Pharmaceuticals
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INITIATION OF COVERAGE
(March 12, 2013)

Key Metrics

ZTS - NYSE (Price as of 3/11/13)		$34.18
Price Target		NA
52-Week Range		$34.89 - $30.47
Shares Outstanding (mm)		500.0
Market Cap. ($mm)		$17,090
3-Mo. Average Daily Volume		4,778,560
Institutional Ownership		NA
Tot. Debt/Tot. Debt+Equity (9/12)		77.7%
ROE (2012)		51.0%
Book Value/Share (3/11/13)		$8.20
Price/Book Value		4.17x
Indicated Dividend / Yield	$0.00	0.0%
LTM EBITDA Margin		24.9%

EPS FY 12/31

	Pro-forma			Prior	Curr.
	2011		2012E	2013E	2013E
1Q	--	--	--	--	--
2Q	--	--	--	--	--
3Q	--	--	--	--	--
4Q	--	--	--	--	--
Year	$0.90		$1.07		$1.25
P/E	38.0x		31.9x		27.3x

Note: Figures exclude non-recurring items

Revenue ($mm)

	Pro-forma			Prior	Curr.
	2011		2012E	2013E	2013E
1Q	--	--	--	--	--
2Q	--	--	--	--	--
3Q	--	--	--	--	--
4Q	--	--	--	--	--
Year	$4,233		$4,300		$4,590

Company Description: *Zoetis operates the world's largest animal health business. Zoetis is involved in the development, production, and marketing of vaccines, medicines, and diagnostic tests to prevent and treat disease in livestock and companion animals. The company sells products worldwide with strong market positions in the U.S., Europe, Africa and the Middle East, Canada, Latin America, and Asia/Pacific.*

Zoetis, Inc.

ZTS – NYSE – Neutral – 2

Initiating Coverage with a Neutral Rating

- **Pfizer has pursued strategic alternatives for its animal health and nutrition businesses**. PFE management noted these businesses had different objectives from PFE's core pharmaceutical businesses, and their value to Pfizer shareholders might be maximized by a spin-off, sale, or other transaction. Pfizer sold Pfizer Nutrition to Nestle for $11.85 billion.
- **Pfizer conducted an initial public offering for its animal health business, named Zoetis**. A minority stake in the unit was offered through the IPO, which began trading on February 1, 2013. The IPO shares were priced at $26 per share.
- **Zoetis's business has characteristics we find attractive**. These include a large and growing market, reliable revenue, a fragmented customer base of mainly cash payers, and limited impact from generics.
- **Zoetis is a global leader in the development, manufacture, and marketing of animal health medicines and vaccines**. The company's over 300 product lines focus on livestock, which includes cattle, poultry, swine, sheep, and fish, as well as companion animals. Key products are vaccines, parasiticides, anti-infectives, and other specialty products. Estimated pro-forma revenue for 2012 was $4.30 billion, up 2% from $4.23 billion in 2011. Estimated 2012 adjusted pro-forma earnings of $535 million rose 19%.
- **Zoetis operates a worldwide business**. More than 3,400 sales employees serve livestock producers and veterinarians in 70 countries. By region, sales are in the U.S. (41%), Europe/Africa/Middle East (25%), Canada/Latin America (17%), and Asia/Pacific (17%).
- **We are initiating coverage of Zoetis with a Neutral rating.** ZTS is the first major participant in the global animal health business available to those interested in investing in the sector, which might explain some of the strong initial interest. ZTS shares rose nearly 20% in the first day of trading and have moved higher since. Using our 2013 EPS estimate, ZTS trades at a P/E of about 27 times, an appropriate valuation, in our view.

Note Important Disclosures on Pages 13 and 14.
Note Analyst Certification on Page 13.

Strategic Alternatives for Animal Health and Nutrition

Pfizer has pursued strategic alternatives for its Animal Health and Nutrition businesses. Management noted these are strong franchises on their own, but had different objectives from the core pharmaceutical businesses. As such, their strategic direction and value to Pfizer shareholders might be maximized by a spin-off, sale, or other transaction. Separation allows the company to focus on its global pharmaceutical and consumer medicines areas.

In December 2012, Pfizer completed the sale of its nutrition unit to Nestle for $11.85 billion. The segment is engaged in both infant and pediatric nutrition. It has operations across the globe, selling products in more than 60 countries. Its top markets are China, the Philippines, the United Kingdom, Mexico, and Australia. Emerging markets in Asia and Latin America have been the fastest growing in the nutrition area. Revenue for Pfizer Nutrition was $2.14 billion in 2011 versus sales of $1.87 billion in 2010, up 15%. By purchasing the business, Nestle solidified its position as the world's leading nutrition company. The ultimate price exceeded earlier expectations of about $10 billion.

Pfizer subsequently completed an initial public offering of a portion of its animal health business, which was named Zoetis. A minority stake in the unit was sold through the IPO. As part of the IPO, Pfizer exchanged Zoetis Class A common stock for Pfizer debt held by certain underwriters, who then sold the shares to the public. The stock was priced at $26 per share on the public offering. Trading began on February 1, 2013. PFE holds Zoetis Class B common stock, and retained approximately 80% ownership in the company. Class A and Class B common shares have identical voting rights except in the election of directors where Class B shares have ten votes per share while Class A shares have one. Each share of Class B Common held by Pfizer is convertible into a share of Class A. Zoetis will remain part of continuing operations for PFE's financial reporting for now. Going forward, PFE plans to ultimately distribute its remaining ownership to shareholders. One option is a split-off transaction in which shares in Zoetis could be exchanged for PFE stock, essentially accomplishing a share repurchase.

Zoetis has not yet reported final 2012 results. ZTS was part of Pfizer for all of 2012 and separating its figures from Pfizer is a complex undertaking. The company plans to issue 2012 results with the filing of a 10K some time in the near future. Figures for the first nine months of 2012 have been provided, as well as pro-forma information adjusted for the separation from Pfizer. We have used this information to estimate Zoetis' revenue and earnings for 2012 as a hypothetical standalone company. For now, references to full year 2012 figures will be estimates.

The Animal Health Industry

The animal health industry, which includes both livestock and companion animals, is large and growing. Animal health products, excluding such items as livestock feed or pet food, accounts for an estimated $100 billion in annual revenue. The industry is composed of medicines, vaccines, diagnostic tests, medical devices, nutritional supplements, veterinary services, and pet supplies. Within this, animal medicines and vaccine are believed to make up about $22 billion in annual revenue.

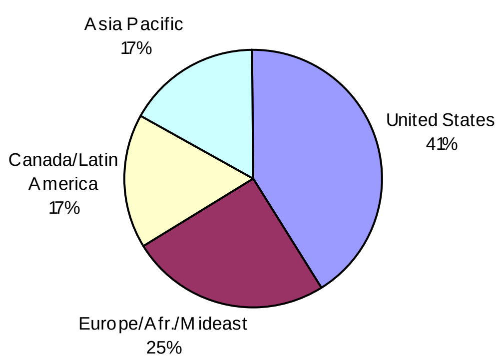
Livestock used in the production of animal protein are cattle, swine, poultry, sheep, and fish. Medicines and vaccines used in livestock make up an estimated 60% of the market. A growing global population with an improving standard of living has resulted in increased demand for animal protein and production efficiency. Animal health products are critical in order to meet this nutritional demand and ensure a safe and reliable food supply. In addition to improvements in production efficiency, these products deal with infectious disease and foodborne illness. Infectious disease can result from certain diseases or parasites. Foodborne illnesses can be traced to pathogens such as *salmonella* and *E. coli* infections in animals. Medicines and vaccines help reduce or prevent the outbreak of infectious disease and inhibit the spread to both animals and humans. Annual market growth is projected to be in the mid single-digits.

Companion animals include dogs, cats, and horses. It is felt that companion animals have a positive effect on the physical and emotional state of their owners. Pet ownership is growing globally with owners likely becoming increasingly attached to their pets. In the U.S., 62% of households owned a pet in 2012 compared to 56% in 1988. Pet owners are willing to spend for nutritious pet food and on medical care for pets. Medicines and vaccines for companion animals can extend the life of a pet and also improve the quality of life. It is estimated that these companion animal products account for about 40% of the animal medicine and vaccine market with growth also projected to be in the mid single-digits.

Overview of Zoetis

Zoetis operates the world's largest animal health business. Zoetis has been involved in the development, production, and marketing of vaccines, medicines, and diagnostic tests to prevent and treat disease in livestock and companion animals for more than 60 years. The business sells products worldwide with strong market positions in the U.S., Europe, Africa and the Middle East, Canada, Latin America, and Asia/Pacific. Sales in emerging markets such as Brazil, China, and India, amounted to about 27% of revenue. Zoetis' global revenue breakdown is shown in Figure 1. Products are used in the livestock species of cattle, swine, poultry, sheep, and fish. In companion animals, the company makes products for dogs, cats, and horses. Estimated pro-forma revenue for 2012 was $4.30 billion, up 2% from $4.23 billion in 2011 (See Figure 3). The business is primarily self-pay with less influence from insurance companies or government reimbursement.

Figure 1. Zoetis Worldwide Revenue Breakdown (Nine Months Ended September 30, 2012)



Source: Zoetis Inc.

Zoetis has a sales organization of approximately 3,400 employees. The organization consists of a network of technical and veterinary operations specialists. These individuals market the company's diverse portfolio of more than 300 products to livestock producers and veterinarians in 70 countries. No one product or line dominates Zoetis' sales. The company's largest product line, the antibiotic ceftiofur, accounts for less than 8% of revenue with Zoetis' top ten products accounting for less than 40% of sales. The company's main product lines are shown in Figure 2. The company generally uses a direct sales model, but engages distributors in markets without a commercial presence.

Figure 2. Key Products

Livestock Products

Product Line/Product	Description	Used In
Vaccines		
Bovishield	Prevent bovine infectious diseases such as diarrhea, influenza, RSV, and others	Cattle
Improvac/Improvest	Reduce boar taint	Swine
RespiSure Line	Prevent chronic pneumonia	Swine
Rispoval Line	Prevent viruses associated with cattle pneumonia and other respiratory diseases	Cattle
Parasiticides		
Cydectin	Control internal and external parasites	Cattle, Sheep
Dectomax	Treat/control internal and external parasitic infections	Cattle, Swine
Anti-Infectives		
Aureomycin	Treat wide range of respiratory, enteric, and reproductive diseases	Cattle, Poultry, Sheep, Swine
BMD	Prevent enteritis, resulting in increased weight and feed efficiency	Cattle, Poultry, Swine
Ceftiofur Line	Broad-spectrum cephalosporin antibiotic	Cattle, Horses Sheep, Swine
Draxxin	Antiobiotic to treat respiratory disease and infectious conjunctivitis	Cattle, Swine
Lincomycin Line	Treat/prevent chronic repiratory disease in chickens, dysentery in swine	Swine, Poultry
Spectramast	Treat/prevent mastitis	Cattle
Terramycin	Antiobiotic for treatment of infections	Cattle, Poultry, Sheep, Swine
Other		
Eazi-Breed CIDR	Progesterone releasing device to control estrus (reproductive) cycle	Cattle, Sheep
Embrex Devices	Device for in ovo hatchery detections and vaccinations	Poultry
Lutalyse	Estrus (reproductive cycle) control	Cattle, Swine

Companion Animal Products

Product Line/Product	Description	Used In
Vaccines		
Vanguard 4-way Lepto	Protect against leptospirosis bacteria	Dogs
Vanguard High Titer	Prevent canine distemper, canine hepaitis, certain canine respiratory disease, canine parainfluenza, and parvoviral enteritis	Dogs
Parasiticides		
Revolution	Protect against fleas, heartworm, mite and ticks for dogs, roundworm and hoofworm for cats	Cats, Dogs
Anti-infectives		
Clavamox/Synulox	Broad-spectrum penicillin antibiotic	Cats, Dogs
Convenia	Anti-infective for bacterial skin infections	Cats, Dogs
Terramycin	Antibiotic for ophthalmic infections	Cats, Dogs, Horses
Other		
Rimadyl	Anti-inflammatory for arthritis and post-operative pain	Dogs

Source: Zoetis Inc.

Estimated revenue from livestock products was $2.75 billion in 2012, or 64% of total revenue. Products include parasiticides used against gastrointestinal and other internal parasites as well as external parasites such as fleas and ticks. Anti-infectives guard against bacteria and infections. Feed additives provide medicine and nutrients. Other products aid in breeding or improve the efficiency of hatchery operations. Vaccines prevent respiratory, gastrointestinal, or reproductive diseases. Products for cattle amounted to an estimated $1.58 billion, or 57% of livestock products' 2012 revenue.

Companion animal products comprised about 36% of 2012 sales, or an estimated $1.55 billion. These can improve or extend the life of pets. Vaccines prevent distemper, hepatitis, respiratory disease, and influenza. Parasiticides protect against fleas, heartworms, and other parasites. Antibiotics treat skin infections and ophthalmic infections. Anti-inflammatories deal with arthritis and post-operative pain.

Growth has been the result of organic growth and acquisitions. A strong research and development function has produced many new products. Zoetis spends between 9% and 10% of revenue on R&D. Management noted that Zoetis obtained approximately one fourth of all animal health medicine approvals by the FDA from 2004 to 2011. During that same time period the company obtained approximately one fifth of all animal health vaccine approvals by the USDA. Most recently, the company introduced the *Equivac HeV* vaccine in Australia for the Hendra virus in horses and *Poulvac E.coli*, a spray vaccine against avian E.coli for use in the poultry industry in Europe.

Key acquisitions were SmithKline Beecham Animal Health in 1995 (vaccines and companion animal products), Embrex in 2007 (poultry devices and vaccines), Alpharma (poultry, cattle, and swine products with King Pharmaceuticals), and several smaller companies. Pfizer's acquisition of Wyeth in 2009 added the Fort Dodge Animal Health products with several important vaccines for dogs, cattle, horses, and poultry.

Key Investment Characteristics

We feel Zoetis' business has several attractive characteristics. These are discussed below.

The company serves a large and growing market. As mentioned earlier, the medicines and vaccines sector of the animal health market is estimated to be approximately $22 billion in size and growing at a single-digit rate. Rising standards of living in emerging markets have resulted in higher demand for animal protein. Increased pet ownership and care provided to companion animals is on the rise. In addition to organic growth, we believe ZTS has opportunities to add to its business through acquisitions or licensing of technology.

Revenue is reliable, in our view. Though not immune to economic conditions, we believe consumption of food and other staples is a recession resistant market. For companion animals, owners seem likely to forgo other discretionary expenditures before curtailing spending on beloved pets.

Though large, Zoetis' market is fragmented. The company's broad sales network sells to individual livestock, swine, and poultry producers and to veterinarians and pet owners in 70 countries. With fewer large customers, there is less pressure on pricing from buyers purchasing large volumes of products.

No one product or line of business dominates the company's revenue. Zoetis has a diverse portfolio of more than 300 products. The company's top ten products account for less than 40% of sales. With numerous products generating relatively small amounts of revenue, there is less to attract new entrants.

The company's large, established sales force presents a barrier to entry. The ZTS direct sales force has existing relationships with livestock producers and veterinarians, which would be expensive to duplicate. The global operations of the company also provide scale that offers a formidable obstacle to potential competitors.

Customers are mainly cash payers. As there are no large government or state-controlled entities involved in the purchase of animal care products, issues of reimbursement are not present. This also reduces the likelihood of a large purchaser imposing its pricing structure on companies such as Zoetis.

We believe generic competition has a limited impact despite patent expirations. Approximately 80% of Zoetis revenue is from products that were not patented or do not have market exclusivity. With numerous small product lines, there is less scale to attract generic producers. In addition, gross margins of over 60% are attractive but less than that of pharmaceutical companies.

Management

Zoetis top management team is composed of former Pfizer executives that were part of the animal health unit. Outside of Zoetis's CEO, the company's 9-member Board of Directors is made up of Pfizer officers and three outside directors.

Juan Ramon Alaix, Chief Executive Officer – Mr. Alaix has served as a director and CEO of Zoetis since July 2012. Prior to that he was President of the Pfizer animal health unit since 2006 and held other positions within Pfizer's pharmaceutical business.

Richard A. Passov, Executive Vice President and Chief Financial Officer – Mr. Passov has been CFO of Zoetis since July 2012. He was a Senior Vice President and Treasurer for Pfizer from 2001 to 2012.

Frank A. D'Amelio, Chairman of the Board – Mr. Amelio has served on the Zoetis Board since July 2012. He is an Executive Vice President and Chief Financial Officer of Pfizer since December 2010. He has been with Pfizer since September 2007.

Outside directors include Michael B. McCallister, former CEO of Humana, Inc., Gregory Norden, former CFO of Wyeth, and William C. Steere, Chairman Emeritus of Pfizer.

Historical Financial Results

Using information contained in Zoetis's IPO prospectus, we have constructed income statements for Zoetis prior to the separation as well as pro-forma figures adjusted for the separation (See Figure 3). Revenue increased 30% to $3.58 billion in 2010 from $2.76 billion in 2009. The acquisition of Fort Dodge Animal Health along with Wyeth added $640 million to revenue. Organic growth was 7% due to higher sales in the U.S. and Asia. Foreign exchange added 3% to growth. Divestitures lowered growth by 3%. Operating income excluding non-recurring items increased 47%. The gross margin declined slightly due to product mix. With added costs from the Wyeth acquisition, SG&A matched the rate of sales growth while research spending grew 13%. Adjusted pretax income rose 55% and, after a higher tax rate, net income on the same basis grew 46% to $275 million.

For 2011, revenue rose 18% to $4.22 billion. Sales were up close to 20% in three of four regions. Organic growth of 7% contributed. Sales from the King Pharmaceuticals acquisition added $329 million to the total. Currency was positive, increasing growth by 3%. Divestitures lowered growth by 1%. Operating income excluding non-recurring items was up 65%. The gross margin was lower, again due to product mix. SG&A rose only 6%. There were added costs from the King acquisition as well as expenses to expand the company's presence in emerging markets, offset by cost reduction and acquisition-related savings associated with the Wyeth acquisition. Research spending fell 1% due to cost savings. Adjusted pretax income rose 68%. The tax rate was lower, so adjusted net income of $503 million increased 83%. On a pro-forma basis, which adjusts for transactions with Pfizer prior to the IPO and includes Zoetis' shares outstanding, adjusted net income was $450 million, or $0.90 per share.

For the first nine months of 2012, pro-forma revenue increased 2% to $3.16 billion from a pro-forma $3.11 billion in the first nine months of 2011. Livestock revenue was flat at $2.02 billion while companion animal sales grew 5% to $1.14 billion. U.S. sales rose 7% to $1.29 billion, mostly organic growth with a small amount from acquisitions. Domestic livestock sales were boosted by sales to the swine industry of a reformulated vaccine and by products to treat infections in swine and cattle. This was partially offset by the negative impact of the North American drought. Companion animal revenue benefited from an extended flea and tick season caused by warm weather. Sales in Europe were flat in local currencies but fell 6% to $799 million due to unfavorable foreign exchange. Challenging macroeconomic conditions and restrictions on antibacterials affected livestock sales. Canada and Latin America declined 3% overall to $549 million but rose 5% in local currencies. A new formulation of a swine vaccine and marketing support for recently acquired products boosted livestock sales, partially offset by competition in the cattle market in Brazil. Growth of vaccine sales in Brazil and higher parasiticides in Canada were factors in higher companion animal sales. Finally, Asia Pacific revenue was up 8% to $518 million, mainly volume growth. Livestock sales benefited from growth in Australia, China, and India while companion animal sales were up in Japan, among other markets.

Pro-forma operating income for the first nine months of 2012, adjusted for non-recurring items, grew 26% as costs declined. The adjusted gross margin improved to 64.7% from 61.9% due to favorable product mix and increased operational efficiencies. Cost reduction initiatives and acquisition integration resulted in lower SG&A and R&D expenses. Adjusted for the separation, pro-forma net income was $440 million in the first nine months of 2012, or $0.88 per share.

Zoetis plans to release final 2012 information when the company publishes its 10K some time in March 2013. For now, we estimate that revenue for all of 2012 increased 2% to $4.30 billion due to high single-digit sales growth in the U.S. and Asia. Sales in Europe and Canada/Latin America declined mainly due to unfavorable currency trends, in our estimation. Overall organic growth of 5% was partially offset by a negative currency impact of 4%. There was a small amount of revenue from acquisitions. Adjusted operating income increased 17% as expenses declined. The full year estimated gross margin was higher while SG&A and R&D spending each declined 3%. Pretax income adjusted for non-recurring items rose 18%. With a stable tax rate, net income rose 19% to $535 million, or $1.07 per share.

Estimates

Our preliminary 2013 revenue projection calls for continued single-digit U.S. revenue growth, assuming more normal weather patterns versus the 2012 drought. European sales could benefit from stabilization in the euro versus the dollar, though some economic problems could persist. Growth in emerging markets is expected to continue. In all, we look for 2013 revenue of $4.59 billion, up 7% from our estimate of $4.30 billion in 2012. We expect margin improvement due to acquisition integration and synergies from acquisitions in recent years. We forecast a modest increase in the gross margin due to operational efficiencies and gains from acquisition integration, partially offset by increased spending for SG&A and R&D. This results in our estimated 15% increase in operating income for 2013. We incorporate a high level of interest expense resulting from the separation and a stable tax rate to arrive at our preliminary 2013 EPS estimate of $1.25, up 17% from our 2012 pro-forma estimate.

Financial

Pro-forma balance sheet figures reflect the transactions with Pfizer as part of the separation. Zoetis issued $3.64 billion in debt in order to transfer cash to Pfizer and retire $1 billion in existing Pfizer debt (See Figure 4). Following these transactions, Zoetis had $3.64 billion in long-term debt compared to $1.04 billion in shareholders' equity.

With organic growth and acquisitions, Zoetis has become a larger company over the last few years. Cash flow from operations in 2011 was almost $500 million, nearly double the 2010 amount, compared to capital expenditures of $135 million (See Figure 5). For the first nine months of 2012, operating cash flow declined to $144 million from $383 million in the same period of 2011 due to the seasonal inventory building for cattle products and higher inventory levels of other targeted products. We will have more information on cash flows once the 2012 10K is published.

Management has indicated its intention to pay a quarterly dividend of $0.065 per share to holders of both Class A and Class B common stock, subject to the discretion of the Board of Directors. No specific date has been provided at this time.

Outlook

As a global provider of animal health products, Zoetis has numerous potential avenues to sustain revenue and earnings growth. With the company's large direct sales force, established customer relationships could result in market share gains and could facilitate the adoption of new products.

Along the same lines, Zoetis spends sizeable amounts on R&D and has been responsible for a significant percentage of new products within its industry. Continued new product development and introduction can enhance the existing product line and provide additional medicines and vaccines to be marketed by ZTS's sales force. Finally, the company's worldwide marketing capabilities could make Zoetis an attractive partner for licensing of new products and technologies.

Emerging markets are a potential source of revenue growth as standards of living improve and the demand for animal protein grows. Similar factors can spur additional spending on companion animals. The Asia/Pacific region has been the fastest growing for Zoetis. Canada and Latin America have performed well, though currency has been negative.

We look for ZTS to pursue complementary acquisitions. The addition of acquired businesses from Wyeth (Fort Dodge Animal Health) and King Pharmaceuticals (King Animal Health) boosted growth in 2010 and 2011, respectively. Smaller tuck-in acquisitions could add products, technology, or an expanded sales presence.

Figure 3. Zoetis Inc. Pro-forma Consolidated Statement of Income
(figures in millions except percentages)

	2013E	% Chg.	2012E (Pro-forma)	% Chg.	2011 (Pro-forma)	2011	% Chg.	2010
Cattle	$1,650	4.8%	$1,575	(2.6%)	$1,617	$1,617	10.5%	$1,464
Swine	600	5.3%	570	1.4%	562	562	29.8%	433
Poultry	550	10.0%	500	(0.2%)	501	501	89.1%	265
Other (Fish and Sheep)	120	14.3%	105	7.1%	98	98	38.0%	71
Total Livestock	2,920	6.2%	$2,750	(1.0%)	2,778	2,778	24.4%	2,233
Dogs and Cats	1,460	7.4%	1,360	5.7%	1,287	1,287	8.2%	1,190
Horses	210	10.5%	190	13.1%	168	168	5.7%	159
Total Companion Animal	1,670	7.7%	1,550	6.5%	1,455	1,455	7.9%	1,349
Revenue	4,590	6.7%	4,300	1.6%	4,233	4,233	18.2%	3,582
Cost of Sales	1,650	4.8%	1,575	(0.6%)	1,585	1,585	20.3%	1,318
Gross Profit	2,940	7.9%	2,725	2.9%	2,648	2,648	17.0%	2,264
Sell., Gen'l. & Admin.	1,450	3.6%	1,400	(3.0%)	1,443	1,443	5.7%	1,365
Research & Develop.	425	7.6%	395	(2.9%)	407	407	(1.0%)	411
Amort. Of Intang.	20	0.0%	20	0.0%	20	20	17.6%	17
Total Operating Exp.	1,895	4.4%	1,815	(2.9%)	1,870	1,870	4.3%	1,793
Operating Income	1,045	14.8%	910	17.0%	778	778	65.2%	471
Interest Expense	(125)	0.0%	(125)	2.5%	(122)			
Other Income	25	0.0%	25	(10.7%)	28	(8)	(33.3%)	(12)
Income before Taxes	945	16.7%	810	18.4%	684	770	67.8%	459
Income Taxes	321	16.7%	275	19.2%	231	264	44.3%	183
Minority Interest'	0	- -	0	- -	3	3	- -	1
Net Income	$624	16.7%	$535	18.8%	$450	$503	82.9%	$275
Earnings Per Share	$1.25	16.7%	$1.07	18.8%	$0.90			
Avg. # Dil. Shs. Outstand'g	500	0.0%	500	0.0%	500			
Gross Margin	64.05%		63.37%		62.56%	62.56%		63.20%
Sell., Gen'l. & Admin.	31.59%		32.56%		34.09%	34.09%		38.11%
Research & Develop.	9.26%		9.19%		9.61%	9.61%		11.47%
Operating Margin	22.77%		21.16%		18.38%	18.38%		13.15%
Tax Rate	34.00%		34.00%		33.77%	34.29%		39.87%
Sales by Region:								
United States	1,890	6.5%	1,775	7.0%	1,659	1,659	19.9%	1,384
Europe/Africa/Meast	1,150	7.0%	1,075	(6.0%)	1,144	1,144	12.2%	1,020
Canada/Latin America	800	6.7%	750	(4.8%)	788	788	18.7%	664
Asia Pacific	750	7.1%	700	9.0%	642	642	24.9%	514
Total	$4,590	6.7%	$4,300	1.6%	$4,233	$4,233	18.2%	$3,582
Percentage of Revenue:								
United States	41.18%		41.28%		39.19%	39.19%		38.64%
Europe/Africa/Meast	25.05%		25.00%		27.03%	27.03%		28.48%
Canada/Latin America	17.43%		17.44%		18.62%	18.62%		18.54%
Asia Pacific	16.34%		16.28%		15.17%	15.17%		14.35%

Note: Figures exclude non-recurring items
Source: Company reports and Hilliard Lyons estimates

Figure 4. Zoetis Inc. Pro-forma Consolidated Balance Sheet
(figures in millions except percentages)

Fiscal Year ends in December	Sept. 30 2012 (Pro-forma)	Sept. 30 2012	Dec. 31 2011	Dec. 31 2010
Assets				
Cash and Equivalents	$300	$133	$79	$63
Accounts Receivable	848	848	871	773
Inventories	1,136	1,272	1,063	995
Deferred Income Taxes	68	72	96	97
Other Current Assets	225	230	202	188
Total Current Assets	2,577	2,555	2,311	2,116
Property and Equipment, net	1,229	1,204	1,243	1,148
Intangible Assets	877	877	928	924
Goodwill	981	981	989	934
Deferred Income Taxes	100	218	143	70
Other Assets	73	69	97	92
Total Assets	$5,837	$5,904	$5,711	$5,284
Liabilities and Shareholders' Equity				
Current Portion of Long-term Debt	$0	$0	$0	$38
Accounts Payable	192	195	214	206
Income Taxes payable	45	42	18	24
Accrued Comp. and Other	141	145	150	144
Other Current Liabilities	341	355	461	396
Total Current Liabilities	719	737	843	808
Long-term Debt	3,640	580	575	673
Deferred Taxes	254	299	311	218
Other Taxes Payable	23	88	122	100
Other Liabilities	142	91	124	141
Total Liabilities	4,778	1,795	1,975	1,940
Commitments and Contingencies	0	0	0	0
Shareholders' Equity	1,044	4,094	3,720	3,344
Minority Interest	15	15	16	0
Total Equity	1,059	4,109	3,736	3,344
Total Liabilities and Shareholders' Equity	$5,837	$5,904	$5,711	$5,284

Note: Figures exclude non-recurring items
Source: Company reports

Figure 5. Zoetis Inc. Pro-forma Statement of Cash Flows
(figures in millions except percentages)

	2011	**2010**	**2009**
Net Income	$248	$111	($101)
Depreciation and Amortization	205	185	124
Stock-based Comp. Expense	19	16	15
Asset Write-offs and Impairments	78	16	29
Net Gains on Assets Sales	(1)	(101)	(2)
Deferred Income Taxes	65	(68)	(334)
Other	0	(5)	10
Cash Flow Before W/C Changes	614	154	(259)
Change in:			
Accounts Receiveable	(85)	30	112
Inventories	40	117	(16)
Other Assets	11	(19)	29
Accounts Payable	(16)	25	38
Other	(15)	5	172
Income Taxes Payable	(52)	(58)	22
Total W/C Changes	(117)	100	357
Cash from Operating Activities	497	254	98
Capital Expenditures	(135)	(124)	(135)
Discretionary Cash Flow	362	130	(37)
Asset Sales	34	203	572
Acquisitions, Net of cash	(345)	(81)	(2,254)
Other Investing Activities	(3)	(7)	(4)
Total Other Investing	(314)	115	(1,686)
Issuance of Long-term Debt	0	0	719
Repaymeny og Long-term Debt	(143)	0	0
Cash Dividends Paid	(416)	(207)	(101)
Net Financing with Pfizer	529	(67)	1,205
Other	0	(3)	0
Total Financing Activities	(30)	(277)	1,823
Effect of Exchange Rates	(2)	(4)	(7)
Change in Cash and Equivalents	16	(36)	93

Note: Figures exclude non-recurring items
Source: Company reports

Conclusion

There are no large, publicly traded animal health companies similar to Zoetis to use as a benchmark for a valuation for Zoetis. Other such businesses are generally part of multinational pharmaceutical firms, similar to the case of Pfizer's ownership of Zoetis. As a standalone business, we have noted certain attractive characteristics of Zoetis. Revenue is fairly reliable due to the needs of livestock producers and pet owners. In addition, research is generally faster and less expensive because clinical studies are less expensive than for human pharmaceuticals. The business is typically self-pay as opposed to third party reimbursement in health care. Finally, there tends to be less generic competition and more brand loyalty. From a financial standpoint, we feel gross margins of over 60% and operating margins of nearly 20% are relatively high though below that of drug companies.

Zoetis shares were priced at $26 per share in the public offering, rose nearly 20% in the first day of trading, and have moved 10% higher since then. We would consider Zoetis a large capitalization growth stock with a strong market position and attractive growth prospects. As a proxy for valuing Zoetis, we looked at a group of companies deriving some or all of their business from the manufacture or distribution of animal care products. We have shown these in Figure 6. After reviewing the comparative valuations, the average P/E ratio is nearly 23 times. We feel Zoetis might receive a premium due to its size, global reach, and strong market position. With the ZTS shares currently trading at 27 times our 2013 EPS estimate, we feel the stock is valued appropriately and rate ZTS Neutral.

Figure 6. Comparative Valuation of Selected Animal Health Companies

		3/11/13	Earnings Per Share			% Chg	% Chg	P/E Ratio		2012	Market	Shares
	Sym	Price	2011	2012	2013E	'11 - '12	'12 - '13E	2012	2013E	Revenue	Cap.	Out.
												(mil.)
Idexx Laboratories	IDXX	$91.83	$2.75	$3.13	$3.54	13.8%	13.1%	29.3X	25.9X	$1,293	$5,021	54.7
MWI Veterinary Suppl	MWIV	$131.56	$3.21	$4.23	$4.86	31.8%	14.9%	31.1X	27.1X	$2,075	$1,683	12.8
Neogen Corp.	NEOG	$47.14	$0.96	$0.94	$1.10	(2.1%)	17.0%	50.1X	42.9X	$184	$1,125	23.9
Petsmart	PETM	$62.83	$2.56	$3.55	$3.91	38.7%	10.1%	17.7X	16.1X	$6,113	$6,752	107.5
PetMed Express	PETS	$13.51	$0.93	$0.80	$0.83	(14.0%)	3.7%	16.9X	16.3X	$233	$270	20.0
Henry Schein	HSIC	$89.86	$3.97	$4.43	$4.87	11.6%	9.9%	20.3X	18.5X	$8,940	$7,907	88.0
VCA Antech	WOOF	$23.15	$1.36	$1.37	$1.50	0.7%	9.5%	16.9X	15.4X	$1,700	$2,033	87.8
Average						11.5%	11.2%	26.1X	23.2X			
Zoetis, Inc.	ZTS	$34.18	$0.90	$1.07	$1.25	18.9%	16.8%	31.9X	27.3X	$4,300	$17,090	500.0

Source: Baseline and Hilliard Lyons Estimates

Risks and Considerations

Risks to our valuation include but are not limited to:

Restriction on use of animal medicines. Resistance to using anti-bacterials or other medicines in animals used for food could reduce demand and negatively impact revenue.

Conditions in the livestock industry. Unfavorable economics in the cattle, poultry, or swine markets could result in smaller herds and reduced demand for animal care products.

Weather extremes. Drought conditions can raise the cost of animal feed, leading to reductions in herd size.

Acquisition-related integration risks. Zoetis has augmented organic growth with acquisitions. Merging of different corporate cultures could make it difficult to achieve desired synergies.

Failure of new products. Zoetis spends a considerable amount on R&D to develop new products. Failure of products to achieve the desired result or reach the market could negatively affect revenue and earnings.

Economic Activity. Rising standards of living, particularly in emerging markets, has increased the demand for animal protein. A weakening of the global economy could reduce this demand. Economic conditions can also affect the amounts consumers can spend on companion animals.

Operating as a separate entity. There will be additional expenses to operate as a standalone company. Pfizer plans to provide support initially, but Zoetis will ultimately be responsible for corporate functions.

High Level of Debt. Following the separation from Pfizer, Zoetis will have $3.65 billion in debt compared to $1.04 billion in equity, along with a significant amount of interest expense.

Prices of stocks mentioned: Humana (HUM - $68.33), Nestle (NSRGY - $71.40), Pfizer (PFE - $28.25)

Additional information is available upon request

Analyst Certification

I, Stephen A. O'Neil, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

The author of this report or members of his household have a long position in the common stock of Pfizer, but may not engage in buying or selling contrary to the recommendation.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	57	42%	12%	88%
Hold/Neutral	76	55%	12%	88%
Sell	4	3%	0%	100%

As of 5 March 2013

Other Disclosures

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