

## Animal Health

## VMX 2024: Puppies, Pricing Power, and (new) Products

Industry Overview

## In Orlando for the comprehensive Animal Health checkup

Earlier this week we attended VMX 2024 (Veterinary Meeting and Expo), the largest companion animal industry conference. While there, on 01/15, we hosted our annual investor booth tour where we met with management teams from Zoetis (ZTS), Elanco (ELAN), IDEXX Laboratories (IDXX), Chewy (CHWY, covered by Curtis Nagle) as well as several individual vets and other industry participants. Despite muted clinic visit trends and a more cautious consumer backdrop, most practitioners we spoke with remained largely constructive given still solid revenue growth and the wave of innovation taking place across the field. Below, we highlight our learnings from our covered companies.

## IDEXX: inVue in focus

As is typical at VMX, IDEXX hosted a more formal session for the investment community. Following last Friday's announcement of the inVue Dx platform (see [our Jan 12 report](#)), the Analyst Meeting focused almost entirely on the market opportunity for inVue, and attempted to quantify the near-term contribution. In terms of the cytology market, IDEXX stratified it into 3 areas of 'unmet needs' - ear swab, blood morphology, and fine needle aspirate (FNA) lumps and bumps. The largest immediate opportunity seems to be for ear swabs, where IDEXX estimates 20% of dogs have some issues, and 2/3 of those have ears sampled currently via microscopy, equating to ~19mn annual tests (that could theoretically be converted to inVue). The next market is hematology, where 2/3 of abnormal CBCs (Complete Blood Count; found via the ProCyte) should have blood morphology run on the inVue, equating to a ~20mn annual tests opportunity. Both testing formats (ear swab & blood morphology) will be available at launch, while the 3rd (FNA) will come at a later point. IDEXX sees a ~11.5mn test annual opportunity for FNA, albeit some vets we spoke with cited FNA as being the most common cytology use-case.

## 50-100bps contributor to sales growth, starting in '25

In terms of specific financial targets, IDEXX sees ~20,000 inVue placements over 5 years, with an ASP in the low teens (ie, ~ \$13k). Annual pull-through per box is expected to be in the \$3,500 to \$5,500 range, or roughly comparable to the SediVue (notably, this is inclusive of FNA contribution). Net-net, this implies roughly \$250mn in instrument revenues (cumulative over the 5 year period), and consumables pull through that ramps up to ~\$80mn in revenues (annually) by year 5. All-in, we est. roughly ~\$40mn in 2025 contribution (+75-100bps to revenue growth), and \$65mn in 2026 (+50bps).

## inVue is impressive, but jury still out on pace of adoption

While we spoke to a number of vets about the inVue specifically, most were still learning about the platform and hadn't reached a strong conclusion (not surprising, given it remains ~9 months away from launch). We came away impressed with the technology and acknowledge that it could become a meaningful contributor to sales growth, albeit 2024 benefit will be minimal. We maintain our Neutral rating and estimates as we think IDXX risk/reward remains balanced, particularly given the premium valuation. **Please see back pages for more on ZTS, ELAN, and general learnings from VMX.**

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OTC: over the counter

OUS: outside the US

ASP: average selling price

Dx: diagnostics

## (Continued from front page)

### **ZTS: strength across key franchises, 2024 moving pieces**

We spoke with ZTS's Weteney Joseph (CFO) and Nick Soonthornchai (IR), with the conversation largely focused on the company's positioning heading into FY24. Mgmt. continues to see a very meaningful sales opportunity for the recently launched Librela in the U.S, highlighting that average time-on-treatment of ~6-7 months in OUS launch geographies is well above initial expectations. While U.S Librela is poised to be the main incremental growth driver in FY24, mgmt. also underscored the expectation for growth in both the key Derm and Simparica Trio franchises in the coming year despite expected competitive entrants in both categories. Pricing will again be a tailwind, and albeit not as favorable as in 2023 it will still remain above historical levels. There was some discussion of a few other discrete 2024 considerations (ie, headwinds in China, livestock markets, some continued macro pressure), but net-net, we think the Librela tailwind will be strong enough to overcome these headwinds. Given the favorable portfolio backdrop, ZTS appears set for another year of solid operational revenue growth – we believe at the high end of the long-term outlook of 6%-8%.

### **One-time / non-operational factors to consider for '24 EBIT growth**

That said, mgmt. also called out a few factors which are expected to weigh on the bottom line. Specifically, ZTS anticipates lower interest income on its sizable cash balance due to declining rates, while the fixed nature of its debt profile will limit any offsetting benefit to interest expense. Additionally, in 1Q24 ZTS will lap a one-time royalty settlement (seen in 1Q23 'other income' line). Zoetis sees these as one-time or non-operational, and excluding these factors, mgmt. would expect FY24 net income to grow faster than revenue (in accordance with ZTS's long-term financial framework). Overall, the conversation served to reinforce our positive outlook on ZTS portfolio, pipeline, and growth potential; thus we maintain our Buy rating.

### **ELAN: Gearing up for a busy year**

We met with ELAN's Todd Young (CFO), Bobby Modi (EVP, U.S Pet Health & Global Digital Transformation) and Katy Grissom (IR) where we discussed several moving pieces in ELAN's pivotal FY24 product launch year. Although they noted that each approval process has its own nuances and regulatory dialogues, mgmt. reiterated the target of 3 product approvals in 1H24 (Zenrelia, Credelio Quattro, Bovaer). Companies in AH are limited in their promotional activities toward individual vets before a product has been fully approved and labeled, but ELAN has been able to hold executive-level meetings with clinic groups to discuss their forthcoming products ahead of approval. Beyond new products, ELAN also remains confident in its ability to achieve constant currency sales growth in FY24 excluding the upcoming launches, with Experior, AdTab, Parvo, and Credelio OTC OUS all expected to be key contributors.

### **New products will drive margins, but not in '24**

While ELAN's sales growth should inflect in FY24, mgmt. flagged a number of factors which will weigh on margin expansion in the coming year. On top of an anticipated 2.5-3.5% average wage increase, ELAN will also face a differential headwind given the rightsizing synergies it benefited from in FY23. Similarly, although ELAN expects savings from its completed ERP (Enterprise Resource Planning) system transition, these IT savings are also being partially offset by price increases from ELAN's remaining tech vendors. Additionally, continued softness in the high-margin US clinic channel will drive some negative mix shift barring end-market improvement. The new product introductions will also not be margin-accretive at launch given initial capacity under-utilization and up-front investments that will take time to pay off. All-in, we currently est. ELAN's EBITDA margin will *contract* by 30bps in 2024, before expanding again in 2025.

## 2024 to be a pivotal year for Elanco

There is plenty of wood to chop for ELAN in FY24, but we see the business as being in a relatively healthy spot after several volatile years. The core portfolio is anticipated to return to some level of growth, and the now imminent approvals are set to refresh offerings across several key categories. The margin expansion story may take a (temporary) step back, but its limiting factors are largely transient and understandable given prior corporate actions and current market conditions. We acknowledge that executing on multiple major simultaneous launches poses an operational challenge for anyone in the industry, but in our view these new product introductions are essential in driving ELAN's sales growth, margin gains, and ultimately multiple expansion. We maintain our Buy rating given ELAN's upcoming product cycle and comparatively un-demanding valuation.

## Vet/KOL feedback: Volumes, Pricing, and Librela

We also hosted sessions with several veterinarians and industry experts over the course of the conference, including both general practitioners and an anesthesiologist / osteoarthritic pain specialist. When discussing the broader market environment, vets acknowledged that patient visit volumes remained generally subdued (as evidenced by 3rd party market data providers such as VetSource). However, not all vets we spoke with were pessimistic on vet visits, and some had seen growth/stability in 2023 - highlighting more variability than we had observed in prior conversations. Vets by-and-large also continue to see strong revenue and profitability growth, which matters a lot more than visit growth. This revenue growth is supported by continued price action (most vets in the 5% to 10% range, but some taking 10%+ price in 2024), although we heard increasing murmurs of pushback to higher prices from pet owners. Vets are also on the receiving end of higher prices from their suppliers/manufacturers (ie, ZTS, ELAN, IDXX), with the largest price increases being seen from IDXX, then ZTS, then ELAN - consistent with our expectations. Vets were visibly frustrated by the magnitude of price their suppliers are taking, but in most cases have little recourse given they're locked into long-term contracts or have limited alternatives. On the topic of consolidation, a number of vet clinic groups seem to be gradually reaccelerating the pace of consolidation after a more subdued 2023. Finally, there was extensive discussion of innovation in the therapeutics space - with vets being very excited about recent/upcoming product launches like Librela (ZTS), parvo mAb (ELAN), various combination parasiticides (ZTS, BI, and ELAN - although we saw a wide range of preference among vets) and looking forward to future product introductions to alleviate unmet areas of need such as obesity.

### Exhibit 1: Stocks mentioned

Rating and price summary

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
ELAN	ELAN US	Elanco Animal Health	US\$ 15.55	B-1-9
IDXX	IDXX US	IDEXX	US\$ 535.29	B-2-9
ZTS	ZTS US	Zoetis Inc.	US\$ 198.94	B-1-7

Source: BofA Global Research

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## Price objective basis & risk

### Elanco Animal Health (ELAN)

Our \$18 PO is based on 14x our FY24 EV/EBITDA estimate.

Our target multiple is a roughly 5x discount to the company's closest animal health peer, given the slower sales growth and lower margin profile, but reflects some expectation of further improvements by Elanco.



Downside risks to our price objective are continued pressure from negative news flow on Seresto safety, market challenges from ongoing Coronavirus outbreak, deal integration challenges, competitive and generic launches for key products, slower-than-expected ramp for new product launches, increased regulation on antibiotic use in livestock, macroeconomic conditions, and currency risks.

### **IDEXX Laboratories (IDXX)**

IDXX shares are trading at a significant premium to the broader animal health peer group and many other high growth healthcare companies. However, given the many positive secular and product tailwinds the company currently enjoys, we believe a premium valuation is justified. Our \$600 PO is based on roughly 55x our 2024E EPS estimate, which is in-line with (but at the higher end of) the company's historic valuation range, which we feel is justified given current macro and company-specific concerns.

Downside risks to our PO are continued market challenges from ongoing Coronavirus outbreak, lower spending on vet services in the event of an economic slowdown, slower-than-expected uptake of new products or OUS expansion, competition, lower-than-expected margin expansion, weather disruptions, and currency fluctuations.

Upside risks are a faster recovery in core vet volume trends in the US and abroad.

### **Zoetis Inc. (ZTS)**

Our \$205 PO is based on 34x our FY24 EPS estimates. This is roughly in-line with the historic ZTS multiple, which we believe is justified given upside from new product launches and incremental capital deployment, further margin expansion opportunity, and the defensive nature of the business, as well as reflects the near-term headwinds due to the Coronavirus outbreak.

Upside risks are continued ramp of new products, larger-than-expected contribution from future and ongoing launches, and accelerating growth from Abaxis acquisition.

Downside risks to our price objective are continued challenges from ongoing Coronavirus outbreak, competition in select markets or new product launches by competitors, weaker demand for animal health products, regulatory issues such as failure to get approval of key products in the pipeline, macroeconomic conditions, currency risks, and headwinds related to regulations of antibiotic use in animal feed additives.

## **Analyst Certification**

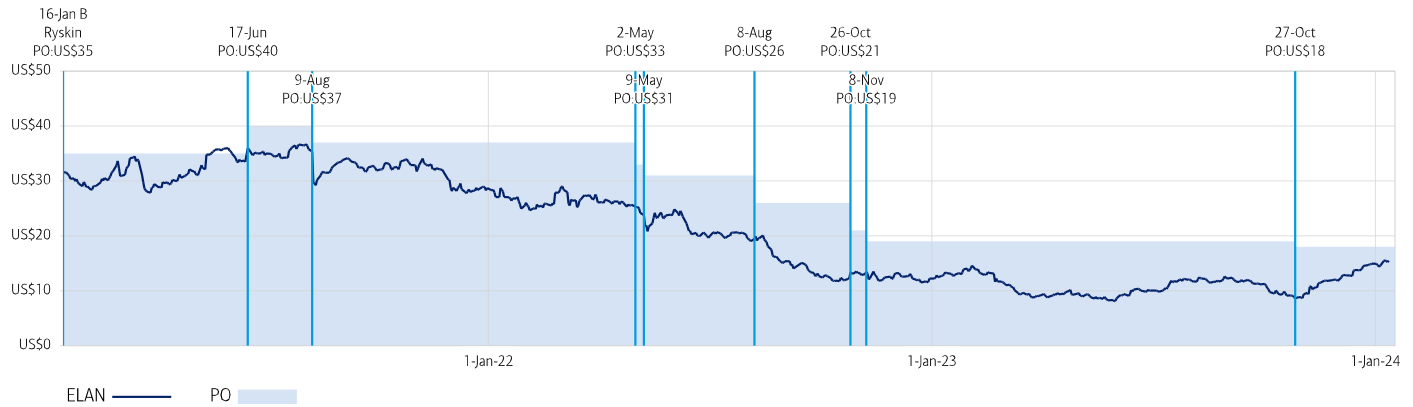
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## US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Avantor, Inc.	AVTR	AVTR US	Michael Ryskin
	Bruker Corporation	BRKR	BRKR US	Derik de Bruin
	Certara	CERT	CERT US	Michael Ryskin
	Charles River Laboratories	CRL	CRL US	Derik de Bruin
	Elanco Animal Health	ELAN	ELAN US	Michael Ryskin
	Exact Sciences	EXAS	EXAS US	Derik de Bruin
	Guardant Health	GH	GH US	Derik de Bruin
	ICON plc	ICLR	ICLR US	Derik de Bruin
	IQVIA Holdings Inc	IQV	IQV US	Derik de Bruin
	LabCorp	LH	LH US	Derik de Bruin
	Maravai	MRVI	MRVI US	Michael Ryskin
	Qiagen	QGEN	QGEN US	Derik de Bruin
	Qiagen N.V.	XQGNF	QIA GY	Derik de Bruin
	Quest Diagnostics	DGX	DGX US	Derik de Bruin
	Stevanato Group S.p.A.	STVN	STVN US	Derik de Bruin
	Thermo Fisher Scientific	TMO	TMO US	Derik de Bruin
	West Pharmaceutical Services	WST	WST US	Derik de Bruin
	Zoetis Inc.	ZTS	ZTS US	Michael Ryskin
<b>NEUTRAL</b>				
	10x Genomics, Inc.	TXG	TXG US	Michael Ryskin
	Agilent Technologies	A	A US	Derik de Bruin
	Danaher Corporation	DHR	DHR US	Michael Ryskin
	Evotec SE	EVO	EVO US	Michael Ryskin
	Hologic, Inc.	HOLX	HOLX US	Derik de Bruin
	IDEXX Laboratories	IDXX	IDXX US	Michael Ryskin
	Mettler-Toledo	MTD	MTD US	Derik de Bruin
	NeoGenomics Inc.	NEO	NEO US	Derik de Bruin
	Revvity Inc	RVTY	RVTY US	Derik de Bruin
	Schrodinger, Inc.	SDGR	SDGR US	Michael Ryskin
	Waters Corp.	WAT	WAT US	Derik de Bruin
<b>UNDERPERFORM</b>				
	Align Technology	ALGN	ALGN US	Michael Ryskin
	Catalent, Inc.	CTLT	CTLT US	Derik de Bruin
	Fortrea	FTRE	FTRE US	Derik de Bruin
	Ginkgo Bioworks Holdings, Inc	DNA	DNA US	Derik de Bruin
	Illumina, Inc.	ILMN	ILMN US	Michael Ryskin
	Myriad Genetics	MYGN	MYGN US	Derik de Bruin
	Phibro Animal Health	PAHC	PAHC US	Michael Ryskin

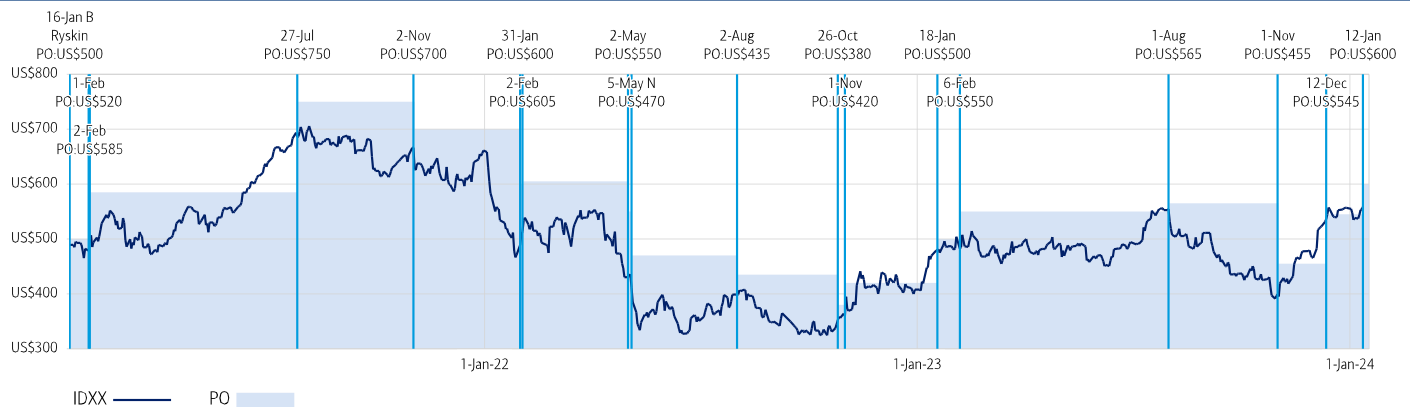
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### Important Disclosures

**Elanco Animal Health (ELAN) Price Chart**

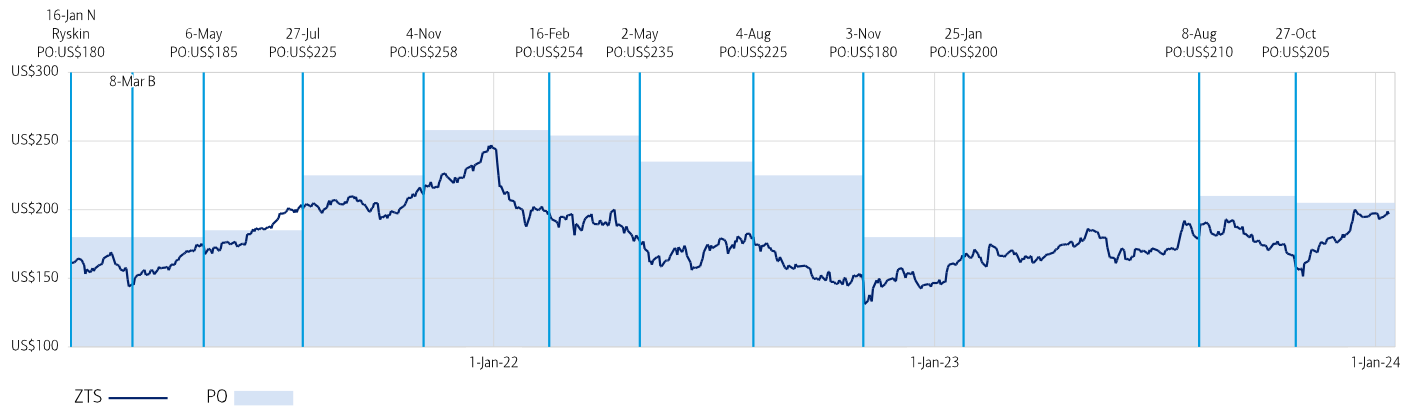
B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

**IDEXX (IDXX) Price Chart**

B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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**Zoetis Inc. (ZTS) Price Chart**

B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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**Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)**

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

**Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)**

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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