

Zoetis

(ZTS-NYSE)

Stock Rating: Outperform
Industry Rating: Market Perform

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3Q Should Be In Line; Increased Confidence in Margin Expansion

Event

We are publishing our 3Q13 earnings preview and updated model for Zoetis.

Impact & Analysis

We expect a closely in-line 3Q, which would be a positive for ZTS shares given bullish Street bias (13 buys, 2 holds, 0 sells). We forecast good operational revenue growth of 6.1%, driven in part by ~5% growth in livestock sales because of improving drought conditions and lower corn prices (biggest impact of drought last year was in 3Q). Our 3Q13 revenue forecast of \$1.06B is slightly (0.9%) below consensus because of 2% unfavorable FX impact, mostly from the CLAR and APAC regions. Our \$0.34 non-GAAP EPS forecast matches the current consensus estimate. Overall, Zoetis is on track to meet its 2013 guidance, although we remain on the lower half because of unfavorable FX expectations partly offsetting ~6% operational revenue growth in 2H13. Looking ahead, our 10-year revenue CAGR is 4.7%. Although we increased our 2015-2016 estimates, we remain slightly below consensus (2013-2016). Finally, following a conversation with Eli Lilly's Elanco management, we have increased confidence that Zoetis should be able to meaningfully improve its gross margin when it eventually separates manufacturing from Pfizer.

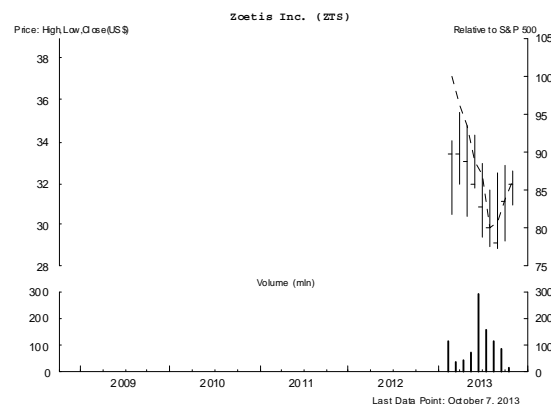
Valuation & Recommendation

We are increasing our price target from \$36/share to \$38/share based on our improved longer-term outlook. Our primary valuation method is DCF, assuming 2.5% terminal growth rate and 8.3% discount rate, supported by 23x our non-GAAP 2014-2016 EPS estimates. We believe the multiple is warranted given: (1) highly diversified revenues with low-risk macro growth drivers, (2) 2013-2016 13% EPS CAGR, (3) 2014-2023 10% operating CF CAGR. We recommend investors buy ZTS shares at current levels.

Securities Info

Price (8-Oct)	\$31.53	Target Price	\$38 ↑
52-Wk High/Low	\$35/\$29	Dividend	\$0.26
Mkt Cap (mm)	\$15,765	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)	4,236

Price Performance



Valuation/Financial Data

(FY-Dec.)	2011A	2012A	2013E	2014E
EPS Pro Forma	\$1.01	\$1.08	\$1.37	\$1.54
P/E			23.0x	20.5x
First Call Cons.			\$1.40	\$1.61
EPS GAAP	\$0.49	\$0.87	\$1.05	\$1.39
FCF	\$0.72	\$0.66	\$1.37↓	\$1.42
P/FCF			23.0x	22.2x
EBITDA (\$mm)	\$943	\$1,142	\$1,226	\$1,405
EV/EBITDA			15.2x	13.3x
Rev. (\$mm)	\$4,233	\$4,336	\$4,455	\$4,655
EV/Rev			4.2x	4.0x
Quarterly EPS	1Q	2Q	3Q	4Q
2012A	\$0.30	\$0.35	\$0.31	\$0.11
2013E	\$0.36A	\$0.36A	\$0.34↑	\$0.32↓
Balance Sheet Data (30-Jun)				
Net Debt (\$mm)	\$2,853		Total Debt/EBITDA	3.0x
Total Debt (\$mm)	\$3,652		EBITDA/IntExp	10.9x
Net Debt/Cap.	60.8%		Price/Book	19.7x

Notes: All values in US\$.

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

Changes

Annual FCF
 2013E \$1.46 to \$1.37

Quarterly EPS
 Q3/13E \$0.33 to \$0.34
 Q4/13E \$0.33 to \$0.32

Target
 \$36.00 to \$38.00

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 14 to 16.

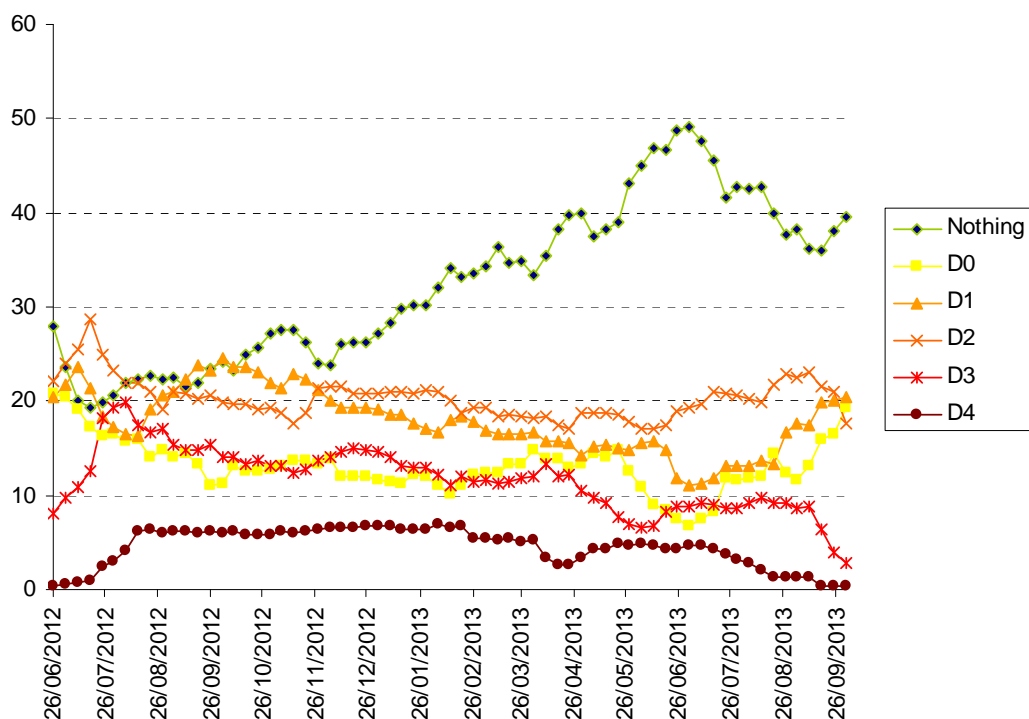
Exhibit 1. Zoetis 3Q13 Overview: We Expect a Mostly In-line Quarter, Which Would Be Positive for ZTS Shares Given Bullish Street Bias

	Q3'13			Q3'12	Y/Y Change (Cons.)	Y/Y Change (BMO)	Comments:
	Consensus	BMO	BMO vs. Cons.				
Revenues	\$1,067	\$1,057	-0.9%	\$1,019	4.7%	3.7%	We forecast 6.1% operational growth, in part driven by strong livestock sales, partly offset by ~2% unfavorable Fx mostly from CLAR and APAC regions.
Gross Profit	\$697	\$696	0%	\$667	4.5%	4.3%	In-line and consistent with FY2013 guidance.
Gross Margin	65.3%	65.8%	1%	65.5%	-0.1%	0.4%	
SG&A		\$333		\$330		0.9%	We're on the low end of FY guidance, assuming ZTS will cut spending to keep guidance within reach.
Research & Development		\$92		\$94		-2.1%	We're on the low end of FY guidance, assuming ZTS will cut spending to keep guidance within reach.
Operating Profit	\$267	\$271	2%	\$243	9.9%	11.6%	Closely in-line with consensus, we do not expect any major surprises in 3Q13.
Taxes	\$70	\$69	-1%	\$89	-21.5%	-22.6%	
Effective Tax Rate	29.2%	29.0%	0%	36.6%	-7.4%	-7.6%	
Net Income	\$169	\$169	0%	\$154	9.9%	9.7%	
EPS	\$0.34	\$0.34	0%	\$0.31	9.7%	9.7%	

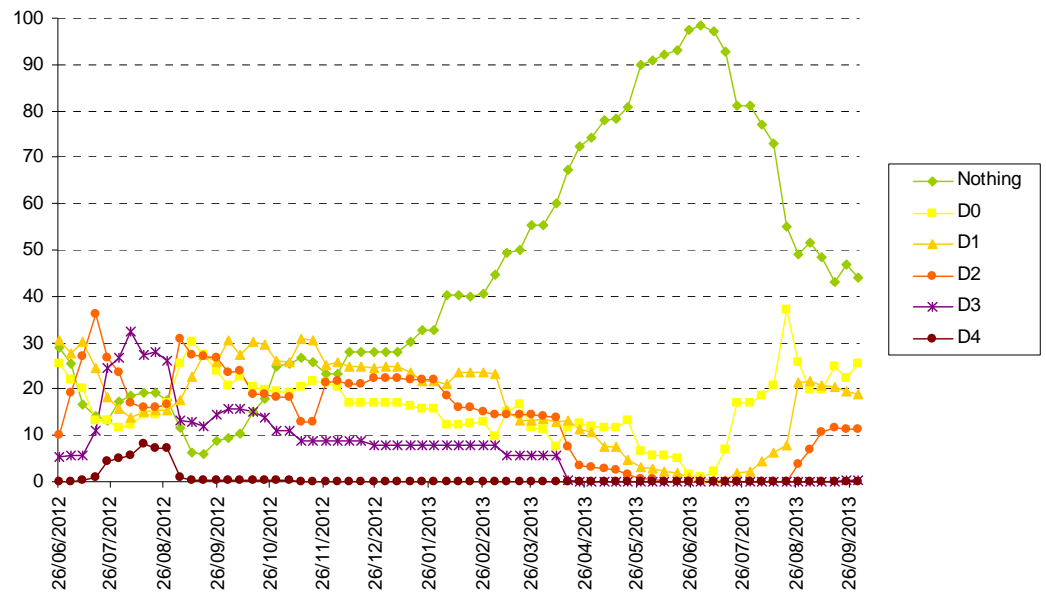
Sources: Zoetis, Bloomberg Finance LP, BMO Capital Markets Pharmaceuticals Research Estimates

Exhibit 2 (two charts): US Drought Conditions Have Improved Significantly Y/Y; Positive for Zoetis' Livestock Business

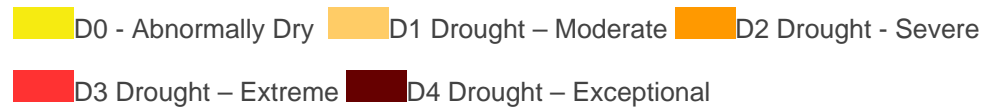
Percent Area in U.S. Drought Monitor Categories: Contiguous US



Percent Area in U.S. Drought Monitor Categories: Midwest



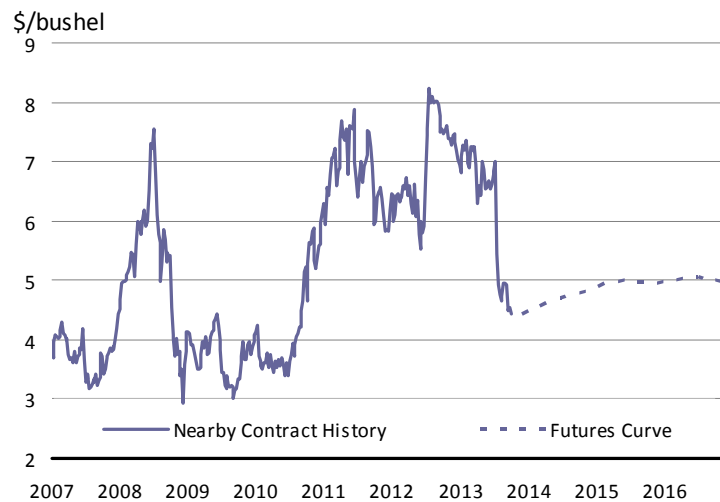
Drought Severity:



Source: US Drought Monitor as of October 1, 2013; BMO Capital Markets Pharmaceutical Research.

Exhibit 3. Corn Prices Are Below 2012 Levels, a Positive for the Livestock Industry and Zoetis

Corn Futures Prices



Source: CME Group

Exhibit 4. Following 2Q13 Earnings, Zoetis Confirmed its 2013 Guidance Partly Based on Confidence in the Improving Livestock Business. We Remain on the Lower End of Guidance Range Because of FX, But Believe It Is Achievable

2013 Guidance & Date Provided	Apr. 30, 2013 (after 1Q 2013)	Aug. 06, 2013 (after 2Q 2013)	BMO	Street	Comments
Revenue	\$4,425 mn to \$4,525 mn	\$4,425 mn to \$4,525 mn	\$4,455 mn	\$4,494 mn	We're in the lower half.
Cost of Sales as % of Revenues	35.0% to 36.0%	35.0% to 36.0%	35.6%	35.5%	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	\$1,382 mn		Zoetis guided that SG&A should increase throughout 2013, but at a slower rate than revenues. We're on the low end, because 1) lower promotion in Europe related to slow tick season, 2) management will likely cut spending to meet guidance.
R&D Expenses	\$385 mn to \$415 mn	\$385 mn to \$415 mn	\$387 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	\$112 mn		We're in-line
Other (Income)/Deductions	~(\$20 mn)	~(\$20 mn)	(\$13 mn)		
Effective Tax Rate	~29.5%	~29.5%	29.1%	29.2%	We're slightly below.
Reported Net Income	~\$500 - \$530	~\$500 - \$530	\$526 mn		We're in-line
Reported Diluted EPS	\$1.00 to \$1.06	\$1.00 to \$1.06	\$1.05		We're in-line
Adjusted Net Income	\$680 mn to \$710	\$680 mn to \$710	\$686 mn	\$701 mn	We're in-line
Adjusted Diluted EPS	\$1.36 to \$1.42	\$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 5. We Have Updated Our Forecasts and Now Have Higher Growth Expectations in 2015-2016

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Prior	New	Prior	New	Prior	New	Prior	New
Revenue	\$4,459	\$4,455	\$4,661	\$4,655	\$4,932	\$4,996	\$5,165	\$5,228
Gross Margin	64.4%	64.4%	64.7%	64.7%	65.0%	65.0%	65.3%	65.3%
Operating Profit (EBIT)	\$1,097	\$1,099	\$1,211	\$1,212	\$1,350	\$1,373	\$1,482	\$1,506
Operating Margin	25%	25%	26%	26%	27%	27%	29%	29%
Pre-tax Profit	968	971	1,092	1,094	1,231	1,255	1,367	1,392
Effective Tax Rate	29%	29%	29%	29%	29%	29%	29%	29%
Net Income	\$685	\$686	\$771	\$773	\$870	\$887	\$967	\$984
Net Margin	15%	15%	17%	17%	18%	18%	19%	19%
EPS	\$1.37	\$1.37	\$1.54	\$1.54	\$1.74	\$1.77	\$1.94	\$1.97
Free Cash Flow per Share	\$1.34	\$1.37	\$1.46	\$1.42	\$1.63	\$1.63	\$1.93	\$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 6. However, We Remain Slightly Below Consensus

Non-GAAP Measures	FY2013E		FY2014E		FY2015E		FY2016E	
	Street	BMO	Street	BMO	Street	BMO	Street	BMO
Revenue	\$4,494	\$4,455	\$4,755	\$4,655	\$5,014	\$4,996	\$5,298	\$5,228
Gross Margin	64.5%	64.4%	65.1%	64.7%	65.4%	65.0%	65.5%	65.3%
Operating Profit	\$1,096	\$1,099	\$1,216	\$1,212	NA	\$1,373	NA	\$1,506
Operating Margin	24%	25%	26%	26%	NA	27%	NA	29%
Pre-tax Profit	990	971	1,134	1,094	1,272	1,255	1,411	1,392
Effective Tax Rate	29%	29%	28%	29%	29%	29%	28%	29%
Net Income	\$701	\$686	\$811	\$773	\$909	\$887	\$1,020	\$984
Net Margin	16%	15%	17%	17%	18%	18%	19%	19%
EPS	\$1.40	\$1.37	\$1.61	\$1.54	\$1.81	\$1.77	\$2.03	\$1.97
Free Cash Flow per Share	\$1.46	\$1.37	\$1.42	\$1.42	\$1.59	\$1.63	\$1.90	\$1.96
Dividend per share	\$0.26	\$0.26	\$0.30	\$0.33	\$0.35	\$0.39	\$0.43	\$0.47
Dividend Payout Ratio	19%	19%	19%	21%	19%	22%	21%	24%

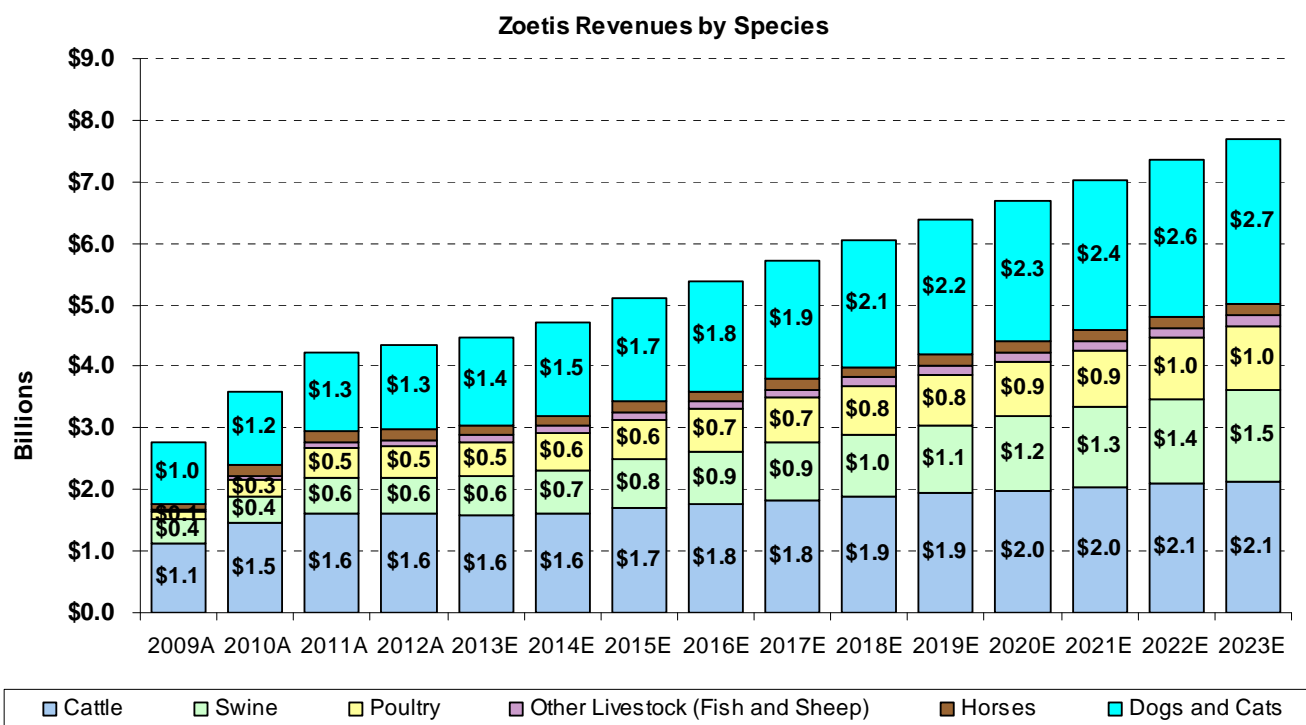
Source: Zoetis, Thomson One, BMO Capital Markets Pharmaceuticals Research

Incremental Insights From Our Discussion With Elanco Management Supports Our Thesis

During Eli Lilly's investor day on October 3, 2013, we met with the company's Animal Health/Elanco management team and discussed the key drivers behind the significant margin expansion for that business (from 2007 to 2012 Elanco EBIT margin expanded from 17% to 25%). According to management, a key driver for this margin expansion was manufacturing efficiency improvements. Specifically, Elanco management stated that having dedicated manufacturing capacity allocated to Elanco products was more efficient than sharing manufacturing with the Lilly pharmaceutical business. Based on this we believe that Zoetis' ongoing efforts to eventually separate manufacturing from Pfizer with its own infrastructure should result in meaningful gross margin expansion. We conservatively estimate that Zoetis' gross margins will improve from 64.4% in 2013 to 67% in 2023.

Moreover, Elanco's President stated that the company has an optimistic outlook for 2014, particularly for its livestock business. This is in part driven by lower corn prices and strong demand from emerging markets. Elanco expects mid-single-digit growth in 2014, in line with the industry, and improved margins for swine and poultry. This is in line with our Zoetis forecasts. We expect Zoetis' livestock business to grow by 5% in 2014. Similarly we expect strong 8-9% growth for swine and poultry products, growing to \$1.3 billion in 2014.

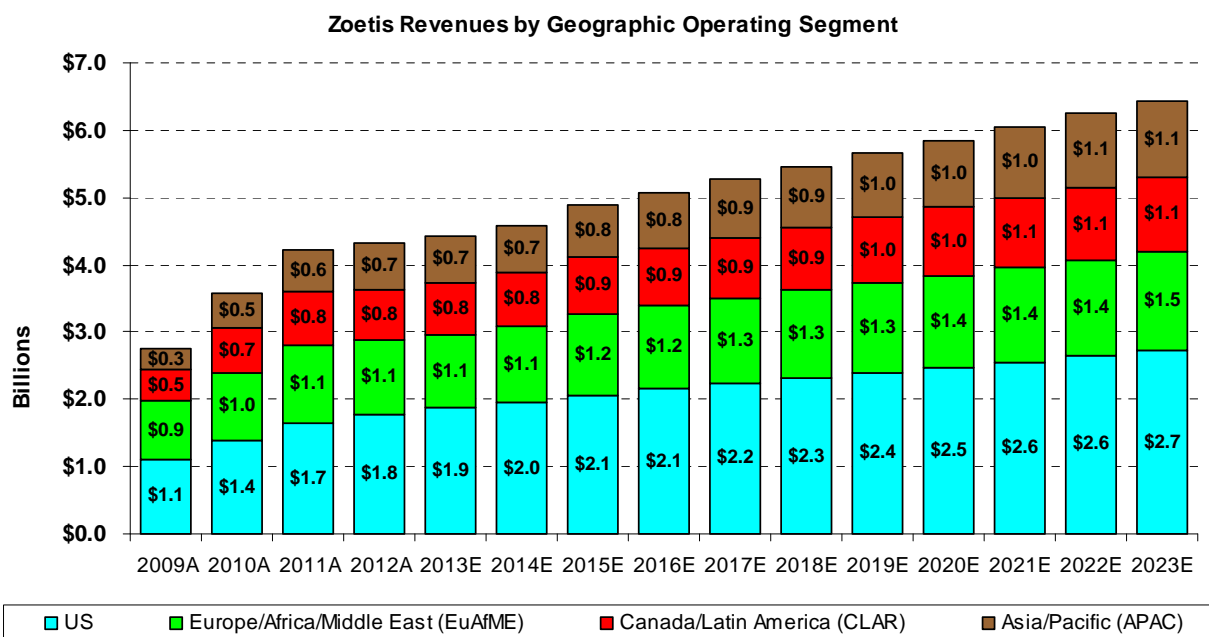
Exhibit 7. Our Zoetis Revenue Forecast by Species: 10-year CAGR of 5.5%



Source: Zoetis, BMO Capital Markets.

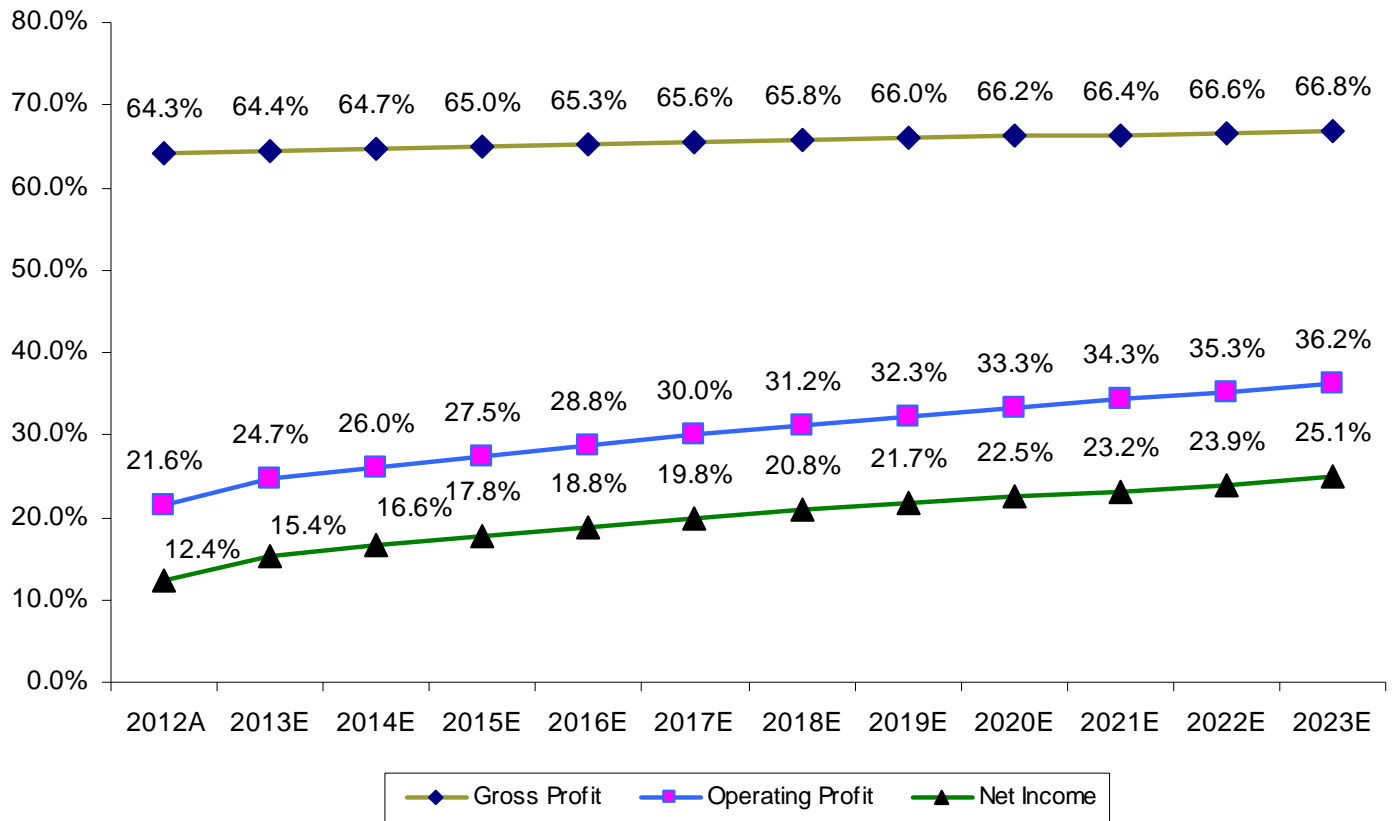
Exhibit 8. Our Zoetis Revenue Forecast by Geo-Segment: 10-year CAGR of 3.8%

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



Source: Zoetis, BMO Capital Markets.

Exhibit 9. 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.

Our Zoetis Valuation

We value Zoetis at \$38/share. Our primary valuation method is DCF, assuming a 2.5% terminal growth rate and 8.3% discount rate, supported by 23x our non-GAAP 2014-2016 EPS estimates. We believe the multiple is warranted given Zoetis' highly diversified revenues with low-risk macro growth drivers, 2013-2016 13% EPS CAGR, and 2014-2023 10% operating cash flow CAGR.

Exhibit 10. 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		564	840	940	1,103	1,179	1,309	1,428	1,541	1,658	1,775	1,959	2,008
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)		536	795	898	1,061	1,131	1,250	1,366	1,481	1,596	1,708	1,868	1,915
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		536	734	765	836	822	839	847	847	843	834	842	
PV of FCFE (2013-2023)		8,745											
Terminal Value at 2023		33,012											
PV of Terminal Value		13,733											
Cash & Equivalents		369											
Total Debt		3,652											
Funding obligation for pension & post retirement benefit plans		45											
Total Equity Value		19,150											
Minority Interest		-23											
Total Zoetis Stockholders' Equity Value		19,127											
Diluted shares, MM		500											
Equity value per current PFE share		\$38											

PE Multiple Valuation Using Non-GAAP EPS

		2012A	2013E	2014E	2015E	2016E	2013-16 EPS CAGR
EPS		\$1.08	\$1.37	\$1.54	\$1.77	\$1.97	12.8%
PEx	20	\$22	\$27	\$31	\$33	\$34	
	21	\$23	\$29	\$32	\$34	\$35	
	22	\$24	\$30	\$34	\$36	\$37	
	23	\$25	\$32	\$36	\$38	\$39	
	24	\$26	\$33	\$37	\$39	\$40	
Discount Period		0 1 2					
Discount rate		8.3%					
Average		\$37					

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

Zoetis Non-GAAP Income Statement: Our Quarterly Estimates

Non-GAAP Income Statement, \$MM	2012A				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
Revenues	1,047	1,094	1,019	1,176	1,090	1,114	1,057	1,193	1,105	1,147	1,119	1,285
Cost of Sales	388	382	352	427	398	400	361	427	400	408	379	456
Gross Profit	659	712	667	749	692	714	696	766	705	738	740	829
Selling, Informational and Administrative Expenses	331	351	330	440	322	339	333	388	319	340	342	402
R&D Expenses	93	91	94	121	90	91	92	114	91	92	95	119
Operating Profit	235	270	243	188	280	284	271	264	295	306	303	308
Amortization of Intangible Assets	4	3	4	4	4	3	11	12	7	7	7	7
EBIT	231	267	239	184	276	281	261	252	289	300	297	301
Other (Income) / Deductions -- Net	2	2	-4	10	24	29	23	23	23	23	23	23
Income From Cont. Operations Before Provision for Taxes	229	265	243	174	252	252	238	229	266	277	273	278
(Benefit) / Provision for Taxes on Income	76	90	89	117	73	74	69	66	77	80	79	81
Net income/(loss) before allocation to non-controlling interests	153	175	154	57	179	178	169	163	189	196	194	197
Less: Income / (Loss) Attributable to Non-Controlling Interests	1	-1		0	0	0	1	1	1	1	1	1
Net Income/ (loss) Attributable to Zoetis	152	176	154	57	179	178	168	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	\$0.39	\$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%	4%	1%	1%	3%	6%	8%
Gross Profit	7%	10%	1%	2%	5%	0%	4%	2%	2%	3%	6%	8%
Operating Income (EBIT)	31%	46%	5%	-6%	19%	5%	9%	37%	5%	7%	14%	19%
Net Income	26%	54%	5%	-54%	18%	1%	9%	184%	5%	10%	15%	21%
EPS- Diluted	26%	54%	5%	-63%	2%	16%	9%	184%	5%	10%	15%	22%
Dividend									25%	25%	25%	25%
Margins												
Gross Profit	62.9%	65.1%	65.5%	63.7%	63.5%	64.1%	65.9%	64.2%	63.8%	64.4%	66.2%	64.5%
Operating Profit	22%	25%	24%	16%	26%	25%	26%	22%	27%	27%	27%	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	\$4,455	\$4,655	\$4,996	\$5,228	\$5,490	\$5,753	\$6,015	\$6,278	\$6,540	\$6,803	\$7,066
Cost of Sales	1,549	1,586	1,643	1,749	1,815	1,889	1,968	2,045	2,122	2,198	2,273	2,346
Gross Profit	2,787	2,868	3,012	3,247	3,414	3,601	3,785	3,969	4,156	4,342	4,531	4,719
SG&A	1,452	1,382	1,403	1,463	1,487	1,521	1,550	1,577	1,603	1,627	1,650	1,671
R&D	399	387	397	411	421	431	441	451	461	471	480	490
Operating Profit	936	1,099	1,212	1,373	1,506	1,650	1,794	1,941	2,091	2,244	2,400	2,559
Amortization of Intangible Assets	15	29	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	99	93	93	88	88	75	74	74	74	74	34
Income From Cont. Operations Before Provision for Taxes	911	971	1,094	1,255	1,392	1,536	1,693	1,841	1,991	2,144	2,300	2,499
(Benefit) / Provision for Taxes on Income	372	282	317	364	404	445	491	534	578	622	667	725
Effective Tax Rate	40.8%	29.1%	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	777	891	988	1,090	1,202	1,307	1,414	1,522	1,633	1,774
Gain / (Loss) Attributable to Non-Controlling Interests	0	2	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$539	\$686	\$773	\$887	\$984	\$1,086	\$1,198	\$1,303	\$1,410	\$1,518	\$1,629	\$1,770
Earnings Per Share - Basic	\$1.08	\$1.37	\$1.55	\$1.78	\$1.98	\$2.19	\$2.42	\$2.64	\$2.87	\$3.11	\$3.35	\$3.66
Earnings Per Share - Diluted	\$1.08	\$1.37	\$1.54	\$1.77	\$1.97	\$2.18	\$2.41	\$2.63	\$2.85	\$3.09	\$3.33	\$3.65
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	494	491	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%	3%	5%	7%	5%	5%	5%	5%	4%	4%	4%	4%
Gross Profit	5%	3%	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%	27%	13%	15%	11%	10%	10%	9%	8%	8%	7%	9%
EPS	7%	27%	13%	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%	64.4%	64.7%	65.0%	65.3%	65.6%	65.8%	66.0%	66.2%	66.4%	66.6%	66.8%
Operating Profit	22%	25%	26%	27%	29%	30%	31%	32%	33%	34%	35%	36%
Net Income	12.4%	15.4%	16.6%	17.8%	18.8%	19.8%	20.8%	21.7%	22.5%	23.2%	23.9%	25.1%
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	\$4,455	\$4,655	\$4,996	\$5,228	\$5,490	\$5,753	\$6,015	\$6,278	\$6,540	\$6,803	\$7,066
Cost of Sales	1,563	1,608	1,647	1,753	1,819	1,893	1,972	2,049	2,126	2,202	2,277	2,350
Gross Profit	2,773	2,846	3,008	3,243	3,410	3,597	3,781	3,965	4,152	4,338	4,527	4,715
SG&A	1,470	1,512	1,419	1,475	1,499	1,533	1,562	1,589	1,615	1,639	1,662	1,683
R&D Expenses	409	401	413	423	433	443	453	463	473	483	492	502
Amortization of Intangible Assets	64	63	66	66	66	66	66	66	66	66	66	66
Restructuring Charges & Certain Acquisition-Related Costs	135	29	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	986	1,163	1,300	1,444	1,601	1,749	1,899	2,052	2,208	2,407
(Benefit) / Provision for Taxes on Income	274	217	286	337	377	419	464	507	551	595	640	698
Net income/(loss) before allocation to non-controlling interests	436	528	700	826	923	1,025	1,137	1,242	1,349	1,457	1,568	1,709
Gain / (Loss) Attributable to Non-Controlling Interests	0	2	4	4	4	4	4	4	4	4	4	4
Net Income (Loss) Attributable to Zoetis	\$436	\$526	\$696	\$822	\$919	\$1,021	\$1,133	\$1,238	\$1,345	\$1,453	\$1,564	\$1,705
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	\$3.51
Weighted-Average Shares - Basic	500	500	500	499	498	497	495	494	491	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	799	1,326	1,915	2,197	2,841	2,781	3,472	4,184	4,937	5,676	5,159
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	1,617	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	3,256	3,892	4,598	4,938	5,691	5,731	6,509	7,321	8,172	9,009	8,554
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	801	735	669	603	537	471	405	339	273	207	141
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	6,986	7,615	7,876	8,549	8,506	9,196	9,911	10,659	11,391	10,820
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	1,626	2,282	2,960	3,634	4,336	5,028	5,734	6,473	7,196	7,966
Total liabilities and equity	6,262	6,421	6,986	7,615	7,876	8,549	8,506	9,196	9,911	10,659	11,391	10,820

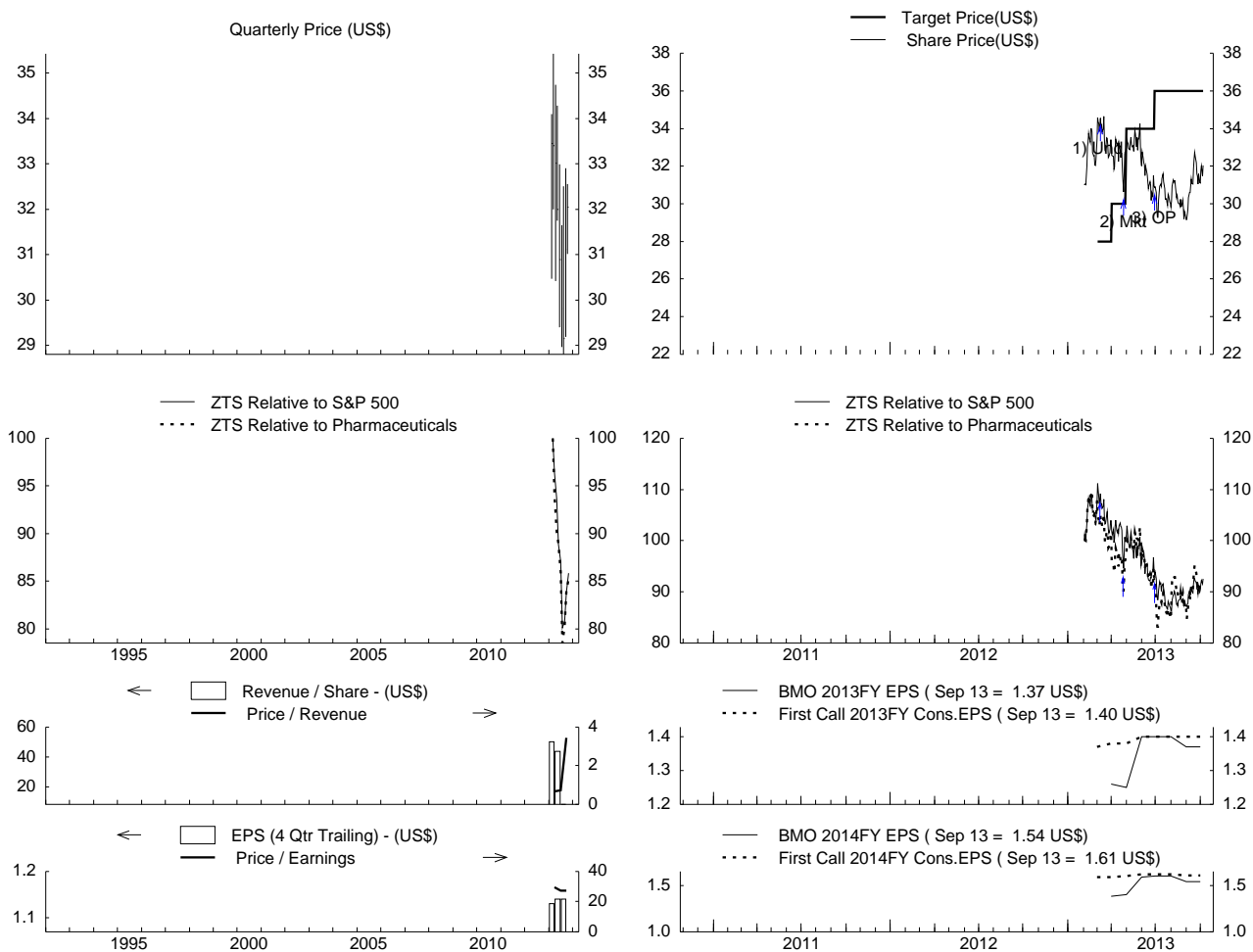
Sources: Pfizer Reports, Zoetis Form S-1, BMO Capital Markets Pharmaceuticals Research

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	700	826	923	1,025	1,137	1,242	1,349	1,457	1,568	1,709
Adjustments:												
Depreciation and amortization expense	200	197	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	833	840	940	1,103	1,179	1,309	1,428	1,541	1,658	1,775	1,959
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	-698	-774	-900	-2,344
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	482	527	590	282	644	-61	691	713	753	739	-517
Cash and cash equivalents, as of beginning of year	79	317	799	1,326	1,915	2,197	2,841	2,781	3,472	4,184	4,937	5,676
Cash and cash equivalents, as of end of year	317	799	1,326	1,915	2,197	2,841	2,781	3,472	4,184	4,937	5,676	5,159

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	1.4	21.9	>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 4, 2013): \$32.05
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	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%

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(S) = Speculative investment;

NR = No rating at this time; and

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