

Tuesday, August 6, 2013

# Zoetis (Outperform)

(ZTS-NYSE)

## In Line Is Good for Now; Guidance Maintained

**Flash:**

This morning Zoetis reported 2Q13 revenues of \$1.114Bn, 1.4% below consensus and 1.8% below our forecast. However, both SG&A and R&D were both below expectations allowing Zoetis to meet non-GAAP EPS consensus of \$0.36, which was also our forecast.

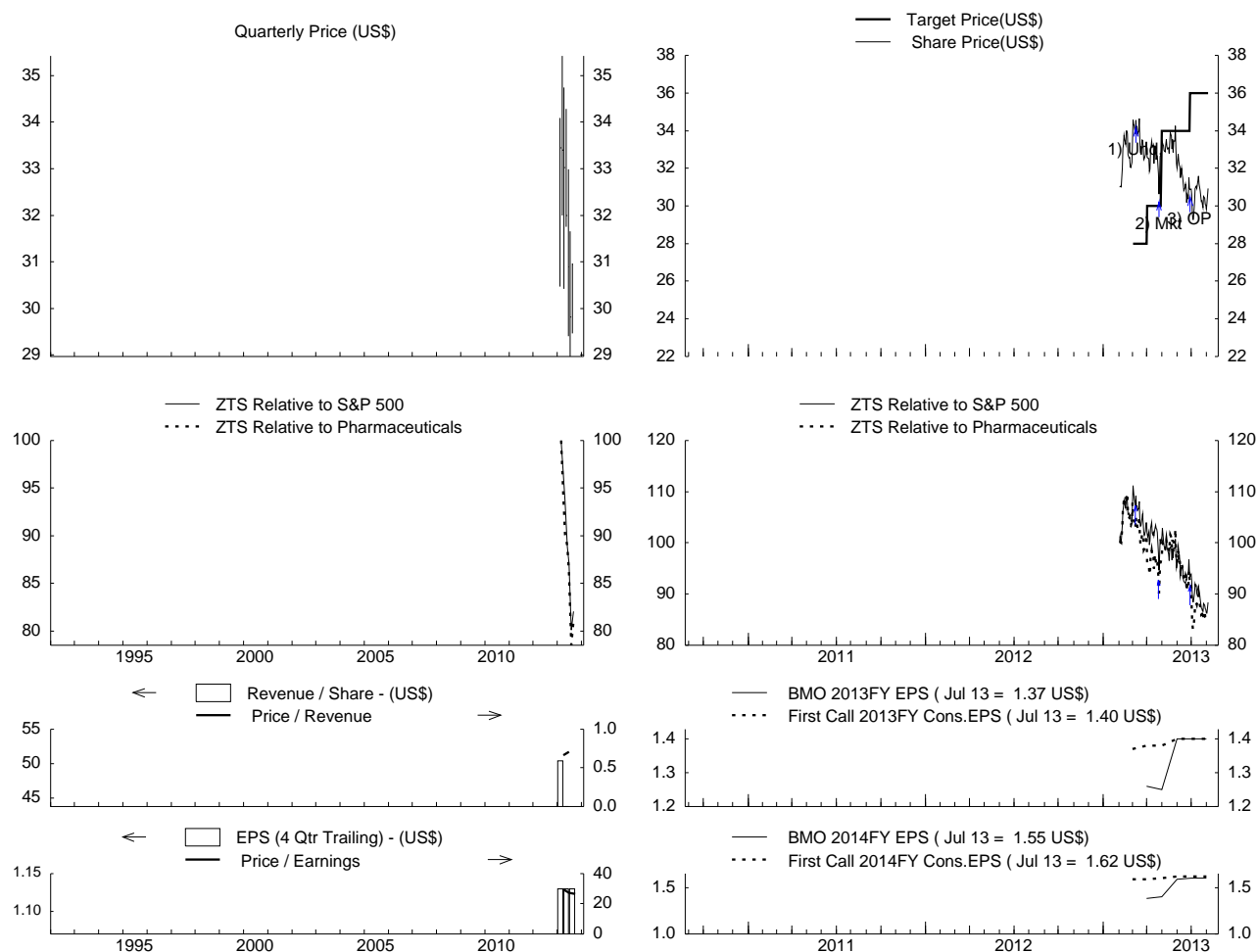
**Our View:**

- \* Positive. The top-line miss compared with our forecasts was driven by lower-than-expected sales from the Europe/Africa/Middle East (EuAfME), which only grew 1% operationally. Sales of livestock products in EuAfME declined, primarily due to lower sales of cattle products resulting from cold weather conditions and overall economic weakness in Europe, partially offset by growth in swine and poultry products. Overall, companion animal product sales of \$444 million was also 4.5% below our forecast as the y/y growth of 3.5% was significantly lower than 7.9% seen in 1Q13. We'll look for more clarification on the call.
- \* Importantly, Zoetis re-affirmed its 2013 guidance: including revenue between \$4.425 billion and \$4.525 billion and non-GAAP EPS of \$1.36-\$1.42. We believe Zoetis will likely come on the lower half of the guidance range: Current BMO forecast (pre-2Q13): revenues of \$4.473bn, EPS of \$1.37. Our longer-term forecasts are somewhat below consensus, which is very bullish, in our view.
- \* Investors had many concerns going into this quarter, including the impact of the drought, a weak parasite season related to colder weather in Europe, aggressive re-launch of Novartis' (NVS, Not Rated) Sentinel, and timing of Zoetis' price increase. We believe these concerns had created a certain level of anxiety that has pressured ZTS shares since the completion of the split from Pfizer (PFE, \$29.19; Outperform). As such, we believe that this mostly in-line quarter should be viewed positively and should lead to a relief rally as new investors enter.
- \* We reiterate our Outperform rating on ZTS shares. Conference call at 8:30 a.m. ET 866-952-1906.

<b>Company:</b>	Zoetis (ZTS)
<b>Price/Rating/Target:</b>	\$31.25/Outperform/\$36.00
<b>Sector Name:</b>	Pharmaceuticals
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This report was prepared by an analyst(s) employed by BMO Nesbitt Burns Inc. For disclosure statements, including the Analyst's Certification, please refer to pages 2 to 6.

## Zoetis Inc. (ZTS)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %	ZTS - Rating as of 1-Feb-13 = NR		
Range*:		na na		NC			>15 >15		Date	Rating Change	Share Price
Current*	1.13	26.4	0.26	0.9	23	1.4	21.0	>50	1 7-Mar-13	NR to Und.	\$34.56
									2 24-Apr-13	Und.to Mkt	\$30.62
									3 27-Jun-13	Mkt to OP	\$30.87

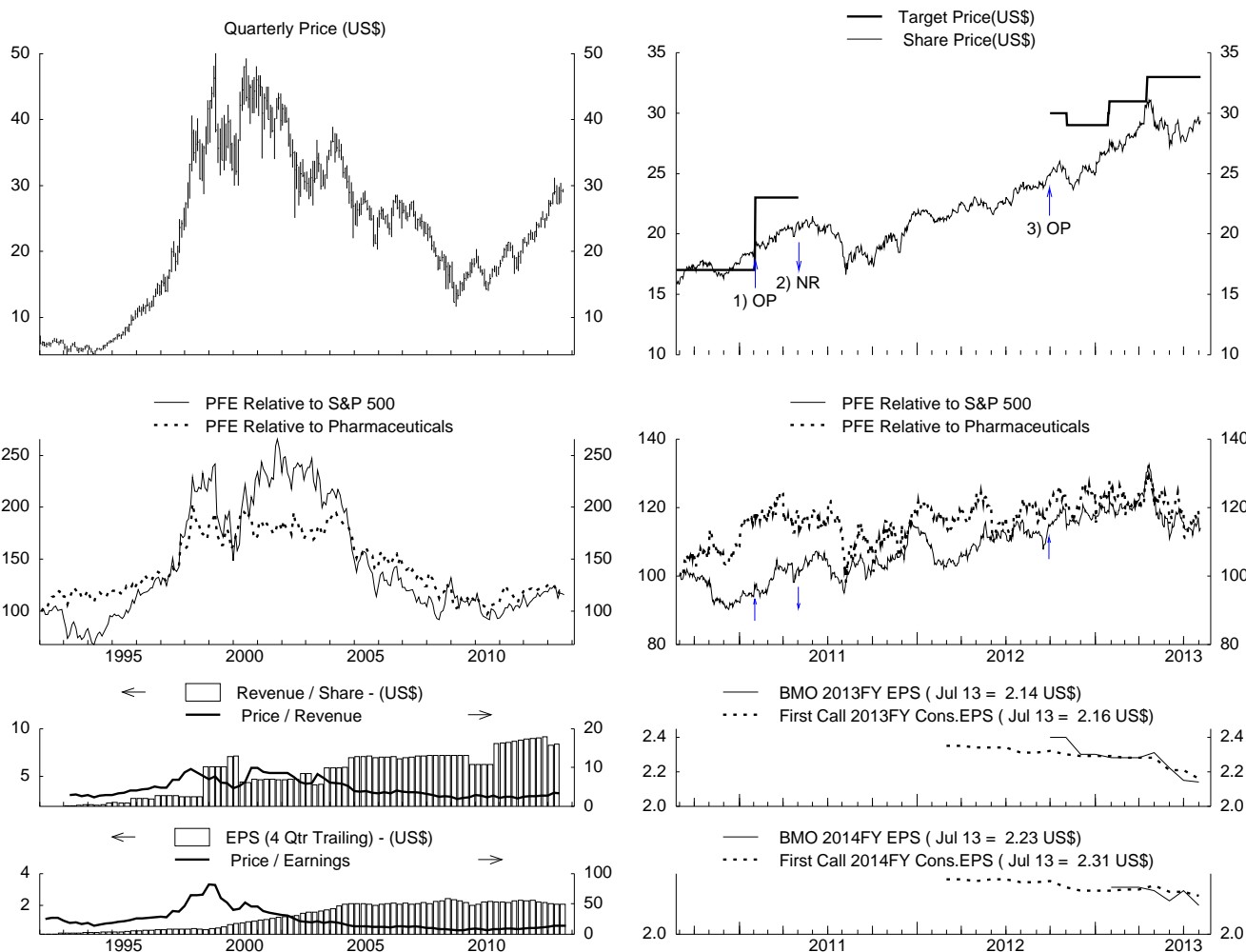
\* Current EPS is the 4 Quarter Trailing to Q1/2013.

\* Valuation metrics are based on high and low for the fiscal year.

\* Range indicates the valuation range for the period presented above.

Last Price ( August 2, 2013): \$30.94  
Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

## Pfizer Inc. (PFE)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %
1992	0.27	26.9 20.1	0.12	2.3 1.7	46	1.2	6.0 4.5	
1993	0.31	21.5 14.1	0.14	3.2 2.1	45	1.0	6.6 4.4	28
1994	0.35	18.9 12.6	0.16	3.5 2.4	45	1.1	5.8 3.9	33
1995	0.41	27.2 14.9	0.09	1.4 0.8	21	1.4	7.7 4.3	32
1996	0.50	30.4 19.4	0.20	2.1 1.3	40	1.8	8.5 5.4	31
1997	0.53	50.3 25.0	0.23	1.7 0.9	43	2.0	13.1 6.5	28
1998	0.51	84.3 45.5	0.29	1.3 0.7	58	2.3	>15 10.2	24
1999	0.82	61.0 38.5	0.36	1.1 0.7	44	2.3	>15 13.7	36
2000	1.02	48.3 29.4	0.44	1.5 0.9	43	2.6	>15 11.8	42
2001	1.27	37.8 26.8	0.52	1.5 1.1	41	2.9	>15 11.7	47
2002	1.53	28.7 16.4	0.60	2.4 1.4	39	3.2	13.6 7.8	50
2003	1.75	21.1 15.4	0.68	2.5 1.8	39	8.5	4.3 3.2	30
2004	2.12	18.3 10.4	0.76	3.5 2.0	36	9.1	4.3 2.4	24
2005	2.02	14.5 10.0	0.96	4.7 3.3	48	8.9	3.3 2.3	22
2006	2.08	13.8 9.7	1.16	5.7 4.1	56	10.0	2.9 2.0	22
2007	2.20	12.7 10.1	1.28	5.8 4.6	58	9.6	2.9 2.3	22
2008	2.43	10.1 5.9	1.28	9.0 5.2	53	8.5	2.9 1.7	27
2009	2.02	9.4 5.8	0.72	6.2 3.8	36	11.2	1.7 1.0	21
2010	2.22	9.2 6.3	0.80	5.7 3.9	36	11.0	1.9 1.3	20
2011	2.31	9.5 7.1	0.88	5.4 4.0	38	10.8	2.0 1.5	21
2012	2.19	11.9 9.0	0.96	4.9 3.7	44	11.1	2.4 1.8	20

Range\*: 84.3 5.8 9.0 0.7 >15 1.0

Current\* 2.07 14.1 0.96 3.3 46 11.6 2.5 18

Growth(%):

5 Year: -1.7  
10 Year: 2.7  
20 Year: 10.3

\* Current EPS is the 4 Quarter Trailing to Q2/2013.

\* Valuation metrics are based on high and low for the fiscal year.

\* Range indicates the valuation range for the period presented above.

PFE - Rating as of 25-Aug-10 = Mkt

Date	Rating Change	Share Price
1 2-Feb-11	Mkt to OP	\$18.96
2 3-May-11	OP to NR	\$20.44
3 27-Sep-12	NR to OP	\$24.96

Last Price ( August 2, 2013): \$29.37

Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

## Important Disclosures

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I, Alex Arfaei, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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### Company Specific Disclosure for ZTS

#### Methodology and Risks to Our Price Target

**Methodology:** DCF and P/E Multiple

**Risks:** Demand for animal health products could fluctuate and there are relatively low barriers to entry for competitors.

### Company Specific Disclosures for PFE

9 - BMO Capital Markets makes a market in this security.

#### Methodology and Risks to Our Price Target

**Methodology:** DCF: Free Cash Flow To Equity.

**Risks:** Uncertainty of Phase 3 Pipeline.

### Distribution of Ratings (June 30, 2013)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	37.9%	17.6%	52.7%	39.6%	51.0%	53.2%
Hold	Market Perform	56.8%	10.2%	45.9%	53.9%	45.5%	41.1%
Sell	Underperform	5.3%	3.2%	1.4%	6.5%	3.5%	5.6%

\* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

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\*\*\*\* Reflects rating distribution of all companies covered by BMO Capital Markets equity research analysts.

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OP = Outperform - Forecast to outperform the analyst's coverage universe on a total return basis;

Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis;

Und = Underperform - Forecast to underperform the analyst's coverage universe on a total return basis;

(S) = Speculative investment;

NR = No rating at this time; and

R = Restricted – Dissemination of research is currently restricted.

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