

Zoetis Inc.

ZTS - BUY - Merck & Vetoquinol 3Q13 Earnings Read-Throughs
Consistent with Other Reports This Quarter

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FLASH NOTE

SECTOR: Specialty Pharmaceuticals

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Takeaways from 3Q13 earnings for Merck's Animal Health business and Vetoquinol continue to indicate two things: 1) strength in the U.S. companion animal business, and 2) emerging markets remain primary driver of growth for production animals. This is in line with trends we noted in our previous note, [ZTS - BUY - Read-Throughs from Other Animal Health Companies Support Our Positive Investment Thesis](#) in which we highlighted 3Q13 earning takeaways from Elanco, Dechra, Idexx, and Virbac.

- **Merck (MRK):** Merck's Animal Health business reported flat year-over-year growth this quarter. Growth in companion animal and swine segments was offset by a decline in the cattle segment of the business. This was primarily due to the temporary withdrawal of Zilmax in the U.S. and Canada. As a reminder, LLY/Elanco's production animal business benefited this quarter from the withdrawal of Zilmax. Management noted that, although the company continues to work toward providing additional data for Zilmax, it is too early to speculate when sales would resume.
- **Vetoquinol:** The company reported 3Q13 and year-to-date organic growth of 4.1% and 1.4%, respectively (excluding negative currency headwinds). Vetoquinol saw accelerating growth this quarter in its core products (+9.4% organic growth), many of which were recently launched, including Zylkene (stress relief in dogs & cats), Cimaljex (treats pain & inflammation), Forcyl (anti-infective, companion animals), and Slevox (flea & tick like Frontline). The company noted that, overall, the animal health market was flattish this quarter, with production animal sales showing growth in emerging markets; meanwhile, companion animal sales strength mainly came from North America. EU sales continued to be weak due to the economic downturn and pricing competition in the flea and tick market.

Despite Zilmax sales disruption this quarter, MRK's management highlighted favorable long-term fundamentals as a growth driver in its Animal Health business. This further reinforces our positive view of the long-term growth prospects for ZTS's production animal business. During Merck's 3Q13 earnings call, CEO Ken Frazier, said, "...the underlying fundamentals of the business remain solid despite what we saw this quarter...from my perspective, we continue to believe that there are favorable macro trends that will help us drive growth in our Animal Health business going forward."

MRK to evaluate value of Animal Health business as part of strategic review, but no plans to spin off asset yet. When asked about potentially spinning off MRK's complementary consumer & animal health businesses, Frazier said, "As we are looking across our R&D and commercial portfolio and sharpening our focus on each of the assets there, so too with respect to Animal Health and the Consumer Care. I would say we are currently evaluating those businesses the way we are evaluating everything, to figure out whether those businesses produce the most value inside our portfolio or outside our portfolio. I did not mean to imply anything whatsoever with respect to timing. But I would say again we are currently evaluating those businesses just as we are sharpening our focus on every aspect of our business."

Companies Mentioned

Merck (MRK, NC, \$46.54)

Vetoquinol (VETO-FR, NC, €28.9)

Eli Lilly (LLY, NC, \$50.66)

Idexx (IDXX, NC, \$104.60)

Dechra (DPH.L, NC, 680.34 GBP)

Virbac (VIRP-FR, NC, €150.00)

Zoetis (ZTS, BUY, \$32.47)

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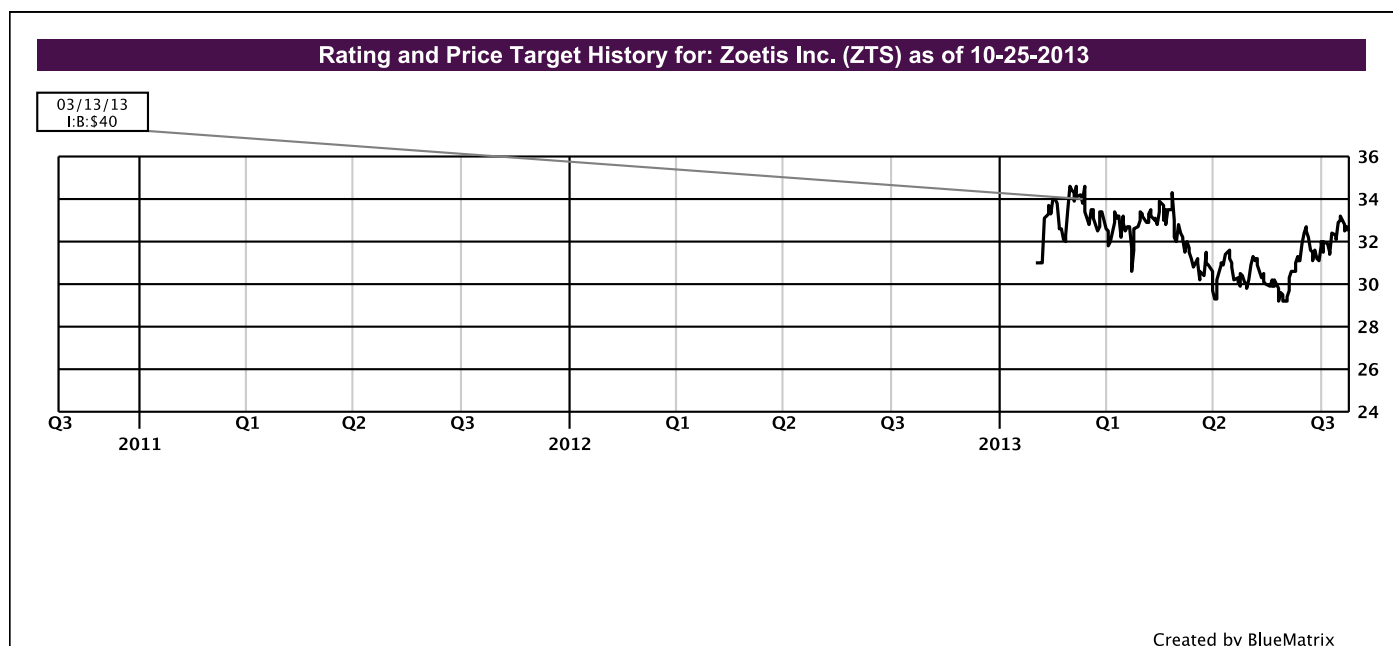
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