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Neogen Corp. (NEOG)

Q1 2023 Earnings Call

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Steven James Quinlan

Chief Financial Officer, Neogen Corp.

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David Westenberg

Analyst, Piper Sandler & Co.

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Neogen Corporation First Quarter Fiscal Year 2023 Earnings Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to John Adent, CEO and President. Please go ahead.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Good morning and welcome to our regular quarterly conference call for investors and analysts. Today, we will be reporting on the first quarter of our 2023 fiscal year which ended on August 31. As usual, some of the statements made here today could be termed as forward-looking statements. These statements are subject to certain risks and uncertainties, and our actual results may differ from those that we discuss today. The risks associated with our business are covered in part in the company's Form 10-K as filed with the Securities and Exchange Commission.

In addition to those of you joining us by live telephone conference, I also welcome those of you joining us via the Internet. Following our prepared comments this morning, we will entertain questions from participants who have joined this live conference. I'm joined this morning by Steve Quinlan, our Chief Financial Officer, who will provide some additional details on our results for the quarter.

As we stated in our press release this morning, we reported 3% growth across our business in the first quarter of our new fiscal year, despite the challenging business environment that we've been operating under throughout these months. Steve will talk about it more in his comments later on the call, and we faced particularly strong currency headwinds that impacted our business. Without these, total revenues would have increased 6% and our Food Safety business would have been up 9%.

I can't say enough about our incredible team here at Neogen and their continued dedication to our mission and Neogen's success. The first quarter presented us with many challenges, both with the current state of the economy and the added responsibilities of our existing job duties as we work to close the 3M Food Safety transaction on September 1.

Thanks to the collective efforts of the Neogen team and our new 3M team members from around the world, we are pleased to successfully close the transaction on the morning of September 1 and begin the integration of the former 3M Food Safety business with our operations.

Since day 1, members of our Neogen team, including myself, have been traveling to visit our new Food Safety teams in person. I just returned home from a trip abroad, where I was able to visit many of our new locations and team members. On my trip, I met with teams across Europe and I returned home more excited than when we announced the deal. The enthusiasm among our team members was fantastic and we were able to discover new synergies between our businesses.

I feel confident that under the new management structure we can accelerate the growth of the business and capture this untapped potential. The sales teams are very excited to be part of the Neogen team and are very eager to begin cross-selling Neogen products with their former 3M Food Safety products.

I also visited the Bridgend facility in the UK that we obtained in the merger and it was tremendous. I was so impressed with the teams, resources and capabilities there, and I'm really excited about the opportunity to grow that business. The team is excellent and I've been in a pilot site for 3M's SAP implementation, they will be one of the first teams to implement our SAP platform. They've been instrumental in assisting with the blueprinting of the system, and their assistance and expertise will be invaluable in the months to come.

While I was there, I found our Bridgend team and our Ireland-based Megazyme business had already found opportunities to increase the efficiency of both locations because of similar manufacturing processes and systems. These are just a few examples of what we believe can be achieved with these businesses as we more fully integrate them into Neogen.

I really enjoyed being able to interact face-to-face with these new members of the Neogen family, answering questions and providing updates in-person. The excitement I gained from this trip is a great motivator as we look to the rest of the fiscal year. These are very strong teams that bring great value to Neogen, and I'll be looking to them to strengthen our leadership across Europe.

We also welcomed our new Food Safety division leaders to our corporate headquarters in Lansing, Michigan, during the second week of September, where they connected with their teammates and began holding important conversations regarding our 30-, 60- and 90-day plans. And they've helped us identify a number of new sales and operational synergies.

Overall, it's been an incredibly positive first month as a combined company, and I feel very confident about the team that we've put together. This has been a busy time for Neogen with many positive changes, and we're very excited about the future. We're well-positioned at the forefront of food safety and digitization; and together as a global industry leader in food security, we'll be able to better serve our customers at every stage of the food chain from behind the farm gate all the way to the dinner plate.

Now, I'm going to turn it over to Steve for some more insights into our numbers for the quarter.

Steven James Quinlan

Chief Financial Officer, Neogen Corp.

Thank you, John, and welcome to everyone listening this morning. Before I talk about the numbers, I'd like to also recognize our Neogen team members for both their efforts in the quarter and in getting the 3M Food Safety transaction across the finish line.

Earlier today, we issued a press release announcing the results for our first quarter, which ended on August 31. Revenues for the quarter were \$132.3 million, an increase of 3% compared to \$128.3 million in the same quarter a year ago.

Excluding the impact of currency translations, this increase would have been 6%. Income for the quarter was \$5.2 million or \$0.05 a share, compared to \$17.1 million or \$0.16 a share a year ago. Excluding \$13.7 million in deal costs associated with the 3M transaction, and after adjusting for taxes, net income would have been \$15.9 million or \$0.15 a share. In the next few minutes, I'll give you some color around the numbers, and I'll start by talking about the negative currency translation impacts to the business in the first quarter. The pound and euro have each devalued 13% against the US dollar compared to the first quarter a year ago. And to a lesser extent, we also experienced negative impacts of a weakened Australian dollar and Argentine peso.

In total, revenues would have been \$3.9 million higher in the first quarter had currency been neutral, which would have resulted in 6% growth. Our overall organic increase, excluding the currency impact, was 4% for the quarter, with the acquisitions of CAPInnoVet, Delf, GVS, and Thai-Neo Biotech contributing the remainder of the growth. The dollar has strengthened further into the second quarter, which will adversely impact our top line for this quarter as well.

Revenues for the Food Safety segment were \$64.6 million in the first quarter of fiscal 2023, an increase of 3% compared to \$62.7 million in last year's first quarter. As our UK and Ireland operations report through the Food Safety segment, most of the adverse currency impact was felt here. Excluding currency, overall Food Safety segment sales increased 9% and organic sales increased 7%. International revenues rose 2% for the quarter. This increase was 10% excluding the currency headwinds. Our UK operations posted a 5% increase when the sales were converted to US dollars, although it was 19% in pounds, partially due to the contribution of Delf, the cleaner and disinfectant business in Liverpool we acquired in November 2021.

Organic growth for our UK operation in pounds was 12%, led by strength in aflatoxin test kits, cleaners and disinfectants, genomic services, vet instruments and animal care products. Offsetting some of this growth were lower sales of several of our diagnostic product lines and softening market conditions in Europe, and the Russia-Ukraine conflict are impacting customer buying patterns.

At our Brazilian operations, fiscal 2023 first quarter sales increased 13%, driven by strong sales of aflatoxin and deoxynivalenol test kits, as increased presence of these mycotoxins during the harvest season are requiring more testing. Brazil also posted strong increases in sales of vet instruments and genomic services. At Neogen's Latin American operations, sales increased 19%, led by broad-based gains in our diagnostic test kits and culture media. Rodent control products and cleaners and disinfectants sold through distributors also recorded revenue increases.

Sales in China were down 18% in US dollars and 14% in Chinese yuan. Our business there was negatively impacted by COVID-19 lockdowns in the first quarter. Our domestic Food Safety business was flat for the quarter. As I already mentioned with regards to Europe, we're also seeing an impact of inflation and softening market conditions in the US and Canada. Our sales team is seeing customers tightening their belts and reducing testing

volumes where they can. They've also reported prolonged pipelines especially in regards to equipment sales. Increases in aflatoxin test kits, Soleris consumables and food quality test kits were offset by a significant decline in Soleris equipment due to a difficult comparison against strong sales in the prior year.

Our allergen and environmental sanitation product lines also declined due to reduced buying patterns from customers and supply chain disruptions on certain products. On a worldwide basis, sales of our mycotoxin test kits increased 3%. Food quality products manufactured by Megazyme in Ireland increased 9% and Soleris consumables increased 6%, offsetting some of this growth, allergens decreased 9%, general sanitation products declined 2%, and Soleris equipment placements were lower.

The Animal Safety segment recorded revenues of \$67.7 million for the quarter, up 3% over the \$65.6 million achieved in last year's first quarter. Our Australian business reports through this segment and the Australian dollar was 7% lower in this year's first quarter compared to the same period a year ago. On a neutral currency basis, Animal Safety segment revenues increased 4%. This increase was 1% after excluding contributions from the CAPInnoVet and Genetic Veterinary Sciences acquisitions.

Sales of our core animal care products, including supplements and vitamin injectables, increased 16% over the prior year, with continued strong and customer demand. We also recorded a 14% increase in insect control products and a 7% increase in cleaners and disinfectants. Partially offsetting these increases, rodent control products declined 12%, a result of diminished rodent pressure in the US; and sales of veterinary instruments declined 6% off a very strong quarter in the prior year.

Genomics revenues recorded in the animal safety segment increased 7%, with sales from the GVS acquisition partly offsetting lower sample volumes in the porcine market and a difficult prior year comparison due to a large research project in fiscal 2022. On a worldwide basis, genomics revenues increased 5% as our international labs were negatively impacted by currency headwinds in the UK and Australia, and COVID-19-related closures in China.

Excluding the FX impact, growth here was 8%. Gross margins were 47% for the quarter compared to 46.8% in last year's first quarter. The slightly improved gross margin is a result of pricing actions taken earlier in the year and favorable product mix in the Animal Safety segment.

We're still experiencing significantly higher freight costs than a couple years ago. But I'm pleased to report our costs for inbound container shipments have gradually come down over the past several months. Operating expenses included \$13.7 million of 3M transaction-related costs. Excluding these charges, operating expenses increased 11%. And of this growth, \$2.1 million was a result of our recent acquisitions. Within sales and marketing, which was 14%, business travel, tradeshow and other customer-facing activities increased significantly as in-person events were still limited in the first quarter of last year.

Compensation and other personnel-related expenses also increased, including head count from recent acquisitions, as did shipping costs and higher rates and volume. G&A expense increased 6% after excluding the deal costs, primarily due to the higher accruals for performance-based incentives and new expense, including amortization from recent acquisitions. R&D expense increased 13%. This includes incremental expense at GVS from R&D personnel absorbed in the acquisition and a large increase on external product development costs.

Operating income for the first quarter was \$6.1 million compared to \$21.7 million in last year's first quarter. Excluding the \$13.7 million in 3M Food Safety deal costs, operating income was \$19.8 million. And expressed as a percent of revenues, adjusted operating income was 15% compared to 16.9% in last year's first quarter. We

recorded \$969,000 in interest income as yields on our investment portfolio continue to rise due to higher interest rates. This compares to \$203,000 in the prior year.

Effective tax rate for the first quarter was 21.8% compared to 21.4% in last year's first quarter. There was minimal tax benefit in the first quarter from the exercise of stock options. Our adjusted EBITDA was \$26.9 million, or 20.4% of sales, compared to \$28.9 million, or 22.5% of sales, in the first quarter of the prior year.

On the balance sheet, our net receivable balances declined by \$6.6 million compared to year-end and our days to collect is currently at 60 compared to 59 in the prior year first quarter and 62 at May 31. Inventory increased by \$6.7 million, or 5%, on raw material cost increases and increased safety stock levels to avoid back orders and delays caused by the ongoing and unpredictable global supply chain issues.

Our operating cash flow was negative for the quarter, due in large part to payments made relating to the 3M deal and, to a lesser extent, increases in inventory. Deal expenses will continue into the second quarter and we should then return to positive cash generation from operations in the third quarter. On the September 1 close of the 3M Food Safety business, we assumed \$1 billion of debt. We'll be paying the principal down aggressively in the next few months as we unwind our marketable securities portfolio. At the end of September, we plan on paying down \$60 million on the term loan.

In addition to the 3M Food Safety transaction, we made a small acquisition in July purchasing our Thailand distributor, which provided some minor incremental revenues and also created a legal operating entity in the country, making it easier to absorb the 3M business in Thailand. Although we'll be laser focused on the integration of the 3M business, we will continue to look at smaller acquisitions that add to our product or geographic portfolio and that are good fits with our existing business. Our teams continue to perform in a very challenging operating environment, and we're grateful for and proud of their efforts. We've got a lot accomplished in the first quarter, and despite some of the headwinds currently in our faces, we're cautiously optimistic for the remainder of the year ahead.

At this point, I'll turn it back to John for further comments.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thanks, Steve. We're well on our way to integrating the new business and providing customers with new products and solutions to enhance their food safety systems. Post-close, we've added 28 new countries to our employee footprint, which also expanded our commercial presence to over 40 countries. We're thrilled to have had a very high conveyance rate of the former 3M Food Safety employees. The outstanding work done by our HR team has allowed us to retain the talent who bring critical business knowledge with them to Neogen, placing us in a strong position for continued forward growth and maintaining business continuity. In addition, 55% of those conveying employees were sales and marketing focused, which greatly expands our ability to penetrate our markets and grow our customer base around the world.

Our IT team has been working diligently to integrate our systems with the former 3M Food Safety systems and evaluating efficiencies as we manage a lot of new data and work to share it with each other. The team has deployed a global CRM instance to support harmonization between our conveying sales teams and our existing sales teams. This platform helps the teams to align targets across the groups and ensure that the targeted benefits associated with the merger are clearly defined and tracked. We are currently in the design phase of our global ERP platform implementation as we look to bring the organization together, eventually enabling shared services and optimizing our supply chain once complete. The former 3M Food Safety commercial software and

cloud capabilities are being migrated to the Neogen cloud, and both groups have pulled together to accelerate our commercial data and analytics road map.

We're also evaluating our global R&D platforms between teams and are developing a plan for the optimization and acceleration of our product development activities. We expect this activity to align with the targeted deployment of our new R&D facility in Minnesota in Q1 of the 2023 calendar year. Our operational teams are working diligently with 3M to fix their back order situation, which has slowed their food safety sales over the last two quarters by 5% to 6%. Doing so will improve sales in the remainder of the fiscal year.

We are receiving a positive reception from customers around the world, which gives us a lot of excitement and momentum as we move forward to combine the company. Post-close, we met with the senior leadership of a leading commercial lab company and presented the unique opportunity that Neogen was now able to provide. They're very excited about the opportunity to work with the combined business and immediately saw improved service levels. Longer-term, the combined company will offer them opportunities to invest in the improved automation technology, which will drive further customer efficiencies and increase the usage of Neogen's consumable products. This excitement from our customers is incredibly encouraging and is driving our teams to work together to find the best systems and solutions to reach our markets around the world.

In July, we ceremoniously broke ground on our planned \$85 million expansion of our Lansing food safety facility. This expansion is centered around the construction of the three-story 175,000 square foot dedicated manufacturing and research building for our food safety products. We're pleased to report that in August we received the necessary approvals and secured the desired state incentives to move forward with the expansion. Construction will begin immediately and continue for the next 14 months with a completion target date of December 2023 with validation and other progress taking place through 2024. This expansion represents a significant investment in our business, technology, people and community, demonstrating our strong belief in Neogen's long-term success. This is an important step in our growth. And as we focus on the integration of the former 3M Food Safety business with our operations, this Lansing expansion will be the location for the manufacturing of the Petrifilm indicator organism testing line of products.

We are currently expanding our distribution centers in Kentucky and Ireland to ensure that we are able to ship products quickly, getting our customers the solutions they need in a timely manner. These are critical for our business as we grow our markets and reach new customers through our expanded food safety division. These larger distribution centers will help us as we make our animal safety products available to our new food safety division customers, as we educate them on the importance of protecting the food supply from farm to fork and creating a sustainable food chain. There's a lot of potential growth for Neogen and our entire team is ready to capture it.

Now that the 3M Food Safety transaction is closed and these expansions are underway, Neogen looks at a transformative remainder of the 2023 fiscal year. We've just acquired a business that generated \$370 million in revenue in its last reported 12-month period. We have over 400 new talented team members worldwide, and we're excited about the potential of this business. We have a great team working here who are passionate about protecting the global food supply and dedicated to our mission to be the leading company in the development and marketing of solutions for food and animal safety. This group does not back down from challenges and takes all change in stride, working together to make Neogen the best company that it can be.

The detailed work of capturing deal synergies is ongoing. And as we seek to position our new global portfolio and set the tactical direction for our line sales and marketing teams, we continue to validate our growth opportunities and refine our targets across the combined portfolio, including our microbiological, immunodiagnostic and

genomics platforms. Execution against these growth strategies at a customer and product level have already begun. There will be a lot of change in the upcoming months and years, but we are well prepared and confident in our ability to continue growing and leading the food security market.

Now back to Steve for some additional comments from him regarding our forward-looking financials.

Steven James Quinlan

Chief Financial Officer, Neogen Corp.

Thanks, John. As you all realize, we've owned the business for less than a month. We've had numerous calls from analysts trying to model the company going forward, given some of the recent headwinds in the 3M business in particular. We're currently working with the commercial teams to review the forecast of the rest of this fiscal year and our plan is to present our revised projections for the combined business for at least the rest of this fiscal year at our second quarter earnings call, which is currently scheduled for the first week of January.

We appreciate your patience and your support as we better understand and integrate the businesses.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thanks so much, Steve. Before we move to Q&A, I'd like to take a moment to announce that Steve will be retiring next year. Steve and I have been working together to plan for this transition, and he will remain with the company through May 31, 2023, the end of Neogen's fiscal year. As you all know, Steve has served as Neogen CFO since 2011, leading the company through more than 30 acquisitions, including the company's most recent acquisition of 3M's Food Safety business. I and all of the Neogen employees are very grateful for Steve's service and commitment to Neogen over the past 11 years, helping us deliver on our mission of protecting the world's food supply from behind the farm gate to the dinner plate. And I want to wish him well on his retirement.

Simultaneously, I am excited to welcome Dave Naemura, who will take on the role of Chief Financial Officer effective January 2, 2023. Dave will work closely with me and Steve until his retirement in May to ensure a smooth transition. Dave has extensive experience working as Chief Financial Officer for public companies, most recently for Vontier Corporation, where he played an instrumental role in the company's separation and launch as an independent public company.

Steve, is there anything you'd like to add?

Steven James Quinlan

Chief Financial Officer, Neogen Corp.

Thanks, John. A little more than a year ago, I discussed with John my future with Neogen, including my potential retirement plans, and here we are. I've had the good fortune to be the CFO of this great company since the beginning of 2011. We ended our fiscal 2011 with \$147 million in revenues and 654 employees. At the end of last year, we were at \$527 million in revenues and over 2,000 employees. It's been a great ride with a lot of great experiences and friendships made, but I'm now looking forward doing a lot of quality time with my wife, our three daughters and their families, which includes four grandchildren, and making up for a lot of time spent away. There's a lot of travel in the near future.

I'm excited about the future of the company. We have a passionate and committed employee base. John has taken what Jim Herbert and Lon Bohannon put together and has built on that, putting a great leadership team together to take the company to the next level. And Dave comes in with large public company experience. So I

believe we're in good hands and I look forward to what I am sure will be a successful integration of the 3M Food Safety business and then to see what will be next. And I'm not done just yet. I've committed to staying through the end of the 2023 fiscal year to assist in whatever way I can to assure a smooth transition. As I exit, I'll still be a shareholder and I plan to continue to be one going forward.

I've always appreciated the support the investing community has shown me and the company over these past nearly 12 years, and I thank you all for that. John?

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thank you, Steve. Now, I'll open up the floor to any questions you may have.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from David Westenberg from Piper Sandler. Please go ahead.

David Westenberg

Analyst, Piper Sandler & Co.

Q

Hi. Thank you for the question. Congrats, Steve. It's been nice working with you and it's nice to read that I think I still get to work with you until May. So, plenty of time to keep chatting. So...

Steven James Quinlan

Chief Financial Officer, Neogen Corp.

A

Please do.

David Westenberg

Analyst, Piper Sandler & Co.

Q

So, before I get into the nits of what an analyst has to do and it is my responsibility to give those nits. I'll just thank you – congrats to you guys on closing this on time and this – you had a lot of work to do all this stuff, and congrats on it. So, anyway, I'm going to start with the \$300 million EBITDA target and I know you mentioned you're still kind of assembling the way to think about it. Are we pushing out the timeframe to that \$300 million or is it maybe you're going to give a number lower than that? Just any kind of way to think about what it is here? And then can you confirm that it is a 3M business that would be the culprit for kind of the changes of weighing to think about that \$300 million?

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah. Thanks, David. So, Steve and I talked about, we've had the business for about 28 – 27 days, so we're learning more about it. The positive is, we're finding a lot more synergies than what we even thought were there before. The negative was that the 3M business over the last couple of quarters has not performed to the way it was forecasted, when we kind of put out the initial \$300 million. So what we want to do is take this time, sit down with our team and we're doing it already and really going over kind of the forecast where the business is, where the opportunities are, what our execution is going to be on a 30-, 60-, 90-day plan, and then give you and the rest of the investor community a lot clearer picture kind of going into January of – where we see the business going

and, to your point, whether it's the bridge on \$300 million or whether it's a timeframe to \$300 million, that's what we're working through right now.

David Westenberg*Analyst, Piper Sandler & Co.*

Q

Okay. Can I – maybe I'll ask another kind of way. What about in terms of – I think when you laid out the borrowing case, we saw you borrowed \$1 billion. I think you had about \$300 million on the balance sheet. And then we had that \$300 million estimate, and you had – leverage was going to be below 2.5%. As we think about leverage here, is – I know you can't necessarily say that EBITDA number, but I think it is important to give some sort of framework in context of that leverage target. I don't know how comfortable you feel about giving that?

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

A

Yeah. No, I think that when we said, I think on a net leverage basis, we're at 2.8%, and then we had about \$370 million in assets on the balance sheet or in cash. So, Steve and I, our expectation is we're not going to be far from that. We're going to – I can't give you the exact number, but it's not going to be far from that 2.8% number. So we feel pretty confident it'll still be a very reasonable debt-to-EBITDA ratio for the business. Steve?

David Westenberg*Analyst, Piper Sandler & Co.*

Q

Perfect.

Steven James Quinlan*Chief Financial Officer, Neogen Corp.*

A

Yeah. No, [indiscernible] (00:32:00).

David Westenberg*Analyst, Piper Sandler & Co.*

Q

Yeah. Okay. Okay, good. Got it. And then can we – I know you've only had that business for 28 days or so. I think the last S4 was a few months ago. Can you talk about – can you mention this about the backlog and it being [indiscernible] (00:32:21) to clarify, it was a 5% headwind to that. Can you maybe give us the number at which it's been growing over the last couple of months, maybe what it is this exact month? And then kind of on a forward basis of that 3M growth rate of business and I guess, I'm looking on to continue this question by maybe asking, if this is a backlog issue, can we expect some numbers above market growth rates as you're fulfilling the backlog because it's kind of double sales? Because I would have to imagine your customers have to keep using these products. Like, I can't imagine they have to stop...

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

A

Yeah. No, that's right.

David Westenberg*Analyst, Piper Sandler & Co.*

Q

Maybe there's some attrition. I don't know. Anyway...

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah. No. No, there's – I'll talk about the back order situation and Steve can talk about the other. So, yeah, we've quantified the back order situation and it's about a 5% to 6% headwind that's been on the business for the last quarter or two. And we're working diligently with 3M to fix that. And the way that we're doing that was when 3M Food Safety was a part of 3M, they were a very small part in a very big business. So they were at the end of the line for manufacturing, they were at the end of the line for critical raw materials, they were at the end of line for everything.

As of September 1, the role has changed where 3M is our contract toll manufacturer for these products. So we've been able to work with 3M to reprioritize kind of those things under the new reality of the business. And so, those are the things that we're seeing that are going to help us alleviate back orders much faster than what 3M – the team would have traditionally been able to do through no fault of their own. So we feel confident and 3M's has been a really good partner to help us move that forward.

And the second part of your question, I'll kick to Steve.

Steven James Quinlan

Chief Financial Officer, Neogen Corp.

A

Yeah. I think, David, you asked if we'll get kind of a kick in sales from the back order situation. I think it's really going to – it'll be gradual and it's really going to restore the growth to levels that we were contemplating when we signed the deal originally. But I don't know that you're going to get a massive bump in results. It's really just getting the growth back to where we think it needs to – can be and needs to be.

David Westenberg

Analyst, Piper Sandler & Co.

Q

Got it. I'm going to hop back in queue. I think Andrew probably has some questions and I'll take it from there.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Thank you.

Operator: And our next question comes from Brandon Vazquez from William Blair. Please go ahead.

Brandon Vazquez

Analyst, William Blair & Co. LLC

Q

Hi, everyone. Thanks for taking the question and congrats on closing the 3M deal. John, you talked a lot about more of these new synergy opportunities as you're kind of meeting the team and traveling across the new location. I was hoping maybe you could talk a little bit about where you're seeing some of these synergies, either qualitatively or quantitatively, both on the sales and profitability lines? Any kind of additional details you can give us there would be helpful.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah. So, I think I'll give you an anecdotal one, Brandon. So when I was at – day after close I was in Europe meeting with the team members. And when I went to the Bridgend facility, I was talking about that and I was

touring the facility and the group has got bioreactors and they're making luciferase and they're making this product line. And it's a 10-liter reactor. And I go to Ireland and we've got 400-liter reactors. And the Megazyme team said, oh, yeah, we've already talked to that group and we're going to help them. We'll take that over because we do it much more efficiently. We can do a lot cheaper, we can send [ph] it to Oman (00:36:26). And so that was a big raw material for the Bridgend Group that now we've got scale and efficiency and other manufacturing that's going to help reduce kind of the costs. And those were – that's just one of many, many things that we saw as the team members started talking and working together.

And what I was happiest about was, this is day three and they've already identified new opportunities and they already had a plan to execute on it, which I was really excited about, right? The teams aren't waiting, they're finding opportunities and documenting them and they're getting started. And so, around the broader, larger opportunities, that's the stuff that we're gathering now, right? And that's the things that we keep telling everybody. Look, there's opportunities around. Make sure that if you have a question about why things operate something ask, ask, right?

So I'll give you another example. I was in France and the group was complaining because they were forced to use a pan-European distributor that was a larger 3M distributor, but that distributor had no food safety business. But they couldn't have a food safety distributor because they were forced to use this one. Well, we fixed it, right? That ought to automatically increase sales because now you have a distributor that knows the business, is tied to the market and isn't being driven by a larger organization, create a relationship than with other product lines, right? So, we just keep finding a little bit of opportunities like that to where once you carve this group out and get them more focused on what they do, they can make other decisions that will help drive the business forward. So putting all that together and quantifying it and like I said, in January, we're going to have a much better picture of what that kind of forecast looks like going forward.

Brandon Vazquez

Analyst, William Blair & Co. LLC

Q

Okay. And – that's helpful. Thanks. And then in terms of going back to the kind of the back orders within 3M business, is there any kind of timing that you could give us in how long it may take? It sounds like you may need to run some manufacturing internally, how long of a process does that usually take? And then kind of the follow up to that is, correct me if I'm wrong, but I think the 3M business used to be more like a double-digit organic grower. So, how do you get maybe from that five to six points gets you into the mid-single digits? What gets you to the delta to like a high-single- or a double-digit grower? I think in the proxies we – and the filings we saw some other headwinds like China, Russia, Ukraine, any other kind of color you can give around those?

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah. So I think, it's going to take a little while, but I wouldn't – our expectation is we're going to see easing of the backorders by the end of the second quarter. So we'll see some easing there. That alone is just the headwind of 5% to 6%. The other things we have to do is continue to grow. And it was interesting because I thought 3M had a much larger share market; and sitting down with their team members when they were showing us the potential markets we can go into, the team has our share of market at about 18%, which gives us a tremendous amount of runway for indicator testing, even more than what we were expecting.

So there's big opportunities for us to continue to grow the market and take share from traditional methods because that's really our biggest challenges on the traditional method side, and then even entering other market segmentations where Petrifilm is applicable and can be used, that 3M didn't – at that point didn't want to go into

those markets, which are markets that Neogen is already in. So these are big opportunities for us to accelerate those growth rates with the current business model.

Brandon Vazquez

Analyst, William Blair & Co. LLC

Q

Got it. And then, last one for me is kind of pivoting a little bit and appreciate it may be a little difficult, it's – maybe take out a crystal ball here, but a lot of investor concerns kind of around recessions, especially as we head into calendar 2023, I'd love if you could just talk a little bit about how resilient your businesses may be, the Food Safety and Animal Safety businesses may be during a more prolonged recession than what we're seeing today, and if those businesses...

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah.

Brandon Vazquez

Analyst, William Blair & Co. LLC

Q

...can still kind of grow on a year-over-year basis? Thank you.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah. And I think it's a great question, Brandon. And I think you can go back and look, if you look at, during the last time we had a slowdown in 2008 to 2010, if you look at Neogen's growth, we continued to grow. And the reason for that is, even in a recession, people need to eat. It's not a discretionary item, right, where you just like, I'm not eating today. I mean, maybe if you're fasting, but I don't do that very often.

So I think there's opportunities for us to continue to find ways to grow in a recessionary environment. And I do think we're heading there, right? I think we see it. I think you can see it around capital equipment. We mentioned that our placements for Soleris were lower than in the past. I think people are preparing. We're talking a lot about it. I think inflation is impacting other businesses, they're tightening their belts. But even I saw a great report that came out of Wells Fargo the other day that was talking about how food companies perform during the – in recessionary environments. And it's not that we are not impacted, it's just that we're not impacted as much.

And I think Neogen's ability to grow, whatever the market situation has been, kind of our trademark and our hallmark, and I think that's something that we pride ourselves in. We're 121 out of 127 quarters of growth. And so, as we head into a tough environment, whether it's currency headwinds, whether it's recession, we know that we find ways to continue to grow because we've got a really strong, resilient base market. And I think we're blessed that we're in the right markets.

But we also work very, very hard to find opportunities and to continue to meet customer needs and find new ways to be creative, to help customers during these tough times because when the times are tough is when customers are really looking for creative solutions. When everything is great, everybody's making money, the resistance to try new things and change is very low. So we have a really good opportunity to now position the new organization with our breadth of solutions and portfolios to really bring something new and exciting to the market when they're looking for something new and exciting because their end market is a little more challenging.

Brandon Vazquez

Analyst, William Blair & Co. LLC

Great. Thanks a lot.

Q

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Thank you.

A

Operator: [Operator Instructions] And our next question is coming from David Westenberg back from Piper Sandler. Please go ahead.

David Westenberg

Analyst, Piper Sandler & Co.

Hi. Thank you, guys, for the follow-ups here. So let's – can you talk about – because there is kind of a big delta between constant currency and the growth – and the growth rate that looks like it's more than currency, can you talk about how much – or sorry, the organic and the constant currency one? So can you talk about how much M&A was in Food Safety business and for us that are not perfectly math inclined, if you could maybe just give us a number of the acquired business in that Food Safety and then obviously not the 3M but the – what was in the prior quarter?

Q

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Yeah, sure, David. On the Food side, there's about a \$1.4 million of acquisition revenue and that's the Delf and the Neogen Thailand business. And then on the Animal Safety, it's more about \$2 million, \$2.1 million.

A

David Westenberg

Analyst, Piper Sandler & Co.

Okay. Perfect. Okay. Thank you so much for that. And then, as we talk about – you gave that kind of that context of like you can be hit and you do think that there would be a incoming recession, as we think about fiscal year 2023, is this a more mid-single-digit growth year for macro? And I'm not saying your business specifically, I'm just thinking about the businesses that you operate in. What's kind of the longer-term way to think about the business in Food and Animal Safety? I know you've – historically said Food Safety I think is 8% to 10%, Animal Safety is 6% to 8%, is that still the right way to think about it?

Q

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Yeah. I think, we've had some really good years on the up-trail for Animal Safety, for growth, because we had three really bad years. So, we've talked about, David, the cyclicity of that business, and kind of how it moves. So I think that we're kind of at the peak of that. So we may not see as that stronger growth rate going forward in Animal Safety.

A

Food Safety, it really is harder to say because while we're entering what I think is going to be a tough environment from a recession standpoint, just – I don't know on the 21, the Biden administration announced that they were going to – they had a \$2 billion investment to strengthen global food security, and they're putting \$2 billion behind it. And so, that's a huge tailwind for us.

Now, there's no details as to what it is, so I'm not quite sure whether that's going to help with our analytics platform, or whether it's going to be around our blockchain solutions, or whether it's going to be around our supply chain solutions for our customers, or whether it's going to be around increased testing because we've seen more foodborne illness. We just saw a big retail, Listeria, the other day. So I'm unsure as to where that's going to go, but that commitment to put that type of money in food security is a huge tailwind, right for Neogen.

So, I just – I'm trying to balance that with kind of the recession on the environment side. So I'm not willing to say that we're going to slow down here. I'm just – I know it's going to be challenging, but we've got some tailwinds that could help push us for that long. So I'm unwilling to go and tell you, yeah, they will knock that back 3 points or 4 points because I just – we've got some positive stuff that I see that I just don't know how to quantify yet.

David Westenberg

Analyst, Piper Sandler & Co.

Q

Got you. You actually took my last question, but I'm going to ask it anyway, and I was going to say, a couple days ago, like, we did see the hunger, I think it was called the hunger, nutrition and health initiatives. Anything there to spot, anything that you see in there? I know Jim used to talk to a lot of the centers. What was the act in 2000 – I think it was 2007, the Food Safety Services Act...

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah. Food, Safety and Modernization Act.

David Westenberg

Analyst, Piper Sandler & Co.

Q

...Modernization Act, I know that was a tailwind for the business. Is there anything in there that – to call out? And I know you just kind of answered that, but...

[indiscernible] (00:48:20)

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Yeah, no, I think – so – no, you're right, because – so that particular one was \$220 million for feeding programs for schools. But that was part of this \$2 billion set aside. And we've had meetings. I know our regular – our governmental affairs group has met with Secretary Vilsack. We've had opportunities to meet with the FDA, FGIS and really the government groups and they're laying out this platform.

But I think what's obvious is that everyone is very – and he saw a little bit, I don't know have you seen it, but I mean, there are a lot of questions around – congressional questions around the FDA, right, how do we improve the FDA on food?

So all of those things are tailwinds for Neogen. Now, I don't -- they haven't specifically said what that money's going for, but with our breath, you know that part of that's going to be a positive for us. So we're working on it. We're actively involved with the government agencies to see how we can help in the direction they want to go and help set policy, because we think that's a really big opportunity for us.

David Westenberg

Analyst, Piper Sandler & Co.

Q

Thank you, guys.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

A

Thank you.

Steven James Quinlan

Chief Financial Officer, Neogen Corp.

A

Thanks, David.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to John Adent for any closing remarks. Please go ahead.

John E. Adent

President, Chief Executive Officer & Director, Neogen Corp.

Great. Thank you. So again, I appreciate all you being on the call. Once again, I want to thank Steve for just doing a great job over the last 10-plus years. Hard to compete with the grandkids, that's what I learned. We worked really hard to try to convince, but hard to compete with the grandkids. So we're excited. And Steve's, as you mentioned, going to stay as a shareholder and we've been on really nice transition put together. So really got a long time to make sure that successful.

Lastly, just a reminder, get your proxy votes in, the annual shareholder meeting is Thursday, the 6th, and we look forward to talking to you all again on our second quarter call in January. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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