

Zoetis Inc.

ZTS - BUY - U.S. Cattle Survey Points to Slower-Than-Expected Recovery of Herd Size, But Calf Crop Is Improving

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FLASH NOTE

SECTOR: Specialty Pharmaceuticals

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The survey noted a 2% decline in herd size and consensus was expecting a 1% decline. This was an important data point for ZTS (BUY, \$30.67) because cattle represent the company's highest margin livestock animal drug sales. Declining cattle herd size has been one of the overhangs on ZTS shares. Margins of companion animal drugs are still higher than livestock drugs sales. ZTS's sales are ~60% livestock/40% companion animal.

The USDA released its Cattle Inventory data today. The report stated that all cattle and calves in the U.S. as of 1/1/14 totaled 87.7MM head, 2% below the 89.3MM on 1/1/13. This is the lowest inventory of cattle and calves since the 82.1MM on hands in 1951. The report supports our belief that livestock expansion for cattle will not pick up until 2015. The number of calves born is a projection of the current year calf crop. The 2013 calf crop was estimated at 33.9MM head, down 1% from 2012 (versus down 3% from 2011). This is the smallest calf crop since the 33.7MM born during 1949. Calves born during 1H13 are estimated at 24.7MM, down 1% from 2012.

The Cattle Inventory surveys provide basic inventory data that describe the nation's cattle herd. The reports provide estimates of the number of breeding animals for beef and milk production as well as the number of heifers being held for breeding herd replacement. Estimates of cattle and calves being raised for meat production are also included. The number of calves born during the previous year is also measured. The Cattle Inventory survey is conducted in all states except Alaska. A sample of cattle producers is selected from the NASS list frame. A sample of area tracts is selected to measure incompleteness of the list. This ensures statistical coverage of all cattle operations in each state. **The January report** provides estimates of total inventory, beef cows, milk cows, bulls, replacement heifers, other steers and heifers, and number of calves born in the previous year by state and the U.S. The January survey includes nearly 50,000 cattle operations of all sizes. Estimates are made for all states.

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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