

Zoetis Inc.

ZTS - BUY - Still Expect Livestock Expansion to Be a Growth Driver for ZTS Post WASDE Report Today

LOUISE CHEN, ANALYST

louise.chen@guggenheimpartners.com
212 381 4195

SWATI KUMAR, ASSOCIATE

swati.kumar@guggenheimpartners.com
212 918 8754

FLASH NOTE

SECTOR: Specialty Pharmaceuticals

September 12, 2013

The USDA released its monthly WASDE (World Agriculture Supply and Demand Estimates) today. The report supports our belief that livestock expansion for poultry and swine will pick up in 2014 and cattle will pick up in 2015. This would be good for ZTS (BUY, \$31.33) because 60% of its revenues come from livestock. The key data points that support our positive investment thesis are highlighted below.

- Corn (energy crop) production is forecast 80M bushels higher at a record 13.8B bushels. The projected season-average farm price for corn is lowered 10 cents at both ends of the range to \$4.40 to \$5.20 (down 25% to 36% YOY). Last year the price of corn was \$6.90.
- Soybean (protein) production is projected at 3.149B bushels, down 106M due to lower yield prospects, especially in the Western Corn Belt. The U.S. season-average soybean price is projected at \$11.50 to \$13.50 per bushel (down 6% to 20% YOY), up \$1.15 on both ends of the range. Last year the price of soybean was \$14.40.
- There were no meaningful changes to the livestock production outlook. We would note that, for 2014, broiler and turkey production forecasts are reduced as soybean meal prices are forecast higher and turkey returns remain under pressure through the early part of the year. Also, the report did note relatively high early-year cow (female had at least one calf) slaughter. This could potentially be a negative read-through for heifer retention needed to expand herd sizes, but expectations for cattle expansion are already modest. The consensus view is that herd size will be down 1.0% to 1.5% when the cattle survey comes out in January 2014.

Potential Stock Moving Catalysts. 1) Operating margin expansion; 2) new product launches; 3) business development; 4) expansion into adjacent categories; 5) U.S. drought subsidies; and 6) strong flea and tick season.

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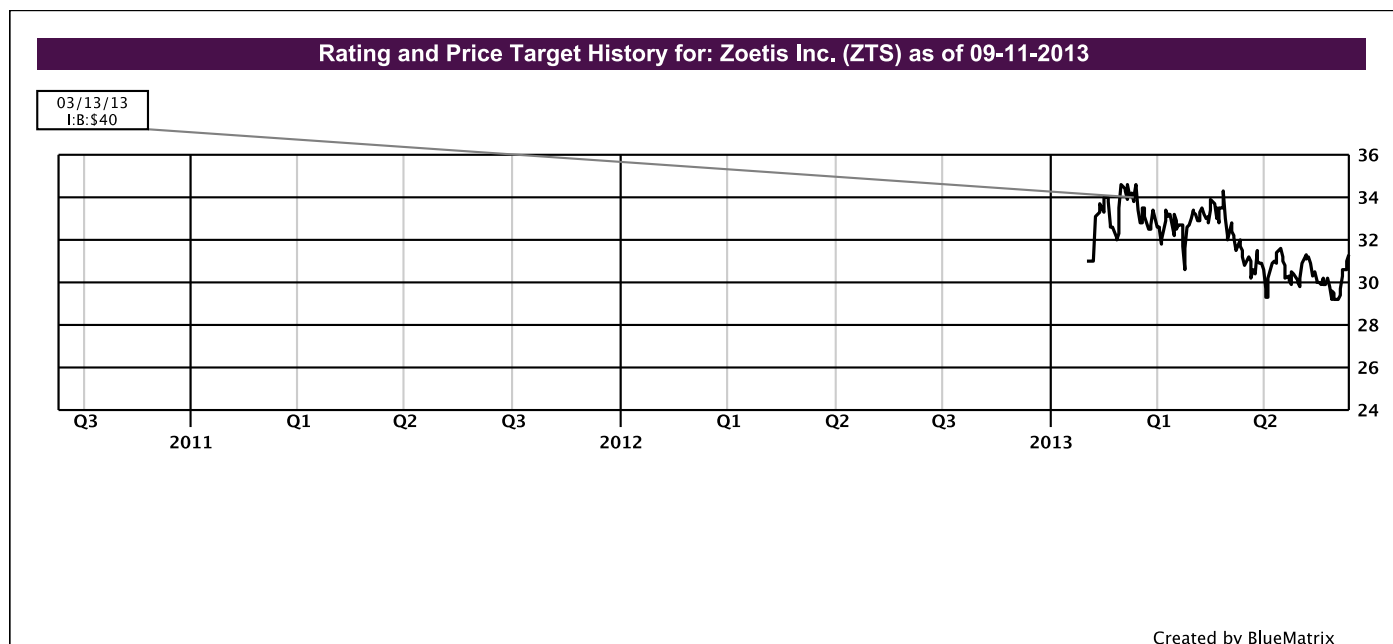
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Contact Information

NEW YORK SALES & TRADING DESK
212 292 4700

EQUITY TRADING DESK
212 292 4701

MEDIA INQUIRIES
312 977 4029

EMAIL
general@guggenheimmcm.com

Locations

NEW YORK
330 Madison Avenue
New York, NY 10017

CHICAGO
222 West Adams Street
Chicago, IL 60606

BOSTON
500 Boylston St, 13th Floor
Boston, MA 02116

LOS ANGELES
15821 Ventura Blvd
Encino, CA 91436
999 Corporate Drive
Ladera Ranch, CA 92694

DALLAS
1717 McKinney Avenue
Suite 870
Dallas, TX 75202

NASHVILLE
104 Woodmont Blvd
Suite 203
Nashville, TN 37205

HERNANDO
1288 Byhalia Road
Suite 2
Hernando, MS 38632

Guggenheim Equity Research

AUTOMOTIVE
Matthew Stover, Analyst
matthew.stover@guggenheimpartners.com
617 859 4605

Brendon Mason, Associate
brendon.mason@guggenheimpartners.com
617 859 4624

ENERGY: EXPLORATION & PRODUCTION
Rob Cordray, Analyst
robert.cordray@guggenheimpartners.com
972 638 5509

Steven Hader, Associate
steven.hader@guggenheimpartners.com
972 638 5507

ENERGY: OIL SERVICES & EQUIPMENT
Darren Gacicia, Analyst
darren.gacicia@guggenheimpartners.com
212 293 3054

Michael LaMotte, Analyst
michael.lamotte@guggenheimpartners.com
972 638 5502

Wilson Waggoner, Associate
wilson.waggoner@guggenheimpartners.com
972 638 5506

FINANCIAL INDUSTRY GROUP
Rahul Agarwal, Associate
rahul.agarwal@guggenheimpartners.com
615 208 1221

Taylor Brodarick, Analyst
taylor.brodarick@guggenheimpartners.com
615 208 1222

David Darst, Analyst
david.darst@guggenheimpartners.com
615 208 1224

Marty Mosby, Analyst
marty.mosby@guggenheimpartners.com
662 469 9595

Mason Mosby, Associate
mason.mosby@guggenheimpartners.com
662 469 9595

HEALTHCARE: BIOTECH
Bret Holley, Analyst
bret.holley@guggenheimpartners.com
212 293 2820

HEALTHCARE: PHARMACEUTICALS
Louise Chen, Analyst
louise.chen@guggenheimpartners.com
212 381 4195

Swati Kumar, Associate
swati.kumar@guggenheimpartners.com
212 918 8754

RETAIL & CONSUMER
Steven Forbes, Associate
steven.forbes@guggenheimpartners.com
212 381 4188

John Heinbockel, Analyst
john.heinbockel@guggenheimpartners.com
212 381 4135

U.S. CABLE
Sabina Nyckowski, Analyst
sabina.nyckowski@guggenheimpartners.com
212 292 4778