

Zoetis

2Q/13 Initial Thoughts: Solid Underlying Growth in the Qtr; Well Positioned from Here - ALERT

Zoetis reported 2Q EPS of \$0.36 this morning, in line with consensus, and reiterated both top-line and EPS guidance for the year. Similar to 1Q/13 results, lower operating expenses resulted in better-than-expected margin performance in the quarter, and operational growth came in roughly 150 bps ahead of our expectations. Given the high level of investor concern around 2Q, we believe today's results will be viewed as positive and see ZTS shares as well positioned heading into the second half of the year, where we anticipate stronger operational growth for the business. We are reiterating our OW rating on ZTS shares.

- **In-line results with solid operational growth and margins again running ahead of expectations.** Zoetis reported 2Q EPS of \$0.36, in line with consensus. Given the high level of investor concern heading into the quarter, we expect the shares to see relief on today's results. Sales of \$1,114 million were \$7 million ahead of our estimate and \$9 million below consensus. Operational sales growth of 4% was roughly 150 bps ahead of our expectation, with greater-than-expected FX headwinds offsetting some of this strength. Gross margin was in line, however operating expenses once again came in lower than expected with operating margin of 25.2% running roughly 100 bps ahead of our forecast.
- **2013 guidance unchanged; highlights diversified business.** Zoetis left its 2013 top-line (\$4,425-\$4,525 million) and EPS (\$1.36-\$1.42) guidance unchanged despite recent swings in several of its major currencies. We see the 4% operational growth reported in 2Q (which will likely be Zoetis's weakest quarter of the year) as encouraging and continue to see the company as a 5-6% top-line growth story over time.
- **Focus for today's call.** We will be listening for 1) any commentary on seasonal factors or YOY comparisons that could impact 2H/13 results; 2) an update on the impact of weakening currencies (Brazilian real, Australian dollar, Japanese yen, etc) will have on top line, expense and EPS results; and 3) any color on longer-term or broader regional market growth trends.

Remain positive on ZTS. Overall, we continue to see Zoetis as a unique asset within the healthcare space with a highly diversified portfolio, a significant emerging markets presence, and lack of third-party payer or generic exposure. Along these lines, we would use recent weakness in ZTS shares as a buying opportunity.

Overweight

ZTS, ZTS US

Price: \$31.25

05 August 2013

Pharmaceuticals — Major & Specialty

Chris Schott, CFA ^{AC}

(1-212) 622-5676

christopher.t.schott@jpmorgan.com

Bloomberg JPMA SCHOTT <GO>

Jessica Fye

(1-212) 622-4165

jessica.m.fye@jpmorgan.com

J.P. Morgan Securities LLC

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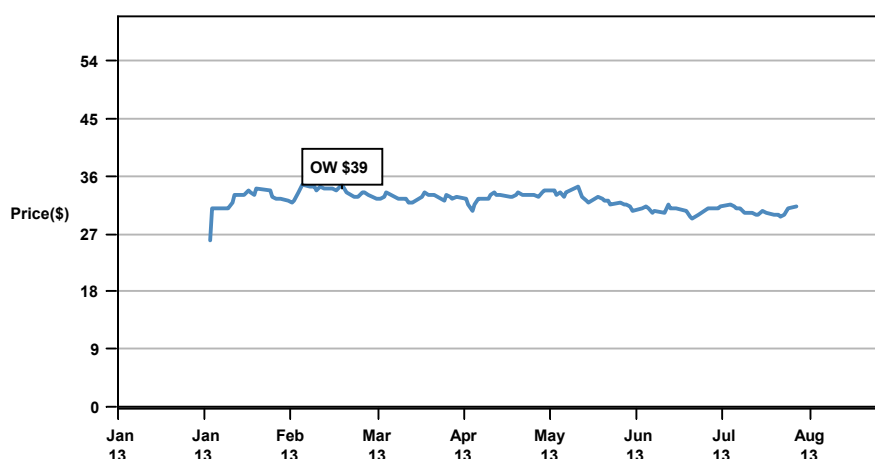
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Zoetis (ZTS, ZTS US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
13-Mar-13	OW	34.00	39.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Mar 13, 2013.

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