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Stock Rating
Equal-weight

Industry View
In-Line

April 30, 2013

Zoetis Inc.

Mgmt. delivers following competitors' headwinds

1Q above; 2013 guidance in-line. 1Q revs. of \$1.09B were 1% above MS and cons' \$1.08B, and 1Q EPS of \$0.36 were 10% above MS and cons' \$0.33. Mgmt. guided 2013E revenues of \$4.43B-\$4.53B and EPS of \$1.36-\$1.42. Revenue midpoint of \$4.48B is 1% below MS and cons' \$4.53B (we assume primarily on FX); EPS midpoint of \$1.39 is 1% below our \$1.41 and 1% above cons' \$1.38. Following disappointing 1Q animal health performance from Lilly, we would expect ZTS shares to slightly outperform on solid revenues and guidance.

U.S. and EuAfME were strong in 1Q; CLAR and APAC were a bit weak. Mgmt. delivered strong results in the U.S. and EuAfME in the wake of the U.S. drought and macroeconomic headwinds in Europe. U.S. revs. of \$454M were 9% above our \$417M, and EuAfME revs. of \$290M were 4% above our \$278M. Conversely, CLAR revs. of \$171M were 10% below our \$190M and APAC revs. of \$175M were 8% below our \$191M. PR noted weakness in companion animals in CLAR; FX was a 5% headwind in CLAR and a 1% headwind in APAC.

1Q operating expenses were below. Relative to our model, the \$0.03 EPS beat was driven by lower than expected SG&A (+\$0.02) and R&D (+\$0.01); gross profit was in-line.

Lower than expected 2013E expenses offset FX-related top-line weakness. Relative to our model, lower-than-expected revenues (1% below MS due to FX) were offset by lower SG&A and other expenses. Importantly, mgmt. guided to a non-GAAP tax rate of 29.5%, essentially in-line with our and cons' 29%.

We appreciated mgmt's transparency. Mgmt. disclosed 1Q segment revenues by species. We believe this added transparency will facilitate modeling and earnings visibility.

Key Ratios and Statistics

Reuters: ZTS.N Bloomberg: ZTS US

Specialty Pharmaceuticals / United States of America

Shr price, close (Apr 29, 2013)	\$32.66
Mkt cap, curr (mm)	\$16,330
52-Week Range	\$35.40-30.42

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April 30, 2013

Zoetis Inc.

Exhibit 1

ZTS 1Q:13 Income Statement Variation (YOY)

	Actual		MS Estimate		Variation vs. MS Est.			CONS. est.		Variation vs. CONS.		Actual
(\$M)	1Q:13A	YOY % Chg.	1Q:13E	YOY % Chg.	Absolute	Pct	EPS Impact	1Q:13E	Absolute	Pct	1Q:12A	
Net revenues	1,090	4%	1,076	3%	14	1%	+0.02	1,078	12	1%	1,047	
COGS	398	3%	387	0%	11	3%	-0.02	388	10	3%	388	
Gross profit	692	5%	689	4%	3	0%	+0.00	690	2	0%	659	
SG&A	322	-3%	338	2%	(16)	-5%	+0.02				331	
R&D	90	-3%	96	3%	(6)	-6%	+0.01				93	
Amortization of intangibles	4	0%	4	0%	-	0%	+0.00				4	
Operating income	276	19%	251	9%	25	10%	+0.04	268	8	3%	231	
Other expenses/(income)	24	N.M.	21	968%	3	12%	+0.00				2	
Interest expense	22	175%	29	267%	(7)	-25%					8	
Other expense (income)	2	-133%	(8)	33%	10	-125%					(6)	
Pretax income	252	10%	230	0%	22	10%	+0.03	242	10	4%	229	
Taxes	73	-4%	67	-12%	6	10%	+0.00				76	
Tax Rate	29.0%	-13%	29.0%	-13%	0.0%	0%					33.2%	
Income attributable to non-controlling interest	-	-100%	-	-100%	-	*	+0.00				1	
Net income (Non-GAAP)	179	18%	163	7%	16	10%	+0.03	170	9	5%	152	
DILUTED EPS, proforma	\$0.36	18%	\$ 0.33	7%	\$0.03	10%		\$0.33	\$0.03	10%	\$ 0.30	
Diluted shares outstanding	500	0%	502	0%	(1)	0%					500	

*\$0.01 per share equates to approximately \$7.0M pretax

Margin Analysis	Actual		MS Estimate		Variation (b.p.)		CONS.			Actual
	1Q:13A		1Q:13E		vs. MS est.	vs. 1Q:12A	1Q:13E	Variation (b.p.)		1Q:12A
COGS	36.5%		36.0%		51	(54)				37.1%
Gross margin	63.5%		64.0%		(51)	54	64.0%	(53)	-1%	62.9%
SG&A	29.5%		31.4%		(184)	(207)				31.6%
R&D	8.3%		8.9%		(65)	(62)				8.9%
Operating margin	25.3%		23.3%		197	325	24.8%	50	2%	22.1%
Pretax margin	23.1%		21.4%		176	124	22.4%	67	3%	21.9%
Net margin	16.4%		15.2%		125	190	15.7%	68	4%	14.5%

Source: Company Data, Thomson Reuters, Morgan Stanley Research

April 30, 2013

Zoetis Inc.

Exhibit 2

Zoetis 1Q:13 Revenue Variation (annual)

(\$M)	Actual		MS Estimate		Variation vs. MS Est.		CONS. est.	Variation vs. Cons.		Actual
	1Q:13A	YOY % Chg.	1Q:13E	YOY % Chg.	Absolute	Pct	1Q:13E	Absolute	Pct	1Q:12A
United States (U.S.)	454	7%	417	-2%	37	9%				425
Base revenue	454	7%	417	1%	37	9%				412
Acquisitions	-	-100%	-	-100%	-	*				14
Europe/Africa/Middle East (EuAfME)	290	5%	278	1%	12	4%				275
Base revenue	286	4%	278	0%	8	3%				277
Fx impact	4	1%	-	N.M.	4	*				(10)
Acquisitions		-100%	-	-100%	-	*				8
Canada/Latin America (CLAR)	171	-1%	190	10%	(19)	-10%				173
Base revenue	179	4%	190	10%	(10)	-5%				172
Fx impact	(8)	-5%	-	N.M.	(8)	*				(6)
Acquisitions		-100%	-	-100%	-	*				7
Asia Pacific (APAC)	175	1%	191	10%	(16)	-8%				174
Base revenue	177	2%	191	17%	(14)	-7%				164
Fx impact	(2)	-1%	-	-100%	(2)	*				2
Acquisitions		-100%	-	-100%	-	*				8
Total Revenue	1,090	4%	1,076	3%	14	1%				1,047

Source: Company Data, Morgan Stanley Research

Exhibit 3

Zoetis 1Q:13 Income Statement Variation (sequential)

(\$M)	Reported	Sequential Growth		Actual
	1Q:13A	Dollar	% Chg.	4Q:12A
Net revenues	1,090	(86)	-7%	1,176
COGS	398	(29)	-7%	427
Gross profit	692	(57)	-8%	749
SG&A	322	(119)	-27%	441
R&D	90	(31)	-26%	121
Amortization of intangibles	4	-	0%	4
Operating income	276	93	50%	183
Other expenses/(income)	24	14	140%	10
Interest expense	22	14	175%	8
Other expense (income)	2	-	0%	2
Pretax income	252	79	45%	173
Taxes	73	(44)	-38%	117
Tax Rate	29.0%	(0)	-57%	67.5%
Income attributable to non-controlling interest	-	-	*	-
Net income (Non-GAAP)	179	123	217%	56

DILUTED EPS, proforma	\$	0.36	\$0.25	217%	\$	0.11
Diluted shares outstanding		500	0	0%		500

Margin Analysis	Reported	Variation	Actual
	1Q:13A	b.p. difference	4Q:12A
COGS	36.5%	22	36.3%
Gross margin	63.5%	-22	63.7%
SG&A	29.5%	-795	37.5%
R&D	8.3%	-203	10.3%
Operating margin	25.3%	973	15.6%
Pretax margin	23.1%	838	14.7%
Net margin	16.4%	1163	4.8%

Source: Company Data, Morgan Stanley Research

Exhibit 4

Zoetis 1Q:13 Revenue Variation (sequential)

(\$M)	Reported	Sequential Growth		Actual
	1Q:13A	Dollar	% Chg.	4Q:12A
United States (U.S.)	454	(29)	-6%	483
Base revenue	454	(29)	-6%	483
Acquisitions	-	-	*	-
Europe/Africa/Middle East (EuAfME)	290	(7)	-2%	297
Base revenue	286	(25)	-4%	311
Fx impact	4	18	N.M.	(14)
Acquisitions	-	-	*	-
Canada/Latin America (CLAR)	171	(49)	-22%	220
Base revenue	179	(54)	-18%	233
Fx impact	(8)	5	N.M.	(13)
Acquisitions	-	-	*	-
Asia Pacific (APAC)	175	(2)	-1%	177
Base revenue	177	1	0%	177
Fx impact	(2)	(3)	-457%	1
Acquisitions	-	-	*	-
Total Revenue	1,090	(86)	-7%	1,176

Source: Company Data, Morgan Stanley Research

Exhibit 5

2013 Mgmt. Guidance

(\$M)	ZTS	MS	Variation (ZTS-MS)	Var % (ZTS/MS)	Cons'	Variation (ZTS-Cons')	Var % (ZTS/Cons')
Total revenue	\$4,425-\$4,525						
Revenue Midpoint	4,475	4,545	(70)	-2%	4,529	(54)	-1%
COGS (% of sales)	35-36%						
Midpoint	35.5%	35.1%	40 bps	1%	35.5%	2 bps	0%
SG&A	\$1,385-\$1,435						
Midpoint	1,410	1,449	(39)	-3%			
R&D	\$385-\$415						
Midpoint	400	398	2	1%			
Interest expense	~115M						
Midpoint	115	117	(2)	-2%			
Other (income)/expenses	~(20M)						
Midpoint	(20)	(32)	12	-38%			
Non-GAAP tax rate	~29.5%						
Midpoint	29.5%	29.0%	50 bps	2%			
Adjusted Cash EPS	\$1.36-\$1.42						
Midpoint	\$1.39	\$1.42	-\$0.03	-2%	\$1.38	\$0.01	1%

Source: Company Data, Thomson Reuters, Morgan Stanley Research

April 30, 2013

Zoetis Inc.



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(as of March 31, 2013)

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April 30, 2013

Zoetis Inc.

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1031	36%	402	39%	39%
Equal-weight/Hold	1250	44%	480	47%	38%
Not-Rated/Hold	105	4%	27	3%	26%
Underweight/Sell	467	16%	113	11%	24%
Total	2,853		1022		

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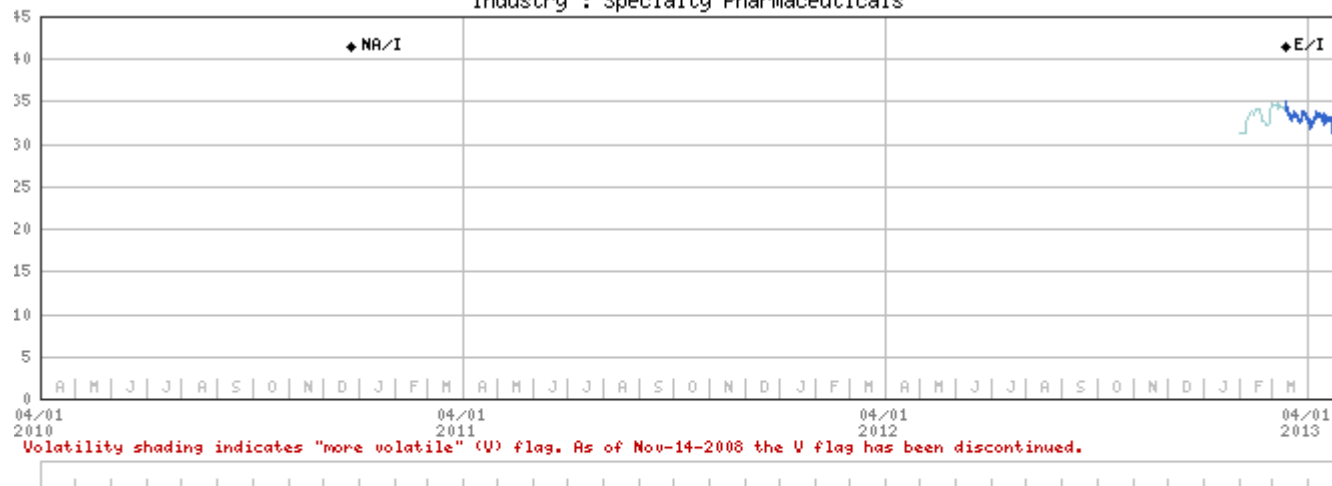
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Stock Price, Price Target and Rating History (See Rating Definitions)

April 30, 2013

Zoetis Inc.

Zoetis Inc. (ZTS.N) - As of 4/29/13 in USD
Industry : Specialty Pharmaceuticals



Stock Rating History: 12/26/10 : NA/I; 3/13/13 : E/I

Price Target History: 3/13/13 : NA

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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April 30, 2013

Zoetis Inc.

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Industry Coverage: Specialty Pharmaceuticals

Company (Ticker)	Rating (as of)	Price* (04/29/2013)
David Risinger		
Actavis Inc (ACT.N)	O (01/25/2012)	\$105.58
Alkermes Plc. (ALKS.O)	O (01/10/2013)	\$31.16
Allergan Inc. (AGN.N)	O (09/07/2010)	\$113.68
Forest Laboratories Inc. (FRX.N)	E (04/26/2011)	\$37.21
Mylan Inc. (MYL.O)	E (03/01/2013)	\$29.01
Perrigo Co. (PRGO.O)	O (02/04/2013)	\$120.08
Teva Pharmaceutical Industries Ltd. (TEVA.N)	E (02/06/2012)	\$38.74
Valeant Pharmaceuticals International (VRX.N)	E (09/14/2012)	\$75.94
Warner Chilcott Plc (WCRX.O)	U (08/21/2012)	\$13.99
Zoetis Inc. (ZTS.N)	E (03/13/2013)	\$32.66
Marshall Urist, M.D., Ph.D.		
Hospira (HSP.N)	E (07/16/2009)	\$33.42
Sagent Pharmaceuticals Inc (SGNT.O)	E (08/13/2012)	\$17.04

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* Historical prices are not split adjusted.