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Elanco Animal Health, Inc. (ELAN)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Elanco Animal Health Q1 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Jim Greffet. Sir, please go ahead.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

Good morning. Thank you for joining us for Elanco Animal Health's Q1 2020 earnings call. I'm Jim Greffet, the Head of Investor Relations. Joining me on today's call are Jeff Simmons, our President and Chief Executive Officer; Todd Young, our Chief Financial Officer; and Katy Grissom from Investor Relations.

During this conference call, we anticipate making projections and forward-looking statements based on our current expectations. Our actual results could differ materially due to a number of factors, including those listed on slide 2 and those outlined in our latest Forms 10-K and 10-Q filed with the Securities and Exchange Commission. The information we provide about our products and pipeline is for the benefit of the investment community. It's not intended to be promotional and is not sufficient for prescribing decisions.

You can find our press release, the slides referenced on this call and an investor workbook on elanco.com. The slides and the press release also contain further information about the non-GAAP financial measures that we'll discuss during today's call. After our prepared remarks, we'll be happy to take your questions. This morning, our introductory comments are longer than usual. So, we are prepared to extend the call to ensure we speak to everyone who has a question.

With that, let me turn the call over to Jeff to provide the highlights.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

Thanks, Jim. Good morning, everyone. These are truly unprecedented times, and from everyone at Elanco, let me begin by offering our thoughts, prayers and well-wishes to all those impacted by COVID-19. We also express our gratitude to those on the frontlines battling this disease, caring for the afflicted and providing the essential needs of life for all of us. This includes the farmers and veterinarians working to maintain the availability of our food supply and keeping our pets healthy. I'd like to personally thank all of my Elanco colleagues who are working diligently to ensure our medicines remain available to pet owners, farmers and veterinarians.

As you know, Elanco is a purpose-driven company guided by our vision of food and companionship enriching life. This vision has never been more relevant than the last couple months. With the animal health industry designated as essential, our manufacturing plants and research labs continue operating to serve our customers, having implemented appropriate personal safety measures. Employees and all other company functions are working remotely, abiding by social distancing rules and maintaining virtual engagement with our customers, investors, regulators and other stakeholders.

We are beginning to put phased return-to-site measures in place where appropriate. Elanco and the Elanco Foundation, formed in 2019, are also doing their part. We're collaborating with leaders and their communities where we operate, providing financial support from the Elanco Foundation to help fight rising food and security challenges brought on by this outbreak. Elanco and the Foundation will continue to look for more ways to help.

The COVID-19 virus and ensuing pandemic are impacting our lives and our industry. From declining vet clinic visits and revenue to pressures in protein production and logistics, our customers began to feel the impacts in the second half of March, and the pressures have continued into April and May in both companion animal and food animal markets. We are carefully watching the leading indicators, and I'll discuss this in more detail at the end of the call.

The COVID-19 pandemic has impacted Elanco in Q1, particularly the effect on our commercial distribution partners' liquidity and thus actions that the pandemic has prompted us to take in working with them, as shown on slide 4. The decline in our Q1 revenue is a direct result of these discrete commercial actions. I will summarize first and then provide more details.

The COVID pandemic created significant working capital and liquidity pressures and uncertainty on near-term end customer demand for our distributors, prompting reductions in the amount of inventory they hold. This unprecedented event also created a tipping point in the changes we were executing in our distribution approach. Recall, at the start of 2020, we consolidated our US companion animal distributors from eight to four and we instituted specific targets for them to generate end customer demand.

I also personally established a monthly review meeting with each of them. Based on this evaluation of distributor performance across our business, we've seen a range of capabilities both across the promotional mix and across individual distributors. Distributors are valuable in servicing vet clinic accounts, providing logistics, home delivery services and other support activities. But a critical conclusion is that our distributors' ability to generate demand is much less effective than our own, especially in generating new clinic placements for our products.

As the Elanco demand creation was increasing, we were seeing less impact directly by distributors in today's environment. Furthermore, the volume of product being held by distributors was not impacting their ability to create demand. This is an insight and a change from our historical experience. The COVID pandemic also impacted the inventory shift from our distributor consolidation. We expected the four remaining distributors would need to increase their inventory levels to handle the larger volume going through their operations, offsetting the inventory drawdown in the eliminated distributors.

With the liquidity and working capital pressure from COVID, the distributors are managing their inventory more tightly. Consequently, in Q1, we reduced the amount of product in distributor inventory by approximately \$60 million, mainly in the US companion animal space, and we expect to further reduce an additional \$80 million to \$100 million mainly in the second quarter as we apply these new tactics across our business and geographies. The evaluation of our distributors was a priority, as I took primary responsibility for our US operations last December.

With the insights gained into distributors' capabilities and broader actions that drive demand, as well as the upcoming close on the Bayer acquisition, I'm excited by the changes in the Elanco's commercial leadership and I'm confident we'll continue to create industry-leading execution in demand creation, product launches and full utilization of the omnichannel. This is an important modification in our tactics, and the COVID pandemic was a trigger that accelerated this change at the end of March and into Q2.

We've gained important insight where our own capabilities are superior and we're adjusting our investments accordingly. We are confident that this tactical change will improve our cash flow, working capital, level of control and commercial execution. In the near-term, however, this decision negatively impacts our reported sales. With that summary, let me provide additional commentary on how we have worked with distributors in the past and how we're changing now.

Manufacturers have a variety of arrangements with distributors. We established our buy-sell distribution structure when we started our companion animal business in 2007, and inventory has been an important part of the equation to do the following: maintain Elanco as a priority in their promotional efforts; ensure strong positioning of our products in the face of new market entrants, generics or other competitive dynamics; facilitate flow through [ph] to all the end (00:08:47) vet clinic; and ensure safety stock at multiple nodes of supply chain with steadily increasing demand and expanding portfolios.

This strategy had worked successfully over the years as we grew share, we introduced new products, we created new clinic placements and built brand awareness with both the clinics and pet owners. We have been evolving the structures, but the basic arrangements including the assumed value of their promotional efforts and importance of inventory has been unchanged for 13 years. However, as we have built our internal promotional capabilities and dug into the data with clear deliverables for our distribution partners and dealt with our customers' liquidity challenges that were triggered by COVID, we concluded we needed to accelerate the change in inventory levels.

As I mentioned, there are areas where distribution plays a valuable role, and we're moving to hybrid approaches to focus scope and targeted value efforts. The planned Bayer acquisition also enables us to do this now, since we will have expanded portfolio across more channels. We will also have the capabilities to use arrangements beyond the buy-sell structure we use now. The majority of our efforts are in the companion animal categories, but we've made adjustments in the food animal space as well. The Q1 decreases in the reported sales in our Companion Animal Disease Prevention and Companion Animal Therapeutic categories are the direct result of these channel inventory adjustments.

We expect second quarter decreases in our food animal business, as COVID began impacting this portion of our business more in Q2, as the processing plants across the US began closing. These changes will strengthen our position, optimize our promotional approach and enable us to direct investment in the commercial activities that drive demand for our products over the long-run. These actions fit directly into our broader price and productivity priorities and our innovation, portfolio and productivity strategy. This change in tactics with our distribution partners and resulting one-time negative impact will largely occur in the first half of 2020, but have immediate positive impact on our commercial competitiveness.

And very important to know I'm also willing to make this change in tactics, because I see positive trends in the underlying business already in 2020 that are the result of Elanco capabilities in sales and purely commercial competitiveness, as well as a targeted marketing approach and leveraging value beyond products throughout the organization. Here are some material examples that highlight why Elanco's own demand creation will become the priority and distribution will play a targeted enabling role.

First and foremost, in the US, the outbound sales of our companion animal products into vet clinics or alternative channels, what we call EDI sales, have been growing in the mid single-digits over the past year, and that continued in the first quarter. In the outside the vet channels, Elanco was outgrowing the overall market and gaining share in Q1. Elanco Q1 growth in these alternative channels is nearly 35%. This is a great example of a trend that we've been betting on, especially with the Bayer acquisition.

We are seeing the market evolve even faster than we anticipated when assembling the Bayer transaction. The same trend and positive execution was demonstrated with solid double-digit growth with Bayer through Q1. Our US food animal business has had flat to slightly negative EDI sales despite the trade challenges with Paylean, the inconsistency of supply related to the contract sterile manufacturing partner and the launch of a generic Rumensin. And I can say that our strategy to maximize Rumensin sales in the US against the generic is working.

And for our productivity agenda, the areas that we directly control, price and cost-facing actions, continue to be positive even in a challenging Q1. External market data from Kynetec, a third-party provider, is also encouraging. In Q1, Credelio's 7% growth in market penetration exceeded all other canine flea and tick brands. Credelio obtains nearly 10% of sales from new puppy starts, nearly double the category average. New patient acquisition is a critical part of our strategy in order to significantly capture the lifetime value of the pet.

Relative to last year, Interceptor Plus has increased penetration even in the face of new competition with over 22% growth in the number of patients. Interceptor Plus continues to see strong growth through our marketing efforts, highlighting the benefits of comprehensive coverage against the worms that pets can be exposed to in their current environment. And in clinics where the product is on the shelf, Galliprant is increasingly used as the first or second most recommended NSAID for osteoarthritis pain in dogs.

Finally, some environmental pressures are abating. China, which was a significant drag on our industry last year, is showing signs of recovery in their swine herds among the large corporate customers, even tracking ahead of our expectations in Q1. Moreover, our international poultry vaccine business and aqua business continue to lead our Future Protein & Health category.

I am aware that our quarterly results have been noisy, and this year presents unique challenges we did not expect when we started the year. But beyond this – behind this noise is a durable business with strong brands, innovation and execution even through the current pandemic and in line with our IPP strategy. The reduction in channel inventory is a structural change with our distribution partners and was a move brought on by COVID-19 pandemic. But ultimately, it strengthens our proven commercial capability while increasing our control, our productivity and our growth potential.

So, let's now transition to slide 5 and review progress on our IPP strategy and the Bayer Animal Health acquisition. We continue to make progress on all of the key elements of our strategy. We launched Galliprant in Brazil in Q1, continuing the geographic expansion for that product. We gained approvals for Galliprant in companion animal markets Australia and Japan. Social distancing measures are driving increased companion animal sales through alternative channels primarily in the US.

This dynamic validates our omnichannel strategy with the Bayer acquisition, which will give us a much larger presence in the alternative channels. As an illustration, Bayer Animal Health posted 17% growth in their Q1 earnings in April. Seresto grew 51% and Advantage grew 10.5%, with both products showing the strongest sales gains in the US. While these benefited from pandemic-related purchasing and a favorable prior year comparison in the US, the underlying demand growth is strong.

Additionally, we announced a collaboration with VetNOW to provide veterinarians access to an industry-leading telemedicine platform. Telemedicine is a part of a bigger agenda to enable the connection between pet owners and veterinarians across multiple mediums and platforms from our sales team, telesales, targeted use of distribution and omnichannel leadership that will come from the combination of both Elanco and Bayer.

And our productivity agenda, anchored in our cost-facing activities throughout manufacturing, is on track and delivering. Our productivity efforts were a benefit to gross margin in the quarter. Todd will discuss the overall margin in more detail later. Finally, the independent company stand-up and ERP development remains on track even with social distancing and remote working arrangements.

The Bayer acquisition continues to progress towards a mid-year close. We recently received antitrust clearances in Colombia, South Africa and Vietnam in addition to the previous approvals in China, Ukraine and Turkey. After several months of constructive pre-notification discussions, on April 14, we submitted Form CO to the European Commission. They now have until June 8 to make a decision. The UK Competition and Markets Authority has accepted the merger filing from Dechra, who is purchasing Osurnia, and commenced their review. This is another positive event towards close.

All of the financing elements for the acquisition are in place. We are making progress in preparation for day-one integration activities and the build-out of the SAP system [indiscernible] (00:18:53) Consulting Services. Despite the need to work remotely, the Bayer and Elanco teams are making significant progress on all integration activities, including preparations to capture synergies. And we announced the new executive team, including personnel from Elanco, Bayer, as well as external hires. We have structured the team and the organization to maximize the value of our combined portfolio, channels and capabilities in all markets.

We're expanding the Executive Committee to include new leaders of US Pet Health and US Farm Animal. We're also dividing our international commercial organization with leaders of Europe and international focused on emerging markets, and these changes become effective when the Bayer acquisition closes. Finally, we're adding a Chief Marketing Officer now to bring greater focus on brands and their connection to pet owners, veterinarians and producers.

These leadership changes give us proven delivery, deep expertise and a continued chemistry that's been established since the IPO. It also gives us a flatter, more agile structure that is closer to the customer; increased animal health and consumer packaged good marketing experience; deeper expertise on commercial execution in animal health; diversity of the Elanco, Bayer and external tenure on the executive team; and a dedicated focus on four market areas that operate substantially different in the competitive landscape, go-to-market models and product priorities.

It is our intent that each of these executives will have their lead teams named and in place by day-one to accelerate value capture and create a more positive initial transition, all combined with increased marketing capabilities to grow across channels and businesses as we enter the next era of launching multiple products. You will have the opportunity to hear from our combined leadership team during an Investor Day that we plan to host within an appropriate time after the Bayer transaction closes.

Let me summarize. Clearly, our sales in the quarter are impacted by COVID and its triggering effect to accelerate an important commercial change. As I look beyond this event, I am positive on the value of our products, our commercial strategy and the moves we are making to position Elanco for the future. We have also made changes to ensure that our execution remains on track and our intensity sustains as we move to a mid-year projected close of Bayer.

Now, I'll turn the call over to Todd to provide more color on our results and outlook.

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

Thanks, Jeff. Slide 6 summarizes our presentation of GAAP results, while slide 7 describes the items considered in the adjusted financials. Slides 17 to 20 in the appendix provide a summary of the adjustments made to the GAAP results to arrive at our adjusted presentation. I'll focus my comments on our adjusted measures to provide insight into the underlying trends in our business. So, please refer to today's earnings press release for a detailed description of the year-on-year changes in our first quarter GAAP results.

Looking at the adjusted measures on slide 8, you'll see total Elanco revenue decreased 10% in the quarter. On a constant currency basis, both total Elanco revenue and core Elanco revenue decreased 9%. Gross margin as a percent of revenue was 50.1%, a decline compared to the first quarter of last year, driven by geographic and category product mix with a larger portion of sales coming from lower margin international markets and food animal products, as well as a negative impact from foreign exchange. This headwind is partially offset by continued productivity gains and positive price.

Our productivity efforts, including a reduction in compensation and benefit costs in our manufacturing and quality area, remain on track and are ahead of expectations in certain areas. Operating expense increased 1% in the first quarter. Marketing, selling and administrative expense was flat at \$182 million, reflecting incremental investments in stand-alone capabilities, offset by strong expense management throughout the organization as illustrated by the \$4 million sequential decline from Q4 2019.

R&D expense increased 4% to \$66.8 million or 10% of revenue, reflecting additional costs from acquired businesses, including Aratana and Prevtec. Operating income declined 43%, reflecting the impact of sales, gross margin and operating expenses I just described. At the bottom line, Q1 adjusted net income decreased 42% to \$53.6 million with an effective tax rate of 15.9%. The adjusted EBITDA margin is 16.2%.

Moving to slide 9, let's take a look at the effect of price, rate and volume on revenue growth. The effect of foreign exchange rates on core revenue was a 1% headwind overall. Price grew 1%, while volume declined 10%. On the slide, you can see the breakdown of revenue across our four categories. I will focus on constant currency growth.

You can see the impact of the recent decisions Jeff described, particularly in our two companion animal categories with the decline in Disease Prevention of 24%, 27% from volume offset by 3% increase in price; and the decline in Therapeutics of 18%, all from volume. As noted, the underlying demand – EDI demand in the US for companion animal products continued to grow at mid single-digit rate despite the slowdown in the last two weeks of the quarter. In the US, we also outgrew the market in alternative channels outside the vet office.

Turning to our Food Animal portfolio and Future Protein & Health, revenue grew 10% in the quarter, 6% from volume and 4% from price. Growth in this category was driven primarily by poultry vaccines and aqua, reflecting both continued strong underlying demand, as well as a small amount of anticipatory buying by some direct customers in international export markets to ensure continuity of supply ahead of potential COVID-19 pandemic disruptions.

Ruminants & Swine revenues decreased 7% in the quarter, driven by a 6% decrease in volume and a 1% decrease in price. The decline is from known headwinds for Rumensin and Paylean, the continued resupply of sterile injectables from our contract manufacturer and some reductions in channel inventory. These declines were offset by encouraging demand we see coming from the China swine market and some anticipatory buying from customers in international export markets as in poultry. The earlier recovery from African Swine Fever in China is particularly encouraging.

Revenue from Strategic Exits decreased 13% in the quarter. Recall that the only two activities in this category are the vaccine contract manufacturing for BI and the production of human growth hormone for Lilly. This decrease is expected and consistent with the continued wind-down of these activities. On slide 10, you can see detail on our overall performance in the US and internationally. Our international business grew core revenues 6% in the quarter, while the US business declined 22%. While the international business was aided by the anticipatory buy in our food animal business in the quarter, we are encouraged by the stabilization in growth in this business.

This quarter, we've added additional cash flow and balance sheet measures shown on slide 11. We ended Q1 with \$1.2 billion of cash and equivalents on our balance sheet after paying down \$371 million of debt. We have also priced our debt financing of \$4.275 billion for the Bayer acquisition in the form of a Term Loan B that will fund at the closing. Between the cash on our balance sheet and the Term Loan B commitment, we have sufficient capital to finalize the Bayer acquisition. After closing of the transaction, we will also have a \$750 million revolver available to us.

Now, moving to our outlook, with uncertainty surrounding COVID-19, we are not providing financial guidance for the remainder of 2020. The performance of both our companion animal and food animal business will be a function of social distancing restrictions, developments in protein markets and our continued tightening of parameters with our distribution partners. As Jeff mentioned, we estimate additional channel inventory destocking of \$80 million to \$100 million in the second quarter, which will bring us to the desired levels for our new model going forward.

Also, as a reminder, Bayer carries less channel inventory given their direct capabilities and retail approach. We are also actively managing our operating expenses and cash flow, including delays in maintenance capital where appropriate, critical evaluation of external spend, careful assessment of open positions and savings from reduced travel. We will continue to invest and stand up in the integration efforts as well as innovation, as these are fundamental to our long-term success.

Let's move to slide 12 and turn things back to Jeff to summarize.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

Thanks, Todd. Let me start by addressing the leading indicators we're watching as we navigate the impact of COVID-19 pandemic on our industry and on our business. In the companion animal space, the easing of social distancing restrictions and the resumption of elective vet visits are key variables, as well as the ability of our sales reps to return to in-person interaction with our customers. Products like Credelio, Galliprant, Nocita and Entyce are early in their life cycles. So, sales promotion and new patient starts are important for continued growth. Likewise, vaccines are delivered exclusively in a vet clinic.

In the meantime, the growth of alternative channel sales is a positive offset for many products and a confirmation of our omnichannel strategy. As a leading indicator, we're encouraged by improvements in vet clinic visits, primarily in the US, where the latter half of April has shown a rebound after sharp declines in the prior weeks. From Elanco, we are encouraged by April EDI sales into the vet clinics and alternative channels that show year-on-year April growth for Credelio, Interceptor Plus, Galliprant and Entyce.

Vaccines show year-on-year decline due to the reduction in wellness visits, but we're optimistic for a rebound in vaccines as pet owners return to the clinics. The food animal business is more difficult to project and may ultimately have a longer tail to return to normal. On the positive front, although we may see trade-down or shift in

consumption, end consumer demand for animal protein persists, supporting the long-term durability of this industry.

In the near-term, we are monitoring three main factors impacting our food animal customers across species. First, shifts in demand from food service to retail and across species. Second, the impact COVID-19 is having on reduced capacity, absenteeism, plant shutdowns at the processing plants and broader supply chain. And third, the economic impact to our customers from these supply and demand variables. These factors impact all three of our main species, cattle, swine and poultry.

In general, cattle and swine producers face headwinds with less food service and consumer trade-down to lower cost proteins and cuts, but our challenge was significant processing capacity offline with the return unpredictable. Across species, the flexibility in production practices will likely determine the severity of the impact for the industry. Dairy producers are perhaps the most challenged, given the inability to shift outputs from food service to retail.

Swine producers have a little flexibility in their production timelines and are having to make difficult decisions as animals back up in the supply chain. Beef players are able to use pasture as a buffer while capacity issues create uncertainty. And finally, poultry is in the most flexible situation, given shorter life spans and more integrated supply chains that can pivot output more easily. For all species, the impact to Elanco products depends on several variables, but in general reductions in animal numbers or compressed producer profitability is a headwind to our business.

It will be difficult to talk about the level of impact and recovery timelines until there is predictability. Until processing plant capacity returns, so that producers can make informed decisions, we anticipate continued uncertainty for our customers. We will monitor these variables over the coming weeks and work with our customers to support a safe, reliable and affordable food supply. Healthy and productive animals are even more important when consumers face such unique markets, and Elanco plays a critical role.

So, in summary, let me close. These are challenging circumstances for the animal health industry and for society overall. But we continue to have confidence in the medium and long-term durability of this industry and our strategy, and we're even more confident about the acquisition and value of Bayer Animal Health later this year. We will endure these challenges and we are taking actions to make us stronger for the medium and long-term. We are analyzing a range of scenarios with senior management, our board, external advisors, and stress testing the impact on our business.

We have contingency plans and degrees of freedom to navigate various possibilities. While we're not quantifying the headwinds to demand at this time, we will continue to monitor the depth and the duration of the COVID-19 pandemic on both the companion and food animal sides of our business, and as we move throughout the year, we anticipate these factors along with the reductions in channel inventory will provide headwinds to our full-year results. Despite this, we are confident that we have the foundation to emerge from this time as a stronger company.

Looking ahead, even in the mid-term, there is much to be excited about. We have a strong pipeline with potentially five launches through the end of 2021. We have a valuable portfolio of differentiated products on the market that are growing. Our productivity agenda will enable us to grow operating income faster than sales. And we're building a company with Bayer that has global scale, market presence and channel expertise to win in a dynamic market. And finally, this is a company, Elanco, that I believe in.

You see some of the character of a team during good times, but you see all of the character and resilience and determination during times of challenge and adversity. This Elanco team is executing at a level I could not have imagined. Our [ph] central wins (00:34:31) are clear and are on track. First, growing our commercial competitiveness and growing key products in key markets. Two, the independent company stand-up in on plan, the Bayer acquisition is set for a mid-year close and our teams are delivering to the key milestones. I'm proud of this company and our team.

Now, Jim will moderate the Q&A.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

Thanks, Jeff. We'd like to take questions from as many callers as possible, and we'll extend time as needed, as I mentioned. Please limit your questions to one or a single question with two parts.

Laura, we're ready to start with the first question, if you're available.

QUESTION AND ANSWER SECTION

Operator: Yes, sir. [Operator Instructions] Our first question comes from Michael Ryskin of Bank of America.

Michael Ryskin

Analyst, BofA Securities, Inc.

Q

Hi. Thanks, guys. I want to start off by asking about the distributor update. Could you clarify a little bit how much of this change was tied to COVID versus unrelated? Is this something that you were gradually moving to anyway, given some of the changes you made [ph] late in (00:35:41) 2019, and the COVID-related pressures on distributors just expedited it? And just as a second part of that, after the drawdown – the further drawdown expected in 2Q, how much inventory will the distributors hold? Is there further risk down the road, especially if you sort of take a step back and read this as a move to going direct fully, especially with Bayer coming into the numbers later in the year? Thanks.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Michael, thank you for the questions. So, let me be very clear right up front that we did not anticipate this change, as Todd stated in his comments, when we started 2020. But it is the right decision and we believe it's the right timing. As I mentioned, this is a strategic decision that is intended for the long-term, and it did – COVID was a catalyst to this, and let me highlight. What COVID did was it really created two challenges to our distributor partners. First, liquidity issues or working capital issues that did not enable the continued existing strategy that we've had for 13 years to continue, and it also – they had a concern about the near-term end user demand and working capital with their customers. So, that was the catalyst. I want to emphasize again, Michael, as I mentioned, we always start and end these discussions in looking constantly at our overall business and underlying organic demand like EDI, as I mentioned. And again, we see that tracking to our original plans through the first quarter and even through April. So, that I want to emphasize.

To your second question, as you look going forward, let me highlight there are a few things as we go forward. First of all, we see very importantly that with this change, we're going to be closer to the end user demand. We'll

have less partners, as you've seen. And over time, what we have really done here is we moved from eight to four distributors. Each one of them brings different expertise. We have tightened terms. And now, what we're doing is we're tightening and lowering inventory. Things that we'll look at is, of course, we'll be closer to end user demand. We'll have less partners that are more efficient, and we'll be looking at month-to-month matching of demand, and that will be much more tighter and more efficient, as we mentioned. And then, we will evolve and move to omnichannel approach with Bayer. And Bayer, again, as Todd mentioned, really keeps much less inventory given their go-to-market strategy, especially with alternative channels.

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

Michael, this is Todd. One thing to add, after we get through with this Q2 destocking, we'll be more than 10% lower than we were at the end of 2016. So, we do think we'll have this structurally set-up going forward.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, can we take the next question?

Operator: Our next question is from Nathan Rich of Goldman Sachs.

Nathan Rich

Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you. Good morning. Jeff, just following up on that, how do you kind of ensure that your products, I guess, are kind of positioned favorably relative to competitors within your four distribution partners? And do you see any investments that the organization needs to make as you kind of decrease your reliance on the traditional distribution channel?

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yeah. So, great question, Nathan. So, let me highlight, and we've spent a lot of time, and as I've highlighted, I've been very actively involved in this from the beginning. And what I would say is there's no question that we see distributors playing a key role, and what we see them doing very well is logistics. 99% of our customers can get product overnight as an example. They can continue, as we look at the way they – collections and the ability to collect, the convenience of one-stop shopping. Distributors receive 30% to 70% of their income through online platforms, and then we continue to see great value with them on home delivery platforms. There's varying differences, as you know, in services and value that these four distributors can do, and I'm talking more specifically about US companion animals.

So, they will continue to enable us and help us. But what we found very clearly – and I think this is really important, Nathan – is we drove the demand creation, the primary demand creation, especially when it came to new clinic penetration. So, what we're doing is we have – just as we have with the Interceptor Plus worm movement and campaign, with Credelio, with Galliprant on pain, we're seeing significant growth in these products by targeted campaigns led by our team. So, we can direct our investment and to do what we do best, which is demand creation and customer relationships, and really create value and pay only for what we feel is appropriate to these distributor partners. So, I feel very good that after 13 years, moving to this new approach to really having – where inventory was a key factor in driving demand and brand awareness, we see this being much less of a factor and our demand creation is much more in our control.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

Laura, next question?

A

Operator: Our next question is from Balaji Prasad of Barclays.

Balaji Prasad

Analyst, Barclays Capital, Inc.

Hi. Good morning. Thanks for taking my questions. Just a couple of quick questions. Firstly, on the pet visits, you had mentioned that you had seen some recovery in April. Can you elaborate more on that and speak about your near-term and longer term volume outlook for how we see pet volumes trending, and if you could also draw some comments on the [ph] pet production trends (00:41:47) we're seeing and what does it mean for the industry long-term? And maybe just a quick one on telemedicine and your collaboration with VetNOW, what this means for longer term volume growth dynamics too? Thanks.

Q

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

Yes. Thank you for the questions. So, as we look specifically at the COVID impact on the companion animal business, again, what we're watching and the metrics that we're looking at of course is vet visit traffic, vet office revenue. We also are keeping an eye on the alternative channels shift that's occurring outside of the clinic, and then ultimately as we navigate this change, especially looking at EDI sales or demand pull through the clinics. As mentioned, what we have seen and has been highlighted in other forums from multiple sources is prior to the last two weeks of March, both traffic and revenue were showing growth. And what we've seen is actually a pick-up of actual traffic, and that's continued here in the last two weeks of the quarter and into April as social distancing restrictions were implemented across the country. I think trailing behind though are wellness visits. They are recovering. But again, they've been the most heavily impacted.

A

So, when we look at our portfolio, we see alternative channels, as we mentioned, growing over 30%. We see our sticky brands around our parasiticide and pain franchise, Galliprant, Credelio, Interceptor Plus, growing very nicely. But what's been impacted the most has been our vaccine and our surgical business, which is around wellness. That's about 20% of our portfolio. And then, as you look at VetNOW just briefly, again a collaboration, much more a part of a bigger strategy that was even linked to Bayer as we're working to enable veterinarians to connect to more pet owners. As we know, more than a third of the pet owners, and that may even change and expand over time, are not visiting the vet clinic. And what we see is again a high move to the use of telemedicine. It's too early right now to say how that will impact. What we do know is a key part of our strategy is being able to enable veterinarians to have portfolios and tools to be able to reach that pet owner more easily and allow that pet owner to shop where they want to shop.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

Great. Laura, can we take the next question?

A

Operator: Our next question is from Erin Wright of Credit Suisse. One moment, please.

Erin Wilson Wright

Analyst, Credit Suisse Securities (USA) LLC

Q

Hello? Hi. So, on the innovation...

Operator: Please go ahead. Your line is open.

Erin Wilson Wright

Analyst, Credit Suisse Securities (USA) LLC

Q

On the innovation front, it does sound like you continue to be dedicated to the R&D efforts here with five revenue generating products next year. Will any of these be blockbusters for you? And I did want to follow up – I think it was Nathan's question. So, do you anticipate stepped up investments required in your own internal sales capabilities as you deemphasize third-party distributors here and how should we think about the net profit dynamics as you cut out distribution? Thanks.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yes. Look, Erin, it's a pipeline. Again, I just want to kind of give the evolution of what we have done here very clearly, as we talked about coming out as an IPO of late-stage development projects during this window of time. We've moved those late-stage development projects to actually launch equivalents. So, as we've talked, these are [ph] probabilized launch (00:45:38) products, and we have about 20 at this point in time from Elanco that we'll launch between now and 2024. And then, we are adding from the view that we have so far – and we'll have more view as we get closer – but five more from Bayer. So, 25 products between now and 2024.

And what we highlighted today is we see five of them coming between now and the end of 2021. So, we do see a constant flow of innovation and really the next era of innovation starting here soon. Relative to the size and the blockbuster, we do believe that, first of all, the criteria coming out is first-in-class or some differentiated best-in-class. They will be a mix between food animal and companion animal, and we do believe that given the threshold that we now have created, yes, we do believe that some of these do have the merits to be blockbusters. Thank you. Todd?

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

With respect to the investments, we do expect to see better value from the distributors. As you know, we've been reducing margin with them over a number of years, and again, this change will certainly put us in a better position on that front with them. With respect to the capabilities, we've certainly been seeing changes as a result of the COVID impact, keeping our sales reps at home and continuing to have good reach and frequency with vet clinics. And so, as we look at the best way to continue to drive our own internal demand, there will be some adjustments on where those investments are made. And then, we throw in obviously the Bayer acquisition as well as our new US commercial leadership, and that will be an evaluation as we move forward. But we're confident that our team has been driving good clinic placement of our growth portfolio and look forward to continuing to augment that going forward.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, can we take the next question?

Operator: Yes, sir. Our next question is from John Kreger of William Blair.

Jonathan Kaufman*Analyst, William Blair & Co. LLC*

Q

Hi. Good morning. This is Jon Kaufman on for Kreger. I know you're not providing any 2020 guide, but can you give us some clarity in terms of how you're thinking about the full-year? So, if you exclude the inventory reduction next quarter, how do you think the rest of the year plays out? Do you think your business will follow the trajectory of the broader market or are there other factors that we need to consider?

Todd S. Young*Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.*

A

Jon, as we've noted, there is a lot of moving pieces with respect to the timelines with respect to COVID, and everyone is trying to evaluate and get the best feel for that. I think as Jeff said in the prepared remarks, the food animal is definitely one which we're keeping eyes on. I think Smithfield was opening up a new swine – or not a new, but opening up a swine facility in Sioux Falls this morning, but didn't expect it to be back full capacity until the end of the month. We continue to spend time with our food animal and processing teams to understand how they're seeing the business. But certainly, there's a lot of uncertainties there, especially on producer economics, as well as head count. So, we do expect that to be negative on our business relative to expectations pre-COVID, as we've called out and why we pulled guidance back in March.

On the vet clinic side, as Jeff said, we do have about 20% of our portfolio that can only be used in the vet clinic. That has an impact, obviously. As you said, we did see some vet traffic tick back up here in April, but it's certainly not back to pre-COVID levels given shelter-in-place is slowly changing in a number of states, but in other places clearly more issues there. And then, the other bit we brought out on the March guidance pull is, at original assumptions, we had about a \$70 million impact on FX. Dollar shrink continues. We're sub-\$1.08 on the euro this morning. So, that continues to be that level of headwind. So, we do expect the items, in addition to the inventory, to continue to be significant headwinds to our overall business in 2020.

Jeffrey N. Simmons*President, Chief Executive Officer & Director, Elanco Animal Health, Inc.*

A

But I would say, Jon, just to pick up on it, when you look at relative competitiveness as the market moves, we feel well-positioned even with this change in distribution. It enables immediate competitiveness, and that's why I wanted to highlight the – even through April data in terms of holding share, growing the key products that we need to grow, and you saw that in the international results. So, just to reiterate, companion animal US mid single-digit; the o-US, we've seen nice growth in that 2% to 4%; and the food animal in the US doing well with our Rumensin, and again, flat to declining, driven more by Paylean and our Micotil situation. So, our eyes are on our competitiveness in the marketplace, and we feel very good about that.

Jim Greffet*Head-Investor Relations, Elanco Animal Health, Inc.*

A

Laura, can we proceed?

Operator: Our next question is from Ekaterina Knyazkova of JPMorgan.

Ekaterina V. Knyazkova*Analyst, JPMorgan Securities LLC*

Q

Hey. This is Ekaterina on for Chris. Thank you for taking our questions. So, one more actually on the distributor changes. Were inventories at distributors at unusually high levels heading into 1Q? And then, you've highlighted

how this kind of strengthens your position going forward. So, just wondering why now, why not change to the structure kind of earlier.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yeah, great question. So, let me be clear that over time, over the 13 years since starting our companion animal business, we've been in this very similar buy-sell where we actually buy – the distributors buy the product and represent the product. And let me just really highlight, it's varied over time. We look at three things – or have looked at three things consistently every quarter with our distributors: 90-day trailing demand, so a very disciplined process; campaigns that are in place; and the upcoming season that's ahead. And that's been our criteria over the years. And again, we've built over \$1 billion franchise in companion animals with this approach with our distribution partners. So, that's been important.

Now, factors that I would say have changed over time is, one, our distribution network has become more concentrated. There's varying differences between them. So, we started to move towards tightening terms and tightening the number of distributors, and this was an evolution. And as we mentioned, this was not something we expected to do in the beginning of the year, but COVID really drove this working capital and concern about vet clinic working capital and our distributors, so they were unable to continue to do this.

Inventory has helped us, as I mentioned, build share of mind, shelf space, brand launching, and as you've seen, it's been very effective to even build the brands of Credelio, Trifexis, Interceptor Plus over the years. But as we see now, and we've been assessing, we've been building our capabilities and continue to do so and will even more so with Bayer, and we believe this allows us to optimize. We do what we do best, and this is to optimize and create demand creation and new placements – new clinic placements, while letting today's distributor, that are fewer, actually enable and help us and build that value-added service, drop shipping, et cetera. So, to me, we feel the timing's right. We've been assessing this, but the tipping point was the COVID pandemic.

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

One thing to add, Ekaterina, on the inventory. The tactical assumption we've made that the four remaining companion animal distributors would need to own the same amount of inventory as the eight before...

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yeah.

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

That just didn't play out as we had assumed. And obviously, some of that's just efficiency of the distribution partners we kept, but there's also the element of the COVID that made tightening down and the expectations of future demand obviously were really uncertain in March as the vet clinic traffic had dropped 20% to 30% depending on what data you were looking at. So, that timing element did – that was a bad assumption on our part that turned out to be even worse with the COVID impact getting triggered.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, next question?

Operator: Our next question is from Elliot Wilbur of Raymond James.

Lucas Lee

Analyst, Raymond James & Associates, Inc.

Q

Hi. Thanks. This is Lucas Lee on for Elliot. I'm not sure if you guys disclosed this already. But what was the operating cash flow for the quarter and how do you see this trending throughout the remainder of 2020? And as a follow-up, I'm not sure how much you could comment on Bayer's animal business, but the first quarter result was one of their best quarter in some time, which appeared to be boosted by Advantage product family, especially in the US region. Is it possible for you guys to provide some color on their outperformance and how much of the increase was due to COVID-19 related stockpiling and how much of that growth do you think is sustainable? Thank you.

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

Sure. Let me address the operating cash flow. We will be filing our 10-Q end of today, early tomorrow. In that, you'll see operating cash flow for the quarter was a positive \$4 million. This is as robust as we'd like. But given the impact on the P&L from the inventory destocking, the positive is really a function of timing of, when we do our collections, you will see working capital improvement. That was certainly something that didn't go well for us in 2019. So, we're off to a better start here in 2020. The other item that's impacting the operating cash flow is the investments we're making both on the stand-up as well as on the integration of Bayer.

As you would see in our GAAP results, we had restructuring and charge impact of about \$77 million, which again a lot of that was cash out the door. So, again, overall positive operating cash flow in Q1 despite the challenges. Q2 will be under additional challenges just given the timing of the sales decline in Q1. But again, we're very focused on our cash and liquidity going into the Bayer transaction. We are set to close that mid-year with the funds available as well as the debt commitments we have. But overall, again, this is challenging times, but we're very much on top of it and looking to find cash where appropriate. I'll let Jeff handle the Bayer results.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yes, Elliot (sic) [Lucas] (00:56:44). So, again, I will start by saying that we remain competitors until the deal closes. But given the color and then the linkage to our diligence, I would say first of all overall revenue, yes, did grow 17% compared to first quarter last year, Seresto up 51%, Advantage up 10.5%. While these results did benefit from some pandemic-related purchasing and favorable prior year comparison, the underlying demand continues to be very strong and continues to outgrow the overall market.

I do think also there's a direct linkage to some our diligence findings that we've communicated in the past. They had over a 10-year head start and moving down this alternative channel. They're the leaders in the alternative channel. And they have the three key capabilities that we've learned in our three years in this business: you need the products to be able to flow; the partnerships with the key alternative channel players; and people and the expertise. And we think these are definite contributors as we move to this mid-year close, and again, validating our assumption in how critical an omnichannel approach is.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, next question?

Operator: Our next question is from David Westenberg of Guggenheim Securities.

David Westenberg

Analyst, Guggenheim Securities LLC

Q

Hi. Thanks for taking the question. So, I want to take a look at past COVID here, maybe in like 2023 when you talk about your pipeline. Innovation last year was a tad under 15% of revenue. What do you think that optimal number looks like in terms of percent of your revenue being a part of the innovation portfolio? And then, a second one on kind of [ph] the out-year outlook would be (00:58:30) do you believe COVID-19 is going to pick up practice consolidation trends just given the higher leverage that veterinary practices have? And do you think you have the right consolidation sales approach? And I'm talking there of course about companion animal veterinary practice consolidation. Thank you.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Hey, David, one clarifying question. Are you talking about percentage of sales in R&D?

[indiscernible] (00:58:55)

David Westenberg

Analyst, Guggenheim Securities LLC

Q

Yeah. So, what I'm talking about is when you lay out – you have a slide. I think it was \$440 million was your innovation portfolio in 2019. And you do the math, that's – I think that's 14% of your total revenue. What is the optimal number as we look at maybe say 2023? As you're bringing this new innovation to the market, what would you hope that number could be?

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Thanks for the clarification.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yeah. So, I think just at a high level, you can look out as 2023, but I would even say, as you start to look at – heading into 2021, as I kind of look at our IPP strategy and innovation, first thing is the launch products continue to perform very well across the company and our key portfolios like salmonella and aqua, et cetera. So, we got over a dozen products that are in growth mode, that are launching. We will bring products like Claro and Seresto in from Bayer as well. So, I start there that a lot of room and a lot of headroom, as you see, with these launched products that are already approved.

Then, we've got these 25 products, I just want to emphasize again, more of a linear approach as we look at, again, 5 here coming out for our next era of innovation. And then, we continue to see that transition being pretty strong as a constant flow. And that investment we see at this point in time, with the size and scale of being able to put Elanco and Bayer together, it's going to give us a lot of optionality, a lot more capability, and we'll be able to optimize through the integration process. But the expectation is we would not see that growing as a percentage. Todd can elaborate.

And then, I just would emphasize too that we are not letting up. Everything that we see, cost-facing, price-wise, the margin expansion story and the agenda continues to remain. Yes, we had a one-time event. We've got some FX challenges. But as a whole, we still feel very good overall about our margin expansion story. And probably what excites me the most is looking at what the combination of this company can do with the expansion, with the size, with the scale, with the diversity, and most importantly, with the omnichannel leadership that we can provide. So, I see us starting as early as 2021 and moving forward here over this next era for Elanco.

Operator: Our next question is from Kathy Miner...

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

Just a moment. Laura, just a moment.

A

Operator: I'm sorry.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

I think [ph] he had asked one other piece (01:01:36) on environment.

A

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

Yeah. I think the question on the consolidation of vet clinics, that's a trend that's been occurring, as we know. And what I would say is there's been consolidation and I think there's also been distinct segmentations, as we've talked about. There are some that are not trying to get bigger but are trying to really specialize. And again, that's another thing we've done with our Aratana acquisition is to really focus on those specialty vet clinics, and they continue to grow and are very sustainable. Yes, there are corporate clinics. But I think in between, there is still a lot of room and a lot of growth for that independent clinic that continues to adapt, innovate, bring on the services that us and other industries can provide them. So, yes, there'll be consolidation. Will it accelerate it? I think it's too early. But there may be some, even maybe outside of the US even more so. But I think more importantly is you're going to see more sophistication, which brings more opportunity for the multinational animal health companies.

A

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

Great. We're ready now, Laura. Thanks.

A

Operator: Thank you. Your next question is from Kathy Miner of Cowen and Company.

Kathy Miner

Analyst, Cowen and Company, LLC

Great. Thank you. I have two questions, please. The first one, when you've commented on 35% growth in the alternate channel sales, is all of that prevention sales or are you starting to see some therapeutics and other products go through the alternate site – channel? Second question on food animal, can you quantify how much of the US Q1 sales were the anticipatory buying or stocking and also maybe point us to any kind of key o-US dynamics in food animal? I think you talked about some of the things you're watching that were more US-related, but any particular o-US comments would be helpful. Thank you.

Q

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yes. So, just on the alternative channel, we saw it across all segments there but – on both sides so – in all categories. And I'll just reemphasize. It represents about 10% of our total companion animal sales, mostly all in the US. So, again, smaller part of our overall base, but again across all categories and really against [ph] all key of our partners. I really wanted to highlight though (01:03:54) e-commerce as well. That would be the leader of growth. Todd?

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

And then, Kathy, on the food animal side, we actually did have a small amount of inventory destocking in the US food animal business and there was no anticipatory buying there. O-US, certain of our export markets – and those are ones where we don't actually have an Elanco entity on the ground, but rather have third-party distributors. They had concerns on product availability and shipping. They bought a small amount of both poultry and a little bit on the Ruminants & Swine side. But overall, o-US, we've really seen – again, as we mentioned [ph] on AFS (01:04:38) being still an issue across China, but less so with our big corporate accounts [ph] as that's expanding (01:04:44). So, we're a little bit ahead on our sales on the China swine business than we anticipated at the start of the year as progress there with the corporate accounts. There's still continuing concerns on [ph] AFS (01:04:58) at the smaller backyard farms.

With respect to the rest of food animal o-US, there's been a little bit of processing plant closures in Brazil, and we're staying very attuned to that. Actually, the devaluation of the real has been really impactful for us there, as just our products just get more expensive as some of them from a dollar cost standpoint, there's trade-down effects. But again, poultry across Europe has been able to maintain things through the COVID times. We'll see if that continues, and our teams are very much on top of it overall. So, again, I'm seeing less of the processing side [indiscernible] (01:05:43) internationally than in the US. But again, we're staying very close to that.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, next question, please?

Operator: Our next question is from Navin Jacob of UBS.

Navin Jacob

Analyst, UBS Securities LLC

Q

Hi. Thank you so much for taking my question. I totally understand the challenges of forecasting in this COVID environment. But given the deal, can you remind us where you think leverage will be once the deal closes as well as your deleveraging plans over the next one to two years? When do you think you will get to less than 3 times? Really appreciate the help.

Todd S. Young

Executive Vice President & Chief Financial Officer, Elanco Animal Health, Inc.

A

Navin, obviously, with the EBITDA drop in our own business here in Q1 and the expectations of impacting Q2, offset by favorability on the Bayer side coming off their strong quarter, we do expect our leverage to be higher at close than we had originally anticipated as a result of these results. At the same time, we're confident in the cash

flow generating ability of the combined business. Throughout this time, we've been very focused on the integration and setting up our teams for value capture and the like. That we feel is very much on track.

And so, our ability to get to below 3 times, we're not going to address that. Given COVID is keeping us from giving guidance for 2020, it makes it difficult to project going forward. That being said, we had anticipated that by the end of 2021. I don't think this is going to make a three-year shift or anything like that, but certainly within the question of how many quarters delta will there be, there'll probably be a little bit of delay just because of the COVID impact here in 2020. That being said, we're very focused as we get cash in the door to be paying down that debt and to get our leverage down as quickly as we can, given the challenges of having high debt in the current environment.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, I think we have one more question in the queue.

Operator: Yes, sir. Our next question is from Umer Raffat of Evercore.

Michael DiFiore

Analyst, Evercore Group LLC

Q

Hi. This is Mike DiFiore in for Umer. Thanks so much for taking my question. I got a few quick ones. Can you provide any color on the, I guess, isolated cases of avian flu that have popped up in South Carolina and how exposed Elanco might be to that? And the follow-up is – and I know it's early days, but [indiscernible] (01:08:28) had just become available in the clinics around mid-April, so for a couple of weeks now. Any early feedback that you're hearing from customers in terms of their preference over your offerings? Thank you.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Thanks, Mike. Real quick on the first question, we see it contained primarily in turkeys and it's in turkeys, and we feel it's pretty well-contained. We'll continue to monitor that, but don't see that as anything, at this stage, of significance. And then, my comment would be our assumptions really haven't changed on the competitive scenarios in companion animals. Our campaigns are in full execution mode. I want to be clear that we feel very good about our competitiveness both on the sales side and the marketing side. Everything is in full motion, even with the changes that have occurred in the marketplace. We've made alterations and adjustments, but as a whole, again, we continue to execute very well and we'll continue to monitor it. But again, everything is on track as we had planned, and again, really want to emphasize, when you look at 22% growth in new placements for Interceptor and Credelio being one of the fastest growing new placements in the area of flea and tick products, we like what we see from a lead indicator perspective and our teams are doing a great job at enabling that.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

Laura, I think we have one follow-up in the queue that we're happy to take.

Operator: Yes, sir. Our next question is from Balaji Prasad of Barclays.

Balaji Prasad

Analyst, Barclays Capital, Inc.

Q

Hi. Thank you for taking the follow-up. I just wanted to get some more color on the five launches you already mentioned that we could see by the end of 2021. Would either [ph] biologics or your own triple (01:10:25) be a part of this 2021 launch basket? And also, do these five products that you spoke of exclude any Bayer contribution in it? Secondly, just want to also check on the livestock dynamics, and in terms of key metrics that we need to track, is the return of processing capacity the most important metric or is there anything else that we need to track? Thank you.

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yes. So, to give you a little color – and again, as we move towards the investor meeting that we'll hold at the appropriate time after the combination of company, it's our intention with Aaron Schacht, our Head of R&D, to give a lot more color. But what we wanted to do today was to highlight that this next era of innovation is in final stages and in preparation. I won't comment on any one specific. I will say no, it does not include any Bayer products this time. So, that could be an additive effect on top of the five that we have, and we'll know a lot more upon day one of the deal.

But we do like their pipeline, and again, see a robust pipeline that is scattered throughout that now to 2024 period. So, that's important. There will be a mix between food animal and companion animal, and it will cover most all the geographies. So – and I would continue to say our threshold is getting higher relative to the size and the significance of products coming out and meeting our IPP strategy, so when it comes to margin, portfolio mix and the ability to compete either in first or best-in-class. So, more to come. But again, we feel very good about the overall portfolio of innovation and these next five.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

A

And then finally, just some livestock metrics that we're...

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

A

Yeah. I think you're exactly right. Predictability is what our customers want. I've spent a lot of time on the phone and in forums with these CEOs of the major meat processing companies, and we've been engaged both in Washington as well as in the coalitions to continue to keep these plants operating, to keep their employees safe is the absolute priority. But to Todd's point earlier, we need to be looking at the best predictability for our producers is the opening of these plants, number one, like the Smithfield plant this morning, to two, more capacity. And I would say the one to watch the most – two is probably pigs. Cattle has the flexibility to go to pasture. Poultry has the flexibility of cuts and moving more to retail and grocery while – and a shorter life cycle, where pigs are caught in between, not having that optionality. So, pig plants and opening to back to full capacity is probably the lead, lead indicator that we're watching the most.

Jim Greffet

Head-Investor Relations, Elanco Animal Health, Inc.

We're almost at quarter past. Jeff, do you want to offer some closing thoughts?

Jeffrey N. Simmons

President, Chief Executive Officer & Director, Elanco Animal Health, Inc.

Yes. I appreciate and we look forward to engaging appropriately with all of you in addressing any more specific questions that you have. I just want to emphasize again, like I said in my comments, we've never seen more the importance of this industry and the durability and the need of this industry as you look at pet shelters empty needing pets and companionship to of course the protein – animal protein shortages around the world. So, we're in a great industry that's durable. We are building a leading company in this industry. We have all the key milestones that we can control on track across that IPP from our pipeline to the new growth products to our margin expansion.

And the additive effect of standing up Elanco is on track, as well as the Bayer acquisition. And again, we feel more and more excited about the value and the leadership of the combination of these two companies as we move to mid-year, which is soon. And I would emphasize that this was a one-time event that we did not have planned with our distribution partners when we started the year. But COVID was the catalyst in making it happen. But ultimately, it's the right decision, the right time. It makes us stronger, more competitive, and we're going to get immediate results from that. And we'll continue to partner with our distributors and play to their strengths as well. Thanks for your time today. We look forward to continuing our dialogue with you going forward.

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

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