earnings call for the fourth quarter of our 2024 fiscal year. After crossing multiple significant integration milestones in the third quarter, progress continued on multiple fronts in the fourth quarter. We finished relocating the former 3M sample handling product lines in our facility in Lexington, Kentucky, and are now in the process of ramping up to full production levels, which we expect to be at the end of next month. We also saw improvement throughout the fourth quarter in our shipping performance. And this progress has allowed our commercial teams to return their focus to what they do best: demand generation.

Food production volumes remained mostly down on a year-over-year basis as customers continue to be under pressure, but the end market environment was stable in the fourth quarter. With a belief that food inflation, in particular, will continue to ease, food production volumes are generally expected to slowly improve over the course of our 2025 fiscal year. Along with the improving end market backdrop, our commercial teams are leveraging the broadest product portfolio in the industry and our reputation for consultative customer service to drive demand.

Now for our results for the quarter. Total Food Safety core revenue grew in the mid-single-digit range following solid growth in the fourth quarter of fiscal 2023. In Animal Safety, channel inventory levels and end user demand for our product categories remained roughly stable compared to the prior quarter. Our lower quarterly sales in this segment are due primarily to our Genomics business in the US and were otherwise flat on a core basis.

In our Genomics business globally, core revenue was still down on a year-over-year basis. In the first quarter, we began to round trip most of the impact on the strategic shift towards larger production animals, which has primarily impacted the US business. We are focusing our efforts on driving growth in the direct-to-producer beef and dairy business, as well as managing through a mostly flat companion animal market by expanding our direct-to-the-consumer genetic testing offerings.

With respect to product technology, we've seen notable developments recently related to two of our priority growth areas: pathogen detection and Petrifilm. In early June, the USDA's Food Safety Inspection Service (sic) [Food Safety and Inspection Service] (00:04:34) named the Neogen Molecular Detection System, or MDS, as its primary screening method for salmonella and listeria in meat, eggs and poultry. Salmonella and listeria represent the majority of pathogen testing in these food categories, and this selection by the USDA further validates the effectiveness, reliability and the ease of use of our MDS testing platform. We believe we have a significant opportunity for growth in pathogen detection, and plan to leverage the core capabilities of the MDS platform as a key part of our product development initiatives in this area.

The USDA announcement was followed in late June by the launch of our Petrifilm automated reader, which automates the loading of Petrifilm plates. The automated reader is specifically designed for high-volume labs and allows users to automatically feed and enumerate up to 300 Petrifilm plates while integrating with existing lab workflows and systems. This level of automation removes the need for lab technicians to manually load individual plates into the reader, reducing labor and providing more capacity for data analysis.

We expect the growth of this product to take some time to ramp up, but allows us to more effectively target the market opportunity for high-volume testing environments, those labs typically running over 100,000 such tests annually. We believe Petrifilm is a clear market leader in indicator testing and are planning continued investment to maintain its market leadership and unlock additional opportunities.

On our last earnings call, we committed to resolve the distribution inefficiencies stemming from our SAP and our new warehouse management system by the end of the first quarter. Although the fourth quarter was impacted by these issues, they have now effectively been resolved and our commercial efforts are squarely focused on winning back the sales that were impacted.

With respect to the integration, there's still work ahead of us, but the vast majority involves the completion and outfitting of our new Petrifilm production facility, which we do not expect will affect the rest of our operations.

Now, I'll turn the call over to Dave for some more insights into our results for the quarter.

David H. Naemura

Chief Financial Officer, Neogen Corp.

Thank you, John, and welcome to everyone on the call today. Jumping into the results, our fourth quarter revenues were $237 million. Core revenue which excludes the impact of foreign currency, acquisitions and discontinued product lines grew 2% for the quarter, while foreign currency was a headwind of 420 basis points compared to the prior year. Although we made significant progress during the quarter, our total revenue was impacted by our lower order fulfillment rates.

Moving to the segment level. Revenues in our Food Safety segment were $167 million in the quarter, a decrease of 1% compared to the prior year, including core growth of over 4%. The core growth was led by the Indicator Testing, Culture Media & Other product category, which benefited from double-digit growth in our Petrifilm product line, as well as solid growth in culture media and food quality and nutritional analysis.

The Bacterial & General Sanitation product category saw growth in pathogens and general sanitation, partially offset by slight decline in microbiology, due primarily to a higher level of equipment sales in the prior-year period. Within the Natural Toxins & Allergens category, modest growth in allergens was offset by a decline in natural toxins, due mainly to reduced product availability.

Quarterly revenues in the Animal Safety segment were $70 million, which includes a core revenue decline of 3% compared to the prior-year quarter. Overall, inventory levels in the channel remained largely stable with our decline in core revenue being driven by a couple of specific product category dynamics. The Vet Instruments & Disposables product line had another quarter of solid core growth.

In the Animal Care & Other product category, core growth was led by higher sales of our vitamin injectables and biologics products. Within our portfolio of biosecurity products, strong growth in insect control was offset by declines in cleaners and disinfectants and rodent control, due primarily to a compare challenge on strong growth in the prior-year quarter and timing of current year shipments.

Worldwide genomics revenue was down mid-single digits on a core basis. Solid growth in beef markets in EMEA and Latin America was offset by the shift away from small production animals in the US. The impact of which we expect to decrease as we exit the first quarter. From a regional perspective, core revenue growth in the fourth quarter was mixed. Growth was led by Latin America, which saw growth well into the double-digits with a strong performance across most key product categories. The growth was driven by progress on backorder fulfillment, some level of distributor restocking, and additional business at key food producers.

Our business in Europe grew low-single-digits on a core basis, with strength in culture media, Petrifilm, general sanitation, and sample handling, partially offset by decline in biosecurity products. Asia Pacific core revenue grew mid-single-digits on a year-over-year basis, with strong growth in Petrifilm and general sanitation offset by declines in pathogen in sample handling. Our US and Canada region saw the largest impact in the quarter from the shipment delays in our main distribution center, with core revenue down in the mid-single-digit range. Despite the impact, Petrifilm did see a modest level of growth, which was offset by declines in most other Food Safety product categories.

In the Animal Safety segment, performance was mixed with vet instruments and animal care, offset by declines in biosecurity and genomics. Gross margin in the quarter was 47.9%, representing a decrease of 300 basis points from 50.9% in the same quarter a year ago.

Adjusting for transaction and integration-related costs, the gross margin decline in Q4 was about 210 basis points. The decline was driven primarily by costs related to stabilization of our distribution and logistics operations and a higher-than-usual level of inventory adjustments.

Adjusted EBITDA was $53 million in the fourth quarter, representing an adjusted EBITDA margin of 22.4%, a year-over-year decline of 370 basis points. The decline in adjusted EBITDA margin resulted primarily from the decline in gross margin with some additional negative impact of transaction effects.

Overall, the adjusted EBITDA margin came in below what we believe is our underlying run rate this level of revenue by approximately 100 basis points as a result of some higher charges in the quarter that should not recur.

Fourth quarter adjusted net income and adjusted earnings per share were $22 million and $0.10, respectively, compared to $30 million and $0.14 in the prior year quarter. The declines in the current year Q4 were driven primarily by the lower adjusted EBITDA.

We ended the quarter with gross debt of $900 million, 67% of which remains at a fixed rate and a total cash position of $171 million. Compared to the third quarter, cash was roughly flat with outflows for capital expenditures offset by operating cash inflows.

Moving to our outlook for the fiscal year 2025, we are expecting core revenue growth in the mid-single-digit range on the back of an end market environment we expect to slowly improve as the year progresses, with total revenue anticipated between $925 million and $955 million. We expect the first half of fiscal 2025 to be a little wider than its usual seasonality of around 48% as we continue our focus on winning back sales, following the shipment constraints we experienced in the second half of fiscal 2024.

Adjusted EBITDA for the full year is expected to be between $215 million and $235 million, reflecting margin expansion of approximately 100 basis points, and an incremental margin of over 70% at the midpoint. We expect this margin expansion to be driven by improvements in gross margin and operating expense efficiency and aligned with revenue growth throughout the year.

With respect to capital expenditures, we're anticipating a sizable decrease as we move past the peak integration spend of fiscal 2024. For fiscal 2025, we expect capital expenditures of approximately $85 million, with approximately $55 million specifically related to integration items. We believe higher adjusted EBITDA combined with lower CapEx and the 3M working capital load-in not repeating will result in free cash flow being well into positive territory.

I'll now hand the call back to John for some closing thoughts.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thanks, Dave. The last couple of quarters have seen a tremendous amount of integration progress as we extricated ourselves from the services previously provided by our transition partner. This progress came with the inefficiencies in our distribution center that we discussed and have now resolved. Fiscal 2024 represented the peak of cash outflows for the integration in terms of both capital expenditures and working capital investment.

Outside of the new facility we're building, the 3M Food Safety operations have now been combined with Neogen, and we're able to shift a significant portion of our operational focus towards driving improvements in these combined operations. Commercially, we're excited to see a continued trend of improvement in our end markets and look forward to operating in a much more normal environment in which we're able to bring the combined power of One Neogen to demand generation on an unconstrained basis.

As demonstrated by some of our recent product launches, innovation remains a top priority. We're continuing to invest behind our key technology platforms where we believe we have a meaningful opportunity to drive growth, particularly in regions where we are underrepresented today. Simultaneously, we're exploring a number of new technologies that can improve the quality and ease of food safety testing, and strengthen our leadership position in the industry. While we have a significant amount of work that's behind us, we understand and are committed to executing on the opportunities ahead of us to continue to position the business for long-term growth.

Speaking of work, all of the progress we've made would not have been possible without the dedication and sacrifices made by our team members around the world. I'm proud of what they've achieved to date and want to thank them all again for their continued efforts.

Now, I'll turn things over to the operator to begin the Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question comes from David Westenberg with Piper Sandler. Your line is now open.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Hey, guys. Thank you for taking the question, and congrats on a good end to the year, right, big beat numbers, all right, and guidance in mind. So let's go with the Petrifilm. I mean, just a bunch on Petrifilm on kind of one question, because I think that is a pretty important business. So as we look at the retrospective on Petrifilm, can you give us some sort of rate of how customers that you've won back, customers that are still ready to come back. And then, can you talk about how that new automated Petrifilm reader can maybe drive business to Petrifilm.

And, of course, you talked about the high-volume customers. Can you give us a distribution of what percent of your customers are high-volume customer versus low-volume customer. Just would love to sort of figure out how much of your customers would actually be able to convert to that system. So, I know it was a lot. Apologies.

John E. Adent
President, Chief Executive Officer & Director, Neogen Corp.

A

Sure. That's all right. I got it. If I've missed something, David, let me know. Thanks for the question. So, yeah, regarding Petrifilm, I mean, I think you saw, we had a nice quarter in the fourth quarter. We saw Petrifilm and grew double digits in the low teens. We thought that was a nice growth for us. I think you saw what we did in Japan where we lost customers. We were able to claw that back, and Japan actually had growth for the year. We see that kind of continuing. It's a great opportunity for us.

The end markets are still a little soft. I mean, we still see that they're at low-single-digit decline. So that's a little bit challenging for us in the food production segment. And we think that's going to continue with – gradually improving in our next fiscal year, kind of on the back half is where we think we're going to see some change there.

Regarding the reader, yeah, I mean, look, we're excited to have that because, today, you manually feed that in and now we can do 300-plus stacks to have it read in. It's really focusing, David, on the food safety high-throughput labs. And when we talk about our market share at 20%, a portion of the remaining 80% is in those high-throughput labs, right? And that's really where we see where we're going to target that growth.

It's going to be an opportunity for us, though, longer term to approach nonfood-producing labs in an ancillary market with that same type of equipment. Now, that's going to take us a little bit longer, because we're developing products today that we're going to use to address those markets. But we can't really produce those until we have manufacturing in our house, because we can't expand the SKU line coming out of 3M. So we're excited about having the reader.

We think it's going to be an opportunity to really address those high-throughput food-producing labs that we currently work with. These are labs that do over 100,000 tests. Those are the ones that we're really targeting with that. And then, it's going to open a broader opportunity for a new market for us probably in the next couple of years as we develop SKUs to meet those markets.

David Westenberg
Analyst, Piper Sandler & Co.
Q

Got it. No, that's helpful. Just maybe if I can dive in a little bit. So it does sound like those high-volume customers do represent a pretty high percentage of the revenue in Petrifilm, did I catch that right? And – anyway, a clarification.

John E. Adent
President, Chief Executive Officer & Director, Neogen Corp.
A

It's a lower number – David, it's a lower number of customers, but they do more volume. So I wouldn't say...

David Westenberg
Analyst, Piper Sandler & Co.
Q

Yeah.

John E. Adent
President, Chief Executive Officer & Director, Neogen Corp.
A

...it's – of that remaining 80%, I wouldn't say, it's the higher piece. I'd say, it's less than half, but it's more targeted because they do a lot...

David Westenberg
Analyst, Piper Sandler & Co.
Q

Okay.

John E. Adent
President, Chief Executive Officer & Director, Neogen Corp.
A

...of volume, but it's a handful of customers.

David Westenberg
Analyst, Piper Sandler & Co.
Q

Got it. No, perfect. And then, you have another analyst on there. So I'll just keep it to two. So can you talk – this one is for Dave. You talked about the gross margins. You cited the distribution and inventory. I think you said more than 200 basis points of headwind there. That does sound like it would be pretty temporary. So as we're doing our model into next year, should we think about that rolling off pretty quickly? Or should we have that as a couple quarter drag? And just as we think about modeling, if you can cite any other year-over-years to compare to think about as we're modeling out our 2025 fiscal year? And I'll stop there. Thank you.

David H. Naemura
Chief Financial Officer, Neogen Corp.
A

Yeah. Thanks, David. I think the fourth quarter gross margin fundamentally came in lighter than where we think the business is running. It's a function of some higher inventory write-down, which, again, we're working on stabilizing our distribution and logistics footprint. And ultimately, as we work through that over a – what's amounted to a two-and-a-half quarter period, it's resulted in some higher level of inventory write-down as well as some continued inefficiency.

So I think if you step back from the quarter, net-net, probably, a couple hundred basis points of inefficiency on the gross margin side, a little lower OpEx than I think representative of the run rate. So I think at the EBITDA margin line, probably around 100 basis points light. I think we see the gross margin, some of those efficiencies come back over time. I think hopefully, second half, we see some of that recovery. As you know, gross margin is also reasonably volume-dependent, given our higher incrementals. So I think you'll see improvement ratably at both the gross margin line and accruing down to the EBITDA margin line as 2025 progresses. So thank you for the question.

David Westenberg
Analyst, Piper Sandler & Co.
Q

Thanks, guys, and congrats on ending the year well.

John E. Adent
President, Chief Executive Officer & Director, Neogen Corp.
A

Thanks, David.

David Westenberg
Analyst, Piper Sandler & Co.
Q

Fiscal year well.

Operator: Your next question comes from Brandon Vazquez with William Blair. Your line is now open.

Brandon Vazquez
Analyst, William Blair & Co. LLC
Q

Hey, everyone. Thanks for taking the question. Maybe on a high level first, can we just start – John, can you just talk about as you look at the organization now, most of the integration of the business is done here. What are the opportunities, and then, even the risks as you look at, call it, the next one to two years from a commercial perspective? And then, maybe, Dave, can you also frame from the P&L side, same kind of discussion of like what are the remaining risks and opportunities here in the next one to two years?

John E. Adent
President, Chief Executive Officer & Director, Neogen Corp.
A

Yeah. Thanks, Brandon. Look, the growth opportunities in the next one to two years are now that we have substantially everything except Petrifilm in-house is to take the One Neogen portfolio to our customers and drive share growth, right, and doing that across multiple regions. As we've talked about in the past, we feel that we're still underpenetrated in Asia, we're underpenetrated in Europe, we're underpenetrated in LatAm, heck, we're underpenetrated in the US. So we still have a 20% share opportunities to continue to grow, right, in these core market. So that's number one.

Secondarily, you see what we're doing with MDS. You saw that MDS. We had an opportunity or we saw that the USDA chose our molecular detection system as the choice for salmonella testing and listeria testing in poultry, eggs and meat. I don't know if you saw yesterday, they also said that now, they're going to start requiring salmonella testing in all poultry products. So when we were asked what does that do, well, to just to get the USDA contract really isn't that big of a revenue deal. But now, as they continue to move testing farther and push it along, that we are the testing of choice, really helps us as they continue to drive this throughout the industry. So big opportunities to continue a new product development like we saw with our MDS and pathogen testing.

As we talked about with David, the readers can open up the opportunity in the high-throughput labs; first starting with the food, high-throughput labs, but then opportunity really past two years to look at commercial labs in general that are using Petrifilm. I was talking to the group, I don't ask for a lot, the only thing I'm asking for is everybody that uses petri dishes in the world should be using Petrifilm. That's not a lot to ask for. So, I think that's something that we're going to aspire to as a group.

I think if you think about the risk side, our biggest risk is still bringing in the new Petrifilm manufacturing into Lansing. Now, the team is in Taiwan, the equipment's up, it's running. We performance-tested it in Taiwan. We were very pleased with the results. So we've approved – signed off. So we're breaking down the equipment. It's going to be sent over to the US. So we're right on track to where we need to be on that progress. But to me, that's the number one.

And then, secondarily, I'd like to see our customers get back to some growth. The unprecedented inflation that we've had it's really had an impact on the market that I haven't seen in seven years here. And you still see it. I mean, I don't know if you saw McDonald's comments, but when you've got people revolting that fast-food prices are too high, you know it's tough. It's tough out there. So, I'd like to see some of that ease. We think that could help a little bit in the second half, which is – and Dave will kind of take you through kind of the quarters. But we think second half is going to be stronger for us as that eases a little bit.

But I'd like to see the markets improve a little bit. And as we talked about, we're kind of going to be in the trough for Animal Safety. The good news is it's a smaller part of our business, but that business is not going to be growing as fast this next fiscal year because of the – kind of the economics right now in the production animal segment.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Hey, Brandon. Just to follow up on the second part of your question, I'd say, maybe in the near term and then the longer term. I'd say, in the near term, we need a year where we're not faced with a sizable integration challenge. In 2023, we had the supply side constraint from 3M. And then, of course, in 2024, we did the shipping, logistics or the cash integration, which resulted in – constrained on our capacity shift. And some of that impact now flows through particularly into the first half of fiscal 2025.

So you know from being around here that we typically see the first half is a little lighter than the second half. I think, historically, in the kind of 48-52 type range.

I think what we'll see in 2025, again in the near term, is a little lighter first half and then a little better second half, with better growth rates in the second half on what amounts to an easier compare. We've got some share to recapture as a result of some of the shipping constraints. We'll see that mostly impacts Q1, which historically is always our lowest quarter from both a revenue and an EBITDA margin perspective. So, it'll put pressure earlier in the year. But as we work through that, like we did following the supply constraint of Petrifilm in 2023, we should see that recover.

I think in the intermediate to longer term, we've talked about the integration thesis remaining intact. And I think it really does. We've always talked about the P&L performance here. Yes, there's always this or that, this put or that take. But at the end of the day, this is going to – P&L performance will come down to volume. So getting back to unconstrained growth, being able to tackle the markets, as John elaborated on, is what really unlocks the opportunity for the P&L. I'll stop there.

Brandon Vazquez
Analyst, William Blair & Co. LLC

Q

Okay. Thanks, Dave. And maybe to follow up on what you were talking about at the end there. If I look at guidance for the year at the midpoint, let's call it a $75 million delta towards EBITDA to get to that $300 million pro forma goal you guys previously put out there, without kind of going into timing of getting there, I think you guys want to take things a year at a time, which I understand, but talk about what the bridge is, how do you get that incremental $75 million in EBITDA, what are the drivers that get you from like a fiscal 2025 EBITDA number up to eventually in an undisclosed timeframe a $300 million EBITDA number.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Yeah. Well, I appreciate that. I think the levers are – first, obviously, growth. We've stated that the $300 million EBITDA number is associated with over $1 billion in revenue, and we need to move into that territory to do that. I also think as we move through years of significant integration activities, that we're able to also drive better fall-through in efficiency as we continue to work the P&L. It was a noisy year. But underlying that is a lot of operational improvements throughout the organization, and bringing some new perspectives to the teams that I think we're going to accrue benefits over time.

So it's really the combination of those two factors and the strong incrementals that the company can do on that growth, including the 3M products, which have shown up, in particular Petrifilm to have very, very strong fall-through. So market timing aside, integration activities aside, we still think that's in play. To your point, we're only guiding one year at a time. But we believe that the post-integration thesis, financial thesis remains intact. It's just a function of time and that's a function of – and that will drive the growth.

Brandon Vazquez
Analyst, William Blair & Co. LLC

Q

Okay. And maybe one last one for me, Dave, again. Can you talk a little bit about what is baked into the high and the low end of the revenue and EBITDA guidance ranges? Thanks, guys.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Sure. First of all, look, we talked – John said in his remarks, I elaborated on it a little bit. We constrained supply to our customers for the better part of two-and-a-half quarters, and there's implications for that. And I think we'll see that in the first half of the year. The shape at which we recover that is meaningful to the shape of the year. So I would say, we contemplated at least a couple of points impact from that in the midpoint of the guide. But, obviously, that's a tough number to estimate even with the data that we have. So that fundamentally could be better or worse.

As we look at our customers, their production levels, we think, we're in a reasonably soft spot in the food safety end market, kind of – through the cycle, it's not flat. And we think right now, we're in a more difficult part of the cycle. We're planning on reasonably slow recovery, but that, again, could be better or worse. And we're also assuming that we remain in the lower part of the little more cyclical animal safety market. So there's market implications. I think there's share and share recapture implications here. And I think those would be the big influencers plus or minus the midpoint, Brandon.

Operator: [Operator Instructions] There are no further questions at this time. I will now turn the call over to John Adent for closing remarks.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Very well. Thanks, everyone. Appreciate you joining us today. And we look forward to updating you again on our first quarter call on October. So have a great summer. Thank you.

Operator: Ladies and gentlemen, this concludes your conference call for today. We thank you for participating, and ask that you please disconnect your lines.