

Zoetis Inc.

ZTS - BUY - November WASDE Data Supports Our Positive Investment Thesis on the Stock

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FLASH NOTE

SECTOR: Specialty Pharmaceuticals

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The USDA released its monthly WASDE (World Agriculture Supply and Demand Estimates) today. The report supports our belief that livestock expansion for poultry and swine will pick up in 2014 and cattle will pick up in 2015. This would be good for ZTS (BUY, \$31.04) because over 60% of its revenues come from livestock. The key data points that support our positive investment thesis are highlighted below.

- Corn (energy crop) production is forecast 146MM bushels higher at a record 13.989B bushels. Despite a late planted crop and July and August dryness across much of the Corn Belt, cooler-than-normal temperatures and an extended growing season have supported higher-than-expected yields for most producers. The projected season-average farm price for corn is lowered 30 cents at both ends of the range to \$4.10 to \$4.90 (down 29% to 41% YOY). Last year, the price of corn was \$6.90.
- Soybean (protein) production is projected at 3.258B bushels, up 109M, as higher yields more than offset lower harvested area. The U.S. season-average soybean price is projected at \$11.15 to \$13.15 per bushel (down 9% to 23% YOY), down \$0.35 at both ends of the range. Last year, the price of soybean was \$14.40.
- The forecasts for total red meat and poultry production for both 2013 and 2014 are lowered from September. For 2013, the beef production is nearly unchanged, as a lower third quarter estimate is largely offset by higher expected fourth quarter production. Pork production is reduced from last month based on third quarter data and a lower-than-expected pace of slaughter in October and early November.
- The broiler production forecast is lowered as higher third quarter production is more than offset by lower expected fourth quarter production. Turkey production is reduced for both the third and fourth quarters.
- For 2014, the beef production forecast is reduced slightly from September on lower placements of cattle in feedlots during 2014. We would note expectations for cattle recovery near term are modest, and the consensus view is that herd size will be down 1.0% to 1.5% when the cattle survey comes out in January 2014.
- The pork production forecast is reduced for 2014. In the September Hogs and Pigs report, producers indicated intentions to expand sows farrowing through early 2014, and increases in farrowings during 2014 will likely be supported by moderating feed costs. However, the 2014 pork production forecast has been tempered by continuing reports of porcine epidemic diarrhea (PED) outbreaks.
- Broiler production is raised as moderating feed costs support continued modest growth in broiler flocks. The turkey production forecast is reduced as turkey prices in the third quarter were weaker than expected and the contraction in production forecast for late 2013 is expected to carry into early 2014.

Potential Stock Moving Catalysts. 1) Operating margin expansion; 2) new product launches; 3) business development; 4) expansion into adjacent categories; 5) U.S. drought subsidies

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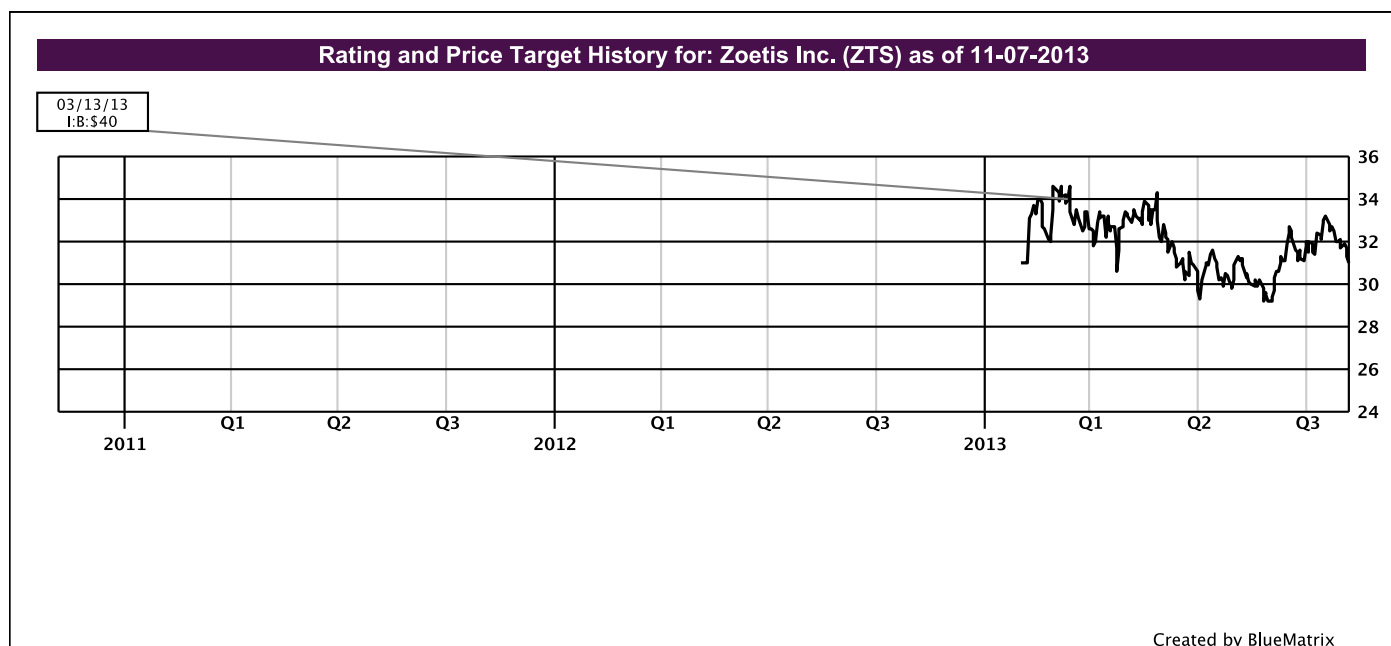
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