

Wednesday, July 24, 2013

Zoetis (Outperform)

(ZTS-NYSE)

Lilly's Good Animal Health Performance Bodes Well for Zoetis

Flash:

This morning Eli Lilly (LLY, \$50.99; Market Perform) reported 2Q13 worldwide sales of animal health products of \$543.5 million, an increase of 6% compared with the second quarter of 2012. Importantly, the 6% y/y growth was driven by 5% volume growth. US sales grew 5%, to \$321.3 million, primarily owing to increased demand for Trifexis, an anti-parasite for dogs. Sales outside the US increased 7%, to \$222.2 million, driven primarily by increased sales of companion animal products.

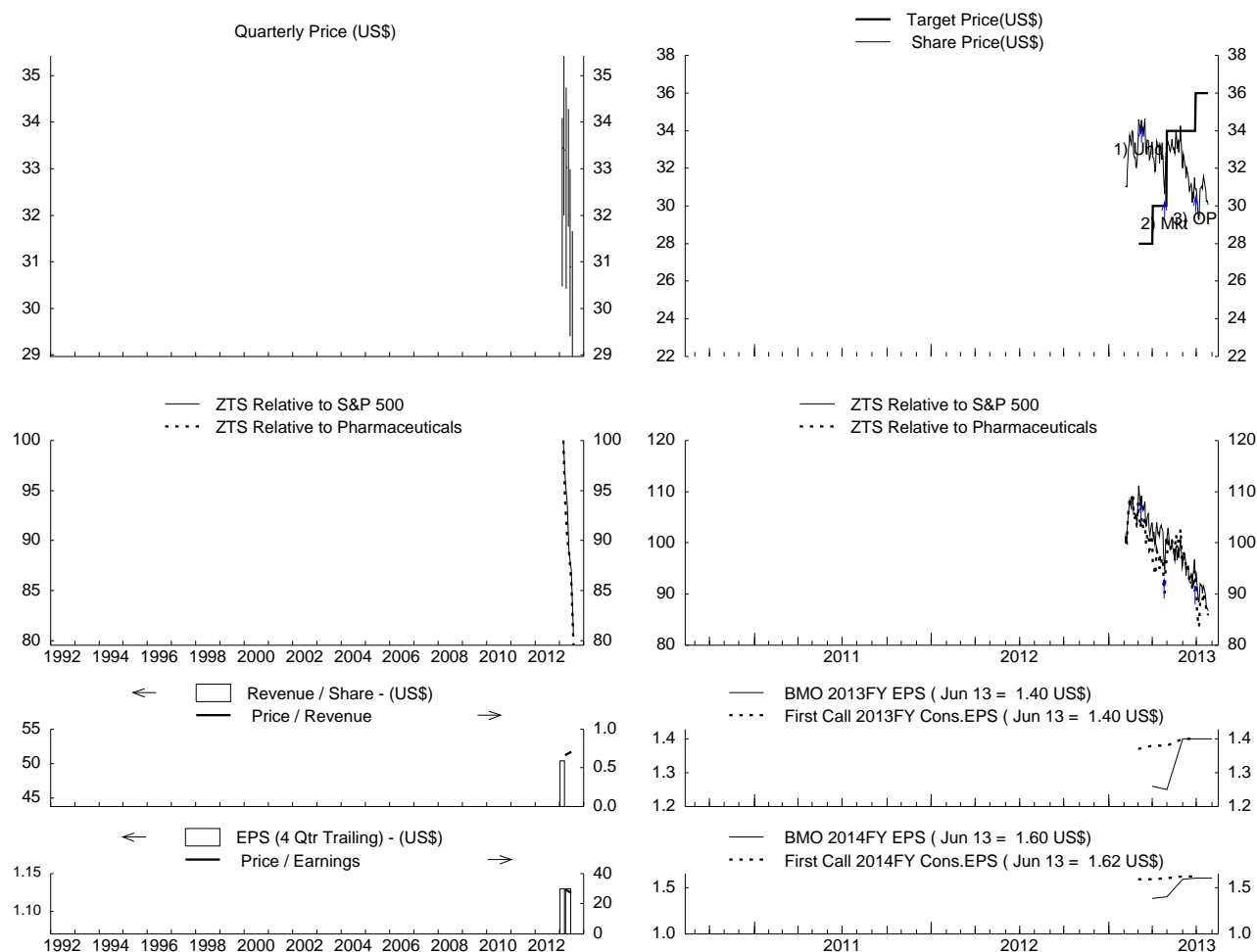
Our View:

- * Incrementally positive for Zoetis. We note current Street expectations are rather low for Zoetis: 2Q13 revenue consensus of \$1.121Bn implies y/y revenue growth of only 2%. Although we recognize some of the reasons for the cautious outlook (drought pressuring livestock sales, re-introduction of a competitive anti-parasite product, timing of price increases, and delayed parasite season in the EU), we believe the current consensus sets a low bar for Zoetis. We believe the strong 5% y/y volume growth for Lilly's products should bode well for Zoetis. We currently forecast 5% top-line y/y growth. Overall, Lilly's performance leads us to believe that Zoetis should meet or exceed conservative 2Q13 estimates.
- * We maintain our Outperform rating on ZTS shares.

Company:	Zoetis (ZTS)
Price/Rating/Target:	\$30.06/Outperform/\$36.00
Sector Name:	Pharmaceuticals
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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 6.

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*	1.13	27.3	0.26	0.8	23	1.4	21.8	>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

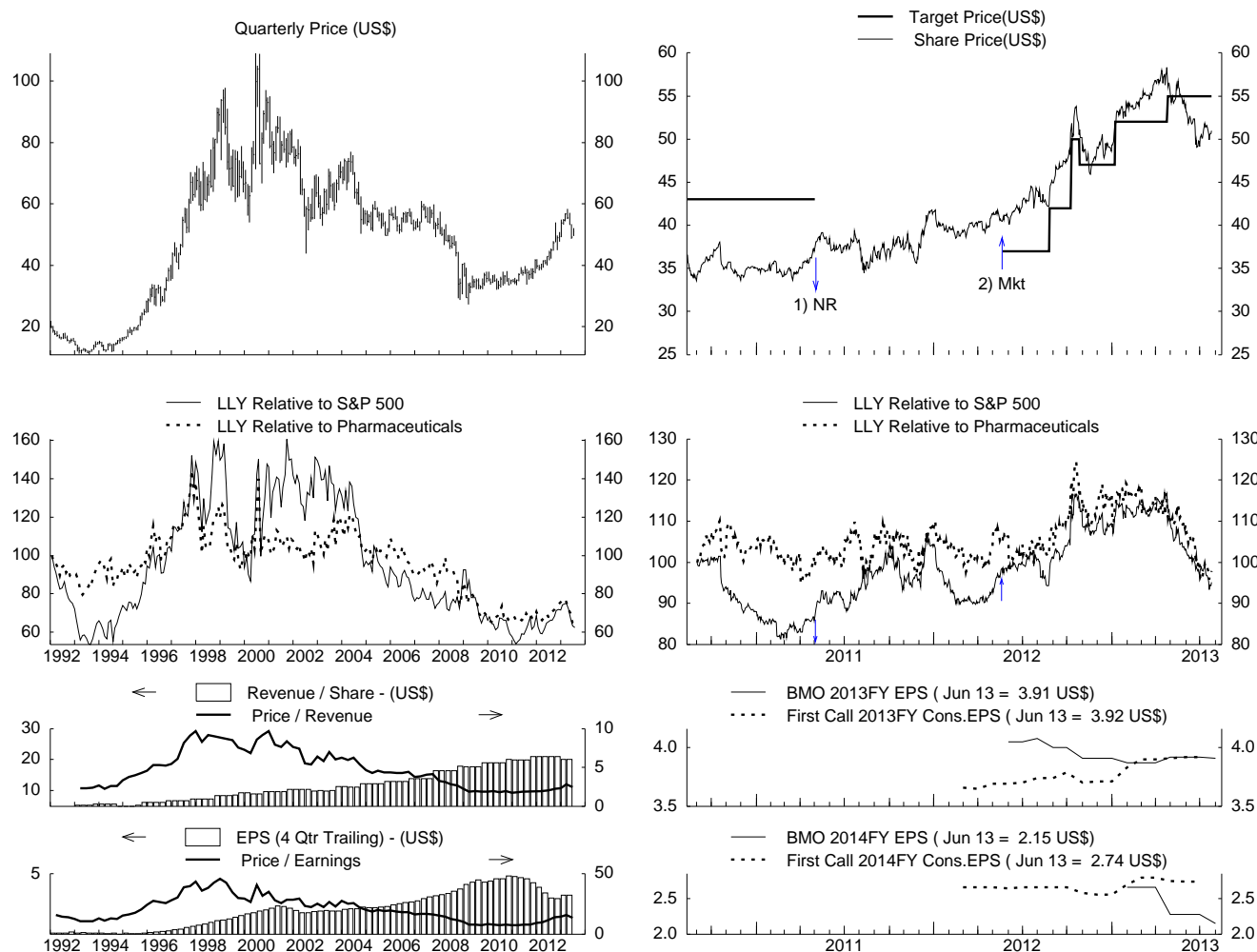
* Current EPS is the 4 Quarter Trailing to Q1/2013.

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

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

Last Price (July 23, 2013): \$30.06
Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

Eli Lilly & Co. (LLY)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %
1992	1.22	18.0 11.8	0.55	3.8 2.5	45	4.2	5.2 3.5	
1993	1.15	14.2 9.5	0.63	5.7 3.8	54	3.9	4.2 2.8	28
1994	1.10	15.1 10.7	0.65	5.5 3.9	59	4.6	3.6 2.6	26
1995	1.15	24.8 13.2	0.69	4.5 2.4	60	4.9	5.8 3.1	24
1996	1.30	30.9 18.8	0.72	3.0 1.8	55	5.5	7.3 4.4	25
1997	1.60	44.0 21.9	0.80	2.3 1.1	50	4.2	>15 8.4	33
1998	1.93	47.3 29.9	0.92	1.6 1.0	48	4.0	>15 14.3	47
1999	2.28	42.9 26.6	1.04	1.7 1.1	46	4.6	>15 13.2	>50
2000	2.65	41.1 20.4	1.12	2.1 1.0	42	5.4	>15 10.1	>50
2001	2.76	34.4 25.4	1.24	1.8 1.3	45	6.3	>15 11.1	47
2002	2.55	33.1 17.2	1.34	3.1 1.6	53	7.4	11.4 5.9	37
2003	2.58	28.6 20.5	1.42	2.7 1.9	55	8.7	8.5 6.1	32
2004	2.82	27.3 17.9	1.52	3.0 2.0	54	9.7	8.0 5.2	31
2005	2.88	21.2 17.2	1.60	3.2 2.6	56	9.6	6.4 5.2	30
2006	3.18	18.6 15.8	1.70	3.4 2.9	53	9.7	6.1 5.2	33
2007	3.55	17.2 13.8	1.88	3.8 3.1	53	12.1	5.1 4.1	33
2008	4.02	14.3 7.1	1.96	6.8 3.4	49	5.9	9.7 4.8	45
2009	4.43	9.2 6.1	1.96	7.2 4.8	44	8.3	4.9 3.3	>50
2010	4.74	8.0 6.8	1.96	6.1 5.1	41	10.8	3.5 3.0	50
2011	4.41	9.5 7.6	1.96	5.9 4.7	44	11.7	3.6 2.9	39
2012	3.39	15.9 11.0	1.96	5.3 3.6	58	12.9	4.2 2.9	28

Range*: 47.3 6.1 7.2 1.0 >15 2.6

Current* 3.61 13.6 1.96 4.0 54 13.3 3.7 27

Growth(%):

5 Year: -0.6 0.8 1.9
10 Year: 3.3 3.9 6.1
20 Year: 5.8 6.1 5.9

* Current EPS is the 4 Quarter Trailing to Q1/2013.

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

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

LLY - Rating as of 12-Aug-10 = OP

Date	Rating Change	Share Price
1 3-May-11	OP to NR	\$38.09
2 18-May-12	NR to Mkt	\$40.44

Last Price (July 23, 2013): \$50.99

Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

Important Disclosures

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Company Specific Disclosure for ZTS

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.

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Methodology and Risks to Our Price Target

Methodology: DCF: Free Cash Flow To Equity and multiple of sales.

Risks: Uncertainty of Phase 3 Pipeline.

Distribution of Ratings (June 30, 2013)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	37.9%	17.6%	52.7%	39.6%	51.0%	53.2%
Hold	Market Perform	56.8%	10.2%	45.9%	53.9%	45.5%	41.1%
Sell	Underperform	5.3%	3.2%	1.4%	6.5%	3.5%	5.6%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.

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Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis;

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(S) = Speculative investment;

NR = No rating at this time; and

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