

Zoetis Inc.

ZTS - BUY - Aratana Acquisition of Vet Therapeutics Underscores Companion Animal Opportunity Represents Unmet Need

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FLASH NOTE

SECTOR: Specialty Pharmaceuticals

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Most of ZTS's sales come from livestock, so expansion of companion animal franchise could be upside. As of 2Q13, companion animal was 40% of ZTS's (BUY, \$32.40) sales. This morning Aratana (PETX, NC, \$23.49) announced that it will acquire Vet Therapeutics, an animal health company focused on biologics for pets. The company held a conference call to review the deal. We highlight the key takeaways from the call that support our positive investment thesis on ZTS.

- The announcement of this acquisition and the discussion of other potential deals in animal health may be a signal that animal health companies, like their human health counterparts, may be starting to undergo a wave of consolidation. This could drive increases in their valuations through multiple expansion. We thus view ZTS as a net acquirer in the near term. Companies like Aratana and other development stage animal health companies show that there are still many pipeline opportunities for ZTS as an independent company outside of Pfizer ([PFE, NC, \$28.72], which has been noted as a downside risk for ZTS). ***Please see our chart below for more details.***
- Vet Therapeutics, Inc., is a San Diego-based company with a proprietary antibody-based biologics platform. Aratana believes the existing market in the U.S. for pet oncology treatment is approximately \$2 billion based on off-label use of human chemotherapy products. Therefore, species-specific antibodies represent a large potential opportunity for animal health companies. Currently, veterinarians treat pets with human drugs, but these may not be effective because these proteins were made for humans.
- Aratana expects the margins for pet biologics to be similar to branded human drug margins. Therefore, an increasing focus on companion animal drugs could drive margin expansion for ZTS. We forecast gross margins of 64% in 2013 for ZTS while brand human drugs can have margins of 90%+.
- Aratana noted that the drug approval process is more efficient through the USDA versus CVM. This was yet another reason why it acquired Pet Therapeutics. It wanted to gain more expertise in dealing with the USDA.

Potential Stock Moving Catalysts. 1) Operating margin expansion; 2) new product launches; 3) business development; 4) expansion into adjacent categories; 5) U.S. drought subsidies; and 6) strong flea and tick season.

Mergers and Acquisitions Comparable Companies Analysis

Year	Buyer Name	Seller Name	EV (\$MM)	EV /Sales	EV / EBITDA ¹
2006	Central Garden & Pet	Farnam Cos.	291	1.8x	NA
2007	Pfizer	Embrex	149	2.8x	14.9x
2008	Pfizer	Catapult Pty.	NA	NA	NA
2008	Pfizer	Bovigen	NA	NA	NA
2009	Sanofi	Merck (50% interest in Merial)	4,000	3.0x	10.2x
2009	Pfizer	Qvax	5	NA	NA
2009	Pfizer	Vetnax	65	NA	NA
2009	Pfizer	Fort Dodge Animal Health	2,300	2.4x	9.6x
2010	Henry Schein	Butler Animal Health Supply	410	NA	NA
2010	Bayer AG	Bomac Laboratories	101	2.2x	NA
2010	Pfizer	Microtek International	6.0	NA	NA
2010	Pfizer	Synbiotics	24.0	NA	NA
2010	VCA Antech	Pet DRx	41	0.6x	NA
2011	Henry Schein	Provet Holdings	91	0.3x	NA
2011	Elanco	Janssen Animal Health	308	1.5x	NA
2011	Pfizer	King Animal Health	345	0.9x	NA
2011	Lextron	Animal Health International	247	0.3x	11.2x
2012	Henry Schein	Butler Schein Animal Health	724	0.4x	NA
2012	Royal DSM	Tortuga	547	1.1x	7.4x
2012	Dechra Pharmaceuticals	Eurovet Animal Health	177	1.8x	NA
2012	Bayer Healthcare	Teva Animal Health	145	NA	NA
2012	Bayer Healthcare	KMG Chemicals	10.2	0.9x	NA
2012	Perrigo	Sargeant's Pet Care	235	1.7x	NA
2012	Nestle ²	Pfizer Nutrition	11,850	5.6x	19.8x
2012	Merial ³	Dosch Pharmaceuticals (Animal Health)	NA	NA	NA
2013	MWI Veterinary Supply	PCI Animal Health	17	0.5x	NA
2013	Neogen	Scidera Genomics	NA	NA	NA
2013	Perrigo	Velcera	160	2.7x	NA
2013	Heska Corp.	Cuattro Veterinary USA	14	0.7x	9.2x
2013	Elanco	China Animal Healthcare	500	3.7x	8.4x
2013	Aratana Therapeutics	Vet Therapeutics	48	NA	NA
Average			\$813	1.9x	11.3x
Median			\$155	1.8x	9.9x
High			\$11,850	5.6x	19.8x
Low			\$5	0.3x	7.4x

Source: Guggenheim Securities, LLC, Factset, Company Reports

(1) EV means Enterprise Value. Multiples are calculated on historical sales and EBITDA; Heska acquisition is showing EV/EBIT

(2) EV/EBITDA for Nestle acquisition is based on Nestle's projected 2012 EBITDA for Pfizer's Nutrition business

(3) Deal expected to close in 1H13

(4) Average is arithmetic.

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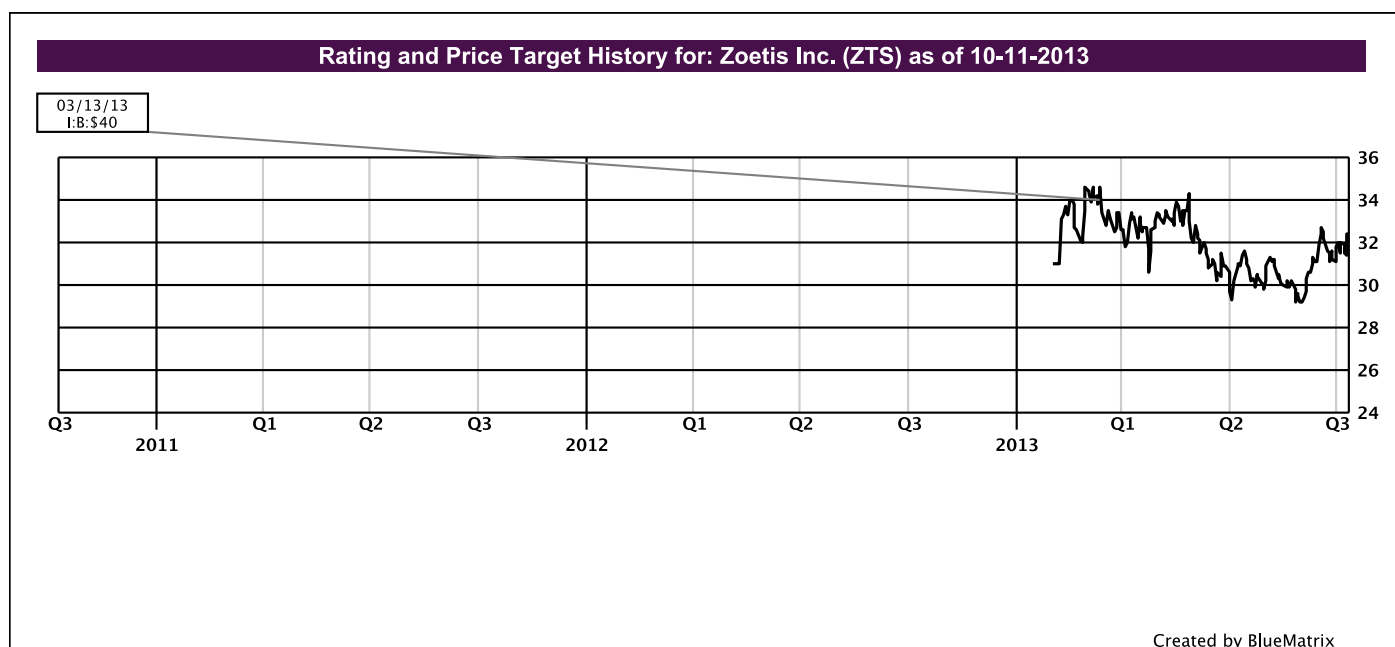
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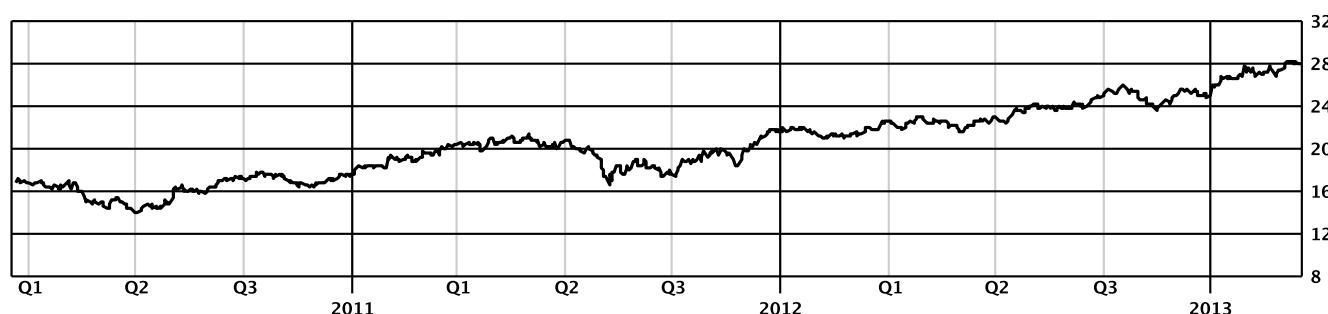
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Rating and Price Target History for: Pfizer Inc. (PFE) as of 03-19-2013



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