



Omega Protein Corporation
First Quarter 2017 Earnings Conference Call
May 9, 2017
8:30 a.m. ET

John Held - EVP, General Counsel and Secretary

Good morning, and welcome to Omega Protein's first quarter 2017 earnings conference call. By now, everyone should have had access to the earnings release for the first quarter ended March 31, 2017. For a copy of the release, please visit Omega Protein's website at www.omegaprotein.com under Investor Relations. This call is being webcast, and a replay as well as a transcript of the prepared remarks will be available on our website for 30 days.

Before we begin, we would like to remind everyone that comments made by management during today's call will contain forward-looking statements. These forward-looking statements discuss plans, expectations, estimates, and projections that might involve significant risks and uncertainties. Actual results may differ materially from the results discussed in these forward-looking statements.

Additional information about risk factors and the uncertainties associated with Omega Protein's forward-looking statements can be found in the Company's earnings release, the Company's Form 10-K for 2016, the Company's Form 10-Q for the first quarter of 2017, and in the Company's other filings with the SEC. Because of these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Omega Protein disclaims any intention or obligation to update or revise any forward-looking statements, except as required by law.

Please also note that on today's call, management will be discussing non-GAAP financial measures, including adjusted EBITDA, adjusted earnings per share and other metrics. Historical non-GAAP financial measures are reconciled to the most directly comparable GAAP measures in our press release, which is available on our website. Some of the information presented is derived from third-party sources. And while we believe this information to be reliable, we have made no independent investigation of these third-party sources or attempted to verify the veracity of the third-party data in any way.

I would now like to turn the call over to our President and Chief Executive Officer, Bret Scholtes, for opening remarks.



Bret Scholtes - President & CEO

Thank you, John. Good morning everyone, and thank you for joining us today. I will begin with a summary of our quarterly business and financial performance. Our CFO, Andrew Johannesen, will then provide you with a more detailed review of first quarter financial results. Finally, we will open the call to take questions.

We are pleased with our start to 2017. We reported consolidated revenues of approximately \$74 million, adjusted earnings of \$0.26 per diluted share and adjusted EBITDA of \$15 million for the first quarter. Our solid consolidated financial results and ability to generate cash flow have enabled us to make strategic investments expected to increase our operating efficiencies, support our future growth and enhance value for shareholders.

I will begin with our animal nutrition segment, which includes sales of specialty ingredients to formulators of companion and production animal diets. As many of you know, we measure the animal nutrition segment's success by three primary drivers: production volumes, revenue per ton and cost per ton.

Production volume is a key driver for both sales and unit costs. Our production volume reflects the results of our harvesting and processing efforts as well as yields. As a reminder, we do not produce fish meal or fish oil during the first quarter, so all of our product sold during the quarter was processed during the 2016 season. For 2017, our fishing season began on April 17th at our Gulf of Mexico facilities. Our Atlantic fishing season will begin this week.

The second driver of success for the animal nutrition segment is revenue per ton which reflects the global supply and demand dynamics of fishmeal and fish oil. We continue to see good demand for our products driven primarily from the aquaculture and pet food sectors, and we are closely monitoring the global supply of fish meal and fish oil. Early indications lead us to expect global supply for fish meal and fish oil to be higher in 2017 versus the prior year, primarily due to higher quotas in Peru. Thus, we expect some softer prices for both fish meal and fish oil for the remainder of 2017. Please keep in mind, 2016 represented the highest revenue per ton in our Company's history, and our forward contracts enabled us to enjoy similar prices in the first quarter of 2017. Based on the seasonality of the industry, we expect to have more supply and demand visibility when we report our second quarter earnings.



The third driver of success for this segment is our cost per ton which is calculated by dividing the cost to catch and process fish by our annual production. Cost per ton for the first quarter was driven by fish catch and production results from the 2016 fishing. Cost per ton for the 2017 season will be driven by this season's catch and production levels. Our ability to control costs has been an important contributor to the strength of our consolidated margin profile over the last few years. During this time period, we have strategically invested capital across our fishing operations, from harvesting to the manufacturing and processing of product, to create a platform to support our growth and to create increased efficiencies.

Several of the strategic initiatives and capital projects we began in 2016 remain on track to contribute to our consolidated results in 2017. These projects include purchase of offshore supply vessels for conversion, additional drying, separating and evaporating capacity to increase processing rates at our Abbeville, LA location, more efficient vessels to improve product quality and efficiencies at our Reedville location and two yield recovery projects to increase both meal and oil production. In addition to completing the remaining capital projects initiated in 2016, this year we plan to invest in a handful of additional growth opportunities, as well as accelerate some hybrid growth and maintenance projects, for a total of about \$25 million of capital in addition to our normal maintenance capital. These include converting one offshore supply vessels that will be converted to carry boats for our Gulf operations, additional product storage, infrastructure and equipment improvements. We expect these projects to strengthen our animal nutrition business by reducing operating costs, maximizing yields, increasing production and efficiencies, and improving product quality.

I will now review our Human Nutrition segment, which includes sales of nutritional ingredients and products to food and supplement manufacturers and retailers. We continue to be encouraged by the recent results in our specialty oils and nutraceuticals operations. The first quarter represented improvement over recent quarters. We remain encouraged by our customer discussions, supply chain improvements, increased focus on product mix and customer diversification. On the other hand, our dairy business continued to struggle with commodity pricing, limited scale and excess capacity. As we progress through 2017, we believe our previously announced decision to exit the Incon oil concentration business in late 2016 will have a positive contribution to our human nutrition segment results.



Please keep in mind, we do not plan to make meaningful additional investments near term in this segment as we focus on driving sales growth, operating efficiencies and increased profitability. In addition, the strategic review of our human nutrition business segment that we previously announced in late February remains ongoing. Our management team and board of directors believe this is an appropriate time for us to undertake this comprehensive review and we will provide an update at the appropriate time.

In summary, we believe the Company is well positioned to capitalize on the macro-economic and industry trends that drive demand for our products. In our opinion, this competitive position, combined with our products, supply chain and customer relationships are the keys to creating and maintaining our competitive advantages, which we plan to further leverage by continuing to enhance our operational and capital efficiencies. We expect this formula to generate increased profitability and cash flow over time and enhance shareholder value.

With that business overview, I would now like to turn the call over to our Executive Vice President and CFO, Andrew Johannesen, to discuss our financial results in more detail.

Andrew Johannesen - EVP and CFO

Thank you, Bret, and good morning everyone. I will begin by reviewing our first quarter financial results, followed by some balance sheet highlights and thoughts on upcoming quarters.

At a consolidated level, revenues for the first quarter of 2017 were \$74 million, down from \$85 million in the same period a year ago due primarily to lower animal nutrition revenues.

Gross profit for the first quarter was \$20 million, decreasing from approximately \$25 million in the first quarter of last year. Gross profit as a percentage of revenues, or gross margin, decreased from 29% a year ago to 27%, as a decrease in the animal nutrition segment was partially offset by an increase in the human nutrition segment.

Looking further into the animal nutrition segment results, revenues declined from the prior year to \$40 million, as lower beginning inventory volumes drove an expected reduction in sale volumes. Product pricing, which was driven by existing forward contracts, was generally flat, and revenue per ton increased 1% to \$1,465.



Animal nutrition gross margin declined from 41% in the first quarter of 2016 to 35%, as the 2016 fishing season production that was sold in early 2017 had a higher cost per unit than 2015 production as a result of lower fish catch.

In the human nutrition segment, revenues of \$34 million decreased \$1 million from the first quarter of 2016 due to lower sales of specialty oils. Segment gross margins, however, improved from 13% to 18%, as a result of improved margins on specialty oils sales and our exit from the oil concentration business.

Returning to the consolidated results, first quarter selling, general, and administrative expenses, including research and development, increased from \$10 million last year to \$11 million due primarily to increased legal and other professional costs.

Our effective tax rate declined from 35.5% in last year's first quarter to 30.8%. The decrease was due primarily to new accounting guidance related to the tax effects of stock compensation, which reduced the quarterly rate by 3.8%. This accounting guidance is expected to increase the variability of quarterly effective tax rates for many companies, including ours. That said, we would still expect our effective tax rate to fall near the mid 30% range in most quarters.

Net income for the first quarter was \$6.1 million, or \$0.27 per diluted share, compared to net income of \$8.4 million, or \$0.37 per diluted share, for the same period a year ago. After making certain adjustments, which are detailed in our earnings release, adjusted net income for the first quarter of 2017 was \$6.0 million, or \$0.26 per diluted share, compared to \$9.1 million, or \$0.40 per diluted share in last year's first quarter.

As a reminder, GAAP requires us to use the "two class method" of calculating EPS as explained in the footnotes to our 10-Q. The same EPS results can be derived for the first quarter of 2017 by applying an average diluted share count of 22.7 million shares to net income.

Wrapping up the quarterly operating results, Adjusted EBITDA was \$15 million, compared to \$20 million for the prior year period.

We continue to maintain a strong balance sheet with \$24 million in cash and \$1 million of debt as of March 31, 2017. We believe we are well-positioned to fund growth and other capital projects in our animal nutrition business, as well as our quarterly dividend program.



Looking ahead, our animal nutrition segment ended the first quarter with approximately 35,000 tons of product in inventory, or about 5,000 less tons than a year ago. As a reminder, in the second quarter we typically sell a large portion of our beginning carryover inventory, along with a smaller amount of current season production. Over the last several years, second quarter sales volume tons have generally ranged from the low 30,000s to the high 40,000s, and we would expect to fall somewhere near the middle of that range this year, with roughly two-thirds coming from carryover inventory and one-third from 2017 production.

As of March 31, 2017, we had sold forward roughly 39,000 short tons of fish meal and 20,000 metric tons of fish oil for anticipated 2017 delivery at prices modestly below those realized in the first quarter of 2017. Gross margins on second quarter sales of carryover 2016 inventory should therefore decline accordingly from first quarter margins.

However, at this time we have significantly less visibility into gross margins on sales of current fishing season production, which will comprise a portion of second quarter sales and virtually all of third and fourth quarter sales. Prices will in many cases be determined by future market conditions, and volumes and unit costs will be heavily influenced by 2017 fish catch and yields.

For example, last season we produced 170,000 tons, and over the last 3 years production has ranged from 138,000 to 182,000 tons. For second quarter results, we will have to make assumptions about a fishing season that is only in its earlier stages. As a result, and after factoring in the increased 2017 Atlantic quota, the absence of H2B workers and the 2016 season's above average yields, second quarter sales of 2017 production will likely assume a production level somewhere inside the 3-year range, and unit costs above those experienced in the 2016 fishing season. This is expected to result in a second quarter gross margin percentage in the high 20s to low 30s for the animal nutrition segment.

In the human nutrition segment, performance will continue to be influenced by sales volumes, product mix, prices and raw material costs. Segment gross margins are likely to continue to experience some variability quarter-over-quarter, but we are encouraged by the trend we have seen over the last several quarters, and we believe the normal range has improved from the low-to-mid teens to the mid-to-high teens.

That concludes our financial review. I will now turn the call back to Bret for some brief closing remarks.



Bret Scholtes - President & CEO

Thank you, Andrew.

We believe that Omega Protein has a strong foundation to fuel future growth and enhance shareholder value. We are confident in our opportunities ahead and plan to continue to use the strength of our balance sheet and cash flow generation to prudently invest in our business and return value to shareholders.

We expect to see some softness in the back half of 2017 compared to 2016, but volatility is not unusual for our fish meal and fish oil business. That is one of the key reasons we maintain a strong balance sheet. We believe the macro trends that have driven strong demand for our products remain in place. We expect that weaker pricing will be the result of additional global supply, but we also expect that global supply to still be less than levels achieved in 2011. We remain optimistic about the long-term prospects for our company, and we will continue to run this business for the long-term time frame. This approach is reflected in our capital investment program, balance sheet management and commitment to our customers and employees.

This concludes our prepared remarks for today. On behalf of Andrew, John and myself, we would like to thank everyone for their interest in Omega Protein. The three of us, along with other members of our management team, are now available to take your questions. Operator?

NOTE: *A Question and Answer session follows the above prepared remarks. For the content of the Question and Answer session please listen to the webcast of the call, which is available at www.omegaprotein.com under the Investors tab.*