

Zoetis

(ZTS-NYSE)

Stock Rating: Outperform
Industry Rating: Market Perform

After a Worrisome 2Q, We Remain Opportunistic Buyers

Event

This morning, Zoetis reported 2Q13 revenues of \$1.114Bn, 1.4% below consensus and 1.8% below our forecast. However, lower SG&A and slightly lower R&D allowed Zoetis to meet non-GAAP EPS consensus of \$0.36. Zoetis also re-affirmed its 2013 guidance. [Please click here for our AM flash.](#)

Impact

Positive. The 4% operational revenue growth in 2Q is Ok given all the headwinds Zoetis was facing this quarter: 2H12 drought impact, ongoing weakness in Europe, unusually cold spring slowing parasite/tick product sales, and Novartis' aggressive re-launch of Sentinel. Management's confident re-affirmation of guidance was important, particularly since it was partly based on a recovery in the livestock business and the drought impact.

Forecasts

We expect Zoetis to meet its 2013 guidance, albeit, we're on the low-end of the range. Our 10-year revenue forecast implies a CAGR of 4.4%, in line with 2Q13 operational growth. Our 2013-2016 forecasts are modestly below consensus, which is very bullish, in our view; we expect consensus to moderate.

Valuation

Our price target is \$36 based on DCF assuming 2.5% terminal growth rate and 8.3% discount rate, supported by 22-23x our non-GAAP 2014-2016 EPS estimates.

Recommendation

We're probably seeing some ongoing turnover in the ZTS shareholder base as near-term investors exit with ~7%-8% gains post Pfizer split in late June and longer term investors enter after a worrisome 2Q. Although longer-term estimates will likely come down, we think the stock still works with 4%-5% revenue growth and margin expansion. We remain longer-term opportunistic buyers.

August 6, 2013

Pharmaceuticals

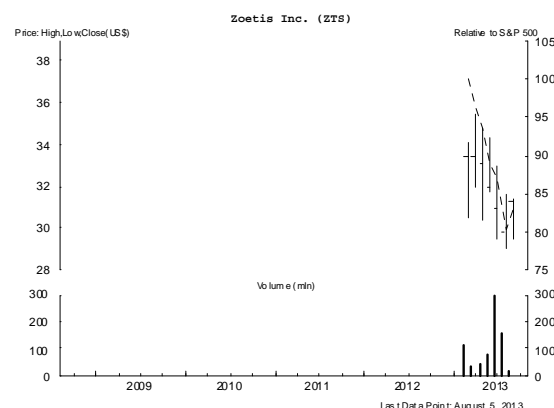
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Securities Info

Price (5-Aug)	\$31.25	Target Price	\$36
52-Wk High/Low	\$35/\$29	Dividend	\$0.26
Mkt Cap (mm)	\$15,625	Yield	0.8%
Shs O/S (mm, BASIC)	500.0	Float O/S (mm)	99.0
Options O/S (mm)	na	ADVol (30-day, 000s)	10,617

Price Performance



Valuation/Financial Data

(FY-Dec.)	2011A	2012A	2013E	2014E
EPS Pro Forma	\$1.01	\$1.08	\$1.37	\$1.54↓
P/E			22.8x	20.3x
First Call Cons.			\$1.40	\$1.61
EPS GAAP	\$0.49	\$0.87	\$1.05	\$1.39
FCF	\$0.72	\$0.66	\$1.46↓	\$1.42↑
P/FCF			21.4x	22.0x
EBITDA (\$mm)	\$943	\$1,142	\$1,216	\$1,402
EV/EBITDA			15.6x	13.5x
Rev. (\$mm)	\$4,233	\$4,336	\$4,459	\$4,661
EV/Rev			4.3x	4.1x
Quarterly EPS	1Q	2Q	3Q	4Q
2012A	\$0.30	\$0.35	\$0.31	\$0.11
2013E	\$0.36A	\$0.36A	\$0.33	\$0.33↑
Balance Sheet Data (31-Mar)				
Net Debt (\$mm)	\$3,333		Total Debt/EBITDA	3.0x
Total Debt (\$mm)	\$3,650		EBITDA/IntExp	11.3x
Net Debt/Cap.	76.5%		Price/Book	22.0x

Notes: All values in US\$.

Source: BMO Capital Markets estimates, Bloomberg, Thomson Reuters, and IHS Global Insight.

Changes

Annual EPS
 2014E \$1.55 to \$1.54

Annual FCF
 2013E \$1.48 to \$1.46
 2014E \$1.41 to \$1.42

Quarterly EPS
 Q4/13E \$0.32 to \$0.33

Exhibit 1. ZTS 2Q13 Overview: 1.5% Top-Line Miss Driven by Weaker EuAfME Segment, But Offset by Lower SG&A as EPS Meets Consensus and Our Forecast

	Q2'13					Q2'12	Y/Y Change	Comments:
	Consensus	BMO	Actual	Actual vs. Consensus	Actual vs. BMO			
Revenues	\$1,130	\$1,134	\$1,114	-1.4%	-1.8%	\$1,094	2%	Operational growth was 4%. The miss was primarily driven by weakness in EuAfME segment, which only grew 1% operationally.
Gross Profit	\$727	\$741	\$714	-1.7%	-3.7%	\$712	0%	50bp improvement over 1Q, making gradual improvement to get to 35-36% COGS/Rev guidance; we're in-line.
Gross Margin	64.3%	65.4%	64.1%	-0.2%	-1.3%	65.1%	-1%	
SG&A	\$347	\$363	\$339	-2.3%	-6.6%	\$351	-3%	Lower compensation as % of revenue; lower spending e.g. less advertising because of weaker parasite season. Expect same seasonality in 3Q except for some anomalies in 4Q12.
Research & Development	\$95	\$96	\$91	-4.3%	-5.5%	\$91	0%	We're on the lower end of guidance.
Operating Profit	\$280	\$282	\$284	1.3%	0.6%	\$270	5%	Lower revenues offset by lower SG&A.
Taxes	\$73	\$73	\$74	2.0%	1.4%	\$90	-18%	In-line
Effective Tax Rate	29.0%	29.0%	29.4%	0.4%	0.4%	34.0%	-5%	
Net Income	\$178	\$178	\$178	0.2%	0.2%	\$176	1%	In-line as lower revenues were offset primarily by lower SG&A and lower R&D.
EPS	\$0.36	\$0.36	\$0.36	0.0%	1.3%	\$0.35	3%	

Sources: Zoetis, Bloomberg Finance LP, BMO Capital Markets Pharmaceuticals Research

Please see Exhibit 2 below for more in-depth discussion of revenue dynamics.

Exhibit 2. Zoetis 2Q13 Revenue Analysis: 4% Operational Revenue Growth Is Ok Given All the Headwinds Zoetis Was Facing this Quarter: 2H12 Drought Impact, Ongoing Weakness in Europe, Unusually Cold Spring, and Novartis' Aggressive Re-Launch of Sentinel

	Q2'13			Q2'12	Y/Y Change	Comments:
	BMO	Actual	Actual vs. BMO			
Revenues	\$1,134	\$1,114	-2%	\$1,094	2%	Operational growth was 4%. The miss was primarily driven by weakness in EuAfME segment, which only grew 1% operationally: lower sales of cattle products resulting from cold weather conditions and overall economic weakness in Europe.
2Q13 Revenues by Segment:						
US	442	437	-1%	\$421	4%	Good momentum, driven by 6% growth in livestock: Cattle returned to growth because of price increases. Vol was flat because of drought, but that's getting better, should improve in 2H13. Swine and poultry growing well because of new products.
Total Ex-US	684	677	-1%	\$673	1%	Stronger sales from APAC offsetting continued weakness in EuAfME region.
EuAfME	288	278	-4%	\$283	-2%	Eu remains weak; long cold spring --> less anti-parasite use for livestock esp. cattle. Livestock down 2% operationally; but companion animal growing well, 6% operationally.
CLAR	218	213	-2%	\$211	1%	Livestock revenue grew 4% operationally, driven by swine and poultry products, while cattle products declined primarily in Brazil. Companion animal revenue grew 6% operationally driven by increased demand.
APAC	178	186	5%	\$179	4%	7% operational growth, livestock revenue grew 5% operationally driven primarily by higher demand and the continued acceptance of new swine products. Companion animal grew 13% operationally, due to the increased penetration of key brands and successful launch of new products; we see sig. more upside here.
2Q13 Revenues by Species:						
Livestock Revenues	678	670	-1%	\$665	1%	Operational growth of 3% driven by swine and poultry offsetting cattle. Expect 2H13 to be stronger because of recovery from 2012 drought.
Cattle	364	356	-2%	\$371	-4%	Recovering after the 2012 drought conditions. US vol flat, but growth because price. Remains weak in EUAfME.
Swine	151	152	1%	\$142	7%	Solid 9% operational growth across regions
Poultry	142	137	-3%	\$129	6%	Solid 9% operational growth across regions
Other	22	25	14%	\$23	9%	
Companion Animal	464	444	-4%	\$429	3%	5% operational growth offset by 2% Fx. US was weak, up only 2% y/y because of colder spring, and aggressive re-launch of Novartis' Sentinel.
Horses	47	45	-4%	\$50	-10%	Seeing a market slow down, less racing, may be a permanent trend. We're lowering our numbers.
Dogs and Cats	417	399	-4%	\$379	5%	Slower than we expected, but still good 7% operational growth despite launch of Novartis' Sentinel.

Sources: Zoetis, BMO Capital Markets Estimates

Exhibit 3. Importantly, Zoetis Confirmed its 2013 Guidance Partly Based on Confidence in Improving Livestock Business. We Remain on the Lower End of Guidance Range.

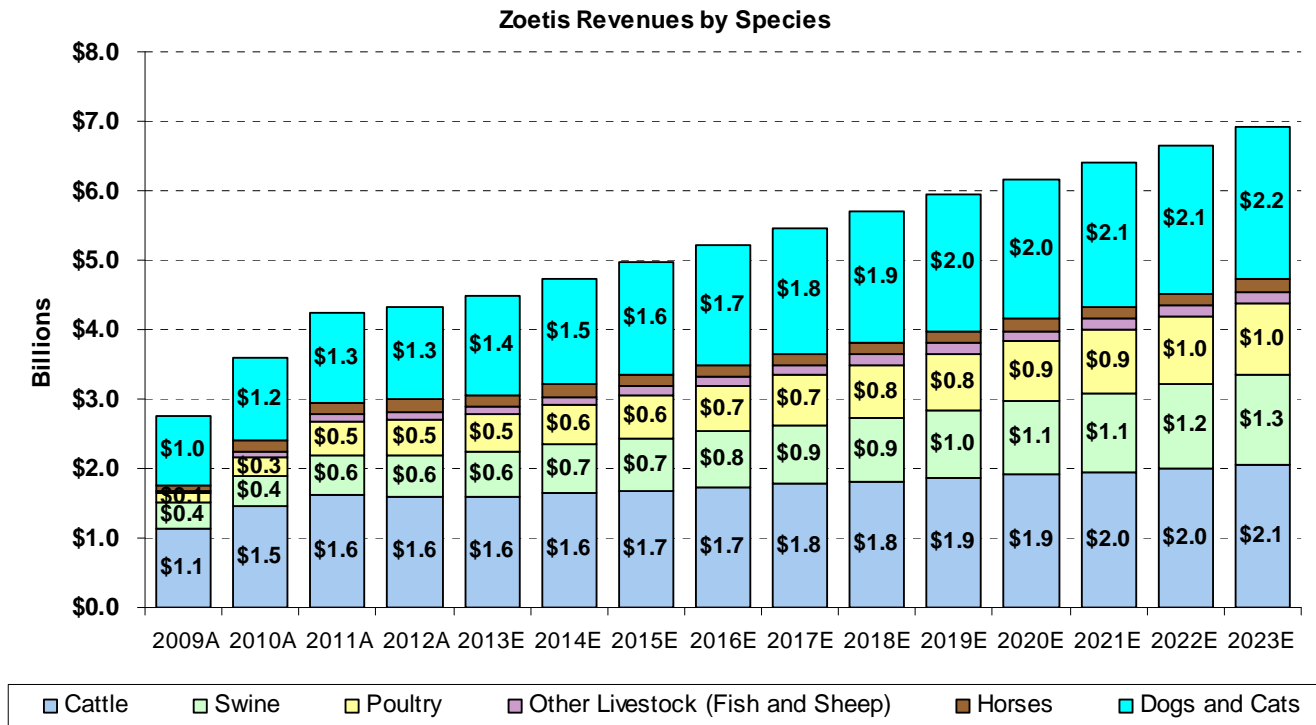
2013 Guidance & Date Provided	Apr. 30, 2013 (after 1Q 2013)	Aug. 06, 2013 (after 2Q 2013)	BMO	Street	Comments
Revenue	\$4,425 mn to \$4,525 mn	\$4,425 mn to \$4,525 mn	\$4,459 mn	\$4,512 mn	We're in the lower half.
Cost of Sales as % of Revenues	35.0% to 36.0%	35.0% to 36.0%	35.6%	35.5%	We're in-line; company is actively looking for manufacturing efficiencies.
SG&A Expenses	\$1,385 mn to \$1,435 mn	\$1,385 mn to \$1,435 mn	\$1,383 mn		Will increase throughout 2013, but at a slower rate than revenues. We're on the low end.
R&D Expenses	\$385 mn to \$415 mn	\$385 mn to \$415 mn	\$391 mn		We're in the lower half. Will increase slightly but at a slower rate than revenues.
Interest Expense	~\$115 mn	~\$115 mn	\$112 mn		We're in-line
Other (Income)/ Deductions	~(\$20 mn)	~(\$20 mn)	(\$13 mn)		
Effective Tax Rate	~29.5%	~29.5%	29.1%	29.6%	We're slightly below.
Adjusted Net Income	\$680 mn to \$710 mn	\$680 mn to \$710 mn	\$685 mn	\$700 mn	We're on the lower end.
Adjusted Diluted EPS	\$1.36 to \$1.42	\$1.36 to \$1.42	\$1.37	\$1.40	We're on the lower end of guidance, but believe it is achievable.

Source: Zoetis Reports, Thomson One, BMO Capital Markets Pharmaceuticals Research

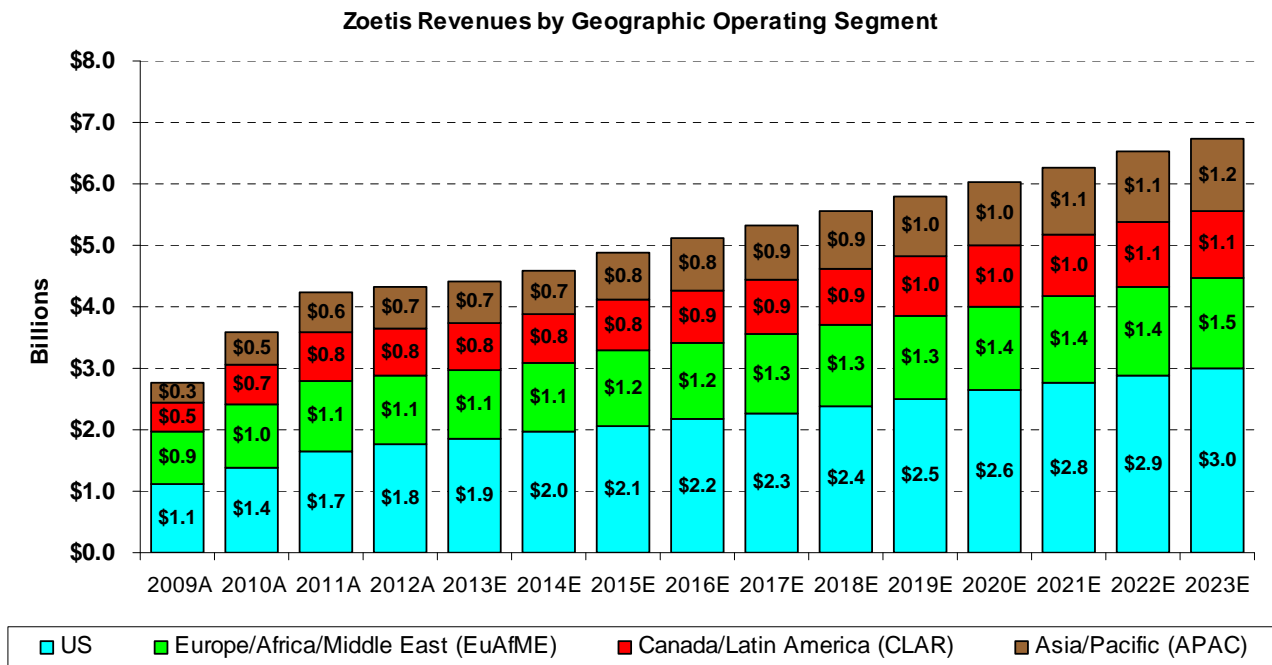
Exhibit 4. We Were More Cautious Than the Street Pre-2Q13, and Continue to Think Street Is Too Bullish. We Expect Consensus Estimates to Come Down Modestly.

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Street	BMO	Street	BMO	Street	BMO	Street	BMO
Revenue	\$4,506	\$4,459	\$4,771	\$4,661	\$5,041	\$4,932	\$5,313	\$5,165
Gross Margin	64.5%	64.4%	65.3%	64.7%	65.6%	65.0%	65.8%	65.3%
Operating Profit (EBIT)	\$1,104	\$1,097	\$1,263	\$1,211	\$1,405	\$1,350	\$1,524	\$1,482
Operating Margin	24%	25%	26%	26%	28%	27%	29%	29%
Pre-tax Profit	1,249	968	1,410	1,092	1,532	1,231	1,681	1,367
Effective Tax Rate	21%	29%	19%	29%	16%	29%	15%	29%
Net Income	\$993	\$685	\$1,148	\$771	\$1,288	\$870	\$1,422	\$967
Net Margin	22%	15%	24%	17%	26%	18%	27%	19%
EPS	\$1.40	\$1.37	\$1.61	\$1.54	\$1.81	\$1.74	\$2.01	\$1.94
Free Cash Flow per Share	\$1.47	\$1.46	\$1.55	\$1.42	\$1.59	\$1.59	\$1.90	\$1.89
Dividend per share	\$0.26	\$0.26	\$0.32	\$0.33	\$0.37	\$0.39	\$0.54	\$0.47
Dividend Payout Ratio	19%	19%	20%	21%	20%	22%	27%	24%

Source: Zoetis, Thomson One, BMO Capital Markets Pharmaceuticals Research

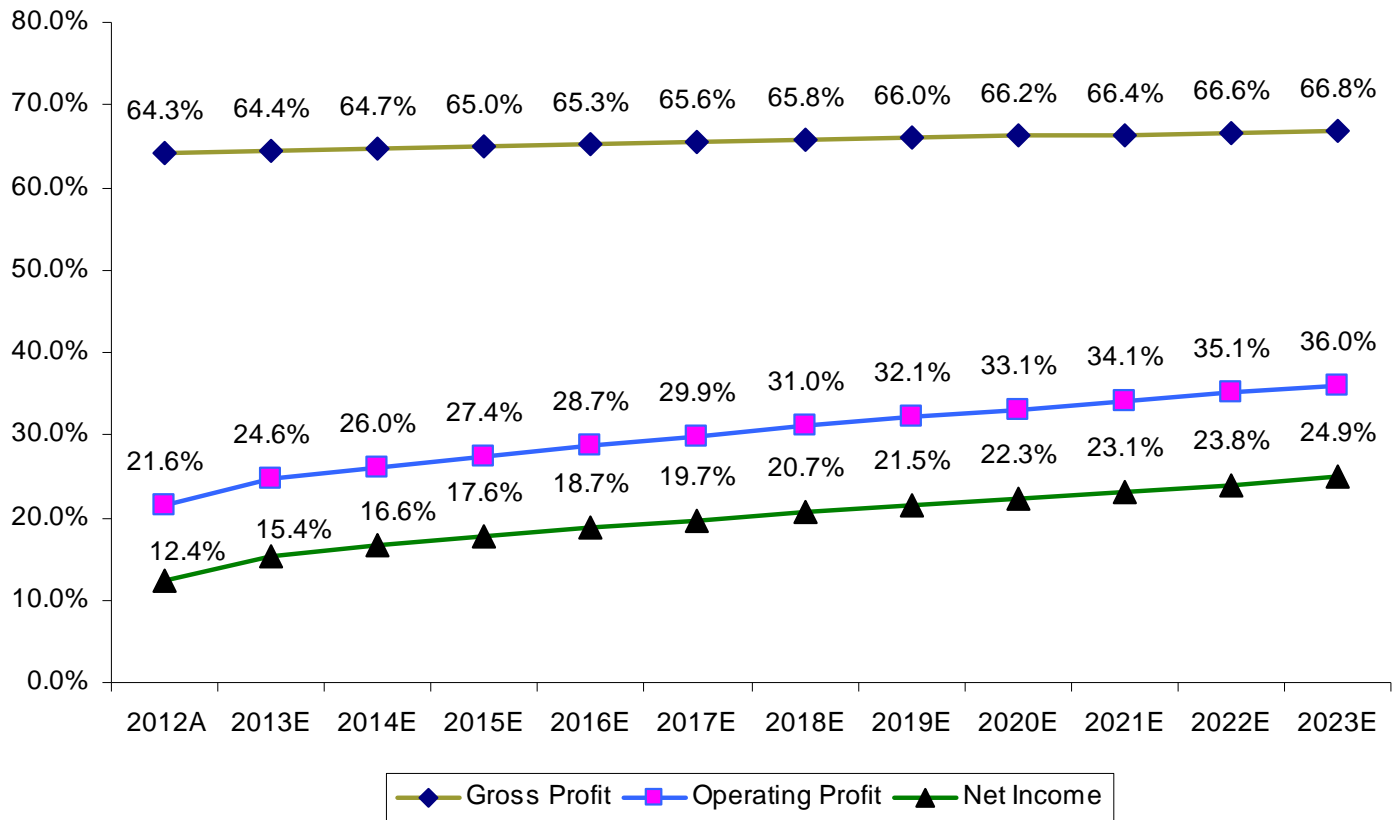
Exhibit 5. Our Zoetis Revenue Forecast by Species: 10-year CAGR of 4.4%; in Line With 2Q13 Operational Growth

Source: Zoetis, BMO Capital Markets.

Exhibit 6. Our Zoetis Revenue Forecast by Geo-Segment: 10-year CAGR of 4.3%; in Line With 2Q13 Operational Growth
(NOTE: Our model uses the average of our revenue forecast by species and geographic segment)

Source: Zoetis, BMO Capital Markets.

Exhibit 7. We Expect Zoetis' Margins to Improve Overtime, Driven by Product Mix and Improved Operational Efficiency as SG&A and R&D Grow at a Slower Rate Than Revenues



Source: Zoetis, BMO Capital Markets.

Our Zoetis Valuation

We value ZTS shares using a DCF model and support it by using P/E multiple. In our DCF, we assume a 2.5% terminal growth rate because of the sustainability of the business, and as such our terminal value accounts for nearly 60% of the firm value. On a relative basis, applying a 22-23 PE multiple, which is on the top range of that seen with other roughly similar companies, to our new 2014-2016E non-GAAP EPS estimates produces an average valuation of \$36, in line with our DCF valuation.

Exhibit 8. Our \$36/share Valuation of ZTS Shares Is Based on DCF and P/E Multiple

FCFF Valuation, \$MM		2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	>2023E
Cash flow from operations		567	835	919	1,063	1,143	1,265	1,374	1,480	1,588	1,697	1,872	1,919
Y/Y Growth			-2%	10%	16%	8%	11%	9%	8%	7%	7%	10%	2.5%
CAPEX		(96)	(126)	(123)	(120)	(125)	(128)	(130)	(128)	(129)	(135)	(130)	(132)
Interest Expense (1-t)		64	83	83	80	80	70	70	70	70	70	41	41
Free Cash Flow to the Firm (FCFF)		535	792	878	1,023	1,097	1,207	1,313	1,421	1,528	1,632	1,784	1,828
Y/Y Growth			48%	11%	16%	7%	10%	9%	8%	8%	7%	9%	2%
Discount Period		0.3	1.3	2.3	3.3	4.3	5.3	6.3	7.3	8.3	9.3	10.3	11.3
Discount Rate	8.3%												
Discounted FCFF		524	717	734	789	782	794	798	797	792	780	788	
PV of FCFE (2013-2023)	Total, \$MM	8,295											
Terminal Value at 2023		31,515											
PV of Terminal Value		12,851											
Cash & Equivalents		468											
Total Debt		3,646											
Funding obligation for pension & post retirement benefit plans		52											
Total Equity Value		17,916											
Minority Interest		(15)											
Total Zoetis Stockholders' Equity Value		17,901											
Diluted shares, MM		500											
Equity value per current PFE share		\$36											

PE Multiple Valuation Using Non-GAAP EPS							2013-16 EPS CAGR
		2012A	2013E	2014E	2015E	2016E	
	EPS	\$1.08	\$1.37	\$1.54	\$1.74	\$1.94	12.2%
	20	\$22	\$27	\$31	\$32	\$33	
	21	\$23	\$29	\$32	\$34	\$35	
PEx	22	\$24	\$30	\$34	\$35	\$36	
	23	\$25	\$31	\$35	\$37	\$38	
	24	\$26	\$33	\$37	\$39	\$40	
Discount Period			0	1	2		
Discount rate	8.3%						
Average	\$36						

Sources: Pfizer Reports, Zoetis, BMO Capital Markets Pharmaceuticals Research

Zoetis Non-GAAP Income Statement: Our Quarterly Estimates

Non-GAAP Income Statement, \$MM	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014
Revenues	1,047	1,094	1,019	1,176	1,090	1,114	1,051	1,204	1,120	1,154	1,108	1,279
Cost of Sales	388	382	352	427	398	400	359	431	406	411	375	454
Gross Profit	659	712	667	749	692	714	692	773	714	743	733	825
Selling, Informational and Administrative Expenses	331	351	330	440	322	339	331	391	323	342	339	400
R&D Expenses	93	91	94	121	90	91	95	115	91	93	97	119
Operating Profit	235	270	243	188	280	284	267	266	300	308	297	306
Amortization of Intangible Assets	4	3	4	4	4	3	11	12	7	7	7	7
EBIT	231	267	239	184	276	281	256	255	293	302	290	299
Other (Income) / Deductions -- Net	2	2	(4)	10	24	29	23	23	23	23	23	23
Income From Cont. Operations Before Provision for Taxes	229	265	243	174	252	252	233	231	270	279	267	276
(Benefit) / Provision for Taxes on Income	76	90	89	117	73	74	68	67	78	81	77	80
Net income/(loss) before allocation to non-controlling interests	153	175	154	57	179	178	165	164	192	198	190	196
Less: Income / (Loss) Attributable to Non-Controlling Interests	1	(1)		0	0	0	1	1	1	1	1	1
Net Income/ (loss) Attributable to Zoetis	152	176	154	57	179	178	164	163	191	197	189	195
Earnings Per Share - Basic	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.36	\$0.33	\$0.33	\$0.38	\$0.39	\$0.38	\$0.39
Earnings Per Share - Diluted	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.36	\$0.33	\$0.33	\$0.38	\$0.39	\$0.38	\$0.39
Weighted-Average Shares - Basic	500	500	500	500	500	500	500	500	500	500	500	500
Weighted-Average Shares - Diluted	500	500	500	500	500	500	500	500	500	500	500	500
Dividend per Share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.07	\$0.07	\$0.07	\$0.07	\$0.08	\$0.08	\$0.08	\$0.08

	2012E				2013E				2014E			
	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014
Growth Rates												
Revenue growth (YOY)	7%	2%	-3%	4%	4%	2%	3%	2%	3%	4%	5%	6%
Gross Profit	7%	10%	1%	2%	5%	0%	4%	3%	3%	4%	6%	7%
Operating Income (EBIT)	31%	46%	5%	-6%	19%	5%	7%	38%	6%	7%	13%	17%
Net Income	26%	54%	5%	-54%	18%	1%	7%	187%	7%	11%	15%	19%
EPS- Diluted	26%	54%	5%	-63%	2%	16%	7%	186%	7%	11%	15%	19%
Dividend									25%	25%	25%	25%
Margins												
Gross Profit	62.9%	65.1%	65.5%	63.7%	63.5%	64.1%	65.9%	64.2%	63.8%	64.4%	66.2%	64.5%
Operating Profit	22%	25%	24%	16%	26%	25%	25%	22%	27%	27%	27%	24%
Net Income	15%	16%	15%	5%	16%	16%	16%	14%	17%	17%	17%	15%
Return Analysis												
Payout Ratio					18%	18%	20%	20%	21%	21%	22%	21%

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Zoetis Non-GAAP Income Statement: Our Annual Estimates

Non-GAAP Income Statement, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Revenues	\$4,336	\$4,459	\$4,661	\$4,932	\$5,165	\$5,397	\$5,628	\$5,867	\$6,106	\$6,343	\$6,588	\$6,834
Cost of Sales	1,549	1,588	1,646	1,727	1,793	1,857	1,925	1,995	2,064	2,132	2,201	2,269
Gross Profit	2,787	2,871	3,015	3,205	3,373	3,540	3,703	3,872	4,041	4,211	4,387	4,564
SG&A	1,452	1,383	1,404	1,444	1,469	1,495	1,516	1,538	1,559	1,578	1,598	1,616
R&D	399	391	400	412	422	431	440	450	459	468	477	486
Operating Profit	936	1,097	1,211	1,350	1,482	1,614	1,746	1,884	2,024	2,165	2,312	2,462
Amortization of Intangible Assets	15	29	26	26	26	26	26	26	26	26	26	26
Restructuring Charges & Certain Acquisition-Related Costs	0	0	0	0	0	0	0	0	0	0	0	0
Other (Income) / Deductions -- Net	10	99	93	93	88	88	75	74	74	74	74	34
Income From Cont. Operations Before Provision for Taxes	911	968	1,092	1,231	1,367	1,500	1,645	1,784	1,924	2,065	2,212	2,403
(Benefit) / Provision for Taxes on Income	372	282	317	357	397	435	477	517	558	599	642	697
Effective Tax Rate	40.8%	29.1%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%
Net income/(loss) before allocation to non-controlling interests	539	687	775	874	971	1,065	1,168	1,267	1,366	1,466	1,571	1,706
Gain / (Loss) Attributable to Non-Controlling Interests	0	2	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$539	\$685	\$771	\$870	\$967	\$1,061	\$1,164	\$1,263	\$1,362	\$1,462	\$1,567	\$1,702
Earnings Per Share - Basic	\$1.08	\$1.37	\$1.54	\$1.74	\$1.94	\$2.14	\$2.35	\$2.56	\$2.77	\$2.99	\$3.22	\$3.52
Earnings Per Share - Diluted	\$1.08	\$1.37	\$1.54	\$1.74	\$1.94	\$2.13	\$2.34	\$2.55	\$2.76	\$2.97	\$3.21	\$3.51
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	494	491	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	500	499	498	496	494	492	489	486
Cash Dividend Paid per Share		\$0.26	\$0.33	\$0.39	\$0.47	\$0.54	\$0.62	\$0.68	\$0.68	\$0.71	\$0.75	\$0.75

	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Growth Rates												
Revenue	2%	3%	5%	6%	5%	4%	4%	4%	4%	4%	4%	4%
Gross Profit	5%	3%	5%	6%	5%	5%	5%	5%	4%	4%	4%	4%
Operating Profit	17%	17%	10%	11%	10%	9%	8%	8%	7%	7%	7%	6%
Net Income	7%	27%	13%	13%	11%	10%	10%	8%	8%	7%	7%	9%
EPS	7%	27%	13%	13%	11%	10%	10%	9%	8%	8%	8%	9%
Dividend per share			25%	20%	20%	15%	15%	10%	0%	5%	5%	0%
Margins												
Gross Profit	64.3%	64.4%	64.7%	65.0%	65.3%	65.6%	65.8%	66.0%	66.2%	66.4%	66.6%	66.8%
Operating Profit	22%	25%	26%	27%	29%	30%	31%	32%	33%	34%	35%	36%
Net Income	12.4%	15.4%	16.6%	17.6%	18.7%	19.7%	20.7%	21.5%	22.3%	23.1%	23.8%	24.9%
Return Analysis												
Payout Ratio		19%	21%	22%	24%	25%	26%	27%	25%	24%	23%	21%

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Zoetis Income Statement: GAAP or Fully Reported Estimates

GAAP Income Statement, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Revenues	\$4,336	\$4,459	\$4,661	\$4,932	\$5,165	\$5,397	\$5,628	\$5,867	\$6,106	\$6,343	\$6,588	\$6,834
Cost of Sales	1,563	1,610	1,650	1,731	1,797	1,861	1,929	1,999	2,068	2,136	2,205	2,273
Gross Profit	2,773	2,849	3,011	3,201	3,369	3,536	3,699	3,868	4,037	4,207	4,383	4,560
SG&A	1,470	1,513	1,420	1,456	1,481	1,507	1,528	1,550	1,571	1,590	1,610	1,628
R&D Expenses	409	405	416	424	434	443	452	462	471	480	489	498
Amortization of Intangible Assets	64	63	66	66	66	66	66	66	66	66	66	66
Restructuring Charges & Certain Acquisition-Related Costs	135	29	32	24	24	24	24	24	24	24	24	24
Other (Income) / Deductions -- Net	(15)	95	93	93	88	88	75	74	74	74	74	34
Income Before Provision for Taxes	710	743	984	1,139	1,275	1,408	1,553	1,692	1,832	1,973	2,120	2,311
(Benefit) / Provision for Taxes on Income	274	217	285	330	370	408	450	491	531	572	615	670
Net income/(loss) before allocation to non-controlling interests	436	527	699	809	905	1,000	1,103	1,202	1,300	1,401	1,505	1,641
Gain / (Loss) Attributable to Non-Controlling Interests	0	2	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$436	\$525	\$695	\$805	\$901	\$996	\$1,099	\$1,198	\$1,296	\$1,397	\$1,501	\$1,637
Earnings Per Share - Basic	\$0.87	\$1.05	\$1.39	\$1.61	\$1.81	\$2.00	\$2.22	\$2.43	\$2.64	\$2.86	\$3.09	\$3.39
Earnings Per Share - Diluted	\$0.87	\$1.05	\$1.39	\$1.61	\$1.80	\$2.00	\$2.21	\$2.41	\$2.62	\$2.84	\$3.07	\$3.37
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	494	491	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	500	499	498	496	494	492	489	486
Cash Dividend per Share	\$0.00	\$0.26	\$0.33	\$0.39	\$0.47	\$0.54	\$0.62	\$0.68	\$0.68	\$0.71	\$0.75	\$0.75

Note: Includes revenues and expenses from acquisitions from the acquisition date

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Zoetis Balance Sheet

Zoetis Balance Sheet, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Assets												
Cash and cash equivalents	317	809	1,338	1,908	2,152	2,762	2,660	3,298	3,950	4,635	5,298	4,696
Accounts receivable, less allowance for doubtful accounts	900	785	807	877	917	958	998	1,040	1,082	1,124	1,167	1,210
Inventories	1,345	1,179	1,237	1,263	1,283	1,339	1,388	1,426	1,474	1,522	1,571	1,586
Current deferred tax assets	101	83	83	83	83	83	83	83	83	83	83	83
Receivable from Pfizer Inc		222	222	222	222	222	222	222	222	222	222	222
Other current assets	201	202	203	204	204	204	204	204	204	204	204	204
Total current assets	2,864	3,279	3,890	4,556	4,861	5,568	5,554	6,272	7,016	7,790	8,545	8,001
Property, plant and equipment, less accumulated depreciation	1,241	1,243	1,241	1,231	1,218	1,204	1,187	1,165	1,134	1,098	1,060	1,010
Identifiable intangible assets, less accumulated amortization	868	807	741	675	609	543	477	411	345	279	213	147
Goodwill	985	985	985	985	985	985	985	985	985	985	985	985
Non-current deferred tax assets	216	63	63	63	63	63	63	63	63	63	63	63
Other noncurrent assets	88	74	73	73	73	73	73	73	73	73	73	73
Total Assets	6,262	6,451	6,994	7,583	7,809	8,436	8,339	8,969	9,616	10,288	10,939	10,279
Liabilities and Equity												
Current portion of allocated long-term debt	73	0	0	0	0	0	0	0	0	0	0	0
Current portion of long-term debt	0	6	0	400	0	750	0	0	0	0	1,350	0
Accounts payable	319	235	238	206	187	183	184	178	184	190	196	202
Income taxes payable	30	39	40	40	40	40	40	40	40	40	40	40
Accrued compensation and related items	194	158	158	161	164	166	169	171	173	175	177	179
Payable to Pfizer Inc.	0	383	383	383	383	383	383	383	383	383	383	383
Other current liabilities	507	451	440	439	438	438	438	438	438	438	438	438
Total current liabilities	1,123	1,272	1,259	1,629	1,212	1,961	1,214	1,211	1,219	1,227	2,585	1,243
Allocated long-term debt	509	0	0	0	0	0	0	0	0	0	0	0
Long-term debt	0	3,640	3,640	3,240	3,240	2,490	2,490	2,490	2,490	2,490	1,140	1,140
Noncurrent deferred tax liabilities	323	325	324	324	324	324	324	324	324	324	324	324
Other taxes payable	159	98	92	92	92	92	92	92	92	92	92	92
Other noncurrent liabilities	107	110	109	109	109	109	109	109	109	109	109	109
Total Liabilities	2,221	5,444	5,424	5,394	4,977	4,975	4,228	4,225	4,233	4,241	4,249	2,907
Commitments and Contingencies												
Total Equity	4,041	1,007	1,569	2,189	2,832	3,462	4,111	4,744	5,383	6,047	6,689	7,372
Total liabilities and equity	6,262	6,451	6,994	7,583	7,809	8,436	8,339	8,969	9,616	10,288	10,939	10,279

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Zoetis Statement of Cash Flows

Zoetis Statement of Cash Flows, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Operating activities												
GAAP Net income/(loss) before allocation to non-controlling interests	436	527	699	809	905	1,000	1,103	1,202	1,300	1,401	1,505	1,641
Adjustments:												
Depreciation and amortization expense	200	190	193	200	199	205	212	218	225	232	238	245
Share-based compensation expense	28	38	37	37	37	37	37	37	37	37	37	37
Asset write-offs and impairments	10	3	0	0	0	0	0	0	0	0	0	0
Net gains on sales of assets	0	0	0	0	0	0	0	0	0	0	0	0
Deferred taxes	(74)	(5)	(1)	(0)	(0)	(0)	(0)	(0)	0	0	0	0
Other non-cash adjustments	3	1	0	0	0	0	0	0	0	0	0	0
Other changes in assets and liabilities, net of acquisitions and divestitures:	(149)	95	(93)	(126)	(78)	(98)	(86)	(83)	(83)	(81)	(84)	(50)
Net cash provided by operating activities	454	848	835	919	1,063	1,143	1,265	1,374	1,480	1,588	1,697	1,872
Investing Activities												
Purchases of property, plant and equipment	(126)	(118)	(126)	(123)	(120)	(125)	(128)	(130)	(128)	(129)	(135)	(130)
Net proceeds from sales of assets	3	0	0	0	0	0	0	0	0	0	0	0
Acquisitions, net of cash acquired	0	0	0	0	0	0	0	0	0	0	0	0
Other investing activities	(12)	0	0	0	0	0	0	0	0	0	0	0
Net cash used in investing activities	(135)	(118)	(126)	(123)	(120)	(125)	(128)	(130)	(128)	(129)	(135)	(130)
Financing activities												
Debt - Net issuance / payment	0	2,630	(6)	0	(400)	0	(750)	0	0	0	0	(1,350)
Cash dividends paid	(63)	(130)	(162)	(195)	(233)	(267)	(307)	(336)	(335)	(349)	(365)	(363)
Purchase of subsidiary shares from noncontrolling interests	0	0	0	0	0	0	0	0	0	0	0	0
Share repurchases	0	0	(11)	(31)	(67)	(140)	(183)	(270)	(364)	(425)	(535)	(632)
Net financing activities with Pfizer	(15)	(2,738)	0	0	0	0	0	0	0	0	0	0
Net cash provided by/(used in) financing activities	(78)	(238)	(180)	(225)	(700)	(407)	(1,240)	(606)	(698)	(774)	(900)	(2,344)
Effect of exchange-rate changes on cash and cash equivalents	(3)	0	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	238	492	529	570	243	611	(103)	638	653	685	662	(602)
Cash and cash equivalents, as of beginning of year	79	317	809	1,338	1,908	2,152	2,762	2,660	3,298	3,950	4,635	5,298
Cash and cash equivalents, as of end of year	317	809	1,338	1,908	2,152	2,762	2,660	3,298	3,950	4,635	5,298	4,696

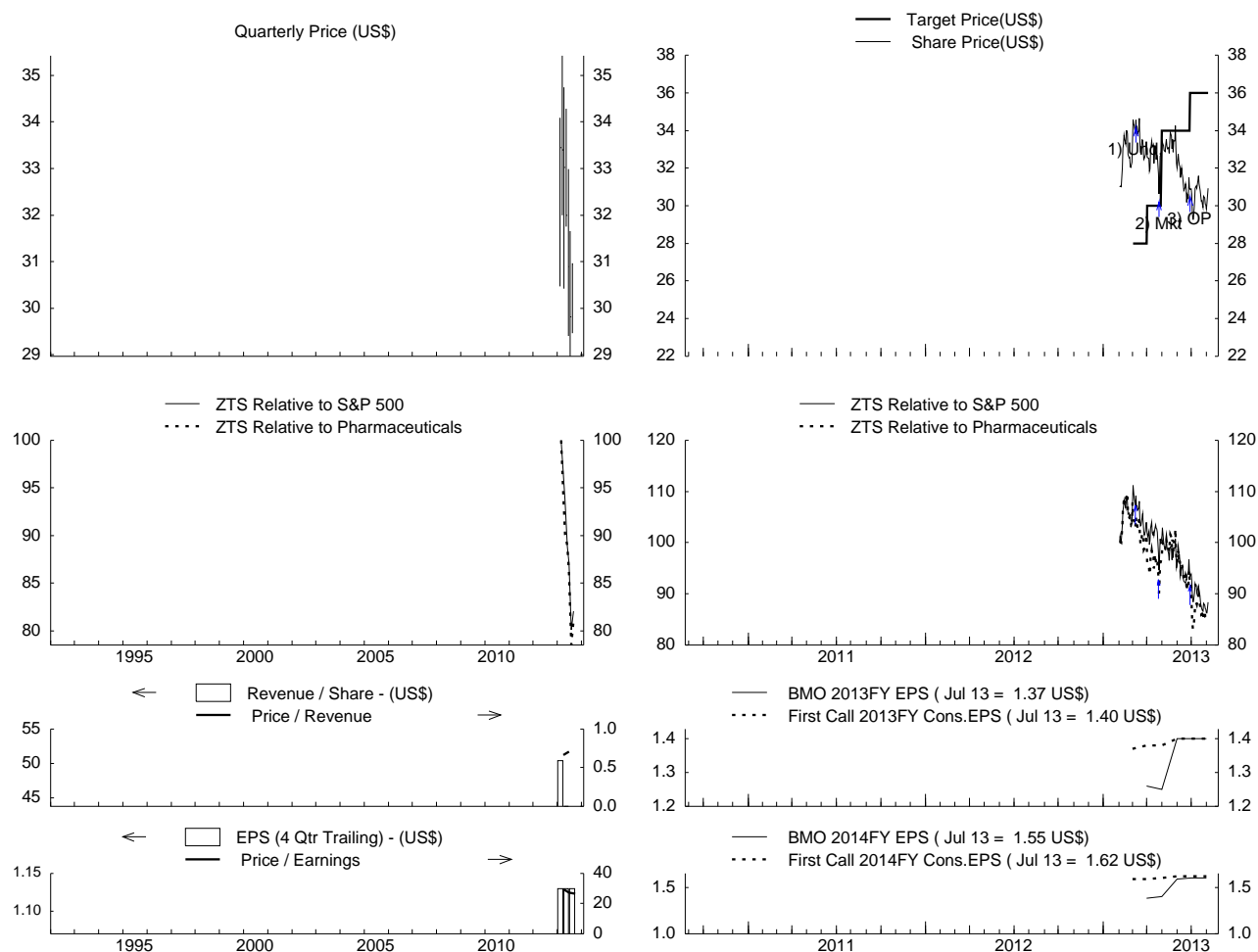
Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Other companies mentioned (priced as of the close on August 5, 2013):

Pfizer (PFE, \$29.19, Outperform)

Novartis ADR (NVS, \$72.48, Not Rated)

Zoetis Inc. (ZTS)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %	ZTS - Rating as of 1-Feb-13 = NR		
Range*:		na na		NC			>15 >15		Date	Rating Change	Share Price
Current*	1.13	26.4	0.26	0.9	23	1.4	21.0	>50	1 7-Mar-13	NR to Und.	\$34.56
									2 24-Apr-13	Und.to Mkt	\$30.62
									3 27-Jun-13	Mkt to OP	\$30.87

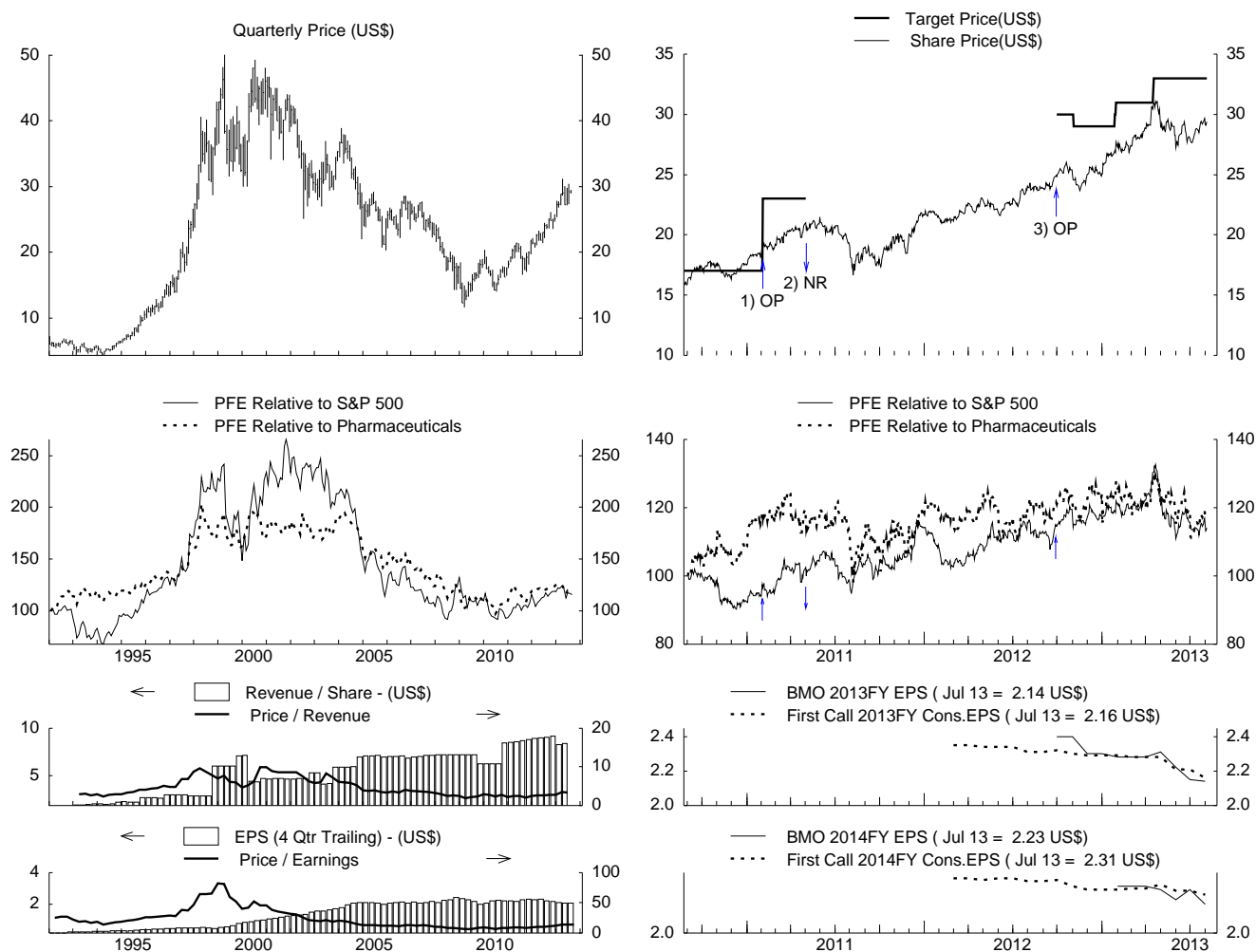
* Current EPS is the 4 Quarter Trailing to Q1/2013.

* Valuation metrics are based on high and low for the fiscal year.

* Range indicates the valuation range for the period presented above.

Last Price (August 2, 2013): \$30.94
Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

Pfizer Inc. (PFE)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %
1992	0.27	26.9 20.1	0.12	2.3 1.7	46	1.2	6.0 4.5	
1993	0.31	21.5 14.1	0.14	3.2 2.1	45	1.0	6.6 4.4	28
1994	0.35	18.9 12.6	0.16	3.5 2.4	45	1.1	5.8 3.9	33
1995	0.41	27.2 14.9	0.09	1.4 0.8	21	1.4	7.7 4.3	32
1996	0.50	30.4 19.4	0.20	2.1 1.3	40	1.8	8.5 5.4	31
1997	0.53	50.3 25.0	0.23	1.7 0.9	43	2.0	13.1 6.5	28
1998	0.51	84.3 45.5	0.29	1.3 0.7	58	2.3	>15 10.2	24
1999	0.82	61.0 38.5	0.36	1.1 0.7	44	2.3	>15 13.7	36
2000	1.02	48.3 29.4	0.44	1.5 0.9	43	2.6	>15 11.8	42
2001	1.27	37.8 26.8	0.52	1.5 1.1	41	2.9	>15 11.7	47
2002	1.53	28.7 16.4	0.60	2.4 1.4	39	3.2	13.6 7.8	50
2003	1.75	21.1 15.4	0.68	2.5 1.8	39	8.5	4.3 3.2	30
2004	2.12	18.3 10.4	0.76	3.5 2.0	36	9.1	4.3 2.4	24
2005	2.02	14.5 10.0	0.96	4.7 3.3	48	8.9	3.3 2.3	22
2006	2.08	13.8 9.7	1.16	5.7 4.1	56	10.0	2.9 2.0	22
2007	2.20	12.7 10.1	1.28	5.8 4.6	58	9.6	2.9 2.3	22
2008	2.43	10.1 5.9	1.28	9.0 5.2	53	8.5	2.9 1.7	27
2009	2.02	9.4 5.8	0.72	6.2 3.8	36	11.2	1.7 1.0	21
2010	2.22	9.2 6.3	0.80	5.7 3.9	36	11.0	1.9 1.3	20
2011	2.31	9.5 7.1	0.88	5.4 4.0	38	10.8	2.0 1.5	21
2012	2.19	11.9 9.0	0.96	4.9 3.7	44	11.1	2.4 1.8	20
Range*		84.3 5.8		9.0 0.7			>15 1.0	
Current*	2.07	14.1	0.96	3.3	46	11.6	2.5	18
Growth(%):								
5 Year:	-1.7		-5.6			3.8		
10 Year:	2.7		4.8			13.6		
20 Year:	10.3		10.1			12.5		

PFE - Rating as of 25-Aug-10 = Mkt

Date	Rating Change	Share Price
1 2-Feb-11	Mkt to OP	\$18.96
2 3-May-11	OP to NR	\$20.44
3 27-Sep-12	NR to OP	\$24.96

* Current EPS is the 4 Quarter Trailing to Q2/2013.

* Valuation metrics are based on high and low for the fiscal year.

* Range indicates the valuation range for the period presented above.

Last Price (August 2, 2013): \$29.37

Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

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Company Specific Disclosure for ZTS

Methodology and Risks to Our Price Target/Valuation

Methodology: DCF and P/E Multiple

Risks: Demand for animal health products could fluctuate and there are relatively low barriers to entry for competitors.

Company Specific Disclosures for PFE

9 - BMO Capital Markets makes a market in this security.

Methodology and Risks to Our Price Target/Valuation

Methodology: DCF: Free Cash Flow To Equity.

Risks: Uncertainty of Phase 3 Pipeline.

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Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	37.9%	17.6%	52.7%	39.6%	51.0%	53.2%
Hold	Market Perform	56.8%	10.2%	45.9%	53.9%	45.5%	41.1%
Sell	Underperform	5.3%	3.2%	1.4%	6.5%	3.5%	5.6%

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(S) = Speculative investment;

NR = No rating at this time; and

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