

Zoetis Inc. (ZTS)

Overweight

Highlights From The 25th Annual Piper Jaffray Healthcare Conference

CONCLUSION

We hosted a discussion with ZTS' CFO Rick Passov to a crowded room at the 25th Annual Piper Jaffray Healthcare Conference. Following our conversation we are more confident in the company's long-term growth strategy and margin expansion story. ZTS believes the production animal market is improving and the cattle market will take a few years to rebuild. ZTS remains a Top Pick as we believe top-line growth could accelerate from the mid-single digits to the high-single digits driven by a improving cattle market, new product introductions, and strategic acquisitions. Our discussion focused on operating margin expansion, long-term growth strategy, competitive landscape, and long-term plans for capital deployment. Maintain Overweight and \$39 PT.

- **Margin expansion opportunity remains intact.** Following a lack of operating leverage in Q3, management reiterated its ability to drive operating margin expansion over the next few years. We believe margin expansion will be driven through incremental pricing growth, continued focus on manufacturing efficiencies, and SG&A leverage.
- **Production animal market continues to improve.** ZTS believes the cattle market is improving as placements into feedlots has increased over the last couple of months, which is consistent with our herd recovery thesis and should result in higher demand for animal health products. Management also indicated pricing, both input costs and auction prices, is attractive for cattle producers to rebuild herds. We believe the cattle herd recovery will provide a multi-year growth tailwind for ZTS which could drive greater use of its products.
- **Capital deployment.** Management believes M&A will be a part of their long-term capital deployment strategy, but will focus on smaller, complementary areas, much like the recent AFT acquisition. Given the company's experience with the FTC on larger transactions, we would not be surprised to see ZTS acquire complementary products on an opportunistic basis.
- **New product introductions still an incremental growth driver.** ZTS highlighted new products such as APOQUEL, which helps relieve itching in dogs, and its new ractopamine products which will launch in 2014. APOQUEL will need to be rolled out carefully and could take a few years to see its full potential.
- **Regulatory environment.** While the FDA is expected to issue final guidance for antibiotic use in production animals, management continues to believe final guidance will not have a material impact on its future financial results as most of their products are not indicated for growth promotion and ZTS has a very diverse business model.

COMPANY DESCRIPTION

Zoetis is the leading global manufacturer of animal health medications and vaccines.

PRICE: US\$31.15
TARGET: US\$39.00
(24.5x FY14E EPS)

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Related Companies:

ZTS

Share Price:

31.15

RISKS TO ACHIEVEMENT OF PRICE TARGET

Risks include increased regulatory pressures, adverse weather conditions, lower utilization of products, increased competition, and macro economic factors.

Price Performance - 1 Year



Source: Bloomberg

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R: Resuming Coverage
T: Transferring Coverage
D: Discontinuing Coverage
S: Suspending Coverage
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N: Neutral
UW: Underweight
NA: Not Available
UR: Under Review

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	352	57.61	73	20.74
HOLD [N]	235	38.46	16	6.81
SELL [UW]	24	3.93	1	4.17

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