Corrected Transcript

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Neogen Corp. (NEOG)

Q2 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Neogen Corporation Second Quarter 2025 Earnings Conference 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 Friday, January 10, 2025.

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 second quarter of our 2025 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 preliminary second quarter results as well as a presentation with both documents available in the Investor Relations section of our website. We are in the process of finalizing our quarterly financials, and while we do not expect them to, actual results could differ from the preliminary results being discussed today.

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.

I'll now 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 second quarter of our 2025 fiscal year. The second quarter reflected steady progress as we saw improvement across the business compared to the first quarter, with core revenue growth accelerating in both of our segments, sequential margin expansion, and significantly better free cash flow.

In our Food Safety segment, the end market continues to work through unprecedented times stemming from the significant inflation of food prices and resulting lower levels of food production. However, we've continued to see gradual improvement, with our proxy for the global food production beginning to approach flat levels on a year-over-year basis. This gradual end market improvement has coincided with what we see as an increasing focus on Food Safety from both consumers and regulators given the number of recent food contamination incidents, some of which have had tragic consequences.

From a regulatory perspective, we are seeing an increased level of interest in food borne pathogen mitigation. Following the USDA's declaration over the summer of salmonella as an adulterant in breaded and stuffed chicken products, the agency has more recently proposed an expanded framework under which salmonella would be declared an adulterant in additional raw poultry products. And would also include additional monitoring and sampling requirements.

The public comment period for this proposed framework ends next week, with any final determination on the path forward likely to be made in late 2025. The agency also announced last month that it will be taking new steps to strengthen its oversight of facilities producing ready-to-eat food products, specifically, in response to several recent foodborne illness outbreaks resulting from exposure to listeria monocytogenes.

The USDA issued a series of notices and directives that provided more robust approach to listeria mitigation and included additional data collection and training, as well as enhanced testing by the agency for listeria species and guidelines for an effective food safety assessment methodology.

From a consumer perspective, the fact that food content more broadly was a prominent topic in the recent US presidential election and seemed to resonate with many people bodes well for our market. We fully expect consumers to continue to demand not only the obvious and safe food, but also increasing disclosure on the content of food and beverage products.

With the broadest product portfolio in the industry, Neogen is, of course, able to offer solutions to food producers that help to address all of these concerns. Last month, we further expanded our product portfolio, Petrifilm, with the addition of Bacillus cereus count plate, which is the first new Petrifilm plate launched in the last seven years, underscoring our commitment to build on this product platform as a part of Neogen.

This ready-to-use plate expands our Petrifilm offering to include another persistent food safety threat and eliminates the prep work associated with traditional agar methods, while delivering easy to interpret, high confidence results in as little as 20 hours. We continue to leverage our product portfolio and the increasing focus on food safety to drive growth despite the temporary headwinds from sample collection production. And made further progress in the quarter winning back market share we ceded from shipping delays late last fiscal year.

In our Animal Safety segment, core revenue growth improved 11% from the first quarter. On our last earnings call, we made the observation that we did not believe the lower first quarter revenue in Animal Safety was the result of a broader destocking trend, and we were pleased to see the return to growth in the second quarter. Despite inventory in the distribution channel being at low levels, growth in the sales of our products out of the channel remained positive. It's difficult to make a call on when the market will turn, but we continue to believe we're operating around cyclical lows and are encouraged by the growth we saw in the quarter.

In our Genomics business globally, second quarter core growth was down mid-single digits on a year-over-year basis. We have round tripped the impact of the strategic shift towards larger production animals and did see growth in our differentiated cattle business in the quarter. This growth was offset by ongoing weakness in the companion animal side of the business, driven by a lower number of pet adoptions and continued inflationary pressure on consumers, as well as a reduced level of outsourced testing.

With respect to the integration, we have discrete initiatives underway to drive improvements and efficiency of our fully integrated shipping and distribution operations, which we will expect to begin to show benefit in the third quarter.

Regarding the relocated sample collection production, the process of ramping up is continuing. All of the product lines are operational and we believe are on track to reach prior production levels by the end of the third quarter. Our new Petrifilm facility continues to progress well. With the first two major shipments of production equipment having already arrived in Lansing where the extensive process of unpacking, assembling and rigging for installation has already begun. We are on track for our goal of beginning initial test production in the new facility in the fall of 2025.

While our primary focus has shifted to winning in the market, we have also undertaken actions to accelerate the building of a more profitable, focused Neogen. During the second quarter, we initiated restructuring actions focused mainly on rightsizing our Genomics business to drive a higher level of profitability with a more streamlined operations focused on our differentiated large animal offering.

We expect additional restructuring activities in the third quarter as we continue to work on opportunities to protect margins and streamline different parts of our business, including further actions planned in Genomics. Over the last several quarters, we've mentioned that portfolio review has been a priority and that there has been a significant amount of work being done to support that.

The internal portion of that work is now mostly behind us, and we have multiple projects underway to explore strategic alternatives for a meaningful portion of our Animal Safety segment. We have not finalized any portfolio moves, but we currently have engagement with other parties that will review opportunities on the basis of creating value for shareholders by improving profitability and further focusing the company on the attractive food safety market.

With the first half of the year now behind us, we're updating our full year outlook. Revenue in the first half was in line with the expectations we communicated, including progress on share recovery. The largest portion of the change in guidance is due to additional foreign exchange headwinds and lower Genomics revenue from our restructuring actions, as well as the longer ramp-up period we're working through for sample collection production.

The change in adjusted EBITDA guidance primarily reflects the change in the anticipated revenue, as well as a first half margin that was a little lower due mainly to higher freight and distribution costs and some elevated inventory impairments. We have projects underway specifically to address freight and distribution from which we expect to see a benefit in the second half, in addition to the restructuring actions taken. These initiatives in combination with higher second half revenue are expected to support higher margins and build on the progress we made in the second quarter.

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

David H. Naemura

Chief Financial Officer, Neogen Corp.

Thank you, John, and welcome to everyone on the call today. Jumping into the results, our second quarter revenues were $231 million. Core revenue, which excludes the impact of foreign currency, acquisitions, and discontinued product lines, grew 3.5% for the quarter, including a positive contribution from pricing, while foreign currency was a headwind of 250 basis points compared to the prior year.

At the segment level, revenues in our Food Safety segment were $164 million in the quarter, flat compared to the prior year, due to the negative impact of FX, which offset core growth of nearly 4%. The core growth was led by our biosecurity products and the bacterial and general sanitation product category, which benefited from strong growth in our ATP product line.

In the indicator testing, culture media and other product category, solid growth in our food quality, culture media and Petrifilm product lines was offset by a decline in sample collection as we continue the process of ramping up the relocated production in our own facility. Within the natural toxins and allergens category, modest growth in allergens was partially offset by slight decline in natural toxins. Excluding the headwinds in sample collection, core revenue in the Food Safety segment grew 8%, which we believe is more reflective of the underlying business, albeit on an easier compare.

Quarterly revenues in the Animal Safety segment were $67 million, which includes core revenue growth of 3.2% compared to the prior year quarter. Within our biosecurity product category, we saw growth in all major product lines. In the animal care and other product category, solid growth was driven primarily by biologics and wound care products, as well as vitamin injectables, which saw the easing of a supplier backlog situation.

The vet instruments and disposables product category accelerated from the first quarter to modest growth in the second quarter, driven mainly by sales of needles and syringes. Outside of Genomics, core revenue in our Animal Safety segment was up over 7%.

Our global genomics revenue was down mid-single digits on a core basis. Growth in US and international beef markets was primarily offset by a decline on the companion animal side of the business. From a regional perspective, core revenue growth in the second quarter was mixed. Growth was again led by Latin America, which saw double-digit growth with a strong performance across most key product categories, including new business wins.

Our business in Europe grew high-single digits on a core basis, led by growth in Petrifilm, general sanitation and natural toxins. Asia-Pacific core revenue was up slightly on a year-over-year basis, with solid growth in Petrifilm, partially offset by declines in pathogens and sample collection.

In our US and Canada region, which has experienced the largest carryover impact from last year's shipping delays, core revenue was roughly flat compared to the prior year period. Solid growth in culture media and food quality and nutritional analysis was offset by declines in most other Food Safety product categories, including a larger impact in sample collection as we continue the process of recapturing market share. In the Animal Safety segment, solid growth across most key product categories was partially offset by the decline in Genomics.

Gross margin in the second quarter was 49%, representing a decrease of 190 basis points from 50.9% in the same quarter a year ago. Excluding integration and restructuring costs, gross margin in Q2 was roughly flat compared to the prior year. Adjusted EBITDA was $51 million in the second quarter, representing a margin of 22.2% for a sequential improvement of 210 basis points.

On a year-over-year basis, the decline in adjusted EBITDA margin was driven primarily by having the full cost to exit the various transition agreements, which we did not fully have in the prior year period. This also includes some impact from higher shipping and distribution costs, where we expect to see improvement in the second half of this year from cost reduction initiatives we have underway.

Second quarter adjusted net income and adjusted earnings per share were $24 million and $0.11 respectively, compared to $25 million and $0.11 in the prior year quarter. The lower adjusted EBITDA in the current year Q2 was mostly offset by lower effective tax rate due largely to regional profitability mix.

Our GAAP net income in the quarter was significantly negative due to the non-cash goodwill impairment charge related to the acquisition of the former 3M Food Safety division. We continue to have full confidence in the post-integration prospects of the business. The impairment charge primarily reflects, from an accounting perspective, the slower start we've had as a result of some of the end market and integration complexities.

We ended the quarter with gross debt of $900 million, approximately 60% of which is at a fixed rate, with our interest rate swap having reduced by $50 million at the end of the quarter, and a total cash position of $140 million. Free cash flow in Q2 improved by approximately $80 million compared to Q1, benefiting primarily from lower capital expenditures, improved working capital performance and the semi-annual bond interest payment not repeating. With capital expenditures expected to step down in the second half, we believe that we are still on track for positive free cash flow for the year.

Moving to our outlook, as John mentioned, we are updating our guidance to account for several changes compared to the assumptions underpinning our guidance entering the fiscal year. First half revenue developed in line with the expectations we communicated. However, with the continued strength of the US dollar, particularly post-election, we're now facing an elevated FX headwind, which is the biggest change reflected in our updated guidance. Additionally, the restructuring of our Genomics business has resulted in additional intentional attrition of some less attractive revenue as we focus our end market exposure and streamline our operating footprint.

Finally, the ramp-up of sample collection production to full capacity has taken longer than originally anticipated, reducing our revenue in this product line as we have been unable to fully meet demand. Due to normal seasonality, the expected ramp of sample collection and continued share recovery, we expect second half revenue to be more weighted towards the fourth quarter.

With the restructuring actions taken and anticipated reductions in our freight and distribution costs combined with operating expense efficiency, we expect to build on the sequential margin improvement we saw in the second quarter and see further expansion in the second half of the year.

Our updated adjusted EBITDA guidance primarily reflects the decrease in revenue and the lower first half margin, as well as some offsetting efficiencies from our restructuring actions. We expect our quarterly margins in the second half to generally be aligned with revenue and higher in the fourth quarter. As I mentioned earlier, we expect capital expenditures to decline in the second half and are maintaining our original outlook.

Specifically related to the goodwill impairment charge, we will be filing Form 12b-25 later today to provide additional time to complete the audit procedures related to our impairment analysis. We do not expect the impairment charge included in the financials in our earnings release to change, but until we file our Form 10-Q, the results technically remain preliminary. We plan to file our 10-Q next week within the grace period provided by SEC rules.

When we do file our 10-Q, it will include the conclusion we have had deficiencies in the control activities and information and communication components of the COSO internal control framework that constitutes material weaknesses. At a high level, these deficiencies are primarily related to the timely execution and documentation of controls.

We have performed additional analysis and other procedures to ensure that our financial statements are free from material misstatement. We remain on the journey of improving our global controls environment and are working through remediation actions, which will be ongoing as we continue to progress through the integration and strengthen our capabilities.

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

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thanks, Dave. The second quarter represented additional progress for Neogen. We saw improved revenue, margins and cash flow from the first quarter, and our primary Food Safety end markets continue to show signs of gradual improvement. We're also taking the actions I covered earlier to protect margins and further focus the business. Part of the process of building Neogen for the future and repositioning our company to win in the end markets.

Along these lines, we also announced this week that Dave will be taking on the role of Chief Operating Officer, in addition to his duties as Chief Financial Officer. With the operations organization already reporting to Dave, this additional responsibility will allow Dave to further strengthen the coordination and strategic alignment between the finance organization and the rest of our business, with the goals of optimizing margin improvement opportunities and capital allocation.

Dave's expanded role coincides with the update we provided that Doug Jones, our current Chief Operating Officer, will be making his retirement official at the end of February, after which he will remain available to us through 2025 to ensure a smooth transition to a new Chief Commercial Officer and provide other assistance as needed. We're well into the process of hiring a Chief Commercial Officer with multiple rounds of interviews conducted with a number of highly qualified candidates. And we're excited by the opportunity we have to further strengthen our team with the addition of someone who will be solely focused on driving growth globally.

The new Chief Commercial Officer will supplement the strong regional leaders we've put in place and will be able to leverage our global scale, comprehensive product portfolio and the largest technical support team in the industry. While we're not relying on the regulatory environment to drive growth, the increasing level of regulatory interest in the US highlights not only the importance of Food Safety overall, but also the significant room for improvement that exists. Our long history and experience going back to the early days of Food Safety testing, puts us in a position to be a trusted partner of both food producers and regulators to help in the mission of reducing the frequency and severity of foodborne illness.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. And ladies and gentlemen, we will now begin the question and answer session. [Operator Instructions] And your first question comes from the line of Brandon Vazquez with William Blair. Please go ahead.

Brandon Vazquez
Analyst, William Blair & Co. LLC

Q

Hey. Good morning, everyone. Thanks for taking the question. I'll start off with one kind of high level question. I think part of the discussions that we've had about putting this business together and reaching kind of higher profitability targets has always been based on volume. And I know a lot of the revenue coming down, example in Genomics, is something you're proactively taking, but it probably still has P&L impact.

So maybe talk to us a little bit about, like, we're going to a lower and lower revenue base to some degree here. What are the implications on what the margins of this business can be? Is this still a business as we're going closer to $900 million rather than closer to $1.1 billion in sales? Can we still think of this as a high-20% EBITDA margin in the foreseeable future?

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Yeah. Hey, Brandon. It's Dave. When we talk about portfolio, you heard us talking about components of the business that maybe don't have the growth profile or the margin profile that we aspire to for Neogen. And I think what we've seen in Genomics over the last, call it – as an example here, what we've seen in Genomics over the last year-and-a-half is a business that hasn't grown. We've seen commoditization and we've seen decline from an EBITDA perspective.

So, it's a big component of bringing down the year was pulling out Genomics. You've heard us talk about restructuring parts of that business, but we think by focusing it more, we can support the margin profile that we're really after here. We have a really good franchise focused on cattle, and that's the focus of the restructuring actions we have done.

I guess I would just further add that, when we think about Animal Safety, you've heard us say a lot. We don't view it as one large business. We think it's a component or it's made up of four or five different components, all with a little bit of different profiles. So we're really doing the analysis at that level. But the objective – to your point, the objective is to, yet, from a revenue standpoint, potentially be smaller but be higher quality from a margin and probably less cyclicality perspective as well.

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

A

Yeah. And, Brandon, it's John. I'd just add to what Dave said. The other piece we're doing is, we talked about the restructuring activities we're taking to make sure that we can continue to drive to our targets, and where we put the guide at the mid-20% range in the second half of the year for EBITDA.

Brandon Vazquez
Analyst, William Blair & Co. LLC

Q

Okay. That makes a lot of sense. Maybe a little bit more granular of a question on near-term trends. On sample handling, can you talk to us a little bit about – obviously, in the past, when you've had some issues in distribution, things like that, this is Food Safety, customers need to test. They moved to someone else. Are you guys getting in a position now as you're the manufacturer, you're taking a little longer in sample handling to ramp?

Are you kind of losing some share there? Is this going to be something that, even if it's fixed, I think, John, you said it at the end of fiscal Q3, we're going to probably have several quarters of headwinds after it because you need to go out, reengage with those customers and get that share back again?

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

A

Yeah, I think that's exactly right, Brandon. You see that that business is a consumable business, right? So, when you lose – when you don't have product available, you lose the sale and the customer has to go buy that product from somewhere else. So I think it's been a bit of a challenge, we've talked about some of the things that happened with it. We weren't able to get the desired safety stock up. We brought four lines over, it was one line that's kind of been the challenge. Product line wasn't decommissioned, right? So we began production in our facility in the second quarter.

We're at about half that output now of historic. We think we're going to be at 100% for Q3. We think the – Q1, the impact was about $4 million to $5 million. We think Q2 it's probably grown a little bit to $6 million. But we see that easing in the second – or in the third quarter and then going into fourth because we're going to be able to bring those capacity rates back up by the end of the third quarter.

Brandon Vazquez
Analyst, William Blair & Co. LLC

Q

Okay. Great. And John, one last one. Another big picture one. You talked a little about the evolving food regulation space. It seems like there's even some potential for a separate food administration, which would be great. I think there's a lot of – there tends to be a lot of questions just around what could this mean for food safety regulation in general, and then what it can mean for Neogen.

I know you touched on a little in the prepared remarks, but maybe talk about like what are some realistic scenarios you could see playing out here and where can you see benefits. Because some of your biggest customers are probably already extensively food testing, right? So, where can you see benefits to the business in an increasingly food regulatory environment? Thanks, guys.

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

A

Yeah. Thanks, Brandon. Yeah. Look, I think the tailwinds from this could be very significant for Neogen over the longer term. When you look at some of the challenges that companies have had recently, and all of us are aware, those are very established companies that have had very significant food safety programs. I think the thing that people need to recognize is food safety monitoring and testing is very much like cybersecurity. It never ends. And there's always new threats and there's always new pathogens and ways these pathogens can kind of get into your system.

And therefore, always updating and improving your risk analysis is extremely important. And I think that's what's going to help continue to drive Neogen's success in the future, because we have the broadest portfolio, we have the broadest team, and we're going to be able to help those customers meet those challenges. And you see it from a regulatory basis where they're going to say this is now the new minimum. But I also think customers are understanding that just because you haven't had an issue in 10 years does not mean you're not going to have an issue tomorrow. It is a day to day constant monitoring fight in a way that we can help our customers win that fight so they provide safe food to their to their consumers.

Operator: Thank you. And your next question...

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

A

Next question.

Operator: Yes. Your next question comes from the line of Subbu Nambi with Guggenheim. Please go ahead.

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Hey, guys. Good morning. Thank you for taking my questions. You touched on this a little. Could you give us more color on magnitude for each currency, Genomics attrition and the delay in sample collection production that resulted in the $25 million reduction in guide at midpoint? And then could you break out some of the accelerators or headwinds getting to that guidance number as well? Thank you.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Yeah. Hi, Subbu. Thanks for the question. So, when we think about the guide reduction at the midpoint, which I think is the heart of the question, the two biggest components is really FX and the Genomics reduction, which makes up a significant portion, call it, over two-thirds of the reduction. The FX has strengthened significantly post-election in November and December, the US dollar has strengthened. So that headwind has grown. And then, of course, as we're proactively taking these actions in Genomics, so that's the biggest piece of it.

Within some other items netting, but really sample collection being kind of the third piece to get to $25 million. When we think of it, the EBITDA line, there's some fall through on that, less so from the Genomics because we've also hand-in-hand restructured out a lot of the infrastructure associated with that. But from – you get the fall through from FX which actually, given our profitability and not having as much kind of overhead and infrastructure internationally, comes through at a little above the fleet average rate. And then, also, as well sample collection and other products come through.

And then I think it's worth pointing out, we've talked consistently through the year that from a shipping and distribution cost standpoint, we knew we had inefficiencies last year and had planned to improve on that this year and we've been running higher than we had thought, particularly in the first half year. Now we have actions in place to do better there, which is not restructuring, but those are operational actions. And we're working on that for the second, but ultimately – the second half, but ultimately that impacts the year guide as well.

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Okay. Thank you for that, David. Why did it take another quarter to realize this? You should've known of all this heading into the year, right? Sorry for being so blunt here.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Are you talking specifically about shipping and distribution costs? I think...

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Exactly.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

...you know a lot of that we're...

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Exactly.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

...yeah. Well, we definitely saw the impact in Q1. And I think we talked with folks about that when we saw the margins lower than we had thought in Q1 at the gross margin level and also impacts OpEx, kind of shipping and distribution. It is. We did see some improvement sequentially in Q2, but it's really about responding to – your question's really fair, Subbu. But, also, I think it requires a look back at what we went through last year in shipping and distribution where we were just focused on trying to get things out the door in our post-integration environment.

And then as we're settling that out, we had to kind of bottom out, I think, what it looked like in a normalized state. And I think we were really working through that coming into the year. In a normal course business that isn't going through these integration activities, I agree with you, but I think it's more of a symptom of the changes we've gone through over the last four quarters. And to be honest, it's been compounded by some shipping rate issues, which are a little difficult to predict, particularly as it relates to ocean freight.

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Got it. And then I have a similar question as Brandon, but for Petrifilm. You've strung a couple quarters together here on offense after losing some customer share, but now you're trying to win it back. Where does the current customer sentiment stand today? And are customers holding off before recommitting?

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

A

Yeah. Subbu, it's John. I'll take that. I think customer sentiment gets better every day because we continue to show them that we have supply and we can meet their needs. And we saw that where we [audio gap] (00:32:21) kind of regaining back those customers over the different – over Q2 over Q1.

And while we know that it's going to be challenging to get everybody back, we do see that the customers are coming back, they're happy with us. And the ones that take a little bit longer, what we need to do is what we're doing now. We need to offset that with new customers and grow. And that's really what we're focused on. So, we've seen the customers come back, but this is something where we need to prove ourselves to them every day and we are, and each day we do it, the more comfortable they get.

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Got it. This is smaller part of your business, but still a significant one. You mentioned in 1Q that Animal Safety peaked in US in 2022 and then declined last two years. Are you expecting that again for the remainder of this year? Or are there any early indicators to prove that is happening? Any factors that would give you a different reaction?

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

A

Yeah. I get into this a lot. I hate to pick the tops and the bottoms, but, last quarter, when we saw Animal Safety kind of drop, we made sure to say, look, it really wasn't a kind of a fundamental destocking. And we saw really good sequential improvement, related to that second quarter. And really, like we said, that first quarter was a couple of specific issues on a few large distributors that we didn't think was a broader issue. And in fact, that was the case.

So we had a bit of a backlog that we had on a third party supplier, which we cleared in the quarter that really helped us. But, look, I think we're on pretty solid footing right now for Animal Safety. We continue to see our move out through distributors being positive. And so, to me, that gives me confidence going forward in Animal Safety.

Subbu Nambi
Analyst, Guggenheim Securities LLC (Research)

Q

Okay. Fair enough. Thank you, guys.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Thank you, Subbu.

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

A

Thank you.

Operator: And your next question comes from the line of David Westenberg with Piper Sandler. Please go ahead.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Hey. Thank you [indiscernible] (00:34:40-00:34:45).

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

David, we're not able to hear you.

David Westenberg
Analyst, Piper Sandler & Co.

Q

[indiscernible] (00:34:50). What about now? Can you hear me now?

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Now we can.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Can you hear me now?

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Now we got you.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Okay. Perfect. All right. Thank you. So, you've been mentioning about the freight and distribution costs. Can you help out piece out how much of it is related to just distribution center changes, kind of that reorganization versus external factors such as oil prices or you mentioned kind of sea shipping? I'm just trying to get a handle of just when that could end, how that comps and what stuff we need to probably continue to worry about in the future just because you obviously can't control oil prices or shipping.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Yeah. Yeah. No, look, David, good question. I think the majority of it relates to where we ended up kind of bottoming out the internal costs associated with our internal logistics and distribution operations. Once we kind of got through what we went through last year, we are seeing higher rates. I would also say I think we have opportunity in rates and that is one of the threads that we're pursuing for second half is renegotiating some of those contracts.

But I think, look, we're also bringing in some additional talent internally on that side. We just had someone start that we're really enthusiastic about, but we'll be taking a new strategic look at our whole global network. So these things are difficult to move in the short period of time because the priority is to keep them moving. But we'll have a number of actions. I think you'll see the change in the future being driven more operationally than by external factors.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Got it. No. Thank you. And then I'm just going to ask on the Genomics and focusing on profitability here. You mentioned on the call just that you have a little bit more focus on large animal. Does that mean you're exiting companion? And if you are, can you talk about some of the – how that impact some of the other areas in terms of companion animal, for example, parasiticides or I know you have a clean – you have the companion cleaners and disinfectants line, anything like that.

I'm just trying to think about – it's kind of a continuation of Brandon's question about how your – you grow by volume, but at the same time, you might be reducing something. So, can you just run us through how you came up with the decision there.

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

A

Yeah. Look, historically, Genomics was a really good growth source for us, both organically and inorganically. But in recent years, we've seen kind of the competition expand. And while some of the markets are attractive, some have been commoditized, and that's why we're really focusing on where we can add value is when we sell a product with insights directly to customers, right?

So we're helping the customer take that data and make good decisions, which is the case in our differentiated cattle. When you think about small production animals and even companion, today, the current big pieces of our business is, we supply the raw genomic results and that's a B2B market and then that customer takes those results, and then they interpret or they then change it and give it to their customer base. So, while we're not exiting that, what we see is that companion genomics market is slowing down. We haven't seen the puppy boom that we saw for COVID has been slowing down. So that market's slowing down. And we're seeing a lot of those tests being more outsourced, because it's raw genomic data, right?

Now, what's challenging to me and frustrates me is, because that market is declining, if I like – what gets me interested and excited about the business, I think Genomics out of second quarter for Animal Safety, the growth rate goes from 3.5% to 7.3%, right? So we have – and I have a similar thing in Food Safety. If I take out sample handling, Q2 growth goes from 3.6% to 8.1% and year-to-date goes from 2.4% to 6%, right? So I have a couple of really bespoke issues that we are working diligently on the fix, but that's what kind of gets me excited and see where the underlying business is growing versus these two things that are really headwinds for us.

David H. Naemura
Chief Financial Officer, Neogen Corp.

A

Yeah, David, let me add two points to what John said. So I think John mentioned this, but I'll reinforce it that we're seeing less outsourcing, and that's what we do. We do the back office testing for companion versus having our product direct to the consumer. So we're seeing that decline. And we anticipate seeing that continue to attrit, frankly.

But to your other point, the relationship to other companion products, we're not exiting companion, we're exiting specifically the back office work that we do, we're not exiting it, we see it attritting, frankly. Now, and it is unrelated to our other products that would be focused on companion. You know that most of our products are focused on production animals, but we do have some focused on companion. But a lot of times that we talk of that, we're talking production, of course. So there wouldn't be any additional spillover from that.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Hope you guys can hear me. I'm having technical issues. But thank you so much.

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

Okay. Thanks, David. Thank you. We're ready for the next question, please.

Operator: Your next question comes from the line of Thomas DeBourcy with Nephron Research. Please go ahead.

Thomas DeBourcy
Analyst, Nephron Research LLC
Q

Hi, guys. My question, I guess, relates...

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

Hi, Tom.

Thomas DeBourcy
Analyst, Nephron Research LLC
Q

Hey. My question relates to kind of Animal Safety and I guess the pruning of the portfolio or potentially, I guess, selling parts. It's a little difficult when it is kind of, I guess, plays out over a longer period of time. So, is there a certain time period where you would expect this to occur? And then if not, this is really the portfolio going forward? Or how do you think about kind of just the timeframe towards, I guess, making any strategic decisions or kind of I guess growing off the base that you have?

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

Yeah. Thanks. Thanks, Tom. Well, look, it's difficult to talk to specifically until we've got something completed. But let me kind of take you through our approach, because I think that will help you kind of think how we're doing. So, look, as you know, Animal Safety is made up of like four or five product categories. It is not a monolithic business. And we looked at those each category in our portfolio analysis. And then what we did is we focused on those few categories that we have that are lower growth, lower profitability and more cyclical.

We did the internal work on those categories and we moved in the next stage with active engagements, right? Collectively, we're targeting a significant amount of Animal Safety revenue, probably around half, and that's kind of the process that we're in right now. And so we'll keep you guys updated as developments happen.

Thomas DeBourcy
Analyst, Nephron Research LLC
Q

Great. Thank you very much. Appreciate it.

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

Thanks, Tom.

Operator: And I'm showing no further questions at this time. I would like to turn it back to our CEO, John Adent for closing remarks.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thank you. So, thanks, everybody. Thanks for being on the call with us today. I want to thank our team members for all their hard work in 2024 and the work they continue to do. We've accomplished a tremendous amount in 2024 and are looking forward to a much better 2025. We hope all of you have a prosperous and happy 2025. So thanks for joining us.

Operator: Thank you, presenters. And ladies and gentlemen, this concludes today's conference call. Thank you all for participating. You may now disconnect.