

Zoetis Inc.

ZTS - BUY - Conference Call on Livestock Sector Reinforces Our Positive View of ZTS

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FLASH NOTE

SECTOR: Specialty Pharmaceuticals

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We expect the livestock sector to expand in 2013, and this would be good for ZTS (BUY, \$33.23). We hosted a conference call (on 4/11/13) with our WRG Agribusiness policy analyst, Mark McMinimy, to discuss the "Outlook for the Livestock Sector in 2013" and its impact on the animal health industry. In summary, the call underscores that a turnaround may be a possibility this year for the beleaguered livestock industry that would put much of it on the path to expansion. If so, this tailwind would likely be mirrored in other countries with commercial-scale, market-oriented livestock sectors as well, leading to an international recovery. **A replay is available for five business days after the call. Toll-free U.S./Canada: 1-800-964-3261; Int'l Toll: 402-220-0605.**

Below, we highlight the key takeaways from our call.

- The most important variables to monitor are the weather in the U.S. Corn Belt this summer and the recovery of drought-ravaged pastures in the Plains states. If corn and soybean yields rebound to more normal levels this year, and the probability is that they will, then feed costs could fall by one-quarter to one-third, providing a green light for livestock expansion.
- Broiler and hog producers will respond most rapidly to a sharp upturn in crop supplies and downturn in prices, whereas cattlemen will also need to be confident about recovery of rangeland and pastures before committing to herd expansion. This is already happening, but slowly. USDA data from 2010 and 2011 indicate that for cow-calf production, feed, excluding grazing, represented roughly 50% of total operating costs excluding overhead. For all hog operations feed ranged from 50% to 60% of total operating costs. The 2012 costs are likely to have been higher still given the higher crop prices. Broiler industry sources indicate that feed costs represented 69% of live production costs last summer-fall when crop prices peaked but are probably closer to 60% now.
- Livestock numbers worldwide have increased markedly over the last 30 years, spurred by economic growth and population expansion. Looking ahead, growth of demand for livestock products is likely to be centered in developing countries paced by higher rates of economic growth and by faster growing and younger populations in those countries. Statistics from the United Nations Food and Agriculture Organization indicate chicken populations have expanded from 7.2B in 1980 to 19.9B in 2011. Pig numbers are estimated to have expanded by 165MM head over this period, or 21% to 963MM. Cattle numbers are up 183MM, or 15%, to 1.4B worldwide.
- On the regulatory and legislative fronts, the reauthorization of the Animal Drug User Fee Act (ADUFA) is one to watch (needs to be done by 9/30/13). Legislative efforts in Congress to further restrict animal antibiotics and to greatly expand industry reporting requirements are emerging, but they do not appear to have strong prospects for being enacted into law. Therefore, for the foreseeable future, the FDA-issued guidance and the veterinary feed directives are likely to define the rules of the road for the use of medically-important anti-microbials in food-producing animals.
- A recent government study on climate change and agriculture suggests that higher temperatures may increase stress on livestock, negatively affecting health and productivity, while also increasing the proliferation and survivability of pathogens and parasites, suggesting the potential for an expanded role for animal health drugs provided by companies such as ZTS. The report is, "Climate Change and Agriculture in the United States: Effects and Adaptation," dated February of this year.
- There are several upcoming harvest signposts in 2013; the dates and nature of the releases are as follows: 1) 5/10/13, World Agricultural Supply and Demand Estimates (WASDE); 2) 6/28/13, USDA Acreage report; 3) 7/11/13 WASDE; and 4) 8/12/13 WASDE.

Potential Stock Moving Catalysts for ZTS. 1) 1Q13 earnings and 2013 financial guidance 4/30/13; 2) operating margin expansion; 3) new product launches; 4) business development; 5) expansion into adjacent categories; 6) U.S. drought subsidies; and 7) strong flea and tick season.

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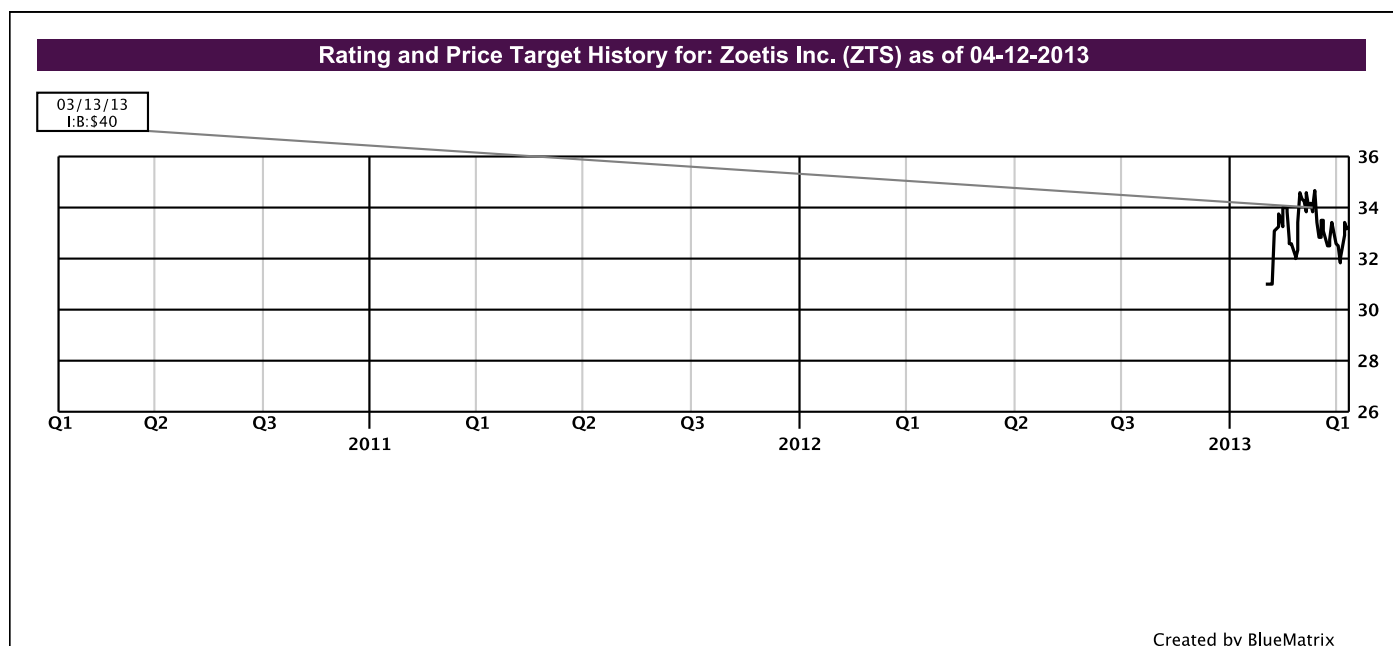
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