11-Jan-2017

Zoetis, Inc. (ZTS)

J.P. Morgan Health Care Conference

CORPORATE PARTICIPANTS

Juan Ramón Alaix
Chief Executive Officer & Director, Zoetis, Inc.

OTHER PARTICIPANTS

Chris Schott
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Chris Schott
Analyst, JPMorgan Securities LLC

Good morning, everybody. I'm Chris Schott, pharmaceutical analyst at JPMorgan. It's my pleasure to next be introducing Zoetis. From Zoetis, we have Juan Ramón Alaix, the company's CEO. With that, I turn it over to Juan Ramón.

Juan Ramón Alaix
Chief Executive Officer & Director, Zoetis, Inc.

Thank you, Chris. Good morning. Thank you for the opportunity to speak once again at JPMorgan Health Care Conference. Before I begin, we make some comments on our presentation today will include forward-looking statements that involve risks and may not represent our future results. In addition, our presentation will include a number of non-GAAP measures. You can read more about the risk and uncertainties that may occur on the future results, and can find a reconciliation of our non-GAAP measures in our SEC filings.

Today, I will highlight one of the most important elements of the animal health and Zoetis. From a perspective of an investor, I will also touch on, where we are in our journey as Zoetis, the global leader in animal health. And I will also discuss about how are we continue working on generating future growth and value to our shareholders. We are fortunate of being in an industry, which is very attractive. And also an industry that is showing a steady and predictable growth. It's an industry of $100 billion, with $30 million (sic) [$30 billion] (2:06) coming from medicines and vaccines, the area where we mostly compete.

The long-term drivers of our industry are easy to understand, and has been growing even in recession periods. And this characteristic of predictability and steady growth has been becoming more apparent and better appreciated by the investor community over time. The industry durability is supported by growth drivers that are related to the population growth, middle-class growth and also urbanization. The increase in population is increasing also the demand for the consumption of animal proteins.

The consumption of animal proteins can be different depending on economic conditions, and also cultural aspects. In some cases it will be pork, it will be poultry, beef and fish, but definitely what is clear is that the global consumption will continue growing in terms of animal proteins. In the same way, the increase in middle-class is also adding consumption of animal proteins, but at the same time adoption of pets, and also the willingness of pet owners to take care of their animals and to increase their health and to make them live longer and happier.

In our journey as a public company, we have seen three different stages; the first stage when we launched the company and a standard Zoetis. There was a significant undertaking to separate it from Pfizer after 60 years of being part of this company. We needed at the time that we separated from Pfizer to define our own processes, also invest in IT, also create our manufacturing network, and also at the same time we conducted also our IPO, and we introduced the company brand to the market, to the investors and to our customers.

In the second stage, it was mid-2015, when we introduced our operational efficiency program. With this program, we wanted to reduce complexity; we wanted also to ensure that we have the right allocation of resources to generate future growth. And at the same time, also we targeted the significant reduction on costs with $300 million target by 2017. At the time that we were implementing also this program, we were completing the implementation of the ERP that has been a considerable investment, and also has been helping us to increase the efficiencies in our operations.

We also reduced our manufacturing footprint, and we also selected some of the markets that will not be any longer part of our direct interaction with customers like Venezuela and some other markets. On this stage number three, it's where we are now in 2017, and we are becoming the company that we envisioned when we start working on the separation from Pfizer, a company that really is creating their own culture, their own processes, a company that is really focused on creating value to our customers, and ensuring that we also translate this value to our shareholders.

And we are pleased to see that our commitments that we made when we launched the company in 2013 has been delivered in these four years of results growing in line or faster than the market, and also meeting or exceeding our expectations in terms of profitability. In these four years, we have proven that the animal health industry is a very attractive investment opportunity. It's an industry that is predictable, and also that Zoetis, it's the leader of this industry. And what we have demonstrated in these four years of public company of Zoetis?

Well, the first one is that we have a business model that is showing very strong results, and also that we have a diverse portfolio that has been also helping us to deliver our commitments to the industry. Second, that we have achieved a significant level of efficiencies. We are more lean now. And we have increased our margins at the same time reducing the complexity of our operations and continue creating value to our customers. And third, as I said, we have demonstrated that the commitment that we made at the time of the IPO in delivering revenue growth, delivering profits, and also allocating capital in the right way has been met.

So let me go to some details on the different areas of our business model. So first, our business model is defined by three interconnected capabilities. We have best-in-class field force, reaching customers in 45 markets. These 45 markets represent 95% of our revenues, or in these markets we are generating this 95% of revenues. And we are building significant loyalty with our customers, with our direct interactions, and we translate to these customers the value of our company, but also we demonstrate that we are not only just selling the products, but also selling support services and technical support to our customers.

In terms of R&D, in 2016, we invested $370 million, and we get 170 product approvals. This was including new products and also lifecycle innovation. In terms of new products, we have a list of products that has been groundbreaking, new products like APOQUEL, CYTOPOINT, and also Simparica. And we are also investing in lifecycle innovation to ensure that our existing portfolio, they have strong brand support, products like Vanguard in vaccines, Draxxin anti-infective or Rimadyl has been benefiting of the investment on lifecycle, and have a significant duration of these products in the market.

In terms of manufacturing, we have 23 manufacturing plants. And where we produce vaccines, we produce medicines, we produce medicated feed additives. We have a presence in many different parts of the world, a significant presence also in the U.S. And we also co-locate some of our R&D teams together with the manufacturing plants to ensure that we have a smooth transition from our R&D activity to the commercial activities in the market. As part of the operational efficiency program, we also divested or exited six plants. But at the same time, we continue investing and ensuring that we have the capabilities and the capacity to meet the current and future growth opportunities.

Recently, we invested in our plant in Lincoln, Nebraska for the product production of monoclonal antibody CYTOPOINT, it's one of the products that we have now in this category. We will continue also investing in R&D to bring some of the products related to monoclonal antibodies. The investment that we are making in R&D, and also especially the investment in lifecycle innovation, and together with our investment in external development has been helping to create very strong portfolio, a portfolio that has been also very durable. And you can see in this slide that our top 24 products, they have been in the market for an average period of 30 years.

These are result of investment in lifecycle innovation, and also the result of different dynamics in terms of generic competition in our industry. There have been a recent consolidation on animal health, but despite of this consolidation we'll remain number one company in animal health. And we have very strong position in many different dimensions, in terms of geographies, in terms of product categories, and also in terms of species, and we'll remain, as I said, the leader in the animal health industry. I mentioned at mid-2015, we implemented an operational efficiency plan. With this plan, we have reduced significant complexity in our operations. We have eliminated many SKUs that they were not adding too much value to our customers.

In total we eliminated 5,000 SKUs. We also moved from direct model to indirect in certain countries, but still, as I mentioned, the direct countries represent 95% of our revenues. We have achieved higher level of standardization, also helped by the fact that we implemented our new ERP, which is now fully operational. And we have improved significantly our capital allocation. We are definitely targeting now areas that we know that will generate future growth to our company. We are pleased to see that by 2017 we'll be exceeding the $300 million that we targeted at the beginning of the program. But despite of this reduction, we are very confident that we didn't eliminate any area that will have a negative impact in our future growth.

We eliminated what we considered was redundant, what was considered not adding value to our operations, and focus on the ideas that will generate future growth in our company. And I have many examples of our improvement in terms of margins. So you see in the slide that from 2013 to 2017 we have been growing significantly faster than the market. In 2016, you see 4.5% expected growth, and this is because we have the negative impact of the SKU rationalization. Excluding that, we're also convinced that our growth in 2016 will be also exceeding the market growth. At the time that we were growing faster than market, we're also improving significantly our profitability.

Our EBIT margin moved from 24% in 2013, and is expected to reach 34.5%, which is the middle of the range that our guidance in 2017, a significant improvement. At the same time that we are improving our margins, we are confident that we are also protecting the company to generate future growth. And we are protecting the company continue investing in R&D, and making sure that we'll have the next generation of new products into the market. Products like APOQUEL, CYTOPOINT, Simparica also we expect that will be also in the future in our portfolio, thanks to the continuous investment in R&D.

But we are also, as I said, combining this new product investment with lifecycle innovation, and making sure that we are also having access to external collaborations that will enhance our internal investment. We are also investing in new product launches, and we are also planning to conduct advertising campaign for APOQUEL in 2017. This will also help to ensure that APOQUEL maximize the opportunities, not only in the chronic segment, in where now it's generating most of the sales, but also in acute and seasonalized part of the use of the product. And we continue assessing opportunities in fast growing markets, in where we see opportunity to generate even higher growth, and expanding our field force like in China or Brazil.

We'll continue also investing in business development, and examples like PHARMAQ or SMB in 2016. We'll continue assessing opportunities to fill gaps in our portfolio. Opportunities also to enhancing our presence in some of the emerging markets, and considering also expanding our portfolio to complement the new spaces like diagnostics, genetics or devices. We have also shown during this four years of journey that we had a prudent allocation of our resources, and a prudent return of excess capital to our shareholders. We have grown our dividends, and we have recently announced an increase for 2017 of 10.5% on our dividends. We concluded our program of $500 million on share backs at the end of 2016, and we announced a multi-year program of $1.5 million (sic) [$1.5 billion] on shares repurchase, that also will be implemented in several years.

And now we are targeting a leverage ratio between 2.5% and 3% (sic) [2.5 – 3.0] (18:31), and these are definitely in absence of M&A. So we think that we have been investing internally, we have investing in external opportunities, M&A, and we have returning the excess capital to our shareholders. And to finalize, let me conclude with the value proposition to our shareholders that we communicated at the time of our launch as independent company, and remain valid today and will remain valid for the future. We plan on a long period five years on CAGR index, we plan to grow in line faster than the market. In the same period, we plan to grow our adjusted net income faster than revenues.

We'll continue targeting investment opportunities, internal and external, and we'll return excess capital to our shareholders. We have demonstrated that. We can really operate as a standalone company, with a singular focus on animal health, continue being a leader in this industry, generating a significant improvement in margins. And we also think that this company will generate significant amount of cash that will be used to maximize the value of Zoetis, or return this value to our shareholders.

With that, let me conclude here, and thank you very much for your attention.