

# Mu Capital Group



17/11/2021

## ZTS

## Zoetis Inc.

A market dominant company in the animal healthcare industry with attractive growth opportunities on the horizon.

### COMPANY OVERVIEW

Zoetis Inc. is an American drug company and is the world's largest producer of medicine and vaccinations for pets and livestock. It is focused on the discovery, development, manufacture and commercialization of medicines, vaccines, diagnostic products, biodevices, genetic tests and precision livestock farming technology. The Company is involved in commercializing products across eight core species: dogs, cats, horses and cattle, swine, poultry, fish, and sheep; and within product categories such as vaccines, anti-infectives, parasiticides, dermatology, other pharmaceutical products, medicated feed additives and animal health diagnostics. The Company's segments include the United States and International. Within each of these operating segments, it offers a product portfolio for both livestock and companion animal customers. The company directly markets the products in approximately 45 countries and sells the products in more than 100 countries.

Another important piece of information to know is that the company was a subsidiary of Pfizer, but with Pfizer's spinoff of its 83% interest in the firm it is now a completely independent company. This is crucial in giving it a distinct advantage as most of the world's largest animal health companies today are subsidiaries of the world's largest pharmaceutical companies.

In terms of revenue break-down, it can be broken down three ways namely, by Geographic area, by Species, and by Major Product Category.

#### Revenue by geographic area

(MILLIONS OF DOLLARS)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
United States	\$ 1,065	\$ 996	\$ 3,002	\$ 2,605
Australia	70	60	196	154
Brazil	78	62	227	181
Canada	56	50	169	144
Chile	32	24	100	72
China	72	66	289	198
France	31	29	98	82
Germany	47	38	135	112
Italy	30	28	87	63
Japan	43	39	140	133
Mexico	31	26	98	84
Spain	33	31	97	83
United Kingdom	61	44	173	125
Other developed markets	127	105	350	282
Other emerging markets	193	165	591	490
	1,969	1,763	5,752	4,808
Contract manufacturing & human health	21	23	57	60
<b>Total Revenue</b>	<b>\$ 1,990</b>	<b>\$ 1,786</b>	<b>\$ 5,809</b>	<b>\$ 4,868</b>

Price [17/11/2021]	\$224,40
Market Cap (bn)	\$105,233
EV (bn)	\$106,08
Beta (5Y monthly)	0,66

### Pharmaceutical (Animal)

Mean Price Target	\$247,50
% Upside	11,5%

#### 24m performance:



#### Market Data:

52- Week Range	141,4 - 222,60
Shares Out. (m)	473,13
P/E (ttm)	53,58x
PEG (5-yr expected)	3,05
EPS (ttm)	4,19
EPS growth	22,50%
Div. (ps)/Yield	\$0,25/0,46%
Payout ratio	24,10%

#### Profitability:

Profit margin	26,02%
Op margin	36,00%
ROA (ttm)	12,49%
ROE (ttm)	47,76%

#### Financial Data:

Revenue (bn)	7,62
Revenue growth	14,10%
EBITDA (bn)	3,14
EBITDA growth	16,61%
EBITDA margin	41,49%

#### Leverage:

Net debt (bn)	3,60
Total debt/equity	1,41x
Current ratio	4,54
Cash ratio	2,23

Revenue by species

(MILLIONS OF DOLLARS)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2021	2020	2021	2020
<b>Companion Animal:</b>				
Dogs and Cats	\$ 1,142	\$ 947	\$ 3,319	\$ 2,524
Horses	60	48	188	150
	1,202	995	3,507	2,674
<b>Livestock:</b>				
Cattle	403	417	1,144	1,107
Swine	153	151	504	454
Poultry	124	129	389	412
Fish	56	45	132	101
Sheep and other	31	26	76	60
	767	768	2,245	2,134
Contract manufacturing & human health	21	23	57	60
<b>Total Revenue</b>	<b>\$ 1,990</b>	<b>\$ 1,786</b>	<b>\$ 5,809</b>	<b>\$ 4,868</b>

Revenue by major product category

(MILLIONS OF DOLLARS)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2021	2020	2021	2020
Vaccines	\$ 421	\$ 401	\$ 1,251	\$ 1,086
Parasiticides	396	305	1,246	867
Anti-infectives	329	349	909	870
Dermatology	326	257	859	681
Other pharmaceuticals	243	208	717	597
Medicated feed additives	99	102	314	336
Animal health diagnostics	95	87	283	216
Other non-pharmaceuticals	60	54	173	155
	1,969	1,763	5,752	4,808
Contract manufacturing & human health	21	23	57	60
<b>Total Revenue</b>	<b>\$ 1,990</b>	<b>\$ 1,786</b>	<b>\$ 5,809</b>	<b>\$ 4,868</b>

All 3 tables above are from Zoetis' 2021 Q3 Financial Statement (10-Q)

- Over 50% of Zoetis' revenue comes from the US market
- Over 50% of its revenue is driven by products related to Dogs and Cats in terms of revenue by species
- Quite diversified in terms of product category with vaccines being the dominant revenue driver

## MARKET POSITION

Zoetis Inc. stands as one of the key companies in the animal pharmaceuticals market, and currently is the largest animal health company in the world by revenue, capturing 17.4% of global sales in 2018. In 2020, Zoetis generates \$6.7 billion, with \$3.56 billion being generated in the US, and the rest being generated elsewhere.

Within the animal health market, Zoetis' main competitors are Boehringer Ingelheim GmbH and Merck & Co Inc. which are based in Germany, and Elanco based in the US. Within the market, Boehringer claim a 14% market share, Merck claim 12.6% and Elanco has a 9.2% share. Despite having the largest market share, the animal health market is incredibly fragmented, with many opportunities for mergers and consolidation. As of November 2021, Zoetis has exceeded earnings and revenue expectations in Q3 2021. In October 2021, the world's first and only COVID vaccine developed by Zoetis for animals was rolled out in a trial in several zoos across the US. As COVID has been proven to have the ability to infect animals, albeit much less frequently, it can seriously harm the animals, a COVID vaccine for domesticated, farm, and zoo animals is a lucrative and high growth area that Zoetis currently claims a monopoly over.

As the COVID pandemic has shifted the world of work from the office to home, the amount of time people spend with their pets has increased dramatically, representing 53% of the revenue of Zoetis, as dogs and cats standing as the most popular species by revenue in Zoetis products. This trend seems to be somewhat permanent, leading to a forecast CAGR of the animal healthcare industry of 4.7% for the period 2021-2027, forecasting a growth from a global market value of \$139 billion in 2020 to >\$190 billion in 2027.

## MANAGEMENT STRUCTURE

Zoetis is led by an experienced team of senior executives who are passionate about animal health and share a commitment to supporting veterinarians and livestock producers around the world.

### Kristin Peck – Chief Executive Officer

Prior to becoming CEO in January 2020, Ms. Peck was executive vice president and group president, U.S. Operations, Business Development and Strategy at Zoetis. Ms. Peck helped usher Zoetis through its Initial Public Offering in 2013 (which at the time was the largest IPO from a US company since Facebook), and has been a driving force of change in many roles at the company including Global Manufacturing and Supply, Global Poultry, Global Diagnostics, Corporate Development, and New Product Marketing and Global Market Research. Despite not being CEO for a considerable length of time yet, her other roles in the company demonstrate her keen interest and commitment in serving the company well.

Before joining Zoetis, Ms. Peck served as executive vice president, Worldwide Business Development and Innovation at Pfizer Inc. and as a member of Pfizer's Executive Leadership Team. Prior to joining Pfizer, Ms. Peck held roles at The Boston Consulting Group (BCG) as well as in private equity and real estate finance at The Prudential Realty Group, The O'Connor Group and J.P. Morgan. This indicates that she has a very diverse set of skills, which is certainly an asset to Zoetis, and ultimately a prospective investor.

Ms. Peck is on the Board of BlackRock, the world's largest asset management firm. Named a Fortune 2020 Businessperson of the Year, Ms. Peck has been recognized for her leadership and Zoetis' strong performance, including its resilience during the COVID-19 pandemic. The numerous experienced roles she has occupied and her demonstrated commitment to Zoetis leave us very confident in investing into a company under her leadership.

### Tim Bettington – Executive Vice President and President, US Operations and Global Customer Experience

Worth knowing more about since company's revenue is predominantly driven from its US operations.

Mr. Bettington leads their U.S. commercial operations supporting their livestock and companion animal portfolios. Additionally, he leads their Global Customer Experience function, where he leverages his extensive experience in the worldwide animal health industry.

Prior to joining Zoetis in 2020, Mr. Bettington enjoyed a successful, diverse, and global career in the animal health industry for more than 20 years, working in both the livestock and companion animal sectors. He joined Zoetis from Boehringer Ingelheim where he served as North American Region Head of Commercial Operations for its animal health business. During his tenure at Boehringer Ingelheim (one of Zoetis' main competitors) and previously at Novartis Animal Health, Mr. Bettington worked in the U.S., Europe and Australia and developed a deep expertise in sales excellence, marketing strategy, and business integration.

## INTEGRITY AND ESG ANALYSIS

### Zoetis Inc

Industry Group: Pharmaceuticals

Country: United States

Identifier: NYS:ZTS

#### ESG Risk Rating

**18.2** Low Risk



#### Ranking

INDUSTRY GROUP

Pharmaceuticals

20 out of 998

UNIVERSE

Global Universe

2454 out of 14641

Environmentally, since 2017, whilst raw CO<sub>2</sub> emissions have increased, they have not increased in line with the much more rapid expansion of Zoetis itself, as they have managed a 4% decrease in CO<sub>2</sub> emissions intensity. In addition, three of their international sites operate on 100% renewable energy, and they are continuing to invest in high-efficiency ventilation and boilers, as well as LED lighting. Similarly, since 2017 Zoetis have managed to reduce their water intake intensity by 5% by introducing new technologies such as closed-loop cooling systems. In terms of solid and hazardous waste production, Zoetis have performed extremely well, managing a 87% solid waste production intensity since 2017, and a 14% increase in the rate of recycling solid waste. They have reduced waste produced by a significant margin by an excellent operations overhaul and changing their product mix and recycling a larger proportion of the waste being produced by recovering recyclable materials and converting an increasing share of waste to energy. With hazardous waste, they have achieved a 9% decrease in hazardous waste intensity, and a 35% increase in the recycling rate of hazardous waste, achieved through expanding on-site treatment facilities and projects such as converting manure waste to fertiliser.

In terms of workplace treatment and diversity, Zoetis is not a leader in diversity, however against other pharmaceutical companies they perform better than the industry in terms of gender diversity and perform at an average level in terms of ethnic diversity. Over 50% of executive team members are women, and over 30% of those at an Executive/Sr. Management level were women, much better than the 24% industry average. However, only ~16% of those at an Executive/Senior Management level were non-white, lower than the industry average of 19%, and ~22% of executive committee members were from a non-white background, in-line with the industry average.

Recently, Zoetis have been subject to investigations by the EU, as they may have infringed EU antitrust rules, prohibiting the abuse of a dominant position. Despite little details being known, with only two of their Belgium sites being investigated, The European commission has emphasised the fact that inspections being carried out does not imply the company themselves are guilty.

### KEY RISKS

We have identified two main risks with Zoetis Inc.

1. A rapidly growing competitor:

Boehringer Ingelheim GmbH, may pose a threat to the dominant position of Zoetis in the animal healthcare market. In 2015, Boehringer only drew in \$1.5 billion in revenue, less than a third of that of Zoetis. In 2020, Boehringer claims 14% market share whilst Zoetis claims 17.4%, showing that whilst Zoetis has strong growth opportunities and a market-leading position, it cannot be taken for granted.

2. Potential vaccine/drug failures:

Like almost all pharmaceutical companies, the risk of expensive projects failing and resulting in lost money for the company is a risk one must consider. For example, GSK's disastrous Covid vaccine trials resulted in tens of millions being wasted as their vaccine was deemed unusable. This risk is not unique to Zoetis, and due to the sheer volume of drugs and vaccines Zoetis has already and are currently developing, this large scale helps prevent against one failed project having a detrimental impact on the company.

## OPPORTUNITIES FOR GROWTH

### 1. Fragmented market:

The animal health market is notoriously fragmented, with Zoetis being the largest at just 17.4% market share, this shows the market is far from saturated and there are clear opportunities to expand and grow. As the animal health market itself is expected to grow significantly over the coming years, Zoetis will capture the largest share of this growth, further fuelling the company's recent expansion

### 2. COVID-19 Animal Vaccination:

As life continues to get back to normal and many countries are adopting a 'live with COVID' policy, as people are vaccinated and the virus becomes less deadly to humans, the same cannot be said for animals. From three endangered Snow Leopards in a US zoo dying, to hyenas at Denver Zoo being the first recorded cases in the species, the protection of pets and endangered animals will be the next large fight against COVID-19. At the forefront of this fight is Zoetis, being the only company who have developed a currently-testing COVID vaccine for animals.

### 3. Shift in attitude towards pets:

The majority of new pet owners during the pandemic pet boom were categorised as Millennial or Gen Z, younger pet owners who have a tendency to be pre-disposed to spend more on their pets, and as the global consciousness shifts in an animal-welfare direction, we will see more money being spent per pet. During Q2 2021, Zoetis saw a 10% increase on spend per visit to a vet, indicating the trend of not just more pets, but more money being spent on each one.

### 4. Jurox and its synergies

Zoetis announced in August 2021 that they are to acquire Jurox, an Australian provider and manufacturer of pet and livestock products. With Australia being Zoetis' 5<sup>th</sup> largest market, generating \$207 million in 2020, the acquisition of Jurox will provide a huge growth opportunity in the Australian market. As well as growth in the Australian market, this acquisition provides access to Jurox's portfolio of products, including Alfaxan®, the leading anaesthetic product for pets and companion animals. The acquisition is expected to be completed in the first half of 2022; we expect the synergies to be created to kick in then.

### 5. Ongoing Collaboration with Regeneron Inc.

In 2018, Zoetis announced collaboration with Regeneron Inc., in which Regeneron granted Zoetis a license to use its *VelocImmune* antibody technology, with which Zoetis will use to develop treatments for companion and livestock animals. These treatments will include those for immune-related conditions, pain, and most-importantly, cancer. The ability to develop such revolutionary treatments provides a great growth opportunity, as illness is no longer the death-sentence for pets and livestock that it used to be, these treatments will be revolutionary in animal illnesses. Already, Zoetis has developed antibody-based treatments for use in dogs and could change how vets treat animals in the future.

## FINANCIAL EVALUATION

Market Summary > Zoetis Inc

**222.33** USD

+58.24 (35.49%) ↑ past year

17 Nov, 18:31 GMT • Disclaimer

LON: OM3Q

+ Follow

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Financial Summary						
	2016	2017	2018	2019	2020	Sum of Previous 4 Quarters
<b>Revenue</b>	<b>4 888</b>	<b>5 307</b>	<b>5 825</b>	<b>6 260</b>	<b>6 675</b>	<b>7 616</b>
growth		8,57%	9,76%	7,47%	6,63%	14,10%
<b>EBITDA</b>	<b>1 644</b>	<b>1 969</b>	<b>2 189</b>	<b>2 430</b>	<b>2 710</b>	<b>3 160</b>
growth		19,77%	11,17%	11,01%	11,52%	16,61%
margin	33,63%	37,10%	37,58%	38,82%	40,60%	41,49%
<b>EBIT</b>	<b>1 404</b>	<b>1 727</b>	<b>1 881</b>	<b>2 018</b>	<b>2 269</b>	<b>-436 840</b>
growth		23,01%	8,92%	7,28%	12,44%	-19352,53%
margin	28,72%	32,54%	32,29%	32,24%	33,99%	-5735,82%
<b>FCF</b>	<b>497</b>	<b>1 122</b>	<b>1 452</b>	<b>1 335</b>	<b>1 673</b>	<b>1 791 000</b>
growth		125,75%	29,41%	-8,06%	25,32%	106953,20%
margin	69,71%	83,36%	81,12%	74,37%	78,69%	79,53%
<b>Net Income</b>	<b>821</b>	<b>864</b>	<b>1 428</b>	<b>1 500</b>	<b>1 638</b>	<b>1 982</b>
growth		5,24%	65,28%	5,04%	9,20%	21,00%
margin	16,80%	16,28%	24,52%	23,96%	24,54%	26,02%
<b>EPS</b>	<b>1,65</b>	<b>1,75</b>	<b>2,93</b>	<b>3,11</b>	<b>3,42</b>	<b>4,19</b>
growth		6,30%	67,31%	6,13%	9,88%	22,50%
<b>IRR</b>	#VALUE!	#VALUE!	26,22%	#VALUE!	31,34%	#VALUE!

Fiscal Year	2016	2017	2018	2019	2020	Qs	Current (Ex-Qs)
<b>Profitability Ratios</b>							
Return on Equity	55%	48%	65%	55%	43%	42%	
Profit Margin	17%	16%	25%	24%	25%	26%	
Internal Rate of Return	#VALUE!	#VALUE!	26%	#VALUE!	31%	#VALUE!	
Asset Turnover	64%	62%	54%	54%	49%	56%	
Profitability	17%	16%	25%	24%	25%	26%	
Leverage	510%	481%	493%	426%	361%	293%	
<b>Liquidity Ratios</b>							
Current Ratio	3,03	3,85	3,60	2,63	3,05	4,54	
Cash Ratio	0,65	1,43	1,39	1,07	1,66	2,23	
<b>Debt Ratios</b>							
Debt to Equity	410%	381%	393%	326%	261%	193%	
Interest Coverage Ratio	4,30	7,69	8,44	7,42	8,54	38169,49	
Interest Coverage Ratio Applicable?	YES	YES	YES	YES	YES	YES	
<b>Valuation Ratios</b>							
Earnings Per Share	1,65	1,75	2,93	3,11	3,42	4,19	
Price to Earnings	-	-	-	-	-	-	53,44
PEG	-	-	-	-	-	-	4,02
PEG Including Dividends	-	-	-	-	-	-	3,91
FCF Per Share	1,00	2,28	2,98	2,77	3,49	3 785,46	-
Price to Free Cash Flow	-	-	-	-	63,54	0,06	63,54
Dividend Per Share	0,38	0,42	0,50	0,65	0,79	955,35	-
Dividend Yield	-	-	-	-	-	-	0,36%

### Profitability and Past Performance

- Consistent increase in sales and net income between 2016-2020, despite Covid. Both have also increased quite dramatically in the last 4 quarters which indicates Zoetis' strong position as we slowly exit the pandemic.
- Profit margin has displayed sustained double-digit figures with an average margin of 21.4% over the years 2016-2020.
- Return on equity has also been consistently strong with an average of 53.2% over the years 2016-2020. This demonstrates a very effective use of assets to generate profits. Return on equity for the last twelve months is 42%.
- Return on Invested Capital is also very attractive, sitting at 24,63% for the trailing twelve months. This indicates that Zoetis is efficient at allocating capital under its control to profitable investments.

### Liquidity

- Zoetis' current ratio remains well above 1 with an average of 3.23 each year during the period 2016-2020, which means the company is in a strong position to cover any short-term obligations.
- Cash ratio is also comfortably over 1 which indicates that Zoetis is able to cover all its short-term debt and still have sufficient cash remaining which places it in a very strong position competitively.

### Debt

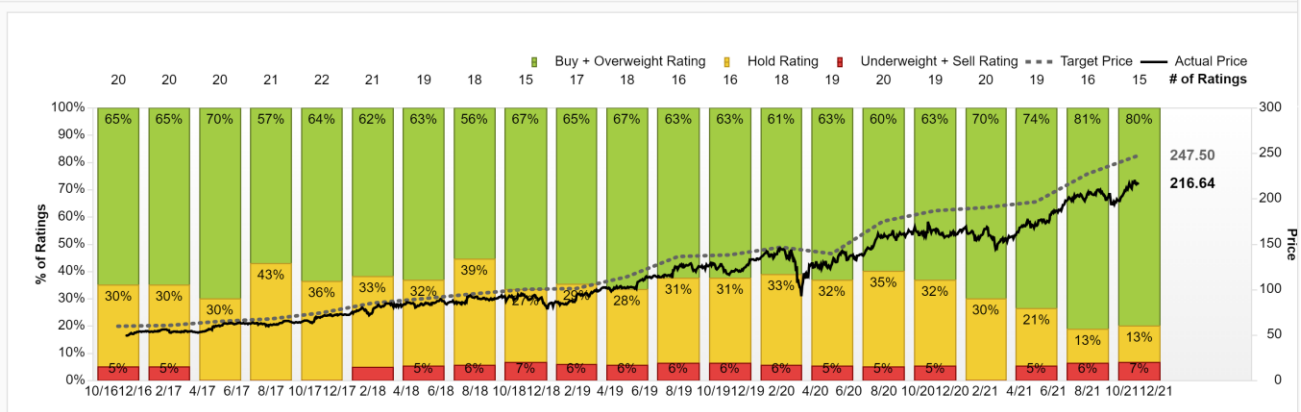
- Debt/Equity ratio is quite high; however, it is dropping consistently and currently stands at 193% for the last 4 quarters. This is a 217% drop since 2016.
- Zoetis has got a very attractive interest coverage ratio which indicates it is sufficiently capable of meeting its interest payments.

**Valuation and Comparables Analysis**

Company Name	Trailing P/E	Forward P/E	EV/REVENUE	EV/EBITDA	EV/EBIT	ROE (ttm)	ROIC (ttm)	P/SALES	P/EBITDA	P/EBIT	P/FCF	P/BV
Elanco	N/A	26,45	4,49	88,98	-41,19	-8,71%	0,88%	3,36	62,54	-28,95		2,03
IDEXX Laboratories	70,98	68,97	17	52,27	58,04	126,53%	45,55%	17,13	52,10	57,86	80,11	69,54
Virbac	21,26	N/A	3,46	12,74	15,54	25,44%	14,29%	3,52	13,34	16,28	33,45	4,96
Vetoquinol SA	42,75	N/A	3,52	15,29	26,50	10,29%	3,86%	3,55	15,67	27,20		4,22
Merck & Co Inc.	25,23	11,90	4,35	15,7	20,49	26,04%	12,66%	4,05	14,40	18,78	36,36	5,93
Mean	40,06	35,77	6,56	37,00	15,88	38,39%	15,45%	6,32	31,61	18,24	49,97	17,34
Median	33,99	26,45	4,35	15,70	20,49	25,44%	9,08%	3,55	15,67	18,78	36,36	4,96
<b>ZOETIS INC. (KNYS:ZTS)</b>	53	43	14,21	34	40	47,76%	24,63%	13,79	33,23	39,92	46,50	22,43
<b>ALL FIGURES TTM (LTM).</b>												
<b>ALL FIGURES \$USD (in millions).</b>												
Over/Under Valuation	-0,3341	-0,1945	-1,1647	0,0743	1,5405			-1,1806	-0,0511	-1,1892	0,0695	-0,2938
Implied Share Price	167,7968312	185,7818956	98,84564317	-4,252473655				101,76649	211,1159351	-16836,60368	189172,1821	171,5184756
Current Stock Price		221,91										
Average Implied Share Price		19252,0168										
% premium to current		8575,60%										

- Quite tough to find accurate comparables given that Zoetis operates in such a niche market. As mentioned previously, most of the world's largest animal health companies today are subsidiaries of the world's largest pharmaceutical companies so valuation ratios are for the company as a whole and not its Animal Health business specifically.
- This means that Zoetis may come across as being heavily overvalued, so we have decided to look into some of the analysts thinking into whether this stock is a buy at the moment.

Zoetis, Inc. Class A (ZTS) \$216.64 Next Rpt Date: 17 Feb '22 Key Statistics Pending Mgt. Change FactSet Estimates



- Coming from a credible source Factset, Analysts thinking is still heavily weighted towards this stock being a buy as of November 2021 and we believe that given the growth opportunities on the horizon as well the very attractive position it has from a profitability, liquidity and debt point of view, we agree with them.
- In terms of ROE and ROIC, it is evident that Zoetis is a very attractive investment when compared to some of its competitors.



## SHAREHOLDER STRUCTURE

- Wide variety of shareholders with the top 25 shareholders owning 54,33% of the company.
- Shareholders have not been meaningfully diluted in the past year.
- Zoetis' free float currently sits at 472,58M



Some of the largest shareholders include:

- BlackRock, Inc. – 8.22%
- The Vanguard Group, Inc. – 7.88%
- State Street Global Advisors, Inc. – 4.09%
- AllianceBernstein L.P. – 3.64%

## INVESTMENT RATIONALE

The animal health market itself is poised to grow massively over the coming years, due to the increased awareness given to animals and other factors, and with Zoetis standing as the main company in the market, they are forecasted to claim the largest share of this growth. When we look at the ESG risk rating, we see Zoetis performing within the top 2% within the industry in this regard. With a consistently improving environmental record, minimal controversies, and a high ESG rating, Zoetis appears to be a forward-looking company with a strong ESG track record. Despite having two main risks identified, both of which are not deemed very serious, as one risk is inherent to all pharmaceutical companies, and lessens with the higher diversity of products we see with the company. Zoetis presents numerous strong growth opportunities, from being in a very fragmented market, to the market itself having strong projected growth. Regarding Zoetis itself, the currently-trialling COVID-19 vaccine for animals is a main growth prospect, a product which will have huge demand. The acquisition of Jurox and collaboration with Regeneron will also create further synergies, with access to more patents and methods to develop products.

Zoetis has demonstrated an impressive financial track record to date from a profitability, liquidity and debt point of view. We have touched on our thoughts with regards to a possible overvaluation, however we agree with analysts thinking that, despite this, the stock is certainly still a buy given the exciting growth prospects on the horizon. Being such a market dominant company in a notoriously fragmented industry certainly gives it a competitive advantage in terms of expansion and growth within the broader industry going forward. A committed management team who certainly have the interests of the company at heart makes us confident that Zoetis is certainly a stock worth investing in. Its diversified portfolio, both from a product category perspective and different species perspective, paralleled by the numerous different markets it already operates in makes Zoetis the ideal stock to diversify the Mu Capital portfolio and we therefore recommend it as a buy.