

Zoetis, Inc.

(ZTS - \$32.66)

April 30, 2013

Company Update **Note**

Medical Devices & Supplies

Strong Buy
\$41.00

Trading Data:

Last Price (4/30/2013)	\$32.66
52-Week High (3/14/2013)	\$35.42
52-Week Low (4/24/2013)	\$30.42
Market Cap. (MM)	\$16,330
Shares Out. (MM)	500
3 Month Avg. Daily Vol. (MM)	3.149

Estimates/TP Changes

Item	FY	Previous	Current
EPS (\$)	FY13E	\$1.30	\$1.36

Earnings Estimates: (\$ per share)

(Dec)	Q1	Q2	Q3	Q4	FY
FY14E	0.35	0.40	0.37	0.38	1.50
FY13E	0.36A	0.35	0.32	0.33	1.36
FY12A	0.30	0.35	0.30	0.12	1.08
FY11A	0.24	0.22	0.29	0.24	1.00

Valuation:

Multiple	Curr. FY	Next FY	Next FY @ PT
P/E	24.0	21.8	27.3
EV / EBITDA	15.0	13.3	27.3
EV / Revs.	4.2	3.8	16.4

Source: CL King & Associates estimates

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See required disclosures at the end of report.

Initial Analysis Suggests Q1 Results Very Good

- Zoetis reported Q1 organic revenue growth of 5%, consistent with our projection of 4.5%. Adjusted EPS were \$0.36 compared to \$0.30 last year and higher than our estimate of \$0.30 and the consensus at \$0.33.
- The company provided 2013 EPS guidance of \$1.36-\$1.42.
- Based on our initial analysis, we view the Q1 results and guidance positively and we reiterate our Strong Buy rating.

Summary of Q1 results: Our initial analysis suggests to us that Zoetis' Q1 (March) results were very good. Organic revenue growth was 5%, essentially in-line with our forecast of 4.5%. Reported revenues were \$1,090MM compared to \$1,047MM last year. Changes in foreign currencies reduced revenues by 1%. Zoetis reported adjusted Q1 EPS of \$0.36 compared to \$0.30 last year, which is higher than our estimate of \$0.30 and the consensus estimate of \$0.33.

Company provides 2013 guidance: Importantly, the company issued 2013 guidance for the first time. 2013 EPS guidance is a range of \$1.36-\$1.42 and 2013 revenue guidance is \$4,425MM-\$4,525MM.

Raising 2013 EPS to reflect higher Q1 result than our forecast: With the \$0.06 higher result in Q1 compared to our forecast we are comfortable raising our 2013 EPS estimate to \$1.36 from \$1.30. Our current revenue estimate is \$4,563MM, which slightly higher than management's guidance, possibly attributable to differences in foreign currency exchange rate assumptions.

Organic revenue growth by region and species: Organic revenue growth was 7% in the U.S., 4% in Europe/Africa/Middle East, 4% in Canada/Latin America/Russia, and 2% in Asia/Pacific. Production animal organic revenue growth was 3% in Q1, while companion animal organic revenue growth was 8%. Within production animal, and on an organic basis, cattle revenues declined 2%, swine increased 11%, poultry increased 12%, and other declined 3%.

Zoetis' U.S. companion animal segment was the fastest growing segment in Q1 with revenues increasing 13% on an organic basis. The situation with Novartis' (NVS^^: NR) Sentinel aided U.S. companion animal growth in the quarter; at the moment we expect growth of this Zoetis segment to moderate in future quarters.

Our initial conclusions: Based on our initial analysis, we believe investors should view the Q1 results and 2013 guidance positively. We remain

comfortable with our projections and investment thesis. We believe the results may ease some of the recent investor concerns about near-term end-market growth that has been driven by the March quarter financial reports of some other animal health pharmaceutical companies over the last two weeks.

Investment thesis and valuation: We believe Zoetis is well positioned to deliver stable, predictable and sustainable growth. We forecast the five-year compound annual growth in organic revenues and EPS should be at least 6% and 10%, respectively. We also view Zoetis as an excellent investment in the growth of the animal health industry. Zoetis has many of the characteristics of the other high-quality growing animal health companies we follow, including stable revenue growth, high margins and returns, and operations within an oligopolistic animal health industry segment. We project the global animal pharmaceutical industry should grow 6% annually over the next five years, driven by both the production animal and companion animal sectors. Also, we believe growth in developing economies and increasing global demand for protein should be an important source of the company's long-term growth. Emerging markets currently contribute 27% of Zoetis' revenues.

We believe in the current sluggish macroeconomic environment investors will continue to be attracted to companies like Zoetis that are able to deliver steady revenue and earnings growth driven by unit growth and pricing power adequate to offset cost inflation. Furthermore, we anticipate healthcare investors will continue to be attracted to companies that are insulated from reimbursement pressure from the government and other third parties. We believe Zoetis' industry-leading position and high market share should facilitate its growth and help mitigate risk. In addition, we believe the company's high level of R&D spending and large direct sales and marketing organization help create sustainable competitive advantages. Valuation data is in the table below.

Table 2: Valuation Multiples for Zoetis

Item	2012PF	2013E	2014E
Stock price	\$32.66	\$32.66	\$32.66
Revenues (in 1,000's)	\$4,336,000	\$4,562,840	\$4,878,018
EBITDA (in 1,000's)	\$1,105,000	\$1,281,428	\$1,406,543
EPS - GAAP	\$1.01	\$1.29	\$1.42
EPS adj to add back amortization exp.	\$1.08	\$1.36	\$1.50
P / E ratio - based on adj. EPS	30.3 x	24.1 x	21.7 x
EV / EBITDA ratio	17.6 x	15.0 x	13.3 x
EV / Revenue ratio	4.5 x	4.2 x	3.8 x
ROA	9.2%	11.0%	12.0%
ROE	22.2%	49.2%	38.7%
Enterprise value computation:			
Equity market value (in 1,000's)	\$16,330,000	\$16,593,085	\$16,759,639
Total debt (in 1,000's)	\$3,640,000	\$3,340,000	\$2,540,000
Cash (in 1,000's)	\$484,000	\$730,552	\$544,019
Enterprise value (in 1,000's)	\$19,486,000	\$19,202,534	\$18,755,620

Source: CL King & Associates estimates

Risks

There are a number of potential risks that could have a negative affect on Zoetis' business and its stock:

- Regulators could impose new restrictions on the use of antibiotics in production animals due to concerns about antimicrobial resistance in humans. Similarly, changes in consumer views of products from animals treated with antibiotics could also impact Zoetis' business.
- The production animal and companion animal markets are sensitive to the economy, so if the economy weakens materially Zoetis' revenues and income may be lower than we project.
- Severe weather conditions such as drought could negatively affect Zoetis' production animal business. For example, drought can result in higher grain and feed prices and reduce available grazing pastures, either one of which could result in a reduction of beef and dairy cattle herds.
- Within our financial forecasts we project Zoetis' margins should expand over the next several years. There is a risk the company may not be successful in improving margins as much as we expect. Also, the company may not be as effective as we project in managing its operations and expenses during its process of fully separating from Pfizer.
- We anticipate Pfizer should eventually distribute its 80% ownership position in Zoetis to Pfizer shareholders. This could result in significant sales of Zoetis stock on the open market, which could cause Zoetis' stock price to decline.

Previous research update – 04/01/13

DISCLOSURES:

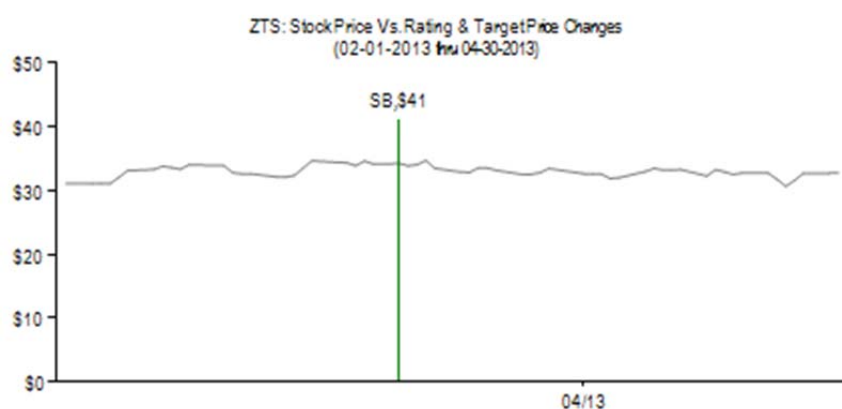
ANALYST CERTIFICATION

I, Ross Taylor, certify that all views expressed by me in this research report regarding the securities, as named herein, and its issuers accurately reflect my personal views. I further certify that I have not and will not receive compensation directly or indirectly related to any specific recommendations or views expressed in this research report.

Additional information available upon request.

^^ The covering analyst owns shares of the company.

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Date	Rating	Closing Price, (\$)
03/11/2013	Strong Buy (SB)	34.18

3 Year Price Change History

Date	Target Price	Closing Price, (\$)
03/11/2013	41.00	34.18

Source: CL King & Associates, Created by: www.ResearchMaestro.net

Note: Prior to 02/01/2011 Buy was Accumulate
Prior to 02/01/2011 Sell was Underperform

CL King Rating System*		% of Companies Under Coverage With This Rating	% of Companies for which CL King has performed services for in the last 12 months	
			Investment Banking	Brokerage
Strong Buy (SB)	Analyst believes shares will appreciate by 20% or more over the next 6-12 months and should significantly outperform the broader market averages. Analyst believes the risk of long-term capital impairment is below-average.	18.25%	0.00%	1.46%
Buy (B)	Analyst believes shares will appreciate in a range of 10% to the upper teens over the next 6-12 months and will outperform the broader capital market averages. Analyst believes the risk of long-term capital impairment is below-average, but not as low as it is for Strong Buy.	35.77%	1.46%	1.46%
Neutral (N)	Analyst believes the current stock price fairly discounts the company's prospects over the next 6-12 months, give or take 10%, and will trade in-line with the broader market averages. Analyst believes the risk of permanent capital impairment is about average.	44.53%	1.46%	1.46%
Sell (S)	Analyst expects the stock price to decline 10% or more over the next 6-12 months and to underperform the broader market averages.	1.46%	0.00%	0.00%

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