

Zoetis Inc. (ZTS)

Overweight

APOQUEL Approval A Positive For 2014; LT Opportunity Could Be Meaningful

CONCLUSION

This morning, ZTS announced FDA approval of APOQUEL® which helps control the itching in dogs 12 months or older. APOQUEL was discovered and developed by Zoetis and is the first JAK (Janus kinase) inhibitor approved for vet use targeting itching and inflammation pathways. With an estimated target market of over 8 million dogs, we view the APOQUEL approval as a positive and estimate the revenue opportunity could approach blockbuster status (>\$100 MM) over a few years depending on vet uptake and pricing. Additionally, we believe there could be other potential indications for this medication as ZTS' R&D efforts are focused on new products and brand lifecycle development. Maintain Overweight rating and \$39 PT.

- **Helping our four-legged friends with skin allergies and atopic dermatitis.** APOQUEL helps control itching that dogs suffer as a result of allergic skin conditions and can be used on dogs that are 12 months or older. Steroids is one method to reduce itching, but it has multiple side effects and the dosing schedules can be challenging for dogs and pet owners. APOQUEL provides fast and long-term relief of itching with limited side effects (most common were vomiting and diarrhea). The medication is administered orally, twice daily for up to 14 days, and then administered once daily for maintenance therapy. APOQUEL will be available by prescription only and ZTS plans on making APOQUEL available to veterinarians by Q1 2014. In the interim, ZTS will educate veterinarians to help ensure a successful product launch.
- **Clinical trials validate effectiveness.** FDA approval was based on two clinical trials. The first was on dogs with allergic dermatitis where treatment success (owner assessed decrease in itching) occurred in 67% of dogs treated with APOQUEL vs. 29% of dogs treated with a placebo after one week. Additionally, dogs that remained on APOQUEL after one week showed constant improvement. The second trial was on dogs with atopic dermatitis and had a success rate of 66% vs. 4% treated with placebo. The most common side effects were vomiting and diarrhea, while other side effects included lethargy, lack of appetite, skin irritation or infection, and ear irritation or infection. We found it interesting that signs of improvement occurred within a few hours and there were minimal adverse events during the long-term trials.
- **APOQUEL approval showcases R&D capabilities.** We view the approval of APOQUEL as an incremental positive since it is a novel product that is innovative and addresses an unmet need in the companion animal market. While there are other temporary treatment options, such as antihistamines and steroids, neither is very effective and its audience is too broad based, in our opinion. There are an estimated 8.2 million dogs that suffer from short- and long-term allergic skin conditions. Assuming 25% of the 8.2 million dogs are treated with APOQUEL with a price point ranging between \$25 to \$75 (not sure on dosing or size of orders), we estimate the medication could generate approximately \$50-\$150 MM of revenues, which equates to approximately \$0.02 to \$0.06 of EPS.

COMPANY DESCRIPTION

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

PRICE: US\$32.79

TARGET: US\$39.00

(24.5x FY14E EPS)

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Related Companies:

ZTS

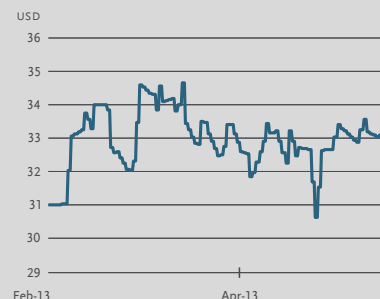
Share Price:

32.79

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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APOQUEL Sensitivity Analysis

APOQUEL Analysis

(units in MM, except per share)

Est. # of dogs w/ allergic skin conditions	8.2
Est. % treated w/ APOQUEL	<u>25%</u>
Est. # of dogs treated w/ Apoquel	2.05

Est. price point	<u>\$25</u>	<u>\$50</u>	<u>\$75</u>
Est. revenues	\$51	\$103	\$154
Est. pretax	\$14	\$27	\$41
Est. net income	\$9	\$19	\$28
Est. EPS	<u>\$0.02</u>	<u>\$0.04</u>	<u>\$0.06</u>

		Estimated Price Point							
		\$20	\$30	\$40	\$50	\$60	\$70	\$80	\$90
% of dogs treated	5%	\$0.00	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
	10%	\$0.01	\$0.01	\$0.01	\$0.01	\$0.02	\$0.02	\$0.02	\$0.03
	15%	\$0.01	\$0.01	\$0.02	\$0.02	\$0.03	\$0.03	\$0.04	\$0.04
	20%	\$0.01	\$0.02	\$0.02	\$0.03	\$0.04	\$0.04	\$0.05	\$0.05
	25%	\$0.01	\$0.02	\$0.03	\$0.04	\$0.04	\$0.05	\$0.06	\$0.07
	30%	\$0.02	\$0.03	\$0.04	\$0.04	\$0.05	\$0.06	\$0.07	\$0.08
	35%	\$0.02	\$0.03	\$0.04	\$0.05	\$0.06	\$0.07	\$0.08	\$0.09
	40%	\$0.02	\$0.04	\$0.05	\$0.06	\$0.07	\$0.08	\$0.10	\$0.11
	45%	\$0.03	\$0.04	\$0.05	\$0.07	\$0.08	\$0.09	\$0.11	\$0.12
	50%	\$0.03	\$0.04	\$0.06	\$0.07	\$0.09	\$0.10	\$0.12	\$0.13

Source: Piper Jaffray estimates

IMPORTANT RESEARCH DISCLOSURES



Notes: The boxes on the Rating and Price Target History chart above indicate the date of the Research Note, the rating, and the price target. Each box represents a date on which an analyst made a change to a rating or price target, except for the first box, which may only represent the first Note written during the past three years.

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I: Initiating Coverage
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D: Discontinuing Coverage
S: Suspending Coverage
OW: Overweight
N: Neutral
UW: Underweight
NA: Not Available
UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	333	56.54	69	20.72
HOLD [N]	226	38.37	12	5.31
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Analyst Certification — Kevin K. Ellich, Sr Research Analyst — Bradley D. Maiers, Research Analyst

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