

Zoetis Inc. (ZTS)

Overweight

2Q13 First Glance Mostly In-Line; Guidance Reaffirmed Despite Some Challenges

CONCLUSION

We believe ZTS will trade higher on essentially in-line Q2 results and reaffirmed FY13 guidance. While revenues were slightly lower than expected, adjusted EPS was in-line and the company's diverse business model and operational focus helped drive slightly better than expected operating margins. Sales growth in the U.S. was in-line with estimates, while FX had a -3% impact on international segment sales. In general, companion animal sales were favorable, while livestock sales were driven by poultry and swine product revenues as the drought, weather and economic weakness impacted cattle product sales during the quarter. Maintain Overweight rating. CC @ 8:30 AM ET, dial-in #: 866-952-1906.

- **Revenues slightly lower.** Total revenues increased 1.8% y/y to \$1,114 MM, which was \$15 MM lower than our estimate and consensus of \$1,129 MM. Operationally, revenues increased 4%, which was partially offset by a 2% FX impact.
 - U.S. revenues increased 3.8% y/y to \$437 MM, which was in-line with our estimate of \$438 MM and \$3 MM lower than StreetAccounts consensus of \$440 MM.
 - EuAfME revenues decreased 1.8% y/y to \$278 MM, which was \$13.5 MM lower than our estimate of \$292 MM and \$8 MM lower than consensus of \$286 MM. Operationally, revenues increased 1%, which was offset by a negative 3% FX impact.
 - CLAR revenues increased 0.9% y/y to \$213 MM, which slightly lower than our estimate of \$215 MM and \$6 MM higher than consensus of \$207 MM. Operationally, revenues increased 4% and was offset by a negative 3% FX impact.
 - APAC revenues increased 3.9% y/y to \$186 MM, which was \$2 MM higher than our estimate of \$184 MM and \$7 MM lower than consensus of \$193 MM. Operationally, revenues increased 7% and was offset by a 3% FX impact.
- **EPS in-line.** Adjusted EPS of \$0.36 was in-line with our estimate and consensus. Adjusted EPS excluded \$0.10 related to purchase accounting adjustments, acquisition-related costs, and other one-time items. Gross margin of 64.09% was 6 bps lower than our estimate of 64.15%. Adjusted operating income increased 3.6% y/y to \$284 MM, which was in-line with our estimate, while adjusted operating margin increased 45 bps y/y to 25.49%, which was 31 bps higher than our estimate of 25.19%. Slightly higher operating margin versus our estimate was primarily attributable to lower SG&A and R&D expense.
- **FY13 guidance reaffirmed.** ZTS reaffirmed its FY13 revenue guidance of \$4.425 to \$4.525 billion and adjusted EPS guidance of \$1.36 to \$1.42, which we find encouraging given concerns heading into the quarter about the challenging operating environment.

COMPANY DESCRIPTION

Zoetis is the leading global manufacturer of animal health medications and vaccines.

PRICE: US\$31.25
TARGET: US\$39.00
(24.5x FY14E EPS)

Kevin K. Ellich

Sr Research Analyst, Piper Jaffray & Co.
612 303-5666, kevin.k.ellich@pjc.com

Bradley D. Maiers

Research Analyst, Piper Jaffray & Co.
612 303-6646, bradley.d.maiers@pjc.com

Related Companies:

ZTS

Share Price:

31.25

RISKS TO ACHIEVEMENT OF PRICE TARGET

Risks include increased regulatory pressures, adverse weather conditions, lower utilization of products, increased competition, and macro economic factors.

Price Performance - 1 Year



Source: Bloomberg

Piper Jaffray does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decisions. This report should be read in conjunction with important disclosure information, including an attestation under Regulation Analyst certification, found on pages 2 - 3 of this report or at the following site: <http://www.piperjaffray.com/researchdisclosures>

IMPORTANT RESEARCH DISCLOSURES



Notes: The boxes on the Rating and Price Target History chart above indicate the date of the Research Note, the rating, and the price target. Each box represents a date on which an analyst made a change to a rating or price target, except for the first box, which may only represent the first Note written during the past three years.

Legend:

I: Initiating Coverage
R: Resuming Coverage
T: Transferring Coverage
D: Discontinuing Coverage
S: Suspending Coverage
OW: Overweight
N: Neutral
UW: Underweight
NA: Not Available
UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	341	57.31	67	19.65
HOLD [N]	224	37.65	14	6.25
SELL [UW]	30	5.04	0	0.00

Note: Distribution of Ratings/IB Services shows the number of companies currently in each rating category from which Piper Jaffray and its affiliates received compensation for investment banking services within the past 12 months. FINRA rules require disclosure of which ratings most closely correspond with "buy," "hold," and "sell" recommendations. Piper Jaffray ratings are not the equivalent of buy, hold or sell, but instead represent recommended relative weightings. Nevertheless, Overweight corresponds most closely with buy, Neutral with hold and Underweight with sell. See Stock Rating definitions below.

Analyst Certification — Kevin K. Ellich, Sr Research Analyst — Bradley D. Maiers, Research Analyst

The views expressed in this report accurately reflect my personal views about the subject company and the subject security. In addition, no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.

Research Disclosures

Piper Jaffray has received compensation for investment banking services from or has had a client relationship with Zoetis Inc. within the past 12 months.

Within the past 12 months Piper Jaffray was a managing underwriter of a public offering of, or dealer manager of a tender offer for, the securities of Zoetis Inc. or the securities of an affiliate.

Within the past 3 years Piper Jaffray participated in a public offering of, or acted as a dealer manager for, Zoetis Inc. securities.

Piper Jaffray usually provides bids and offers for the securities of Zoetis Inc. and will, from time to time, buy and sell Zoetis Inc. securities on a principal basis.

Piper Jaffray research analysts receive compensation that is based, in part, on overall firm revenues, which include investment banking revenues.

Rating Definitions

Stock Ratings: Piper Jaffray ratings are indicators of expected total return (price appreciation plus dividend) within the next 12 months. At times analysts may specify a different investment horizon or may include additional investment time horizons for specific stocks. Stock performance is measured relative to the group of stocks covered by each analyst. Lists of the stocks covered by each are available at www.piperjaffray.com/researchdisclosures. Stock ratings and/or stock coverage may be suspended from time to time in the event that there is no active analyst opinion or analyst coverage, but the opinion or coverage is expected to resume. Research reports and ratings should not be relied upon as individual investment advice. As always, an investor's decision to buy or sell a security must depend on individual circumstances, including existing holdings, time horizons and risk tolerance. Piper Jaffray sales and trading personnel may provide written or oral commentary, trade ideas, or other information about a particular stock to clients or internal trading desks reflecting different opinions than those expressed by the research analyst. In addition, Piper Jaffray technical research products are based on different methodologies and may contradict the opinions contained in fundamental research reports.

- **Overweight (OW):** Anticipated to outperform relative to the median of the group of stocks covered by the analyst.
- **Neutral (N):** Anticipated to perform in line relative to the median of the group of stocks covered by the analyst.
- **Underweight (UW):** Anticipated to underperform relative to the median of the group of stocks covered by the analyst.

Other Important Information

The material regarding the subject company is based on data obtained from sources we deem to be reliable; it is not guaranteed as to accuracy and does not purport to be complete. This report is solely for informational purposes and is not intended to be used as the primary basis of investment decisions. Piper Jaffray has not assessed the suitability of the subject company for any person. Because of individual client requirements, it is not, and it should not be construed as, advice designed to meet the particular investment needs of any investor. This report is not an offer or the solicitation of an offer to sell or buy any security. Unless otherwise noted, the price of a security mentioned in this report is the market closing price as of the end of the prior business day. Piper Jaffray does not maintain a predetermined schedule for publication of research and will not necessarily update this report. Piper Jaffray policy generally prohibits research analysts from sending draft research reports to subject companies; however, it should be presumed that the analyst(s) who authored this report has had discussions with the subject company to ensure factual accuracy prior to publication, and has had assistance from the company in conducting diligence, including visits to company sites and meetings with company management and other representatives.

Notice to customers: This material is not directed to, or intended for distribution to or use by, any person or entity if Piper Jaffray is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to such person or entity. Customers in any of the jurisdictions where Piper Jaffray and its affiliates do business who wish to effect a transaction in the securities discussed in this report should contact their local Piper Jaffray representative. **Europe:** This material is for the use of intended recipients only and only for distribution to professional and institutional investors, i.e. persons who are authorised persons or exempted persons within the meaning of the Financial Services and Markets Act 2000 of the United Kingdom, or persons who have been categorised by Piper Jaffray Ltd. as professional clients under the rules of the Financial Conduct Authority. **United States:** This report is distributed in the United States by Piper Jaffray & Co., member SIPC, FINRA and NYSE, Inc., which accepts responsibility for its contents. The securities described in this report may not have been registered under the U.S. Securities Act of 1933 and, in such case, may not be offered or sold in the United States or to U.S. persons unless they have been so registered, or an exemption from the registration requirements is available.

This report is produced for the use of Piper Jaffray customers and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose without the prior consent of Piper Jaffray & Co. Additional information is available upon request.

Copyright 2013 Piper Jaffray. All rights reserved.