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Zoetis, Inc. (ZTS)

Cowen & Co. Health Care Conference

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CORPORATE PARTICIPANTS

Kristin C. Peck
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Kathleen Miner
Analyst, Cowen and Company

Steve Scala
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MANAGEMENT DISCUSSION SECTION

Kathleen Miner
Analyst, Cowen and Company

Good afternoon, everyone. This is the Zoetis company presentation. I'm Kathy Miner and I'm joined by my colleague, Steve Scala. We're very happy today to have Zoetis with us. Zoetis, as you know, is the global leader in animal health, and the stock has been one of our top performing names every year over the past five years. We continue to see the company as extremely well positioned in this attractive market.

With us today, we're also very happy to have with us once again CEO, Kristin Peck. Kristin, welcome, and we're just sorry that we can't do this in person this time around.

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

Great to be here. Thanks so much, Kathy.

Kathleen Miner
Analyst, Cowen and Company

Great. We have a lot that we hope to cover today. It's a great story. There's a lot of news. And before we jump into it, just as a reminder, if anyone in the audience has a question, they can either use the question box up at the top of the screen or they can e-mail either Steve Scala or myself, Kathy Miner, at cowen.com. Thank you.

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QUESTION AND ANSWER SECTION

Kathleen Miner
Analyst, Cowen and Company

Q

So, to get started. Kristin, we'll start with a couple big picture issues first. First one on the political legislative side, given the new administration with the Democratic House and Senate, what sort of initiatives or proposals is Zoetis most closely monitoring?

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

A

Sure. I mean, we've always worked across the aisle, mostly because we think the issues for animal health are largely bipartisan. I think, first and foremost, we want to make sure that we have a good environment for innovation in the animal health space, which I think is really important when you consider 70% of the diseases affecting humans – infectious diseases affecting humans are zoonotic.

So, I think ensuring that we have a robust, innovative way to bring our products to market and to address disease will be important for us. We look at trade as a big issue for us, making sure that there's certainty around trade. As you've seen over the last few years, Kathy, you and I've spoken about, whether that's USMCA, China trade, etcetera, trade is really important in our livestock space.

We're also focused obviously on immigration issues with regards to making sure that there's workers to support the agricultural businesses in the US, issues such as ensuring that you can get – rural connectivity is very important to us as we think about our portfolio and diagnostic connectivity, and most of these, honestly, are pretty bipartisan.

Obviously, we'll have to deal with taxes and things like that, and we'll manage through that one. But we're looking forward to working with the new administration and we've worked quite well across the aisle, as you've seen over the last eight years.

Kathleen Miner
Analyst, Cowen and Company

Q

Do you expect anything in 2021 or is it likely the focus remains on COVID-related issues from Washington's perspective?

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

A

We're expecting the focus to remain on COVID-related. The only space that we're hoping for this year is a little bit of investment in infrastructure, which we think could be helpful in hoping to get rural broadband as part of that infrastructure package, which we think could really be highly supportive of many of our producer customers.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay, great. So, second question big picture is on pricing, which is always a question from investors. Can you just talk to us about how you see this evolving not only this year, but in the next three years? And if you could differentiate between companion and farm animal.

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

Sure. As you probably know, on average, we increase prices around 2% per year, and we see that as a long-term trend. I think you may see a slight decrease in 2021 only because of Draxxin and the size of Draxxin and hitting generic competition. But in general, you'll see 2% and sometimes in a given year, that's a little bit higher on the companion animal side, where there's a little more pricing leverage than you have in the livestock side, and it also varies a little bit about where innovation is.

When you have innovation, we can get a pricing premium, as you've seen both in the livestock side and the companion animal side. But we really believe that long-term trends, which we've demonstrated year after year of about 2% on price in the top line, is something that we plan on doing over the short, medium, and long term with probably maybe a little bit less in 2021, just given Draxxin.

Kathleen Miner
Analyst, Cowen and Company
Q

Okay. And lastly, just on the big picture side, can you – has the recent – the weather issues that have been in Texas, have those impacted any of your businesses or your customers and might we see any impacts in Q1 on the numbers?

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

Sure. They definitely impacted some of our customers, especially the cow/calf and stocker groups and some of those geographies. That's not a huge part of our business, so I don't expect this to impact our business. It will have impacted within the quarter if you look at February, vet clinic visit traffic obviously in February, but that will all come out in the wash. So, we don't expect it to influence or impact our overall numbers for the quarter.

It definitely influence timing of certain things. But we're a little bit more concerned just on some of those small – animal welfare issues, to be perfectly honest with you. Those conditions, it was really tough to especially calving at that point. It was just really difficult for some of our customers. So, that was an impact. But we don't think from a Zoetis, Inc. perspective to see any significant impact in the quarter.

Kathleen Miner
Analyst, Cowen and Company
Q

Okay, great. Good news all around then.

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

Yeah. So except for some of those animals, yes.

Kathleen Miner
Analyst, Cowen and Company
Q

Except for some animals. Okay. Then if we can shift maybe, there are couple specific issues that investors have been focused on. First, we're going to touch on the pain monoclonals. And we have a number of questions in this area, not only because it's very important to Zoetis, as we anticipate this is going to be a future blockbuster, but it's also been important as the human version is going through the US regulatory process right now at the same

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time. It's been a challenging path. So maybe we can start – congratulations on both Librela and Solensia being approved to the EU. When should we anticipate the launch of both now and will you launch them together?

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

Sure. You should anticipate the launch of both of those probably by the first half of this year. So, pretty soon for Librela, and Solensia probably by the end of Q2. So I think both of those by the second quarter by midyear, we're really excited to be launching those. We're already in early experience trials in the markets where they're approved, in Europe, in Canada, etcetera, which we think has been – we've demonstrated through Cytopoint and other launches, even with Apoquel, really important part of building the market for our products, etcetera. So, we are quite excited to launch those products this year and to really bring what I think are truly innovative products to the market.

Kathleen Miner
Analyst, Cowen and Company
Q

So, you are launching out – so you have gone through this before with Cytopoint and Apoquel in terms of because you can't use DTC in Europe. So, you're able to go out using a similar template, except now it's on pain in cats and dogs.

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

So, we don't do direct-to-consumer brand-specific anywhere. And honestly, we've actually never done disease awareness campaigns in Europe. I think one of the things that we're learning here is as you look at – using derm as an example, two-thirds of our sales are in the US, but actually 50% of dogs are outside of the US. So, we really believe we need to engage the pet owner more deeply. So, we are for the first time going to do unbranded disease awareness to make sure that customers know that there is a product if they have an itchy dog.

And when we get penetration into clinics on pain, the same thing. But this would be disease awareness outside of the US. There are certain countries where we can do advertising directly. Brazil, you can; there's definitely a few markets where we can. But largely in Europe where we have the approvals, it would just be disease awareness. And this will be the first time we're really going to take that tactic. But we really believe that if we can build these markets faster, it would be much better for us. So, we're going to try something we've never tried before, which is really doing disease awareness.

Kathleen Miner
Analyst, Cowen and Company
Q

And I assume once it launches, then we will all know what the pricing is on the product [indiscernible] (00:07:33). Is your pricing strategy, though, to have a similar price both in Europe and the US?

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

Yes. We always look at pricing from a global perspective. There are differences market by market for a host of different reasons. Examples of why they might be different would be the competitive situation is actually often different in different markets. So, for example, in the US there really is no other cat product. In Europe, they actually do have a few markets where they do have a competition. But we look at that overall globally to set a strategy.

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So, all of our pricing strategies are global. It doesn't mean it's exact same price, but on a relative basis, we do look at the market, the competition, etcetera. So, if you want to give example like, right now, Trio is priced differently in Europe than the US, because there is competition in Europe. There is NexGard Spectra, etcetera. So, the situation has to be market by market, but we have a global approach.

Kathleen Miner
Analyst, Cowen and Company

And just to clarify on that, competition for the cat pain, are those small molecules?

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

Yes. The ones that are approved today are small molecules, correct.

Kathleen Miner
Analyst, Cowen and Company

Okay. Fair enough. And if there's a tremendous response to this, like it was to Apoquel initially, do you have sufficient manufacturing to ramp up for both of these products?

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

Yes, we have learned our lesson, Kathy. Our goal is to never repeat that one. So, yes, we're focused to ensure that we have full supply before we launch these products. Absolutely.

Kathleen Miner
Analyst, Cowen and Company

Okay. Just to switch a little bit to the US side, a few questions and clarifications here. You've indicated that both Librela and Solensia are manufactured outside of the US, so that inspection of – site inspection will be needed. But clearly, in the current environment, that's not happening or difficult to happen. Do you know if the CVM has conducted any OUS facility inspections recently?

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

I do not know the answer to that question, no.

Kathleen Miner
Analyst, Cowen and Company

And is Cytopoint also manufactured in one of those same locations?

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

No. Cytopoint is manufactured in Lincoln, Nebraska.

Kathleen Miner
Analyst, Cowen and Company

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Okay.

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

I mean, what's interesting here is some of these sites are biologic sites. I mean, our Lincoln site has actually got a small molecule and large molecule. So, I'm not sure there's a regulatory body in the world that isn't visiting Lincoln, Nebraska for everything we manufacture there. When it's a dedicated site to one or the other, you tend to have either FDA visiting more often or USDA.

In the case of the two sites where these products are made, the FDA has never visited these sites before. They're not ones where they have other products. So, it would be a first time. It's called the prior-approval inspection would be required. It's just different.

In Europe, these are the same sites who make other products and they don't have different regulatory bodies reviewing them. So, European authorities had already been to these sites and were quite comfortable with some of these sites. So...

Kathleen Miner
Analyst, Cowen and Company
Q

Okay. Very good. And on the US side, do you know if the CVM, which is the animal equivalent for the FDA, do they look at human data when they review a process? And the reason we bring this up is I'm curious – there's 1.5 day FDA Advisory Committee meeting on tanezumab later this month. Do you think that discussion, those things will come into play as they're looking at Librela and Solensia?

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

I don't think they look at the data, no. Do I think they're aware of it and understanding some risks that can be in a certain profile? I think we have to look at, as you know, in different animals, different drugs have very different reactions. So, I think what they're going to do is look at the data, know that they want to be looking in those areas, if you know that there's a side effect that you don't – in humans, you're going to make sure that you focus a lot on that data when you look at our products.

So, I don't think they'll ignore it, but they're going to look at the data very specific, because animals react, as you know, very differently to different products. Certain products are deadly to one animal and not to another. So, I don't think they're going to look at the human data, but they'll certainly be focused on the areas and to make sure that they look at our data to make sure that they don't see the same trends.

Kathleen Miner
Analyst, Cowen and Company
Q

So, this would be we're talking bone fractures or RPOA in the case of the animals. Is that your understanding also?

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

Yes. But I think they'll look at our data, and that's what I'm saying. I think they'll look at our data and see – we think they're quite different in different species here. But, I mean, of course, again, they'll look at our data, but they'll have in the back of their mind the areas that they're focused on.

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Kathleen Miner
Analyst, Cowen and Company

Q

Okay. Okay. And also one more on the same topic. Since Cytopoint was approved by the USDA a few years ago, does the CVM talk to the USDA and would they have had any initial look at what a biologic is for an animal that could be helpful in this process?

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

A

I would have no – I mean, I would like – as a US citizen, I'd like to believe they speak. I have no idea if they do or they don't. As I'm sure you can imagine, it's not just through the agencies. It's through the individual reviewers on individual product cases speak to each other, and that I honestly don't know.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. Fair enough. So the expectation is we're still looking for 2020 approval would be your best guess at this point?

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

A

For 2020 approval – first of all, we're in 2021, so I definitely don't think I'll have a 2020 approval.

Kathleen Miner
Analyst, Cowen and Company

Q

2022, I'm sorry. 2022.

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

A

I was like definitely don't think that. No, honestly, we've not given guidance. I don't know. I mean, a lot of these timing things are up – until we know inspections and all these other questions. So, we're not giving guidance as we said. As soon as we are able to – trust me, I've spent most of my day Kathy, as you might imagine answering this question. And if I had a better answer, I'd give it you. I just feel like to give an answer when I really – they haven't given me a timeline. I have to get a timeline from them in order to give a more specific.

We had assumed they would have followed, when we gave our original guidance, the approach that we saw in the EU and in Canada and wherever. And they're clearly following a different process. To our knowledge, it is the first monoclonal antibody in animal health at CVM, the Center for Veterinary Medicine is looking at. So, until we have a better sense of how they're going to run this process, we're not providing specific guidance on approval timelines.

Kathleen Miner
Analyst, Cowen and Company

Q

Good enough. Is Zoetis looking at any other biologic besides nerve growth factors?

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

A

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Oh, yes. We're very focused on the monoclonal antibody space. We think there's a number of different diseases that we can target with this technology. So, I would assume many of us in the industry are targeting monoclonal antibodies for a range of diseases.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. How about gene therapy? Is that of interest to you? There's been some small companies focusing on that. And is that something that you are working on or you would like to work on?

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

A

Sure. We're monitoring that space. We're the leader, as you know, in genetic testing. I think we're a little hesitant on this space, to be honest with you as a regulatory pathway and a consumer willingness on this one, it still seems unclear to us. What do I mean by that? Telling somebody they're having genetically modified corn or wheat, they're already upset about it. If I told you the meat on your table was genetically modified, we're not really sure how consumers feel about that today. We think there's a significant reluctance, and what the regulatory and food safety pathway would be for some of these products remains uncertain.

There's no question in our view to your point, Kathy, that the technology is there actually to develop products that have some significant benefits. But we want to make sure that there is a regulatory pathway to approval and that consumers are willing to actually purchase it before we really think there's a real commercial need to enter the space. So, we're monitoring it quite clearly. We certainly have expertise in the space. But right now, I'd say it's a little early before we're willing to go all-in on this just given the regulatory and consumer challenges we see there.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. Great. All right. With that, maybe we'll move on to another topics unless, Steve, did you have any follow up there or...

Steve Scala
Analyst, Cowen and Company

Q

Yeah. I did want to ask, who is Zoetis' closest competitor with a pain monoclonal antibody and how close are they?

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

A

I really don't know. I'm not trying to be difficult. I really don't know the answer. We know a number of people are working in this space, small companies, large companies. The challenge in our space, as you know, Steve, is people don't have to be public about it. So, other than Elanco, who's public, and a few other smaller ones, Kindred's I think public. I mean, some people have been public about it. Most of them are not. So it's very difficult to understand where somebody is in the process and who is going to be our closest competitor.

We like to assume all the time, Steve, that these are exciting spaces that we would assume most of our competitors are in. BI just did another partnership to build its monoclonal antibody capability. So, we assume everybody is working at it. I don't have the specific knowledge on who we think is closest to us on this. But we assume that there is at least two or three companies in this space at this point who are well-resourced and have the capabilities to do it.

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We're still the only one who's commercialized one, as we're learning regulatory pathways are maybe a little more complicated than we expected in the US on some of this. In Europe, it's so much clear what the pathway is honestly. So, I think if you'll see a competitor, we likely believe it will first be in Europe.

Steve Scala
Analyst, Cowen and Company

Q

Okay. Thank you.

Kathleen Miner
Analyst, Cowen and Company

Q

Great. Maybe now we'll move over to the parasiticides, which is the other most common topic that you, I'm sure, and we hear about, Trio. It's been a great product. It's been on the market almost a year now and the uptake has been impressive, especially given the pandemic. As we go into the 2021 flea and tick season, is there anything from last year that's going to influence your marketing efforts as we go into this current year?

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

A

Well, a few things. It hasn't quite been a year. Actually, we only launched, as you remember, in Q2. So, we're excited for starters in 2021 to have a full 12 months, and that's really an additional quarter. We're also excited to beginning the year with the penetration that we ended the year with.

It took us longer to get the penetration that we wanted last year as we talked about, but we're really excited to be ending the year where we wanted so that we can really continue to drive share in those clinics, as we saw. We saw really good uptake early on, as you might remember, Kathy, in our corporate accounts who signed on quite early.

But we're really excited to just see that – we didn't take all this at the expense of Simparica. As you saw, Simparica still grew last year 16% globally. So we're still growing Simparica, but we really think that we can get a contribution at or greater than this last year, which was the [ph] $150 million (00:17:23). So, we're quite excited with where this product can go. We're focused on direct-to-consumer advertising and continuing to really have a great portfolio play for vet clinics across parasiticide. So, Simparica, Simparica Trio, ProHeart, Revolution, Revolution Plus.

So, we really feel like we have a full portfolio that can meet whatever pet comes in, dog, cat. We think we have the portfolio to help with that clinic.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. You've commented that your guidance does not assume a triple this year in the US market. Is 2022 flea and tick season more likely? And also, can you comment on what your expectations are for the additional triples? Would they compete on something on efficacy or coverage? Or do you anticipate this being like the oral flea and ticks, where they're kind of all very similar once they get out there?

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

A

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Again, it's always hard without a label. I'm not really sure how much more differentiated they could be, to be honest with you. To get at your first question, which is when would we see a launch, I honestly have no idea. As you know, Kathy, I always like to be paranoid that it's six months from whenever you ask me the question, so that I'm prepared. But that is not because I actually have any knowledge. The only company that's gone public with their timeline is Elanco, and that's not likely a 2022 launch as you saw. So, the other two companies haven't been public of what they're doing.

So, I have no idea if it's 2022 or 2023 or 2024. What I'd like to say, again, similar to the question Steve asked is, I assume they're all working on it and going as fast as they can. I don't think it's probably this year based on what I've heard. I have no idea if it's next year, but I would like to be prepared whenever we see that competition.

But we still think – as you look at, we were third to market with Simparica and we entered a market and those products were $400 million when we entered. We now are a $400 million with Simparica franchise. There are $600 million in dogs alone. And I say that because the market itself continues to grow.

So, we do expect there to be competition, but we don't think that means that we stop growing our franchise just because there's competition. I think we'll move more people to the triple combination. We'll move more from OTC, more from topical. So, I still think there's a real opportunity to increase that. And lastly, I think we're really focused this year as well on compliance. So as you add heartworm, we really feel like we should get people to 12 months a year, and partnering with alternative channels and others to do that is a big focus for us as well.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. And speaking of alternative channels, can you tell us what percentage of your flea, tick, and heartworm are sold in alternative channels right now?

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

A

Oh, I don't have it in that division. I can tell you, we had about 5% of our US companion animal sales in 2019 were through alternative channels and now it's 7%.

Kathleen Miner
Analyst, Cowen and Company

Q

I would assume most of that would be flea/tick [indiscernible] (00:20:09).

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

A

I don't think most of it actually, interestingly enough. Apoquel is one of the largest products. So, I think – I don't know, I can get back to you on that one, Kathy. I don't really know the answer to that. I know that Apoquel's actually very large as well there. So, it's pretty much mostly, I would say, Apoquel and parasiticides.

Kathleen Miner
Analyst, Cowen and Company

Q

And do you expect that – we understand that the pandemic increased the movement to alternate site purchasing. Do you expect this to drop back, assuming the pandemic wanes, or do you think this is kind of the new the way that sales are going to happen now?

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

I don't think it's going back. I actually think it will grow. I think, it may have moved quickly out of necessity, but we believe the convenience and value will keep it there. I think it's very easy for pet owners. I think there's some pretty strong players there who are making it as easy as possible for pet owners to stay with them, whether that's Chewy or Vetsource or Vets First Choice, they did a very good job, I think, of keeping the consumer engaged.

As you look at our Q4, I think our alternative channel business went up 63%. So, we continue to see this growing. And I think most people assume at some point, whether it's this year or next year, Amazon will eventually enter the market. So, we're focused on working with vets to incorporate home delivery into their business models today. So, to keep that convenience, that value. and keep them connected. But I don't think this is going to go down.

I mean, for us, it's limited to how large a percentage of portfolio can be, given 50% of what we sell still has to be administered in a clinic anyway. So, it definitely can increase. It can never become a majority of our business just based on what we sell. But look, we think consumers want to be shopping there. It's good for compliance. So, we're building our capabilities to be able to better merchandise our products there, to better engage with pet owners in these channels. So, we do see this as sign that's here to say honestly, Kathy.

Kathleen Miner
Analyst, Cowen and Company
Q

Okay. All right. With that, we're moving right along. I'm going to maybe shift to a little bit about kind of a lightning round and just hit a number of topics as we go forward here, if that's all right. So, I'm going to start with the derm franchise. It was $940 million in sales in 2020, projecting for $1 billion or better in this year. What's been better than expected and why is this still growing the way it's growing?

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

A few things I'll say. We invested in direct-to-consumer advertising, which continues to grow the market. I think we're getting more dogs diagnosed and more dogs treated, but we're still optimistic, because if you look at the US alone, we still have got [ph] 67 million (00:22:36) dogs that are still not treated that are already diagnosed.

And back to what I mentioned before, two-thirds of our sales right now are in the US, which doesn't really make sense, because one half of the animals are outside the US. So, I think we've got to do a better job outside the US in building that market, hence the investment in direct to consumer disease awareness campaigns outside of the US. We still are pretty optimistic for growth here, although we would expect more of that growth to come in the coming years outside of the US.

Kathleen Miner
Analyst, Cowen and Company
Q

Okay. And could we see either of these products used in cats or a cat version?

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

We are definitely looking at derm in other species and products for cats and other species as well. Yes.

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Kathleen Miner
Analyst, Cowen and Company

Q

Okay. From cats to cattle...

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

A

Okay. Wow, that's a big jump.

Kathleen Miner
Analyst, Cowen and Company

Q

It is. Where are we in the US beef cattle cycle? And has this been impacted by the pandemic?

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

A

Sure. I mean, it has been impacted by the pandemic, but I think the cycle was going there anyway. We were expecting, as you remember, Kathy, even a year ago before the pandemic for number of animals to be slowing down overall. So, I do think that trend was already underway. Did COVID help? It did not. I think fewer people eating out, dining out, less entertainment, it's definitely hurt the industry overall. So it probably accelerated what was already a curve. But it's always cyclical, Kathy, and it will come back the same way it always does. So, I do think it made it a little worse. But I think that trend, honestly, was there before it.

And I think to really get US cattle back into the mid-single digits where it was before, we're also going to probably need a little bit of innovation. I think you can get to low single digits just as the cycle naturally moves. But we're excited to bring innovation to get it back to the mid-single digits. But, again as, Kathy, a reminder, 60% of our livestock business is outside the US. So as you saw, we did change our overall guidance on livestock when we originally thought maybe – back at JPMorgan maybe flat. Given the strong growth we saw in China, Brazil, and some other markets, we're now expecting at least low single-digit growth in the livestock for us.

Kathleen Miner
Analyst, Cowen and Company

Q

And since you already mentioned the needing innovation in livestock, and there really hasn't been anything significant, like I mean probably decades. Do you anticipate this changing sometime soon? And what sort of areas could this materialize?

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

A

Sure. I think there has been innovation in species such as swine and in poultry. I think cattle is where we've really seen the gap. And it has been a long time, to your point, Kathy. And I think we are excited about some innovations coming. Real big ones, I would say, are probably three to five years out. [ph] We have (00:25:07) really truly disruptive large scale ones, we'll have incremental ones. But we are seeing significant innovation continuing in the swine side and poultry.

So, Fostera PCV MH in the swine side, and also the vector vaccines which you saw recent approvals for us on. And you've seen overall in the industry the movement to vector vaccines, which is also leveraging our Inovoject, in ovo device for vaccination as well. So, I think you'll see some – fish has been doing great on the livestock side.

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But your point on the beef and dairy side, we need to bring some significant innovation to the overall US – especially US cattle side.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. And when you talk about some disruptive ones three to five years, can you put any other color on those?

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

A

Sure. I mean, our focus is really on immunotherapies and diagnostics and alternatives to antibiotics. And as you think about immunotherapies, there's both small molecule ones and biologics there. You've probably heard a lot about our partnership with Colorado State on some of the biologics. But internally, we're working on a number of small molecules as well on that.

I think that's what consumers want. That's what producers want. Keep animals healthier longer, less use of antibiotics and anti-infectives. We're also looking at alternatives to those. We're also looking at diagnostics chute-side/barn-side, so you can diagnose quicker and infect fewer animals. I think there's a huge need there, and that might actually be sooner than some of these other technologies that we can get there.

But I think there's a lot of spaces of unmet medical need. So I am quite optimistic in the medium to long-term about innovation in cattle and, honestly, more broadly in livestock. But I do think just given the timing, as you know, Kathy, it takes to do these food animal safety studies, the timelines are generally a little longer than they are in companion animal.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay. Swine in China and the herd rebuilding process, where do you see the industry in China? Are they halfway rebuilt? Are they quarter rebuilt? And how quickly do you see this going?

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

A

Sure. I mean, we've been quite impressed. It actually moved faster than we expected. And I think what's really changed is a consolidation into a number of really sophisticated, technified large integrated producers in China. That's what the country is betting on. They want to make sure they can feed their people and they're investing in strong biosecurity.

The advantage of these producers, Kathy, is they want to partner with companies like Zoetis, who can help them on their own journey. So, we've seen a much faster uptick in China than we expected in swine. As you look at our numbers last year, we had about 34% growth in China. About half that came out of the livestock side. And we can see that continue to accelerate.

We don't think their herds will be back to pre-ASF numbers until 2024, maybe 2025. We would have said 2025. It could be 2024 now, given how fast they're moving. But it just takes time, as you know, Kathy. So we do think they're accelerating, but they're still a few years away before they'll be back to pre-ASF levels [indiscernible] (00:28:00).

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Kathleen Miner
Analyst, Cowen and Company

Q

And will there be fewer small farmers? Because it was a plethora of small groups. Are those groups consolidating or going away and then shifting to the large producers?

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

A

Yeah. You're seeing a significant shift away from the small farmers. And I think the country just requires that if they're going to feed their people, they can't afford it. I think two things from smaller to larger, and that also means from less sophisticated to more sophisticated customers and producers. That's what it's going to take. If China wants to be able to – this disease, until there's a vaccine, they're going to really have to have biosecurity as a central theme to them of being able to supply their market with internal pork, which is certainly their goal, given they're the largest consumer of pork in the world.

Kathleen Miner
Analyst, Cowen and Company

Q

Sure. Boy, the time is moving along. Let me try a couple of quick ones. How big is the vector vaccine market in poultry [indiscernible] (00:28:48)?

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

A

Today, the vector vaccine market is around $300 million, but we expect that to grow. I think our view, again, as you get more technified and sophisticated producers especially in Southeast Asia, where poultry is growing incredibly quickly, we think there's a significant opportunity to take that $300 million market and grow it.

We're also, as you know, the leader in in ovo vaccination with our Inovoject machines. So we very much believe we can take those machines with our vaccines and really put those in producers that aren't using that technology today to grow that $300 million market.

Kathleen Miner
Analyst, Cowen and Company

Q

Okay.

Steve Scala
Analyst, Cowen and Company

Q

Kristin, can I pivot for a second? One of the first things you said today was taxes or tax rates. We're looking for a flat tax rate of 19.5% through the middle of the decade. Is that realistic?

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

A

I'm sorry. You're looking at that from what perspective?

Steve Scala
Analyst, Cowen and Company

Q

Through 2025 we're looking at basically a level tax rate. Is that realistic? Because you did call out taxes early on.

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

Well, I mean, I think most people are expecting the Biden plan to be looking at taxes. How that influences us and how he goes after that and what they can get approved, we think that early is going to be looked at next year. I think most business people – I'm on the business roundtable – we're really focused on ensuring that any tax plan really focus on investing in companies that are doing R&D, high-quality manufacturing jobs. We think Zoetis is a leader, honestly, amongst the S&P 500 in a number of high-quality R&D and manufacturing jobs in the US. So, we're hopeful this will do well for us.

But, I mean, if you listen to some of what the rhetoric that's out there, they're looking at pretty broad-based taxes. So, I'm not sure. We're certainly going to make sure we advocate for positions we think makes the US most competitive, but I would say I think the tax rates are likely going up at least a little bit in the US.

Kathleen Miner
Analyst, Cowen and Company
Q

Okay. We're almost out of time here. One last question, if I may. Can you talk a little bit about your business development? Last year your M&A was a little bit more modest for you relative to prior years and certainly the pandemic I assume was part of that. But can you talk about what that's going to look like or what you would expect it to be this year and what are your areas of interest?

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

Sure. We were actually active last year. It is hard getting some deals done I will tell you, and it did affect the timing on some deals last year being able to do due diligence, although we did find a way to get some of it done. I think we're going – from a BD perspective, we're going to be really focused on the same priorities we always have been. I don't think we need any huge large scale deals. We have the scale that we need.

So, we'll continue to be focused on filling any gaps in our portfolio, either geographically, therapeutically, etcetera, looking at business development to get capabilities, such as we've done with tech side and AI that we need. So, I think we see our BD strategy as we'll be doing small and modest deals that are really complementary to what we've got internally.

Kathleen Miner
Analyst, Cowen and Company
Q

Terrific. Steve, do you have anything to wrap up?

Steve Scala
Analyst, Cowen and Company
Q

I'm good. Thank you.

Kathleen Miner
Analyst, Cowen and Company

Trying to stay on time here. So, as always, I appreciate going through everything. We covered a lot. I don't know if you want to add anything at the end, but it's...

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Kristin C. Peck

Chief Executive Officer & Director, Zoetis, Inc.

No, I can say I feel like the whole time is speed round with you two. You got through more questions than anyone else I've ever talked to.

Kathleen Miner

Analyst, Cowen and Company

All right. Well, we appreciate that. Well, we thank you for taking your time and we appreciate your support.

Kristin C. Peck

Chief Executive Officer & Director, Zoetis, Inc.

Thanks so much, everybody. Thanks, Steve. Thanks, Kathy.

Steve Scala

Analyst, Cowen and Company

All the best. Take care.

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