

Zoetis

(ZTS-NYSE)

Stock Rating: Outperform
Industry Rating: Market Perform

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Looking at The Big Picture and Defending ZTS

Event

We are publishing our updated forecasts following Zoetis' 3Q13 earnings and defending the stock following some recent weakness.

Impact & Analysis

ZTS shares have been somewhat weak following the company's 3Q13 earnings on November 5. We believe 3Q was a good quarter and the Street is overreacting to some of the issues raised. Specifically, there seems to be some concerns about 3Q SG&A being 9% higher than expected; however, this is partly explained by the delayed promotional spending in 2Q because of the weaker parasite season (recall 2Q SG&A was 2.3% below consensus). We urge investors to look past quarterly fluctuations and focus on the big picture: total OPEX has increased 2.5% (4% ex-FX) YTD, whereas revenues have grown 4.7% (6% ex-FX); this should be in line with most investors' expectations. There is also some concern about US FDA issuing its final guidance regarding eliminating the growth promotion indication for medically important antibiotics. We view this as a headwind as opposed to an event that will lead to a drastic decline in sales, partly because many of the antibiotics in question have therapeutically relevant indications as well, such as prevention of disease. Thus, although their use may be curtailed, we highly doubt it will cease. Offsetting this, Zoetis has a number of promising new products launching, such as Apoquel in the very large dog atopic dermatitis market, and two generic beta agonists that will likely benefit from ongoing concerns from Merck's Zilmax. Yes, possible spin-outs of the animal health businesses of Merck and Novartis could steal the spotlight from Zoetis, but they could also highlight the company's relative strengths.

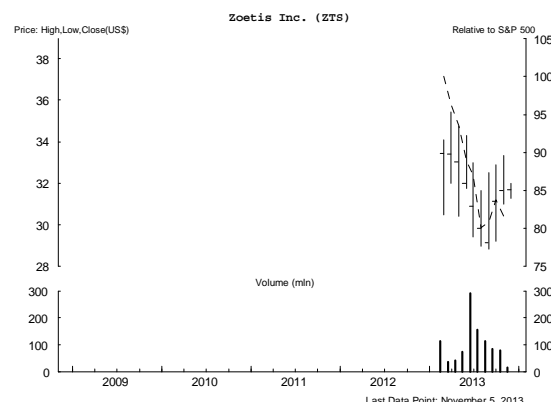
Valuation & Recommendation

\$38 based on DCF: 2.5% terminal growth rate, 8.3% discount rate supported by 23x 2015 EPS of \$1.77, based on 2013-2016 EPS CAGR of 13%, and 2014-2013 OCF CAGR of 10%. We reiterate our Outperform rating.

Securities Info

Price (6-Nov)	\$31.27	Target Price	\$38.00
52-Wk High/Low	\$35/\$29	Dividend	\$0.26
Mkt Cap (mm)	\$15,635	Yield	0.8%
Shs O/S (mm, BASIC)	500.0	Float O/S (mm)	499.9
Options O/S (mm)	na	ADVol (30-day, 000s)	3,575

Price Performance



Valuation/Financial Data

(FY-Dec.)	2011A	2012A	2013E	2014E
EPS Pro Forma	\$1.01	\$1.08	\$1.38↑	\$1.54
P/E			22.7x	20.3x
First Call Cons.			\$1.40	\$1.62
EPS GAAP	\$0.49	\$0.87	\$1.05	\$1.39
FCF	\$0.72	\$0.66	\$1.36↓	\$1.42
P/FCF			23.0x	22.0x
EBITDA (\$mm)	\$943	\$1,142	\$1,201	\$1,404
EV/EBITDA			15.4x	13.2x
Rev. (\$mm)	\$4,233	\$4,336	\$4,500	\$4,703
EV/Rev			4.1x	3.9x
Quarterly EPS	1Q	2Q	3Q	4Q
2012A	\$0.30	\$0.35	\$0.31	\$0.11
2013E	\$0.36A	\$0.36A	\$0.34A	\$0.32
Balance Sheet Data (30-Jun)				
Net Debt (\$mm)	\$2,853	Total Debt/EBITDA		3.0x
Total Debt (\$mm)	\$3,652	EBITDA/IntExp		10.7x
Net Debt/Cap.	64.1%	Price/Book		19.5x

Notes: All values in US\$.

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

Changes

Annual EPS
 2013E \$1.37 to \$1.38

Annual FCF
 2013E \$1.37 to \$1.36

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 14.

Exhibit 1. ZTS 3Q13 Overview: We Believe This Was a Solid Quarter on the Top Line; YTD OPEX Grew 2.5% (4% ex-FX), Revenues Grew 4.7% (6% ex-FX), In Line With Our Expectations

	Q3'13					Q3'12	Y/Y Change	Comments:
	Consensus	BMO	Actual	Actual vs. Consensus	Actual vs. BMO			
Revenues	\$1,060	\$1,057	\$1,103	4%	4%	\$1,019	8%	Solid top line beat by most segments; plz see Exhibit 2
Gross Profit	\$693	\$696	\$720	4%	3%	\$667	8%	GM In-line
Gross Margin	65.4%	65.8%	65.3%	0%	-1%	65.5%	0%	
SG&A	\$331	\$333	\$359	9%	8%	\$330	9%	Post-poned promotional spend of the parasiticide season (delayed from 2Q); enabling function spend. YTD SG&A is only up 0.8% whereas revenues are up 4.7%
Research & Development	\$96	\$92	\$91	-6%	-1%	\$94	-3%	Below expectations, partly offsetting higher SG&A
OPEX	\$794	\$786	\$833	5%	6%	\$776	7%	Total OPEX growth of 7% lower than revenue growth of 8%. YTD OPEX 2.5% growth << revenue growth of 4.7%
Operating Profit	\$267	\$271	\$270	1%	0%	\$243	11%	In-line; higher revenues offset by lower OPEX.
Taxes	\$72	\$69	\$72	1%	4%	\$89	-19%	Slightly higher than we expected, but in-line with consensus.
Effective Tax Rate	29.7%	29.0%	29.5%	0%	1%	36.6%	-7%	
Net Income	\$170	\$169	\$172	1%	2%	\$154	12%	In-line; higher revenues offset by higher OPEX.
EPS	\$0.34	\$0.34	\$0.34	0%	0%	\$0.31	10%	

Sources: Zoetis, Bloomberg Finance LP, BMO Capital Markets Pharmaceuticals Research Estimates

	Q3'13			Q3'12	Y/Y Change	Comments:
	BMO	Actual	Actual vs. BMO			
Revenues	1,057	\$1,103	4%	1,019	8%	9% operational growth, impressive, but 3Q12 was also very weak because of the drought
3Q13 Revenues by Segment:						
US	469	495	6%	\$448	10%	US livestock improving sig. post drought +11%, companion animal also strong +10%
Total Ex-US	575	608	6%	\$571	6%	Beat driven by EuAfME and CLAR
EuAfME	247	270	9%	\$241	12%	9% operational growth, 3% Fx benefit. Livestock grew 7% operationally, across many EM while Western EU continued to decline. New swine vaccine. CA grew 15% operationally, but had 3rd party manufacturing agreement; ex this, it grew 5% operationally.
CLAR	165	171	4%	\$165	4%	Solid 9% operational growth, 5% Fx headwind. Livestock up 6% operationally, CA up 19% operationally.
APAC	164	167	2%	\$165	1%	7% operational growth offset by 6% Fx headwind. Livestock grew 8% operationally, CA grew 3%. Australia cattle remains weak because of the drought.
3Q13 Revenues by Species:						
Livestock Revenues	691	706	2%	\$659	7%	Strong growth in the US and many EM
Cattle	367	388	6%	\$365	6%	Strong growth in the US and many EM
Swine	153	155	1%	\$140	11%	New Vaccine
Poultry	139	134	-4%	\$125	7%	
Other	31	29	-6%	\$29	0%	
Companion Animal	380	397	4%	\$360	10%	Strong growth in the US, EuAfME and CLAR.
Horses	34	37	9%	\$35	6%	
Dogs and Cats	347	360	4%	\$325	11%	

Sources: Zoetis, BMO Capital Markets Estimates

Exhibit 2. Zoetis Should Be Able to Achieve Its 2013 Guidance

2013 Guidance & Date Provided	Apr. 30, 2013 (after 1Q 2013)	Aug. 06, 2013 (after 2Q 2013)	Nov. 05, 2013 (after 3Q 2013)	BMO	Street	Comments
Revenue	\$4,425 mn to \$4,525 mn	\$4,425 mn to \$4,525 mn	\$4,475 mn to \$4,525 mn	\$4,500 mn	\$4,502 mn	We're in the middle
Cost of Sales as % of Revenues	35.0% to 36.0%	35.0% to 36.0%	~35.5%	35.7%	35.4%	We're in-line; company is actively looking for manufacturing efficiencies.
SG&A Expenses	\$1,385 mn to \$1,435 mn	\$1,385 mn to \$1,435 mn	\$1,405 mn to \$1,425 mn	\$1,408 mn		Zoetis guided that SG&A should increase throughout 2013, but at a slower rate than revenues.
R&D Expenses	\$385 mn to \$415 mn	\$385 mn to \$415 mn	\$380 mn to \$390 mn	\$386 mn		We're in the lower half. Going forward, Zoetis believes this will increase slightly but at a slower rate than revenues.
Interest Expense	~\$115 mn	~\$115 mn	~\$115 mn	\$112 mn		We're in-line
Other (Income)/Deductions	~(\$20 mn)	~(\$20 mn)	~(\$15 mn)	(\$14 mn)		
Effective Tax Rate	~29.5%	~29.5%	~29.5%	29.2%	29.0%	We're slightly below.
Adjusted Net Income	\$680 mn to \$710 mn	\$680 mn to \$710 mn	\$690 mn to \$710 mn	\$691 mn	\$700 mn	We're in-line
Adjusted Diluted EPS	\$1.36 to \$1.42	\$1.36 to \$1.42	\$1.38 to \$1.42	\$1.38	\$1.40	We're on the lower end of guidance, but believe it is achievable.

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

Exhibit 3. We've Made Minimal Changes to Our Forecasts

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Prior	New	Prior	New	Prior	New	Prior	New
Revenue	\$4,455	\$4,500	\$4,655	\$4,703	\$4,996	\$5,047	\$5,228	\$5,282
Gross Margin	64.4%	64.3%	64.7%	64.6%	65.0%	64.9%	65.3%	65.2%
Operating Profit (EBIT)	\$1,099	\$1,098	\$1,212	\$1,212	\$1,373	\$1,373	\$1,506	\$1,506
Operating Margin	25%	24%	26%	26%	27%	27%	29%	29%
Pre-tax Profit	971	977	1,094	1,093	1,255	1,254	1,392	1,392
Effective Tax Rate	29%	29%	29%	29%	29%	29%	29%	29%
Net Income	\$686	\$691	\$773	\$772	\$887	\$887	\$984	\$984
Net Margin	15%	15%	17%	16%	18%	18%	19%	19%
EPS	\$1.37	\$1.38	\$1.54	\$1.54	\$1.77	\$1.77	\$1.97	\$1.97
Free Cash Flow per Share	\$1.37	\$1.36	\$1.42	\$1.42	\$1.63	\$1.63	\$1.96	\$1.96
Dividend per share	\$0.26	\$0.26	\$0.33	\$0.33	\$0.39	\$0.39	\$0.47	\$0.47
Dividend Payout Ratio	19%	19%	21%	21%	22%	22%	24%	24%

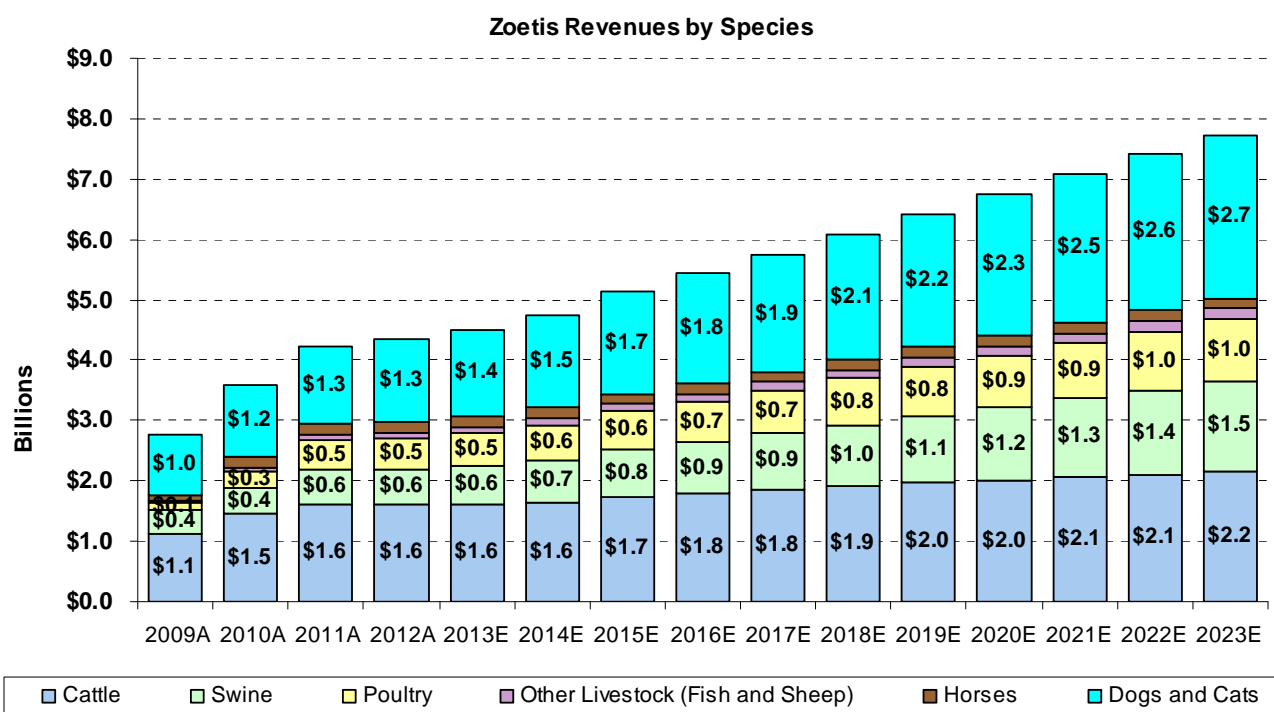
Source: Zoetis, Thomson One, BMO Capital Markets Pharmaceuticals Research

Exhibit 4. We Remain Slightly Below Consensus

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Street	BMO	Street	BMO	Street	BMO	Street	BMO
Revenue	\$4,502	\$4,500	\$4,763	\$4,703	\$5,044	\$5,047	\$5,306	\$5,282
Gross Margin	64.6%	64.3%	65.1%	64.6%	65.4%	64.9%	65.6%	65.2%
Operating Profit (EBIT)	\$1,106	\$1,098	\$1,248	\$1,212	\$1,404	\$1,373	\$1,532	\$1,506
Operating Margin	25%	24%	26%	26%	28%	27%	29%	29%
Pre-tax Profit	987	977	1,130	1,093	1,273	1,254	1,406	1,392
Effective Tax Rate	29%	29%	29%	29%	29%	29%	28%	29%
Net Income	\$700	\$691	\$807	\$772	\$906	\$887	\$1,016	\$984
Net Margin	16%	15%	17%	16%	18%	18%	19%	19%
EPS	\$1.40	\$1.38	\$1.62	\$1.54	\$1.82	\$1.77	\$2.03	\$1.97
Free Cash Flow per Share	\$1.37	\$1.36	\$1.42	\$1.42	\$1.63	\$1.63	\$1.96	\$1.96
Dividend per share	\$0.26	\$0.26	\$0.31	\$0.33	\$0.35	\$0.39	\$0.42	\$0.47
Dividend Payout Ratio	19%	19%	19%	21%	19%	22%	21%	24%

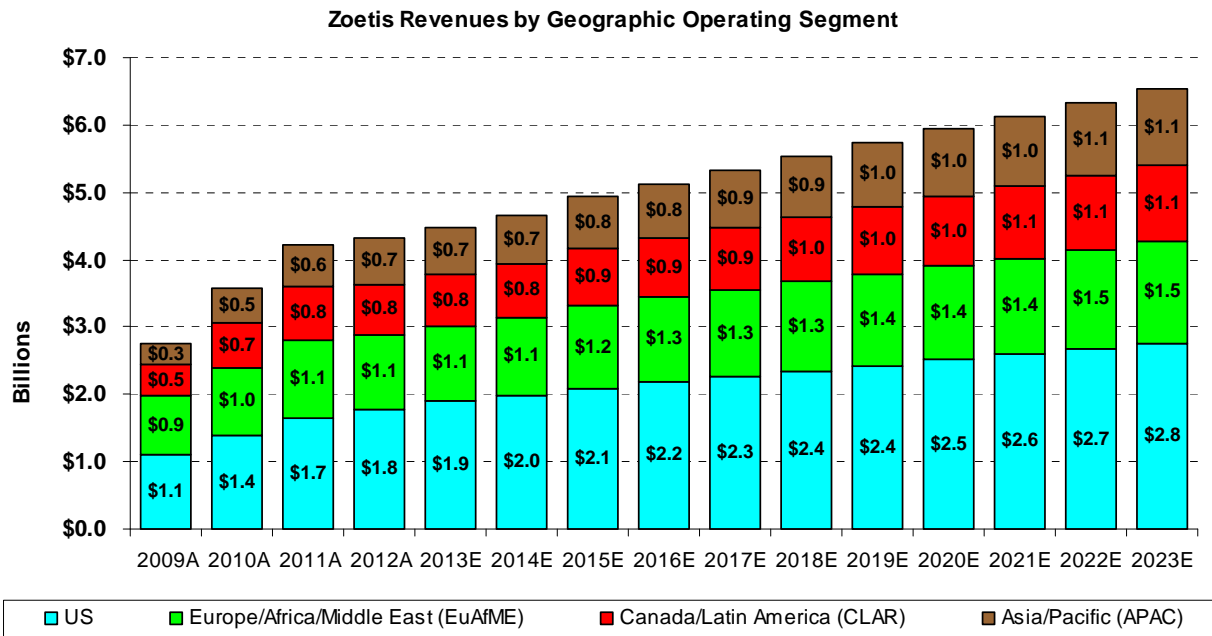
Source: Zoetis, Thomson One, BMO Capital Markets Pharmaceuticals Research

Exhibit 5. Our Zoetis Revenue Forecast by Species: 10-year CAGR of 5.5%



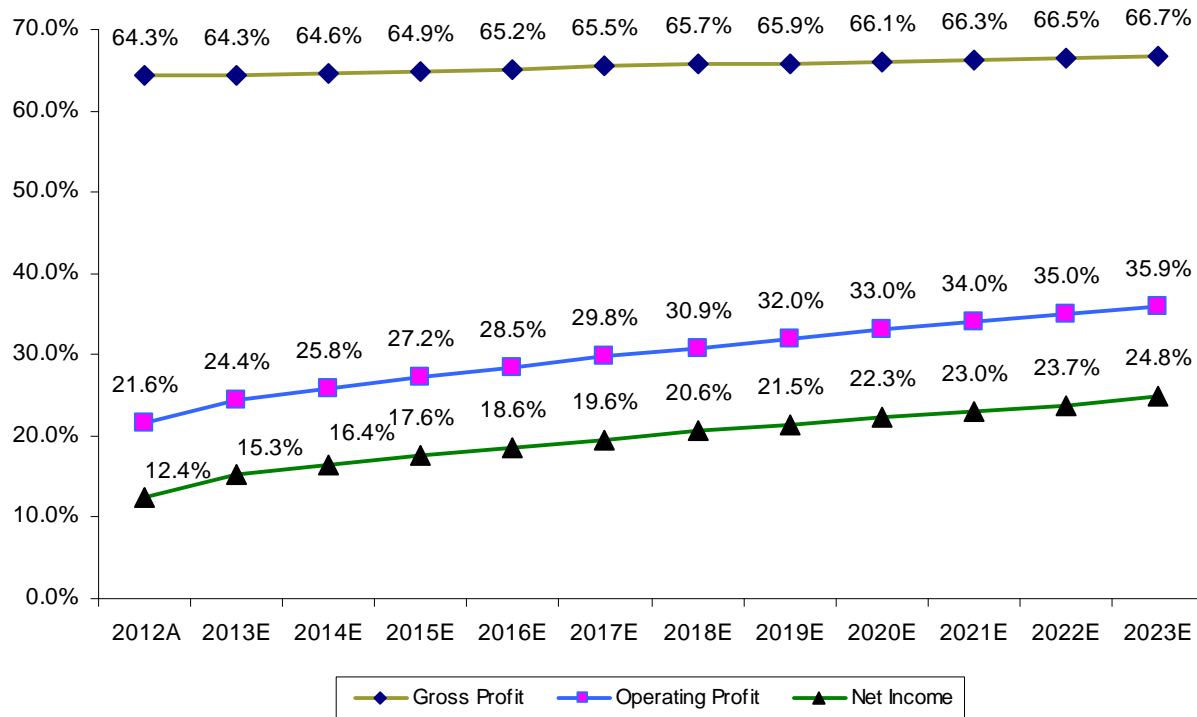
Source: Zoetis, BMO Capital Markets Pharmaceuticals Research.

Exhibit 6. Our Zoetis Revenue Forecast by Geo-Segment: 10-year CAGR of 3.8%



Source: Zoetis, BMO Capital Markets Pharmaceuticals Research.

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



Source: Zoetis, BMO Capital Markets Pharmaceuticals Research.

Exhibit 8. Our \$38/share 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		562	839	940	1,103	1,179	1,310	1,430	1,543	1,660	1,778	1,962	2,011
Y/Y Growth			1%	12%	17%	7%	11%	9%	8%	8%	7%	10%	2.5%
CAPEX		-69	-127	-125	-122	-127	-130	-132	-130	-131	-136	-131	-134
Interest Expense (1-t)		41	83	83	80	80	70	70	70	70	70	41	41
Free Cash Flow to the Firm (FCFF)		534	794	898	1,061	1,131	1,250	1,367	1,482	1,598	1,711	1,871	1,918
Discount Period		0.0	1.0	2.0	3.0	4.0	5.0	6.0	7.0	8.0	9.0	10.0	11.0
Discount Rate		8.3%											
Discounted FCFF		534	733	765	836	822	839	847	848	844	835	843	
PV of FCFE (2013-2023) Terminal Value at 2023 PV of Terminal Value Cash & Equivalents Total Debt Funding obligation for pension & post retirement benefit plans Total Equity Value Minority Interest Total Zoetis Stockholders' Equity Value Diluted shares, MM Equity value per current PFE share	Total, \$MM	Our 2014-2023 operating cash flow forecast CAGR is 10% Terminal growth rate: 2.5% Accounts for nearly 60% of firm value given sustainability of business. Current outstanding debt As of 2Q13. Source: Zoetis Form 10-Q As of Q3'13											
	8,748												
	33,064												
	13,754												
	369												
	3,652												
	45												
	19,174												
	-23												
	19,151												
500													
\$38													
		PE Multiple Valuation Using Non-GAAP EPS											
		2012A 2013E 2014E 2015E 2016E					2013-16 EPS CAGR						
		EPS	\$1.08	\$1.38	\$1.54	\$1.77	\$1.97	12.6%					
		20	\$22	\$28	\$31	\$33	\$34						
		21	\$23	\$29	\$32	\$34	\$35						
		PEx 22	\$24	\$30	\$34	\$36	\$37						
		23	\$25	\$32	\$35	\$38	\$39						
		24	\$26	\$33	\$37	\$39	\$40						
		Discount Period	0 1 2										
		Discount rate	8.3%										

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

Zoetis Non-GAAP Income Statement: Our Quarterly Estimates

	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
Revenues	1,047	1,094	1,019	1,176	1,090	1,114	1,103	1,193	1,105	1,147	1,167	1,285
Cost of Sales	388	382	352	427	398	400	383	427	400	408	402	456
Gross Profit	659	712	667	749	692	714	720	766	705	738	765	829
Selling, Informational and Administrative Expenses	331	351	330	440	322	339	359	388	319	340	369	402
R&D Expenses	93	91	94	121	90	91	91	114	91	92	94	119
Operating Profit	235	270	243	188	280	284	270	264	295	306	302	308
Amortization of Intangible Assets	4	3	4	4	4	3	4	12	7	7	7	7
EBIT	231	267	239	184	276	281	266	252	289	300	296	301
Other (Income) / Deductions -- Net	2	2	-4	10	24	29	22	23	23	23	23	23
Income From Cont. Operations Before Provision for Taxes	229	265	243	174	252	252	244	229	266	277	273	278
(Benefit) / Provision for Taxes on Income	76	90	89	117	73	74	72	66	77	80	79	81
Net income/(loss) before allocation to non-controlling interests	153	175	154	57	179	178	172	163	189	196	194	197
Less: Income / (Loss) Attributable to Non-Controlling Interests	1	-1		0	0	0	0	1	1	1	1	1
Net Income/ (loss) Attributable to Zoetis	152	176	154	57	179	178	172	162	188	195	193	196
Earnings Per Share - Basic	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.36	\$0.34	\$0.32	\$0.38	\$0.39	\$0.39	\$0.39
Earnings Per Share - Diluted	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.36	\$0.34	\$0.32	\$0.38	\$0.39	\$0.38	\$0.39
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
Dividend per Share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.07	\$0.07	\$0.07	\$0.07	\$0.08	\$0.08	\$0.08	\$0.08

	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
Growth Rates												
Revenue growth (YOY)	7%	2%	-3%	4%	4%	2%	8%	1%	1%	3%	6%	8%
Gross Profit	7%	10%	1%	2%	5%	0%	8%	2%	2%	3%	6%	8%
Operating Income (EBIT)	31%	46%	5%	-6%	19%	5%	11%	37%	5%	7%	11%	19%
Net Income	26%	54%	5%	-54%	18%	1%	12%	184%	5%	10%	12%	21%
EPS- Diluted	26%	54%	5%	-63%	2%	16%	12%	183%	5%	10%	12%	22%
Dividend									25%	25%	25%	25%
Margins												
Gross Profit	62.9%	65.1%	65.5%	63.7%	63.5%	64.1%	65.3%	64.2%	63.8%	64.4%	65.6%	64.5%
Operating Profit	22%	25%	24%	16%	26%	25%	24%	22%	27%	27%	26%	24%
Net Income	15%	16%	15%	5%	16%	16%	16%	14%	17%	17%	17%	15%
Return Analysis												
Payout Ratio					18%	18%	19%	20%	22%	21%	21%	21%

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

Zoetis Non-GAAP Income Statement: Our Annual Estimates

Non-GAAP Income Statement, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Revenues	\$4,336	\$4,500	\$4,703	\$5,047	\$5,282	\$5,546	\$5,812	\$6,076	\$6,342	\$6,607	\$6,872	\$7,137
Cost of Sales	1,549	1,608	1,666	1,773	1,840	1,915	1,995	2,074	2,152	2,229	2,305	2,379
Gross Profit	2,787	2,892	3,037	3,274	3,442	3,631	3,817	4,002	4,190	4,378	4,568	4,758
SG&A	1,452	1,408	1,430	1,491	1,517	1,551	1,581	1,609	1,636	1,662	1,685	1,707
R&D	399	386	396	410	419	430	440	450	460	470	479	488
Operating Profit	936	1,098	1,212	1,373	1,506	1,650	1,795	1,943	2,094	2,247	2,403	2,563
Amortization of Intangible Assets	15	23	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
Other (Income) / Deductions -- Net	10	98	93	93	88	88	75	74	74	74	74	34
Income From Cont. Operations Before Provision for Taxes	911	977	1,093	1,254	1,392	1,536	1,694	1,843	1,994	2,147	2,304	2,503
(Benefit) / Provision for Taxes on Income	372	285	317	364	404	446	491	534	578	623	668	726
Effective Tax Rate	40.8%	29.2%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%
Net income/(loss) before allocation to non-controlling interests	539	692	776	891	988	1,091	1,203	1,309	1,415	1,524	1,636	1,777
Gain / (Loss) Attributable to Non-Controlling Interests	0	1	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$539	\$691	\$772	\$887	\$984	\$1,087	\$1,199	\$1,305	\$1,411	\$1,520	\$1,632	\$1,773
Earnings Per Share - Basic	\$1.08	\$1.38	\$1.54	\$1.78	\$1.98	\$2.19	\$2.42	\$2.64	\$2.87	\$3.11	\$3.35	\$3.67
Earnings Per Share - Diluted	\$1.08	\$1.38	\$1.54	\$1.77	\$1.97	\$2.18	\$2.41	\$2.63	\$2.86	\$3.09	\$3.34	\$3.65
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	494	492	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	500	499	498	496	494	492	489	486
Cash Dividend Paid per Share		\$0.26	\$0.33	\$0.39	\$0.47	\$0.54	\$0.62	\$0.68	\$0.68	\$0.71	\$0.75	\$0.75

	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Growth Rates												
Revenue	2%	4%	5%	7%	5%	5%	5%	5%	4%	4%	4%	4%
Gross Profit	5%	4%	5%	8%	5%	5%	5%	5%	5%	4%	4%	4%
Operating Profit	17%	17%	10%	13%	10%	10%	9%	8%	8%	7%	7%	7%
Net Income	7%	28%	12%	15%	11%	10%	10%	9%	8%	8%	7%	9%
EPS	7%	28%	12%	15%	11%	11%	11%	9%	9%	8%	8%	9%
Dividend per share			25%	20%	20%	15%	15%	10%	0%	5%	5%	0%
Margins												
Gross Profit	64.3%	64.3%	64.6%	64.9%	65.2%	65.5%	65.7%	65.9%	66.1%	66.3%	66.5%	66.7%
Operating Profit	22%	24%	26%	27%	29%	30%	31%	32%	33%	34%	35%	36%
Net Income	12.4%	15.3%	16.4%	17.6%	18.6%	19.6%	20.6%	21.5%	22.3%	23.0%	23.7%	24.8%
Return Analysis												
Payout Ratio		19%	21%	22%	24%	25%	26%	26%	24%	23%	22%	21%

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

Zoetis Income Statement: GAAP or Fully Reported Estimates

GAAP Income Statement, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Revenues	\$4,336	\$4,500	\$4,703	\$5,047	\$5,282	\$5,546	\$5,812	\$6,076	\$6,342	\$6,607	\$6,872	\$7,137
Cost of Sales	1,563	1,631	1,670	1,777	1,844	1,919	1,999	2,078	2,156	2,233	2,309	2,383
Gross Profit	2,773	2,869	3,033	3,270	3,438	3,627	3,813	3,998	4,186	4,374	4,564	4,754
SG&A	1,470	1,558	1,446	1,503	1,529	1,563	1,593	1,621	1,648	1,674	1,697	1,719
R&D Expenses	409	397	412	422	431	442	452	462	472	482	491	500
Amortization of Intangible Assets	64	62	66	66	66	66	66	66	66	66	66	66
Restructuring Charges & Certain Acquisition-Related Costs	135	11	32	24	24	24	24	24	24	24	24	24
Other (Income) / Deductions -- Net	-15	95	93	93	88	88	75	74	74	74	74	34
Income Before Provision for Taxes	710	746	985	1,162	1,300	1,444	1,602	1,751	1,902	2,055	2,212	2,411
(Benefit) / Provision for Taxes on Income	274	218	286	337	377	419	465	508	551	596	641	699
Net income/(loss) before allocation to non-controlling interests	436	528	699	825	923	1,025	1,137	1,243	1,350	1,459	1,570	1,712
Gain / (Loss) Attributable to Non-Controlling Interests	0	1	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$436	\$527	\$695	\$821	\$919	\$1,021	\$1,133	\$1,239	\$1,346	\$1,455	\$1,566	\$1,708
Earnings Per Share - Basic	\$0.87	\$1.05	\$1.39	\$1.65	\$1.84	\$2.06	\$2.29	\$2.51	\$2.74	\$2.98	\$3.22	\$3.53
Earnings Per Share - Diluted	\$0.87	\$1.05	\$1.39	\$1.64	\$1.84	\$2.05	\$2.28	\$2.50	\$2.72	\$2.96	\$3.20	\$3.52
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	494	492	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	500	499	498	496	494	492	489	486
Cash Dividend per Share	\$0.00	\$0.26	\$0.33	\$0.39	\$0.47	\$0.54	\$0.62	\$0.68	\$0.68	\$0.71	\$0.75	\$0.75

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	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Assets												
Cash and cash equivalents	317	797	1,323	1,913	2,195	2,839	2,779	3,471	4,185	4,940	5,681	5,167
Accounts receivable, less allowance for doubtful accounts	900	778	810	888	928	973	1,019	1,064	1,110	1,156	1,201	1,247
Inventories	1,345	1,168	1,243	1,280	1,298	1,361	1,417	1,459	1,513	1,565	1,618	1,634
Current deferred tax assets	101	92	92	92	92	92	92	92	92	92	92	92
Receivable from Pfizer Inc		212	212	212	212	212	212	212	212	212	212	212
Other current assets	201	207	210	210	210	210	210	210	210	210	210	210
Total current assets	2,864	3,255	3,890	4,595	4,935	5,689	5,730	6,509	7,323	8,175	9,014	8,562
Property, plant and equipment, less accumulated depreciation	1,241	1,259	1,258	1,247	1,234	1,220	1,203	1,180	1,149	1,112	1,074	1,024
Identifiable intangible assets, less accumulated amortization	868	803	737	671	605	539	473	407	341	275	209	143
Goodwill	985	982	982	982	982	982	982	982	982	982	982	982
Non-current deferred tax assets	216	54	54	54	54	54	54	54	54	54	54	54
Other noncurrent assets	88	68	66	65	65	65	65	65	65	65	65	65
Total Assets	6,262	6,421	6,985	7,614	7,875	8,549	8,506	9,197	9,913	10,664	11,398	10,829
Liabilities and Equity												
Current portion of allocated long-term debt	73	0	0	0	0	0	0	0	0	0	0	0
Current portion of long-term debt	0	12	0	400	0	750	0	0	0	0	1,350	0
Accounts payable	319	233	239	209	189	186	187	182	189	196	202	209
Income taxes payable	30	53	58	58	58	58	58	58	58	58	58	58
Accrued compensation and related items	194	157	159	163	165	169	171	174	177	179	182	184
Payable to Pfizer Inc.	0	297	297	297	297	297	297	297	297	297	297	297
Other current liabilities	507	469	463	462	462	462	462	462	462	462	462	462
Total current liabilities	1,123	1,221	1,215	1,590	1,172	1,922	1,176	1,174	1,183	1,192	2,551	1,210
Allocated long-term debt	509	0	0	0	0	0	0	0	0	0	0	0
Long-term debt	0	3,640	3,640	3,240	3,240	2,490	2,490	2,490	2,490	2,490	1,140	1,140
Noncurrent deferred tax liabilities	323	321	319	319	319	319	319	319	319	319	319	319
Other taxes payable	159	77	67	66	66	66	66	66	66	66	66	66
Other noncurrent liabilities	107	118	119	119	119	119	119	119	119	119	119	119
Total Liabilities	2,221	5,377	5,360	5,333	4,916	4,915	4,170	4,168	4,177	4,186	4,195	2,853
Commitments and Contingencies												
Total Equity	4,041	1,043	1,625	2,280	2,959	3,633	4,336	5,029	5,737	6,477	7,203	7,976
Total liabilities and equity	6,262	6,421	6,985	7,614	7,875	8,549	8,506	9,197	9,913	10,664	11,398	10,829

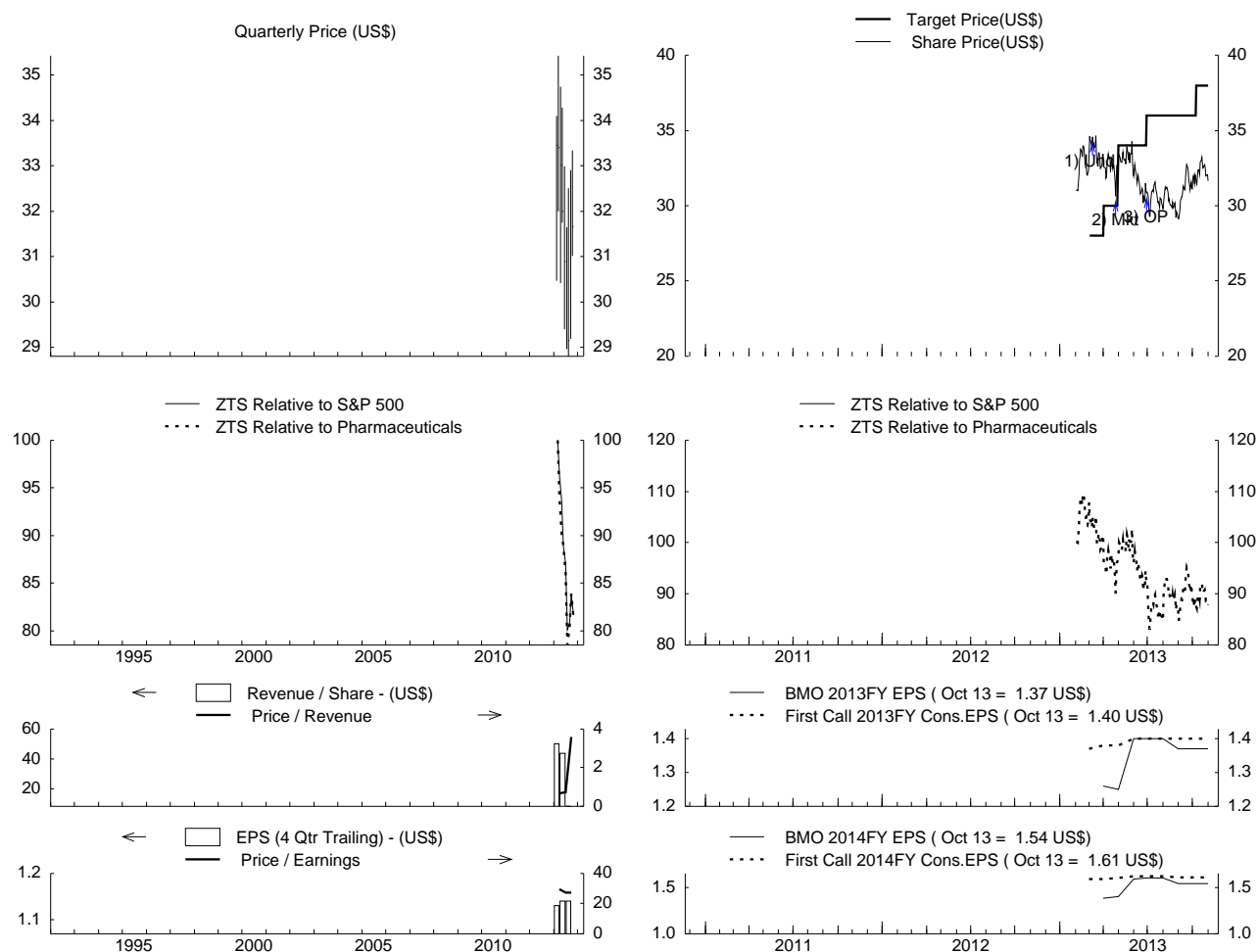
Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

Zoetis Statement of Cash Flow

Zoetis Statement of Cash Flows, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Operating activities												
GAAP Net income/(loss) before allocation to non-controlling interests	436	528	699	825	923	1,025	1,137	1,243	1,350	1,459	1,570	1,712
Adjustments:												
Depreciation and amortization expense	200	195	195	202	200	207	214	220	227	234	241	248
Share-based compensation expense	28	56	56	56	56	56	56	56	56	56	56	56
Asset write-offs and impairments	10	3	0	0	0	0	0	0	0	0	0	0
Net gains on sales of assets	0	0	0	0	0	0	0	0	0	0	0	0
Deferred taxes	-74	-6	-2	-0	-0	-0	-0	0	0	0	0	0
Other non-cash adjustments	3	-1	0	0	0	0	0	0	0	0	0	0
Other changes in assets and liabilities, net of acquisitions and divestitures:	-149	55	-109	-143	-76	-109	-97	-90	-90	-89	-89	-53
Net cash provided by operating activities	454	831	839	940	1,103	1,179	1,310	1,430	1,543	1,660	1,778	1,962
Investing Activities												
Purchases of property, plant and equipment	-126	-149	-127	-125	-122	-127	-130	-132	-130	-131	-136	-131
Net proceeds from sales of assets	3	6	0	0	0	0	0	0	0	0	0	0
Acquisitions, net of cash acquired	0	0	0	0	0	0	0	0	0	0	0	0
Other investing activities	-12	0	0	0	0	0	0	0	0	0	0	0
Net cash used in investing activities	-135	-143	-127	-125	-122	-127	-130	-132	-130	-131	-136	-131
Financing activities												
Debt - Net issuance / payment	0	2,636	-12	0	-400	0	-750	0	0	0	0	-1,350
Cash dividends paid	-63	-98	-162	-195	-233	-267	-307	-336	-335	-349	-365	-363
Purchase of subsidiary shares from noncontrolling interests	0	0	0	0	0	0	0	0	0	0	0	0
Share repurchases	0	0	-11	-31	-67	-140	-183	-270	-364	-425	-535	-632
Net financing activities with Pfizer	-15	-2,743	0	0	0	0	0	0	0	0	0	0
Net cash provided by/(used in) financing activities	-78	-205	-186	-225	-700	-407	-1,240	-606	-699	-774	-900	-2,345
Effect of exchange-rate changes on cash and cash equivalents	-3	-3	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	238	480	526	589	282	645	-60	692	714	755	741	-514
Cash and cash equivalents, as of beginning of year	79	317	797	1,323	1,913	2,195	2,839	2,779	3,471	4,185	4,940	5,681
Cash and cash equivalents, as of end of year	317	797	1,323	1,913	2,195	2,839	2,779	3,471	4,185	4,940	5,681	5,167

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

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*	1.14	27.3	0.26	0.8	23	1.6	19.5	>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 Q2/2013.

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

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

Last Price (October 31, 2013): \$31.66
Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

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Methodology: DCF and P/E Multiple

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

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Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	35.8%	20.3%	47.8%	36.7%	48.3%	52.6%
Hold	Market Perform	59.4%	13.1%	51.1%	56.9%	50.2%	41.7%
Sell	Underperform	4.9%	3.4%	1.1%	6.4%	1.5%	5.6%

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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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