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Zoetis, Inc. (ZTS)

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CORPORATE PARTICIPANTS

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

MANAGEMENT DISCUSSION SECTION

Unverified Participant

[Abrupt Start] and we will be able to give us an update on the efforts on [indiscernible] (00:04). Clint, thank you for joining us here.

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

Thank you, [ph] Kathleen (00:07), and thanks to Cowen. Hopefully everybody can hear me. Well, it's a privilege to be here. Having been to many conferences, I'm sure, like yourself, it's always a dubious distinction standing in front of this audience and whatever happens for reception and dinner but I'll try to keep it as engaging as possible.

So as [ph] Kathleen (00:29) said, I have the privilege of being the head of the international business. I've been in this role just shy of about two years. Prior to that, I was the President for our U.S. business with Zoetis for a little over eight years. Some additional history, spent 20 years on the human health side and a number of commercial opportunities with Pfizer, and then joined the animal health division in 2007. So again, it's a privilege to be here.

And I would say maybe an interesting break from some of the other types of companies that you've met with during the conference. First, let me get out some housekeeping notes. First, obviously I'll be reviewing some forward-looking statements, as well as discussing some of our performance in non-GAAP measures. I want to make sure obviously that, I draw your attention to our various SEC filings that talks about the inherent risks in the business, as well as the definition of the components of between GAAP and non-GAAP.

Let me cut right to the chase. So, on the heel of [ph] Kathleen's (01:38) introductory comments, the animal health industry and the core part that Zoetis sits, sits in that middle. It makes up roughly \$30 billion in various therapeutic categories across medicines, vaccines, medicated feed additives, parasiticides. But if you think also more broadly on the industry, you can see the other components that make up this industry that we sit largely in that middle sector, comprising roughly \$30 billion, but at the same time you'll see components of our business that do play also into the area of diagnostics and emerging space risk, as well as in the area of genetics and herd management.

We continue to talk about the underlying predictable trends that underpin this industry of where Zoetis sits at the nexus of that, whether that be population growth, the continued growth of the middle class, as well as increased urbanization. We also see as the population grows that population also ages and so too, does the desire for what we call more human quality care for those extended members of the family if you think about it from a companion animal standpoint.

If we also look at the continued challenge with respect to availability of land and natural resources, there continues to be across livestock and protein production, a performance and productivity imperative that continues to underpin the need for ongoing innovation. A couple of things I also want you to take forward and look in this industry in terms of the durability of that growth that underpins this industry and the resiliency of that. And again, from a Zoetis standpoint, we have a set of inherent natural hedges if you think about the diversity of our business, whether it be species diversity, therapeutic area of product segment diversity, as well as geographic diversity.

I'd like to speak quickly about the journey that we've been on and put it into three categories. Clearly in 2013, 2014 was the IPO, the launch of Zoetis and while Zoetis was a new entity, we sprang out of Pfizer from a 60-year history in animal health. That 60-year history in animal health also saw us become and earn the market leadership, the access, the trust and loyalty of our customers globally. Also, as we separated out and become our own standalone company, big focus on setting up the necessary IT systems and other processes that made sense for a standalone independent animal health company.

Stage 2 is we're kind of just coming out as we look at formerly being a division of Pfizer and now being standalone, making sure that we had an organizational construct and resourcing model that made sense not for a former division of Pfizer, but again as a standalone independent solely focused on animal health. We also introduced a global operational efficiency initiative that we're almost largely completed. It will be fully done by the end of 2017, but again making sure that we have a model and a resources structure that's fit for purpose. That operational initiative we committed to generating \$300 million in savings by the end of 2017, and as we've commented publicly, we're well on our way to completing that and exceeding that \$300 million target.

And as we find ourselves in 2017 and moving forward, we have in essence become the company we always envisioned that we can be. Again, well-positioned to continue to benefit more so than our peers in terms of the broader market trends that underpinned this industry, continue to be disciplined in our capital allocation and our investments to continue to position ourselves for continued growth and sustainable growth in that regard and continue to bring value to our customers and shareholders.

If we think about that performance, you can see here in this chart, despite industry consolidation and the dynamic nature of the marketplace, Zoetis remains the global leader when you look in terms of total revenue. We've also continued year-after-year to continue to outperform the market and many of our key competitors. And as you can see here, in terms of the effectiveness of the model, continued to expand our EBIT margin and continued to grow adjusted net income at a rate faster than sales and that we continue to commit to that as we move forward in 2017.

Turning specifically to the breakdown of our business from an international segment, you can see that we're largely a little over 30% companion animal and the rest of the other 70%-some-odd distributed over livestock. If you were to contrast it, let's say, in the U.S., U.S. would be more 50%-50% between companion animal and livestock, including globally across so what is more kind of 65%-35% livestock to companion animal, and you could see the various categories in which we break down.

Again, if we look at the performance of international broken down by our key markets. So this, as you see, now external reports the performance of our top 11 markets outside of the U.S. You can see the breakdown between livestock and companion animal. You also see the operational growth that we've continued to see over in 2016 and also compare that to our reported growth, again continue to be encouraged about the prospects for growth broadly in the markets outside of the U.S. as well as in the U.S.

Two areas I'd like to really highlight, maybe there will be some Q&A afterwards, and this is the performance in markets like Brazil and China. Brazil is a very developed market as it relates to livestock and protein production, with very much an emerging market as it relates to companion animal. China, we also see continues to grow significant across both livestock and companion animal and we'll continue to invest both in Brazil and China continued to capitalize on the growth trend that we see both across livestock and companion animal.

Move to the last slide. And lastly, as we think about how we continue to drive our performance in international, especially having come from the U.S., the operational initiative found us again, making sure that we could set up a organizational model that made sense for the business. We streamlined lower value areas, whether that was in SKUs, whether in terms of infrastructure above our markets to make sure that we could get closer to the customer, especially for those key markets.

We've continued to bring discipline in the area of pricing, digital marketing, business analytics and leverage in a very efficient way from our international headquarters to make sure that we're effectively supporting the market as well as aligning the mindset around the opportunities to both see and sieze growth.

Keep in mind, historically before this change, we had operated in four distinct geographic segments: the U.S., Europe, Africa, Middle East, Canada, Latin America and Asia Pacific. And now we, in essence, operate two: the U.S. and international. And we've continued to focus on investments in key markets, Brazil and China being two noteworthy ones, and continued to expand key technologies that we're seeing in the U.S. to other markets. And this is an opportunity that we believe will continue to grow as we move forward. So with that, let me stop here and turn it over to you for any questions that you might have.

QUESTION AND ANSWER SECTION

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

Yes?

A

[indiscernible] (10:19-10:46)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

Yeah. Well again, very good question. I would say first, let's do some level setting. So we see the broader animal health industry, very resilient with respect to its predictability in growth. And that growth on a global scale has been in that 5% range. Clearly as we think about economic, geopolitical issues, weather patterns become something that also affect the business, it could have some tempering, but I would still say – and Zoetis benefits from a set of natural hedges, right? So where you may have a challenge in one particular market or one particular species, you see that clearly offset in a number of different areas. Obviously, what continues to fuel that top line growth is the introduction of new technology, new innovation. And clearly, Zoetis has benefited from that if you look at both net new product approvals as well as geoexpansion of products that we've had in Europe or U.S. to other markets like Latin America and Asia. So these will be some of the things that will continue to contribute to growth. And again, there's a durability, there's a sustainability of that growth that we've seen year-over-year.

Q

A

Yes?

Q

[indiscernible] (12:01-12:05)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

Yeah.

Q

[indiscernible] (12:06-12:21)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

Yeah. So it's a great question about PHARMAQ and more broadly the aquatic health or aquaculture segment. First, to your point, protein for fish, aquatic health is one of the fastest growing protein segments in the broader animal health category. I would also say our acquisition of PHARMAQ was an opportunity, not only to enter into the aquatic health area, but to do it at scale by acquiring the market leader with PHARMAQ. And we continue to be encouraged by both the pipeline and portfolio of products that we see, as well as our ability to continue to gain some appropriate leverage from PHARMAQ now being a part of Zoetis. So very excited about PHARMAQ, but also the continued prospects for growth in that segment.

Yeah?

Q

[indiscernible] (13:15-13:31)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

So [ph] look (13:32), in terms of APOQUEL, in terms of being launched and introduced, in addition to its launch in the U.S., I would say as we sit here today in the beginning part of 2017 or early part of 2017, we have effectively launched APOQUEL into every major companion animal market globally, last one being in the third quarter which was Japan. And now similar to the U.S., it's continuing to make sure that we're working closely with veterinarians to understand and exploit the full utility of this product across the spectrum of atopic dermatitis.

The last part of your question relative to DC (sic) [DTC] (14:14). So we will be focused on DTC in the U.S. to further complement the growth and the expansion of the product. But from a regulatory standpoint outside of the U.S. somewhat similar to human health, is that from a regulatory standpoint you can't do branded DTC especially in the number of markets outside of the U.S. like Europe. So right now, we'll be focused primarily in the U.S.

Other question? Yes, sir?

Q

[indiscernible] (14:39-14:44)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

Yeah. So we're in the genetic space now. Again, we acquired two companies several years ago, Bovigen and Catapult, which was more in the genetic markers. So these are tests for specific traits, largely in cattle. We do have some in – they have some application in sheep, so the focus is more of a beef and dairy cattle and looking at things like marbling, tenderness and also high quality calf in the dairy segment.

Clearly, we see over the next 5, 10, 15, 20 years that genetics will continue to be influencing more of what's done, why it's done, when and how. And so we're continuing to explore opportunities to further expand and complement our existing portfolio in genetics in that space. I think – what was the second part of the question?

Q

[indiscernible] (15:44 -15:53)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

So it's – yes, right? So we're exploring this space clearly from a standpoint of – or you call it digitally enabled care, so we clearly think about the opportunity that technology will provide to be able to look and to provide farmers and veterinarians better understanding of different dynamics impacting health, performance and productivity. Clearly, we have the access in major markets like the U.S. to sit shoulder-to-shoulder with farmers and their veterinarians to understanding different dynamics and we do see the roll that technology will start to play. We're starting to do on a small scale today experimentation with different technologies and platforms and assessing the applicability of that across a number of the different lifestyle sectors, largely focused now in the dairy and beef segment.

There is another question, I think. Yes?

Q

[indiscernible] (16:53-17:01)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

So we've – from a Zoetis standpoint, a little bit similar to the comments earlier about aquatic health, we see the area of diagnostics growing at a rate faster than the overall traditional or core animal health business. We also see diagnostics in many ways complementary to our business. If you think about being able to have this, the full suite of care, right. So vaccines, the focus on preventative diagnostics to help veterinarians make differential diagnoses and then they have the appropriate products to treat based on the assessment.

It's an area that we have started to expand in largely in the companion animal segment, but we do believe that especially outside of the U.S., there still tends to be much more fragmentation in the area of diagnostics outside

the U.S. in companion animal, and we think that the market is largely underserved in the area of livestock. And so to the previous gentleman's question about herd management, we do believe that there's an appropriate role for rapid on-farm diagnostics to help veterinarians and producers make that assessment then be able to take the appropriate treatment as a result of that insight. Yes, [ph] on the side (18:23)?

Q

[indiscernible] (18:25-18:41)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

Yeah. Again, I think what we also try to do in the earnings call is to give a little bit more color and clarity around the impact that our operational efficiency initiative. So discontinuing a number of lower margin, lower value SKUs that happen to be disproportionately impacting the livestock business. So that added a little bit of color that you need to kind of work through. But if I think about macro trends outside of the U.S., there's a lot to feel very good about. If you think about our livestock segment, let me first start with cattle, cattle both beef and then dairy. When I look at beef cattle, look at the trends in Canada, Mexico, Argentina, Brazil, Australia, very strong trends, structurally good in terms of rebuilding back the herds, good prices at the retail side, good producer profitability and it provides continued opportunities for them to invest in the optimal health status for their herds.

If I look at dairy, dairy in 2016 was largely soft across the industry. There was a number of different factors for that. You had – the end of 2015, you had the quota system that had largely been in place in Western Europe be removed, which sent again from a free market, signals to producers across the different major dairy producing countries in Western Europe to increase their production.

The hope for that outlet for that milk was going to be two primary places beyond consumption in Europe: Russia and then China. Russia, when you have the geopolitical dynamics about annexation of Crimea, Ukraine and the sanctions that were imposed both in U.S. and in Europe, obviously did not then provide an outlet for that dairy production into Russia.

Second, as it relates to China, China as we went into 2016 still was working off high historical stocks of dairy powder, but in – while we don't necessarily see immediate changes to the geopolitical situation as it relates to Russia, we do believe that conditions will improve in China for more exports, so that will open up opportunities to both Europe, as well as continued exports from New Zealand. We also believe that producers are naturally working with the dynamics of supply and demand so that we do believe that production would be better managed and you'll see an increase in retail milk prices that will also contribute to better profitability for dairy producers.

If I switch to pork, we see good rebound for pork and poultry in markets like Brazil. Brazil was impacted more in 2016 because you had higher input costs largely in corn and soybean, so their yield was less than expected, their contracts were more tied up for exports, so therefore there was not as much availability for local consumption. We see that dynamic changing, assuming normal weather patterns for 2017, so feel much more optimistic about the prospects for pork and poultry in Brazil.

In Western Europe, we have launched a new vaccine, a new combination vaccine for PCV and M Hyo, one of the major areas of prevention in the swine herd. That product has just launched and we're encouraged about the prospects for what that will add for growth in Western Europe. And then lastly, as I look to China, China has an

insatiable appetite for pork both in terms of its domestic consumption, but will continue to require exports from a number of key markets like Brazil into China.

Last but certainly not least with respect to poultry, we'll see growth with poultry. I think the wild card for poultry in 2017 is going to be the continued impacts of Avian Influenza. So we have had a number of reports of Avian Influenza in Western Europe. You've seen some of it also in Asia, knock on wood, Latin America seems to have been spared. And again, I think these dynamics speak to both the resiliency but also the natural hedges that are built into our business. So if you might have softness in a geography in a particular protein or species segment, you'll also often see an offset in a positive way in other sectors, other segments, other geographies.

Yes, sir?

Q

[indiscernible] (23:30-23:44)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

Yes.

A

Q

[indiscernible] (23:46-24:03)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

Yeah. You wouldn't fault me for first looking at it potentially as an opportunity, all right. So clearly, as I said, one of the benefits of having been in the genetics space is that we have the ability both within our genetics team, but also on our traditional R&D to think about different opportunities and manifestations of where genetics and genomics can help, and we continue to look at that area. I won't speak specifically into the gene editing space, but I would say again we have both experience and understanding about how that space continues to unfold and what's the right way to be able to approach it either internally or externally as it relates to Zoetis.

But again, I think when you look at some of the work, you mentioned genes, but others are doing in that gene editing, the CRISPR platform, again, I think it becomes yet another opportunity of – the opportunity for technology and innovation in the space. So we don't see that as a material threat in the immediate or foreseeable future. But at the same time, as I responded earlier, we do see genetics as an important adjacency that Zoetis will continue to look for to innovate both internally as well as externally.

Any other questions? Yes, sir?

Q

[indiscernible] (25:29-25:44)

Clinton A. Lewis

Executive VP & President-International Operations, Zoetis, Inc.

A

Yeah. So I mean if you think about the broader \$30 billion category for the core in traditional animal health business, parasiticides, especially in companion animal is the largest, it's also the most competitive and it's an area in full transparency that we've commented in the past that Zoetis is under index. And we are excited about our entrance into that, in this case sarolaner or Simparica, this is a compound compared to our competitors that we discovered in-house as opposed to licensing it in. And while we have come third to the market, we're also excited about the profile of that product both in its onset of action, duration of [indiscernible] (26:39) also to continue even post-launch to bring new claims to it, as well as life cycle enhancement.

So Simparica as a standalone asset is an oral, it's an isoxazoline. It's an oral for dogs. But we are about to launch the first life cycle enhancement for that platform with another agent that we've had in the parasiticide area, Stronghold or Selamectin to create Stronghold Plus. And so lastly, to your question about the uptake, again with all of those positives we still – the fact is came third to market. And it is really now in this 2017 spring season, both in the U.S. and outside of the U.S. and specially in Western Europe where we have tremendous opportunity to have that product in full availability early enough and through the spring season, but the fact is we're still coming third to market in that regard. But we're excited about that category, and obviously the platform and the life cycle opportunities that we'll have with Simparica.

Any other questions? [ph] Kathleen (27:54), how are we doing on time?

Okay. First of all, Cowen, thank you very much for the opportunity, and thanks for the questions.

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