

11-Jan-2017

# Zoetis, Inc. (ZTS)

J.P. Morgan Health Care Conference - Q&A

## CORPORATE PARTICIPANTS

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

---

## MANAGEMENT DISCUSSION SECTION

Unverified Participant

Great. So, I think we're ready to kick off the Zoetis breakout session here. So, maybe I'll just kick off with just one question we've been getting a lot on the non-fundamental side and then we can jump into some stuff here.

---

## QUESTION AND ANSWER SECTION

Q

I guess, Glenn, maybe a question for you is that FX has been a – we've seen strengthening dollar, just how should investors be thinking about the – how that affects your business kind of from a top line perspective and kind of flow through the bottom line?

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

A

Sure. So when you look at foreign exchange, when we provided the guidance back in November, it was based on foreign exchange rates as of the end of October and since then, as [ph] Chris (00:36) mentioned, the dollar has strengthened against many of the major currencies. So, when you look at the impact to revenue, at the revenue line, it's almost \$100 million in terms of the impact versus when we set guidance to where we are today and at an EPS level, it's about \$0.05. Now that's something that we'll continue to monitor over time and when we provide further updates, we'll base it based on the most recent foreign exchange rates, but that's where we are as of essentially today.

Q

I have a two part question. One is related to your...

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

A

I think you need to talk through the microphone.

Q

[indiscernible] (01:10)

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

A

Yes [ph] we are going to be. (01:11)

Q

Okay.

Q

The first one has to do with operational efficiency. You laid out the plan [indiscernible] (01:20) And the second question is on [indiscernible] (01:28) as you look at your product portfolio, are you going to do more M&A now that you [indiscernible] (01:34-01:44)?

Glenn David  
*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

A

Sure. So, the question was related to the operational efficiency initiative and where we are in that in terms of completion in 2017 and also what additional business development opportunities may exist post 2017 now that we've established the infrastructure, executed the operational efficiency initiative.

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

A

Okay. Let me start with the first question. So the actions that we needed to take and to implement has been already implemented. So now, as beginning of this year, we have all the plans in place and we are very confident that at the end of the year, we'll be exceeding the \$300 million target. So it's just now realizing all the actions that we have been taking in the last 18 months and then get all the savings that we will generate in 2017. So in this year, we plan also to achieve this \$300 million savings.

In terms of SKUs also, the SKUs that we needed to eliminate have been eliminated, moving that from countries that we had a direct presence and now we are using the distributors [ph] so have been done, so all the permits (02:52) has been already implemented.

In terms of M&A, I think the situation has not changed in terms of identifying opportunities in the market. We want to make sure that the opportunities make sense from the strategic point of view and also deliver the value that we expect out of these acquisitions. We have the expertise and also the experience on integrating the companies and maximizing the assets [indiscernible] (03:22) companies and creating a significant value out of these acquisitions. So, we'll continue being active. We have a group which is understanding all the different opportunities and these opportunities will be discussed and depending on the criteria that we have in terms of M&A, if they are meeting the criteria, then we'll be considering these acquisitions.

Q

[indiscernible] (03:48-03:58)

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

So, the question was related to the pricing on CYTOPOINT and then further opportunities that we have with [indiscernible] (04:04) within our portfolio.

A

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

So, the price of CYTOPOINT has a favorable price compared to APOQUEL. I think it's a price that it's, again, responding to what we think is a value that we bring into the market. And based on the early experience of CYTOPOINT in the market and the feedback from veterinarians and the use of the prototype has been well accepted and well perceived in terms of pricing level.

A

Definitely, we see opportunities on continued investing in biologicals, not only on vaccines, but also in pharma and biopharma. We have already products in biopharma like Improvest, which is a product that is reducing the boar taint in pigs and it's also adding some feed efficiencies. It's a product that has been introduced worldwide.

We also have this new CYTOPOINT, which is a biopharmaceutical product, and we'll continue investing in this monoclonal antibody platform to bring new products into the market. The prototype can be in the area of pain or some other indication that also will be adding more portfolio, more products to our portfolio.

Q

[indiscernible] (05:22-05:31)

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

The question was related to PHARMAQ and now that we've integrated it, what are our opportunities to enhance the growth rate of that moving forward?

A

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

So, we are very pleased with the acquisition of PHARMAQ. With PHARMAQ, we are now leading the vaccine segment of aquaculture. We also saw that the results of the R&D work with the PHARMAQ is already delivering a complete vaccines and we were able to introduce the first vaccine after the acquisition of PHARMAQ in January last year. It's a vaccine for salmon, which is treating a disease that has been devastating the salmon industry in Chile. And until the introduction of these vaccine, the only option for treating salmon was a massive use of antibiotics. The vaccine has been adopted by the industry and we are very pleased with the progression of our investment in PHARMAQ.

A

At the same time, we are also assessing opportunities of expanding not just in salmon, but other species in fish. We are investing in Vietnam. We are also investing in China with a lab to develop vaccines for fish. And we are

planning really to generate significant revenues. We are targeting \$125 million in 2017 for PHARMAQ. So, the results of PHARMAQ has been in line or even exceeded expectations.

Q

[indiscernible] (07:12-07:34)

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

So, we do believe that there is continued SG&A leverage in the model as we look. We believe we have the infrastructure in all of our key markets. So, when we look to the G&A line, in particular, that's an area that we're going to try to be very efficient on, keep that expense growing below inflation.

And then on the selling side, we will continue to look across the markets where there are opportunities to invest, but also where there are opportunities, where it's okay to grow similar to inflation. So, we think we have the right infrastructure, particularly with our field force. There are certain markets such as Brazil and China where we've made some recent investment in that field force, because we saw the opportunity to grow revenue faster. But overall, we have the right infrastructure in place and we do believe we'll be able to get continued leverage from that.

Q

[indiscernible] (08:14-08:31)

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

Right. So the question was will we be providing essentially more multi-year guidance in that three to five-year similar to what we did when we announced the operational efficiency initiative. Our intention moving forward is to provide one-year guidance. The purpose then was there are a lot of moving parts with the SKU rationalization with the cost of goods improvement, with the improvement in operating expenses, and we want to be very transparent about what the P&L would look like moving forward. Now, that we're through that large change, we believe annual guidance will be more appropriate moving forward.

Q

Could you comment on your outlook for the cattle genomics business [indiscernible] (09:06-09:18)?

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

So, the question was related to our cattle genomics business and what we see as the outlook for that.

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

So, we entered into the genetic business in 2007. At that time, probably the market was not that ready for adopting this new technology. We are pleased now with the adoption of genetic markers. We have seen that this

5

option has been mainly on the dairy part of our business and we are providing day markers or markers for improving fertility, also feed efficiencies and selecting animal that will be responding to certain characteristics. We think that the genetic part of our business is something that will continue growing. This is related to genetic markers, but there are other areas on genetic use that that also can be equally important.

We are not in the business of genetic manipulation, but using genetic information to make better selection of animals, selection of animals that can provide many different attributes, not only fertility or feed efficiency, but even animals that can be better protected against diseases. So, this is an area that definitely we are very interested. It's an area that we have also integrated in the rest of our R&D programs. And in some cases, we incorporate the genetic information to understand what will be the impact on certain vaccines or certain pharmaceuticals in specific target animals.

Q

[indiscernible] (11:07-11:19)

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

A

So, the question was related to new product introductions. And we'll first introduce the next product in the platform that we develop with Simparica, sarolaner, which is the active ingredient, and we will launch in Europe a topical formulation combining with another agent that will be targeting cats. So, cats are not an animal that it's, what, friendly or happy with the pills. Topical formulation is much more adequate for cats. So we will introduce this product in Europe and then in the future also we'll be introducing this product in the U.S.

Also, we are working on using sarolaner in combination with other agents for dogs, again with oral formulation to ensure that we have a broader protection not only against the ticks and fleas, but also against internal parasiticide like heartworm. We think that this will create a good opportunity for maximizing the asset that we have developed internally.

And another area that we are also investing, it's expanding a monoclonal antibody not only to indication of atopic dermatitis, but also indications like pain. And, again, we can introduce a product for pain which is efficacious, at same time, with very limited side or no side effects for both dogs and cats and will be a significant opportunity. And this will be – it is for injectable formulation that will be – we are also working to introduce in the market.

Q

[indiscernible] (13:15-13:32)

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

A

The question was about the recent consolidation in our industry and how this is affecting our competitive landscape. The most recent has been the consolidation of BI with Merial. This has been completed. As a result of this consolidation, they divested also some vaccines to Elanco. These vaccines were in the U.S. and where the vaccines that which we sold to BI when we acquired Fort Dodge.

We don't think that this new company that will be the second largest in the animal health industry will change significantly our competitive landscape. In fact, [ph] if we see (14:13) the different part of the portfolio that would result of this consolidation, the portfolio in companion animal will be basically the portfolio of Merial, the portfolio in swine will be the portfolio of BI. In poultry, will be the portfolio of Merial. And where we see some opportunities in terms of a synergy or combining in portfolio, will be in cattle.

We don't think that this will represent a significant change on the way we compete in the market. Definitely, they will have the opportunity through benefit of the critical mass. At the same time also, they will also go through the process of integration that also will create some distraction.

Q

[indiscernible] (14:59-15:18)

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

A

The question was about diagnostics and the acquisition that we made last year and if we will be small or we want to play big in the diagnostic space. Well, we are committed to diagnostics. We acquired Synbiotics in 2010, if I remember well. It was a small company. It's a company mainly developing rapid test at the point of care. But we saw that there were other areas of diagnostics that were equally interesting, I'm referring to equipment.

We have been assessing different companies in this space. And we decided that SMB, the company that we acquired in 2016 was the company that – it was the most attractive in terms of the pipeline that they were developing. We see that with the pipeline that we acquired, we can compete successfully in the equipment with many different platforms including chemistry, including also even molecular technology that in our opinion will bring [ph] disruptive (16:29) innovation to the market and we expect to really compete successfully in diagnostic.

Diagnostic is very complementary to our business. When we reach customers, veterinarians in companion animal or livestock, we discuss about diseases, we discuss about how to identify the disease and how to identify the products that will be targeting the disease or protecting the animal. So it's something that, in any case, it's part of our discussion, is part of our business. We consider that integrating that as part of our conversation with customers was very synergistic and we can use the current infrastructure, the current knowledge, maybe add in some additional capabilities to support the equipment, but definitely, we see our current field force as the one that also can create the demand for these products.

Q

[indiscernible] (17:29-17:44)

Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

A

Sure. So our cash flow does improve significantly as we move through 2017. As you mentioned, when we first were spun out of Pfizer, there were a certain amount of costs related to spinning out and standing us up as an independent organization. Then with the operational efficiency initiative, there were also some significant cash outlays related to that and we also had the implementation of our ERP system.

With that behind us and the continued strong performance of the business, we will have significant cash flows moving forward in 2017 and beyond, and that does give us a lot of additional flexibility, A, to make certain investments internally that we believe will be critical for the long-term success of the business either within R&D or manufacturing, and then also to evaluate other business development opportunities.

And then finally, in terms of capital deployment, we've increased our dividend. We have a 10.5% increase in the dividend that we just announced and we also announced a \$1.5 billion share repurchase program. That's a multi-year program. It's a flexible program and the timing of how fast we'll execute that will depend on some of our other capital needs.

Q

[indiscernible] (18:42-18:57)

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

A

I think that definitely, the cash flow is something that can impact our ability to have some acquisitions. We also had that during a certain period. Maybe [ph] they (19:08) need to focus on building up Zoetis, creating the infrastructure, ensuring that we're delivering our commitments, and not to add too much complexity or distraction to our operations.

Once we passed this period on having a full control of all the support functions, control of manufacturing, we felt that we were in much better position to really target some acquisitions that will be adding value to our operations. And now that we also have the flexibility in terms of cash that will be generated, that definitely is something that we'll continue assessing. And I think it's – we have also a good investment rating now and this is also allowing us to have access to cash that will be also helping us to target some additional opportunities in the market.

Q

[ph] Are there any more questions? (20:05)

Q

[indiscernible] (20:10-20:24)

Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

A

The question was about the access that we have on the R&D library of compounds. It was an agreement that we signed at the time of the separation that will be covering seven years from the separation. We have the opportunity of renewing that. It's something that we'll be assessing. What I want to say is that, I think when we are part of Pfizer, we have access only to Pfizer, because at that time, having access to other companies could create some conflict of interest. Now, we don't have this limitation.

Now, we have the opportunity to continue having access to the library of compounds of Pfizer, but at the same time, discussing with other pharmaceutical companies without animal health unit that they want also to collaborate with us. Definitely, this can be an opportunity for these companies to get some additional value on products that



they have in their library, but also the opportunity of these companies to work with us in terms of providing the expertise that we have in animals, because most of the human health company, they start with animals and we have the expertise and the access to the animals. So, we think that this can be a good way of collaborating with small and large companies in the human health segment.

---

## Unverified Participant

[ph] I think we are out of time. (22:00) Thank you, guys, so much.

---

## Juan Ramón Alaix

*Chief Executive Officer & Director, Zoetis, Inc.*

Thank you.

---

## Glenn David

*Chief Financial Officer & Executive Vice President, Zoetis, Inc.*

Thank you.

---

### Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2017 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.