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Zoetis, Inc. (ZTS)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Third Quarter 2022 Financial Results Conference Call and Webcast for Zoetis. Hosting the call today is Steve Frank, Vice President of Investor Relations for Zoetis. The presentation materials and additional financial tables are currently posted on the Investor Relations section of zoetis.com. The presentation slides can be managed by you, the viewer, and will not be forwarded automatically. In addition, a replay of this call will be available approximately two hours after the conclusion of this call via dial-in or on the Investor Relations section of zoetis.com.

At this time, all participants have been placed in a listen-only mode and the floor will be open for your questions following the presentation. [Operator Instructions] In the interest of time, we ask that you limit yourself to one question and then queue up again with any follow-ups. Your line will be muted when you complete your question. [Operator Instructions]

It is now my pleasure to turn the floor over to Steve Frank. Steve, you may begin.

Steven Frank

Vice President-Investor Relations, Zoetis, Inc.

Thank you, operator. Good morning, everyone. And welcome to the Zoetis Third Quarter 2022 Earnings Call. I am joined today by Kristin Peck, our Chief Executive Officer; and Wetteny Joseph, our Chief Financial Officer.

Before we begin, I'll remind you that the slides presented on this call are available on the Investor Relations section of our website and that our remarks today will include forward-looking statements and that actual results could differ materially from those projections. For a list and description of certain factors that could cause results to differ, I refer you to the forward-looking statements in today's press release and our SEC filings, including but not limited to, our Annual Report on Form 10-K and our reports on Form 10-Q.

Our remarks today will also include references to certain financial measures, which were not prepared in accordance with Generally Accepted Accounting Principles, or US GAAP. A reconciliation of these non-GAAP financial measures to the most directly comparable US GAAP measures is included in the financial tables that accompany our earnings press release and the company's 8-K filing dated today, Thursday, November 3, 2022. We also cite operational results, which exclude the impact of foreign exchange.

With that, I will turn the call over to Kristin.

Kristin C. Peck

Chief Executive Officer & Director, Zoetis, Inc.

Thank you, Steve. And welcome everyone to our third quarter earnings call for 2022. While the world faces a dynamic external environment and uncertainty in the global economy, our business has been tested and continues to perform well, based on our diverse, durable portfolio and global footprint. In the third quarter we delivered solid results with 5% operational revenue growth, reflecting steady performance across our innovation-driven companion animal portfolio, especially in our International markets.

Our International business grew 8% operationally, and the US grew 2% in the quarter. As we've been saying for some time, supply challenges throughout the year remain a headwind to meeting global demand, and those impacts were more pronounced in the third quarter. Supply has been improving in certain product categories, such as parasiticides, and we continue prioritizing supply for key products and markets. However, we do expect constraints in some categories to continue.

Overall, positive pet care trends in terms of increasing spend and pet owner demographics continue to underpin the strength of our business. With 10% operational growth in companion animal products in the third quarter, we continue to see strong demand globally for Simparica Trio and other parasiticides; our key dermatology products, Apoquel and Cytopoint; small animal vaccines; and monoclonal antibodies, Librela and Solensia.

In the US, supply constraints for companion animal products hampered some of our expected growth in the quarter. And we also experienced an impact related to workforce challenges in veterinary clinics. The decline in clinic visits is stabilizing at pre-COVID rates as clinics struggle with capacity issues. That being said, average revenues per visit continued to rise in the US as pet owners place a premium on the care of their pets, a positive long-term trend.

This commitment to pet well-being is also demonstrated in the success of our monoclonal antibodies for osteoarthritis pain, Librela and Solensia. They are performing exceptionally well in the EU, and Solensia is on track after being launched in the US at the end of the third quarter. We are investing in building a feline market for pain treatment, an undertreated condition for cats.

Outside of the US, companion animal products showed strong growth of 17% operationally. In some of our largest markets like China and Australia, we're seeing our innovative pet care products contributing more and more to growth in these traditionally livestock-driven markets. Meanwhile, our global livestock business performed largely as expected in the third quarter, with a decline of 3% operationally.

We continue to face generic competition for livestock products, especially in cattle and poultry; and we face supply constraints in products such as vaccines. However, we are seeing solid pockets of growth, especially in aquaculture and poultry products and certain markets outside the US. As we stabilize from the generic competition and review more consistent supply, we will improve our livestock performance.

Looking ahead, we remain confident in the innovation-driven strength of our business, especially in areas such as parasiticides, key dermatology products, vaccines, and monoclonal antibodies. I am optimistic about the fundamental growth drivers and essential nature of the animal health industry to weather challenging times. However, we are revising our full-year guidance to reflect lower than expected sales in the second half of the year due to supply constraints, veterinary workforce challenges, and recent changes to foreign exchange rates. We believe it is prudent to take a more cautious view, given the increasing uncertainty around supply, inflation, and other macroeconomic conditions that have become less predictable.

As we look ahead to our 10th anniversary as an independent company next year, and I reflect on all that we've achieved in the last decade, I feel very positive about where we are and the capabilities we have to overcome any challenges we face. Historically, we've always been able to adapt our business to meet evolving customer needs, drive growth faster than the market, and achieve our purpose in nurturing the world and humankind by advancing care for animals.

The human-animal bond and people's connection to pets and farm animals is powerful. It's a bond we support with a diverse portfolio that remains the strength of our business. And we see strong global demand for our innovative products, especially in companion animal parasiticides, dermatology, vaccines, diagnostics, and monoclonal antibodies for pain.

Positive pet owner demographics and their willingness to spend on the care of their animals remain long-term sustainable drivers of growth, despite some of the workforce challenges in clinics. And livestock continues to be an important part of our business, an area where we drive significant value for our customers and shareholders. To sustain our growth, innovation remains our lifeblood, and we continue investing in the industry's leading R&D engine at Zoetis.

Our monoclonal antibody portfolio for OA pain is a game-changer. It has been performing exceptionally well as a pet treatment and growth driver in an increasing number of markets, and Librela is expected to be a blockbuster for Zoetis in 2022. In terms of the US approval for Librela, we have confirmed dates for the FDA site inspections outside the US, but their timing makes it unlikely to have an approval this year. Given our ongoing conversations with the FDA, we are confident in receiving approval in the first half of 2023, with a launch planned for late in the year.

In closing, our business continues to perform well in a dynamic market, and we are well-positioned to advance our strategic growth opportunities in parasiticides, dermatology, pain, diagnostics, and emerging markets. Even as we face challenging supply constraints, generic competition, and macroeconomic uncertainty, I remain confident in the resilience of our business and colleagues as we finish 2022 and we go into 2023.

Given the importance of the companionship and nutrition provided by pets and farm animals and the power of the human-animal bond, the animal health industry has consistently grown in the mid-single digits, even in down markets. And, as the leader in animal health, we have the pipeline, market leadership position, global scale, and financial strength to continue outpacing the market.

Throughout the last 10 years in various market conditions, we have grown the top line an average of about 8%. And even in the last recession, when our business was more livestock than companion animal, we still grew. As we look toward the end of the year and into 2023, I expect us to continue setting the bar on innovation, cultivating a high-performing culture, and delivering superior customer experiences. All of this will have us growing significantly above the market and building enduring value for shareholders in this dynamic market.

Thank you. Now, let me hand things over to Wetteny.

Wetteny Joseph

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

Thank you, Kristin, and good morning, everyone. As Kristin mentioned, we had a solid quarter with growth across a number of our core franchises, driven by our companion animal performance, especially in International. Today, I will focus my comments on our third quarter financial results, the key drivers contributing to our performance, and provide an update on our full year 2022 guidance.

In the third quarter, we generated revenue of $2 billion, growing 1% on a reported basis and 5% on an operational basis. Adjusted net income of $566 million declined 5% on a reported basis and grew 2% on an operational basis. Of the 5% operational revenue growth, 4% is from volume and 1% from price. Volume growth consisted of 4% on new products, which includes Simparica Trio and our monoclonal antibodies for osteoarthritis pain in dogs and cats, Librela and Solensia, and 1% from key dermatology products, while other in-line products declined 1%. The decline was largely the result of supply challenges.

Companion animal products continued to be the primary driver of growth, growing 10% operationally, with livestock declining 3% on an operational basis in the quarter. Simparica Trio was the largest contributor to growth in the quarter. Simparica Trio posted global revenue of $172 million, representing operational growth of 43% versus the comparable period in 2021. We expect to continue to grow the addressable market for flea, tick, and heartworm globally, and see significant room for growth with brands like Simparica Trio, Simparica, ProHeart, and Revolution Plus.

Meanwhile, our key dermatology products, Apoquel and Cytopoint, have solid global growth, especially internationally, with $343 million of revenue representing 11% operational growth against a robust prior year in which these products grew 26% operationally. Year-to-date revenue is $966 million, representing 18% operational growth. Sales of our monoclonal antibodies for osteoarthritis pain in dogs and cats in International continue to exceed expectations, posting $37 million of sales in the quarter.

Switching to diagnostics, our global companion animal diagnostics portfolio recorded $78 million in revenue in Q3, declining 9% operationally. Despite declining revenues, we saw solid new instrument placements in the quarter. The decline in our US diagnostics portfolio was partially offset by growth internationally in the quarter. In the US, our diagnostics results were also impacted by the vet clinic workforce challenges, and we continue to experience a slowdown in sales as we transition to our new go-to-market model, and build out a sizable and new dedicated field force for diagnostics.

While disruptive in the short term, this investment is putting the necessary elements in place to position and grow our diagnostics portfolio over the long run. We expect the effectiveness of our new diagnostics field force to improve gradually into 2023. Diagnostics remains core to our business and a key long-term growth driver for Zoetis.

Meanwhile, sales of livestock products declined by 3% operationally in the quarter. Our portfolio continues to be challenged by generics and cheaper alternatives to Draxxin in cattle, as well as Zoamix in poultry, and supply challenges for certain products. Our fish portfolio grew 19% operationally in the quarter, and along with the strength of our sheep products in Australia, partially offset the broader decline.

Now moving on to revenue growth by segment for the quarter, US revenue was $1.1 billion in the quarter, growing 2% with companion animal sales growing 6%, and livestock sales declining by 7%. Focusing first on companion animal, the effects of our ongoing supply challenges were more pronounced in the third quarter, tempering growth in our parasiticides. In US companion animal, we are also seeing vet clinic workforce challenges limiting appointment availability as visits declined 4% in the quarter.

Despite lower visits, practice revenue is growing approximately 5% as spending per visit remained strong again this quarter, increasing more than 9%. The declining clinic visits is stabilizing at pre-COVID levels as the impact of higher pet ownership growth rates due to COVID normalize, and vet practices deal with workforce challenges. However, underlying demand for veterinary care remains robust throughout the country even as people return to work. While vet clinic workforce challenges do exist, we believe vet clinic revenue will continue to grow at levels above what we were seeing prior to COVID as the standard of veterinary care continues to increase through innovation, better pet ownership demographics, higher compliance and more pets.

Even with the robust comparative year, we continue to see volume growth in our companion animal products, driven by our innovative products such as Simparica Trio and our key dermatology products Apoquel and Cytopoint. Growth of Simparica Trio was again strong in the quarter with sales of $157 million in the US, growing 43%. Despite the impact of supply constraints and the vet clinic workforce challenges, we continue to take share within individual clinics. These dynamics will provide additional run rate for future expansion of both the broader market and revenue growth for Simparica Trio.

Key dermatology product sales in the US were $231 million for the quarter, growing 6%, with Apoquel and Cytopoint each contributing to growth. Year-to-date, our US derm portfolio has grown 12%. Growth is tempered by prior-year COVID-related spikes in derm visits that drove visit growth of 25% in Q3 2021 and helped to accelerate market expansion. This growth was also impacted by the ongoing vet clinic workforce challenges. We expect continued expansion of the market for the foreseeable future.

US livestock declined 7% in the quarter as expected, with sales of cattle products impacted by generic competition for Draxxin. Meanwhile, our US poultry portfolio continues to be negatively impacted by the extended use of lower cost alternatives and generic competition for Zoamix. US swine product sales declined 3% in the quarter, driven primarily by increased competition for vaccines.

Moving onto our International segment where revenue declined 2% on a reported basis and grew 8% operationally in the quarter. International companion animal revenue grew 17% operationally and livestock revenue was flat operationally. Increased sales of companion animal products resulted from growth of monoclonal antibodies for alleviation of osteoarthritis pain, our key dermatology products and Simparica Trio. We remain excited with the long-term prospects of these innovative brands and expect future direct-to-consumer advertising to help drive additional growth. Sales of companion animal vaccines also contributed to growth in the quarter.

We continue to be pleased with the performance of our monoclonal antibodies for OA pain with Librela generating $31 million and Solensia delivering $6 million in third quarter sales. Librela remains on track to exceed $100 million in revenue this year, a new blockbuster for Zoetis.

As we have mentioned in prior quarters, Librela is the number one pain product in the EU with the underlying performance metrics being very favorable for future growth. Reordering rates remained high. Compliance continues to exceed our initial expectations, and we continue to see significant opportunity to expand the pain market with a meaningful percentage of dogs on Librela being new to the market.

We saw volume growth in our International companion animal portfolio in the third quarter, and we also saw growth across our injectable products including monoclonal antibodies and vaccines. Meanwhile, International livestock was flat operationally in the quarter. Our fish portfolio grew 19% operationally and experienced increased demand for vaccines in key salmon markets, including Norway and Chile.

Sales of sheep products grew as a result of favorable market conditions and new product launches in Australia. Growth was offset by swine sales, which declined due to supply constraints across International and lower sales across Europe due to reduced exports to China and higher input costs for producers. Sales in Brazil also declined as we are seeing supply challenges on cattle products. Additionally, inflationary impacts on consumer spending are driving consumption away from beef to lower cost animal proteins such as pork and chicken and reducing [ph] producer profitability (00:19:21). Lastly, the Jurox acquisition, which is based in Australia, was completed on September 30th and is not reflected in our Q3 results.

Now moving on to the rest of P&L for the quarter. Adjusted gross margins of 69.8% decreased 90 basis points on a comparable basis to the prior year, resulting primarily from unfavorable foreign exchange impacts. Operationally, gross margin slightly declined, driven by higher manufacturing, freight and other costs, which were largely offset by favorable mix and price. Adjusted operating expenses increased 3% operationally with SG&A growth of 3% operationally, driven by T&E costs beginning to return to pre-COVID levels as well as freight and logistics.

R&D expenses increased 4% operationally due to higher competition costs and higher operating costs. The adjusted effective tax rate for the quarter was 20.9%, an increase of 420 basis points due to unfavorable changes to the jurisdictional mix of earnings, including decreased favorability related to foreign-derived intangible income in the prior year period.

And finally, adjusted net income grew 2% operationally, and adjusted diluted EPS grew 4% operationally for the quarter. Capital expenditures in the third quarter were $154 million. In the quarter, we repurchased approximately $375 million of Zoetis' shares and returned over $0.5 billion to shareholders through a combination of share repurchases and dividends. Year-to-date, we have repurchased almost $1.2 billion of Zoetis' shares.

Now moving along to our updated guidance for the full year 2022. For operational revenue growth, we are lowering our growth to 7% to 8%, previously 9.5% to 10.5%. We are also lowering our operational growth expectations for adjusted net income to a range of 9% to 11%, previously 11% to 13%. This change in guidance is reflective of our Q3 results, continued impact from supply challenges and the ongoing vet clinic workforce challenges. Foreign exchange rates on our updated guidance are as of late October and reflect a continued strengthening of the US dollar.

Beginning with revenue for the full year 2022, due to lowering of our guidance and the impact of foreign exchange, we are now projecting revenue of between $8.0 billion and $8.075 billion. We lowered our operating expense guidance for the full year, reflecting lower expenses in both Q3 and Q4, which reflects our ability to manage costs. Additionally, it is worth noting that our expected Q4 expense decline is also impacted by an easier comp due to heavy spending in the fourth quarter last year.

Additionally, our guidance for adjusted interest expense and OID was changed to reflect favorable changes to interest income. We now expect adjusted net income to be in the range of $2.27 billion to $2.31 billion. And finally, we expect the adjusted diluted EPS to be in the range of $4.83 to $4.90 and reported diluted EPS to be in the range of $4.51 to $4.59.

While lower, our full year 2022 guidance once again reflects our value proposition of growing revenue in line with or faster than the market, and growing adjusted net income faster than revenue over the long-term. Our success will continue to come from our diversified portfolio of enduring brands, driven by multiple sources of in-line growth, productive innovation and our infrastructure to develop and expand markets globally. We expect to continue to execute across multiple dimensions of our business and capitalize on key growth opportunities for the foreseeable future.

Now, I'll hand things over to the operator to open the line for your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Erin Wright with Morgan Stanley. Please go ahead. Your line is open.

Erin Wilson Wright
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you for taking my question. So, when we think about some of these headwinds and tailwinds related to 2022, what is now proving to be more challenging than anticipated? Is it mostly the supply chain issues or is it other factors here? And can you quantify the supply chain constraints, what sales would've been, excluding these dynamics?

And then how should we think about those broader headwinds and tailwinds from an operational perspective into 2023? As we think about both livestock and companion animals, should low single-digit livestock growth in 2023 be the right way to think about it? And then if that's the case, how do we think about companion animal operational growth in 2023? And – I'll stop there. Thanks.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. Thanks, Erin. I'll start, and I'll let Wetteny build on this one. I mean, I think the first thing to start with is, fundamentally and structurally, the veterinary business, and importantly demand for our products, remains stronger than it was before COVID. I think we've got still a very healthy business. As you look at sort of the headwinds as we looked at the second half of this year, by far, supply was the biggest, and I'll let Wetteny comment on sort of sizing them – I would say that was the significant driver for us in Q3 and as we look into Q4. I mean, certainly we can talk about vet clinic visits as well, but I think for us, we really believe that the supply issues that we were facing were really the primary driver for us.

And as we look into 2023, I think the really good news around that is, as we look at the ones we faced this year, as we talked about supply from the beginning of the year, we had mAbs issues; we worked through that. We're now in full supply on our mAbs in all the markets that we've launched in. So I think that one is one we've addressed. We did had paras challenges in Q2. Q3, honestly our supply came in too late in Q3.

And I think as you look at Simparica Trio in particular, our competitors took advantage in stock shelves, and so it's taken us a little longer to get back on shelves than we had hoped. But again, I think the paras problem will work itself out as you look into Q4. We had challenges as well in Rev. And for Rev and Simparica, Q3 is a really important quarter for us. And so I think you saw that. I think again the really good news is demand remained strong for these products, and we've addressed most of the supply issues.

But we had some small ongoing ones. As you know, in our industry, Erin you followed us a long time, we always have challenges around vaccines. When you supply as many products as we do across as many species globally, there's always some level of it. And some of those will continue into next year. But we're really confident that the biggest challenges we were anticipating this year around mAbs have been addressed. As you look at paras, both Simparica Trio, Rev, we'll work through that by the end of this year. We have really clear plans in place. I mean, obviously there'll be some ongoing one in vaccines, but that's more a usual course.

But Wetteny, do you want to sort of get [indiscernible] (00:26:24) second and third questions?

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah, sure. Erin, as we've been saying throughout this year, supply certainly remains a headwind to meeting global demand. And as Kristin mentioned, the timing of recovery on some of these is very important. So as we went throughout the year and faced supply constraints, particularly in Simparica Trio, despite the fact that Simparica Trio has performed really well for us, growing 65% on a year-to-date basis, the reality is we had outages throughout the peak of parasiticide season for Simparica Trio to Q2 and Q3. Though we recovered late in Q3, the impact was such that we allowed competitors to be more aggressive about placing products on shelves, which we saw that impact as we exited Q3.

But going forward, we do anticipate continuing to see some impacts for Revolution or Revolution Plus, where we are selectively looking at key markets to deliver those products against others. So that is something that we're carrying into the fourth quarter and we have reflected in the guidance that we have issued today.

So while our business faces other impacts outside of supply, whether its workforce or macro in certain markets, by far, the supply constraint saw the biggest impact here, looking at how we've seen the year sort of transition versus what we saw earlier. And so if you look at the guidance change here of about $200 million reduction in guidance, I would say FX and supply account for more than 75% of that, with supply being by far the largest majority of that.

Operator: Okay. We'll take our next question from Michael Ryskin with Bank of America. Please go ahead.

Michael Ryskin
Analyst, BofA Securities, Inc.

Q

Great. Thanks. I want to have a quick follow-up on that last point and then touch on something else. So on the supply issues, I think a lot of what you just commented on, Kristin and Wetteny, was that as you guys had these challenges in the quarter, your competitors took advantage to stock shelves. How should we think about that longer term? Is that a temporary switchover, meaning can you gain that back once you resolve, especially some of the older products, Revolution, but also Simparica Trio? Whether that happens this quarter or next quarter, are you going to be able to push those competitors out of those positions easily, or is that something that's going to be a little bit more of a challenge to regain your footing there?

And then I also want to touch on Librela approval. It seems like that timeline has slipped a little bit with the OUS inspection date. I'm just wondering, how does that change your launch expectations and ramp expectations in the United States? I know you talked about the second half 2023 or later in 2023 launch. So just walk us through the dynamics there. Thanks.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.
A

Sure. I'll start and let Wetteny build on this one. As you think about competitors, yes, I am very confident that we will get our shelf space back. And I very much see this as temporary. We're not worried. As Wetteny said, this product is really well-received by our customers and by pet owners. It's growing 65% on a year, so I am very confident we will get that back. So I do see that absolutely as temporary.

So I think the other important thing here as we look at Simparica Trio in particular is that when it comes to competition, the latest update we have is we are no longer expecting competition early in 2023 based on what we're hearing. As always, this is hard. It's a private company, and no one gives as much information as some of the private companies here, and a lot of them are not public. But our basic intelligence at this point is we don't see something launching against us as well early in the year. And we'll clearly leverage that opportunity to gain share as well. So I think that is also incremental news as we think about Simparica Trio.

And when it comes to Librela, I mean, obviously, we were hoping for an approval this year. Depending on when we get it next year, we just have to – everything moves based on what that is. So, we're still obviously hoping for a launch as we expected, but without knowing the exact timing of the approval into next year, it just moves proportionally, as you probably know. So, I think that's just the only incremental news there. We're confident no matter what, we'll get a launch next year, but the timing of it is just we'll have to update it once we get the final approval on that. And, Wetteny, did I miss anything there?

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.
A

I'll just add a couple of points on Simparica Trio. Look, if you look at combination flea, tick, heartworm, it's still a relatively new standard of care. And what you continue to see is in this very important part of the market, which is north of $5 billion globally, this expansion going from topicals and collars into orals, and then now with triple combinations, we'll continue to extend that into the market and grow the market as well. So, even with competition, we expect to continue to grow. So this dynamic that we described that occurred as we exited Q3, between Q2 and Q3, we see that as a temporary effect and will continue to drive our share here. And particularly, since we are now anticipating a delay in terms of competition, though it's hard to say exactly when it will come, it could come in 2023, but we no longer expect it early in the year.

With respect to Librela, what I would say is we continue to be extremely pleased, and the product continues to perform better than our expectations across Europe. And though we've had capacity constraints that didn't allow us to be able to take full advantage of demand this year, and we've had to actually make trade-offs in terms of delaying launches in other markets. As we exit the year, we anticipate next year being able to launch the product in additional markets outside the US and outside of Europe. And the product, again, continues to perform really well for us. So we're very pleased with that.

And so this sort of delay in terms of when the actual approval will happen in the US, given the dynamics we're seeing in terms of the expansion of 40% of the dogs that are being put on the product and new to the market, the lesser time duration of use of the product, et cetera, all bode well for sort of continued growth in this area and expansion of the pain market beyond the timing of the launch, et cetera.

Operator: And we'll take our next question from Nathan Rich with Goldman Sachs. Please go ahead.

Nathan Rich
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks for the questions. I had a follow-up on the supply constraints as well. Wetteny, it seems like based on your commentary on the second half revenue revision, the supply constraints would be something like a 200 basis point to 300 basis point impact on second half volumes. I just wanted to see if that number is in the right ballpark. And as we think about the go-forward, will there be a headwind in 4Q? It sounded like a large majority of the constraints may have been resolved by the end of the third quarter. Just wanted to see what we should expect for the fourth quarter. And then into 2023, would you anticipate there to be any lingering supply constraints or should everything be resolved at that point? Thank you.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah. So, look, what I would say is, supply issues is not unique to us, given the wide variety of products and species. It's relatively commonplace in this industry as I've learned [ph] since coming in (00:33:47) about a year-and-a-half ago. I think the level that we're seeing now is certainly elevated over the last couple years, and in particular we saw more of an impact here in Q3 given the timing of our recovery on some of these, right? So I do think we expect to see some continued impacts into Q4, but we reflected those in the guidance that we just issued today. I mentioned Revolution, for example, being one of them, and quite frankly, throughout the year in mAbs where we are confident in our ability to fulfill demand next year, not only in Europe but other markets outside of Europe.

We've made trade-offs in mAbs even between, for example, Cytopoint and Librela, right? So I do think those impacts have had their effects on this year. But as we go into next year, we're confident in those. I think vaccines is an area that you typically see certain supply constraints in and challenges, and I think we'll continue to see those into 2024. And as we exit the year, we're continuing to make progress on Revolution, but it is certainly having an impact on the fourth quarter as well is what I would say.

Of course, we'll have a lot more color to provide on the next call with respect to 2023. But we feel confident on the biggest products that have the greatest impacts. If you look at Simparica Trio from a parasiticide perspective, confidence in terms of supply going into next year. And for our mAbs, particularly Librela launches, et cetera, and for Cytopoint for next year, we feel very confident about that as well. So those are big movers for us going into 2023.

Operator: And we'll take our next question from Louise Chen with Cantor. Please go ahead; your line is open.

Louise Chen
Analyst, Cantor Fitzgerald & Co.

Q

Hi. Thanks for taking my questions here. So I wanted to ask you, with potential competition coming for some of your key products next year, do you still think you can grow through those if they do come next year?

And then second question I had for you was on innovation in livestock. When do you see that next phase of innovation? And when will we possibly see growth getting beyond that sort of 3% to 4% that we've seen historically for a while? Thank you.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure, Louise. And your first question with regards to competition, I think the good news is we're not expecting competition early in the year anymore on Simparica Trio. But regardless of when competition arrives, I do think we'll continue to grow through this. If you look at this category, even when isoxazolines were introduced and you saw one, then two, then three, this category grew. We launched a triple combination, and we grew incredibly well. I think there's plenty of space here.

Wetteny mentioned earlier there is still movement from topicals and collars. And this is a really innovative category. So I do believe you'll continue to see growth. As you look at dermatology, I would say the same thing. I think a competitor could help us continue to grow this market. There are still 6 million untreated dogs. The usage of this product in International is still significantly below that of the US, when you have the same number of dogs with the condition. So we continue to believe there is growth across these.

Obviously, growth may decelerate in derm with a competitor, but I still think these are going to be growing markets. I think the innovation – and don't forget, we continue to look at lifecycle enhancements for all of these products. We are not stopping with what we have. So I think there is a lot of visibility into a competitor might come but not necessarily some of the innovations in these key product categories that we'll continue to do. With regards to innovation and livestock, Wetteny, do you want to take that one with regards to growth rates?

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah, sure. Look. I think if you look at livestock, as we've said, this is a segment that has grown in the 3% to 4% range historically. And given the impact that we're seeing from generic competition for Draxxin, Zoamix, et cetera., we've been performing below that. But as we sit here, if we, for example, were to pro forma out the Draxxin impact, you would see growth in our livestock business even in the quarter that we delivered a negative 3 on Q3, which is similar to last quarter.

And so I think as we look to exit this year, I think livestock will be slightly below the performance you saw in Q3 given the anticipation of some of the generic competition. But beyond that as we look beyond exiting 2023 into 2024, et cetera, we'll have to take a look at what the macro is. I think if you look at cattle in key markets across Brazil and elsewhere in the US, we'll have to really continue to look at what the macro is.

But in terms of innovation, we continue to make innovation that, quite frankly, you'd not see the impact of them in the current year because of the impact of generic competition. So if you look at innovation in terms of poultry with vector vaccines that we're starting to launch in the US. If you look at some of our swine vaccines that we're launching elsewhere, we've had some supply constraints in those as well. So you're not seeing the full effect of those. But beyond this year and beyond the generic competition as that starts to plateau, you start to see growth coming out of our livestock business.

I just want to make one more point going back to derm. Last earnings, we said we don't see competition for derm in the first half of next year. Now three months later, there is still no new news, right. And so I think, as you know, in this space it's not that we have specific data on what folks have, and so it's about a six month timeframe that we look ahead. And three months later we still don't see anything. So it's not to say that we expect competition next year, it's just we don't have any data that says there will be any in the first half. So I just want to make that clarifying point as you asked the question around competition next year.

Operator: And we'll take our next question from Jon Block with Stifel. Please go ahead; your line is open.

Jonathan D. Block
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks, guys. Good morning. I'll ask both upfront. I think the 2022 op margin was, I believe, largely unchanged despite the lower revenue. And Wetteny, you mentioned managing OpEx. But I think you guys also wanted to invest. You've got some notable new opportunities in front of you. So, how do we think about that? In other words, is this an OpEx push on the investment into 2023 or should we still expect the bottom line growing decently above the top line next year 2023?

And then Kristin, just to shift gears, can you just maybe elaborate a little bit on, call it the company's line of sight into the supply constraints fully resolving in 2023, at least for me it seemed like the Simparica Trio issue came as a little bit of a surprise. And maybe just to tack on to that, do we think of these sales as lost, fully lost or at least a portion push? Because I would think from a consumer to go to a triple and then back to a duo, is there something where some of these can be recouped in the early part of 2023? Thanks, guys.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah. So I'll take the first part of the question in terms of how we see margins and investments, et cetera. We've made a number of investments across the business, whether you look at what we're doing in R&D, what we've done with respect to our field force and we're continuing to do across our diagnostics in our pet care field force, for example, in the US. We're making investments across our supply chain and manufacturing obviously, given the demand we're seeing across our products and anticipated launches of other products out into the future. So we'll continue to make those investments. But we do have the ability to manage discretionary spend. And you see that play out in the third quarter where OpEx growth was below top line growth.

And in fact, other than the tax rate difference to last year, if you look at our earnings before taxes, those grew at 8% on a 5% top line growth. So you see that leverage playing out in the P&L. And we have the ability to continue to do that. I think we'll continue to use price to drive margins. And mix is favorable to us given companion animal continues to grow faster than livestock. So companion animal grew 10% in the quarter where livestock declined 3%. So that mix is favorable to us, although we see some offset with respect to inflation and so on. But you continue to see those drivers. And we can anticipate those going into next year.

So we'll continue to make investments in select areas. Again prioritizing R&D, prioritizing manufacturing and supply chain, for example. But we'll manage discretionary spend elsewhere to still deliver a leveraged P&L, which is what we've said. Now there may be quarters where that doesn't play out exactly. But I think if you look at a year, you will see us continuing to do that. And that margin between top line growth and bottom line growth may be less than what the business naturally can do. But that's because we're making investments where we see the need, but we'll still manage to deliver annually a leveraged P&L is our target.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

And sure, I'll take you second question around visibility into supply resolution. When we started the year like many companies across many different sectors, we knew supply challenges would be there waiting on things. As you look at ones where, to your point, were we a little surprised by what happened with specifically Simparica Trio and Rev? I mean, the honest answer is yes. We thought they would resolve faster. It's not that we weren't aware. This was a capacity issue. We needed to build capacity, and specifically some of this at a third party.

And honestly, getting that third party on took us a little longer than we expected. We sent an OpEx team over there to try to work on it, and the timing of the resolution took us longer than we expected on that one. Why am I – have visibility to why I say it's better, because we're having a weekly call. I'm looking at their output on a weekly basis for both Revolution and Simparica Trio, and they're doing really well. I think they are delivering consistently. They're up and running. And so I had visibility, and that's why I have strong confidence.

And that's why Wetteny has strong confidence that as we look into resolve through Q4, we're managing through backorders right now. So we just got to get products out to markets. And we're prioritizing the markets, the biggest ones right now, and we'll get it to everyone by the end of this year, early next year. But when you're back a few months on a product like Rev Plus, for example, in markets where that's a huge product, it takes a little while to get them fully back into supply. And that's why we have full confidence that we knew what the issue was; it was capacity there.

With Librela and Solensia, it was component parts. And we knew we were competing as well. That's why Wetteny was talking about we were making trade-offs between products there. We have that in full supply. A lot of these were – some were COVID-related, some of these were capacity related and some were component parts related. It's been challenging for many companies to work through this. But we are as a leadership team managing this very carefully, as Wetteny and I have said, in the first and second quarter calls. Constantly working with GMS, we have full visibility into what is happening for each of these products, and that's why we have confidence as to when they will resolve and when we'll get into supply in key markets. So hopefully, anything else Wetteny you want to add there?

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah. Look, I just think – one of the things that I've really learned in the last 18 months being in this space is it's not if you recover from a supply constraint; it's when you recover that really matters. So we talked about that already in parasiticides from a season perspective. But that's true too across livestock. If you look at getting supply in time for a cattle run in the US is important. And so if you missed that window, you have a greater impact than you thought.

So if you were planning to and executing towards the timing of that and you recover a little bit later, that's where you start to see the impact. And I think that's what's played out here as we exit Q3 and why some of this might appear as a little bit of a surprise to you.

Operator: Then we'll take our next question from Brandon Vazquez with William Blair. Please go ahead. Your line is open.

Brandon Vazquez
Analyst, William Blair & Co. LLC

Q

Hi, everyone. Thanks for taking the question. I wanted to focus on, we had talked about 75% of the lowered guide was FX and some of the supply constraints. Maybe that smaller portion, the 25% that's less, I think was vet staffing issues. So maybe can you talk a little bit about what kind of change, what's incrementally maybe got worse in the vet staffing issues, how that's trending into the fourth quarter, so we can kind of frame up how that might be a headwind as we go into 2023? And really what kind of confidence do you have that it's not maybe a demand issue as macro conditions worse; it's really just a vet staffing issue? Thanks.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. I mean, look, I'll go back to where I started. If you look at demand at the vet clinic, there is no question that it is fundamentally remaining strong. Current staffing and vet visits is ahead of where it was pre-COVID. So this is not like, oh, my god, everything went down, where are we going? It is a realignment. And I think why are we confident in demand, well, there are more pets. I mean, why we have a capacity problem is not actually that there are fewer visits; it's there are more pets than we had before as we saw the sort of pandemic boom. The pet parents are more millennials. They spend more time on their pets, spend more money on their pets. They're more invested in the preventative care of their pets, which increases demand.

So we remain very confident that demand is very strong. It has proved resilient through other challenging macroeconomic times. So what we need to work with vets on is how to better leverage vet techs and other ways to make sure that they can see as many pets as they possibly can. So we remain very confident this is not a demand issue; it is a capacity issue. We have to create more capacity than they had pre-COVID. There's ways of doing this by helping them improve their productivity across different spaces.

But I mean just putting that in numbers, why are we confident that we're fine is if you look overall right now, the spend per visit is up 9%. Clinic revenues are up 5% in the quarter. We did see a 4% decline in vet visits, but that was over a quarter at unprecedented levels, if you look back to last Q3. So the veterinary industry is structurally and fundamentally in good shape. We have to help them create additional capacity for all the new pets we have. But I think demand remains strong.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

I would just say, look, as I said earlier, there are other factors that impact our business. I mean, you do see some macro in some select markets. So if I look at Brazil, for example, you see a trade-down from beef through poultry and swine. If you look at China, we continue to see lockdowns impact consumption, particularly on the livestock side. But if you look at companion animal performance, even in those markets despite the significant lockdowns in China, you see strong double-digit growth in companion animal. We saw double-digit growth in companion animal even in Brazil despite the macro. So I do think this speaks to the resiliency of particularly on the companion animal side, of the space, even in challenging macro areas.

And the other thing I would say with respect to a very strong comp is, if you look at derm, our third quarter last year, derm grew 26% globally. It was north of 20% in the US. And so, when you have labor capacity constraints at the vet clinic, being able to perform above that level of growth from a prior-year perspective becomes a challenge. So, again supply is by far the biggest challenge we faced all year and certainly in the third quarter, but the macro continues to be largely and from a demand perspective remain strong.

Operator: And we'll take our next question from Chris Schott with JPMorgan. Please go ahead.

Chris Schott
Analyst, JPMorgan Securities LLC

Q

Great. Thanks so much. Just a couple of quick ones here for me, I just want to come back to Simparica Trio. With this competitor delay that you're talking about for early next year, I just want to make sure I'm clear, is there going to be any supply issues as a rate limiter for growth of Simparica Trio in 2023, or was this more of a one-time issue in 2022? So I guess can you fully take advantage of that delay in competition as we think about the spring season next year?

And then my second question was on these unknown supply issues. I know this is – in the near term you can't do much about this. Is there an ability to either hold higher inventories or just think about supply differently kind of going forward to ensure that, I guess, these issues don't happen again in the future? And again, I know you can't deal with that in the 3Q, but just as we think about kind of 2023 and beyond, or do you view this as just kind of a moment in time where there's not much of an ability to manage this? Thanks so much.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. As you look at Simparica Trio for 2023, yes, we will be able to leverage the opportunity. Again, the challenge we had this year was getting new capacity online with a third party that took us longer than we expected. That is online and performing well, so we remain confident going into next year that we can leverage that opportunity and certainly have plans in place to do so. And your second question was around – what was your second question?

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

If the demand is – inventory and so on to...

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Yeah. I mean, look, we're holding – by the way, we have tried to do that already, if you look – focusing on resilience and managing inventory better. If you look at our inventory, we've invested a lot in making sure that we have component parts. As we see in our industry, being out of stock has a significant cost to the company, so we're certainly looking at how we can invest in that. But prudently, a lot of the buildup you're seeing right now is in raw materials and things like that to make sure we have on hand what we need to make it, and we're focusing that on our most important products.

So, you can manage a lot of this through inventory, assuming you have capacity. But as you look at the biggest challenges we faced this year, it was getting on board capacity in key products and getting some of the component parts for things like mAbs. And we have figured that out, but in the sense of the mAbs, and we do have the capacity online. So, you can definitely leverage inventory in certain cases, except when your challenge is capacity or component parts. But I don't know if you want to comment.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

No, the only thing I would say is, look, the actions we've taken this year and continue to execute against give us confidence in our ability to capitalize on the opportunity here with a delay from a competition standpoint. But what we've learned over the last two-plus years is, things happen in this world, whether geopolitical and so on. So barring any sort of major events, we do feel confident with our ability to capitalize on this and execute to meet the demand for the product. And we anticipate we'll continue to see demand beyond when a competitor comes into place as well, for the reasons we've already stated.

Operator: Okay. We'll take our next question from David Westenberg with Piper Sandler. Please go ahead.

David Westenberg
Analyst, Piper Sandler & Co.

Q

Hi. Thank you for taking my questions. Most on supply chain have already been answered, so I'll start with Librela. I think you mentioned it's a blockbuster. It's only outside of the US. I think we typically think of animal health as being – or companion animal as being kind of half in the US, half outside the US. Is there something specific about outside the US that's made it resonate so well, or should we still think of this as maybe a $200 million product if it was available in the US?

And then a question for Wetteny, you've mentioned a lot more, I think, on competition in livestock than I've heard commentary in the past. I mean, I think you said poultry vaccines and Draxxin, of course, as being the ongoing issue. Can you talk about – is there a way to quantify how much more this quarter or what we're seeing now is competition versus just dynamics across livestock? Because of course, dynamics across livestock have been a little bit on the weaker side, and I just want to see how much is transitory and how much of this might be permanent. Thank you for the questions.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. So I'll take your first question, then I'll let Wetteny take the second question. As we think about Librela, we are proud that it is a blockbuster in its first full year in launch outside of the US. I would note that it hasn't even been launched in every market outside the US. I wouldn't even say it's everywhere there.

And if you just take a slight step back here, as you look at the pain category globally in dogs, traditionally it's been about a $400 million market. We believe with this product, we can double the size of that market. And we've talked about this before, taking a $400 million market to an $800 million market. We believe we can do this because we think this product's efficacy is really, really strong. And so as you think about that, we think we can get more dogs to be cared for. It doesn't have some of the safety profile issues of other products. We're seeing that people are staying on it longer. It is already in Europe the number one pain product, as you think about it.

So, very strongly, if look at this, 40% [indiscernible] (00:54:04) customers to Librela are new to the category. This really speaks to the power of this product, that's excitement with this. And we're seeing a 90% reorder rate. So I think you're going to see significant potential for this product as you look at growing it outside to other markets as Wetteny mentioned earlier, beyond the ones we've already launched in International. And then certainly when you add to the US, we've seen in some of these really advanced technology products, the US is often bigger than International on most of these products.

So, we remain very optimistic for the success of this product just based on, so far, we've talked about this on previous calls, it's done incredibly well and where we've even been upside surprised is how many customers are staying on it. So, we'll continue to see how that evolves over time, but we're very optimistic about this product not just in International but as we bring it into the US, and as we expand it across International. But Wetteny, do you want to take the second question on livestock?

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah. Sure. Look, the first thing I would say is there is no structural change with respect to the competitive nature of livestock. It's always been competitive, and it remains so. So, our commentary here today and what we've been talking about over the last couple of years isn't necessarily different. What is is that generic competition has had an impact on us over the last couple of years, as we anticipated and as we said. So Draxxin, if you look at Draxxin prior to LOE, was roughly in the mid-300s, call it $350 million in revenue.

That's by far the largest sort of individual product within livestock, and so, certainly, we anticipated about a 20% impact in the first year, another 20% in the second year. The first year was a little bit better than that. It was south of 20%, but the second year was above that. And so, still in the neighborhood, maybe a little bit worse than what we thought initially with respect to Draxxin, but there's no other large product like that, I would say, in the portfolio, though Zoamix also has seen some competition but was nowhere near the size of a Draxxin. So, short story is no change in terms of what we're seeing in terms of the competitiveness of livestock. It's just a little bit more intensification in terms of products that have become generic if they're sizable.

Operator: And we'll take our next question from Steve Scala with Cowen. Please go ahead.

Steve Scala
Analyst, Cowen and Company

Q

Many thanks. First, just to clarify, in the prepared remarks it was stated that supply challenges were more pronounced in Q3 and that there is increased uncertainty. Can you clarify why supply challenges peaked in Q3? And why there's now more uncertainty as opposed to what was seen in Q2 or apparently what is anticipated in Q4? And then secondly, China lockdowns were mentioned. Can you quantify the impact? And then lastly, what is the capacity of Lincoln to manufacture the pain monoclonal antibodies? I thought at one point some small-scale manufacturing was done there. Is that a possibility to be expanded? Thank you.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

So I'll start, and see if Kristin wants to add anything. With respect to the supply challenges, I think we've described in a fair amount of detail what we saw happen and why the impact was more noticeable in the third quarter, though we also made significant progress as we exited at the quarter. So the impact that we're seeing in the third quarter, if we double-click on parasiticides, for example, particularly with Simparica Trio, and from Q1 we've had outages on Simparica Trio across certain [ph] strains, strengths, (00:57:24) et cetera.

And we continue to run with constraints throughout the year, but in particular in Q2 and Q3, those outages really left more space across vet clinics for competitors to fill those shelves. And so as we got into Q3, again, continuing to be in the parasiticide season, we saw switchovers with respect to new patients coming off of collars and topicals, for example, going into orals, rather than coming into our product, going into some of our competitors because our competitors filled shelves when we had gaps. So that's why we saw a bigger impact in that in terms of what we saw particular for Simparica Trio.

Revolution has been an issue, quite frankly throughout the year and remains so even as we've gotten into Q4 here, which is why we say we continue to see uncertainty in certain products here. Vaccines I would say are relatively commonplace across the industry in terms of having supply issues. And again, we've seen a little bit more of those this year, and again particularly in Q3 given the cattle run in the US in the fall, et cetera. So we saw some of the impact of those outages more pronounced in the quarter. So hopefully that gives you plenty. If there's a follow up, I'm sure you can take it up with Steve offline as well. But that's the detail that we've shared.

With respect to capacity for mAbs, these are long-lead time areas, right. If you take the time to manufacture this long-lead time, the time to add capacity in monoclonal antibodies is also relatively long. So we've been working on those for some time, which is why as we've gone through this year and we express confidence into next year being able to not only capitalize on demand that we see across Europe but be able to launch in other products outside of Europe across our International segment. We're confident because we have been able to expand in various areas.

I won't go into a specific site in terms of what their capacity is, but suffice it to say our monoclonal antibody manufacturing is more than just one location in terms of where we do that. And you've seen us take an uptick as well in terms of CapEx growing from last year to this year, we've talked about that all year, and you continue to see an uptick in CapEx as we go into the next year or two as well because we continue to make investments in capacity and monoclonal antibodies are an important platform for us, not only with respect to derm with Cytopoint with the pain franchise, but other products that we're working on and our pipeline will require those. So we'll continue to make investments with respect to mAb capacity.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

A few follow-ups there. I mean, for starters the comment on uncertainty had to do with the macroeconomic environment. I mean, the question is we're still seeing very strong consumer demand but there's still a belief that we'll have potentially a recession in Q1, Q2, Q3. It was not about increased uncertainty, to be clear, in supply. It was uncertainty as to the macroeconomic environment and what we'll be looking at into 2023 or even in Q4. So let me be clear; the uncertainty comment was not related to supply.

The only other comment I'll make is with regards to the China question. I mean look, in Q3, China grew 35% even with these lockdowns, again underlining what we've been saying. The demand for our products remains very strong. What's important there is, you look like four or five years ago, it was a majority livestock business. It became about 50/50 last year between livestock and companion animal. And if you look at it right now, the lockdowns are clearly impacting livestock, but companion animal, given it's close to 50/50, grew almost double what you see is China's growth at. So even with the lockdowns, we really see China remaining a strong market for us and growing quite well.

So I think we can weather those lockdowns. I mean look, if those lockdowns stop, which does not appear, based on the news in the last 24 hours, to be something that's going to be happening in the near-term, you might see livestock recover a little faster than what it is. But again, even in this environment, even with lockdowns, you saw 35% growth in Q3 in China. So I would just underscore that.

Operator: And we'll take our next question from Elliott Wilbur with Raymond James. Please go ahead.

Michael Parolari
Analyst, Raymond James & Associates, Inc.

Q

Hi, guys. This is actually Michael Parolari on for Elliott. Thanks for taking my questions. So first one from me, you guys might've touched on this earlier, so apologies if I missed that commentary. But any early commentary on how we should be thinking about currency impacts on top line and margin trends into 2023?

And then second question is growth contribution from price this quarter, I believe you said, was 1% compared to 3% over the past two quarters. Most of the industry seems to be moving in the other direction given the current macro-environment, so just wondering if you guys could touch on perhaps what negatively impacted that growth contribution in the period and how to be thinking about that moving forward. Thank you.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah. I'll start, and see what Kristin will add. First of all, with respect to currency, if you look at this year top line impact from FX given the strength of the US dollar, is about 4%. So on the year, 4% which is roughly $309 million headwind versus prior year rates. If you can look at the impact all the way down to the bottom line, it's about 8%. And so from an EPS standpoint, that's about $0.36 of headwind. It's about $0.07 worse than our prior guidance given the continued strength of the US dollar. So that's where we are.

We're not going to forecast what FX might do, but our guidance is based on where the rates were at the end of October here, and we'll continue to update, but we'll focus on commentary around operational growth given FX's impact. But that's the impact that we're seeing this year.

If I didn't go into price here, on the year-to-date basis, if you look at our companion animal product sales and revenues, we've taken about 5% price on a year-to-date basis. And so what is offsetting that largely is what we've been talking about here today, which is the generic competition, particularly on Draxxin, that's offsetting that growth where you see a net of 1% in the quarter. But on a year-to-date basis, our price is about 2% if you include the impact of generic competition and higher than that but companion animal is where we have innovative products. We continue to see strong demand, and we're taking price at the tune of about 5%.

And if you look at our margins, roughly 90 basis points down year-over-year. FX is by far the biggest contributor to that. So if you take FX out, you've got about 20 basis points. So essentially, our price is offsetting increases in manufacturing costs, et cetera [ph] within price mix (01:04:13) and so on is what we are seeing. So that's where the offset is. We're right about where you might see across elsewhere in the industry. Our vet practice has given the strong demand we continue to see are actually taking price at or above what we are taking in that 5% of companion animal as well.

Operator: And we'll go next to Balaji Prasad with Barclays. Please go ahead.

Q

Hi. This is actually [ph] Michaela (01:04:40) on for Balaji. Thanks for taking my question. Just on Simparica Trio. Just wondering what the penetration has been for corporate accounts and just how much room is left for further expansion? Thank you.

Wetteny Joseph
Executive Vice President & Chief Financial Officer, Zoetis, Inc.

A

Yeah. So we've been very pleased with the penetration across large corporate accounts. We're about 90%. But we still see more room even within those large corporate accounts to increase utilization of Simparica Trio, and we continue to work on those. And that's part of where our expanded field force in the US is focused, in addition to obviously with the launches of other products, et cetera, and across derm to continue to penetrate and so on.

So we have been very pleased with the overall penetration across large corporates and continue to work on smaller and midsize accounts as well. And we see more room within those penetrated clinics to get better utilization on Simparica Trio. I don't know if you would add anything to that, Kristin?

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

No.

Operator: And there are no further questions at this time. I'll turn the call back over to Kristin Peck for any closing remarks.

Kristin C. Peck

Chief Executive Officer & Director, Zoetis, Inc.

Great. Look, thanks everybody for your questions today and for your continued interest in Zoetis. Just to summarize, we continue to see strength across our diverse global portfolio, especially in our products for pet care and the fundamental drivers of animal health, as I've said throughout this call, remain fundamentally and structurally very strong. We continue to invest in talent and innovation, certainly in manufacturing expansions as we've talked to you today that can support this future growth while adapting and optimizing our business for the increasingly dynamic macroeconomic environment that we all operate in. We look forward to keeping you updated on future calls. Thanks so much for joining us today.

Operator: Thank you. And this does conclude today's program. Thank you for your participation. You may disconnect at any time.