

Zoetis

(ZTS-NYSE)

Stock Rating: Outperform
Stock Price: \$31.17
Target Price: \$38.00

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Pharmaceuticals

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We View the FDA's Final Guidance on Livestock Antibiotics as Merely a Headwind

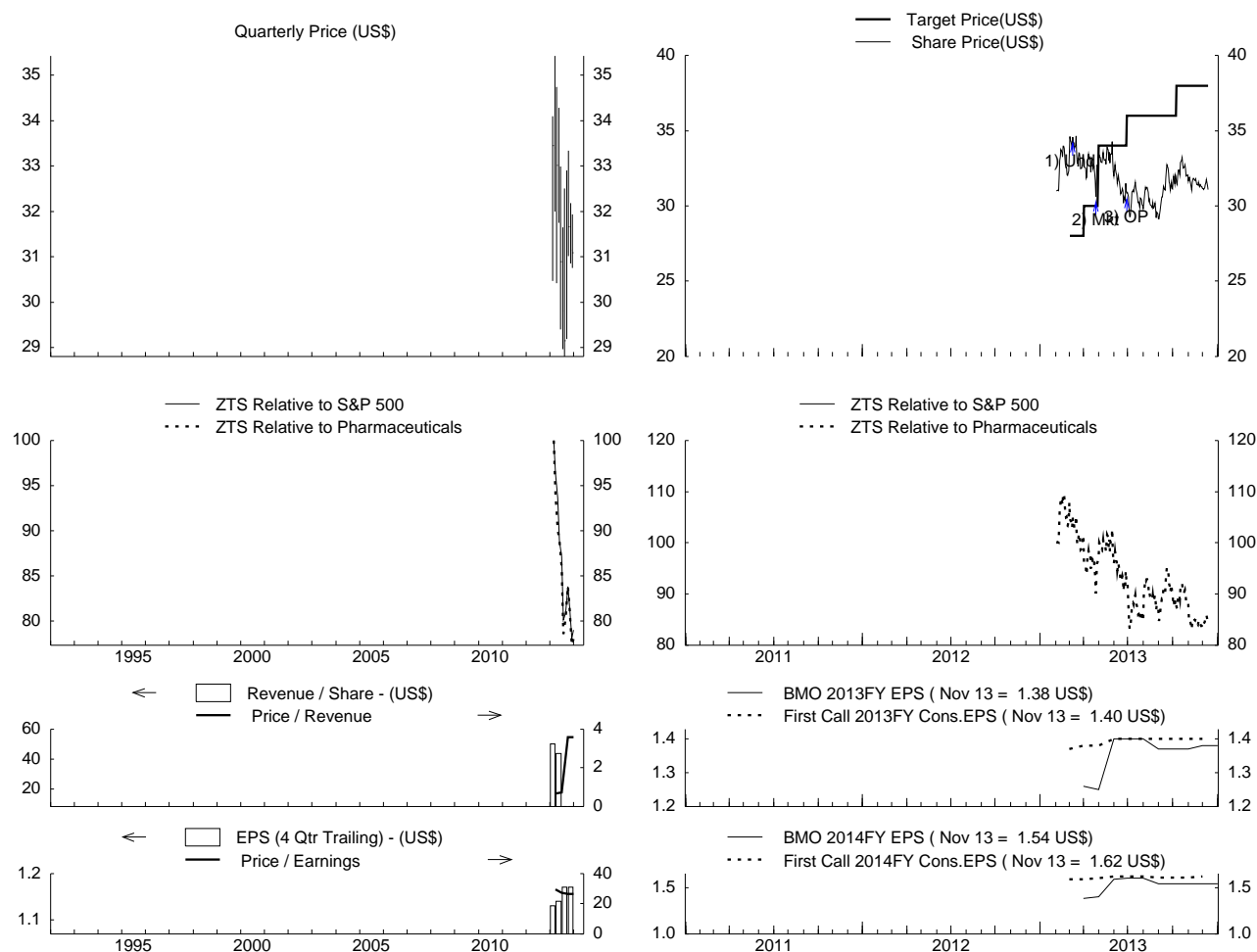
The FDA recently issued its final guidance for a plan to help phase out the use of medically important antimicrobials in food animals for food production purposes. The plan calls for the companies to voluntarily revise the FDA-approved label of these products to remove the production indications (i.e., growth promotion, and feeding efficiency). This would be a three-year transition process. The plan also calls for changing the current over-the-counter (OTC) status of these products to bring the remaining appropriate therapeutic uses under veterinary oversight.

Our View:

- Positive. The issuance of the guidance was widely expected; however, we believe that the FDA could have been more strict. Based on our conversation with the company, Zoetis believes that the plan would have an “insignificant” impact on their financial performance. The company had been anticipating this for some time. In 2012, antibiotics for livestock accounted for nearly 27% of Zoetis’s worldwide revenues, or roughly \$1.2 billion. Zoetis’s top selling product line, the Ceftiofur line, is an anti-infective for livestock and accounted for 7% of total revenues. We estimate that the next top selling anti-infective for livestock is Draxxin, and that it accounts for roughly 6.5% of revenues. Therefore, we estimate that roughly half of the revenues from livestock anti-infectives come from Zoetis’s premium antibiotic products that are mostly used for disease control. That leaves 14% of Zoetis’s worldwide revenues, of which we estimate ~40-50% come from the US (i.e., \$240-\$300 million). Moreover, not all of these anti-infectives are what the FDA would consider medically important, and most are generics with lower margins. Finally, the removal of the growth promotion and feeding efficiency labels of these products does not necessarily mean that they are not going to be used. They can still be used with veterinary oversight for disease control and disease prevention, provided that the animal producers, with the aid of a veterinarian, can show there is a risk of a specific disease and that there is scientific rationale for using the drugs. Finally, the process is voluntary and will be a three-year transition; thus, the impact should be gradual.
- Overall, we see this development as merely a headwind for Zoetis. Offsetting this, Zoetis has a number of promising new products launching, such as Apoquel in the large dog atopic dermatitis market, and two generic beta agonists that will likely benefit from ongoing concerns with Merck’s Zilmax. We reiterate our Outperform rating for ZTS shares.

This report was prepared by an analyst(s) employed by BMO Nesbitt Burns Inc. For disclosure statements, including the Analyst's Certification, please refer to pages 2 to 4.

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*	1.17	26.6	0.26	0.8	22	1.6	19.5	>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 Q3/2013.

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

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

Last Price (December 11, 2013): \$31.09
Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

Important Disclosures

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Company Specific Disclosure

Methodology and Risks to Our Price Target

Methodology: DCF and P/E Multiple

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

Distribution of Ratings (September 30, 2013)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
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Hold	Market Perform	59.4%	13.1%	51.1%	56.9%	50.2%	41.7%
Sell	Underperform	4.9%	3.4%	1.1%	6.4%	1.5%	5.6%

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(S) = Speculative investment;

NR = No rating at this time; and

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