

Zoetis

(ZTS-NYSE)

Stock Rating: Outperform
Industry Rating: Market Perform

We Expect an in Line 2Q, Which Would Be Positive

Event

We are publishing our 2Q13 preview for Zoetis ahead of earnings on Tuesday August 6 pre-open; conference call at 8:30 a.m. ET 866-952-1906.

Impact

We believe Zoetis is likely to meet consensus expectations. Many concerns have already been raised about this quarter, including the impact of the drought, weak parasite season, aggressive re-launch of Novartis' Sentinel, and timing of Zoetis' price increase. We believe these concerns have created a certain level of anxiety that has pressured ZTS shares since the completion of the split from Pfizer. As such, we believe that an in-line quarter would be viewed positively and should lead to a relief rally as new investors enter.

Forecasts

We analyzed the performance of other animal health businesses this quarter and conclude that a 3%-4% top-line revenue growth for Zoetis is achievable. This is in line with our forecast and current consensus of \$1.13Bn. Similarly our \$0.36 EPS forecast is in line with consensus, and we believe Zoetis could still come close to this even if revenue growth a little light (~2%). Our longer-term forecasts are somewhat below consensus, which is very bullish.

Valuation

\$36 based on DCF assuming 2.5% terminal growth rate and 8.5% discount rate, supported by 21-23x our non-GAAP 2014-2016 EPS estimates.

Recommendation

We reiterate our Outperform rating on ZTS shares and would be buyers ahead of 2Q earnings.

August 2, 2013

Pharmaceuticals

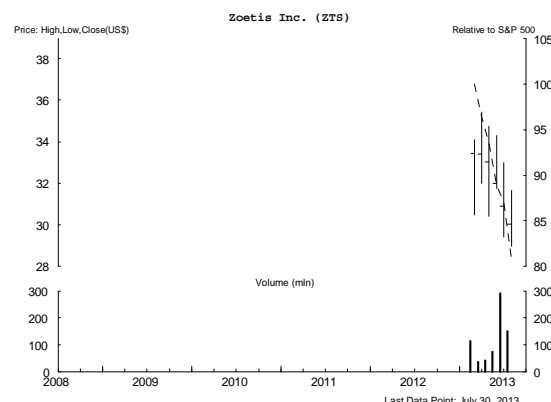
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Securities Info

Price (1-Aug)	\$30.16	Target Price	\$36
52-Wk High/Low	\$35/\$29	Dividend	\$0.26
Mkt Cap (mm)	\$15,080	Yield	0.9%
Shs O/S (mm, BASIC)	500.0	Float O/S (mm)	99.0
Options O/S (mm)	na	ADVol (30-day, 000s)	12,084

Price Performance



Valuation/Financial Data

(FY-Dec.)	2011A	2012A	2013E	2014E
EPS Pro Forma	\$1.01	\$1.08	\$1.37↓	\$1.55↓
P/E			22.0x	19.5x
First Call Cons.			\$1.40	\$1.62
EPS GAAP	\$0.49	\$0.87	\$1.07	\$1.40
FCF	\$0.72	\$0.66	\$1.48↑	\$1.41↑
P/FCF			20.4x	21.4x
EBITDA (\$mm)	\$943	\$1,142	\$1,247	\$1,407
EV/EBITDA			14.8x	13.1x
Rev. (\$mm)	\$4,233	\$4,336	\$4,473	\$4,696
EV/Rev			4.1x	3.9x
Quarterly EPS	1Q	2Q	3Q	4Q
2012A	\$0.30	\$0.35	\$0.31	\$0.11
2013E	\$0.36A	\$0.36↓	\$0.33	\$0.32↓
Balance Sheet Data (31-Mar)				
Net Debt (\$mm)	\$3,333			2.9x
Total Debt (\$mm)	\$3,650			11.5x
Net Debt/Cap.	76.5%			21.2x
		Total Debt/EBITDA		
		EBITDA/IntExp		
		Price/Book		

Notes: All values in US\$.

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

Changes

Annual EPS

2013E \$1.40 to \$1.37
 2014E \$1.60 to \$1.55

Annual FCF

2013E \$1.06 to \$1.48
 2014E \$1.38 to \$1.41

Quarterly EPS

Q2/13E \$0.38 to \$0.36
 Q4/13E \$0.33 to \$0.32

Exhibit 1. Other companies with animal health businesses have reported mixed results this quarter but those with declining sales have a good explanation; we believe 3%-4% Y/Y growth for Zoetis is achievable.

Company	Date reported	Results & Commentary:	Implications for ZTS
Novartis	7/17/2013	Double digit-growth driven by relaunch of Sentinel in North America; "strongly regaining market share". EU: mid-single-digit growth. Emerging markets delivered double-digit growth, led by Brazil, Russia, and India.	Mixed, probably net positive: relaunch of Sentinel is a negative for ZTS' Revolution, but that could be offset by mid-single-digit growth in Europe and double-digit growth in EM.
Virbac	7/18/2013	Excluding Fx and acquisitions in 2012, sales increased 1.3%, "a rebound after the slow start of the year but yet a moderate growth." Difficult economic environment in Europe and by weather conditions remaining unfavourable in many regions." Emerging markets (Latin America, India, Asia) enjoyed a significant growth, compensating for the slow down recorded in Europe and other developed countries (Japan, Australia). US stable.	Positive. Some of the slow growth is related to the decrease of sales of the CaniLeish vaccine in Southern Europe due to the built-in impact of the vaccination protocol. Also withdrew a parasiticide in the US in early April. Despite this "sales in the US were slightly up." Results indicate EM should be strong and US is stable.
Lilly (Elanco)	7/24/2013	In the US, sales grew 5% primarily due to increased demand of Trifexis. Outside the US, sales increased 7%, also driven by increased sales of companion animal products. "We saw a further stabilization in our food animal business, versus the drag that we were experiencing in Q1"	Incrementally positive for both the companion animal business and livestock; however, much of the growth was driven by a specific Lilly product and may not reflect overall market strength. "Stabilization" in livestock market is a positive.
Merck	7/30/2013	Sales increased 1% year-over-year excluding exchange driven by companion animal and poultry businesses. But also had a strong 2Q12 where they took advantage of supply issues with a competitor.	Neutral to negative. 1% operational growth despite a strong 2Q12 is not particularly positive for ZTS but Merck's business is also mostly livestock.
Bayer	7/31/2013	Grew 2.5% y/y. Tick and worm control products receded as a consequence of unfavorable weather conditions in the United States.	Negative, but manageable and unlikely. ~2% growth is somewhat modest given recent launch of Seresto flea and tick product, but again we know this is a weak season. ZTS has a more diversified portfolio. But we believe ZTS could still come close to meeting current 2Q EPS consensus with 2.5% revenue growth, and would not need to lower guidance.
Sanofi (Merial)	8/1/2013	Overall, animal health was down 5.7% but up 11% in Emerging markets driven by vaccines. Production animals (i.e. livestock) grew 11% in emerging markets. "Animal Health is going to be broadly in line with the first half as we go into the second half".	Neutral to positive. 5.7% y/y decline not too relevant for ZTS since it was driven by generic competition for their biggest product, the anti-parasiticide Frontline. Nonetheless, this is a weak season for fleas and ticks. The 11% growth in EM driven by vaccines is encouraging. Vaccines account for 26% of ZTS revenues. EM also accounts for roughly 27% of ZTS revenues. We also forecast that 2H13 will be similar to 1H.

Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Exhibit 2. Zoetis 2Q13 Overview: Our forecasts are closely in line with consensus; we believe that a 3%-4% Y/Y revenue growth is achievable

	Q2'13			Q2'12	Y/Y Change (Cons.)	Y/Y Change (BMO)
	Consensus	BMO	BMO vs. Cons.			
Revenues	\$1,131	\$1,134	0.3%	\$1,094	3.4%	3.7%
Gross Profit	\$727	\$741	2%	\$712	2.2%	4.1%
Gross Margin	64.3%	65.4%	1%	65.1%	-0.8%	0.3%
SG&A		\$363		\$351		3.4%
Research & Development		\$96		\$91		5.5%
Operating Profit	\$283	\$282	0%	\$270	4.7%	4.4%
Taxes	\$73	\$73	0%	\$90	-18.6%	-18.9%
Effective Tax Rate	29.0%	29.0%	0%	34.0%	-4.9%	-5.0%
Net Income	\$179	\$178	-1%	\$176	1.8%	1.1%
EPS	\$0.36	\$0.36	1%	\$0.35	1.7%	2.9%

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

Exhibit 3. Zoetis should meet 2013 guidance; given how diversified the business is, we see limited risk of lowering and/or missing guidance

2013 Guidance & Date Provided	Apr. 30, 2013 (after 1Q 2013)	BMO	Street	Comments
Revenue	\$4,425 mn to \$4,525 mn	\$4,473 mn	\$4,512 mn	We're in the lower half.
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	\$1,405 mn		Will increase throughout 2013, but at a slower rate than revenues.
R&D Expenses	\$385 mn to \$415 mn	\$390 mn		We're in the lower half. 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%	29.6%	We're slightly below.
Adjusted Net Income	\$680 mn to \$710 mn	\$685 mn	\$700 mn	We're on the lower end.
Adjusted Diluted EPS	\$1.36 to \$1.42	\$1.37	\$1.40	We're on the lower end of guidance, but believe it is achievable.

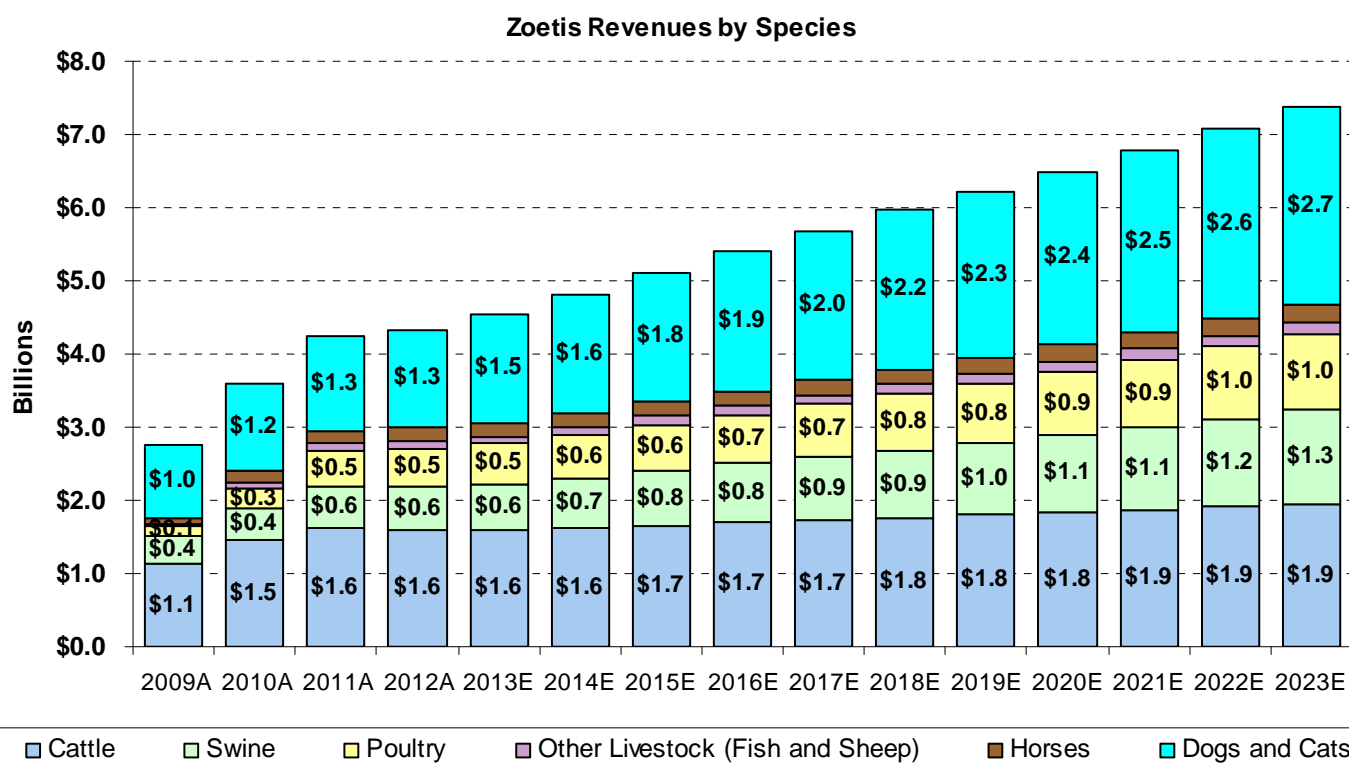
Source: Zoetis Reports, Thomson One, BMO Capital Markets Pharmaceuticals Research

Exhibit 4. We're still more cautious than the Street, which is overwhelmingly bullish (13 Buys, 3 Holds, 0 Sells)

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Street	BMO	Street	BMO	Street	BMO	Street	BMO
Revenue	\$4,512	\$4,473	\$4,780	\$4,696	\$5,050	\$4,993	\$5,326	\$5,250
Gross Margin	64.5%	64.6%	65.3%	64.9%	65.6%	65.2%	65.8%	65.5%
Operating Profit (EBIT)	\$1,102	\$1,096	\$1,260	\$1,216	\$1,404	\$1,363	\$1,526	\$1,503
Operating Margin	24%	24%	26%	26%	28%	27%	29%	29%
Pre-tax Profit	994	969	1,150	1,097	1,290	1,245	1,424	1,389
Effective Tax Rate	30%	29%	29%	29%	29%	29%	29%	29%
Net Income	\$700	\$685	\$811	\$775	\$914	\$880	\$1,012	\$982
Net Margin	16%	15%	17%	17%	18%	18%	19%	19%
EPS	\$1.40	\$1.37	\$1.62	\$1.55	\$1.81	\$1.76	\$2.01	\$1.97
Free Cash Flow per Share	\$1.26	\$1.48	\$1.53	\$1.41	\$1.78	\$1.59	\$1.97	\$1.90
Dividend per share	\$0.26	\$0.26	\$0.32	\$0.33	\$0.37	\$0.39	\$0.54	\$0.47
Dividend Payout Ratio	19%	19%	20%	21%	20%	22%	27%	24%

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

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



Source: Zoetis, BMO Capital Markets.

Exhibit 6. Our Zoetis Revenue Forecast by Geographic Segment: 10-Year CAGR of 4.3%

(NOTE: Our model uses the average of our revenue forecast by species and geographic segment)

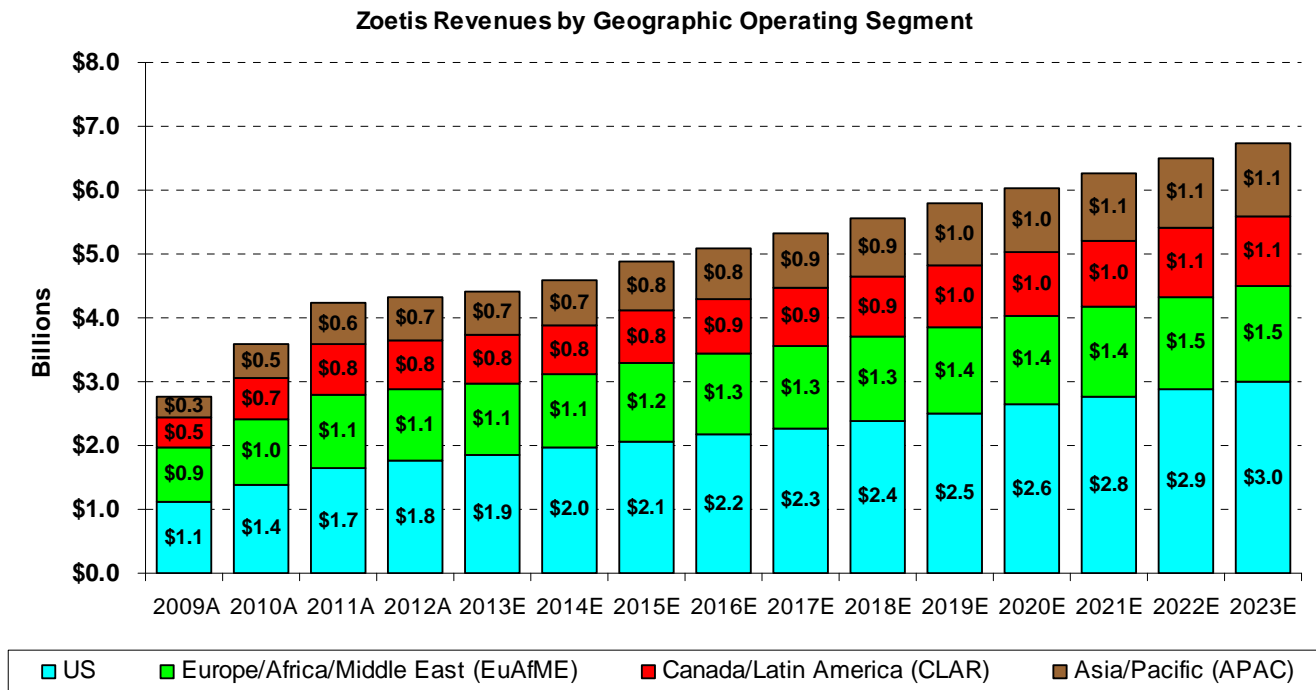
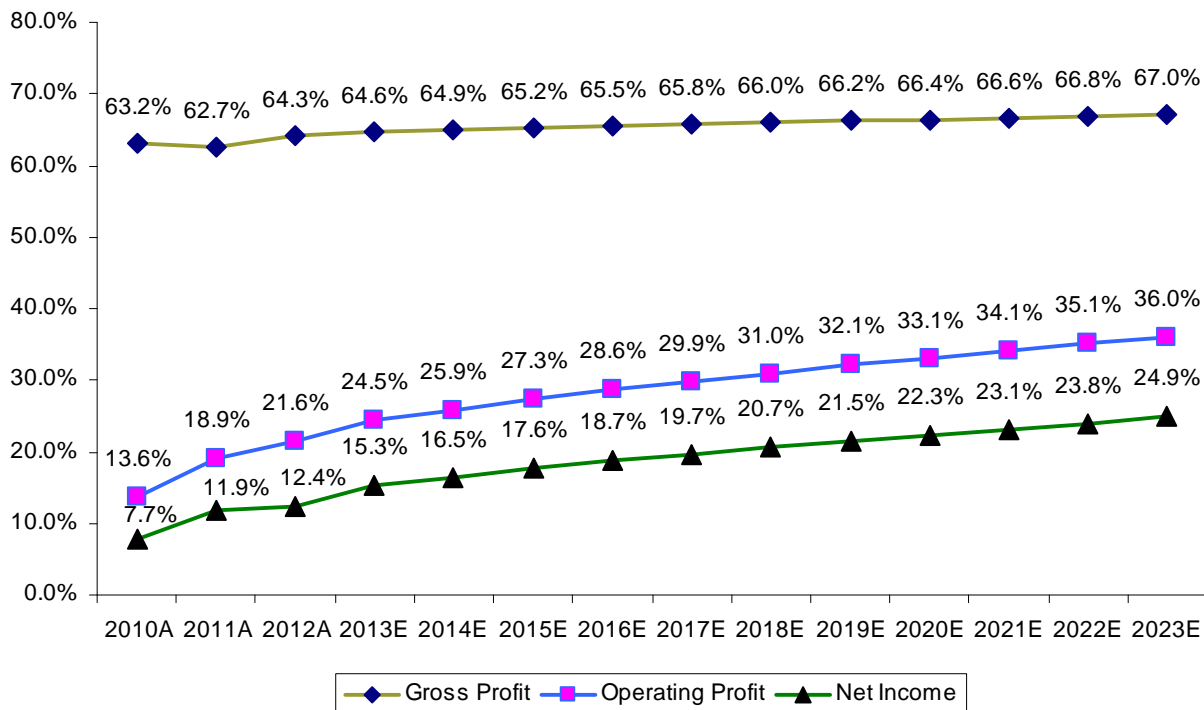


Exhibit 7. We expect Zoetis' margins to improve overtime, driven by product mix and improved operational efficiency as SG&A and R&D should grow at a slower rate than revenues



Source: Zoetis, BMO Capital Markets.

Our Zoetis Valuation

We value ZTS shares using a DCF model and support it by using P/E multiple. In our DCF, we assume a 2.5% terminal growth rate because of 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 21x-23x multiple, which is on the top range of that seen with other roughly similar companies, to our new 2014-2016E non-GAAP EPS estimates produces an average valuation of \$36, 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		578	832	919	1,070	1,157	1,285	1,401	1,509	1,623	1,738	1,921	1,969
Y/Y Growth			-3%	10%	16%	8%	11%	9%	8%	8%	7%	11%	2.5%
CAPEX		(96)	(126)	(123)	(120)	(125)	(128)	(130)	(128)	(129)	(135)	(130)	(132)
Interest Expense (1-t)		63	83	83	80	80	70	70	70	70	70	41	41
Free Cash Flow to the Firm (FCFF)		545	789	879	1,030	1,111	1,227	1,340	1,450	1,563	1,673	1,833	1,878
Discount Period		0.3	1.3	2.3	3.3	4.3	5.3	6.3	7.3	8.3	9.3	10.3	11.3
Discount Rate		8.5%											
Discounted FCFF		534	713	732	791	787	802	807	805	800	790	798	
Total, \$MM													
PV of FCFE (2013-2023)	8,360	Terminal growth rate: 2.5%											
Terminal Value at 2023	31,563												
PV of Terminal Value	12,672	Accounts for nearly 60% of firm value given sustainability of business.											
Cash & Equivalents	468												
Total Debt	3,646	Current outstanding debt											
Funding obligation for pension & post retirement benefit plans	52	As of 1Q13.											
Total Equity Value	17,802												
Minority Interest	(15)	Source: Zoetis Form 10-K											
Total Zoetis Stockholders' Equity Value	17,787												
Diluted shares, MM	500	Post split-off from Pfizer											
Equity value per current PFE share	\$36												

PE Multiple Valuation Using Non-GAAP EPS

		2012A	2013E	2014E	2015E	2016E	2013-16 EPS CAGR
EPS		\$1.08	\$1.37	\$1.55	\$1.76	\$1.97	
PEx	20	\$22	\$27	\$31	\$32	\$33	12.8%
	21	\$23	\$29	\$33	\$34	\$35	
	22	\$24	\$30	\$34	\$36	\$37	
	23	\$25	\$31	\$36	\$37	\$38	
	24	\$26	\$33	\$37	\$39	\$40	
Discount Period		0 1 2					
Discount rate		8.5%					
Average		\$36					

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

Zoetis Non-GAAP Income Statement: Our Quarterly Estimates

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	1,134	1,048	1,201	1,124	1,182	1,109	1,281
Cost of Sales	388	382	352	427	398	393	359	432	407	406	376	457
Gross Profit	659	712	667	749	692	741	689	768	717	776	732	823
Selling, Informational and Administrative Expenses	331	351	330	440	322	363	330	390	324	369	339	401
R&D Expenses	93	91	94	121	90	96	89	115	92	99	91	119
Operating Profit	235	270	243	188	280	282	270	263	301	309	302	304
Amortization of Intangible Assets	4	3	4	4	4	8	11	12	7	7	7	7
EBIT	231	267	239	184	276	275	260	252	295	303	295	297
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	252	237	228	272	279	272	274
(Benefit) / Provision for Taxes on Income	76	90	89	117	73	73	69	66	79	81	79	79
Net income/(loss) before allocation to non-controlling interests	153	175	154	57	179	179	168	162	193	198	193	195
Less: Income / (Loss) Attributable to Non-Controlling Interests	1	(1)		0	0	1	1	1	1	1	1	1
Net Income/ (loss) Attributable to Zoetis	152	176	154	57	179	178	167	161	192	197	192	194
Earnings Per Share - Basic	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.36	\$0.33	\$0.32	\$0.38	\$0.40	\$0.39	\$0.39
Earnings Per Share - Diluted	\$0.30	\$0.35	\$0.31	\$0.11	\$0.36	\$0.36	\$0.33	\$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%	4%	3%	2%	3%	4%	6%	7%
Gross Profit	7%	10%	1%	2%	5%	4%	3%	3%	4%	5%	6%	7%
Operating Income (EBIT)	31%	46%	5%	-6%	19%	3%	9%	37%	7%	10%	14%	18%
Net Income	26%	54%	5%	-54%	18%	1%	8%	183%	7%	11%	15%	20%
EPS- Diluted	26%	54%	5%	-63%	2%	15%	8%	183%	7%	11%	15%	20%
Dividend									25%	25%	25%	25%
Margins												
Gross Profit	63%	65%	65%	64%	63%	65%	66%	64%	64%	66%	66%	64%
Operating Profit	22%	25%	24%	16%	26%	25%	26%	22%	27%	26%	27%	24%
Net Income	15%	16%	15%	5%	16%	16%	16%	13%	17%	17%	17%	15%
Return Analysis												
Payout Ratio					18%	18%	19%	20%	21%	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	\$4,473	\$4,696	\$4,993	\$5,250	\$5,503	\$5,756	\$6,003	\$6,260	\$6,517	\$6,783	\$7,051
Cost of Sales	1,549	1,582	1,646	1,736	1,809	1,880	1,955	2,027	2,101	2,174	2,249	2,324
Gross Profit	2,787	2,891	3,049	3,257	3,441	3,623	3,801	3,976	4,159	4,343	4,533	4,727
SG&A	1,452	1,405	1,433	1,481	1,514	1,546	1,573	1,597	1,623	1,647	1,672	1,696
R&D	399	390	400	413	423	434	444	453	463	472	482	491
Operating Profit	936	1,096	1,216	1,363	1,503	1,644	1,784	1,926	2,073	2,223	2,379	2,540
Amortization of Intangible Assets	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
Other (Income) / Deductions -- Net	10	93	93	93	88	88	75	74	74	74	74	34
Income From Cont. Operations Before Provision for Taxes	911	969	1,097	1,245	1,389	1,530	1,683	1,826	1,973	2,123	2,280	2,480
(Benefit) / Provision for Taxes on Income	372	281	318	361	403	444	488	530	572	616	661	719
Effective Tax Rate	40.8%	29.0%	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	688	779	884	986	1,086	1,195	1,297	1,401	1,507	1,618	1,761
Gain / (Loss) Attributable to Non-Controlling Interests	0	3	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$539	\$685	\$775	\$880	\$982	\$1,082	\$1,191	\$1,293	\$1,397	\$1,503	\$1,614	\$1,757
Earnings Per Share - Basic	\$1.08	\$1.37	\$1.55	\$1.76	\$1.97	\$2.18	\$2.40	\$2.62	\$2.84	\$3.08	\$3.32	\$3.64
Earnings Per Share - Diluted	\$1.08	\$1.37	\$1.55	\$1.76	\$1.97	\$2.17	\$2.39	\$2.61	\$2.83	\$3.06	\$3.30	\$3.62
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	493	491	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	499	499	497	496	494	491	489	485
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%	3%	5%	6%	5%	5%	5%	4%	4%	4%	4%	4%
Gross Profit	5%	4%	5%	7%	6%	5%	5%	5%	5%	4%	4%	4%
Operating Profit	17%	17%	11%	12%	10%	9%	9%	8%	8%	7%	7%	7%
Net Income	7%	27%	13%	13%	12%	10%	10%	9%	8%	8%	7%	9%
EPS	7%	27%	13%	14%	12%	10%	10%	9%	9%	8%	8%	10%
Dividend per share			25%	20%	20%	15%	15%	10%	0%	5%	5%	0%
Margins												
Gross Profit	64.3%	64.6%	64.9%	65.2%	65.5%	65.8%	66.0%	66.2%	66.4%	66.6%	66.8%	67.0%
Operating Profit	22%	24%	26%	27%	29%	30%	31%	32%	33%	34%	35%	36%
Net Income	12.4%	15.3%	16.5%	17.6%	18.7%	19.7%	20.7%	21.5%	22.3%	23.1%	23.8%	24.9%
Return Analysis												
Payout Ratio		19%	21%	22%	24%	25%	26%	26%	24%	23%	23%	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	\$4,473	\$4,696	\$4,993	\$5,250	\$5,503	\$5,756	\$6,003	\$6,260	\$6,517	\$6,783	\$7,051
Cost of Sales	1,563	1,589	1,650	1,740	1,813	1,884	1,959	2,031	2,105	2,178	2,253	2,328
Gross Profit	2,773	2,884	3,045	3,253	3,437	3,619	3,797	3,972	4,155	4,339	4,529	4,723
SG&A	1,470	1,495	1,449	1,493	1,526	1,558	1,585	1,609	1,635	1,659	1,684	1,708
R&D Expenses	409	405	416	425	435	446	456	465	475	484	494	503
Amortization of Intangible Assets	64	65	66	66	66	66	66	66	66	66	66	66
Restructuring Charges & Certain Acquisition-Related Costs	135	70	32	24	24	24	24	24	24	24	24	24
Other (Income) / Deductions -- Net	(15)	96	93	93	88	88	75	74	74	74	74	34
Income Before Provision for Taxes	710	753	989	1,153	1,297	1,438	1,591	1,734	1,881	2,031	2,188	2,388
(Benefit) / Provision for Taxes on Income	274	215	287	334	376	417	461	503	546	589	634	693
Net income/(loss) before allocation to non-controlling interests	436	538	702	818	921	1,021	1,130	1,231	1,336	1,442	1,553	1,695
Gain / (Loss) Attributable to Non-Controlling Interests	0	3	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$436	\$535	\$698	\$814	\$917	\$1,017	\$1,126	\$1,227	\$1,332	\$1,438	\$1,549	\$1,691
Earnings Per Share - Basic	\$0.87	\$1.07	\$1.40	\$1.63	\$1.84	\$2.05	\$2.27	\$2.49	\$2.71	\$2.95	\$3.19	\$3.50
Earnings Per Share - Diluted	\$0.87	\$1.07	\$1.40	\$1.63	\$1.84	\$2.04	\$2.26	\$2.47	\$2.70	\$2.93	\$3.17	\$3.48
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	493	491	488	486	483
Weighted-Average Shares - Diluted	500	500	500	500	499	499	497	496	494	491	489	485
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	820	1,347	1,918	2,168	2,793	2,710	3,376	4,058	4,778	5,481	4,928
Accounts receivable, less allowance for doubtful accounts	900	783	808	882	926	970	1,014	1,057	1,101	1,146	1,192	1,239
Inventories	1,345	1,183	1,246	1,278	1,303	1,364	1,417	1,457	1,509	1,561	1,615	1,633
Current deferred tax assets	101	83	83	83	83	83	83	83	83	83	83	83
Receivable from Pfizer Inc		222	222	222	222	222	222	222	222	222	222	222
Other current assets	201	202	203	204	204	204	204	204	204	204	204	204
Total current assets	2,864	3,293	3,909	4,586	4,907	5,636	5,650	6,398	7,177	7,994	8,797	8,309
Property, plant and equipment, less accumulated depreciation	1,241	1,243	1,241	1,231	1,218	1,204	1,187	1,165	1,134	1,098	1,060	1,010
Identifiable intangible assets, less accumulated amortization	868	806	740	674	608	542	476	410	344	278	212	146
Goodwill	985	985	985	985	985	985	985	985	985	985	985	985
Non-current deferred tax assets	216	63	63	63	63	63	63	63	63	63	63	63
Other noncurrent assets	88	74	73	73	73	73	73	73	73	73	73	73
Total Assets	6,262	6,463	7,010	7,611	7,853	8,503	8,433	9,093	9,776	10,490	11,189	10,586
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	6	0	400	0	750	0	0	0	0	1,350	0
Accounts payable	319	236	239	209	190	186	187	182	189	195	202	208
Income taxes payable	30	39	40	40	40	40	40	40	40	40	40	40
Accrued compensation and related items	194	158	158	162	165	168	171	173	176	178	180	183
Payable to Pfizer Inc.	0	383	383	383	383	383	383	383	383	383	383	383
Other current liabilities	507	451	440	439	438	438	438	438	438	438	438	438
Total current liabilities	1,123	1,272	1,261	1,633	1,217	1,966	1,220	1,217	1,226	1,235	2,594	1,253
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	325	324	324	324	324	324	324	324	324	324	324
Other taxes payable	159	98	92	92	92	92	92	92	92	92	92	92
Other noncurrent liabilities	107	110	109	109	109	109	109	109	109	109	109	109
Total Liabilities	2,221	5,445	5,426	5,397	4,981	4,980	4,234	4,231	4,240	4,249	4,258	2,917
Commitments and Contingencies												
Total Equity	4,041	1,019	1,584	2,214	2,872	3,523	4,199	4,862	5,536	6,241	6,931	7,669
Total liabilities and equity	6,262	6,463	7,010	7,611	7,853	8,503	8,433	9,093	9,776	10,490	11,189	10,586

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

Zoetis Statement of Cash Flows

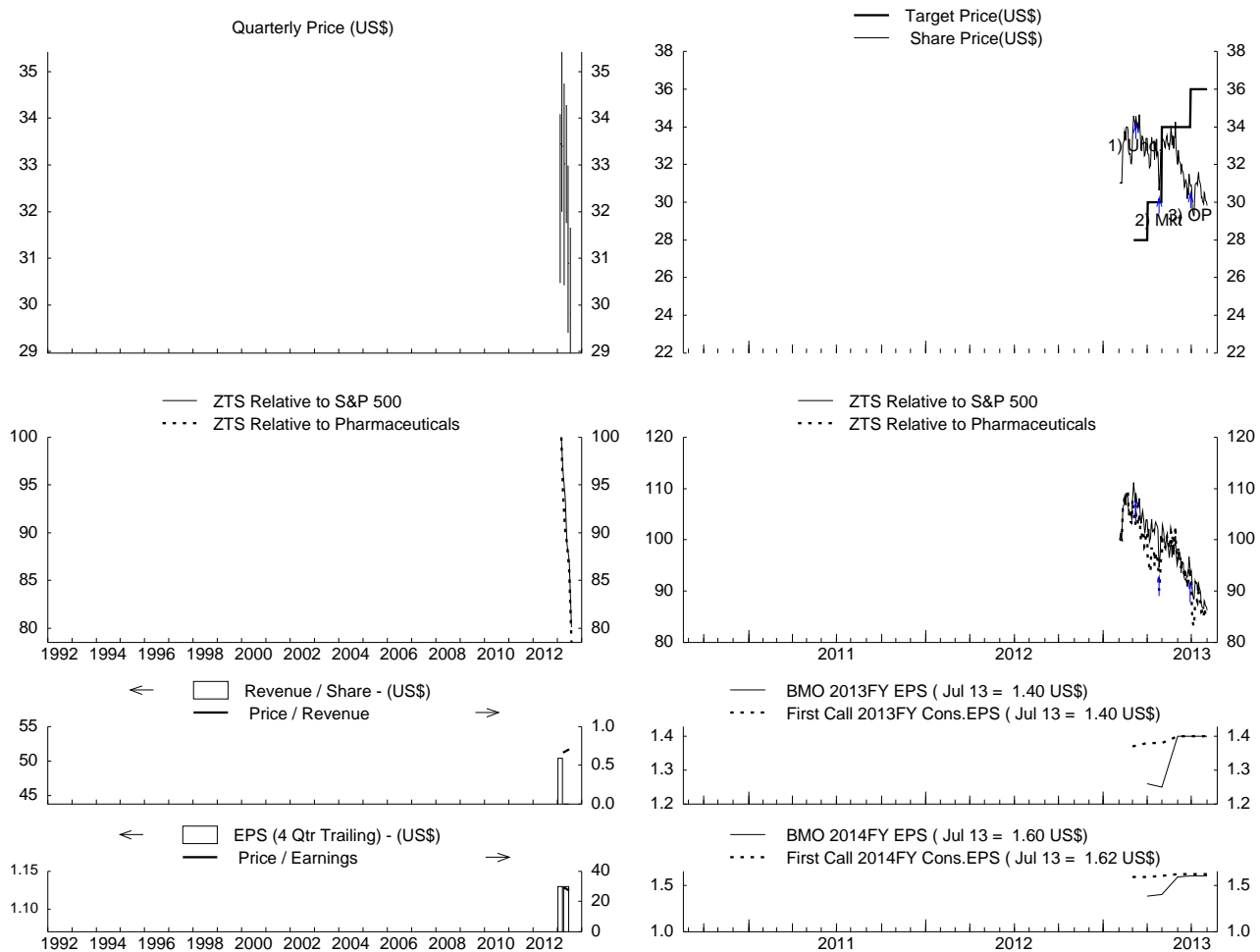
Zoetis Statement of Cash Flows, \$MM	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Operating activities												
GAAP Net income/(loss) before allocation to non-controlling interests	436	538	702	818	921	1,021	1,130	1,231	1,336	1,442	1,553	1,695
Adjustments:												
Depreciation and amortization expense	200	191	193	200	199	205	212	218	225	232	238	245
Share-based compensation expense	28	38	37	37	37	37	37	37	37	37	37	37
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)	(5)	(1)	(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)	94	(99)	(135)	(86)	(105)	(93)	(85)	(88)	(88)	(91)	(56)
Net cash provided by operating activities	454	859	832	919	1,070	1,157	1,285	1,401	1,509	1,623	1,738	1,921
Investing Activities												
Purchases of property, plant and equipment	(126)	(118)	(126)	(123)	(120)	(125)	(128)	(130)	(128)	(129)	(135)	(130)
Net proceeds from sales of assets	3	0	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)	(118)	(126)	(123)	(120)	(125)	(128)	(130)	(128)	(129)	(135)	(130)
Financing activities												
Debt - Net issuance / payment	0	2,630	(6)	0	(400)	0	(750)	0	0	0	0	(1,350)
Cash dividends paid	(63)	(130)	(162)	(195)	(233)	(267)	(307)	(336)	(335)	(349)	(365)	(362)
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)	(2,738)	0	0	0	0	0	0	0	0	0	0
Net cash provided by/(used in) financing activities	(78)	(238)	(180)	(225)	(700)	(407)	(1,240)	(605)	(698)	(774)	(900)	(2,344)
Effect of exchange-rate changes on cash and cash equivalents	(3)	0	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	238	503	527	571	251	625	(83)	665	682	720	703	(553)
Cash and cash equivalents, as of beginning of year	79	317	820	1,347	1,918	2,168	2,793	2,710	3,376	4,058	4,778	5,481
Cash and cash equivalents, as of end of year	317	820	1,347	1,918	2,168	2,793	2,710	3,376	4,058	4,778	5,481	4,928

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

Other companies mentioned (priced as of the close on August 1, 2013):

Pfizer (PFE, \$29.11, Outperform)
Novartis (NVS, \$71.98, Not Rated)
Eli Lilly (LLY, \$53.50, Market Perform)
Virbac (VIRP-FR, 146.8, Not Rated)
Merck (MRK, \$48.58, Market Perform)
Bayer AG ADR (BAYRY, \$118.75, Not Rated)
Sanofi ADR (SNY, \$51.08, Not Rated)

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	27.3	0.26	0.8	23	1.4	21.8	>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

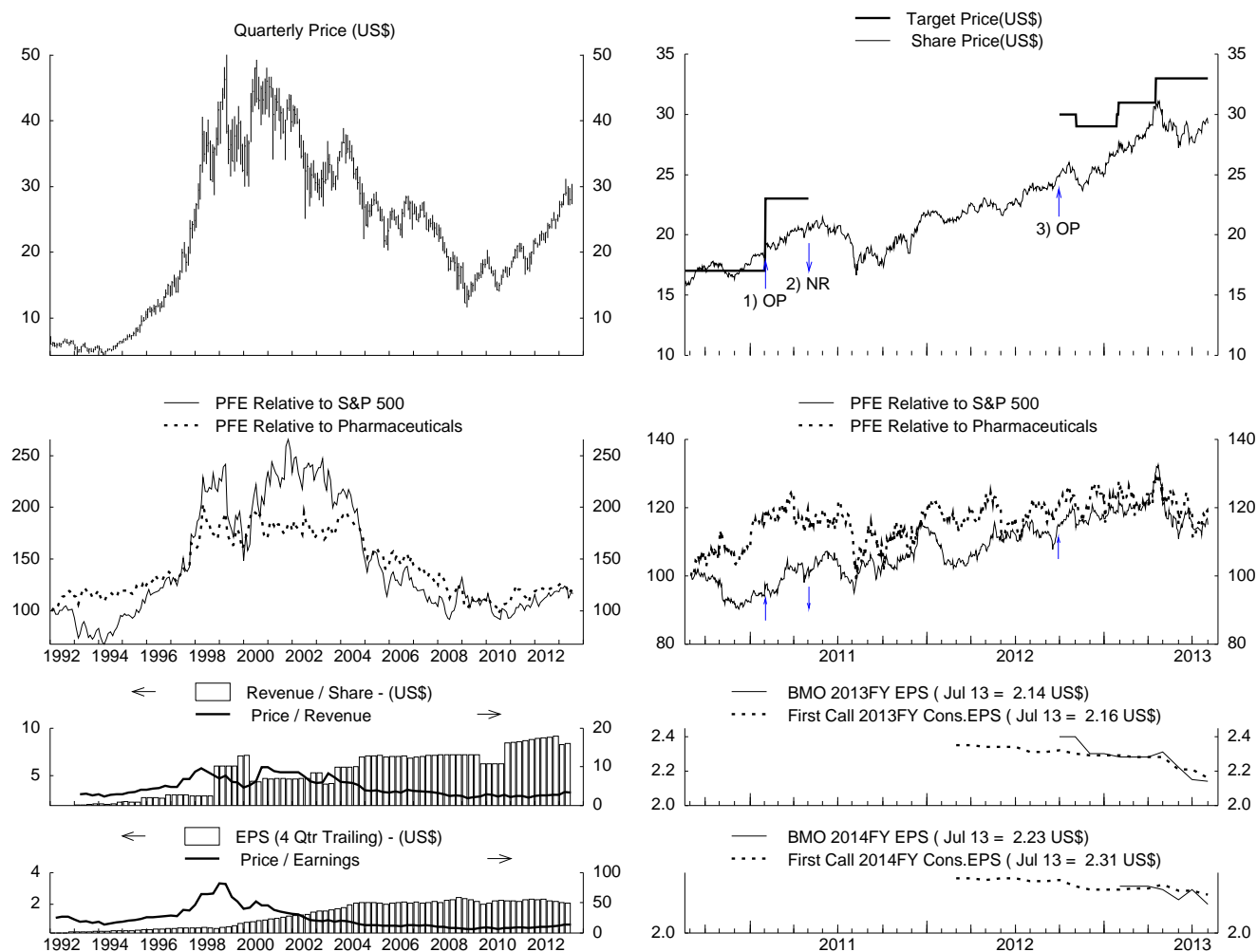
* Current EPS is the 4 Quarter Trailing to Q1/2013.

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

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

Last Price (July 31, 2013): \$29.81
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	13.5	0.96	3.4	46	11.6	2.4	18
Growth(%):								
5 Year:	-1.7		-5.6			3.8		
10 Year:	2.7		4.8			13.6		
20 Year:	10.3		10.1			12.5		

PFE - Rating as of 20-Aug-10 = Mkt

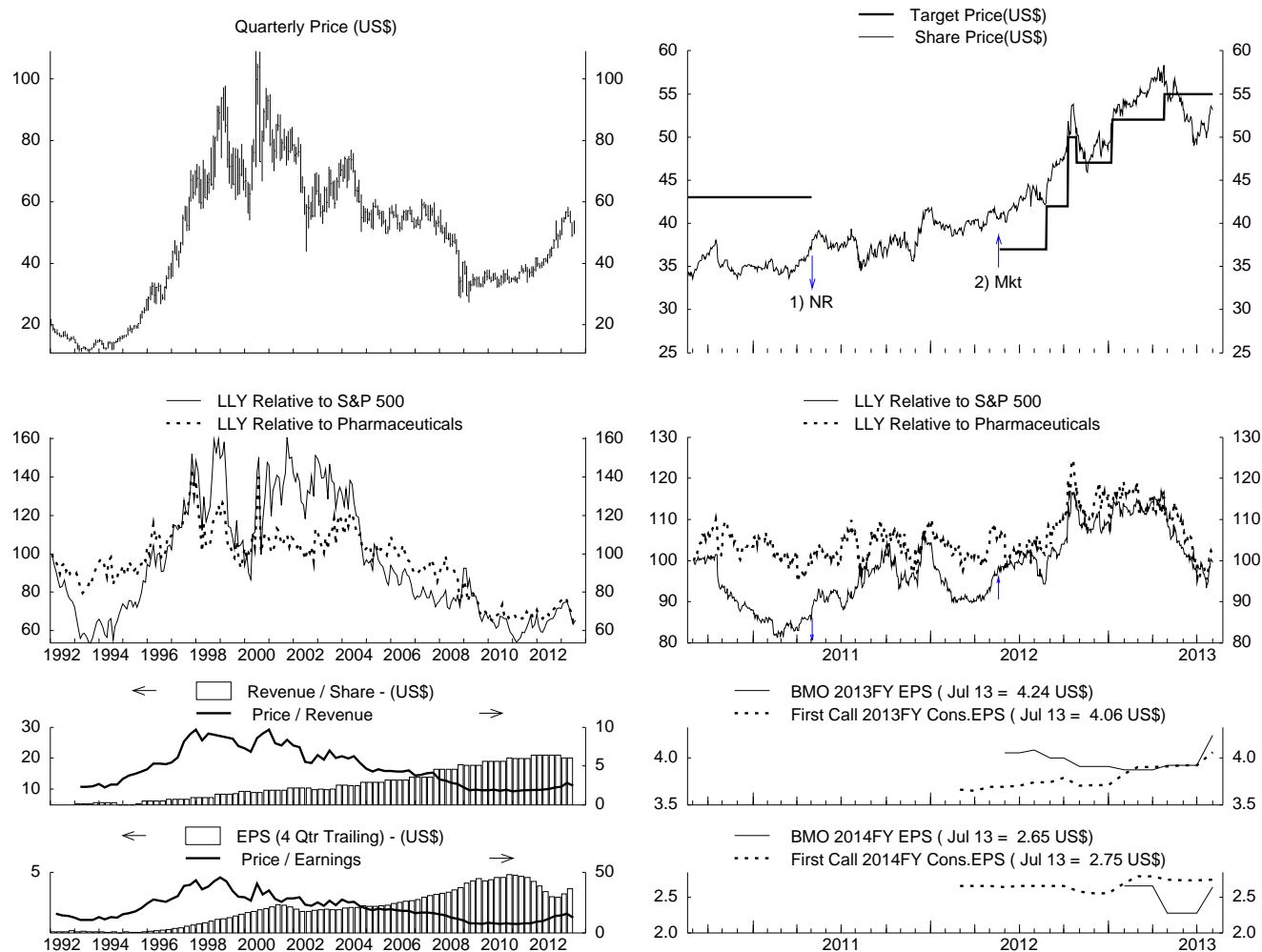
Date	Rating Change	Share Price
1 2-Feb-11	Mkt to OP	\$18.96
2 3-May-11	OP to NR	\$20.44
3 27-Sep-12	NR to OP	\$24.96

* 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 (July 31, 2013): \$29.23

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

Eli Lilly & Co. (LLY)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %
1992	1.22	18.0 11.8	0.55	3.8 2.5	45	4.2	5.2 3.5	
1993	1.15	14.2 9.5	0.63	5.7 3.8	54	3.9	4.2 2.8	28
1994	1.10	15.1 10.7	0.65	5.5 3.9	59	4.6	3.6 2.6	26
1995	1.15	24.8 13.2	0.69	4.5 2.4	60	4.9	5.8 3.1	24
1996	1.30	30.9 18.8	0.72	3.0 1.8	55	5.5	7.3 4.4	25
1997	1.60	44.0 21.9	0.80	2.3 1.1	50	4.2	>15 8.4	33
1998	1.93	47.3 29.9	0.92	1.6 1.0	48	4.0	>15 14.3	47
1999	2.28	42.9 26.6	1.04	1.7 1.1	46	4.6	>15 13.2	>50
2000	2.65	41.1 20.4	1.12	2.1 1.0	42	5.4	>15 10.1	>50
2001	2.76	34.4 25.4	1.24	1.8 1.3	45	6.3	>15 11.1	47
2002	2.55	33.1 17.2	1.34	3.1 1.6	53	7.4	11.4 5.9	37
2003	2.58	28.6 20.5	1.42	2.7 1.9	55	8.7	8.5 6.1	32
2004	2.82	27.3 17.9	1.52	3.0 2.0	54	9.7	8.0 5.2	31
2005	2.88	21.2 17.2	1.60	3.2 2.6	56	9.6	6.4 5.2	30
2006	3.18	18.6 15.8	1.70	3.4 2.9	53	9.7	6.1 5.2	33
2007	3.55	17.2 13.8	1.88	3.8 3.1	53	12.1	5.1 4.1	33
2008	4.02	14.3 7.1	1.96	6.8 3.4	49	5.9	9.7 4.8	45
2009	4.43	9.2 6.1	1.96	7.2 4.8	44	8.3	4.9 3.3	>50
2010	4.74	8.0 6.8	1.96	6.1 5.1	41	10.8	3.5 3.0	50
2011	4.41	9.5 7.6	1.96	5.9 4.7	44	11.7	3.6 2.9	39
2012	3.39	15.9 11.0	1.96	5.3 3.6	58	12.9	4.2 2.9	28
Range*		47.3 6.1		7.2 1.0			>15 2.6	
Current*	3.94	12.5	1.96	4.0	50	13.3	3.7	30
Growth(%):								
5 Year:	1.2		0.8			1.9		
10 Year:	4.2		3.9			6.1		
20 Year:	6.3		6.1			5.9		

LLY - Rating as of 20-Aug-10 = OP

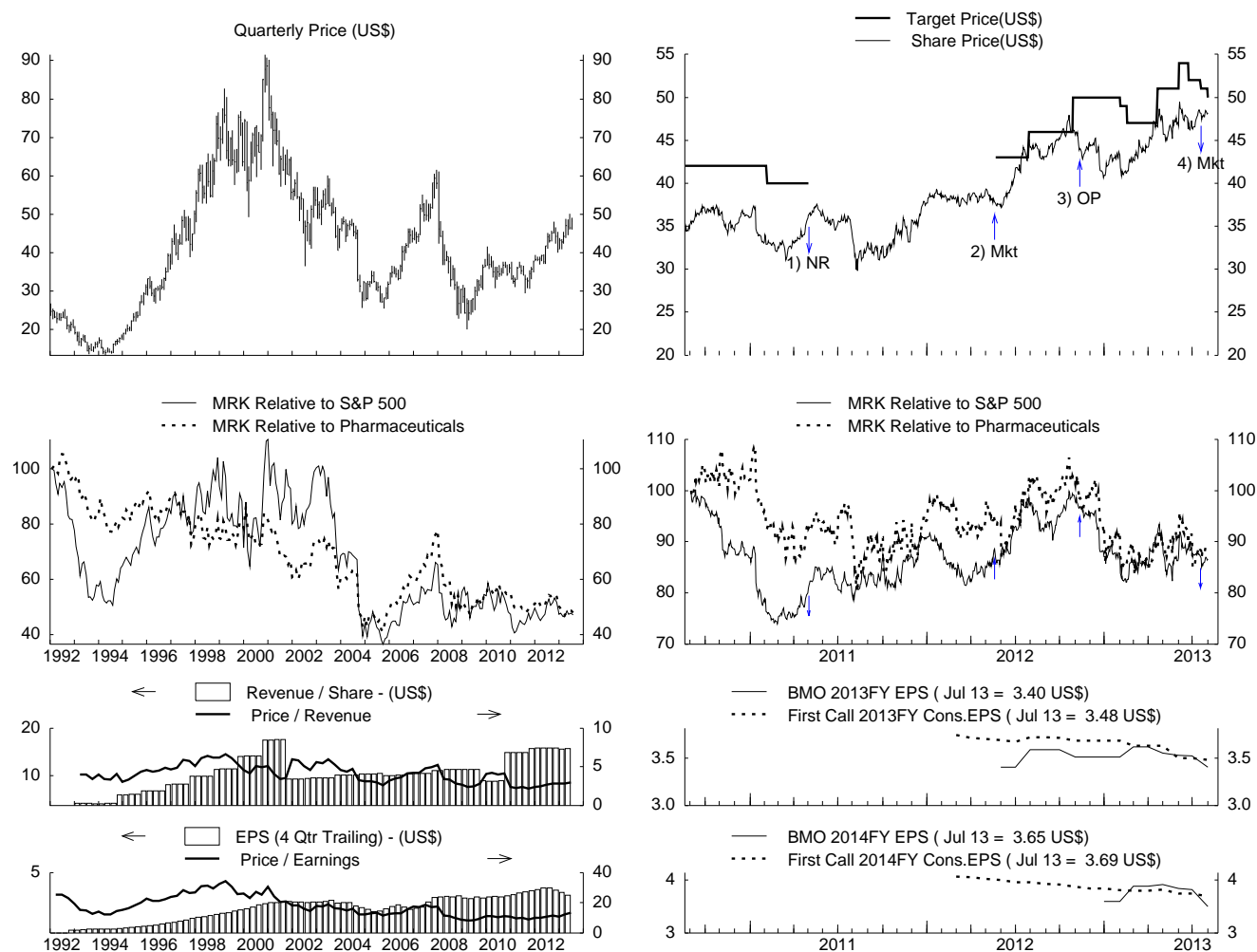
Date	Rating Change	Share Price
1 3-May-11	OP to NR	\$38.09
2 18-May-12	NR to Mkt	\$40.44

* 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 (July 31, 2013): \$53.11

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

Merck & Co. Inc. (MRK)



FYE (Dec.)	EPS US\$	P/E Hi - Lo		DPS US\$	Yield% Hi - Lo		Payout %	BV US\$	P/B Hi - Lo		ROE %
1992	1.06	25.3	18.1	0.45	2.4	1.7	43	2.2	12.2	8.8	
1993	1.17	19.3	11.6	0.53	3.9	2.3	45	4.0	5.6	3.4	38
1994	1.19	15.7	11.2	0.57	4.3	3.0	48	4.5	4.2	3.0	28
1995	1.35	23.6	12.8	0.64	3.7	2.0	48	4.8	6.7	3.6	29
1996	1.56	25.6	17.1	0.76	2.8	1.9	49	5.0	8.0	5.4	32
1997	1.87	27.4	19.0	0.85	2.4	1.7	46	5.3	9.7	6.7	37
1998	2.15	35.6	20.9	1.02	2.3	1.3	48	5.4	14.1	8.3	40
1999	2.45	33.8	23.5	1.10	1.9	1.3	45	5.7	14.5	10.1	44
2000	2.90	31.6	17.0	1.29	2.6	1.4	44	6.4	14.2	7.7	48
2001	3.04	29.9	17.7	1.33	2.5	1.5	44	7.1	12.9	7.6	45
2002	2.98	21.8	12.2	1.36	3.7	2.1	46	8.1	8.0	4.5	39
2003	2.92	20.6	13.9	1.48	3.6	2.5	51	7.0	8.6	5.8	39
2004	2.62	18.8	9.8	1.52	5.9	3.1	58	7.8	6.3	3.3	35
2005	2.53	14.0	10.1	1.52	6.0	4.3	60	8.2	4.3	3.1	32
2006	2.52	18.4	11.1	1.52	5.4	3.3	60	8.1	5.7	3.5	31
2007	3.31	18.6	12.8	1.52	3.6	2.5	46	8.4	7.4	5.1	40
2008	3.42	18.0	6.7	1.52	6.7	2.5	44	8.9	6.9	2.6	40
2009	3.26	11.8	6.2	1.52	7.6	4.0	47	19.0	2.0	1.1	23
2010	3.42	12.2	9.0	1.52	5.0	3.7	44	17.6	2.4	1.7	19
2011	3.77	10.1	7.8	1.68	5.7	4.4	45	17.9	2.1	1.6	21
2012	3.82	12.6	9.1	1.72	4.9	3.6	45	18.3	2.6	1.9	21
Range*		35.6	6.2		7.6	1.3			14.5	1.1	
Current*	3.46		13.4	1.72		3.7	50	17.6		2.6	20
Growth(%):											
5 Year:	0.4			2.5				16.0			
10 Year:	1.3			2.4				8.0			
20 Year:	5.8			6.7				11.0			

MRK - Rating as of 20-Aug-10 = OP

Date	Rating Change	Share Price
1 3-May-11	OP to NR	\$36.41
2 18-May-12	NR to Mkt	\$37.82
3 9-Nov-12	Mkt to OP	\$44.05
4 17-Jul-13	OP to Mkt	\$48.13

* 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 (July 31, 2013): \$48.17

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

Important Disclosures

Analyst's Certification

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/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.

Company Specific Disclosures for LLY

5 - BMO Capital Markets or an affiliate received compensation for products or services other than investment banking services within the past 12 months.

6C - This issuer is a client (or was a client) of BMO Capital Markets or an affiliate within the past 12 months: Non-Securities Related Services

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 and multiple of sales.

Risks: Uncertainty of Phase 3 Pipeline.

Company Specific Disclosures for MRK

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 and P/E multiple.

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.

** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.

*** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage of Investment Banking clients.

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Rating and Sector Key (as of April 5, 2013)

We use the following ratings system definitions:

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

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