

Morgan Stanley & Co. LLC

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Stock Rating
Overweight

Industry View
In-Line

November 6, 2013

Zoetis Inc.

Don't fret about SG&A; business on track

Although 3Q SG&A was above forecast and offset revenue upside, we believe the profit growth outlook is unchanged. We updated our model for 3Q results; lowered '13E EPS by \$0.01 to \$1.40 to reflect \$0.01 downside vs our 3Q estimate and left '14 unch at \$1.67. Reiterate OW.

SG&A impacted by timing of expenses; full-yr SG&A guidance raised <1%. 3Q SG&A was higher YOY due to an easy comp; last year's drought reduced some promotional spend that is aligned with revenue opportunities in 3Q:12. Also, it was sequentially higher due to certain enabling function expenses (finance + HR + legal), which were lighter in 1H:13, but have ramped up to a more stable run-rate as of 3Q:13. 2013 SG&A guidance midpt bumped just \$5M from \$1,410M to \$1,415M.

Going forward, SG&A spend as percent of revs expected to decline; margins set to expand. Mgmt maintained that revenues should grow at or above the expected industry growth rate of 6%. We currently model growth in revs of +8% in '14E (above-norm due to easy YOY comps in 1H) and +6% in '15E. ZTS expects SG&A spend to increase over time as it builds scale and scope so ZTS can capture industry growth, but the YOY growth rate is expected to be in-line with the rate of inflation, ~2-3%; we model YOY growth in SG&A of +3% and +1% in '14E and '15E, respectively. We also model R&D growing slower vs. revs: +5% for '14E and +3% for '15E. Accordingly, since we model SG&A and R&D as percent of revs falling, we estimate operating margins will grow from 24.3% in '13E to 26.2% in '14E and 28.3% in '15E.

We maintained our '14E and '15E EPS estimates. There were no surprises on the call that caused us to revise our out-year estimates. Business trends continue to improve and we believe everything is on track. We continue to model EPS of \$1.67 in '14E and \$1.91 in '15E.

Key Ratios and Statistics

Reuters: ZTS.N Bloomberg: ZTS US

Specialty Pharmaceuticals / United States of America

Price target	\$36.00
Shr price, close (Nov 5, 2013)	\$31.69
Mkt cap, curr (mm)	\$15,867
52-Week Range	\$35.40-28.81

Fiscal Year ending	12/12	12/13e	12/14e	12/15e
ModelWare EPS (\$)	1.08	1.40	1.67	1.91
Prior ModelWare EPS (\$)	-	1.41	1.67	1.91
P/E	-	22.6	19.0	16.6
Consensus EPS (\$)	1.22	1.40	1.62	1.81
Div yld (%)	-	0.8	0.9	1.1

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

\$ = Consensus data is provided by Thomson Reuters Estimates.

e = Morgan Stanley Research estimates

Quarterly ModelWare EPS

Quarter	2012	2013e	2013e	2014e	2014e
		Prior	Current	Prior	Current
Q1	0.30	-	0.36a	-	-
Q2	0.35	-	0.36a	-	-
Q3	0.31	-	0.34a	-	-
Q4	0.11	0.35	0.35	-	-

e = Morgan Stanley Research estimates, a = Actual company reported data

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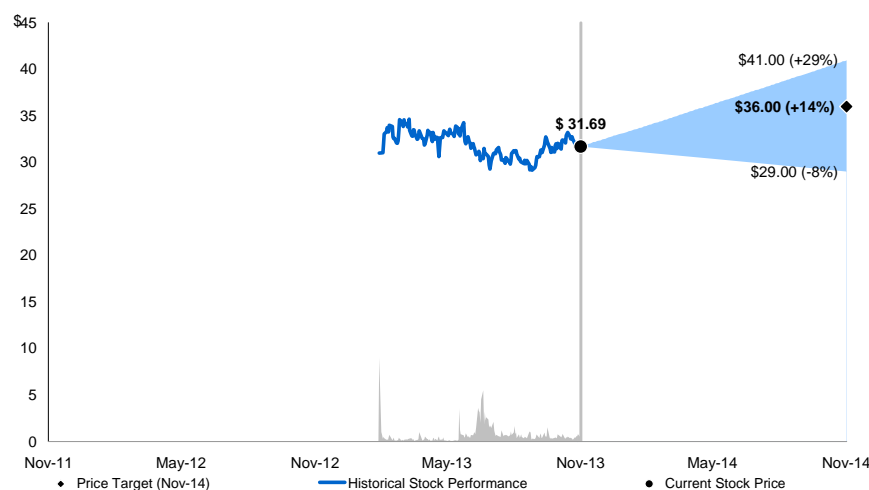
For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.

November 6, 2013

Zoetis Inc.

Risk- Reward Snapshot: Zoetis Inc. (ZTS), Overweight

Risk-Reward: Accelerating revenue growth in 2014E should drive stock outperformance



Source: Thomson Reuters, Morgan Stanley Research estimates

Price Target \$36		Valuation based upon 2015E P/E and EV/EBITDA
Bull Case	21x Bull Case 15e EPS of \$2.04	Rev and earnings upside drive both E and P/E higher than forecast. Our bull case assumes revenue and operating margin upside. We project 7% YOY rev growth in our bull case in 2015 (vs. +6% in our base case) and operating margins of 30% (vs. 28.6% in our base case).
Base Case	19x Base Case 15e EPS of \$1.91	Accelerating revenue growth should sustain current multiple through 2015E. We expect Zoetis revenue growth to accelerate from +4% in 2013E to +8% in 2014E on easier comps, livestock recovery, and normalized weather conditions. Prospects for improved market conditions give us greater confidence in our revenue and earnings projections as well as the sustainability of the current multiple on 2014E earnings into 2015E.
Bear Case	17x Bear Case 15e EPS of \$1.75	Bear case assumes margin expansion fails to materialize. Our bear case assumes 2015E operating margins in-line with our 2014E est. of 26.6% (vs. 28.6% in our base case).

Investment Thesis

- Zoetis is a global leader in animal health, and we expect mgmt. to deliver mid-teens EPS growth over the next several years.
- We view ZTS as a compelling alternative to traditional pharma
- We believe accelerating revenue growth in 2014E should drive stock outperformance
- We see an attractive risk-reward, and we believe lack of exposure to binary events limits downside risk

Key Value Drivers

- Operating margin expansion and global business expansion
- **Livestock** (65% of revs.): Demand for meat and milk is projected to at least double over the next 40 years due in large part to population growth and an increase in affluence in emerging markets (key driver of NT growth)
- **Companion Animals** (35% of revs): Global spending on pets is growing

Potential Catalysts/ Launches

- Livestock recovery in 2014E and beyond as farmers rebuild cattle herds
- Implementation of new antibiotic restrictions and potential for new govt. legislation
- Vet Rx legislation

Investment Risks

- Margin expansion fails to materialize
- Drought persists longer than expected
- Increased govt. antibiotic regulations
- New pharmacy entrants pressure ZTS margins
- Dollar strength relative to foreign currencies causes FX-driven financial shortfalls.
- SAP implementation

Morgan Stanley Research Model

Exhibit 1

Annual Income Statement (1 of 2)

(\$M)	2010A	2011A	2012A	2013E	2014E	2015E
Net revenues	3,582	4,233	4,336	4,511	4,853	5,124
COGS	1,318	1,581	1,549	1,600	1,699	1,768
Gross profit	2,264	2,652	2,787	2,912	3,155	3,356
SG&A	1,365	1,447	1,453	1,415	1,463	1,478
R&D	411	407	399	383	402	415
Amortization of intangibles	17	20	15	15	15	15
Operating income	471	778	920	1,098	1,274	1,449
Other expense (income)	25	28	21	15	25	30
Adjusted EBIT*	496	806	941	1,113	1,299	1,479
Depreciation	86	95	133	115	110	105
EBITDA	599	921	1,089	1,243	1,424	1,599
Other expenses/(income)	12	8	10	103	93	88
Interest expense	37	36	31	118	118	118
Other expense (income)	(25)	(28)	(21)	(15)	(25)	(30)
Pretax income	459	770	910	995	1,181	1,361
Taxes	183	264	372	293	342	395
Tax Rate	39.9%	34.3%	40.9%	29.5%	29.0%	29.0%
Income attributable to non-controlling interest	1	3	-	-	-	-
Net income (Non-GAAP)	275	503	538	702	838	966

DILUTED EPS, proforma	\$0.55	\$1.01	\$1.08	\$1.40	\$1.67	\$1.91
Diluted shares outstanding	500	500	500	500	503	505
Average basic shares outstanding	500	500	500	500	503	505
Period-end basic shares outstanding	500	500	500	500	503	505

*We add back other income in the calc. of EBIT, but exclude from op. income b/c it is not an operating line item

Margin Analysis	2010A	2011A	2012A	2013E	2014E	2015E
COGS	36.8%	37.3%	35.7%	35.5%	35.0%	34.5%
Gross margin	63.2%	62.7%	64.3%	64.5%	65.0%	65.5%
SG&A	38.1%	34.2%	33.5%	31.4%	30.1%	28.8%
R&D	11.5%	9.6%	9.2%	8.5%	8.3%	8.1%
Operating margin	13.1%	18.4%	21.2%	24.3%	26.2%	28.3%
EBIT margin	13.8%	19.0%	21.7%	24.7%	26.8%	28.9%
D&A	2.9%	2.7%	3.4%	2.9%	2.6%	2.3%
EBITDA margin	16.7%	21.8%	25.1%	27.6%	29.3%	31.2%
Pretax margin	12.8%	18.2%	21.0%	22.1%	24.3%	26.6%
Net margin	7.7%	11.9%	12.4%	15.6%	17.3%	18.9%

Source: Company Data, Morgan Stanley Research

Exhibit 2

Income Statement (2 of 2)

YOY % Change	2010A	2011A	2012A	2013E	2014E	2015E
Net revenues	30%	18%	2%	4%	8%	6%
COGS	32%	20%	-2%	3%	6%	4%
Gross profit	29%	17%	5%	4%	8%	6%
SG&A	29%	6%	0%	-3%	3%	1%
R&D	13%	-1%	-2%	-4%	5%	3%
Operating income	47%	65%	18%	19%	16%	14%
<i>EBIT</i>	54%	62%	17%	18%	17%	14%
<i>EBITDA</i>	65%	54%	18%	14%	15%	12%
Pretax income	55%	68%	18%	9%	19%	15%
Net income (Non-GAAP)	46%	83%	7%	31%	19%	15%
DILUTED EPS, proforma	46%	83%	7%	30%	19%	15%
Diluted shares outstanding	0%	0%	0%	0%	1%	1%

Source: Company Data, Morgan Stanley Research

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Zoetis Inc.

Exhibit 3

Quarterly Income Statement

(\$M)	1Q:12A	2Q:12A	3Q:12A	4Q:12A	2012A	1Q:13A	2Q:13A	3Q:13A	4Q:13E	2013E
Net revenues	1,047	1,094	1,018	1,176	4,336	1,090	1,114	1,103	1,204	4,511
COGS	388	382	352	427	1,549	398	400	383	419	1,600
Gross profit	659	712	666	749	2,787	692	714	720	786	2,912
SG&A	331	351	330	441	1,453	322	339	359	395	1,415
R&D	93	91	94	121	399	90	91	91	111	383
Amortization of intangibles	4	3	4	4	15	4	3	4	4	15
Operating income	231	267	238	183	920	276	281	266	275	1,098
Other expense (income)	6	7	10	(2)	21	(2)	3	7	7	15
Adjusted EBIT*	237	274	248	181	941	274	284	273	282	1,113
Depreciation	19	33	41	40	133	35	34	23	23	115
EBITDA	260	310	293	225	1,089	313	321	300	309	1,243
Other expenses/(income)	2	1	(3)	10	10	24	29	22	28	103
Interest expense	8	8	7	8	31	22	32	29	35	118
Other expense (income)	(6)	(7)	(10)	2	(21)	2	(3)	(7)	(7)	(15)
Pretax income	229	266	241	173	910	252	252	244	247	995
Taxes	76	90	89	117	372	73	74	72	74	293
Tax Rate	33.2%	33.8%	36.9%	67.5%	40.9%	29.0%	29.4%	29.5%	30.0%	29.5%
Income attributable to non-controlling int	1	-	(1)	-	-	-	-	-	-	-
Net income (Non-GAAP)	152	176	153	56	538	179	178	172	173	702
DILUTED EPS, proforma	\$0.30	\$0.35	\$0.31	\$0.11	\$1.08	\$0.36	\$0.36	\$0.34	\$0.35	\$1.40
Diluted shares outstanding	500	500	500	500	500	500	500	500	501	500
Margin Analysis	1Q:12A	2Q:12A	3Q:12A	4Q:12A	2012A	1Q:13A	2Q:13A	3Q:13A	4Q:13E	2013E
COGS	37.1%	34.9%	34.6%	36.3%	35.7%	36.5%	35.9%	34.7%	34.8%	35.5%
Gross margin	62.9%	65.1%	65.4%	63.7%	64.3%	63.5%	64.1%	65.3%	65.3%	64.5%
SG&A	31.6%	32.1%	32.4%	37.5%	33.5%	29.5%	30.4%	32.5%	32.8%	31.4%
R&D	8.9%	8.3%	9.2%	10.3%	9.2%	8.3%	8.2%	8.3%	9.2%	8.5%
Operating margin	22.1%	24.4%	23.4%	15.6%	21.2%	25.3%	25.2%	24.1%	22.9%	24.3%
EBIT margin	22.6%	25.0%	24.4%	15.4%	21.7%	25.1%	25.5%	24.8%	23.4%	24.7%
D&A	2.2%	3.3%	4.4%	3.7%	3.4%	3.6%	3.3%	2.4%	2.2%	2.9%
EBITDA margin	24.8%	28.3%	28.8%	19.2%	25.1%	28.7%	28.8%	27.2%	25.7%	27.6%
Pretax margin	21.9%	24.3%	23.7%	14.7%	21.0%	23.1%	22.6%	22.1%	20.5%	22.1%
Net margin	14.5%	16.1%	15.1%	4.8%	12.4%	16.4%	16.0%	15.6%	14.4%	15.6%
YOY % Change	1Q:12A	2Q:12A	3Q:12A	4Q:12A	2012A	1Q:13A	2Q:13A	3Q:13A	4Q:13E	2013E
Net revenues	6%	2%	-3%	4%	2%	4%	2%	8%	2%	4%
COGS	5%	-11%	-10%	8%	-2%	3%	5%	9%	-2%	3%
Gross profit	7%	10%	1%	3%	5%	5%	0%	8%	5%	4%
SG&A	-1%	-2%	0%	4%	0%	-3%	-3%	9%	-10%	-3%
R&D	-6%	-9%	-4%	10%	-2%	-3%	0%	-3%	-8%	-4%
Operating income	31%	46%	5%	-4%	18%	19%	5%	12%	50%	19%
EBIT	29%	47%	6%	-10%	17%	16%	4%	10%	56%	18%
EBITDA	20%	44%	8%	4%	18%	20%	4%	2%	37%	14%
Pretax income	31%	50%	7%	-10%	18%	10%	-5%	1%	43%	9%
Net income (Non-GAAP)	25%	55%	5%	-54%	7%	18%	1%	12%	207%	31%
DILUTED EPS, proforma	26%	55%	5%	-54%	7%	18%	1%	12%	206%	30%
Diluted shares outstanding	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%

Source: Company Data, Morgan Stanley Research

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Zoetis Inc.

Exhibit 4

Management Reported Segment Profitability (1 of 2)

(\$M)	2010A	2011A	2012A	1Q:13A	2Q:13A	3Q:13A
Revenues	3,582	4,233	4,336	1,090	1,114	1,103
U.S.	1,384	1,659	1,776	454	437	495
EuAfME	1,020	1,144	1,096	290	278	270
CLAR	664	788	769	171	213	171
APAC	514	642	695	175	186	167
Segment Pretax Earnings (pre-corp)*	1,333	1,656	1,785	478	494	490
U.S.	656	820	921	234	254	285
EuAfME	328	365	375	117	91	92
CLAR	203	275	253	52	78	56
APAC	146	196	236	75	71	57
Other business activities**	(264)	(279)	(275)	(74)	(74)	(80)
Corporate†	(533)	(504)	(506)	(116)	(137)	(139)
Other unallocated‡	(77)	(103)	(93)	(36)	(96)	(86)
Consolidated Pre-tax income	459	770	911	252	187	185
Margin Analysis	2010A	2011A	2012A	1Q:13A	2Q:13A	3Q:13A
Segment Pretax Earnings (pre-corp)*	37%	39%	41%	44%	44%	44%
U.S.	47%	49%	52%	52%	58%	58%
EuAfME	32%	32%	34%	40%	33%	34%
CLAR	31%	35%	33%	30%	37%	33%
APAC	28%	31%	34%	43%	38%	34%
Other business activities**	-7%	-7%	-6%	-7%	-7%	-7%
Corporate†	-15%	-12%	-12%	-11%	-12%	-13%
Other unallocated‡	-2%	-2%	-2%	-3%	-9%	-8%
Consolidated Pre-tax income	13%	18%	21%	23%	17%	17%

Source: Company Data, Morgan Stanley Research\

Exhibit 5

Management Reported Segment Profitability (2 of 2)

YOY % Change	2010A	2011A	2012A	1Q:13A	2Q:13A	3Q:13A
Revenues	30%	18%	2%	4%	2%	8%
U.S.	25%	20%	7%	7%	4%	10%
EuAfME	16%	12%	-4%	5%	-2%	12%
CLAR	47%	19%	-2%	-1%	1%	4%
APAC	59%	25%	8%	1%	4%	1%
Segment Pretax Earnings (pre-corp)*	23%	24%	8%	7%	9%	13%
U.S.	24%	25%	12%	8%	12%	23%
EuAfME	4%	11%	3%	13%	3%	1%
CLAR	33%	35%	-8%	-4%	1%	6%
APAC	64%	34%	20%	6%	13%	-3%
Other business activities**	18%	6%	-1%	14%	21%	23%
Corporate†	7%	-5%	0%	-10%	32%	23%
Other unallocated‡	10%	34%	-10%	57%	300%	473%
Consolidated Pre-tax income	55%	68%	18%	10%	-30%	-24%
Segment Contributor Analysis	2010A	2011A	2012A	1Q:13A	2Q:13A	3Q:13A
Revenues						
U.S.	39%	39%	41%	42%	39%	45%
EuAfME	28%	27%	25%	27%	25%	24%
CLAR	19%	19%	18%	16%	19%	16%
APAC	14%	15%	16%	16%	17%	15%
Segment Pretax Earnings (pre-corp)*						
U.S.	49%	50%	52%	49%	51%	58%
EuAfME	25%	22%	21%	24%	18%	19%
CLAR	15%	17%	14%	11%	16%	11%
APAC	11%	12%	13%	16%	14%	12%

Footnotes

* Defined as income/ (loss) before provision/ (benefit)for taxes on income

** Other business activities reflect the R&D costs managed by ZTS' Research and Development organization (not equal to 100% of consolidated R&D on the I/S)

† Corporate includes, among other things, administration expenses, allocated interest expense, certain compensation, and other costs not charged to operating segments.

‡ Includes overhead expenses associated with ZTS's manufacturing operations

Source: Company Data, Morgan Stanley Research

Exhibit 6

Annual Revenue (1 of 2)

(\$M)	2010A	2011A	2012A	2013E	2014E	2015E
Total Revenue	3,582	4,233	4,336	4,511	4,853	5,124
Base revenue	2,968	3,821	4,445	4,567	4,830	5,124
Fx impact	69	104	(146)	(55)	24	-
Acquisitions	640	329	37	-	-	-
Divestitures	(95)	(21)	-	-	-	-
United States (U.S.)	1,384	1,659	1,776	1,883	2,034	2,135
Base revenue	1,250	1,473	1,762	1,883	2,034	2,135
Acquisitions	147	186	14	-	-	-
Divestitures	(13)	-	-	-	-	-
Europe/Africa/Middle East (EuAfME)	1,020	1,144	1,096	1,135	1,192	1,239
Total Base revenue	871	1,051	1,165	1,134	1,192	1,239
Fx impact	(6)	34	(77)	0	-	-
Acquisitions	229	59	8	-	-	-
Divestitures	(74)	-	-	-	-	-
Canada/Latin America (CLAR)	664	788	769	786	841	892
Base revenue	474	720	823	812	833	892
Fx impact	44	28	(61)	(27)	8	-
Acquisitions	146	49	7	-	-	-
Divestitures	-	(9)	-	-	-	-
Asia Pacific (APAC)	514	642	695	708	787	858
Base revenue	373	577	695	737	772	858
Fx impact	31	42	(8)	(29)	15	-
Acquisitions	118	35	8	-	-	-
Divestitures	(8)	(12)	-	-	-	-

Source: Company Data, Morgan Stanley Research

Exhibit 7

Annual Revenue (2 of 2)

YOY % CHANGE	2010A	2011A	2012A	2013E	2014E	2015E
Total Revenue	30%	18%	2%	4%	8%	6%
Base revenue	8%	7%	5%	5%	7%	6%
Fx impact	2%	3%	-3%	-1%	0%	0%
Acquisitions	23%	9%	1%	NM	NM	NM
Divestitures	-3%	-1%	0%	NM	NM	NM
United States (U.S.)	25%	20%	7%	6%	8%	5%
Base revenue	13%	6%	6%	6%	8%	5%
Acquisitions	13%	13%	1%	NM	NM	NM
Divestitures	-1%	0%	0%	NM	NM	NM
Europe/Africa/Middle East (EuAfME)	16%	12%	-4%	4%	5%	4%
Base revenue	-1%	3%	2%	4%	5%	4%
Fx impact	-1%	3%	-7%	0%	0%	0%
Acquisitions	26%	6%	1%	NM	NM	NM
Divestitures	-8%	0%	0%	NM	NM	NM
Canada/Latin America (CLAR)	47%	19%	-2%	2%	7%	6%
Base revenue	5%	8%	4%	6%	6%	6%
Fx impact	10%	4%	-7%	-3%	1%	0%
Acquisitions	32%	7%	1%	NM	NM	NM
Divestitures	0%	-1%	0%	NM	NM	NM
Asia Pacific (APAC)	59%	25%	8%	2%	11%	9%
Base revenue	15%	12%	8%	6%	9%	9%
Fx impact	10%	8%	-1%	-4%	2%	0%
Acquisitions	36%	7%	1%	NM	NM	NM
Divestitures	-2%	-2%	0%	NM	NM	NM

Source: Company Data, Morgan Stanley Research

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Exhibit 8

Historical and Projected Revenues by Species

Revenue by Species (\$M)	2010A	2011A	2012A	2013E	2014E	2015E
Livestock	2,233	2,778	2,806	2,874	3,130	3,305
Cattle	1,464	1,617	1,608			
Swine	433	562	590			
Poultry	265	501	501			
Other (Fish and Sheep)	71	98	107			
Companion Animal	1,349	1,455	1,530	1,628	1,723	1,819
Horses	159	168	187			
Dogs and Cats	1,190	1,287	1,343			
YOY % CHANGE	2010A	2011A	2012A	2013E	2014E	2015E
Livestock	32%	24%	1%	2%	9%	6%
Cattle	30%	10%	-1%			
Swine	12%	30%	5%			
Poultry	112%	89%	0%			
Other (Fish and Sheep)	51%	38%	9%			
Companion Animal	26%	8%	5%	6%	6%	6%
Horses	99%	6%	11%			
Dogs and Cats	20%	8%	4%			

Source: Company Data, Morgan Stanley Research

Exhibit 9

Segment Revenue Breakdown

% of total revenue	2010A	2011A	2012A	2013E	2014E	2015E
United States (U.S.)	39%	39%	41%	42%	42%	42%
Europe/Africa/Middle East (EuAfME)	28%	27%	25%	25%	25%	24%
Canada/Latin America (CLAR)	19%	19%	18%	17%	17%	17%
Asia Pacific (APAC)	14%	15%	16%	16%	16%	17%
Livestock	62.3%	65.6%	64.7%	63.7%	64.5%	64.5%
Companion Animal	37.7%	34.4%	35.3%	36.1%	35.5%	35.5%

Source: Company Data, Morgan Stanley Research

November 6, 2013

Zoetis Inc.

Exhibit 10

Quarterly Revenue

(\$M)	1Q:12A	2Q:12A	3Q:12A	4Q:12A	2012A	1Q:13A	2Q:13A	3Q:13A	4Q:13E	2013E
Total Revenue	1,047	1,094	1,018	1,176	4,336	1,090	1,114	1,103	1,204	4,511
Base revenue	1,024	1,137	1,081	1,203	4,445	1,097	1,135	1,114	1,221	4,567
Fx impact	(14)	(43)	(63)	(27)	(146)	(7)	(21)	(11)	(17)	(55)
United States (U.S.)	425	420	448	483	1,776	454	437	495	497	1,883
Base revenue	412	420	448	483	1,762	454	437	495	497	1,883
Europe/Africa/Middle East (EuAfME)	275	283	241	297	1,096	290	278	270	297	1,135
Total Base revenue	277	305	272	311	1,165	286	286	262	300	1,134
Fx impact	(10)	(22)	(31)	(14)	(77)	4	(8)	8	(3)	0
Canada/Latin America (CLAR)	173	211	165	220	769	171	213	171	231	786
Base revenue	172	230	188	233	823	179	220	180	233	812
Fx impact	(6)	(19)	(23)	(13)	(61)	(8)	(7)	(9)	(2)	(27)
Asia Pacific (APAC)	174	179	165	177	695	175	186	167	180	708
Base revenue	164	182	173	177	695	177	192	176	191	737
Fx impact	2	(2)	(8)	1	(8)	(2)	(6)	(9)	(11)	(29)
YOY % CHANGE	1Q:12A	2Q:12A	3Q:12A	4Q:12A	2012A	1Q:13A	2Q:13A	3Q:13A	4Q:13E	2013E
Total Revenue	6%	2%	-3%	4%	2%	4%	2%	8%	2%	4%
Base revenue	4%	6%	3%	7%	5%	5%	4%	9%	4%	5%
Fx impact	-1%	-4%	-6%	-2%	-3%	-1%	-2%	-1%	-1%	-1%
Acquisitions	4%	0%	0%	0%	1%	0%	0%	0%	0%	NM
Divestitures	0%	0%	0%	0%	0%	0%	0%	0%	0%	NM
United States (U.S.)	12%	7%	2%	7%	7%	7%	4%	10%	3%	6%
Base revenue	8%	7%	2%	7%	6%	7%	4%	10%	3%	6%
Europe/Africa/Middle East (EuAfME)	-2%	-4%	-12%	1%	-4%	5%	-2%	12%	0%	4%
Base revenue	-2%	3%	0%	6%	2%	4%	1%	9%	1%	4%
Fx impact	-3%	-7%	-12%	-5%	-7%	1%	-3%	3%	-1%	0%
Acquisitions	3%	0%	0%	0	1%	NM	NM	NM	NM	NM
Divestitures	0%	0%	0%	0	0%	NM	NM	NM	NM	NM
Canada/Latin America (CLAR)	2%	-2%	-8%	-1%	-2%	-1%	1%	3%	5%	2%
Base revenue	2%	6%	4%	4%	4%	4%	4%	9%	6%	6%
Fx impact	-4%	-8%	-12%	-6%	-7%	-5%	-3%	-5%	-1%	-3%
Asia Pacific (APAC)	15%	5%	4%	9%	8%	1%	4%	1%	2%	2%
Base revenue	8%	6%	9%	9%	8%	2%	7%	7%	8%	6%
Fx impact	1%	-1%	-5%	0%	-1%	-1%	-3%	-5%	-6%	-4%

Source: Company Data, Morgan Stanley Research

Exhibit 11

Cash flow statement

(\$M)	2010A	2011A	2012A	2013E	2014E	2015E
Net income (Non-GAAP)	275	503	538	702	838	966
GAAP adjustments	(164)	(255)	(102)	(175)	(100)	(75)
Net income before minority interest (GAAP)	111	248	436	527	738	891
Depreciation & amortization	185	205	200	185	180	175
Depreciation	86	95	133	115	110	105
Amortization	99	110	67	70	70	70
Change in operating assets and liabilities	100	(117)	(149)	(148)	10	(115)
Other operating activities	(142)	161	(33)	(89)	90	-
Net cash from operating activities	254	497	454	475	1,019	951
Purchase of PP&E	(124)	(135)	(126)	(150)	(150)	(150)
Other investing activities	115	(314)	(9)	-	-	-
Net cash from investing activities	(9)	(449)	(135)	(150)	(150)	(150)
Cash dividends paid	(207)	(416)	(63)	(3,271)	(150)	(174)
Net change in short-term debt	-	-	-	-	-	-
Net change in long-term debt	-	(143)	-	3,141	-	-
Acquisitions, share repurchases, other	(70)	529	(15)	-	-	-
Net cash from financing activities	(277)	(30)	(78)	(130)	(150)	(174)
Effect of exchange rates	(4)	(2)	(3)	-	-	-
Net increase in cash	(36)	16	238	195	719	628
Cash at beginning of period	99	63	79	317	512	1,231
Cash at end of period	63	79	317	512	1,231	1,858

Source: Company Data, Morgan Stanley Research

Exhibit 12

Balance Sheet

(\$M)	2010A	2011A	2012A	2013E	2014E	2015E
Cash and short-term investments	63	79	317	512	1,231	1,858
Receivables	773	871	900	1,000	1,023	1,112
Inventories	995	1,063	1,345	1,214	1,360	1,279
Other current assets	285	298	302	300	300	300
Current assets	2,116	2,311	2,864	3,026	3,913	4,550
Net property, plant and equipment	1,148	1,243	1,241	1,276	1,316	1,361
Other assets	2,020	2,157	2,157	2,087	2,017	1,947
Total Assets	5,284	5,711	6,262	6,389	7,246	7,858
Short-term debt	38	-	73	73	73	73
Accounts Payable	206	214	319	219	348	242
Other current liabilities	564	629	731	650	700	700
Current liabilities	808	843	1,123	942	1,121	1,015
Long-term debt	673	575	509	3,650	3,650	3,650
Other liabilities	459	557	589	500	590	590
Total Liabilities	1,940	1,975	2,221	5,092	5,361	5,255
Preferred stock	-	-	-	-	-	-
Common Equity	3,344	3,720	4,026	1,282	1,870	2,588
Minority Interest	-	16	15	15	15	15
Shareholders' Equity	3,344	3,736	4,041	1,297	1,885	2,603
Total Liabilities and SE	5,284	5,711	6,262	6,389	7,246	7,858

Source: Company Data, Morgan Stanley Research

Exhibit 13

Capital Structure

	2010A	2011A	2012A	2013E	2014E	2015E
Capital structure						
Net debt	648	496	265	3,211	2,492	1,865
Net debt-to-equity	0.2	0.1	0.1	2.5	1.3	0.7
Net Debt to Capital	16.0%	11.5%	5.7%	64.0%	44.4%	29.5%
Total Debt	711	575	582	3,723	3,723	3,723
Total Debt to Capital	17.5%	13.3%	12.6%	74.2%	66.4%	58.9%
Total Debt to EBITDA (current year)	1.2x	0.6x	0.5x	3.0x	2.6x	2.3x
Net Debt to EBITDA (current year)	1.1x	0.5x	0.2x	2.6x	1.8x	1.2x
Interest coverage ratio	(13)	(22)	(30)	(9)	(11)	(13)
Interest expense	(37)	(36)	(31)	(118)	(118)	(118)
Dividend payout ratio	75%	83%	12%	19%	18%	18%
Dividend per share	\$0.41	\$0.83	\$0.13	\$0.26	\$0.30	\$0.34
Dividend growth	105%	101%	-85%	106%	15%	15%

Source: Company Data, Morgan Stanley Research

Exhibit 14

Financial Metrics

(\$M)	2010A	2011A	2012A	2013E	2014E	2015E
Operating efficiency						
Accounts receivable turnover	4.6x	5.1x	4.9x	4.8x	4.8x	4.8x
Inventory turnover	1.3x	1.5x	1.3x	1.3x	1.3x	1.3x
Accounts payable turnover	6.4x	7.5x	5.8x	6.0x	6.0x	6.0x
Fixed asset turnover	3.1x	3.5x	3.5x	3.6x	3.7x	3.8x
Capex as % sales	3.5%	3.2%	2.9%	3.3%	3.1%	2.9%
Depreciation to fixed assets ratio		0.08x	0.11x	0.09x	0.09x	0.08x
Days sales outstanding	79	71	75	77	76	76
Days payables outstanding	57	48	63	61	61	61
Days inventory held	276	238	284	292	277	272
Cash conversion cycle (days)	297	260	295	307	292	288
Liquidity						
Working capital	1,308	1,468	1,741	2,084	2,792	3,535
Current ratio	2.6	2.7	2.6	3.2	3.5	4.5
Quick ratio	1.4	1.5	1.4	1.9	2.3	3.2
Cash ratio	0.1	0.1	0.3	0.5	1.1	1.8
Profitability						
Adjusted EPS	\$0.55	\$1.01	\$1.08	\$1.40	\$1.67	\$1.91
GAAP EPS	\$0.22	\$0.50	\$0.87	\$1.05	\$1.47	\$1.76
GAAP vs adjusted	(\$0.33)	(\$0.51)	(\$0.20)	(\$0.35)	(\$0.20)	(\$0.15)
Adjusted EBIT*	\$496	\$806	\$941	\$1,113	\$1,299	\$1,479
Adjusted EBITDA	\$599	\$921	\$1,089	\$1,243	\$1,424	\$1,599
Operating cash flow per share	\$0.94	\$1.43	\$1.49	\$1.92	\$2.16	\$2.38
FCF per share	\$0.11	\$0.56	\$0.56	\$0.85	\$1.58	\$1.61
OCF	468	716	744	960	1,085	1,204
FCF	54	279	279	427	793	815
FCF less dividends	(153)	(137)	216	(2,844)	643	641
FCF less dividends/share buybacks	(156)	(137)	216	(2,844)	643	641
Book value per share	\$6.69	\$7.47	\$8.08	\$2.59	\$3.75	\$5.15
Return on asset/equity						
EBT margin	12.8%	18.2%	21.0%	22.1%	24.3%	26.6%
ROA	24.0%	42.1%	43.3%	55.8%	64.7%	72.2%
Leverage (assets/equity)	1.6	1.6	1.5	2.4	4.3	3.4
Tax effect	60.1%	65.7%	59.1%	70.5%	71.0%	71.0%
ROE	8.2%	13.5%	13.3%	54.1%	44.5%	37.1%
ROIC				15.5%	18.2%	20.3%
NOPAT				775	905	1,029
Invested Capital (Assets- Cash- Current Liabilities)				5,008	4,968	5,058

Source: Company data, Morgan Stanley Research estimates

Exhibit 15

Footnotes

3Q:13A

- **Constant currency revenue growth:** Total +9%, U.S. +10%, EUAfME +9%, CLAR +9%, APAC +7%
- **U.S.:** livestock products grew 11%, driven by cattle, poultry and swine. Sales of cattle products increased, benefiting from a weak year-ago quarter when the impact of the drought was most evident. Sales of companion animal products grew 10%.
- **EUAfME:** livestock products grew 7% operationally. Sales of companion animal products grew 15% operationally, and benefited again this quarter from increased sales associated with third-party manufacturing agreements. Excluding these sales, companion animal product sales grew 5% operationally, driven by sales of anti-infective and parasiticide products.
- **CLAR:** livestock products grew 6% operationally, driven by poultry products, primarily in Brazil. Sales of companion animal products grew 19% operationally, largely due to a later start in 2013 of the parasiticide season in Canada as well as increased demand in Brazil.
- **APAC:** livestock products grew 8% operationally, driven by the launch of new products for swine. Sales of companion animal products grew 3% operationally, based on increases in developed markets such as Taiwan and Japan and in emerging markets such as China

2Q:13A

- **Constant currency revenue growth:** Total +4%, U.S. +4%, EUAfME +1%, CLAR +4%, APAC +7%
- **U.S.:** Companion animal growth of +2% YOY was positively impacted by a competitor's supply disruption. Livestock was up 6% YOY; poultry and swine offset declines in cattle due to drought.
- **EUAfME:** Unseasonably cold spring negatively impacted growth in livestock and companion animal segments.
- **CLAR:** Companion animal growth was 6% YOY, despite somewhat tougher comps in Canada (competitor faced a supply disruption last year).
- **APAC:** Growth driven by launch of new products, slightly offset by drought in Australia and New Zealand

1Q:13A

- **Constant currency revenue growth:** Total +5%, U.S. +7%, EUAfME +4%, CLAR +4%, APAC +2%
- **U.S.:** Companion animal growth of +13% YOY was positively impacted by a competitor's supply disruption. Livestock was up 7% YOY; poultry and swine offset declines in cattle due to drought.
- **EUAfME:** Timing of price increases positively impacted growth (last year ZTS raised prices in 2Q instead of 1Q)
- **CLAR:** Companion animal was down 5% YOY on tougher companion animal comps in Canada (competitor faced a supply disruption last year).
- **APAC:** Headwinds included drought in Australia, macroeconomic weakness in Japan and Korea, and regulatory delays in India.

4Q:12A

- **U.S. Organic Growth:** +7% YOY offset light 3Q:12 (+3%). Farmers kept herds on pasture longer in 3Q (farmers may have been holding out for rain/higher beef prices), which resulted in a bolus of demand in feedlots in 4Q)
- **CLAR:** Drought (primarily in Northern Mexico) negatively impacted cattle sales, which also had a negative impact on segment margins (cattle are among the most profitable livestock animals)
- **Abnormally high SG&A**
 - Seasonality
 - Costs associated with buildup of internal capabilities
 - "Dis-"synergies: Higher than expected corporate overhead costs (PFE switched cost allocation from %-of sales to actual costs)
- **EUAfME:** Strength in emerging markets (e.g., Africa, Russia, Turkey) offset continued macroeconomic weakness in Western Europe
- **Inventories:** Mgmt. built in safety stock in advance of shifting over internal systems
- **67.5% tax rate:** 10K notes: "tax costs related to uncertain tax positions, substantially all of which will remain with Pfizer and to a lesser extent, tax costs associated with repatriation decisions among other impacts."

Source: Company Data, Morgan Stanley Research

Exhibit 16

Management Guidance

For period	2013	2013	2013
Date provided	4/30/2013	8/6/2013	11/5/2013
Revenue	\$4,425-\$4,525M	\$4,425-\$4,525M	\$4,475-\$4,525M
COGS (% of sales)	35-36%	35-36%	35.5%
SG&A	\$1,385-\$1,435M	\$1,385-\$1,435M	\$1,405-\$1,425M
R&D	\$385-\$415M	\$385-\$415M	\$380-\$390M
Interest expense	~115M	~115M	~115M
Other (income)/expenses	~(20M)	~(20M)	~(15M)
Tax rate	~29.5%	~29.5%	~29.5%
Net income (Non-GAAP)	~\$680M-\$710M	~\$680M-\$710M	~\$690M-\$710M
Adjusted Diluted EPS	\$1.36-\$1.42	\$1.36-\$1.42	\$1.38-\$1.42

Source: Company Data



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November 6, 2013

Zoetis Inc.

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	988	34%	400	37%	40%
Equal-weight/Hold	1296	44%	496	46%	38%
Not-Rated/Hold	109	4%	28	3%	26%
Underweight/Sell	541	18%	152	14%	28%
Total	2,934		1076		

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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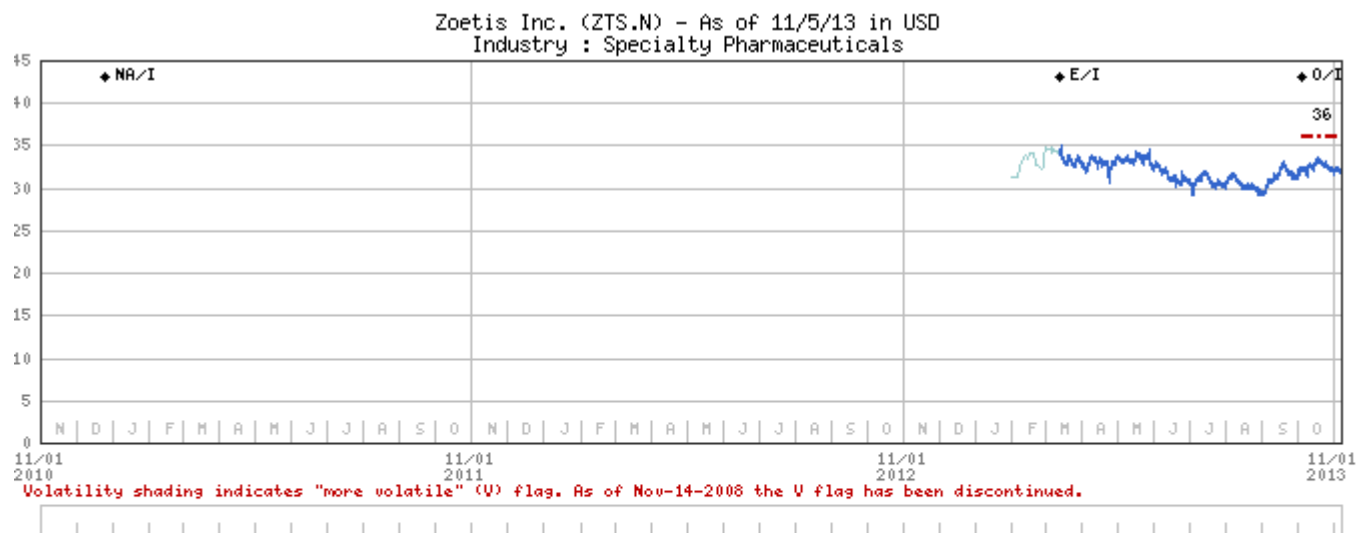
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

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Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 12/26/10 : NA/I; 3/13/13 : E/I; 10/4/13 : O/I

Price Target History: 3/13/13 : NA; 10/4/13 : 36

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage: Specialty Pharmaceuticals

Company (Ticker)	Rating (as of)	Price* (11/05/2013)
Christopher Caponetti, CFA		
Endo Health Solutions Inc (ENDP.O)	E (07/24/2013)	\$56.22
David Risinger		
Actavis Inc (ACT.N)	O (01/25/2012)	\$156.53
Alkermes Plc. (ALKS.O)	E (10/01/2013)	\$35.82
Allergan Inc. (AGN.N)	E (05/01/2013)	\$89.24
Forest Laboratories Inc. (FRX.N)	E (04/26/2011)	\$46.91
Mylan Inc. (MYL.O)	E (10/14/2013)	\$39.88
Perrigo Co. (PRGO.N)	++	\$142.5
Teva Pharmaceutical Industries Ltd. (TEVA.N)	U (08/05/2013)	\$36.97
Valeant Pharmaceuticals International (VRX.N)	E (09/14/2012)	\$109.45
Zoetis Inc. (ZTS.N)	O (11/06/2013)	\$31.69

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