

# Zoetis

(ZTS-NYSE)

**Stock Rating:** Market Perform**Industry Rating:** Market Perform

## Acknowledging the Good Qtr and Guidance; Raising Estimates

### Event

We are raising our forecasts and price target for Zoetis shares following the company's good performance in 1Q13 and 2013 guidance.

### Impact

Positive. We were cautious going into Zoetis's first earnings call. However, the company reported good in-line revenues of \$1.09 bn driven by strong growth from companion animal products, particularly in the US, and beat the Street's \$0.33 EPS consensus by \$0.03 primarily because of lower opex. The most important news was the company's 2013 guidance and longer term opex outlook, which were both better than our expectations.

### Forecasts

2013 revenues of \$4.56 bn were slightly above guidance of \$4.43-\$4.53 bn, and non-GAAP EPS of \$1.40 were at the higher end of \$1.36-\$1.42 guidance. We have raised our forecasts to reflect 1Q13 and the guidance. The most significant change is that we now expect a slower rate of opex growth, which brings our estimates in line with the Street (we were significantly below the Street prior to 1Q13). Zoetis should grow revenues by a CAGR of 4.6% through 2023. Moreover, we forecast non-GAAP EPS and operating cash flow CAGR of roughly 10% through 2023.

### Valuation

Now \$34/share based on DCF per above forecasts, in line with 24x our 2014 EPS of \$1.40.

### Recommendation

We maintain our Market Perform rating on ZTS shares, but now with a neutral to positive bias.

#### Changes

**Annual EPS**  
2013E \$1.25 to \$1.40  
2014E \$1.40 to \$1.59

**Annual FCF**  
2013E \$1.00 to \$1.05  
2014E \$1.21 to \$1.38

**Quarterly EPS**  
Q2/13E \$0.37 to \$0.38  
Q3/13E \$0.33 to \$0.34  
Q4/13E \$0.24 to \$0.33

**Target**  
\$30.00 to \$34.00

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 12 to 16.

May 1, 2013

## Pharmaceuticals

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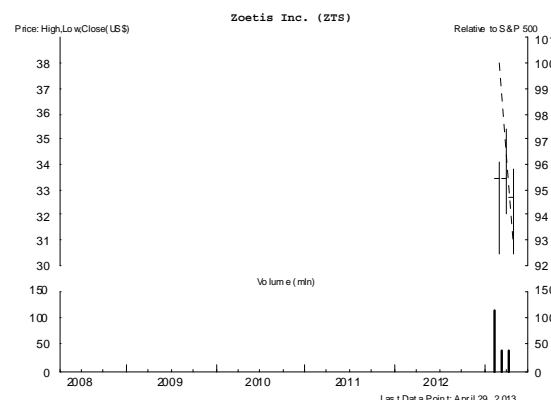
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### Securities Info

<b>Price (30-Apr)</b>	<b>\$33.02</b>	<b>Target Price</b>	<b>\$34 ↑</b>
52-Wk High/Low	\$35/\$30	Dividend	\$0.26
Mkt Cap (mm)	\$16,510	Yield	0.8%
Shs O/S (mm, BASIC)	500.0	Float O/S (mm)	99.0
Options O/S (mm)	na	ADVol (30-day, 000s)	1,922

### Price Performance



### Valuation/Financial Data

(FY-Dec.)	2011A	2012A	2013E	2014E
EPS Pro Forma	\$1.01	\$1.08	\$1.40↑	\$1.59↑
P/E			23.6x	20.8x
First Call Cons.			\$1.38	\$1.60
EPS GAAP	\$0.49	\$0.87	\$1.10	\$1.44
FCF	\$0.72	\$0.66	\$1.05↑	\$1.38↑
P/FCF			31.4x	23.9x
EBITDA (\$mm)	\$943	\$1,142	\$1,290	\$1,444
EV/EBITDA			15.4x	13.7x
Rev. (\$mm)	\$4,233	\$4,336	\$4,559	\$4,841
EV/Rev			4.4x	4.1x
<b>Quarterly EPS</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>
2012A	\$0.30	\$0.35	\$0.31	\$0.11
2013E	\$0.36A	\$0.38↑	\$0.34↑	\$0.33↑

#### Balance Sheet Data (30-Sep)

Net Debt (\$mm)	\$3,333	Total Debt/EBITDA	2.8x
Total Debt (\$mm)	\$3,650	EBITDA/IntExp	11.9x
Net Debt/Cap.	71.3%	Price/Book	#DIV/0!

Notes: All values in US\$.

Source: BMO Capital Markets estimates, Bloomberg, Thomson Reuters, and IHS Global Insight.

## Exhibit 1. Zoetis 1Q13 Variance Analysis: Overall, a Good Quarter; Beat Driven by Lower Opex

	Q1'13					Q1'12	Y/Y Change	Comments:
	Consensus	BMO	Actual	Actual vs. Consensus	Actual vs. BMO			
<b>Revenues</b>	<b>\$1,078</b>	<b>\$1,093</b>	<b>\$1,090</b>	<b>1%</b>	<b>0%</b>	<b>\$1,047</b>	<b>4%</b>	Matched, -1% Fx. Good operational growth of 5% led by US companion animal business.
Gross Profit	\$691	\$690	\$692	0%	0%	\$659	5%	In-line
Gross Margin	64.1%	63.1%	63.5%	-1%	0%	62.9%	1%	Gross margin slightly better than expected, working to improve manufacturing efficiency.
SG&A		\$341	\$322		-6%	\$331	-3%	Below our forecast, but also below the 2013 run-rate.
Research & Development		\$108	\$90		-16%	\$93	-3%	Below our forecast
Operating Profit	<b>\$259</b>	<b>\$241</b>	<b>\$280</b>	<b>8%</b>	<b>16%</b>	<b>\$235</b>	<b>19%</b>	Driven by lower OPEX.
Operating margin	24%	22%	26%					Better than expected, but expenses below run rate.
Taxes	\$67	\$64	\$73	9%	13%	\$76	-4%	Tax rate in-line with expectations.
Effective Tax Rate	28.4%	29.0%	29.0%	1%	0%	33.2%	-4%	
Net Income	<b>\$168</b>	<b>\$157</b>	<b>\$179</b>	<b>6%</b>	<b>14%</b>	<b>\$152</b>	<b>18%</b>	Beat driven by lower OPEX.
EPS	<b>\$0.33</b>	<b>\$0.30</b>	<b>\$0.36</b>	<b>8%</b>	<b>21%</b>	<b>\$0.30</b>	<b>18%</b>	

Sources: ZTS, Bloomberg Finance LP, BMO Capital Markets Estimates

## Exhibit 2. The Long-Awaited 2013 Guidance Seems Beatable

2013 Guidance & Date Provided	Apr. 30, 2013 (after 1Q 2013)	BMO	Street	Comments
<b>Revenue</b>	<b>\$4,425 mn to \$4,525 mn</b>	<b>\$4,559 mn</b>	<b>\$4,526 mn</b>	<b>We're on the top end and in-line with consensus.</b>
Cost of Sales as % of Revenues	35.0% to 36.0%	35.4%	35.5%	We're in-line; company is actively looking for manufacturing efficiencies.
SG&A Expenses	\$1,385 mn to \$1,435 mn	\$1,427 mn		Will increase throughout 2013, but at a slower rate than revenues.
R&D Expenses	\$385 mn to \$415 mn	\$398 mn		We're in-line. Will increase slightly but at a slower rate than revenues.
Interest Expense	~\$115 mn	\$109 mn		We're in-line
Other (Income)/ Deductions	~(\$20 mn)	(\$16 mn)		
Effective Tax Rate	~29.5%	29.0%	29.9%	We're in-line
Adjusted Net Income	\$680 mn to \$710 mn	\$701 mn	\$692 mn	We're in-line
<b>Adjusted Diluted EPS</b>	<b>\$1.36 to \$1.42</b>	<b>\$1.40</b>	<b>\$1.39</b>	<b>We're on the top end.</b>

Source: Zoetis Reports, Thomson One, BMO Capital Markets Pharmaceuticals Research

**Exhibit 3. We Raised Our Forecasts Based on 1Q13 Performance and Guidance; the EPS Increase Is Primarily Driven by Lower-Than-Expected Growth of Expenses per Management Expectations**

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Prior	New	Prior	New	Prior	New	Prior	New
<b>Revenue</b>	<b>\$4,551</b>	<b>\$4,559</b>	<b>\$4,810</b>	<b>\$4,841</b>	<b>\$5,057</b>	<b>\$5,106</b>	<b>\$5,295</b>	<b>\$5,354</b>
Gross Margin	64.5%	64.6%	64.7%	64.8%	64.9%	65.0%	65.1%	65.2%
Operating Profit (EBIT)	\$1,034	\$1,119	\$1,157	\$1,246	\$1,275	\$1,377	\$1,400	\$1,508
Operating Margin	23%	25%	24%	26%	25%	27%	26%	28%
Pre-tax Profit	928	992	1,039	1,128	1,157	1,259	1,285	1,393
Effective Tax Rate	29%	29%	29%	29%	29%	29%	29%	29%
Net Income	\$655	\$701	\$734	\$797	\$817	\$890	\$909	\$985
Net Margin	14%	15%	15%	16%	16%	17%	17%	18%
<b>EPS</b>	<b>\$1.25</b>	<b>\$1.40</b>	<b>\$1.40</b>	<b>\$1.59</b>	<b>\$1.56</b>	<b>\$1.78</b>	<b>\$1.73</b>	<b>\$1.97</b>
Free Cash Flow per Share	\$1.00	\$1.05	\$1.21	\$1.38	\$1.36	\$1.56	\$1.56	\$1.78
<b>Dividend per share</b>	<b>\$0.26</b>	<b>\$0.26</b>	<b>\$0.33</b>	<b>\$0.33</b>	<b>\$0.39</b>	<b>\$0.39</b>	<b>\$0.47</b>	<b>\$0.47</b>
Dividend Payout Ratio	21%	19%	23%	20%	25%	22%	27%	24%

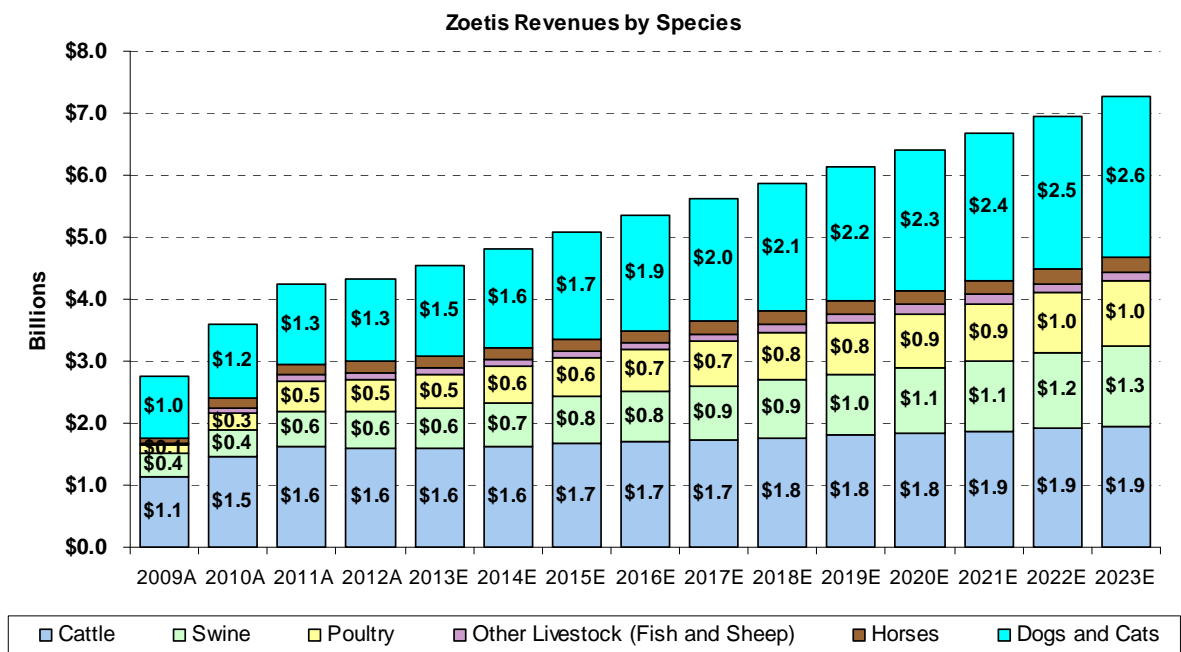
Source: Zoetis, Thomson One, BMO Capital Markets Pharmaceuticals Research

**Exhibit 4. Our Forecasts Are Now in Line With Consensus; We Were Significantly Below Prior to 1Q13**

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Street	BMO	Street	BMO	Street	BMO	Street	BMO
<b>Revenue</b>	<b>\$4,526</b>	<b>\$4,559</b>	<b>\$4,804</b>	<b>\$4,841</b>	<b>\$5,076</b>	<b>\$5,106</b>	<b>\$5,344</b>	<b>\$5,354</b>
Gross Margin	64.5%	64.6%	65.3%	64.8%	65.6%	65.0%	65.8%	65.2%
Operating Profit (EBIT)	\$1,096	\$1,119	\$1,255	\$1,246	\$1,394	\$1,377	\$1,513	\$1,508
Operating Margin	24%	25%	26%	26%	27%	27%	28%	28%
Pre-tax Profit	987	992	1,146	1,128	1,285	1,259	1,407	1,393
Effective Tax Rate	30%	29%	30%	29%	29%	29%	29%	29%
Net Income	\$692	\$701	\$805	\$797	\$912	\$890	\$1,001	\$985
Net Margin	15%	15%	17%	16%	18%	17%	19%	18%
<b>EPS</b>	<b>\$1.39</b>	<b>\$1.40</b>	<b>\$1.59</b>	<b>\$1.59</b>	<b>\$1.82</b>	<b>\$1.78</b>	<b>\$1.97</b>	<b>\$1.97</b>
Free Cash Flow per Share	\$1.23	\$1.05	\$1.45	\$1.38	NA	\$1.56	NA	\$1.78
<b>Dividend per share</b>	<b>\$0.26</b>	<b>\$0.26</b>	<b>\$0.32</b>	<b>\$0.33</b>	<b>\$0.37</b>	<b>\$0.39</b>	<b>\$0.54</b>	<b>\$0.47</b>
Dividend Payout Ratio	19%	19%	20%	20%	20%	22%	27%	24%

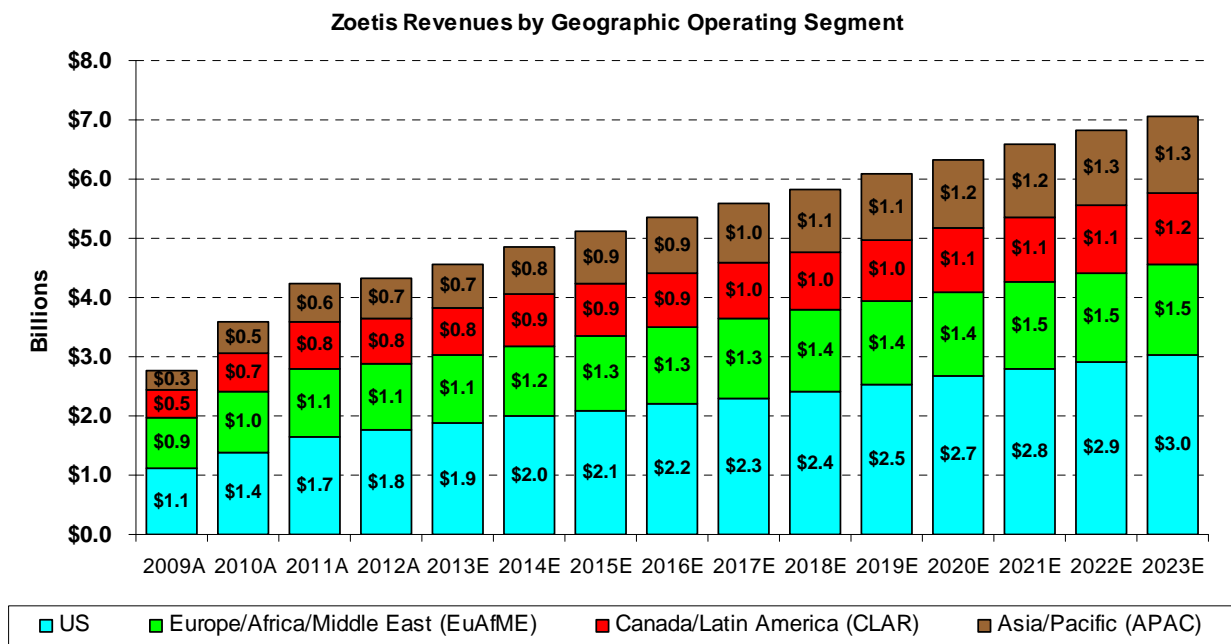
Source: Zoetis, Thomson One, BMO Capital Markets Pharmaceuticals Research

Exhibit 5. Our Zoetis Revenue Forecast by Species: Ten-Year CAGR of 4.8%



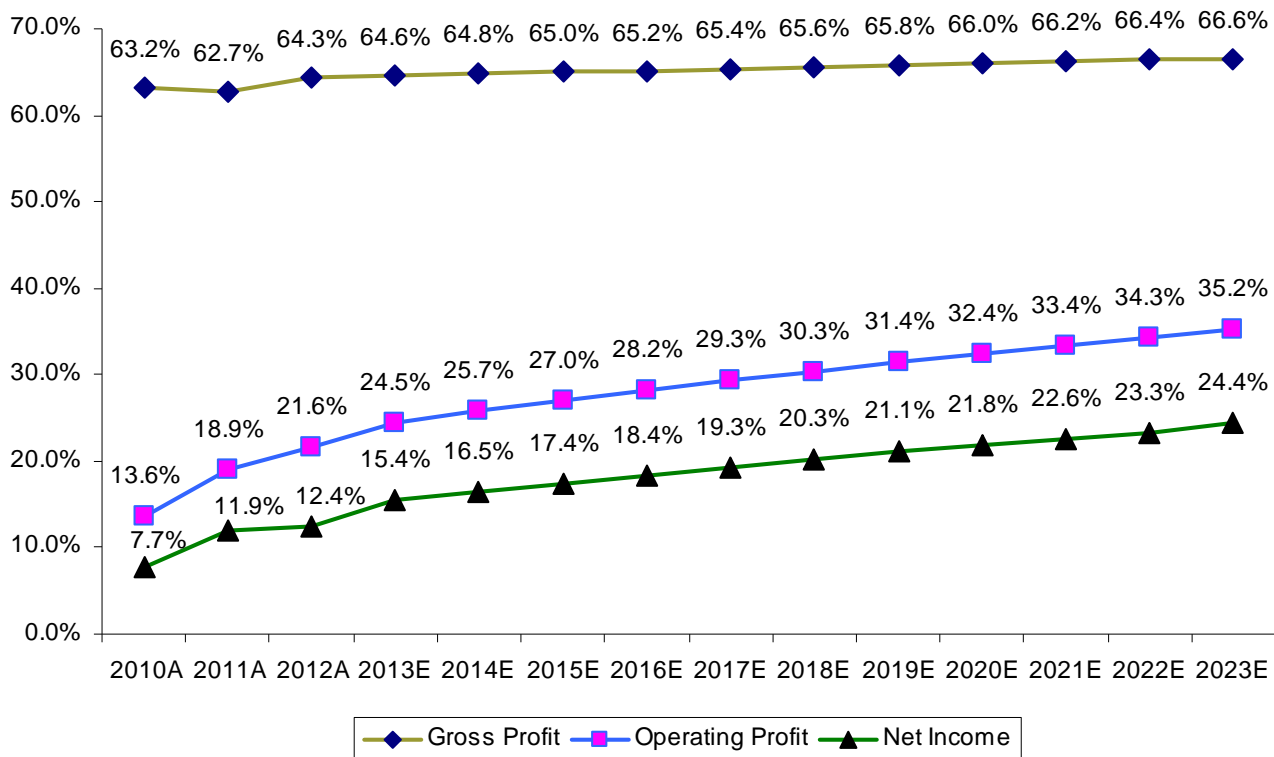
Source: Zoetis, BMO Capital Markets

Exhibit 6. Our Zoetis Revenue Forecast by Geographic Segment: Ten-Year CAGR of 4.5%  
(NOTE: Our model uses the average of our revenue forecast by species and geographic segment)



Source: Zoetis, BMO Capital Markets

**Exhibit 7. We Expect Zoetis's Margins to Improve Over Time, Driven Primarily by Improved Operational Efficiency as SG&A and R&D Should Grow at a Slower Rate Than Revenues**



Source: Zoetis, BMO Capital Markets

## Zoetis Investment Thesis

Zoetis, a former business unit of Pfizer (PFE), is the largest global animal medicines and vaccines company and the only pure-play large-cap animal health company that is publicly traded. Zoetis is a unique healthcare growth story with therapeutic and geographically diversified revenues and strong fundamental growth drivers (i.e., growing global demand for animal protein and pet ownership, particularly in emerging markets).

Zoetis's base revenue (excluding acquisitions, divestitures, and Fx) is growing at a similar rate as the animal vaccines and medicines market at roughly 5%, which isn't surprising given that the company has about 19% market share. The market is projected to grow by a CAGR of 6% between 2011 and 2016 (ex-Fx). Forecasting revenues using two different methods (i.e., by species and operating segment), we estimate that Zoetis's revenues should grow by a CAGR of 4.6% through 2023. Moreover, we forecast non-GAAP EPS CAGR of roughly 10% and operating cash flow CAGR of 10% through 2023.

## Valuation

We have increased our forecasts following the company's good performance in 1Q13 and are increasing our price target from \$30 to \$34/share using DCF. We assume a 2.5% terminal growth rate, given the sustainability of the business, and as such our terminal value accounts for nearly 60% of the firm value. On a relative basis, applying a 22-24x multiple, which is in the top range of that seen with other roughly similar companies, to our new 2013E to 2016E non-GAAP EPS estimates produces an average valuation of \$34, in line with our DCF valuation.

### Exhibit 8. Our Valuation of ZTS Shares Is Based on DCF and P/E Multiple

FCFF Valuation, \$MM		2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	>2023E
Cash flow from operations		630	820	912	1,017	1,123	1,234	1,361	1,504	1,658	1,797	1,966	2,015
Y/Y Growth			25%	11%	12%	10%	10%	10%	10%	10%	8%	9%	2.5%
CAPEX		(101)	(132)	(130)	(126)	(132)	(135)	(137)	(135)	(136)	(142)	(136)	(139)
Interest Expense (1-t)		62	83	83	80	80	70	70	70	70	70	41	41
Free Cash Flow to the Firm (FCFF)		592	771	865	970	1,071	1,169	1,294	1,438	1,591	1,724	1,870	1,917
Y/Y Growth			30%	12%	12%	10%	9%	11%	11%	11%	8%	8%	2%
Discount Period		0.50	1.50	2.50	3.50	4.50	5.50	6.50	7.50	8.50	9.50	10.50	11.50
Discount Rate	8.5%												
Discounted FCFF		568	682	705	729	742	747	761	780	795	794	794	
PV of FCFE (2013-2023)	Total, \$MM	Terminal growth rate: 2.5% Accounts for nearly 60% of firm value given sustainability of business.  Current outstanding debt  Source: Zoetis Form 10-K  As of 1Q13.											
Terminal Value at 2023	8,098												
PV of Terminal Value	31,944												
Cash & Equivalents	12,501												
Total Debt	279												
Total Equity Value	3,650												
Minority Interest	17,228												
Total Zoetis Stockholders' Equity Value	(15)												
Diluted shares, MM	17,213												
Equity value per current PFE share	500												
	\$34												

### PE Multiple Valuation Using Non-GAAP EPS

		2012A	2013E	2014E	2015E	2016E	2013-16 EPS CAGR
EPS		\$1.08	\$1.40	\$1.59	\$1.78	\$1.97	
PEx	20	\$22	\$28	\$29	\$30	\$31	12.0%
	21	\$23	\$29	\$31	\$32	\$32	
	22	\$24	\$31	\$32	\$33	\$34	
	23	\$25	\$32	\$34	\$35	\$36	
	24	\$26	\$34	\$35	\$36	\$37	
Discount Period		0 1 2 3					
Discount rate		8.5%					
Average		\$34					

Sources: Pfizer Reports, Zoetis, BMO Capital Markets Pharmaceuticals Research

## Zoetis Income Statement: Our Non-GAAP Quarterly Forecasts

	2012A				2013E				2014E			
Non-GAAP Income Statement, \$MM	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014
<b>Revenues</b>	<b>1,047</b>	<b>1,094</b>	<b>1,019</b>	<b>1,176</b>	<b>1,090</b>	<b>1,156</b>	<b>1,077</b>	<b>1,236</b>	<b>1,153</b>	<b>1,228</b>	<b>1,145</b>	<b>1,314</b>
Cost of Sales	388	382	352	427	398	401	370	446	419	424	391	472
<b>Gross Profit</b>	<b>659</b>	<b>712</b>	<b>667</b>	<b>749</b>	<b>692</b>	<b>755</b>	<b>707</b>	<b>789</b>	<b>734</b>	<b>804</b>	<b>754</b>	<b>842</b>
Selling, Informational and Administrative Expenses	331	351	330	440	322	358	345	402	338	371	356	411
R&D Expenses	93	91	94	121	90	98	91	118	93	102	95	123
<b>Operating Profit</b>	<b>235</b>	<b>270</b>	<b>243</b>	<b>188</b>	<b>280</b>	<b>298</b>	<b>271</b>	<b>269</b>	<b>304</b>	<b>331</b>	<b>303</b>	<b>308</b>
Amortization of Intangible Assets	4	3	4	4	4	8	11	12	7	7	7	7
EBIT	231	267	239	184	276	291	261	258	297	325	297	302
Other (Income) / Deductions -- Net	2	2	(4)	10	24	23	23	23	23	23	23	23
Income From Cont. Operations Before Provision for Taxes	229	265	243	174	252	268	238	235	274	302	274	278
(Benefit) / Provision for Taxes on Income	76	90	89	117	73	78	69	68	79	88	79	81
<b>Net income/(loss) before allocation to non-controlling interests</b>	<b>153</b>	<b>175</b>	<b>154</b>	<b>57</b>	<b>179</b>	<b>190</b>	<b>169</b>	<b>167</b>	<b>194</b>	<b>214</b>	<b>194</b>	<b>198</b>
Less: Income / (Loss) Attributable to Non-Controlling Interests	1	(1)		0	0	1	1	1	1	1	1	1
<b>Net Income/ (loss) Attributable to Zoetis</b>	<b>152</b>	<b>176</b>	<b>154</b>	<b>57</b>	<b>179</b>	<b>189</b>	<b>168</b>	<b>166</b>	<b>193</b>	<b>213</b>	<b>193</b>	<b>197</b>
Earnings Per Share - Basic	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.38	\$0.34	\$0.33	\$0.39	\$0.43	\$0.39	\$0.39
<b>Earnings Per Share - Diluted</b>	<b>\$0.30</b>	<b>\$0.35</b>	<b>\$0.31</b>	<b>\$0.11</b>	<b>\$0.36</b>	<b>\$0.38</b>	<b>\$0.34</b>	<b>\$0.33</b>	<b>\$0.39</b>	<b>\$0.43</b>	<b>\$0.39</b>	<b>\$0.39</b>
Weighted-Average Shares - Basic	500	500	500	500	500	500	500	500	500	500	500	500
Weighted-Average Shares - Diluted	500	500	500	500	500	500	500	500	500	500	500	500
<b>Dividend per Share</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.07</b>	<b>\$0.07</b>	<b>\$0.07</b>	<b>\$0.07</b>	<b>\$0.08</b>	<b>\$0.08</b>	<b>\$0.08</b>	<b>\$0.08</b>

	2012E				2013E				2014E			
	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014
<b>Growth Rates</b>												
Revenue growth (YOY)	7%	2%	-3%	4%	4%	6%	6%	5%	6%	6%	6%	6%
Gross Profit	7%	10%	1%	2%	5%	6%	6%	5%	6%	7%	7%	7%
Operating Income (EBIT)	31%	46%	5%	-6%	19%	9%	9%	40%	8%	12%	14%	17%
Net Income	26%	54%	5%	-54%	18%	7%	9%	191%	8%	13%	15%	19%
EPS- Diluted	26%	54%	5%	-63%	2%	23%	9%	191%	8%	13%	15%	19%
Dividend									25%	25%	25%	25%
<b>Margins</b>												
Gross Profit	63%	65%	65%	64%	63%	65%	66%	64%	64%	65%	66%	64%
Operating Profit	22%	25%	24%	16%	26%	26%	25%	22%	26%	27%	26%	23%
Net Income	15%	16%	15%	5%	16%	16%	16%	13%	17%	17%	17%	15%
<b>Return Analysis</b>												
Payout Ratio					18%	17%	19%	20%	21%	19%	21%	21%

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

## Zoetis Income Statement: Our Non-GAAP Annual Forecasts

Non-GAAP Income Statement, \$MM	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
<b>Revenues</b>	<b>\$3,582</b>	<b>\$4,233</b>	<b>\$4,336</b>	<b>\$4,559</b>	<b>\$4,841</b>	<b>\$5,106</b>	<b>\$5,354</b>	<b>\$5,602</b>	<b>\$5,849</b>	<b>\$6,101</b>	<b>\$6,362</b>	<b>\$6,623</b>	<b>\$6,892</b>	<b>\$7,164</b>
Cost of Sales	1,318	1,581	1,549	1,615	1,706	1,789	1,865	1,940	2,014	2,089	2,165	2,241	2,318	2,395
<b>Gross Profit</b>	<b>2,264</b>	<b>2,652</b>	<b>2,787</b>	<b>2,943</b>	<b>3,135</b>	<b>3,317</b>	<b>3,489</b>	<b>3,662</b>	<b>3,835</b>	<b>4,012</b>	<b>4,197</b>	<b>4,382</b>	<b>4,574</b>	<b>4,769</b>
SG&A	1,365	1,443	1,452	1,427	1,476	1,513	1,543	1,572	1,597	1,622	1,648	1,673	1,697	1,721
R&D	411	407	399	398	412	426	438	451	462	474	487	499	511	523
<b>Operating Profit</b>	<b>488</b>	<b>802</b>	<b>936</b>	<b>1,119</b>	<b>1,246</b>	<b>1,377</b>	<b>1,508</b>	<b>1,639</b>	<b>1,775</b>	<b>1,916</b>	<b>2,062</b>	<b>2,211</b>	<b>2,366</b>	<b>2,525</b>
Amortization of Intangible Assets	17	20	15	34	26	26	26	26	26	26	26	26	26	26
Restructuring Charges & Certain Acquisition-Related Costs	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other (Income) / Deductions -- Net	12	12	10	93	93	93	88	88	75	74	74	74	74	34
Income From Cont. Operations Before Provision for Taxes	459	770	911	992	1,128	1,259	1,393	1,525	1,674	1,816	1,962	2,111	2,266	2,465
(Benefit) / Provision for Taxes on Income	183	264	372	288	327	365	404	442	486	527	569	612	657	715
Effective Tax Rate	39.9%	34.3%	40.8%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%
<b>Net income/(loss) before allocation to non-controlling interests</b>	<b>276</b>	<b>506</b>	<b>539</b>	<b>704</b>	<b>801</b>	<b>894</b>	<b>989</b>	<b>1,083</b>	<b>1,189</b>	<b>1,290</b>	<b>1,393</b>	<b>1,499</b>	<b>1,609</b>	<b>1,750</b>
Gain / (Loss) Attributable to Non-Controlling Interests	1	3	0	3	4	4	4	4	4	4	4	4	4	4
<b>Net Income (Loss) Attributable to Zoetis</b>	<b>\$275</b>	<b>\$503</b>	<b>\$539</b>	<b>\$701</b>	<b>\$797</b>	<b>\$890</b>	<b>\$985</b>	<b>\$1,079</b>	<b>\$1,185</b>	<b>\$1,286</b>	<b>\$1,389</b>	<b>\$1,495</b>	<b>\$1,605</b>	<b>\$1,746</b>
Earnings Per Share - Basic	\$0.55	\$1.01	\$1.08	\$1.40	\$1.59	\$1.78	\$1.98	\$2.17	\$2.39	\$2.61	\$2.83	\$3.06	\$3.30	\$3.62
<b>Earnings Per Share - Diluted</b>	<b>\$0.55</b>	<b>\$1.01</b>	<b>\$1.08</b>	<b>\$1.40</b>	<b>\$1.59</b>	<b>\$1.78</b>	<b>\$1.97</b>	<b>\$2.16</b>	<b>\$2.38</b>	<b>\$2.59</b>	<b>\$2.81</b>	<b>\$3.04</b>	<b>\$3.28</b>	<b>\$3.60</b>
Weighted-Average Shares - Basic	500	500	500	500	500	499	498	497	495	493	491	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	500	500	499	499	497	496	494	491	489	485
<b>Cash Dividend Paid per Share</b>				<b>\$0.26</b>	<b>\$0.33</b>	<b>\$0.39</b>	<b>\$0.47</b>	<b>\$0.54</b>	<b>\$0.62</b>	<b>\$0.68</b>	<b>\$0.68</b>	<b>\$0.71</b>	<b>\$0.75</b>	<b>\$0.75</b>

	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
<b>Growth Rates</b>														
Revenue	30%	18%	2%	5%	6%	5%	5%	5%	4%	4%	4%	4%	4%	4%
Gross Profit	29%	17%	5%	6%	7%	6%	5%	5%	5%	5%	5%	4%	4%	4%
Operating Profit	49%	64%	17%	20%	11%	11%	9%	9%	8%	8%	8%	7%	7%	7%
Net Income	54%	83%	7%	30%	14%	12%	11%	9%	10%	9%	8%	8%	7%	9%
EPS		83%	7%	30%	14%	12%	11%	10%	10%	9%	9%	8%	8%	10%
Dividend per share					25%	20%	20%	15%	15%	10%	0%	5%	5%	0%
<b>Margins</b>														
Gross Profit	63.2%	62.7%	64.3%	64.6%	64.8%	65.0%	65.2%	65.4%	65.6%	65.8%	66.0%	66.2%	66.4%	66.6%
Operating Profit	14%	19%	22%	25%	26%	27%	28%	29%	30%	31%	32%	33%	34%	35%
Net Income	7.7%	11.9%	12.4%	15.4%	16.5%	17.4%	18.4%	19.3%	20.3%	21.1%	21.8%	22.6%	23.3%	24.4%
<b>Return Analysis</b>														
Payout Ratio				19%	20%	22%	24%	25%	26%	26%	24%	24%	23%	21%

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research



## Zoetis Income Statement: Our GAAP Annual Forecasts

GAAP Income Statement, \$MM	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
<b>Revenues</b>	<b>\$3,582</b>	<b>\$4,233</b>	<b>\$4,336</b>	<b>\$4,559</b>	<b>\$4,841</b>	<b>\$5,106</b>	<b>\$5,354</b>	<b>\$5,602</b>	<b>\$5,849</b>	<b>\$6,101</b>	<b>\$6,362</b>	<b>\$6,623</b>	<b>\$6,892</b>	<b>\$7,164</b>
Cost of Sales	1,444	1,652	1,563	1,622	1,710	1,793	1,869	1,944	2,018	2,093	2,169	2,245	2,322	2,399
<b>Gross Profit</b>	<b>2,138</b>	<b>2,581</b>	<b>2,773</b>	<b>2,936</b>	<b>3,131</b>	<b>3,313</b>	<b>3,485</b>	<b>3,658</b>	<b>3,831</b>	<b>4,008</b>	<b>4,193</b>	<b>4,378</b>	<b>4,570</b>	<b>4,765</b>
SG&A	1,382	1,453	1,470	1,517	1,492	1,525	1,555	1,584	1,609	1,634	1,660	1,685	1,709	1,733
R&D Expenses	411	427	409	413	428	438	450	463	474	486	499	511	523	535
Amortization of Intangible Assets	58	69	64	65	66	66	66	66	66	66	66	66	66	66
Restructuring Charges & Certain Acquisition-Related Costs	202	154	135	70	32	24	24	24	24	24	24	24	24	24
Other (Income) / Deductions -- Net	(93)	84	(15)	96	93	93	88	88	75	74	74	74	74	34
Income Before Provision for Taxes	178	394	710	776	1,020	1,167	1,301	1,433	1,582	1,724	1,870	2,019	2,174	2,373
(Benefit) / Provision for Taxes on Income	67	146	274	221	296	338	377	416	459	500	542	586	631	688
<b>Net income/(loss) before allocation to non-controlling interests</b>	<b>111</b>	<b>248</b>	<b>436</b>	<b>555</b>	<b>724</b>	<b>828</b>	<b>924</b>	<b>1,018</b>	<b>1,123</b>	<b>1,224</b>	<b>1,328</b>	<b>1,433</b>	<b>1,544</b>	<b>1,685</b>
Gain / (Loss) Attributable to Non-Controlling Interests	1	3	0	3	4	4	4	4	4	4	4	4	4	4
<b>Net Income (Loss) Attributable to Zoetis</b>	<b>\$110</b>	<b>\$245</b>	<b>\$436</b>	<b>\$552</b>	<b>\$720</b>	<b>\$824</b>	<b>\$920</b>	<b>\$1,014</b>	<b>\$1,119</b>	<b>\$1,220</b>	<b>\$1,324</b>	<b>\$1,429</b>	<b>\$1,540</b>	<b>\$1,681</b>
Earnings Per Share - Basic	\$0.22	\$0.49	\$0.87	\$1.10	\$1.44	\$1.65	\$1.85	\$2.04	\$2.26	\$2.47	\$2.69	\$2.93	\$3.17	\$3.48
<b>Earnings Per Share - Diluted</b>	<b>\$0.22</b>	<b>\$0.49</b>	<b>\$0.87</b>	<b>\$1.10</b>	<b>\$1.44</b>	<b>\$1.65</b>	<b>\$1.84</b>	<b>\$2.03</b>	<b>\$2.25</b>	<b>\$2.46</b>	<b>\$2.68</b>	<b>\$2.91</b>	<b>\$3.15</b>	<b>\$3.46</b>
Weighted-Average Shares - Basic	500	500	500	500	500	499	498	497	495	493	491	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	500	500	499	499	497	496	494	491	489	485
<b>Cash Dividend per Share</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.26</b>	<b>\$0.33</b>	<b>\$0.39</b>	<b>\$0.47</b>	<b>\$0.54</b>	<b>\$0.62</b>	<b>\$0.68</b>	<b>\$0.68</b>	<b>\$0.71</b>	<b>\$0.75</b>	<b>\$0.75</b>

Note: Includes revenues and expenses from acquisitions from the acquisition date

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

## Zoetis Balance Sheet

Zoetis Balance Sheet, \$MM	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
<b>Assets</b>														
Cash and cash equivalents	63	79	317	711	1,225	1,782	1,972	2,557	2,416	3,035	3,705	4,453	5,208	4,693
Accounts receivable, less allowance for doubtful accounts	773	871	900	913	1,000	1,109	1,209	1,281	1,371	1,447	1,489	1,492	1,471	1,466
Inventories	995	1,063	1,345	1,264	1,285	1,314	1,341	1,406	1,458	1,499	1,554	1,607	1,662	1,681
Current deferred tax assets	97	96	101	91	90	89	89	89	89	89	89	89	89	89
Other current assets	188	202	201	215	217	218	218	218	218	218	218	218	218	218
<b>Total current assets</b>	<b>2,116</b>	<b>2,311</b>	<b>2,864</b>	<b>3,194</b>	<b>3,817</b>	<b>4,512</b>	<b>4,830</b>	<b>5,550</b>	<b>5,552</b>	<b>6,288</b>	<b>7,055</b>	<b>7,859</b>	<b>8,649</b>	<b>8,147</b>
Property, plant and equipment, less accumulated depreciation	1,148	1,243	1,241	1,246	1,244	1,233	1,219	1,205	1,187	1,164	1,131	1,093	1,053	1,001
Identifiable intangible assets, less accumulated amortization	924	928	868	804	738	672	606	540	474	408	342	276	210	144
Goodwill	934	989	985	985	985	985	985	985	985	985	985	985	985	985
Non-current deferred tax assets	70	143	216	201	200	200	200	200	200	200	200	200	200	200
Other noncurrent assets	92	97	88	83	83	82	82	82	82	82	82	82	82	82
<b>Total Assets</b>	<b>5,284</b>	<b>5,711</b>	<b>6,262</b>	<b>6,513</b>	<b>7,066</b>	<b>7,683</b>	<b>7,922</b>	<b>8,562</b>	<b>8,479</b>	<b>9,126</b>	<b>9,795</b>	<b>10,495</b>	<b>11,179</b>	<b>10,559</b>
<b>Liabilities and Equity</b>														
Current portion of allocated long-term debt	0	0	73	0	0	0	0	0	0	0	0	0	0	0
Current portion of long-term debt	38	0	0	0	0	400	0	750	0	0	0	0	1,350	0
Accounts payable	206	214	319	243	231	215	196	192	193	187	194	201	208	215
Income taxes payable	24	18	30	31	32	32	32	32	32	32	32	32	32	32
Accrued compensation and related items	144	150	194	162	163	166	169	172	174	177	180	183	185	188
Other current liabilities	396	461	507	444	433	432	431	431	431	431	431	431	431	431
<b>Total current liabilities</b>	<b>808</b>	<b>843</b>	<b>1,123</b>	<b>880</b>	<b>859</b>	<b>1,244</b>	<b>828</b>	<b>1,577</b>	<b>831</b>	<b>828</b>	<b>838</b>	<b>847</b>	<b>2,207</b>	<b>866</b>
Allocated long-term debt	673	575	509	0	0	0	0	0	0	0	0	0	0	0
Long-term debt	0	0	0	3,650	3,650	3,250	3,250	2,500	2,500	2,500	2,500	2,500	1,150	1,150
Noncurrent deferred tax liabilities	218	311	323	317	316	316	316	316	316	316	316	316	316	316
Other taxes payable	100	122	159	134	129	129	129	129	129	129	129	129	129	129
Other noncurrent liabilities	141	124	107	104	103	103	103	103	103	103	103	103	103	103
<b>Total Liabilities</b>	<b>1,940</b>	<b>1,975</b>	<b>2,221</b>	<b>5,085</b>	<b>5,058</b>	<b>5,042</b>	<b>4,625</b>	<b>4,624</b>	<b>3,878</b>	<b>3,875</b>	<b>3,885</b>	<b>3,894</b>	<b>3,904</b>	<b>2,563</b>
Commitments and Contingencies														
<b>Total Equity</b>	<b>3,344</b>	<b>3,736</b>	<b>4,041</b>	<b>1,427</b>	<b>2,008</b>	<b>2,642</b>	<b>3,297</b>	<b>3,937</b>	<b>4,601</b>	<b>5,250</b>	<b>5,910</b>	<b>6,601</b>	<b>7,275</b>	<b>7,996</b>
<b>Total liabilities and equity</b>	<b>5,284</b>	<b>5,711</b>	<b>6,262</b>	<b>6,513</b>	<b>7,066</b>	<b>7,683</b>	<b>7,922</b>	<b>8,562</b>	<b>8,479</b>	<b>9,126</b>	<b>9,795</b>	<b>10,495</b>	<b>11,179</b>	<b>10,559</b>

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

## Zoetis Statement of Cash Flows

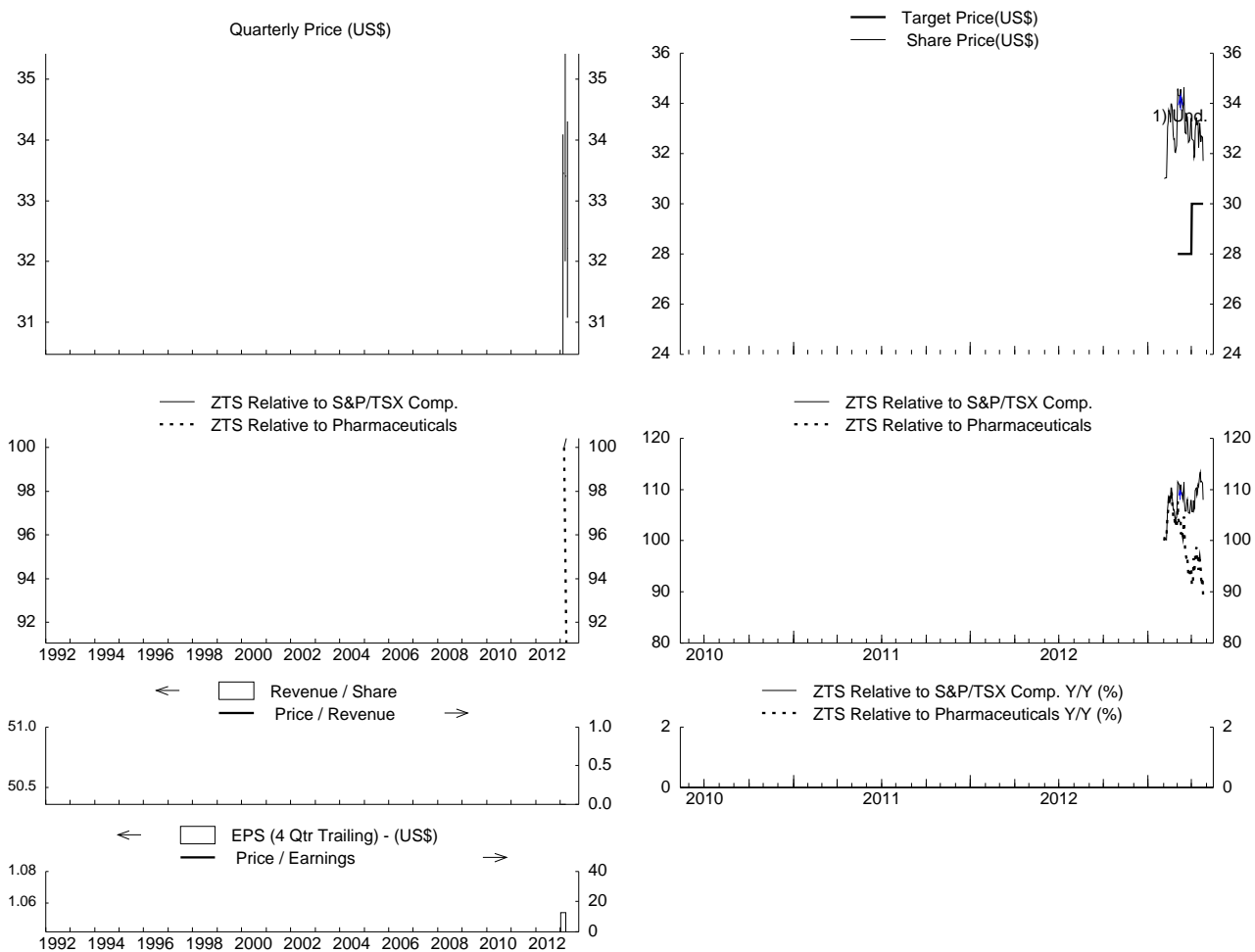
Zoetis Statement of Cash Flows, \$MM	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
<b>Operating activities</b>														
GAAP Net income/(loss) before allocation to non-controlling interests	111	248	436	555	724	828	924	1,018	1,123	1,224	1,328	1,433	1,544	1,685
Adjustments:														
Depreciation and amortization expense	185	205	200	191	200	207	206	212	219	226	233	240	248	255
Share-based compensation expense	16	19	28	30	30	30	30	30	30	30	30	30	30	30
Asset write-offs and impairments	16	78	10	0	0	0	0	0	0	0	0	0	0	0
Net gains on sales of assets	(101)	(1)	0	0	0	0	0	0	0	0	0	0	0	0
Deferred taxes	(68)	65	(74)	19	2	0	(0)	(0)	(0)	(0)	(0)	(0)	0	0
Other non-cash adjustments	(5)	0	3	0	0	0	0	0	0	0	0	0	0	0
Other changes in assets and liabilities, net of acquisitions and divestitures:	100	(117)	(149)	(139)	(136)	(154)	(143)	(137)	(139)	(120)	(87)	(46)	(25)	(4)
<b>Net cash provided by operating activities</b>	<b>254</b>	<b>497</b>	<b>454</b>	<b>654</b>	<b>820</b>	<b>912</b>	<b>1,017</b>	<b>1,123</b>	<b>1,234</b>	<b>1,361</b>	<b>1,504</b>	<b>1,658</b>	<b>1,797</b>	<b>1,966</b>
<b>Investing Activities</b>														
Purchases of property, plant and equipment	(124)	(135)	(126)	(131)	(132)	(130)	(126)	(132)	(135)	(137)	(135)	(136)	(142)	(136)
Net proceeds from sales of assets	203	34	3	0	0	0	0	0	0	0	0	0	0	0
Acquisitions, net of cash acquired	(81)	(345)	0	0	0	0	0	0	0	0	0	0	0	0
Other investing activities	(7)	(3)	(12)	0	0	0	0	0	0	0	0	0	0	0
<b>Net cash used in investing activities</b>	<b>(9)</b>	<b>(449)</b>	<b>(135)</b>	<b>(131)</b>	<b>(132)</b>	<b>(130)</b>	<b>(126)</b>	<b>(132)</b>	<b>(135)</b>	<b>(137)</b>	<b>(135)</b>	<b>(136)</b>	<b>(142)</b>	<b>(136)</b>
<b>Financing activities</b>														
Debt - Net issuance / payment	0	(143)	0	2,650	0	0	(400)	0	(750)	0	0	0	0	(1,350)
Cash dividends paid	(207)	(416)	(63)	(130)	(162)	(195)	(233)	(267)	(307)	(336)	(335)	(349)	(365)	(362)
Purchase of subsidiary shares from noncontrolling interests	(3)	0	0	0	0	0	0	0	0	0	0	0	0	0
Share repurchases	0	0	0	0	(11)	(31)	(67)	(140)	(183)	(270)	(364)	(425)	(535)	(632)
Net financing activities with Pfizer	(67)	529	(15)	(2,650)	0	0	0	0	0	0	0	0	0	0
<b>Net cash provided by/(used in) financing activities</b>	<b>(277)</b>	<b>(30)</b>	<b>(78)</b>	<b>(130)</b>	<b>(174)</b>	<b>(225)</b>	<b>(700)</b>	<b>(407)</b>	<b>(1,240)</b>	<b>(605)</b>	<b>(698)</b>	<b>(774)</b>	<b>(900)</b>	<b>(2,344)</b>
Effect of exchange-rate changes on cash and cash equivalents	(4)	(2)	(3)	0	0	0	0	0	0	0	0	0	0	0
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>(36)</b>	<b>16</b>	<b>238</b>	<b>394</b>	<b>514</b>	<b>557</b>	<b>191</b>	<b>584</b>	<b>(141)</b>	<b>619</b>	<b>671</b>	<b>748</b>	<b>755</b>	<b>(515)</b>
Cash and cash equivalents, as of beginning of year	99	63	79	317	711	1,225	1,782	1,972	2,557	2,416	3,035	3,705	4,453	5,208
Cash and cash equivalents, as of end of year	63	79	317	711	1,225	1,782	1,972	2,557	2,416	3,035	3,705	4,453	5,208	4,693

Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Other companies mentioned (priced as of the close on April 30, 2013):

Pfizer (PFE, \$29.07, Outperform)

Zoetis Inc. (ZTS)



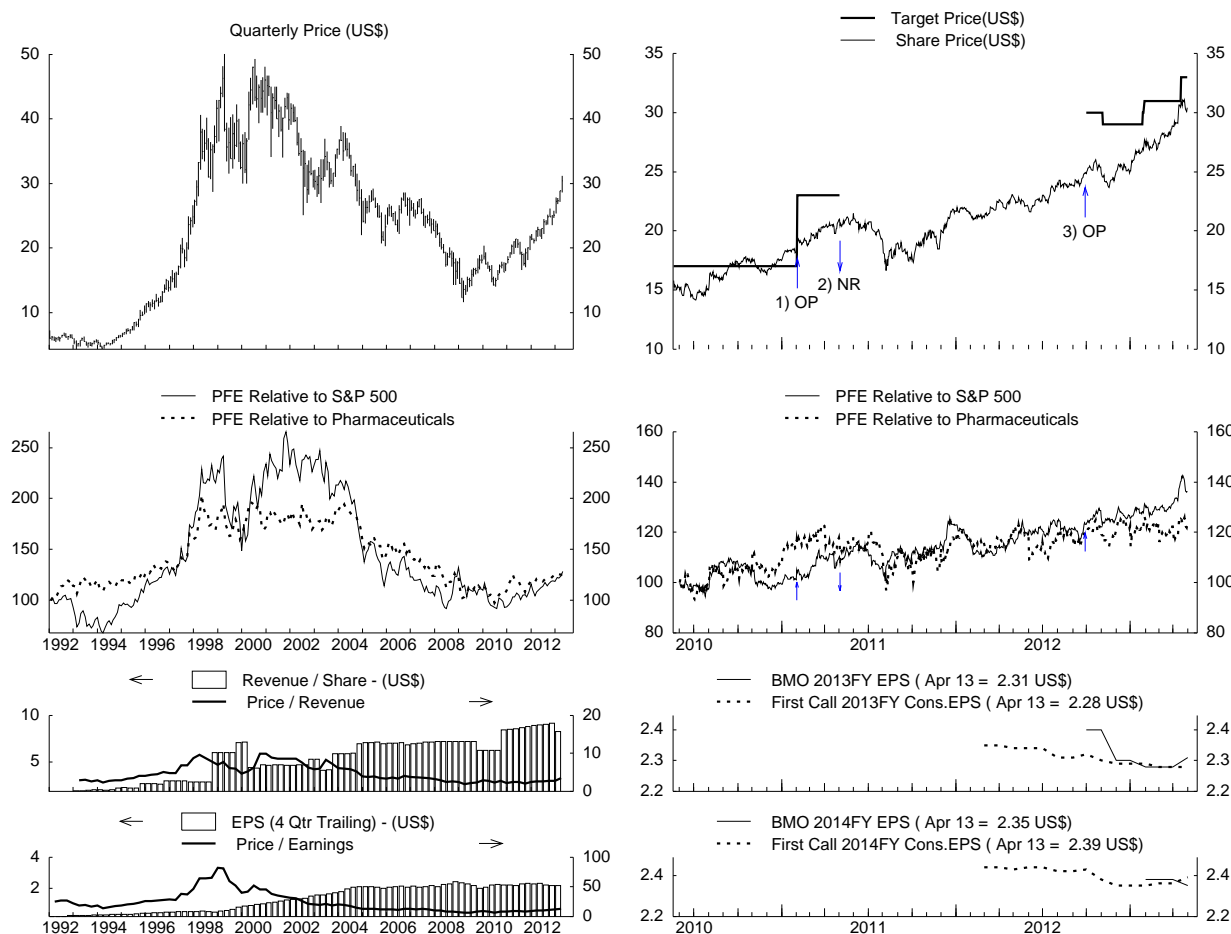
FYE (Dec.)	EPS US\$	P/E	DPS \$	Yield %	Payout %	BV \$	P/B	ROE %
Current*	1.05	31	0.00	0.0	0	ND	nm	nm

ZTS - Rating as of 1-Feb-13 = NR		
Date	Rating Change	Share Price
1 7-Mar-13	NR to Und.	\$34.56

\* Current EPS is the 4 Quarter Trailing to Q4/2012.

Last Price ( April 23, 2013): \$32.22  
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 28.8	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*	2.20	13.1	0.96	3.3	44	11.2	2.6	20

Growth(%):

5 Year:	0.6	-5.6	3.1
10 Year:	3.3	4.8	13.2
20 Year:	10.9	10.1	12.0

\* Current EPS is the 4 Quarter Trailing to Q4/2012.  
 \* 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 19-May-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 ( April 29, 2013): \$30.43

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

## Important Disclosures

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### Company Specific Disclosure for ZTS

#### Methodology and Risks to Our Price Target/Valuation

**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/Valuation

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

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

#### Distribution of Ratings (March 31, 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	37.3%	16.5%	53.8%	38.2%	51.3%	53.2%
Hold	Market Perform	58.0%	8.8%	44.6%	56.8%	47.7%	41.1%
Sell	Underperform	4.7%	3.7%	1.5%	4.9%	1.0%	5.7%

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

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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

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