

ZTS, KIN, PAHC - BUY - VETO and Virbac's 1Q15 Results Underscore Growth Drivers Remain Intact

SECTOR: Specialty Pharmaceuticals

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Conclusion: We believe positive takeaways from Vetoquinol (VETO-FR, NC, €36.74) and Virbac's (Private) 1Q15 results support our investment thesis for ZTS (BUY, \$47.14), PAHC (BUY, \$34.24), and KIN (BUY, \$7.35): 1) The companion animal and livestock markets continue to grow; 2) Emerging Markets (Asia/Pacific) remain robust; 3) Both Virbac and Vetoquinol experienced some headwinds related to the operating environment in France, but M&A helped offset this. For Virbac, EU sales growth excluding France was 9.8% at CER. Neither ZTS nor PAHC are meaningfully leveraged to the French market. For 2014 ZTS reported \$151MM of sales in France, of which 65% came from livestock sales. For context, ZTS's total sales in 2014 were \$4.8B. PAHC's European and Africa segment made up ~5% of total sales in fiscal 2014.

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Vetoquinol reported 1Q15 revenue growth of 11.0% and 4.8% on a constant exchange rate (CER) basis, respectively.

- Sales of Vetoquinol's core products (~50 products) increased 17.2% in 1Q15 (11.7% at CER). Core products accounted for 48.1% of 1Q15 sales (up from 45.6% in 1Q14). Results included sales from the Bioniche acquisition in April 2014.
- 1Q15 sales increased across all geographies. Sales increased in Europe by 0.6%, the Americas (including Bioniche) by 39.6%, and Asia/Pacific by 15.6%. Sales growth excluding Bioniche was 14.1% in the Americas and 1.7% in Asia/Pacific. Currency tailwinds assisted growth in the quarter.
- Companion Animal sales rose 8.8% in 1Q15, and livestock products increased 13.4%. The implementation of new legislation in France (which restricts commercial discounts) caused a slow down in anti-infective sales in 1Q15.

Virbac reported 1Q15 revenue growth of 17.1% and 7% on a constant exchange rate (CER) basis, respectively.

- Virbac's 1Q15 sales were down 6.1% on a constant scope and exchange rate, due to manufacturing issues in the U.S., as well as the headwinds faced in the French market. The unadjusted growth was driven by the acquisition of the Sentinel brands in the U.S. and by a positive effect from exchange rates.
- In the U.S., sales were driven by Sentinel with sales of \$32MM in the quarter. Virbac acquired the Sentinel products from Novartis (NVS, NC, \$103.31) Animal Health in January of this year.
- 2014 sales grew 17.1% and 7% including F/X impact. Growth at constant scope was down 6.1%. Manufacturing and deliveries at Virbac's Missouri facilities, due to weaknesses highlighted during a recent regulatory inspection, negatively affected the company's Ivehart products. The company began shipping Ivehart Plus at the end of

March, and Ivehart Max in mid-April, while gradually getting back to full capacity on the full range during 2Q15. In France, sales were negatively affected by the new legislation on discounts. Wholesales ran down their inventories, which they had increased in 4Q14 to take advantage of discounts before the introduction of the new legislation.

- *Regional perspective.* Emerging countries had steady growth, in Mexico, Columbia, and India. The company also reported good performance in the large markets of Australia, New Zealand and Japan. European sales growth excluding France was 9.8% at CER.
- *Species perspective.* Companion animal sales increased by 20.2%, but were down 12.4% at constant scope due to the U.S. issues. Excluding the U.S., organic growth within the companion animal sector grew 4.9%, driven by the launch of Milpro and Effitix in Europe.
- Production segment generated 4.6% growth with a slightly positive growth in ruminants and industrial (swine and poultry). The aquaculture sector showed an expected rebound after the 2014 slowdown.

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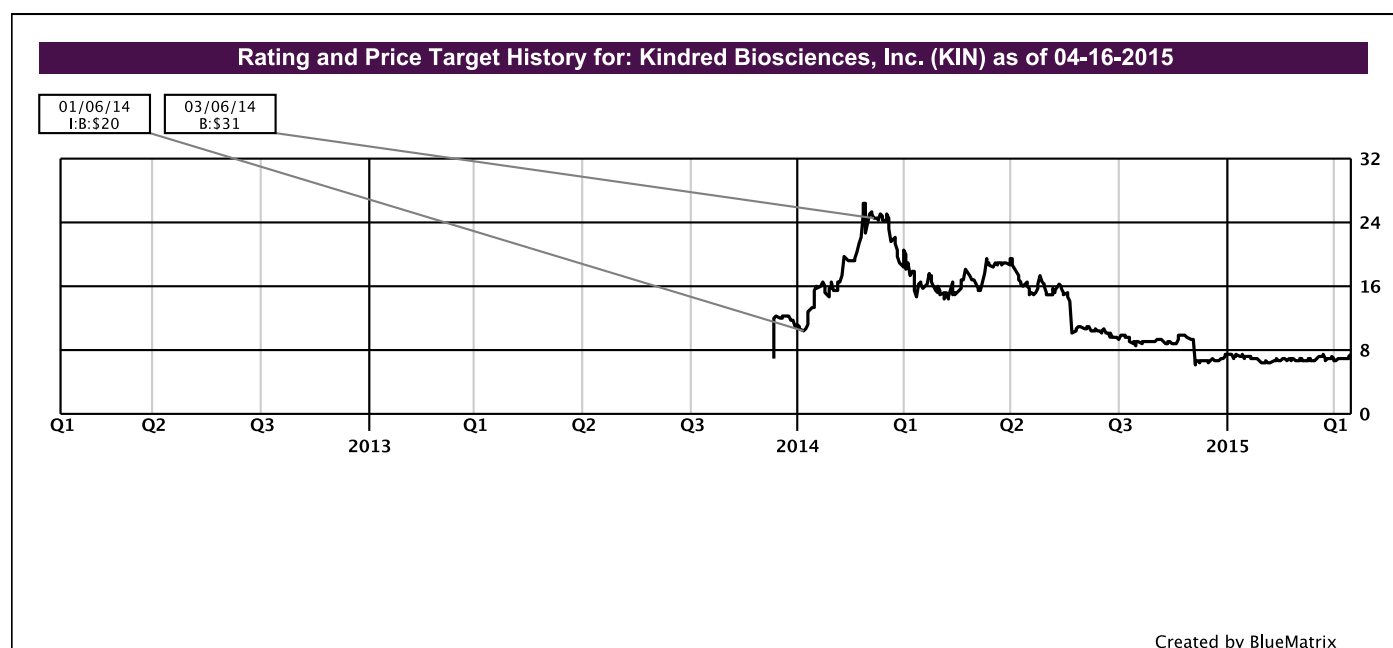
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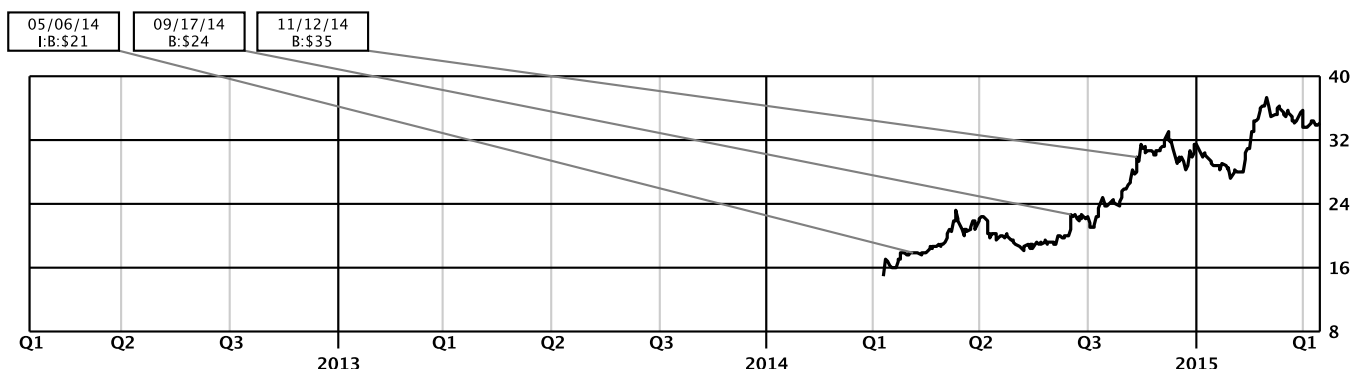
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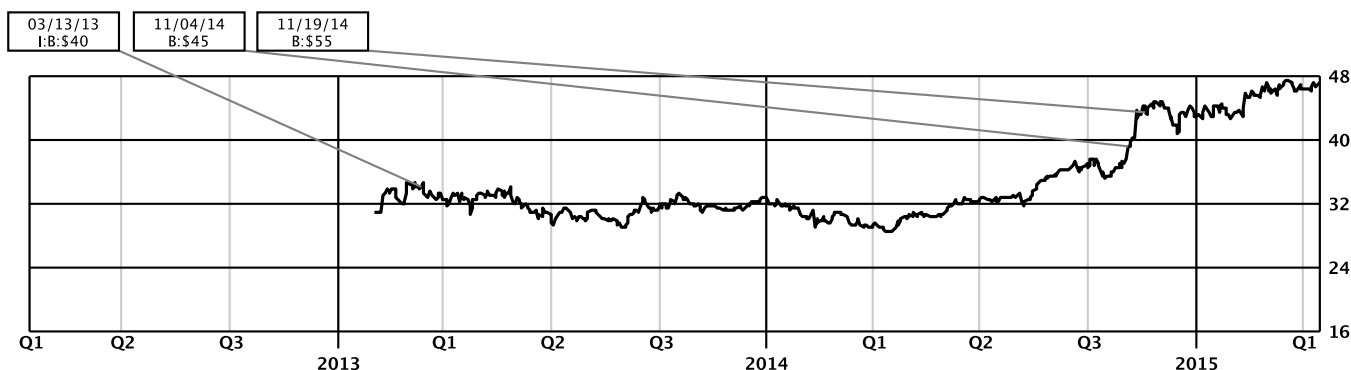


Rating and Price Target History for: Phibro Animal Health Corporation (PAHC) as of 04-16-2015



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Rating and Price Target History for: Zoetis Inc. (ZTS) as of 04-16-2015



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