

Gabelli & Company, Inc.

Zoetis Inc. (ZTS - \$33.02 - NYSE)

Off to a Good Start - Buy

Year	EPS ^(a)	P/E	PMV	Dividend: \$0.26	Current Return: 0.79%
2015P	\$1.80	18.3x	\$45	Shares O/S: 99.0 million Class A ^(b)	
2014P	1.65	20.0	40		401.0 million Class B
2013E	1.40	23.6	34		
2012A	1.08	30.6	---	52-Week Range: \$35.42 – \$30.42	

(a) Adjusted EPS excluding certain amortization charges, acquisition, separation, and other one-time charges

(b) All Class B shares are owned by Pfizer and offer 10 votes per share for directors

COMPANY OVERVIEW

Zoetis, located in Madison, NJ, is world's largest animal health company with medicines for both production and companion animals. The company was spun out of Pfizer in February 2013, with Pfizer retaining an 80.2% stake in the company.

Reason For Comment

On April 30, Zoetis reported results for Q1 2013, its first quarter as a public company. Sales were up 4% to \$1.09 billion (5% excluding currency) and adjusted EPS was \$0.36 vs. \$0.30 the prior year on a pro forma basis.

- Sales were driven by US companion animals (up 13%), which benefited from a competitor's supply disruption. Global livestock sales (up 3% operationally) were hurt by low cattle herds but benefited from strength in swine and poultry. The impact of the drought, especially on cattle herds, is expected to linger throughout the year as turnaround time for cattle is 2-3 years.
- Adjusted earnings of \$0.36 per share were driven by cost controls for SG&A and R&D, both of which declined year over year. While both are expected to tick up as 2013 progresses, the company continues to anticipate revenue growth ahead of operating expense growth. Q1 also benefited from an effective tax rate of 29% vs. 33.2% in Q1 2012.
- Zoetis also provided guidance for 2013, with sales expected to be \$4.425-4.525 billion and adjusted EPS of \$1.36-\$1.42 per share. Based on guidance of a lower tax (29.5%) than we previously anticipated, we now expect adjusted EPS of \$1.40 in 2013, growing to \$1.65 in 2014.
- We continue to recommend shares of ZTS, which trade at 14.5x 2014 EBITDA and 20.0x 2014 adjusted EPS. While this is towards the high end of comparable companies, we expect Zoetis' emerging market exposure and operating leverage opportunities to drive EPS growth of 15% annually over the next five years. We are also raising our PMV multiple from 15x to 16x EBITDA to reflect the value of Zoetis' leadership position in the industry and diversification among different animal types and geographies. Zoetis currently trades at a 17% discount to our 2014 PMV of \$40 per share.

Table 1

Zoetis, Inc. Income Statement 2010A – 2017P

(\$ in millions, except per share data)

	2010A ^(a)	2011A ^(a)	2012A ^(a)	2013E	2014P	2015P	2016P	2017P
Net Sales	\$ 3,582	\$ 4,233	\$ 4,336	\$ 4,510	\$ 4,764	\$ 5,021	\$ 5,288	\$ 5,570
% Growth	29.8%	18.2%	2.4%	4.0%	5.6%	5.4%	5.3%	5.3%
EBITDA	593	924	1,068	1,240	1,373	1,485	1,603	1,730
% Margin	16.6%	21.8%	24.6%	27.5%	28.8%	29.6%	30.3%	31.1%
Adjusted EPS (b)	\$0.55	\$1.01	\$1.08	\$1.40	\$1.65	\$1.80	\$2.05	\$2.25
% Growth	45.5%	82.9%	7.2%	29.9%	17.9%	9.1%	13.9%	9.8%

(a) Pro forma for IPO

(b) Adjusted EPS, excludes certain non-cash items, restructuring, and certain one-time items, assume 500 million shares outstanding

Source: Company filings and Gabelli & Company, Inc. estimates

Table 2

Zoetis, Inc.
Private Market Value Analysis
2012A – 2017P

(\$ in millions, except per share data)

	<u>2012A</u>	<u>2013E</u>	<u>2014P</u>	<u>2015P</u>	<u>2016P</u>	<u>2017P</u>
Production	\$ 2,806	\$ 2,882	\$ 3,028	\$ 3,183	\$ 3,340	\$ 3,505
Companion	1,530	1,628	1,736	1,838	1,948	2,065
Total Revenue	\$ 4,336	\$ 4,510	\$ 4,764	\$ 5,021	\$ 5,288	\$ 5,570
EBITDA	1,068	1,240	1,373	1,485	1,603	1,730
Valuation Multiple	16 x	16 x	16 x	16 x	16 x	16 x
Total Private Market Value	\$ 17,088	\$ 19,838	\$ 21,974	\$ 23,756	\$ 25,651	\$ 27,682
Less: Net Debt	(3,350)	(2,725)	(1,997)	(1,176)	(247)	783
Equity Private Market Value	\$ 13,738	\$ 17,113	\$ 19,978	\$ 22,581	\$ 25,404	\$ 28,465
Shares Outstanding	500	500	500	500	500	500
PMV Per Share	\$27	\$34	\$40	\$45	\$51	\$57
Current Market - Discount to PM	-20.2%	3.5%	17.4%	26.9%	35.0%	42.0%

Source: Company filings and Gabelli & Company, Inc. estimates

Other companies mentioned:

Pfizer Inc. (PFE – NYSE)

I, **Kevin Kedra**, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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Important Disclosures

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Ratings

Analysts' ratings are largely (but not always) determined by our "private market value," or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

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