Deutsche Bank
Markets Research

Rating
**Buy**

North America
United States

Health Care
Pharmaceuticals / Specialty

Company
**Zoetis**

| Reuters | Bloomberg | Exchange | Ticker |
|---|---|---|---|
| ZTS.N | ZTS US | NYS | ZTS |

Date
13 March 2013

## Coverage Change

| | |
|---|---|
| Price at 12 Mar 2013 (USD) | 33.82 |
| Price target | 38.00 |
| 52-week range | 34.60 - 31.01 |

# Initiating with a Buy Rating and a $38 Price Target

David M Steinberg
Research Analyst
(+1) 415 617-3296
david.m.steinberg@db.com

Edward Y Chung
Research Associate
(+1) 415 617-3301
edward.y.chung@db.com

### Dominant Global Player In Animal Health; Core Holding

During its 60+ year operating history, Zoetis has established itself as the premier company in animal health – a $22 Billion worldwide market – focusing on products for livestock and companion animals. In recent years, Zoetis has become the #1 or #2 ranked participant in all geographies, species, and product categories. Moreover, Zoetis is broadly diversified. Its top 10 products represent just 38% of revenue. And post a series of acquisitions and internal investments, Zoetis is poised to reap the benefits of its global infrastructure and robust product portfolio. We consider Zoetis a core holding and initiate coverage with a Buy rating.

### Why is Animal Health a Very Good Business?

Strong brand loyalty amongst key customers (livestock producers, veterinarians), being a largely "cash pay" business outside the scope of 3rd party payors, having minimal impact from generic drug entrants, and benefitting from low risk R&D, and relatively quick regulatory approval times are just some of the characteristics of why animal health is a very good business. Moreover, customers are generally "price inelastic".

### Zoetis Positioned to Benefit from Two Long Term Secular Trends

Worldwide demand for animal protein products is expected to double in the next 40 years. And given natural resource constraints, higher efficiency livestock production will critical. Secondly, ownership and spending per companion animal continues to grow globally with no letup in sight. In both cases, there should be a sustained, increased need for medications to 1) maintain livestock health and 2) treat chronic conditions in pets.

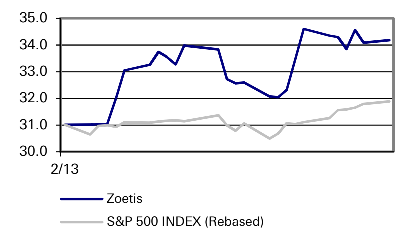
### Expect 5-6% Topline Growth and 13%+ EPS Growth

Excluding potential acquisitions, we project a mix of volume, price increases, and new introductions will yield sustainable and predictable mid-single digit revenue growth. In tandem with prospects from improved gross margin expansion, operating leverage, and a lower tax rate, we expect 13%+ EPS growth going forward.

### Valuation, Price Target, and Risks

While there are no ideal comparables, an assessment of several proxies (see page 17) leads us to conclude that Zoetis' premium valuation is warranted. Moreover, due to factors cited above, we believe that Zoetis will still grow predictably under most economic environments. What we don't know is how management will execute as a public, independent company. We are confident they will deliver. As such, we view this unique company as a long term holding. Our initial 12 month price target is $38 – 23.8x our 2014 EPS estimate – or 1.8x its PEG ratio (see details). Key risks are largely exogenous (food safety issues, major infectious disease outbreak, macroeconomic "shock," etc.).

Price/price relative




| Performance (%) | 1m | 3m | 12m |
|---|---|---|---|
| Absolute | 0.2 | – | – |
| S&P 500 INDEX | 2.2 | 8.7 | 13.2 |

Forecasts And Ratios

| Year End Dec 31 | 2012A | 2013E | 2014E |
|---|---|---|---|
| FY EPS (USD) | 1.47 | 1.37 | 1.60 |
| DPS (USD) | 0.00 | 0.26 | 0.27 |
| Revenue (USDm) | 4,302.0 | 4,510.0 | 4,775.3 |

*Source: Deutsche Bank estimates, company data*

Deutsche Bank Securities Inc.

Model updated:13 March 2013

## Running the numbers

North America

United States

Pharmaceuticals / Specialty

## Zoetis

| | |
|---|---|
| Reuters: ZTS.N | Bloomberg: ZTS US |

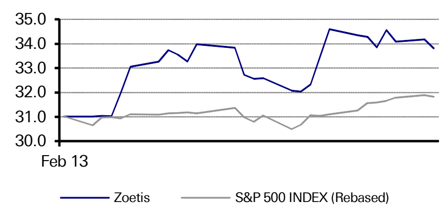
## Buy

| | |
|---|---|
| Price (12 Mar 13) | USD 33.82 |
| Target Price | USD 38.00 |
| 52 Week range | USD 31.01 - 34.60 |
| Market Cap (m) | USDm 16,925 |
| | EURm 12,987 |

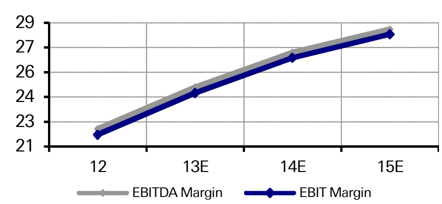
### Company Profile

Zoetis is the global leader in the development, manufacturing, and commercialization of veterinary medicines and vaccines. Headquartered in Madison, New Jersey, the company provides a wide range of products to livestock producers and veterinarians for the care of companion animals. Zoetis directly markets its products to customers in the US, Europe, Canada, the Asia Pacific, and emerging markets. Founded in 1952, the company was formerly the animal health subsidiary of Pfizer.

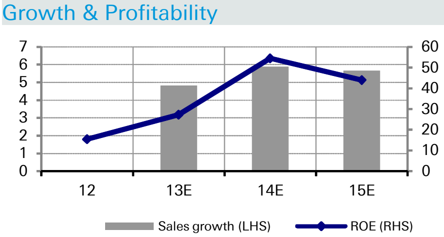
### Price Performance



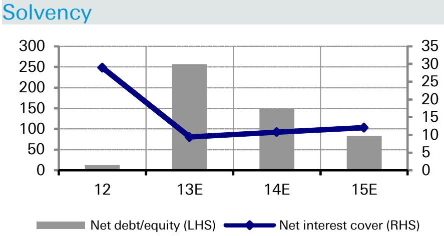

### Margin Trends




### Growth & Profitability




### Solvency




David Steinberg
+1 415 617-3296 david.m.steinberg@db.com

| Fiscal year end 31-Dec | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|
| **Financial Summary** | | | | |
| DB EPS (USD) | 1.47 | 1.37 | 1.60 | 1.80 |
| Reported EPS (USD) | 1.18 | 1.37 | 1.60 | 1.80 |
| DPS (USD) | 0.00 | 0.26 | 0.27 | 0.29 |
| BVPS (USD) | 7.72 | 2.44 | 3.51 | 4.76 |
| **Valuation Metrics** | | | | |
| Price/Sales (x) | nm | 3.8 | 3.6 | 3.4 |
| P/E (DB) (x) | na | 24.6 | 21.1 | 18.8 |
| P/E (Reported) (x) | na | 24.6 | 21.1 | 18.8 |
| P/BV (x) | 0.0 | 13.9 | 9.6 | 7.1 |
| FCF yield (%) | na | 3.3 | 3.8 | 4.5 |
| Dividend yield (%) | na | 0.8 | 0.8 | 0.9 |
| EV/Sales | nm | 4.4 | 4.1 | 3.8 |
| EV/EBITDA | nm | 18.1 | 15.4 | 13.4 |
| EV/EBIT | nm | 18.4 | 15.6 | 13.6 |
| **Income Statement (USDm)** | | | | |
| Sales | 4,302 | 4,510 | 4,775 | 5,046 |
| EBITDA | 949 | 1,109 | 1,275 | 1,418 |
| EBIT | 934 | 1,093 | 1,260 | 1,403 |
| Pre-tax profit | 902 | 977 | 1,143 | 1,286 |
| Net income | 595 | 693 | 812 | 913 |
| **Cash Flow (USDm)** | | | | |
| Cash flow from operations | 524 | 721 | 809 | 905 |
| Net Capex | -131 | -170 | -170 | -130 |
| Free cash flow | 393 | 551 | 639 | 775 |
| Equity raised/(bought back) | 0 | 0 | 0 | 0 |
| Dividends paid | -430 | -131 | -139 | -147 |
| Net inc/(dec) in borrowings | 0 | 3,650 | 0 | -92 |
| Other investing/financing cash flows | 54 | -3,650 | 0 | 0 |
| Net cash flow | 17 | 420 | 500 | 536 |
| *Change in working capital* | *-197* | *-50* | *-82* | *-91* |
| **Balance Sheet (USDm)** | | | | |
| Cash and cash equivalents | 96 | 515 | 1,016 | 1,552 |
| Property, plant & equipment | 1,333 | 1,387 | 1,440 | 1,454 |
| Goodwill | 981 | 981 | 981 | 981 |
| Other assets | 3,406 | 3,397 | 3,425 | 3,464 |
| Total assets | 5,815 | 6,280 | 6,862 | 7,451 |
| Debt | 580 | 3,650 | 3,650 | 3,558 |
| Other liabilities | 1,373 | 1,408 | 1,451 | 1,498 |
| Total liabilities | 1,953 | 5,058 | 5,101 | 5,056 |
| Total shareholders' equity | 3,862 | 1,221 | 1,761 | 2,395 |
| *Net debt* | *484* | *3,135* | *2,634* | *2,006* |
| **Key Company Metrics** | | | | |
| Sales growth (%) | nm | 4.8 | 5.9 | 5.7 |
| DB EPS growth (%) | na | -6.5 | 16.6 | 12.2 |
| Payout ratio (%) | 0.0 | 18.8 | 17.0 | 15.9 |
| EBITDA Margin (%) | 22.1 | 24.6 | 26.7 | 28.1 |
| EBIT Margin (%) | 21.7 | 24.2 | 26.4 | 27.8 |
| ROE (%) | 15.4 | 27.3 | 54.4 | 43.9 |
| Net debt/equity (%) | 12.5 | 256.7 | 149.6 | 83.8 |
| Net interest cover (x) | 29.0 | 9.4 | 10.8 | 12.0 |
| **DuPont Analysis** | | | | |
| EBIT margin (%) | 21.7 | 24.2 | 26.4 | 27.8 |
| x Asset turnover (x) | 0.7 | 0.7 | 0.7 | 0.7 |
| x Financial cost ratio (x) | 1.0 | 0.9 | 0.9 | 0.9 |
| x Tax and other effects (x) | 0.7 | 0.7 | 0.7 | 0.7 |
| = ROA (post tax) (%) | 10.2 | 11.5 | 12.4 | 12.8 |
| x Financial leverage (x) | 1.5 | 2.4 | 4.4 | 3.4 |
| = ROE (%) | 15.4 | 27.3 | 54.4 | 43.9 |
| *annual growth (%)* | *na* | *77.0* | *99.5* | *-19.2* |
| x NTA/share (avg) (x) | 7.7 | 5.0 | 2.9 | 4.1 |
| = Reported EPS | 1.18 | 1.37 | 1.60 | 1.80 |
| *annual growth (%)* | *na* | *16.4* | *16.6* | *12.2* |

*Source: Company data, Deutsche Bank estimates*

# Executive Summary

Zoetis is the largest "pure play" animal health company in the world, with a $4B+ revenue base. The company competes in the $22B animal health market, focusing on products for livestock (approximately 66% of corporate revenue) and companion animals (approximately 34% of corporate revenue). Importantly, the company is highly diversified by product, species, therapeutic area, and geography. In fact, Zoetis' largest product represents just 8% of sales and its top 10 products represent 38% of revenue (see section "**A Highly Diversified Revenue Base**").

Over its 60+ year history, the company has developed strong relationships with its key customers – large livestock producers and veterinarians/pet owners. Via these key relationships and innovative products, Zoetis has become the clear industry leader and is ranked #1 or #2 in all geographies, species, and product categories. And from 2004-2011, Zoetis received approximately 25% of all FDA approvals of animal health medicines and has had 59+ new products (including significant lifecycle management products) approved since 2006. Post separation from Pfizer, the company will continue to have access to Pfizer's proprietary compound library.

The company has built a strong track record of profitable revenue growth (24% CAGR from 2009-2011), which has been bolstered by acquisitions, and significant cash flow generation. Given strong execution, Zoetis has historically exceeded market growth. And excluding acquisitions, we believe the company should continue to post mid-single digit revenue growth (no worse than the market) and double-digit increases in earnings over the next few years.

## Company Overview

Zoetis is the world leader in the discovery, development, manufacturing, and commercialization of veterinary vaccines and medicines. While Zoetis was formed in July 2012, the business was previously a wholly-owned subsidiary of Pfizer and has been in existence since 1952. The company now has 9,000+ worldwide employees, with approximately 3,400 in direct sales operating in 70+ countries, and 1,000+ veterinary R&D scientists – headquartered in Kalamazoo, MI, with satellite facilities around the world. Prior to separation, Zoetis was Pfizer's animal health division, but product development has been functionally independent from Pfizer since 2003.

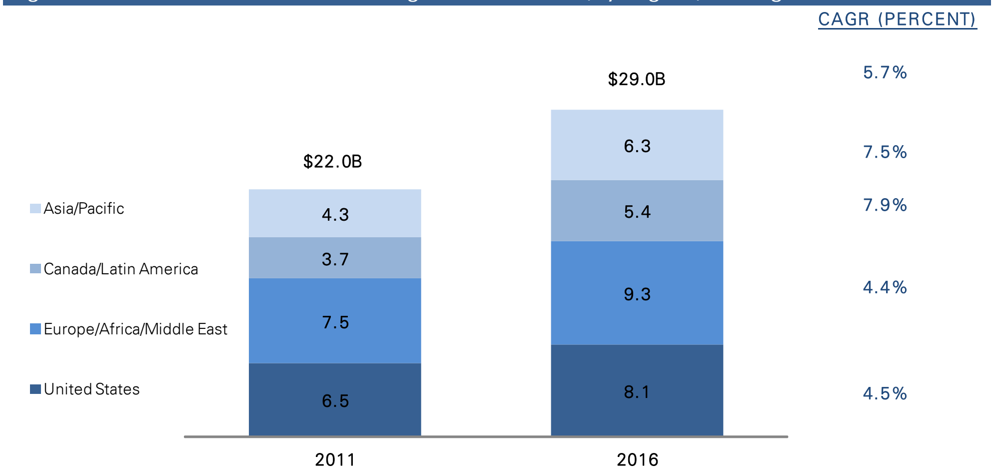
Through the acquisitions of Fort Dodge and King Animal Health (via Pfizer's purchase of Wyeth in 2010 and King in 2011), the company posted revenue growth of 24% annually from 2009 to 2011 to reach $4.2B. Excluding acquisitions, divestitures, and currency impact, Zoetis' "base" revenue increased 7% during this period.

While Zoetis operates in a regulated environment, its animal health business differs in a number of positive ways from human pharmaceuticals (see following section "**Why is Animal Health a Good Business?**"). Animal health is in many ways similar to OTC pharmaceuticals, where larger products are $75-100M in size and cash flows from key franchises are sustainable – typically long past patent expiries.

# Why is Animal Health a Good Business?

According to Vetnosis – a leading industry consulting firm – animal health is a steadily growing $22B market at the intersection of two dynamic sectors – companion animal/pet care and livestock. This market – excluding livestock feed and pet food – is poised to reach $29B by 2016, representing a CAGR of 5.7% (see Figure 1) and is propelled by two long-term secular drivers, 1) increasing demand for animal protein products and 2) companion animals becoming more integrated into families (see section below "**Two Secular Drivers…**"). Growth in more mature, developed markets of the US and Europe are forecasted to increase ~4.5%, while the emerging markets – principally Latin America and Asia/Pacific – are projected increase at a more rapid clip (~7.5-7.9%), according to Vetnosis.

Figure 1: Animal healthcare market growth outlook (by region) through 2016




*Source: Vetnosis STORM release, November 2012, FX neutral projections*

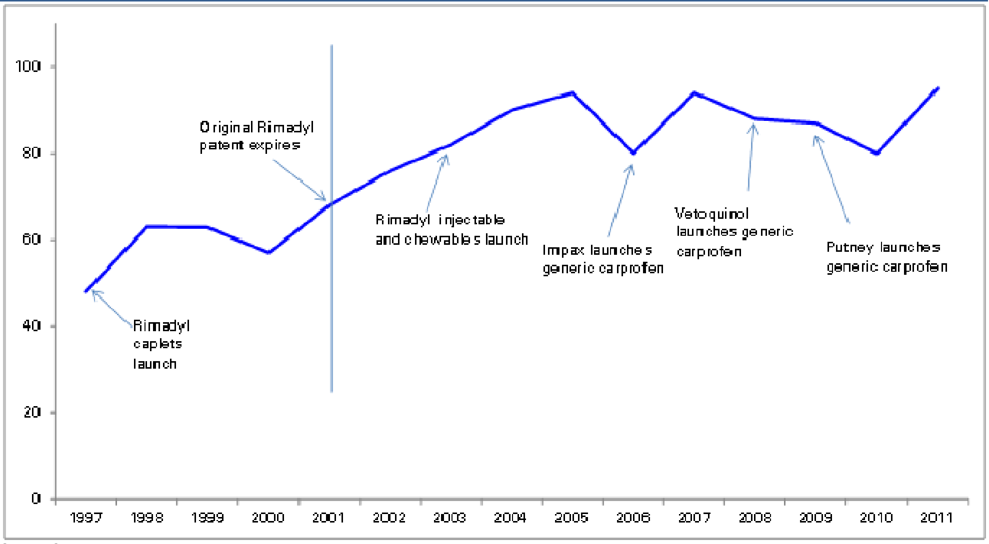
## Brand Loyalty and Cash Pay

Given the distribution and sale of animal health products, there is historically high brand loyalty in this business, as marketers are able to leverage relationships with key customers – i.e., larger livestock producers, veterinary offices, etc. Moreover, animal health is primarily a "cash pay" business that is somewhat insulated from third party payers. Hence, in tandem with a smaller pricing differential between brands and generic products, there is typically much less generic pressure and greater sustainability of cash flow from product franchises. Hence, from a cash flow perspective, animal health is in many ways similar to human OTC pharmaceuticals.

## Minimal Impact from Generic Entrants

For example, Zoetis/Pfizer in 1997 launched Rimadyl (carprofen), an NSAID for pain management, which achieved initial sales of nearly $50M. Zoetis subsequently introduced in 2002 two line extension products for this brand – an injectable and chewable formulation – which drove sales to over $90M by 2005. And despite the introduction of three different generics from 2006 to 2009, this pain management product still generated sales in excess of $90M in 2011 (see Figure 2). Another example is Zoetis' Terramycin – an anti-infective that was launched in the 1950's, genericized in the 1960's, but still contributed close to $100M in 2011 revenue.

Figure 2: Rimadyl and generic competition since 1997




*Source: Company reports*

## Animal vs Human Pharma: No "Blockbusters" But Lower Risk, Lower Cost, and Quicker Development Times

Animal health is a regulated industry and can create challenges (e.g., oversight on product approvals, food safety, etc.) for participants. Conversely, regulations also create barriers to entry, which can lead to more optimal environments with minimal or no competition. And relative to human pharmaceuticals, there are actually a number of factors that make the animal health market more attractive. First, animal health typically has lower R&D risk and there is higher predictability in early development. In animal health, there are typically far fewer clinical studies which require fewer subjects in demonstrating product safety and efficacy. Hence, development times and related expenses are significantly less than for human pharmaceuticals. And whereas development of human pharmaceuticals starts with animal studies, clinical programs for animal health end in animal testing. Additionally, there are opportunities to leverage development across multiple species as well as applicability of innovations across pet care and livestock.

Figure 3: Drugs for human vs. animals – points of comparison

| Human Pharmaceuticals | Animal Health Products |
|---|---|
| • "Blockbusters" – great while they last; but high revenue concentration | • Big products are $100-200M; low revenue concentration |
| • Patent cliffs – wreak havoc on revenue, EPS | • No patent cliffs – some brands still growing after 30+ years |
| • Managed care heavily influences utilization and pricing | • Minimal influence from third party payers and government |
| • Government increasingly involved in pricing decisions/reimbursement | • Sell directly to doctors (veterinarians) and livestock producers |
| • Very long clinical trial process – starts with animal studies | • Clinical trials end with animal studies |
| • Clinical trials exceedingly expensive and R&D productivity has been poor | • R&D relatively inexpensive and lower risk |

*Source: Deutsche Bank*

## Two Secular Drivers Should Create Long-term Demand for Animal Healthcare Products

Keys to Zoetis' growth outlook are long term secular trends that drive the company's two main businesses – livestock and companion animal. Both segments benefit from global population growth and rising standards of living.

### Animal Health Products are Important in Maintaining Livestock Health and Critical to Higher Efficiency Livestock Production

From a current base of nearly 7 billion people, the global population is expected to increase by 2 billion by the year 2050, according to the United Nations. Based on these projections, demand for animal protein products and dairy are forecasted to double over the next 40 years. That said, there are some "headwinds" facing humanity's ability to increase livestock production, which include: 1) 25-35% of arable land has already degraded, 2) water shortages, 3) global climate change, and 4) increased competition for cultivated land from urbanization and growth in use of crops for energy production.

Given the likely increased demand for animal protein products and natural resource constraints, higher efficiency livestock production will be critical going forward and animal healthcare products are key enablers of this paradigm. Moreover, livestock health is critical to assuring a safe, sustainable food supply.

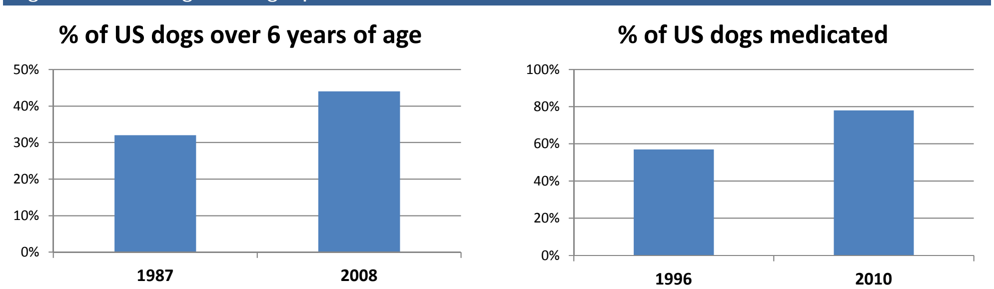
According to Vetnosis, the livestock market for animal health products posted a 7% CAGR from 2006-2011 and is estimated to increase 6% CAGR through 2016.

### Pets are Living Longer and Becoming More Integrated into Households

In the companion animal market, ownership and spending per pet is growing globally. In the US, already 62% of households own at least one dog or cat and the overwhelming majority (90%) of pet owners believe that having dogs and cats have contributed to their own well-being. And since the advent of vaccines and parasiticides in the 1960's, pets in the US have increasingly become more integrated into households – from the yard, to the house, and on to beds. With pets living closer to the family unit and living longer, there is increased demand for advanced animal health products that treat chronic care conditions, including pain, inflammation, cardiology, oncology, etc. For instance, as Figure 4 depicts, the percentage of dogs six years or older increased from 31% in 1998 to 44% in 2008. Concomitantly, the percentage of dog who received medication increased from 57% to 78% between 1996 and 2010. Importantly, this phenomenon, which occurred in developed countries from the 1960's to 2000's, is now taking place in emerging markets – reflecting growth of the middle class and disposable income.

After posting 6% CAGR between 2006-2011, the global companion animal market is projected to increase 5% CAGR from 2011-2016.

Figure 4: US dog demographics




*Source: American Pet Products Manufacturers Association, National Pet Owners Survey*

# What's Unique about Zoetis? – Company Strategy

Zoetis has become the leading animal health focused company globally, having historically been an innovator of new products for this market. The company augments its portfolio with value-add life cycle management products that further enhance the growth of its key franchises. In fact, from 2004-2011, Zoetis obtained approximately 25% of all animal health medicines approved by the US FDA and has had 59+ new products (including significant lifecycle management products) approved since 2006.

In addition to its development achievements, one of the other keys to Zoetis' success has been the strength of its 3,400 person global sales and marketing organization that has built lasting, leverageable relationships with its key customers – large livestock producers and veterinarian offices. The company has direct selling capabilities in approximately 70 countries and sales in over 120 countries (via distributorships). As a result, Zoetis is the global leader in most geographic markets (with the exception of Western Europe where the company is #2) as well as a top three player in key product categories (#1 in anti-infectives, #1 in pain/internal medicines, #2 in vaccines, #3 in parasiticides).

Figure 5: The dominant global animal health company

| Market position by geography | | Market position by product category | | Market position by species | |
|---|---|---|---|---|---|
| North America | #1 | Medicinal Feed Additives (MFA) | #2 | Companion Animal | #2 |
| Latin America | #1 | Vaccines (biologicals) | #2 | Cattle | #1 |
| Western Europe | #2 | Anti-Infectives | #1 | Swine | #1 |
| Eastern Europe | #1 | Parasiticides | #3 | Poultry | #2 |
| Asia | #1 | Other pharma* | #1 | | |
| Rest of world | #1 | | | | |

*Includes pain, sedation, internal medicine, etc.

*Source: Vetnosis*

Given its leadership position and sales capabilities, Zoetis is able to augment its growth with an active business development strategy – as it is often viewed as a partner of choice to commercialize new products and technologies. And post separation from Pfizer, the company will be one of the few independent animal health pure plays and an even more likely candidate as a collaborator.

### External Strategy: Likely "Bolt on" Acquisitions Going Forward

While an active business development strategy is factored into the company's growth outlook, Zoetis has and expects to be an acquirer of assets going forward – which is not included in management's forecast. Given its size and post the combination with Fort Dodge and King, Zoetis is unlikely to be a consolidator of significant animal health assets going forward, given potential FTC concerns. That said, the company has a goal of expanding into complementary businesses in diagnostics, genetics, devices, and services. Bolt-on acquisitions in recent years include Embrex (poultry devices) in 2007, Bovigen and Catapult (livestock genetics) in 2008, and Synbiotics (animal diagnostics) in 2010.

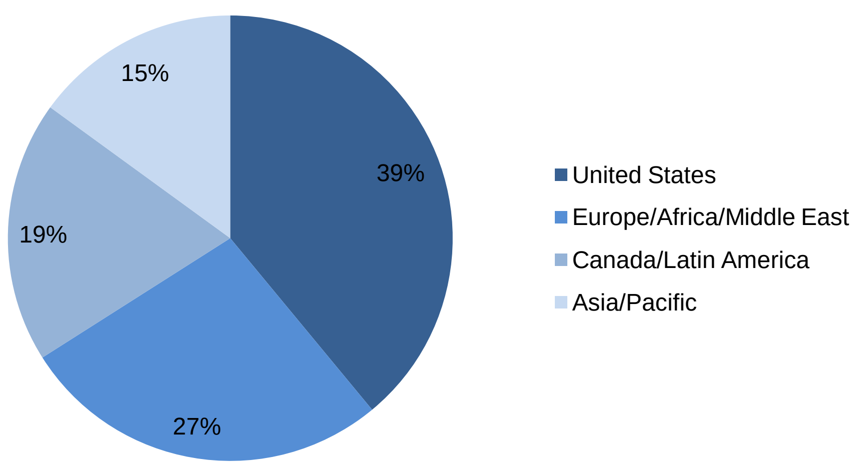
### Other Strategic Initiatives

Other strategic initiatives for Zoetis in the coming years include increasing penetration and share in the faster growing emerging markets. For example, in China, where approximately 85% of pigs produced are still farmed in "backyard" settings, Zoetis could be well positioned to capture share as this market becomes more efficient with industrial scale production. Lastly, Zoetis aspires to improve manufacturing processes and operational efficiencies to help achieve P&L leverage.

## Key Trends by Region

Zoetis' operations are managed on a regional basis – given distinct differences which require expertise in each area where the company operates. The four key regions – in order of revenue concentration – are 1) the US (39%), 2) Europe/Africa/Middle East (27%), 3) Canada/Latin America (19%), and 4) Asia Pacific (15%).

Figure 6: Zoetis revenue by geography



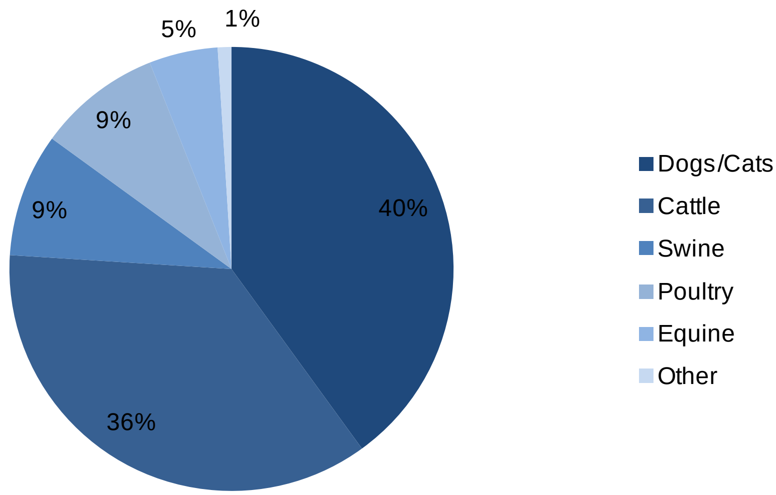

*Source: Company reports*

### US – Solid Growth Despite The Worst Drought in 50 Years

The US represents Zoetis' largest revenue contributor ($1.7B in 2011) and its business is dominated by products that serve livestock production of beef (39% of 2011 US sales), followed by household pets (dogs and cats) at approximately 36% of 2011 US sales. Through the first nine months of 2012, reported US revenue growth was a solid 7%, after posting increases of 20% and 25% in 2011 and 2010, respectively. Note that acquisitions in 2011 and 2010 contributed 13% growth in each of the two years. This has been a very solid performance thus far in 2012, in our view, given that the livestock business in the US was adversely impacted by a severe drought that has been characterized as the worst in 50 years.

In this region, spending on pets has held steady despite uncertainties in the broader economy and overall consumer confidence. And there continues to be strong demand for exports across all livestock segments. One theoretical risk has emerged in this region in recent years, as there has been some shifting of product distribution for pets to OTC and retail segments, although veterinarian offices remain the key channel for pet care medicines and vaccines. We will need to watch developments in the OTC channel closely during the next few years.

Figure 7: US 2011 revenue by species



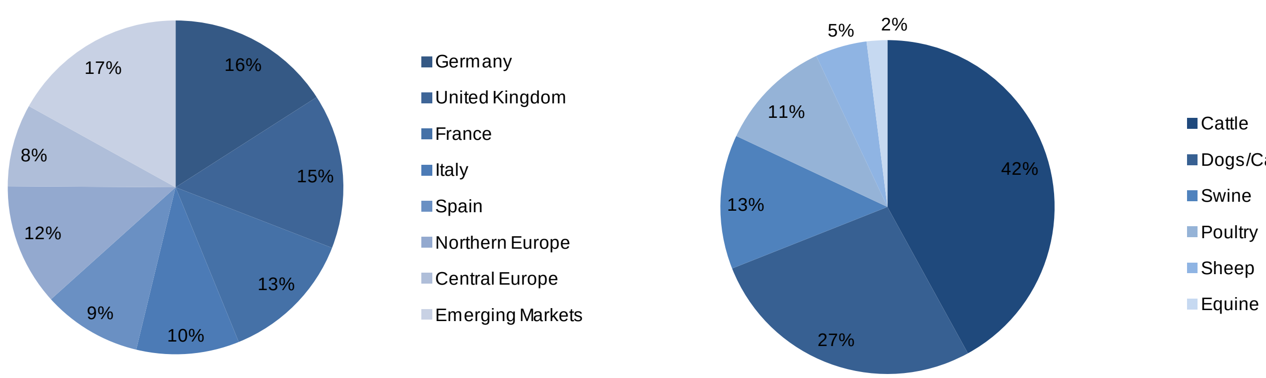

*Source: Company reports*

Zoetis' key objective in the US is to increase its core business by leveraging new platforms – diagnostics, genetics, and services. Via product offerings and service, the company's goal is to help customers manage through the ever changing regulatory environment.

## Europe/Africa/Middle East – Challenging Macroeconomic Conditions in Western Europe Have Been a Drag on Business

Sales from the Europe/Africa/Middle East reached $1.1B in 2011 or 27% of Zoetis revenue. In this region – characterized by the developed Western Europe, alongside of the emerging countries of Africa and the Middle East – approximately 42% of sales were derived from cattle/livestock products and secondly, 27% from dogs and cats. After posting growth of 16% in 2010 and 12% in 2011, revenue in this region declined 6% Y/Y in the first nine months of 2012 – principally reflecting a -7% currency headwind and challenging economic and strict regulatory environments. With likely difficult conditions to persist in Western Europe, there could well be a drag on Zoetis' business for some time. Conversely, growth remains strong in the emerging markets, driven by demand for livestock from the growing middle class.

Figure 8: Europe / Africa / Middle East 2011 revenue by country and species




*Source: Company reports*

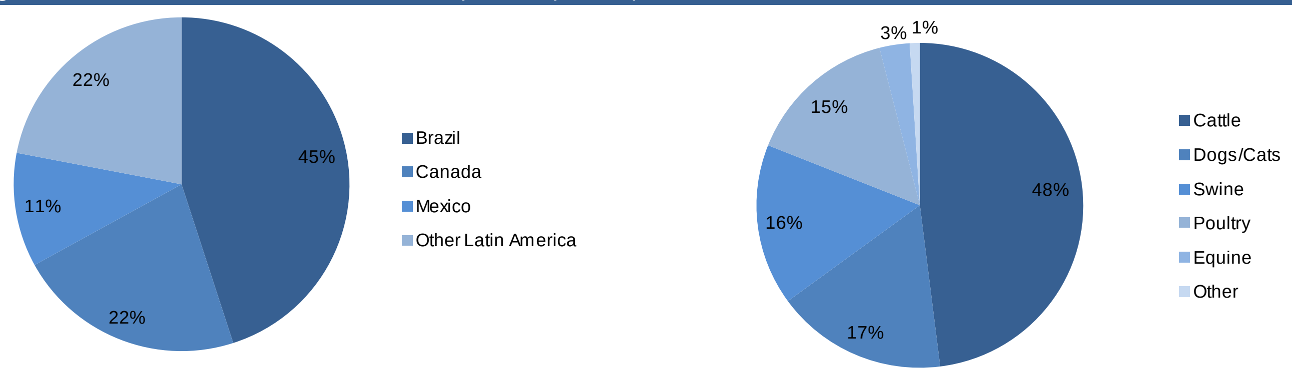
The company's key objectives in this region are to maximize market share among key brands and new product launches, leverage branded generics that will complement

Zoetis' portfolio, achieve differentiation from competitors through its sales force, and enhance core products with complementary offerings (e.g., diagnostics, services, etc.).

### Canada/Latin America – Population Expansion and Rising Middle Class Keys to Regional Growth Outlook

Similar to Europe/Africa/Middle East, the Canada/Latin America segment – 2011 sales of $788M or 19% of corporate revenue – has both emerging (faster growing) and developed (maturing growth) market characteristics. In this region, Brazil represents the highest concentration of revenue at 45%, followed by Canada, which represents 22% of regional revenue. As with the US and Europe/African markets, products for cattle livestock are the biggest revenue generators, representing 48% of regional sales. Pet care (dogs and cats) products are second in terms of percentage of sales at 17%, but are a fast-growing component particularly in Latin America. After posting strong growth of 47% and 19% in 2010 and 2011 – with acquisitions contributing increases of 32% and 7%, respectively – revenue in this region declined 3% in the first nine months of 2012 – negatively impacted by a -8% currency "headwind" as well as the severe drought impacting North America, which reduced livestock product demand in Canada and Mexico.

Figure 9: Canada / Latin America revenue by country and species




*Source: Company reports*

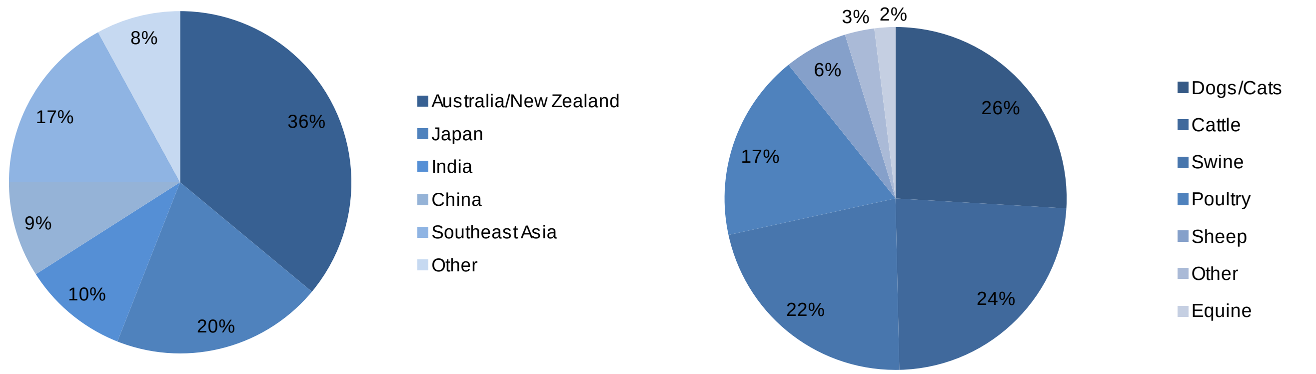
As for key dynamics impacting this region, expanding populations and economies in Latin America are fueling both meat protein consumption and increased pet ownership. Moreover, increasing global protein demand is creating demand for increased exports of meat proteins – particularly in Brazil.

While this region benefits from the broader macro environment, Zoetis is in the process of implementing a new sales model and with a primary focus on training and maximizing its field force effectiveness. Moreover, the company also is seeking to optimize sales of it new region specific product pipeline as well as strengthen its regional R&D efforts.

### Asia Pacific – Zoetis' Fastest Growing Region

While the Asia Pacific region is currently Zoetis' smallest contributor, with sales of $642M in 2011 or 15% of corporate revenue, this region posted robust growth of 59% and 25% in 2010 and 2011, with acquisitions contributing growth of 36% and 7%, respectively. And through the first nine months of 2012, sales in this region grew 8%. Australia/New Zealand is the largest market in the Asia Pacific region, with 36% of regional sales, followed by Japan at 20%. Other key countries – India and China – represent just 10% and 9% of Asia Pacific sales and hence, remain significant future potential revenue opportunities. Moreover, there is less product concentration in this region, as revenues are derived from four broad categories – dogs/cats (26%), cattle livestock (24%), swine (22%), and poultry (18%).

Figure 10: Asia Pacific revenue by country and species




*Source: Company reports*

In addition to benefiting from population growth, a growing middle class, and increased demand for animal protein, growth in Asia Pacific appears poised to benefit from increased modernization in livestock production. As discussed above, the vast majority of swine production in China is still farmed in "backyard" settings.

For Zoetis, key initiatives for this region include expanding market leadership, with a keen focus on emerging markets and further driving sales of select species segments in established markets (Australia and Japan). And in South East Asia – the next generation of emerging markets (i.e., Indonesia, Vietnam, etc.) – Zoetis plans to shift to a direct sales model from current distributorships to capture greater economics. And for China and India, further sales force expansion and increased branded generic presences are key components of the company's growth strategies in this region.

# Consistent Base Business Growth

Zoetis has posted solid financial results historically – exceeding market growth despite periods of challenging economic and adverse macro conditions. In recent years, the company's reported financial results have been further bolstered by two sizeable transactions – Fort Dodge (via Pfizer's purchase of Wyeth) in October 2009 and King Animal Health (via Pfizer's acquisition of King Pharmaceuticals) in January 2011. Excluding the acquisitions, divestitures, and currency impact, Zoetis achieved "base" (organic) revenue growth of 7% in 2010 and 7% in 2011 (see Figure 11). And while currency negatively impacted revenue by 4% in the first nine months of 2012, the company still posted a solid 5% "base" revenue increase, despite a severe drought that impacted 2012 livestock production in the key US market.

Figure 11: Zoetis recent "base" revenue growth

| USD Millions | 2009A | 2010A[1] | 2011A[2] | 3Q12A |
|---|---|---|---|---|
| Zoetis | $2,760 | $3,582 | $4,233 | $3,160 |
| *% Growth Reported* | | *30%* | *18%* | *2%* |
| ***% Base Growth*** | | ***7%*** | ***7%*** | ***5%*** |
| *% Acquisition* | | *23%* | *9%* | *1%* |
| *% Divested Products* | | *-3%* | *-1%* | *0%* |
| *% Foreign Exchange* | | *3%* | *3%* | *-4%* |
| United States | $1,105 | $1,384 | $1,659 | $1,294 |
| *% Growth Reported* | | *25%* | *20%* | *7%* |
| ***% Base Growth*** | | ***13%*** | ***7%*** | ***6%*** |
| *% Acquisition* | | *13%* | *13%* | *1%* |
| *% Divested Products* | | *-1%* | *0%* | *0%* |
| *% Foreign Exchange* | | *0%* | *0%* | *0%* |
| Europe/Africa/Middle East | $880 | $1,020 | $1,144 | $799 |
| *% Growth Reported* | | *16%* | *12%* | *-6%* |
| ***% Base Growth*** | | ***-1%*** | ***3%*** | ***0%*** |
| *% Acquisition* | | *26%* | *6%* | *1%* |
| *% Divested Products* | | *-8%* | *0%* | *0%* |
| *% Foreign Exchange* | | *-1%* | *3%* | *-7%* |
| Asia/Pacific | $324 | $514 | $642 | $518 |
| *% Growth Reported* | | *59%* | *25%* | *8%* |
| ***% Base Growth*** | | ***15%*** | ***12%*** | ***8%*** |
| *% Acquisition* | | *36%* | *7%* | *2%* |
| *% Divested Products* | | *-2%* | *-2%* | *0%* |
| *% Foreign Exchange* | | *10%* | *8%* | *-2%* |
| Canada/Latin America | $451 | $664 | $788 | $549 |
| *% Growth Reported* | | *47%* | *19%* | *-3%* |
| ***% Base Growth*** | | ***5%*** | ***9%*** | ***4%*** |
| *% Acquisition* | | *32%* | *7%* | *1%* |
| *% Divested Products* | | *0%* | *-1%* | *0%* |
| *% Foreign Exchange* | | *10%* | *4%* | *-8%* |

[1] *impact of Wyeth/Fort Dodge acquisition*

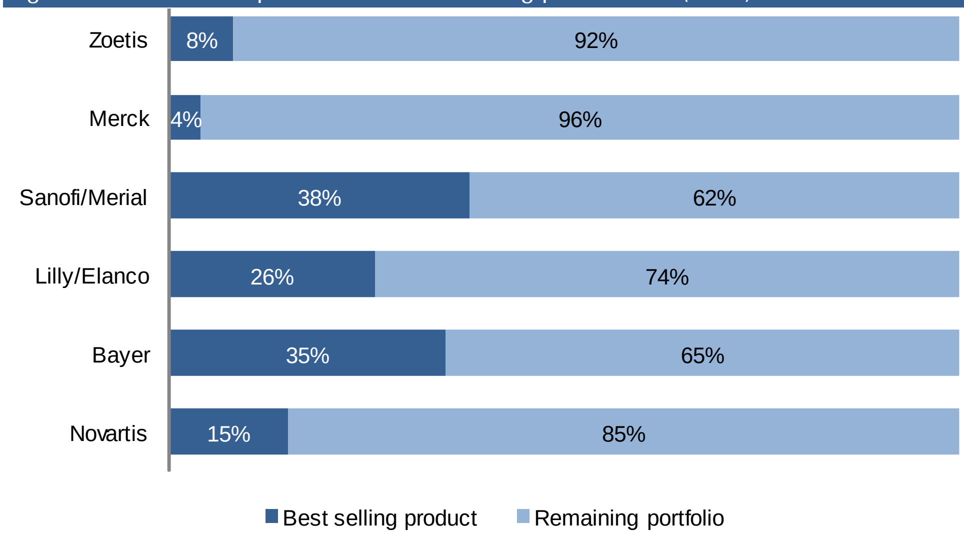
[2] *impact of King/King Animal Health acquisition*

*Source: Company reports*

## A Highly Diversified Revenue Base

Of importance, Zoetis' revenues are highly diversified – by product, species, therapeutic area, and geography. As mentioned previously, Zoetis' largest product (ceftiofur) represents just 8% of 2011 reported sales, the next nine products represent 30% of sales, and its top 10 products in aggregate represent 38% of corporate revenue. By comparison to the company's closest animal health competitors, Zoetis has one of the more diversified product portfolios in the industry (see Figure 12).

Figure 12: Revenue dependence on best selling product line (2011)*

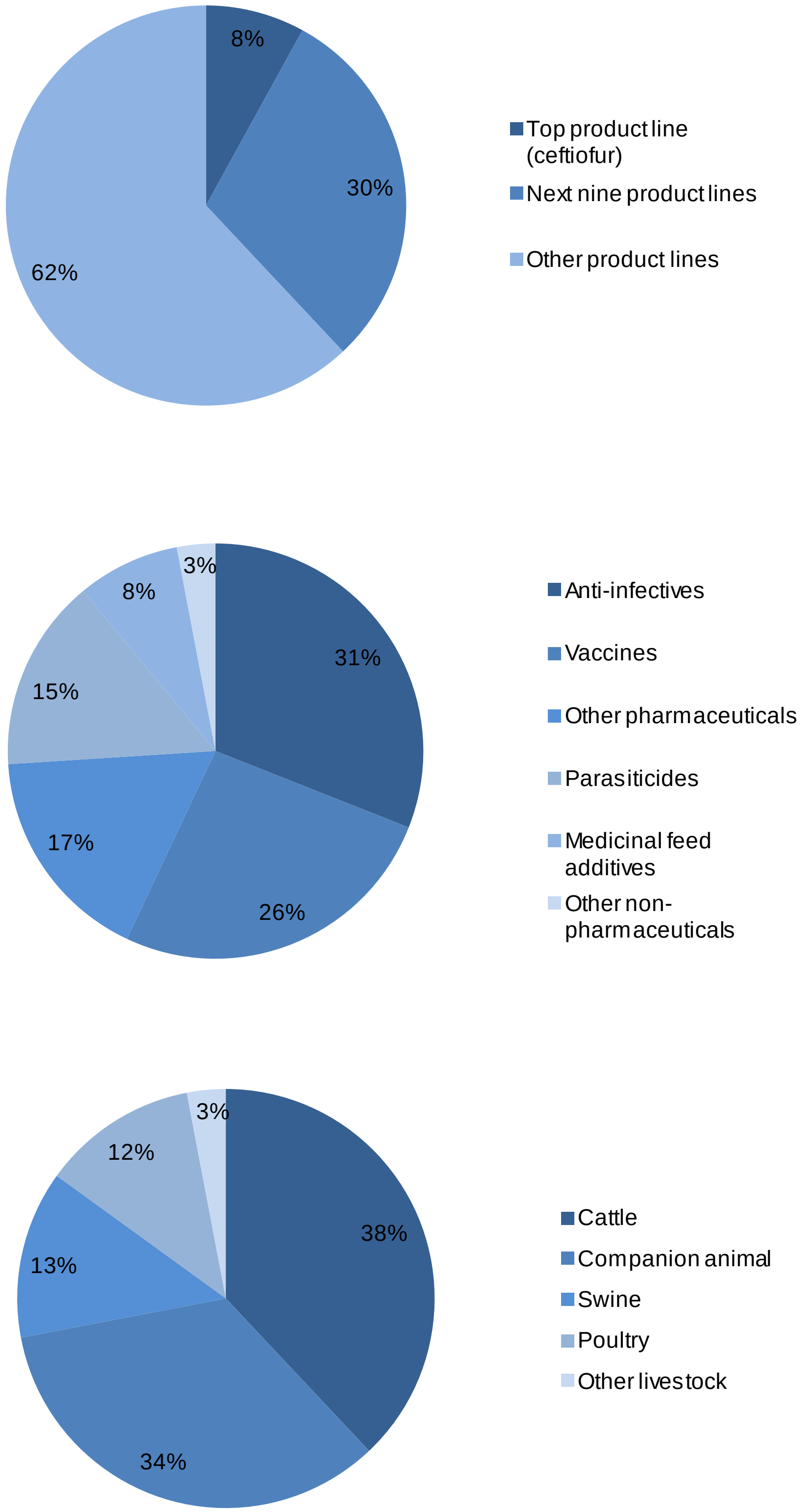



*Merck data from 2009. All others are from 2011

*Source: Company data, Vetnosis*

Likewise, the company has a balanced product portfolio that doesn't have significant concentration in any one product category, with anti-infectives, vaccines, and parasiticides representing 31%, 26%, and 15% of 2011 revenue.

Figure 13: Zoetis 2011 revenue concentration

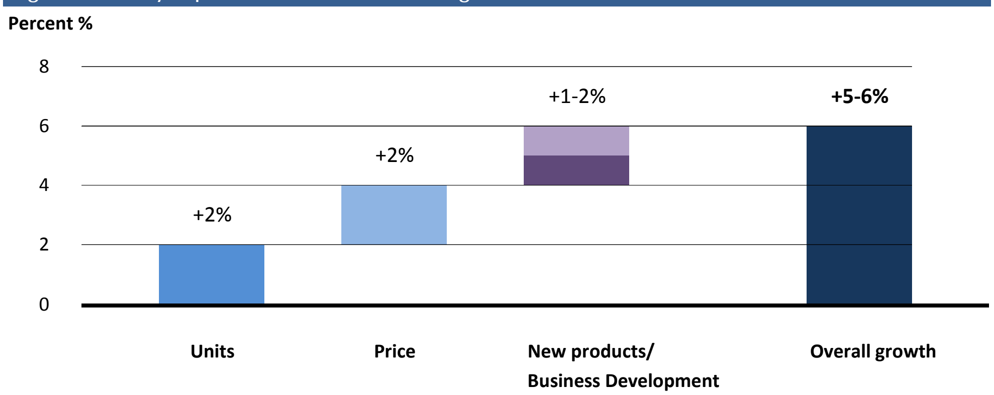



*Source: Company reports*

## 2013-2015: Expect 5-6% Topline Growth and 13.2% EPS Growth Via Gross Margin Expansion, Operating Efficiencies, and Improved Tax Rate

Looking ahead, we believe that Zoetis – at a minimum – should achieve revenue increases in-line with market growth expectations for animal healthcare products (see Figure 1, "**Animal healthcare market growth outlook"**), given the company's solid track record. Hence, our model projects mid-single digit topline growth through 2017, excluding acquisitions, and assumes the following: ~2% annual unit volume growth, ~2% price increases, and ~1-2% growth derived from new product introductions and business development (see Figure 14). In tandem with 1) expected modest gross margin expansion – via increased volume and pricing, 2) improved operating efficiencies and leverage, and 3) an improved corporate tax rate post separation from Pfizer, we see Zoetis capable of generating low-to-mid teens earnings growth over the next five years. Taken together, we project 2013-2017 revenue of $4.51B, $4.78B, $5.05B, $5.32B, and $5.61B and EPS of $1.37, $1.60, $1.80, $1.99, and $2.19, respectively. For details, please see our annual, quarterly, and geographic-based models on pages 24-26.

Figure 14: Key inputs to annual revenue growth




*Source: Deutsche Bank*

### Historically, Fx Exposure Managed Through Operations, Not Hedging

Previously, as a business unit of Pfizer, Zoetis managed foreign exchange risk – principally translation exposure to the Euro, Brazilian Real, and Australian Dollar – in part through operations, including managing same-currency revenue in relation to same-currency costs. Given that the company's products are sold in more than 120 countries (61% of 2011 revenue was denominated in foreign currencies) and the potential for significant currency swings – Zoetis may not be able to fully offset currency "headwinds" through operations. And if this were to occur, the company's earnings will certainly fluctuate. That said, while it currently doesn't actively hedge against foreign currencies, the company may implement a hedging strategy in the future to limit its foreign exchange risk.

# Management Team

### Juan Ramón Alaix

Juan Ramón Alaix was appointed Chief Executive Officer of Zoetis in July 2012. He joined Pfizer from Pharmacia in 2003, as Regional President of Central/Southern Europe, and has served as President of Pfizer Animal Health since 2006. With 20 years of experience in the pharmaceutical industry, Mr. Alaix, currently serves as President and as a member of the board of directors and the executive committee of the International Federation for Animal Health.

### Richard A. Passov

Rick Passov joined Pfizer in 1997 and was appointed Executive Vice President and Chief Financial Officer of Zoetis in July 2012. Previously, Mr. Passov served as Senior Vice President and Treasurer for Pfizer from 2001 to 2012. During his stint at Pfizer, he played a key role throughout the acquisition of Wyeth and its franchises in biopharmaceuticals, vaccines, and animal health.

### Kristin C. Peck

Kristin Peck was appointed Executive Vice President and Group President of Zoetis in October 2012. She joined Pfizer in 2004 and has held a number of leadership positions, including Executive Vice President Worldwide Business Development and Innovation and as a member of Pfizer's Executive Leadership Team. Prior to Pfizer, Ms. Peck focused on strategy and merger-related issues in the pharmaceutical and financial services industries at the Boston Consulting Group.

### Catherine A. Knupp

Cathy Knupp is Executive Vice President and President of Research and Development at Zoetis since October 2012. She previously served as Vice President of Pfizer's Veterinary Medicine Research and Development since 2005. Prior to joining Pfizer in 2001, Dr. Knupp led Pfizer's Michigan laboratories for Pharmacokinetics, Dynamics, and Metabolism. She began her career in 1987 at Bristol-Myers Squibb where she held positions of increasing responsibility in drug metabolism and pharmacokinetics.

Figure 15: Zoetis' management team

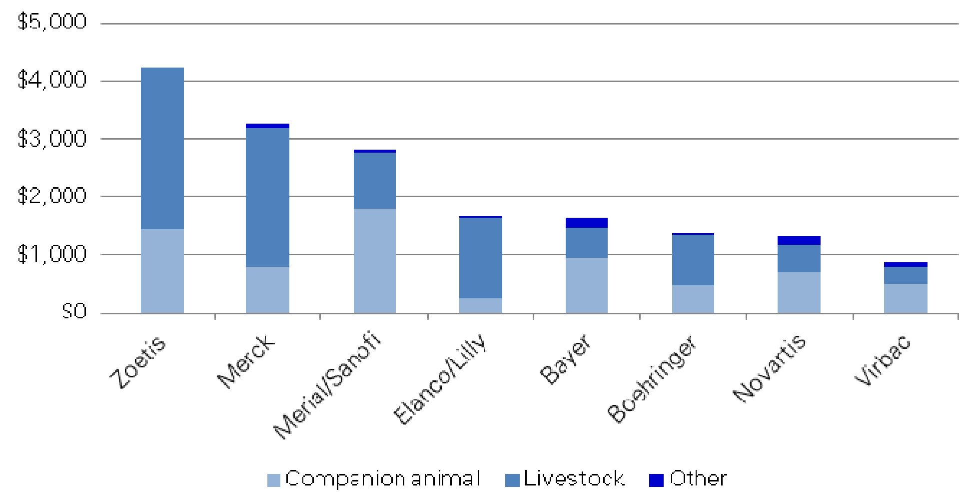
| Name | Title | Years of Experience | Companies |
|---|---|---|---|
| Juan Ramon Alaix | CEO | 20 | PFE/Pharmacia, Rhone-Poulenc Rorer |
| Richard Passov | CFO | 16 | PFE |
| Kristin Peck | Group President | 10+ | PFE, BCG |
| Catherine Knupp | President of R&D | 25+ | PFE, BMY |
| Clinton Lewis | Pres of US Operations | 25 | PFE |
| Alejandro Bernal | Pres of EU/Africa | 15+ | PFE, Aurora Dairy |
| Joyce Lee | Pres of Canada/LatAm | 10+ | PFE |
| Stefan Weiskopf | Pres of Asia Pacific | 25+ | PFE/Pharmacia |

*Source: Company reports*

# Valuation – Few Ideal Publicly Traded Comparable Companies

There are very few, if any, ideal publicly traded comparables for Zoetis. Historically, most all major animal healthcare focused businesses have been subsidiaries within large pharmaceutical enterprises. And prior to Zoetis' initial public offering, seven of the top eight animal health/veterinary medicine companies were divisions of Major Pharmaceutical companies such as Lilly, Merck, and Sanofi (see Figure 16). As such, we have attempted to assess value by examining a wider range of companies that at least have some common businesses/characteristics. We define the groupings as 1) "pure play" animal health companies 2) "ancillary" animal health companies, 3) top-tier branded specialty pharmaceutical companies with a consumer focus, and 4) top-tier consumer products companies. We also take a look at a recent "split off" comparable – Mead Johnson.

Figure 16: Top animal health businesses, sales in $ million




*Source: Company reports, Vetnosis*

### One Other "Pure Play" – Virbac

Outside of Zoetis, there is only one other publicly traded company amongst the top eight animal healthcare businesses – France-based Virbac (traded on the Paris Stock Exchange). While operating on a smaller scale, Virbac has a business profile that is similar to Zoetis. That said, given that its primary business focus resides in France and continental Europe (~50% of corporate revenue) as well as the fact that its shares are listed on the Paris Stock Exchange, Virbac is not well known by most US investors. As such, while it currently trades at a significant discount on virtually all metrics to Zoetis – we're not sure Virbac should be considered a close comparable.

### Two "Ancillary" Animal Health Businesses

In the US, there are two other publicly traded animal health focused companies – IDEXX Labs (IDXX) and MWI Veterinary Supply (MWIV). IDEXX Labs is primarily focused on veterinary diagnostics and information technology-based products and services while MWI is a leading distributor of animal health products to veterinarians in the US and UK. As such, neither of these two companies is focused on developing and marketing therapeutics and vaccines for animals – like Zoetis. We'd also note that MWI

– as a distributor – is a relatively low margin business, as implied by its 0.8x EV/Sales ratio. Nonetheless, they are both constructive comparables to look at – particularly IDEXX –as it looks to be a dominant player in its animal health "niche". Indeed, IDEXX's EV/Sales (3.6x), EV/EBITDA (15.3x), and PEG (1.8x) ratios are not too dissimilar to those of Zoetis currently – offering a good crosscheck on valuation. And its P/E multiple is exactly the same – with a growth rate just 100 bp higher.

### Two Top-Tier Spec Pharma Companies with a Consumer Focus

Within our Specialty Pharma coverage universe, we see Allegan and Perrigo as reasonable comparables due to 1) a strong track records of earnings growth, 2) having large businesses that are essentially immune to generics (e.g., Botox, OTC's), 3) good visibility on sustainable cash flows, and 4) having a large consumer component to their overall business. As a result, both Allergan and Perrigo shares have consistently traded at a significant premium to their growth rates – or P/E to growth (PEG) over the past two years. In fact, Allergan's current PEG ratio (1.8x) is just modestly below Zoetis', with a very similar EPS growth rate. However, in our view, Allergan should have a slightly lower PEG ratio, as a portion of its business is susceptible to generics (principally its ophthalmics business).

### Top-Tier Consumer Companies and A "Split Off" Comparable

As for other comparables worth assessing, we think that investors could compare Zoetis to top-tier consumer product companies – such as P&G, Reckitt Benckiser, Unilever among others – given 1) their large, global presence, 2) their ability to generate consistent growth under a variety of economic conditions, 3) steady, strong cash flow generation, and 4) having consumers that are relatively "price inelastic". And given that these three comparables are far larger than Zoetis – their growth rates are lower – as are their P/E ratios. As such, perhaps the best point of comparison would be their PEG ratios. Not surprisingly, all three trade at PEG ratios over 2.2x. And given that they have generated consistent, predictable earnings as public companies for many years, it makes sense that Zoetis would trade at a modestly lower PEG ratio.

As for a possible "split off" comparable, Zoetis has certain characteristics similar to Mead Johnson, which was formerly an operating division of Bristol Myers. While clearly very different business models, both companies have a consumer-focused aspect, similar revenue levels, as well as gross and operating margins. That said, Mead Johnson's lower earnings growth rate (10.8% vs 13.2% for Zoetis) may imply that it is further along in benefiting from operating leverage – hence, a higher PEG of 2.0x.

Figure 17: Possible Zoetis comparables (based on March 12, 2013 closing prices)

| Company | Ticker | Recent Price (in USD) | Market Cap (in $MM) | Enterprise Value (in $MM) | Sales 2013 | Sales 2014 | EBITDA 2013 | EBITDA 2014 | EV/Sales 2013 | EV/Sales 2014 | EV/EBITDA 2013 | EV/EBITDA 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **"Pure Play" Animal Health** | | | | | | | | | | | | |
| Zoetis* | ZTS | 33.82 | 16,910 | 20,481 | 4,510 | 4,775 | 1,244 | 1,410 | 4.5x | 4.3x | 16.5x | 14.5x |
| Virbac | VIRP-FR | 216.15 | 1,828 | 1,874 | 1,030 | 1,101 | 183 | 200 | 1.8x | 1.7x | 10.2x | 9.4x |
| **"Ancillary" Animal Health** | | | | | | | | | | | | |
| IDEXX Labs | IDXX | 91.51 | 5,032 | 5,114 | 1,401 | 1,503 | 335 | 370 | 3.6x | 3.4x | 15.3x | 13.8x |
| MWI Veterinary Supply | MWIV | 131.89 | 1,664 | 1,725 | 2,363 | 2,584 | 110 | 123 | 0.7x | 0.7x | 15.7x | 14.0x |
| **Specialty Pharma** | | | | | | | | | | | | |
| Allergan | AGN | 110.08 | 33,189 | 32,335 | 6,167 | 6,695 | 2,204 | 2,523 | 5.2x | 4.8x | 14.7x | 12.8x |
| Perrigo | PRGO | 117.60 | 10,963 | 11,908 | 3,586 | 4,014 | 902 | 1,046 | 3.3x | 3.0x | 13.2x | 11.4x |
| **Consumer Products** | | | | | | | | | | | | |
| Procter & Gamble | PG | 77.17 | 212,318 | 254,373 | 84,723 | 87,856 | 19,308 | 20,648 | 3.0x | 2.9x | 13.2x | 12.3x |
| Reckitt Benckiser | RB-GB | 69.37 | 50,238 | 54,788 | 15,098 | 15,849 | 4,157 | 4,381 | 3.6x | 3.5x | 13.2x | 12.5x |
| Unilever | UNA-NL | 40.30 | 114,001 | 128,625 | 69,550 | 73,503 | 11,435 | 12,239 | 1.8x | 1.7x | 11.2x | 10.5x |
| **"Split Off" Comparable** | | | | | | | | | | | | |
| Mead Johnson | MJN | 71.70 | 14,598 | 15,470 | 4,143 | 4,486 | 1,049 | 1,168 | 3.7x | 3.4x | 14.7x | 13.2x |

** Deutsche Bank estimates*

| Company | Ticker | Recent Price (in USD) | Market Cap (in $MM) | Enterprise Value (in $MM) | EPS 2013 | EPS 2014 | P/E 2013 | P/E 2014 | PEG 2013 | PEG 2014 | Growth Rate (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **"Pure Play" Animal Health** | | | | | | | | | | | |
| Zoetis* | ZTS | 33.82 | 16,910 | 20,501 | 1.37 | 1.60 | 26.0x | 22.2x | 2.0x | 1.7x | 13.2 |
| Virbac | VIRP-FR | 216.15 | 1,828 | 1,874 | 11.41 | 12.62 | 18.7x | 16.9x | 1.5x | 1.3x | 12.9 |
| **"Ancillary" Animal Health** | | | | | | | | | | | |
| IDEXX Labs | IDXX | 91.51 | 5,032 | 5,114 | 3.54 | 3.90 | 26.0x | 23.6x | 1.8x | 1.6x | 14.3 |
| MWI Veterinary Supply | MWIV | 131.89 | 1,664 | 1,725 | 4.86 | 5.45 | 27.1x | 24.2x | 1.8x | 1.6x | 15.0 |
| **Specialty Pharma** | | | | | | | | | | | |
| Allergan | AGN | 110.08 | 33,189 | 32,335 | 4.76 | 5.44 | 23.2x | 20.3x | 1.8x | 1.6x | 13.1 |
| Perrigo | PRGO | 117.60 | 10,963 | 11,908 | 5.63 | 6.58 | 20.7x | 17.7x | 1.5x | 1.3x | 13.3 |
| **Consumer Products** | | | | | | | | | | | |
| Procter & Gamble | PG | 77.17 | 212,318 | 254,373 | 4.06 | 4.38 | 19.1x | 17.7x | 2.2x | 2.1x | 8.5 |
| Reckitt Benckiser | RB-GB | 69.37 | 50,238 | 54,788 | 3.95 | 4.18 | 17.7x | 16.7x | 3.4x | 3.2x | 5.2 |
| Unilever | UNA-NL | 40.30 | 114,001 | 128,625 | 2.20 | 2.38 | 18.4x | 17.0x | 2.3x | 2.1x | 8.0 |
| **"Split Off" Comparable** | | | | | | | | | | | |
| Mead Johnson | MJN | 71.70 | 14,598 | 15,470 | 3.30 | 3.72 | 22.1x | 19.5x | 2.0x | 1.8x | 10.8 |

** Deutsche Bank estimates*

*Source: Company reports, FactSet, Deutsche Bank*

In putting this all together – while there are no ideal comparables in our view – Zoetis could be viewed most similarly to IDEXX Labs, Allergan, and to a certain extent a few of the large consumer products companies. Taking into effect the modest variances in growth rates, the IDEXX and Allergan PEG ratios on current year estimates are both 1.8x. Moreover, on a price to sales basis, Zoetis falls in between, likely reflecting varying levels of margin and profitability. And Zoetis's PEG multiple should, in fact, be modestly lower than that of Procter & Gamble, Unilever, etc., given that PEG ratios of 2.3x or higher can't be justified for a company with the characteristics and size of Zoetis. We think these are reasonable cross checks and as such we think applying the IDEXX and Allergan PEG ratios 12 months forward is a reasonable way to look at a price target for Zoetis.

At present, Zoetis shares currently trade at 26x and 22x our 2013 and 2014 EPS estimates and corresponding 2.0x and 1.7x PEG ratios. Certainly, these can be considered robust valuation metrics although comparable companies certainly have similar financial ratios as the broader market continues to reach all-time highs. However, given the fact that Zoetis has 1) the lowest product concentration of any company we cover, 2) is the dominant player in the industry, 3) is #1 or #2 in virtually every territory, product line and species, 4) is benefitting from two powerful long term underlying global trends, 5) has a consumer base that is largely "price inelastic", 6) can generate fairly predictable revenue and cash flow, 6) will likely benefit from operating leverage in the years ahead, and 7) has a certain degree of scarcity value we believe such valuation metrics are warranted and merit Zoetis being a core holding in any healthcare or growth equity portfolio.

As such, our initial 12 month price target is $38 – which represents a 23.8x P/E multiple on our 2014 EPS estimate – or a PEG of 1.8x. This implies a one year return of 12% and perhaps a 24 month return of 26 % ($43) utilizing the same methodology. At this point, while Zoetis has had a very long operating history, it's been "buried" inside Pfizer. Thus, one variable we just don't know about yet is how this experienced management team will perform as a public company. Our bet is that they will execute and potentially generate upside to estimates which is another reason for our Buy rating. But of course, at this time we just don't know.

With such a positive view, do we have concerns? Of course. But it seems to us as if they are largely exogenous or even "acts of god" if you will – which are nearly impossible to predict. For instance, a long-term global drought could certainly have negative implications as could some sort of mass infectious disease outbreak amongst livestock. In addition, given that a significant portion of expected future growth will emanate from emerging markets – some sort of protracted downturn in the global economy could adversely impact the company's growth outlook.

# How Will the Remaining 80% of ZTS Stock Be Distributed?

Following Zoetis' initial public offering, Pfizer still retains 80% ownership of its former animal healthcare subsidiary. Given a low tax basis for its animal healthcare asset, there could be significant tax implications if Pfizer conducted a direct sale of this business. Pfizer's other options are to enter into a transaction that would be done on a tax free basis (see Figure 18). And according to commentary in the S1 documents, Pfizer has indicated to Zoetis that it may make a tax-free distribution to its stockholders of all or a portion of its remaining equity interest in the company.

Figure 18: How to think about separating a business

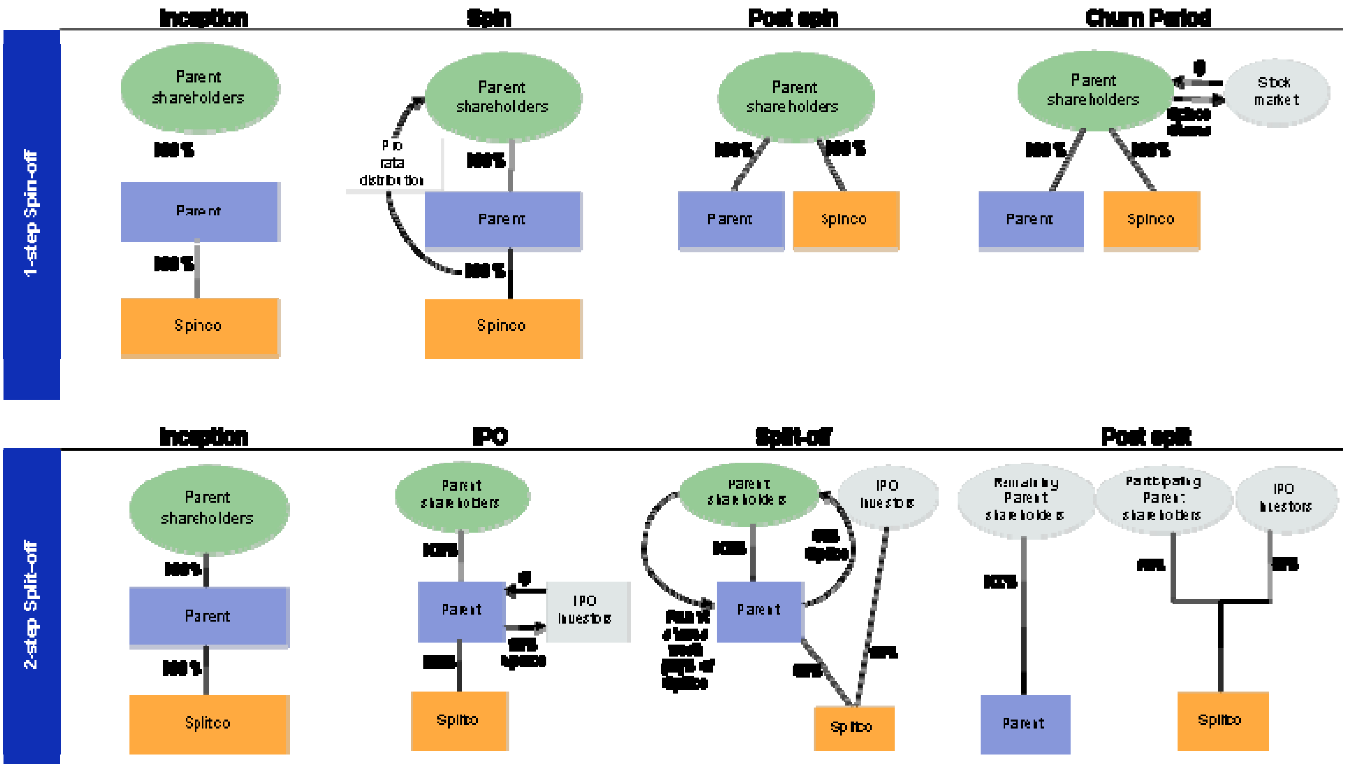
| | Taxable separation | | Tax-free separation | |
|---|---|---|---|---|
| | **Private sale** | **Public sale** | **Spin-off** | **Split-off** |
| **Description** | •Cash sale to another company or sponsor | •IPO with subsequent follow-ons | •Distribute stock to shareholders pro-rata via dividend | •Parent executes tax-free share repurchase by exchanging Splitco stock for Parent stock |
| **Benefits** | •Cash proceeds<br>•No public market risk | •Cash proceeds<br>•Full pubic market auction | •Tax-free<br>•Cash up to basis<br>•Debt retirement above a basis up to standalone leverage level<br>•No market risk | •Tax free<br>•Cash up to basis<br>•Debt retirement above basis up to standalone leverage level<br>•Share repurchase for full equity value of subsidiary |
| **Considerations** | •Taxable above basis | •Taxable above basis | •Churn | •Added complexity<br>•Public market risk<br>•Split-off discount |
| **Timing** | •6-12 months | •14-20 months | •7-10 months | •11-14 months |

*Source: Deutsche Bank*

At this point, Pfizer has two tax efficient options to dispose of its remaining Zoetis' holdings post the six month lock up period – either 1) a "spin-off" or 2) a "split-off" (see Figure 19). If a spin-off approach is taken, Pfizer would distribute its Zoetis stock to all Pfizer shareholders pro-rata via a dividend. This transaction would be tax-free to Pfizer, without market risk, but Pfizer shareholders would have tax considerations at the time of the "dividend" distribution. The implication for Zoetis shareholders is that not all Pfizer shareholders would want to hold Zoetis stock. Hence, this could create temporary weakness for Zoetis shares, as the selling of the Pfizer distributed stock work its way through the system.

The second approach that Pfizer could take is to complete a "split off" transaction. Instead of distributing the remaining 80% ownership in Zoetis, Pfizer could conduct a tender whereby Pfizer shareholders can trade Pfizer stock for Zoetis shares. To create an incentive, the tender could be done at a modest premium. Importantly, via the tender, the additional Zoetis stock would likely end up the hands of shareholders who would want to hold the asset. And for Pfizer, it would effectively conduct a very efficient, tax-free share repurchase. Finally, if there is a lack of demand via the tender, Pfizer still has the option to do a Zoetis stock distribution to shareholders.

Figure 19: Overview of spin-offs and split-offs




*Source: Deutsche Bank*

A good example of this type of transaction is the 2009 Mead Johnson separation from Bristol Myers. Following Mead Johnson's IPO in February 2009, Bristol Myers commenced a tender offer in November 2009. Under the terms of the tender, shareholders received approximately $1.11 of Mead Johnson common stock for each $1.00 of Bristol Myers common stock accepted in the exchange offer, subject to the upper limit on the exchange ratio, which was determined by a 10% discount to the daily volume-weighted average price of Bristol Myers and Mead Johnson shares over a three-day period (December 8-10, 2009). And based on the 170M shares of Mead Johnson owned by Bristol and Mead Johnson's closing stock price of $45.25 prior to the announcement of the tender, the value of this stake was $7.7B, if all shares were tendered. On December 23, 2009, with tenders for nearly double the 170M shares that were available, Bristol Myers successfully completed the exchange offer.

# Investment Risks

Key risks to our investment rating and price target for Zoetis are related to:

1) Regulatory: Potential restriction or ban on the use of animal health products (medicines/vaccines) and regulatory action on the raising, processing, or consumption of food-producing animals could reduce demand for Zoetis' products. This includes potential increased restrictions on the use of antibacterials, which represent ~30% of Zoetis' revenue.

2) Food safety: Perceived adverse effects on human health linked to consumption of food derived from animals that utilize Zoetis' products. Also, infectious disease outbreaks – including mad cow, avian flu, foot-and-mouth disease, etc. – could negatively impact sales and production of livestock.

3) Macro environment: Increased cost of raising livestock, adverse weather, and the availability of natural resources (fresh water, grazing pastures, etc.) could adversely impact livestock production and reduce demand for Zoetis' products.

4) Development risk: While product development risk is lower than human pharmaceuticals, there are still hazards associated with R&D in animal health. These potential setbacks could put Zoetis at a competitive disadvantage relative to key competitors.

5) New / increased competition: As with human pharmaceutical developers, Zoetis may face competition from lower-priced generic alternatives. The margin of pricing differential relative to generic products may widen, causing a shift toward increased use of generic drugs. Note that approximately 80% of Zoetis' 2011 revenue was derived from unpatented/off-patent products. Also, changes in distribution channels for companion animal products (e.g., increased use of store brand OTC products) could adversely impact Zoetis' market share and distribution products. Additionally, animal health is a competitive market and ZTS may experience increased competition to its current products or areas where it is developing new products.

6) Execution risk: While Zoetis has historically been successful in executing on its stated business strategies, the company could experience missteps at some point in time, including failure to acquire future growth drivers as well as inability to achieve expected margin improvements.

7) Foreign exchange risk: As a business unit of Pfizer, Zoetis had historically managed foreign exchange risk – principally translation exposure to the Euro, Brazilian Real, and Australian Dollar – in part through operations, including managing same-currency revenue in relation to same-currency costs. Given the potential for significant currency swings driven by macroeconomic deveopments, Zoetis may not be able to fully offset currency "headwinds" through operations, which potentially could adversely impact the company's earnings. While it currently does not actively hedge against foreign currencies, the company may implement a hedging strategy in the future to limit foreign exchange risk.

Figure 20: Statement of Operations – Annual Income ($ in thousands, except per – share data)

| FY: DEC | 2009A* | 2010A* | 2011A* | 2012E* | 2013E | 2014E | 2015E | 2016E | 2017E |
|---|---|---|---|---|---|---|---|---|---|
| **Revenues:** | | | | | | | | | |
| Net sales | $2,760 | $3,582 | $4,233 | $4,302 | $4,510 | $4,775 | $5,046 | $5,322 | $5,607 |
| **TOTAL REVENUES** | **$2,760** | **$3,582** | **$4,233** | **$4,302** | **$4,510** | **$4,775** | **$5,046** | **$5,322** | **$5,607** |
| **Cost of Goods Sold:** | | | | | | | | | |
| COGS | 1,001 | 1,318 | 1,581 | $1,564 | $1,580 | 1,633 | 1,700 | 1,772 | 1,850 |
| GROSS PROFIT | 1,759 | 2,264 | 2,652 | 2,738 | 2,930 | 3,142 | 3,345 | 3,550 | 3,757 |
| **Operating Expenses:** | | | | | | | | | |
| R&D | 365 | 411 | 407 | 398 | 407 | 417 | 427 | 438 | 450 |
| SG&A | 1,057 | 1,365 | 1,447 | 1,405 | 1,414 | 1,450 | 1,501 | 1,552 | 1,602 |
| Amortization of Intangible Assets | 16 | 17 | 20 | 15 | 16 | 16 | 15 | 15 | 14 |
| Other (Income) / Expenses | (1) | (25) | (28) | (14) | - | - | - | - | - |
| Total Operating Expenses | 1,437 | 1,768 | 1,846 | 1,804 | 1,837 | 1,883 | 1,942 | 2,005 | 2,066 |
| OPERATING INCOME | 322 | 496 | 806 | 934 | 1,093 | 1,260 | 1,403 | 1,545 | 1,690 |
| Interest expense | 26 | 37 | 36 | 32 | 116 | 117 | 117 | 117 | 112 |
| PRETAX INCOME | 296 | 459 | 770 | 902 | 977 | 1,143 | 1,286 | 1,428 | 1,578 |
| Taxes | 108 | 183 | 264 | 307 | 283 | 331 | 373 | 414 | 458 |
| Net Income Before Minority Interests | 188 | 276 | 506 | 595 | 693 | 812 | 913 | 1,014 | 1,120 |
| Minority Interests | (1) | 1 | 3 | - | - | | | | |
| NET INCOME | 189 | 275 | 503 | 595 | 693 | 812 | 913 | 1,014 | 1,120 |
| Adjusted EBIT | | | | 935 | 1,109 | 1,275 | 1,418 | 1,560 | 1,704 |
| Adjusted EBITDA | | | | 1,084 | 1,244 | 1,410 | 1,553 | 1,695 | 1,839 |
| Shares Outstanding | | | | | 500.5 | 502.2 | 503.7 | 505.2 | 506.7 |
| Shares Outstanding (fully diluted) | | | | | 505.0 | 506.7 | 508.2 | 509.7 | 511.2 |
| Reported EPS--basic | | | | | $1.39 | $1.62 | $1.81 | $2.01 | $2.21 |
| **Reported EPS--fully diluted** | | | | | **$1.37** | **$1.60** | **$1.80** | **$1.99** | **$2.19** |

** Financials prior to 2013 are based on animal healthcare "carve outs" from Pfizer*

| MARGINS: | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| Gross | 63.7% | 63.2% | 62.7% | 63.7% | 65.0% | 65.8% | 66.3% | 66.7% | 67.0% |
| R&D | 13.2% | 11.5% | 9.6% | 9.3% | 9.0% | 8.7% | 8.5% | 8.2% | 8.0% |
| SG&A | 38.3% | 38.1% | 34.2% | 32.7% | 31.4% | 30.4% | 29.7% | 29.2% | 28.6% |
| Operating | 11.7% | 13.8% | 19.0% | 21.7% | 24.2% | 26.4% | 27.8% | 29.0% | 30.1% |
| Pre-tax | 10.7% | 12.8% | 18.2% | 21.0% | 21.7% | 23.9% | 25.5% | 26.8% | 28.1% |
| Tax Rate | 36.5% | 39.9% | 34.3% | 34.0% | 29.0% | 29.0% | 29.0% | 29.0% | 29.0% |
| Net Income | 6.8% | 7.7% | 11.9% | 13.8% | 15.4% | 17.0% | 18.1% | 19.1% | 20.0% |

*Source: Deutsche Bank and company reports*

Figure 21: Statement of Operations – Quarterly Income ($ in thousands, except per – share data)

| FY: DEC | Jan-Mar 1Q11A | Apr-Jun 2Q11A | Jul-Sep 3Q11A | Oct-Dec 4Q11A | Jan-Mar 1Q12A | Apr-Jun 2Q12A | Jul-Sep 3Q12A | Oct-Dec 4Q12E | Jan-Mar 1Q13E | Apr-Jun 2Q13E | Jul-Sep 3Q13E | Oct-Dec 4Q13E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenues:** | | | | | | | | | | | | |
| Net sales | $983 | $1,074 | $1,049 | $1,127 | $1,047 | $1,094 | $1,019 | $1,142 | $1,082 | $1,143 | $1,074 | $1,211 |
| TOTAL REVENUES | 983 | 1,074 | 1,049 | 1,127 | 1,047 | 1,094 | 1,019 | 1,142 | 1,082 | 1,143 | 1,074 | 1,211 |
| **Cost of Goods Sold:** | | | | | | | | | | | | |
| COGS | $381 | $454 | $398 | $419 | $393 | $377 | $360 | $434 | $383 | $401 | $375 | $421 |
| GROSS PROFIT | 602 | 620 | 651 | 708 | 654 | 717 | 659 | 708 | 699 | 742 | 699 | 790 |
| **Operating Expenses:** | | | | | | | | | | | | |
| R&D | 101 | 105 | 102 | 119 | 94 | 90 | 104 | 110 | 98 | 100 | 103 | 106 |
| SG&A | 335 | 360 | 331 | 427 | 338 | 344 | 335 | 388 | 340 | 346 | 339 | 389 |
| Amortization of Intangible Assets | 5 | 5 | 5 | 5 | 4 | 3 | 4 | 4 | 4 | 4 | 4 | 4 |
| Other (Income) / Expenses | 1 | 13 | 2 | 68 | 2 | (12) | (4) | - | - | - | - | - |
| Total Operating Expenses | 442 | 483 | 440 | 619 | 438 | 425 | 439 | 502 | 442 | 450 | 446 | 499 |
| OPERATING INCOME | 160 | 137 | 211 | 89 | 216 | 292 | 220 | 206 | 257 | 292 | 253 | 291 |
| Interest expense | | | | | 8 | 8 | 8 | 8 | 29 | 29 | 29 | 29 |
| PRETAX INCOME | 160 | 137 | 211 | 89 | 208 | 284 | 212 | 198 | 228 | 263 | 224 | 262 |
| Taxes | 35 | 38 | 53 | 20 | 59 | 107 | 24 | 117 | 66 | 76 | 65 | 76 |
| Net Income Before Minority Interest | 125 | 99 | 158 | 69 | 149 | 177 | 188 | 81 | 162 | 186 | 159 | 186 |
| Minority Interests | 1 | - | 1 | 1 | 1 | - | (1) | | | | | |
| Net Income Attributable to Zoetis | 124 | 99 | 157 | 68 | 148 | 177 | 189 | 81 | 162 | 186 | 159 | 186 |
| NET INCOME | 169 | 147 | 209 | 181 | 189 | 180 | 181 | 81 | 162 | 186 | 159 | 186 |
| Adjusted EBIT | 166 | 155 | 218 | 162 | 222 | 283 | 220 | 210 | 261 | 296 | 257 | 295 |
| Adjusted EBITDA | | | | | | | | 240 | 291 | 325 | 287 | 325 |
| Shares Outstanding | | | | | | | | | 500.0 | 500.3 | 500.6 | 500.9 |
| Shares Outstanding (fully diluted) | | | | | | | | | 504.5 | 504.8 | 505.1 | 505.4 |
| Reported EPS--basic | | | | | | | | | $0.32 | $0.37 | $0.32 | $0.37 |
| **Reported EPS--fully diluted** | | | | | | | | | **$0.32** | **$0.37** | **$0.31** | **$0.37** |

| **MARGINS:** | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross | 61.2% | 57.7% | 62.1% | 62.8% | 62.5% | 65.5% | 64.7% | 62.0% | 64.6% | 64.9% | 65.1% | 65.3% |
| R&D | 10.3% | 9.8% | 9.7% | 10.6% | 9.0% | 8.2% | 10.2% | 9.6% | 9.1% | 8.7% | 9.6% | 8.8% |
| SG&A (total) | 34.1% | 33.5% | 31.6% | 37.9% | 32.3% | 31.4% | 32.9% | 34.0% | 31.4% | 30.3% | 31.6% | 32.1% |
| Operating | 16.3% | 12.8% | 20.1% | 7.9% | 20.6% | 26.7% | 21.6% | 18.1% | 23.8% | 25.5% | 23.6% | 24.0% |
| Pre-tax | 16.3% | 12.8% | 20.1% | 7.9% | 19.9% | 26.0% | 20.8% | 17.3% | 21.1% | 23.0% | 20.9% | 21.6% |
| Tax Rate | 21.9% | 27.7% | 25.1% | 22.5% | 28.4% | 37.7% | 11.3% | 58.9% | 29.0% | 29.0% | 29.0% | 29.0% |
| Net Income | 12.7% | 9.2% | 15.1% | 6.1% | 14.2% | 16.2% | 18.4% | 7.1% | 15.0% | 16.3% | 14.8% | 15.4% |

*Source: Deutsche Bank and company reports*

**Figure 22: Zoetis Product Summary ($ in thousands)**

| FY: DEC | 2009A | 2010A | 2011A | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E |
|---|---|---|---|---|---|---|---|---|---|
| **Operating Segment (Summary)** | | | | | | | | | |
| **U.S.** | **1,105** | **1,384** | **1,659** | **1,760** | **1,850** | **1,937** | **2,024** | **2,113** | **2,204** |
| *% year-over-year* | | *25.2%* | *19.9%* | *6.1%* | *5.1%* | *4.7%* | *4.5%* | *4.4%* | *4.3%* |
| *% of total revenue* | *40.0%* | *38.6%* | *39.2%* | *40.9%* | *41.0%* | *40.6%* | *40.1%* | *39.7%* | *39.3%* |
| **EuAfME (Europe, Africa, M. East)** | **880** | **1,020** | **1,144** | **1,084** | **1,109** | **1,158** | **1,207** | **1,255** | **1,305** |
| *% year-over-year* | | *15.9%* | *12.2%* | *-5.2%* | *2.3%* | *4.4%* | *4.2%* | *4.0%* | *4.0%* |
| *% of total revenue* | *31.9%* | *28.5%* | *27.0%* | *25.2%* | *24.6%* | *24.3%* | *23.9%* | *23.6%* | *23.3%* |
| **CLAR (Canada, Latin America)** | **451** | **664** | **788** | **769** | **803** | **871** | **942** | **1,017** | **1,094** |
| *% year-over-year* | | *47.2%* | *18.7%* | *-2.4%* | *4.4%* | *8.5%* | *8.2%* | *7.9%* | *7.6%* |
| *% of total revenue* | *16.3%* | *18.5%* | *18.6%* | *17.9%* | *17.8%* | *18.2%* | *18.7%* | *19.1%* | *19.5%* |
| **APAC (Asia, Pacific)** | **324** | **514** | **642** | **689** | **748** | **809** | **872** | **937** | **1,003** |
| *% year-over-year* | | *58.6%* | *24.9%* | *7.3%* | *8.5%* | *8.2%* | *7.8%* | *7.4%* | *7.1%* |
| *% of total revenue* | *11.7%* | *14.3%* | *15.2%* | *16.0%* | *16.6%* | *16.9%* | *17.3%* | *17.6%* | *17.9%* |
| **TOTAL REVENUE** | **$2,760** | **$3,582** | **$4,233** | **$4,302** | **$4,510** | **$4,775** | **$5,046** | **$5,322** | **$5,607** |
| *Year-over-year % growth* | | *29.8%* | *18.2%* | *1.6%* | *4.8%* | *5.9%* | *5.7%* | *5.5%* | *5.4%* |
| **TOTAL COGS** | **1,001** | **1,318** | **1,581** | **1,564** | **1,580** | **1,633** | **1,700** | **1,772** | **1,850** |
| COGS % | *36.3%* | *36.8%* | *37.3%* | *36.4%* | *35.0%* | *34.2%* | *33.7%* | *33.3%* | *33.0%* |
| GROSS PROFIT % | *63.7%* | *63.2%* | *62.7%* | *63.7%* | *65.0%* | *65.8%* | *66.3%* | *66.7%* | *67.0%* |

*Source: Deutsche Bank and company reports*

# Appendix A

Figure 23: Zoetis' largest livestock and companion animal brands

| Livestock Portfolio | | |
|---|---|---|
| **Products** | **Primary Species** | **Therapeutic Area** |
| Bovi-Shield line | Cattle | Vaccines |
| Improvac / Improvest | Swine | Vaccines |
| RespiSure line | Swine | Vaccines |
| Rispoval line | Cattle | Vaccines |
| Cydectin | Cattle, Sheep | Parasiticides |
| Dectomax | Cattle, Swine | Parasiticides |
| Aureomycin | Cattle, Poultry, Sheep, Swine | Anti-Infectives |
| BMD | Cattle, Poultry, Swine | Anti-Infectives |
| Excenel RTU | Cattle, Horses, Sheep, Swine | Anti-Infectives |
| Draxxin | Cattle, Swine | Anti-Infectives |
| Lincomycin line | Swine, Poultry | Anti-Infectives |
| Spectramast | Cattle | Anti-Infectives |
| Terramycin | Cattle, Poultry, Sheep, Swine | Anti-Infectives |
| Eazi - Breed CIDR | Cattle, Sheep | Other |
| Embrex devices | Poultry | Other |
| Lutalyse | Cattle, Swine | Other |

| Companion Animal Portfolio | | |
|---|---|---|
| **Products** | **Primary Species** | **Therapeutic Area** |
| Vanguard 4-way Lepto | Dogs | Vaccines |
| Vanguard High Titer | Dogs | Vaccines |
| Revolution | Cats, Dogs | Parasiticides |
| Clavamox / Synulox | Cats, Dogs | Anti-Infectives |
| Convenia | Cats, Dogs | Anti-Infectives |
| Terramycin | Cats, Dogs, Horses | Anti-Infectives |
| Rimadyl | Dogs | Pain / Sedation |

*Source: Company reports*

# Appendix 1

## Important Disclosures

### Additional information available upon request

| Disclosure checklist | | | |
|---|---|---|---|
| Company | Ticker | Recent price* | Disclosure |
| Zoetis | ZTS.N | 33.82 (USD) 12 Mar 13 | 1 |

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies

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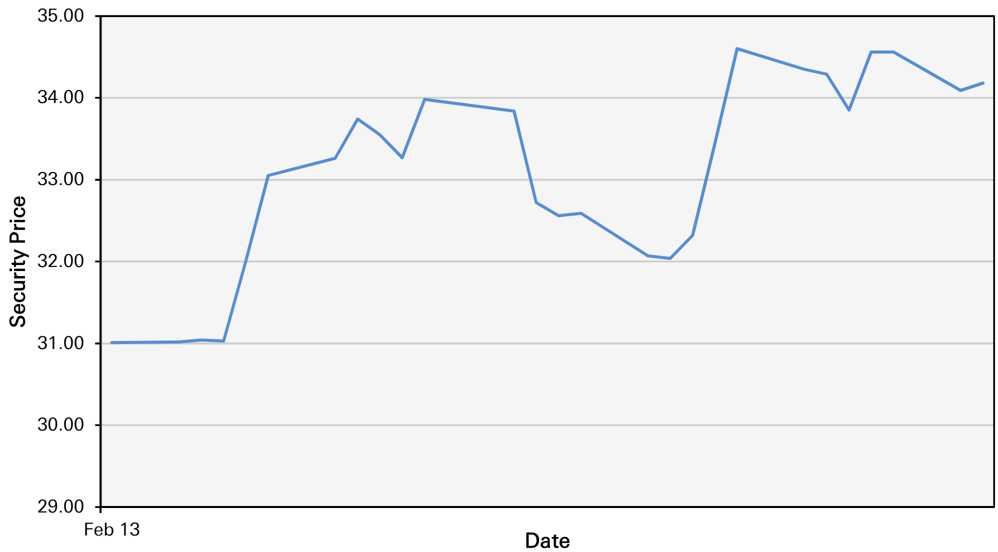
## Historical recommendations and target price: Zoetis (ZTS.N)

*(as of 3/12/2013)*




Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

## Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield ) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
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Notes:

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2. Ratings definitions prior to 27 January, 2007 were:

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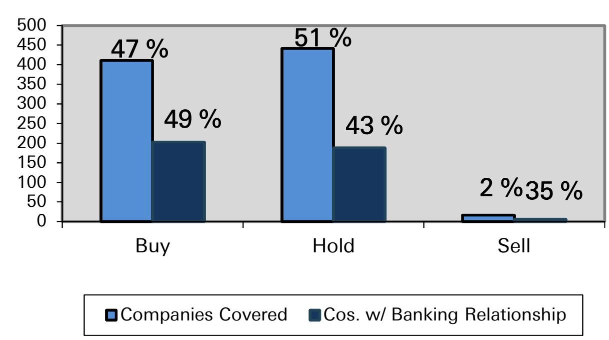
## Equity rating dispersion and banking relationships




North American Universe

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## Deutsche Bank Securities Inc.

### North American locations


Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
Tel: (212) 250 2500

Deutsche Bank Securities Inc.
One International Place
12th Floor
Boston, MA 02110
United States of America
Tel: (1) 617 217 6100

Deutsche Bank Securities Inc.
222 South Riverside Plaza
30th Floor
Chicago, IL 60606
Tel: (312) 537-3758

Deutsche Bank Securities Inc.
1735 Market Street
24th Floor
Philadelphia, PA 19103
Tel: (215) 854 1546

Deutsche Bank Securities Inc.
101 California Street
46th Floor
San Francisco, CA 94111
Tel: (415) 617 2800

Deutsche Bank Securities Inc.
700 Louisiana Street
Houston, TX 77002
Tel: (832) 239-4600


### International locations


Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500

Deutsche Bank AG London
1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank AG
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG
Filiale Hongkong
International Commerce Centre,
1 Austin Road West,Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770


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