

## Zoetis Inc. (ZTS)

Overweight

### Q3 Revenue Growth Impressive, Solid Results Should Calm Concerns

#### CONCLUSION

Q3 results were in line with expectations highlighted by slightly higher revenues and EPS that met Street estimates. FY13 guidance was narrowed and ZTS highlighted new product approvals, including two branded generic ractopamine products that gives them exposure to the beta-agonist market. While margins were lower than expected, we were impressed with strong revenue growth in the U.S. and international markets. As we expected, livestock product sales increased 11% and companion animal revenues also grew 10%. We expect to hear more about the livestock market recovery, new product launches, and margin expansion opportunities. CC @ 8:30 AM ET, dial-in #: 866-952-1906, ID: ZTSQ313.

- **Revenues slightly better.** Total revenues increased 8.2% y/y to \$1,103 MM, which was \$33 MM higher than our estimate of \$1,070 MM and \$38 MM higher than consensus of \$1,065 MM. Operationally, revenues increased 9%, which was partially offset by a 1% FX impact.
  - U.S. revenues increased 10.5% y/y to \$495 MM, \$20 MM higher than our estimate of \$475 MM and \$16 MM higher than the StreetAccounts (SA) consensus of \$479 MM.
  - EuAfME revenues increased 12.0% y/y to \$270 MM, which was \$19 MM higher than our estimate of \$251 MM and \$28 MM higher than SA consensus of \$242 MM. Base revenues increased 9%, which was aided by a 3% favorable FX impact.
  - CLAR revenues increased 3.6% y/y to \$171 MM, slightly lower than our estimate of \$173 MM and \$3 MM higher than consensus of \$168 MM. Operationally, revenues increased 9% and was offset by a negative 5% FX impact.
  - APAC revenues increased 1.2% y/y to \$167 MM, which was ~\$5 MM lower than our estimate of \$172 MM and in line with SA consensus of \$166 MM. Operationally, revenues increased 7% and was offset by a 6% FX impact.
- **EPS in line; margins expand, but not meaningfully.** Adjusted EPS of \$0.34 was in line with our estimate and consensus of \$0.34. Adjusted EPS excluded the net impact of \$41 MM or \$0.08 related to purchase accounting adjustments, acquisition costs and other one-time items. Gross margin of 65.28% was 53 bps higher than our estimate of 64.75%. Adjusted operating income increased ~10% y/y to \$273 MM, which was in line with our estimate of \$275 MM, while adjusted operating margin increased 31 bps y/y to 24.75%, which was 94 bps lower than our estimate of 25.69%. Lower operating margin versus our estimate was primarily attributable to higher than expected SG&A, which grew ~9% y/y.
- **FY13 guidance narrowed.** ZTS raised the low end of its revenue and EPS guidance ranges. Revenues are now expected to be \$4.475-\$4.525 billion vs. the prior range of \$4.425-\$4.525 billion and adjusted EPS guidance is expected to be \$1.38-\$1.42 from the prior range of \$1.36-\$1.42.

#### COMPANY DESCRIPTION

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

PRICE: US\$31.93

TARGET: US\$39.00

(24.5x FY14E EPS)

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Related Companies:

ZTS

Share Price:

31.93

#### 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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### Analyst Certification — Kevin K. Ellich, Sr Research Analyst — Bradley D. Maiers, Research Analyst

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