



Rating
Buy

North America
United States

Health Care
Pharmaceuticals /
Specialty

Company
Zoetis Alert

Reuters
ZTS.N

Bloomberg
ZTS US

Exchange
NYS

Ticker
ZTS

Date
7 August 2013

Results

Price at 6 Aug 2013 (USD)	31.13
Price target	38.00
52-week range	34.64 - 29.28

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Q2 In-line; Revs Poised to Reaccelerate in 2H13

Q2 EPS In-line; Revs Slightly Light (-\$15M) Due -2% Fx Impact

Zoetis reported adjusted Q2 non-GAAP EPS of \$0.36 (+3% Y/Y), exactly in-line with consensus. Revenue of \$1.11B (+4% Y/Y in constant currency) was a little light (-\$15M) vs the Street – primarily due to currency fluctuations, which negatively impacted the company's topline by 2%. Relative to our projections, slightly lower than forecasted gross margin (-80 bp) and an incrementally higher tax rate (+40 bp) were offset by lower than estimated operating expenses (-\$16M). Importantly, given Zoetis' global scale and diversity of portfolio, the solid Q2 results were achieved despite ongoing weather related challenges and economic issues impacting certain regions (see below).

Ex-Currency Drag, Weather Negatively Impacted Europe and Asia Pacific; Solid 4% Gains in the US and Canada/LatAm

As expected (see our note *"Recent Share Price Weakness Offers Attractive Entry Point"* published July 7), a cooler, wet Spring and challenging economic conditions in the region negatively impacted livestock products in Europe (resulting in a 1% Y/Y operational increase in segment rev growth). And drought conditions, which negatively impacted livestock in Australia, dampened what was otherwise a strong 7% Y/Y operational gain in Asia Pacific. US revs increased a modest 4% driven by uptake of livestock products (cattle, swine, poultry) and to a lesser extent growth in small companion animal products, despite more difficult comparables due to the return to market of Novartis' flea/tick product Sentinel. Overall Canada/LatAm revs grew 4% operationally, driven by companion animal product gains in Brazil and Mexico, but were slightly offset by lower sales in cattle products in Canada.

2013 Guidance Reaffirmed; Early Signs of Drought Impact Easing in the US

Mgt reaffirmed its prior full year 2013 financial guidance (EPS of \$1.36-1.42 on revs of \$4.425-\$4.525B). And despite challenging conditions in 1H13, mgt noted that some of the broader economic and business-related factors impacting its customers are improving. For instance, mgt highlighted lower corn prices benefiting the overall livestock industry – which is resulting in herds being moved from the pasture to feed lots. As a result, mgt expects livestock activity to improve in 2H13 – reflecting both easier comps and lower livestock production costs – with the market anticipated to return to pre-drought levels over the next 12 months. Potentially slightly offsetting the aforementioned positive livestock dynamics (particularly for cattle) in the US is an outbreak of porcine epidemic diarrhea virus in the US, similar to an outbreak in China last year. After posting 3% rev growth in 1H13, we forecast a modest acceleration in 2H13 (+5%) and maintain our project full year 2013 rev and EPS ests of \$4.51B and \$1.41.

Attractive Entry Point for ZTS Shares Post Q2 Results; PT Remains \$38

Our 12 month PT remains \$38 – 23.8x our 2014 EPS est of \$1.60 – or 1.8x its PEG ratio. Key risks are largely exogenous (food safety issues, major infectious disease outbreak, macroeconomic "shock," etc.).

Key changes

EPS (USD)	1.41 to 1.41	↓	-0.0%
Revenue (USDm)	4,511.9 to 4,505.9	↓	-0.1%

Source: Deutsche Bank

Stock & option liquidity data

Market cap (USD)	15,572.0
Shares outstanding (m)	500.2
Free float (%)	100
Volume (6 Aug 2013)	1,671,213
Option volume (und. shrs., 1M avg.)	–

Source: Deutsche Bank

Key data

FYE 12/31	2012A	2013E	2014E
1Q EPS	–	0.36A	–
2Q EPS	–	0.36A	–
3Q EPS	–	0.34	–
4Q EPS	–	0.36	–
FY EPS (USD)	1.08	1.41	1.60
P/E (x)	–	22.1	19.5

Source: Deutsche Bank

* Includes the impact of FAS123R requiring the expensing of stock options.

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