

zoetis

NYSE: Zoetis (ZTS)

Healthcare & Industrials

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Abhra Kundu

Sophomore

BBA Finance

akundu@tamu.edu



Mckenzie Stanley

Junior

BBA Finance

mckenziestanley@tamu.edu

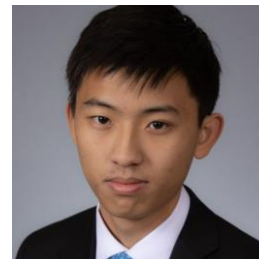


David Rabalais

Sophomore

BBA Finance

rabaldavs@tamu.edu



Rick Zhang

Junior

BBA Finance

rz2021am@tamu.edu



Thomas Dowdy

Sophomore

BBA Finance

tnd1697426@tamu.edu



Garrett Nobles

Sophomore

BBA Finance

gnobles@tamu.edu



I. Company Overview



Company Overview

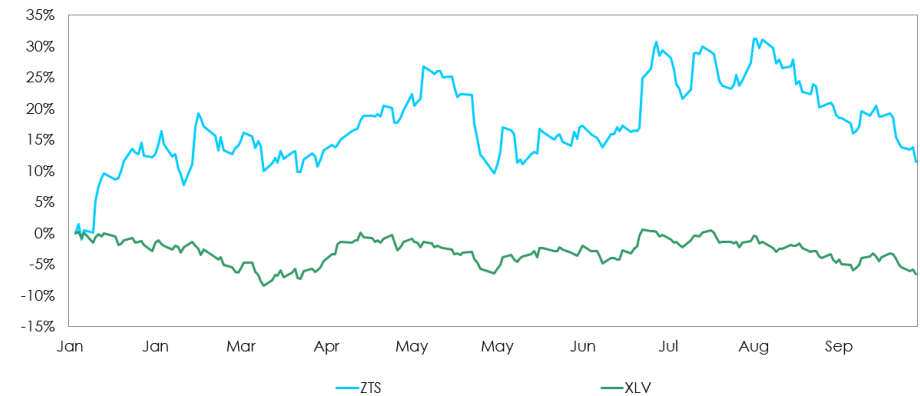
A diverse portfolio of products and research areas



General overview

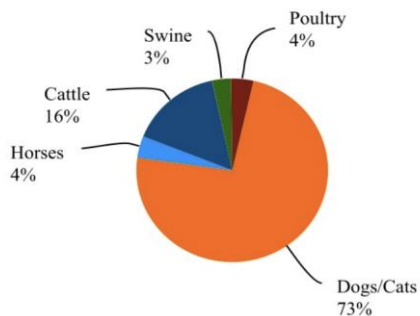
- ❑ Zoetis Inc. (ZTS) is a global leader in the animal health industry, and focuses on the discovery, development, manufacture, and commercialization of various products including medicines, vaccines, biodevices, and precision animal health technologies
- ❑ Products are sold in over 100 countries, including developed and emerging markets and operates through two primary segments, United States and International
- ❑ Zoetis has a diversified business model, commercializing products in eight core species: dogs, cats, horses (companion animals) and cattle, swine, poultry, fish, sheep (livestock)

Historical performance

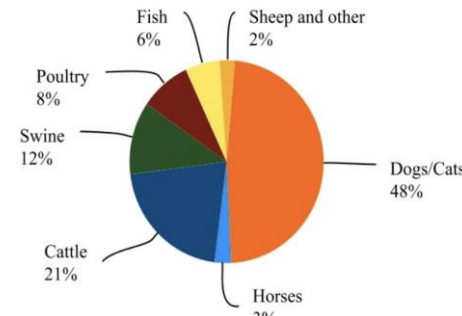


Revenue by segment (2022)

2022 United States Segment Revenue - By Species



2022 International Segment Revenue - By Species



Recent company news

- ❑ Zoetis recently reported Q3 earnings on 11/02/2023, where they delivered an EPS of \$1.36/share, beating Zachs Consensus Estimate of \$1.35/share
- ❑ Total revenues grew YOY to \$2.151B, slightly falling short of an expected \$2.168B, likely due to a modest decline in clinic visits this past quarter due to labor constraints and limited hours
- ❑ Petcare sector grew the most, with 11% growth in the quarter due to dermatology, parasiticides, and led by pain portfolio developments with two new monoclonal antibodies for osteoarthritis pain (Librela and Solensia)
- ❑ CEO Kristin Peck states that she has "continued to see the resilience in not just the animal health sector, but of Zoetis" throughout many economic cycles

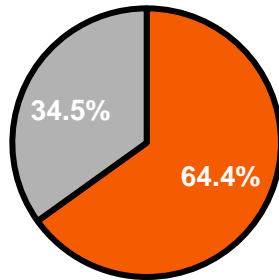
Sources:
Company Filings, S&P CapIQ, Nasdaq, CNBC



Additional Company Breakdown

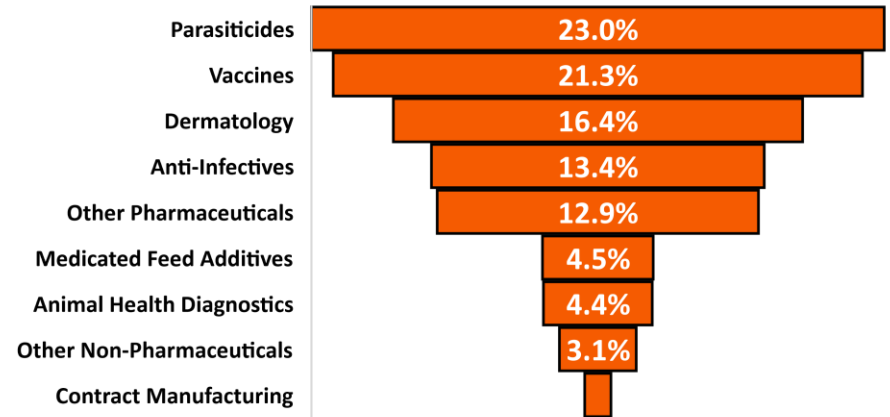


Revenue segment breakdown

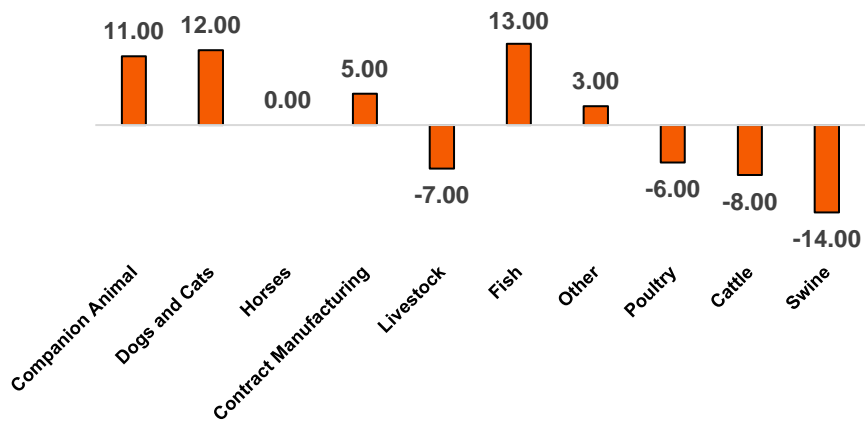


■ Companion Animal ■ Livestock

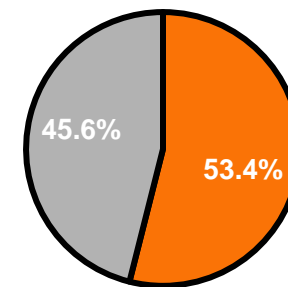
Revenue supplementary breakdown



Segment revenue growth



Geography breakdown



■ U.S. ■ International



Management Team

Experienced team with significant industry experience



Management Overview



Kristin Peck, CEO & Director

- Former Executive Vice President in the Worldwide Business Development and Innovation at Pfizer Inc., and previously held roles in BCG, The Prudential Realty Group, The O'Connor Group, and J.P. Morgan
- Was Executive Vice President, U.S. Operations, Business Development and Strategy at Zoetis before becoming CEO in 2020
- Named by Barron's as one of the top CEOs in 2022 and by Fortune as a 2020 Businessperson of the Year



Weteney Joseph, Executive Vice President & CFO

- Spent 13 years in executive positions in Catalent, a global leader in pharmaceuticals and consumer health products, including 3 years as Chief Financial Officer at the firm
- Held senior financial positions at industrial distribution company HD Supply and corporate controller of Hughes Supply, which was eventually acquired by Home Depot
- Appointed to Chief Financial Officer at Zoetis in 2021



Ester Banque, Executive Vice President & President, U.S. Operations

- Previously Senior Vice President and General Manager of Bristol Myers-Squibb's U.S. Hematology and Cell Therapy Business and accelerated the launch of five products
- Prior to BMS, spent 25 years at Novartis, a Swiss healthcare company
- Joined Zoetis in 2023



Financial Analysis

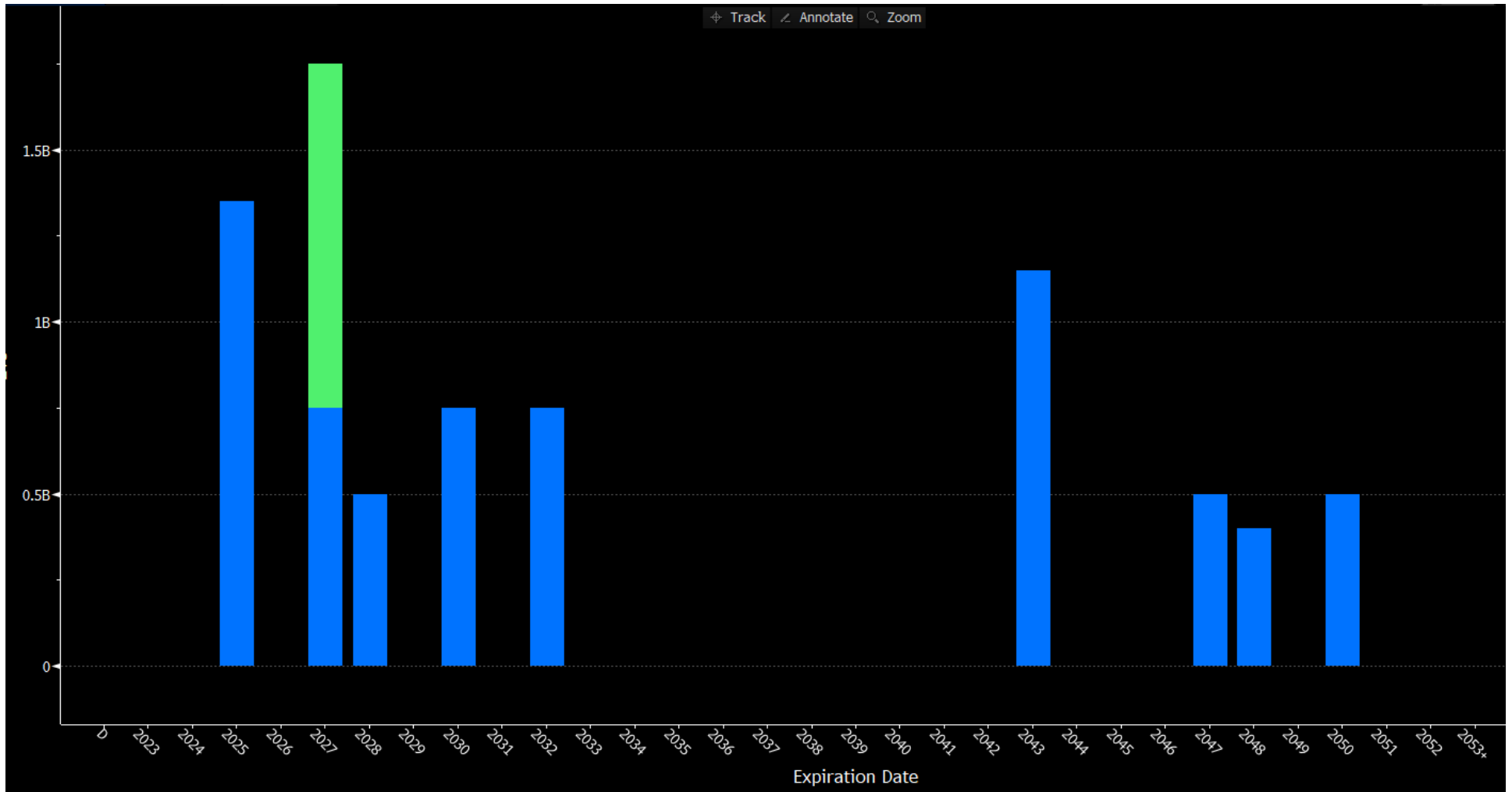
All numbers are in millions unless noted otherwise



Last Close	\$170.63	LTM Revenue	8,371
Market Cap	78,388.6	Net Debt/Equity	103.38
Total Debt	6,745	Debt/EBITDA	1.93x
Cash	1,754	EBITDA/Int. Exp	15.53
EV	83,325.6	FCF	1,492
Trailing P/E	34.75x	ROE	47.25%
Forward P/E	31.62x	ROA	14.67%
EV/EBITDA	23.90x	ROIC	19.09%



Debt Maturity Profile



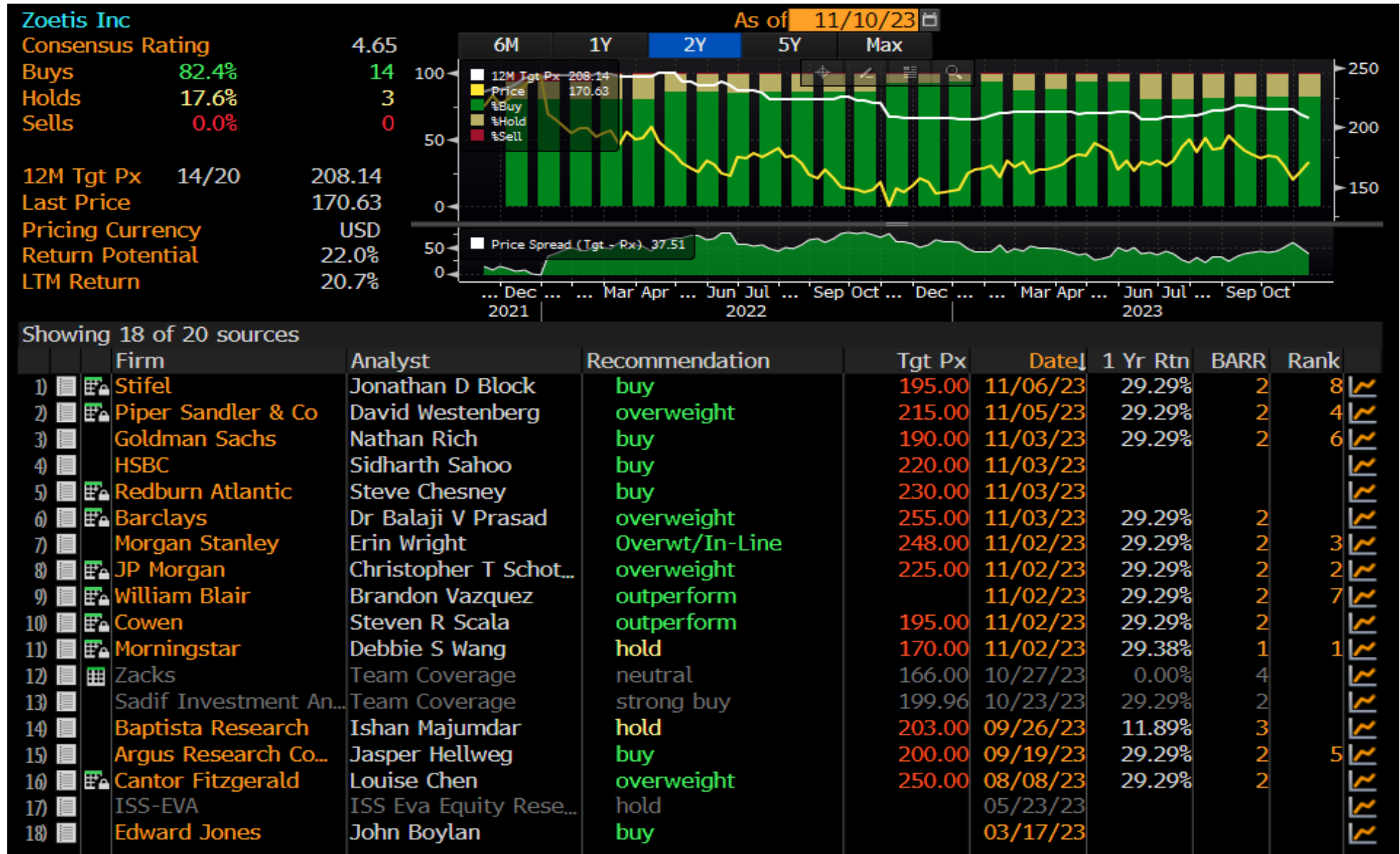
Ownership Summary



Holder Name	Portfolio Name	Source	Opt	Position↓	% Out	Latest Chg
		All	All			
1. + BlackRock Inc		13F		39,894,450	8.69	0
2. + Vanguard Group Inc/The		ULT-AGG		39,743,203	8.66	-30,384
3. + Capital Group Cos Inc/The	Multiple Portfolios	13F		29,028,896	6.32	174,716
4. + State Street Corp		ULT-AGG		19,634,457	4.28	213,907
5. + STATE FARM MUTUAL AUTO INS		ULT-AGG		18,409,985	4.01	-215
6. + AllianceBernstein LP	ALLIANCEBERNSTEIN LP	13F		16,115,567	3.51	-2,482,515
7. + Wellington Management Group LLP	WELLINGTON MANAGEMENT GROUP LLP	13F		12,047,648	2.62	39,808
8. Bank of America Corp	BANK OF AMERICA CORP	13F		11,429,467	2.49	-2,783,582
9. + Morgan Stanley		ULT-AGG		10,440,844	2.27	723,277
10. + Geode Capital Management LLC	GEODE CAPITAL MANAGEMENT LLC	13F		10,031,189	2.18	291,819



Analyst Recommendations



II. Industry Overview



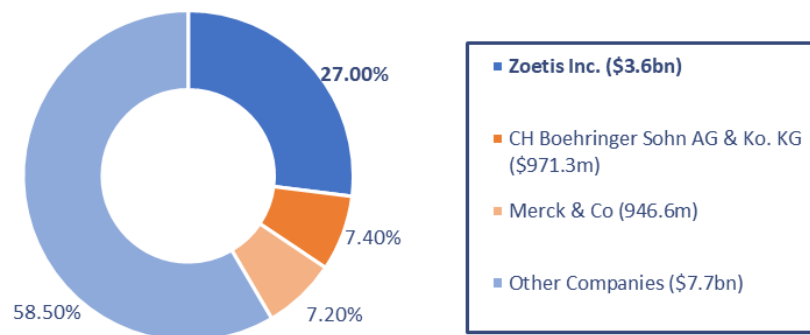
Animal Health Biotechnology

Market Share

Heavy consolidation

- ❑ Zoetis generates ~3.5 times more revenue than its closest competitor in an industry where small corporations get acquired at a rapid pace. These factors have driven Zoetis to make 16 strategic acquisitions in its life span, with 2 being this year.
- ❑ While the industry profit margins outperform the sector, theoretically attracting new competition, the high-rate environment has made it difficult for early-stage competitors to secure R&D funding from private investments. This results in these companies just being acquired by a larger player in the market.
- ❑ As investor risk-aversion increases, and Zoetis continues to acquire competition despite anti-trust concerns, investors will look to Zoetis as a safe investment in a growing industry.

Market share by revenue



Barriers to entry

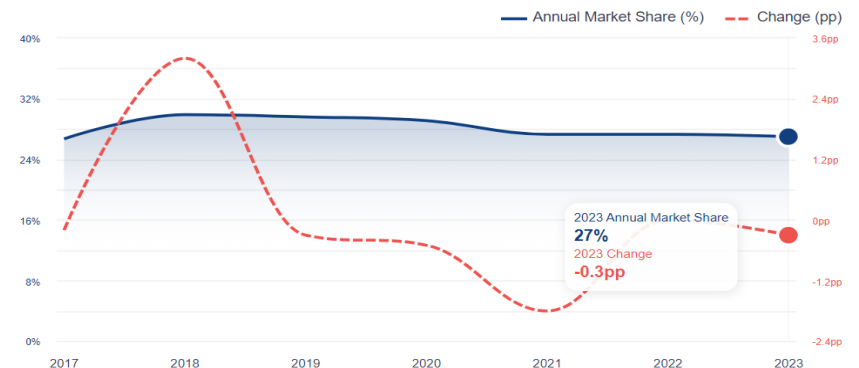
Legal: A complex regulatory environment consisting of over 6 regulatory agencies oversees the research, development and sale of genetically engineered animal health products.

Start-Up Costs: The industry diversifies funding from multiple sources to maintain long-term growth. Maintaining financing can be challenging since R&D expenditures are sky-high without a promise of return.

Differentiation: The industry strives to develop a breakthrough product or treatment. Products must be new and novel for a company to receive patent protection on them.

Labor Intensity: Companies require teams of highly trained and specialized personnel to perform R&D activities, which would call for high wages to remain competitive.

Zoetis market share recent history



IBISWorld

Source: IBISWorld

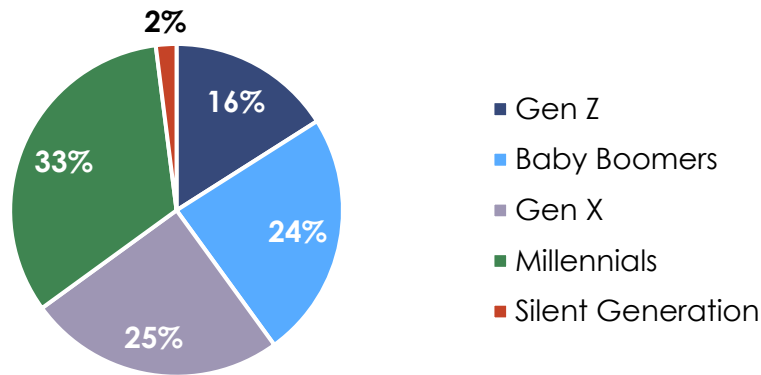


Industry Drivers

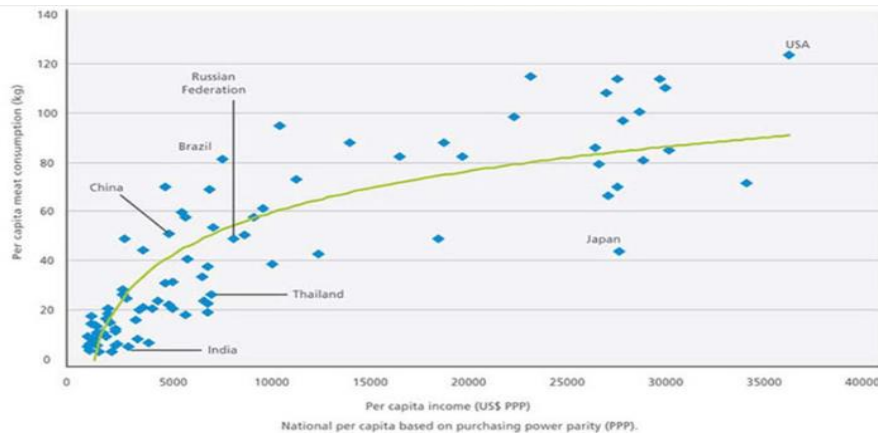
Pros



Pet ownership by generation



Increased income = Increase meat consumption



Recession resilient

- ❑ In 2008, pet industry grew 5.1%
- ❑ Despite the Bloomberg recession probability at 55%, Barclays reported that 78% of vets say that spending per visit has increased, and pet owners aren't lowering spending across any segment
- ❑ APPA survey revealed 74% of pet owners are not influenced by the economy when it comes to their pets
 - ❑ 40% of pets in sleep in the bed with owners

Less cyclical than livestock

- ❑ Growth drivers: rising demand for protein from rising incomes in emerging markets, and need to produce more with less land
- ❑ Animal farmers turn to Zoetis to protect animals (investment) by keeping animal healthy and maximizing yield
- ❑ Animal health companies (Zoetis) sees less volatility than traditional livestock business because producers cut back on other supplies before reducing expenditures on medicine



Industry Headwinds

Cons

Interest rates

- ❑ Rising interest rates can make debt more expensive to repay while simultaneously potentially reducing Zoetis' potential for growth
- ❑ Higher rates can lead to companies possibly turning to cost-cutting methods like layoffs or reduced wages in order to reduce fixed costs
- ❑ Slower growth rates due to higher rates due to difficulty in getting access to lending

International business

- ❑ Approximately 46% of Zoetis' revenue is international
- ❑ Can potentially be a problem due to exchange rate risks, political and economic instability, supply chain disruptions, legal and regulatory challenges, and diversification risks
- ❑ Despite these potential issues, the international segment is growing at approximately 3% YOY while the U.S. is decreasing at 1% YOY

R&D costs

- ❑ Zoetis' R&D costs are increasing at an average of 6.31%, using data from the past five years
- ❑ High levels of R&D spending needed to maintain relevance in this industry, with the need to develop the best products
- ❑ Increasing R&D costs likely needed to stay relevant in this industry, however, Zoetis is maintaining stable growth relative to R&D spending, with only 20% of other operating expenses being made up of R&D

Supply chain issues

- ❑ Disruptions in the supply chain can cause detrimental effects to Zoetis as a large percentage of their business has operations internationally
- ❑ Disruptions that cannot be avoided, things like natural disasters and global events (e.g., pandemics) would impact both Zoetis and the economy as a whole
- ❑ Transportation issues and internal supply chain issues could impact Zoetis solely, thus allowing for competitors to gain a competitive advantage and possibly gain market share



V. Risks



Key Risks and Mitigants

Concentrated revenue streams and regulatory dependent

Risks

1. Reliant On Success Of Top-Selling Products

- Approximately 37% over revenue is dependent upon the top five product lines: Simparica/Simparica Trio, Apoquel, Cytoint, Revolution/Revolution Plus/Stronghold and Ceftiofur line

2. Generic Alternatives

- As existing patents expire and the FDA approves cheaper generic alternatives, sales of top revenue generating drugs could steeply decline

“For example, several companies **have launched generic versions** of our Rimadyl chewable and Draxxin products. In the years since the start of generic and other competition, **sales of our Rimadyl chewable and Draxxin products have declined in the U.S.**, the largest market for these products, **by 23% and 45%**, respectively, and additional declines are expected in subsequent years.”

3. Pricing Power

- Current trend of consolidation among customers and distributors could result in loss of pricing power and negatively impact margins

4. Regulation and Consumer Preference Regarding Antibiotic Use

- Increasing cases of antibiotic resistance have led to the proposal of regulation restricting the usage of antibiotics in the agricultural industry. Total revenue attributable to antibacterials for livestock was approximately \$1.0 billion

Mitigants

1. Revenue Streams

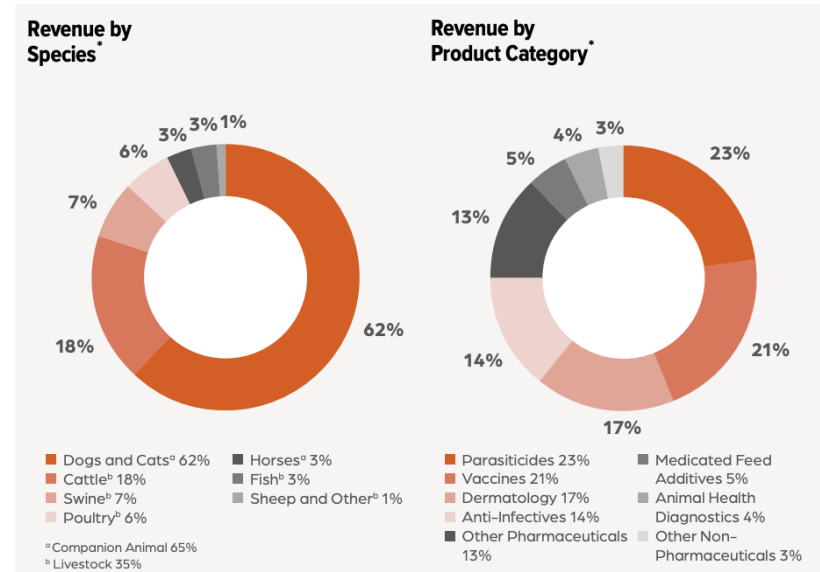
- Growth in the animal companion industry enables Zoetis to expand its' range of pharmaceutical offerings to a greater pet/consumer base including in dermatology, parasiticides, and pain relief
- Broad Portfolio of 300 product lines across 7 therapeutic areas and 8 species

2. R&D Spend & Durable Portfolio

- More than \$200 million of R&D spending during 2022
- Average market life of top products is approximately 30 years

3. Expansion to New Geographies

- Zoetis continues to grow key product franchises through the expansion of their offerings in major markets



VI. Valuation



Comparable Model



Small cap companies in the animal health sector trade at almost half the multiple as the larger-dominant players in the industry. This is most likely due to their profitability and the ever-likely event of being squeezed out of the consolidating industry



Though there is a small sample size, Zoetis seems to trade most similarly to IDEXX Labs, who is not a direct competitor, but instead only competes against Zoetis in the diagnostic space. However, the similarities are that they both are growing at a fast space and related to veterinary treatment for pets



Zoetis does not trade at all similar to the traditional, established pharmaceutical companies, almost certainly because of its growth potential. From the comparable, it is fair to state, despite the small sample size that Zoetis trades at or above fair market price

Company	Ticker	Current Share Price	% of 52-wk. high	Equity Value	Enterprise Value	Enterprise Value /									LTM EBITDA Margin	Total Debt / EBITDA	Price /			LT EPS Growth
						LTM Sales	2024E Sales	2025E Sales	LTM EBITDA	2024E EBITDA	2025E EBITDA	LTM EBIT	2024E EBIT	2025E EBIT			LTM EPS	2024E EPS	2025E EPS	
Tier I: Animal Health (Dominant)																				
Zoetis	ZTS	151.44	78%	\$ 69,710	\$ 74,766	9.1x	8.4x	8.1x	21.6x	19.2x	18.3x	25.1x	21.7x	20.4x	41%	2.0x	31.9x	26.9x	25.0x	15%
Merck & Co.	MRK	102.85	86%	260,984	291,566	4.9x	4.8x	4.6x	22.3x	11.9x	9.9x	31.6x	15.6x	11.2x	22%	2.8x	57.1x	16.8x	12.2x	10%
IDEXX Labs	IDXX	395.35	70%	32,819	33,506	9.3x	8.6x	8.4x	28.1x	25.7x	25.4x	31.1x	30.9x	28.3x	33%	0.9x	40.3x	37.1x	36.2x	19%
Mean						7.8x	7.3x	7.1x	24.0x	18.9x	17.9x	29.3x	22.7x	19.9x	32%	1.9x	43.1x	26.9x	24.5x	15%
Median						9.1x	8.4x	8.1x	22.3x	19.2x	18.3x	31.1x	21.7x	20.4x	33%	2.0x	40.3x	26.9x	25.0x	15%
Tier II: Animal Health Biotech (Weak)																				
Elanco	ELAN	8.63	59%	\$ 4,251	\$ 9,906	2.3x	2.2x	2.2x	9.7x	10.6x	9.7x	27.9x	11.5x	11.0x	23%	5.9x	NM	10.8x	9.7x	-11%
Phibro	PAHC	11.19	68%	453	867	0.9x	0.9x	0.8x	7.5x	7.4x	6.9x	12.1x	10.3x	9.1x	11%	4.4x	13.9x	9.5x	8.5x	NA
Median						1.6x	1.5x	1.5x	8.6x	9.0x	8.3x	20.0x	10.9x	10.1x	17%	5.2x	13.9x	10.1x	9.1x	-11%
Tier III: Pharmaceutical Large Cap																				
Bristol-Myers	BMJ	50.41	62%	\$ 102,572	\$ 138,039	3.0x	2.9x	2.9x	7.2x	7.4x	7.5x	15.8x	7.8x	7.8x	41%	2.1x	12.8x	6.6x	6.8x	0%
J&J	JNJ	147.42	81%	354,881	368,344	3.7x	4.2x	4.1x	10.2x	11.0x	10.8x	13.1x	12.8x	12.3x	36%	0.8x	27.6x	14.0x	13.7x	3%
Pfizer	PFE	29.68	54%	167,585	194,244	2.7x	3.2x	3.2x	12.0x	9.5x	8.3x	22.5x	21.9x	8.9x	20%	4.2x	16.2x	13.8x	9.3x	3%
Mean						3.1x	3.4x	3.4x	9.8x	9.3x	8.9x	17.1x	14.2x	9.7x	32%	2.4x	18.9x	11.5x	9.9x	2%
Median						3.0x	3.2x	3.2x	10.2x	9.5x	8.3x	15.8x	12.8x	8.9x	36%	2.1x	16.2x	13.8x	9.3x	3%



Discounted Cashflow Analysis

Overvalued



We are going to have to purchase the company at a **premium** to its intrinsic fair value

High Growth Company	Taking a deeper look at the present value of future cash flows and present value of the Terminal Value, we see that PV of Terminal Value is 84.9% of total Fair Value
High Exit Multiple Premium	The EV/EBITDA multiple is very similar to the current multiple the market values the company at. However, with slowing growth, the exit multiple could potentially be lower
Estimates were a little low	Revenue and expense assumptions which can be found in the Appendix section illustrate some conservatism in growth, but were not bearish enough to make this company fairly valued
Leader could warrant premium	Given that fact that Zoetis has the dominant market share for animal health in the U.S. and the world, a higher price could be warranted

Exit Multiple Method:

Terminal Value:	
2028 EBITDA	\$4,914.0
Exit Multiple	18.3x
Terminal Value	\$89,925.6
Period	4.9
PV of Terminal Value	\$59,858.9
Implied PGR	2.0%

Value Distribution:	
PV of Period Cash Flows	\$10,673.8
PV of Terminal Value	\$59,858.9
Total	\$70,532.8
Period Cash Flows	15.1%
Terminal Value	85%
Total	100.0%

Implied Share Price:	
Enterprise Value	\$70,532.8
(-) Total Debt	6991.0
(+) Cash	3581.0
Equity Value	\$67,122.8
Shares Outstanding	475.5
Share Price	\$141.16
Upside/Downside	(17.3%)

Gordon Growth Method:

Terminal Value:	
2028 FCF	\$3,025.4
PGR	4.0%
Terminal Value	\$68,291.9
Period	4.9
PV of Terminal Value	\$45,458.48
Implied Exit Multiple	9.3x

Value Distribution:	
PV of Period Cash Flows	\$10,673.8
PV of Terminal Value	\$45,458.5
Total	\$56,132.3
Period Cash Flows	19.0%
Terminal Value	81.0%
Total	100.0%

Implied Share Price:	
Enterprise Value	\$56,132.3
(-) Total Debt	6991.0
(+) Cash	3581.0
Equity Value	\$52,722.3
Shares Outstanding	475.5
Share Price	\$110.88
Upside/Downside	(35.0%)

Blended Share Price:	
Exit Multiple Method:	\$141.16
<i>% Weight</i>	50%
Gordon Growth Method:	\$110.88
<i>% Weight</i>	50%
Blended Share Price	\$126.02
Upside/Downside	(26.1%)



III. Thesis



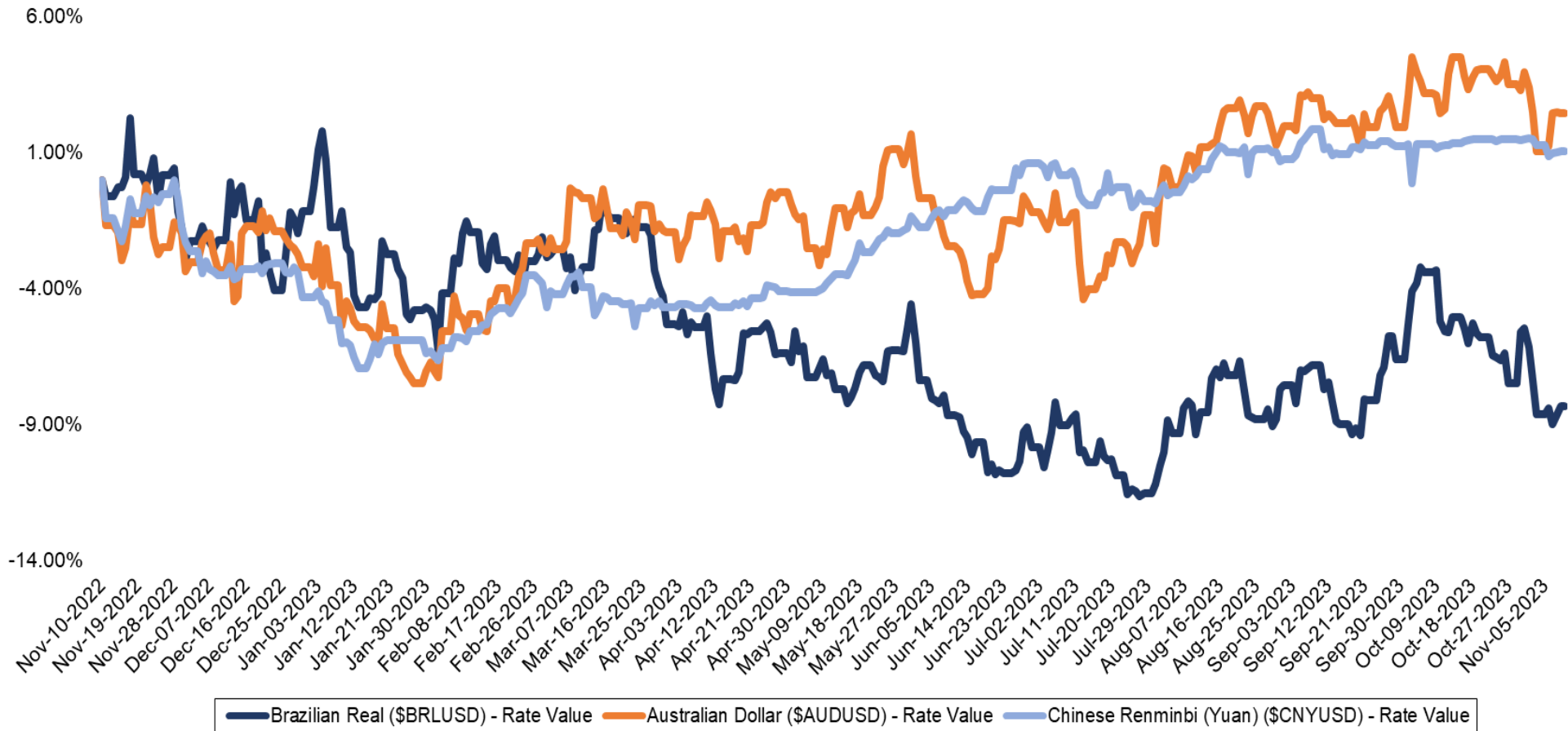
We believe there are FOUR main components that Zoetis an investable company, despite its price

01	Wide Moat Barriers to Entry	With rising labor costs, and high R&D research expenditures, only a startup with serious financing can challenge the existing industry leaders. Generics in livestock are a concern.
02	Dominant Player in Growing Industry	Zoetis currently holds 27% market share in its industry, with its nearest competitor at only 7.4% market share. Multiple acquisitions have taken place over the last decade, with the largest being Abaxis in 2018.
03	Strong, Predictable Cashflows	Zoetis has grown revenues at a steady predictable rate of ~6.5% per annum, with margins only getting better and better over the last decade due to consolidation and economies of scale .
04	American Love Their Dogs	Over the last three years, despite a flat trend in pet visits to vets, vet revenues have grown at an average rate of 7% per year in that time, showing increased willingness of Americans to spend on their pets.

Appendix



Three largest international locations and their currency relative to the USD over time



Inflationary Pressures Good for Livestock portfolio



Commodity prices increase



Suppliers respond to high prices by increasing their production of livestock



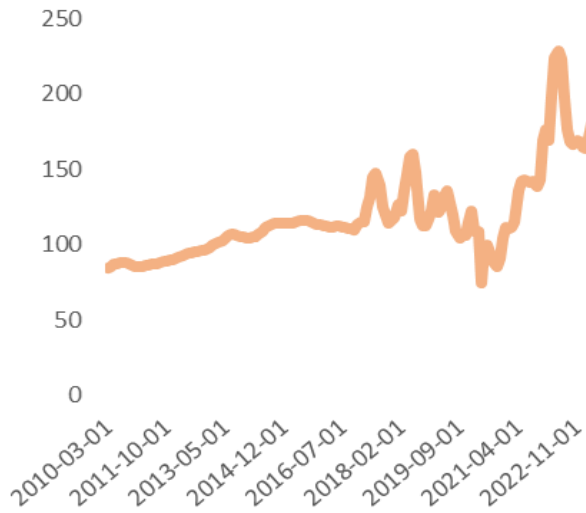
Increase revenues on the Livestock side, though generic drugs are eating DRAXXIN at profits



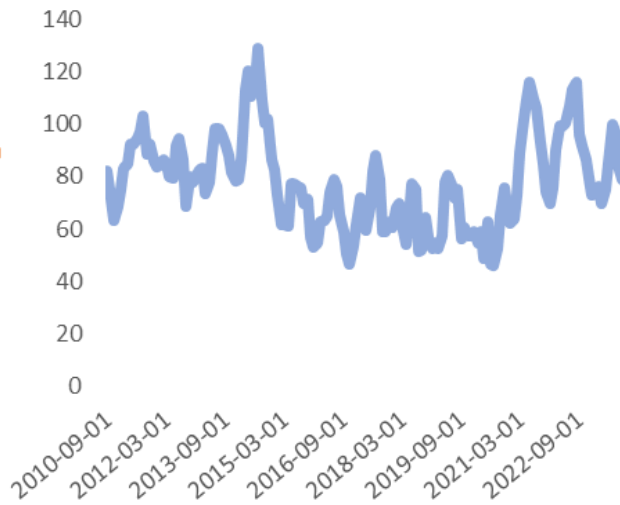
With increased production of livestock comes an increased need for livestock vaccine and other medicine

"Growth in our livestock was driven primarily by price, especially in high inflationary markets"
 Zoetis CFO
 November 2023

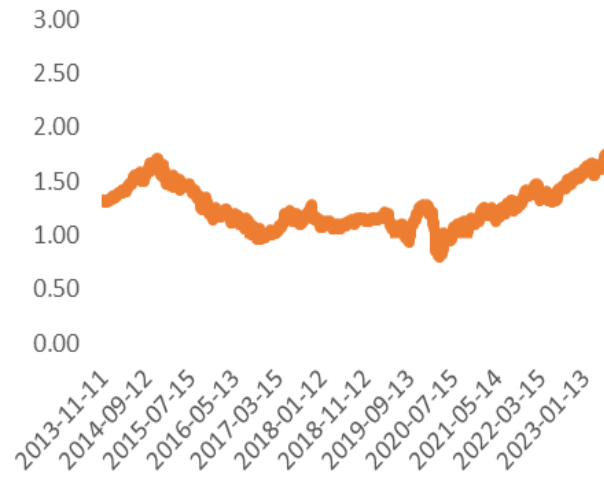
Global Swine Prices



Global Poultry Prices



Feeder Cattle Prices



Weighted Average Cost of Capital:	
Market Risk Premium	5.0%
Beta	0.8
Risk Free Rate	5.0%
Cost of Equity	9.1%
Risk Free Rate	5.0%
Spread	4.0%
Tax Rate	21.0%
Cost of Debt	2.7%
Total Equity	\$78,389
Total Debt	\$6,991
Equity / Total Capitalization	91.8%
Debt / Total Capitalization	8.2%
WACC	8.6%

PV of UFCF

Base Case



<i>\$ in millions</i>	For Fiscal Year Ending June 30th						CAGR
	2023E	2024E	2025E	2026E	2027E	2028E	
Revenue	8,443.6	8,908.0	9,602.8	10,294.2	10,942.8	11,632.2	5.5%
<i>% Growth</i>	4.5%	5.5%	7.8%	7.2%	6.3%	6.3%	
(-) Operating Expenses	(5,391)	(5,618)	(6,018)	(6,505)	(6,907)	(7,342)	
(+) D&A	439	399	423	460	488	519	
(+) Stock Based Compensation	76	80	86	92	98	104	
EBITDA	3,567.5	3,768.6	4,094.6	4,341.1	4,621.8	4,914.0	5.5%
<i>% Margin</i>	42.3%	42.3%	42.6%	42.2%	42.2%	42.2%	
(-) D&A	(439)	(399)	(423)	(460)	(488)	(519)	
(-) Stock Based Compensation	(76)	(80)	(86)	(92)	(98)	(104)	
EBIT	3,053.1	3,289.8	3,585.3	3,789.1	4,035.4	4,290.5	5.8%
<i>% Margin</i>	36.2%	36.9%	37.3%	36.8%	36.9%	36.9%	
(-) Taxes	(641.2)	(690.8)	(752.9)	(795.7)	(847.4)	(901.0)	
NOPAT	2,411.9	2,598.9	2,832.4	2,993.4	3,188.0	3,389.5	5.8%
(+) D&A	439	399	423	460	488	519	
(-) Capital Expenditures	(703.0)	(592.7)	(625.3)	(674.1)	(722.6)	(768.1)	
(-) Change in Net Working Capital	(627.6)	(8.4)	(185.6)	(115.7)	(108.5)	(115.3)	
UFCF	1,520.2	2,397.0	2,444.8	2,663.5	2,845.3	3,025.4	12.2%
(-) Stub-Year	(1,305.9)						
FCF For Discounting	214.4	2,397.0	2,444.8	2,663.5	2,845.3	3,025.4	
Discount Period	0.43	0.93	1.93	2.93	3.93	4.93	
Discount Factor	0.97	0.93	0.85	0.79	0.72	0.67	
PV of UFCF	206.9	2,219.9	2,084.8	2,091.3	2,057.0	2,013.8	