Q2 2023 Earnings Call *(Corrected version)*

Event Details

Date: 2023-08-08
Company: Zoetis, Inc.
Ticker: ZTS-US

Company Participants

Steven Frank - Zoetis, Inc., Vice President-Investor Relations
Kristin C. Peck - Zoetis, Inc., Chief Executive Officer & Director
Wetteny Joseph - Zoetis, Inc., Executive Vice President & Chief Financial Officer

Other Participants

Michael Ryskin - Analyst
Nathan Rich - Analyst
Jonathan D. Block - Analyst
David Westenberg - Analyst
Brandon Vazquez - Analyst
Ekaterina V. Knyazkova - Analyst
Louise Chen - Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the Second Quarter 2023 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, 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.

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

Steven Frank

Thank you, operator. Good morning, everyone, and welcome to the Zoetis second quarter 2023 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 statement 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, Tuesday, August 8, 2023. We also cite operational result, which exclude the impact of foreign exchange.

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

Kristin C. Peck

Thank you, Steve, and welcome, everyone, to our second quarter earnings call for 2023. I hope you were able to join us or listen to our Investor Day this past May. If you missed it, please check out our replay on Zoetis.com. I think you'll find it worth the time in learning more about Zoetis and where we see future growth in animal health. We appreciated the opportunity to step beyond the cadence of our quarterly earnings calls and speak to you about the long-range perspective on our business and on our industry during Investor Day. We also appreciated your questions and the ongoing dialogue about the issues most important to you.

As you know, we shared more detail about our growth strategy, innovative pipeline, and the key franchises, capabilities and investments we are making to build on our competitive advantages as the world-leader in animal health. The four tenets of our value proposition were affirmed and expanded on throughout the day and you can expect us to revisit that framework and provide progress updates in future investor interactions. Our goal is always to ensure that you understand how we are positioned to deliver on our value proposition, the revenue growth, strategic investments, margin expansion, and capital returns.

With that covered, let's turn now to the second quarter financial results. Today, we reported strong second quarter results of 9% operational growth in revenue and 12% operational growth in adjusted net income, based on our diverse portfolio across markets and species. As expected, we returned to a more balanced segment growth this quarter with 11% operational growth internationally and 7% growth in the US. Our companion animal portfolio grew 11% operationally, driven by our major franchises in dermatology, osteoarthritis pain and pet parasiticides. The second quarter results and drivers were more in line with our performance trends in recent years, with innovations and strength in our companion animal portfolio leading the way.

Meanwhile, our livestock portfolio grew 4% operationally in the second quarter, driven by sales of poultry, cattle and fish products, and continued to demonstrate the benefits of our diversified portfolio across species and geographies with a strong first half. Overall, the first half of 2023 has played out much as we expected. We have grown revenue 6% operationally in the first half, driven by strong results from our international markets and livestock performance, which were partially offset by the distributor destocking we explained in the first quarter. As expected, the impact of distributor destocking in our US companion animal portfolio has stabilized and was not a significant factor in the second quarter.

We continue to see strong customer demand for our companion animal portfolio. For the first half of 2023, companion animal grew 5% operationally. We believe companion animal should be a bigger driver of performance for the remainder of the year, with a stronger second half driven by our key franchises. While we are monitoring how inflationary pressures may impact pet care spending in markets around the world, the underlying demand has remained steady and resilient to date and this is what we have seen historically. In the US, veterinary clinic visits continue to stabilize, staying relatively flat through the first half of the year, and clinic revenue and spend per visit were both up about 9% in the US in the first half.

Meanwhile, our livestock portfolio grew 8% operationally in the first half of 2023, reflecting strong growth internationally and continued supply recovery in our US cattle products. We expect livestock growth for the full year to be in the low-single digits operationally, reflecting tougher comparisons in the second half of the year for our US portfolio. With the first half of the year playing out largely as expected, we are maintaining our full year guidance for operational growth of 6% to 8% in revenue and 7% to 9% in adjusted net income. In our companion animal portfolio, we expect Librela and Solensia to continue to ramp up in various markets as we build our franchise for osteoarthritis pain.

One way we are supporting growth for both products is increased use of direct-to-consumer campaigns in launch markets. These campaigns are building disease and product awareness, creating conversations among vets and pet owners, and accelerating our efforts in markets where DTC is available. We're also pleased to have received US regulatory approvals in the second quarter for Librela and for Apoquel Chewable, both have been performing well in markets outside the US to date. Librela is expected to launch in the US in November, with an early experience trial beginning in September. As we look at the second half, we continue to expect strong growth, even as we factor in uncertainty around the macroeconomic conditions and drought that exist in certain countries around the globe, particularly Asia-Pacific, and tougher comparisons for US livestock portfolio in the US.

As we have seen historically in these type of environments, our global footprint and diverse portfolio provide more stability to our business during uncertain times, and we remain ready to pivot resources and investments to the greatest opportunity areas that it can ensure we can continue to deliver on our commitments. For example, we continued to expand in large and growing product areas such as parasiticides, dermatology, monoclonal antibodies for pain, vaccines, and diagnostics, and invest in the franchises and capabilities that support our future growth, many for pain, vaccines, and diagnostics, and invest in the franchises and capabilities that support our future growth, many of which we discussed at Investor Day. Before I wrap up, three quick points around our colleagues. First, I want to welcome Ester Banque to our Zoetis executive team as EVP and President of US Operations.

Ester joined us in July coming most recently from Bristol Myers-Squibb and having spent a major part of her career at Novartis as well. She brings diverse, global experience in healthcare and an impressive track record of driving results to Zoetis, and I'm happy to say she is already off and running with the US business. I also wanted to call out the recent publication of our 2022 sustainability report. This year's report captures how sustainability is integrated across the business and shares the progress we are making toward our Driven to Care aspiration. This report honors our outstanding Zoetis colleagues who champion our purpose and work every day to make us the world's most trusted and valued animal health company.

And finally, I wanted to mention a recent recognition from Fast Company, which named Zoetis as one of the Best Workplaces for Innovators. Shaping animal care through innovation is something we've always done across the company and it has been a key element of our success. This is a well-deserved honor for our culture and our people who continuously strive to solve critical unmet medical needs in animal health from chronic illnesses like osteoarthritis pain and allergic dermatitis for pets, to emerging infectious diseases threatening the food supply. I am truly proud of our colleagues for receiving this recognition. In conclusion, with a solid first half behind us, I remain very positive about achieving our full year guidance, thanks to the purpose-driven colleagues, innovation-driven culture and diverse portfolio that continue to drive our success.

Thank you. And now, let me hand it off to Wetteny. Wetteny?

Wetteny Joseph

Thank you, Kristin, and good morning. As Kristin mentioned, we had a strong second quarter with balanced growth across both our companion animal and livestock portfolios, as well as our US and international segments. In the second quarter, we generated revenue of $2.2 billion, growing 6% on a reported basis and 9% on an operational basis. Adjusted net income of $652 million grew 15% on a reported basis and 12% on an operational basis. Of the 9% operational revenue growth, 4% is from price and 5% is from volume. Volume growth consisted of 2% from other in-line products, 2% from new products, including our monoclonal antibodies for osteoarthritis pain, and 1% from our key dermatology portfolio.

Companion animal products are the primary driver of growth this quarter, growing 11% operationally, with livestock growing 4% on an operational basis in the quarter. For companion animal, our key dermatology portfolio was the largest contributor to growth in the quarter, posting $355 million in revenue, our largest quarter ever, and representing 14% growth on an operational basis. We saw double-digit operational growth in both international and the US driven by strong growth in Cytopoint as well as growth driven by Apoquel and the conversion to Apoquel Chewable in certain international markets. Our monoclonal antibody for osteoarthritis pain in dogs and cats, Librela and Solensia, posted $69 million in revenue globally in the quarter with strong demand for both products as well as the impact of the launch of Librela in several new international markets.

Our companion animal parasiticides also contributed to growth in the quarter driven by our Revolution franchise which had $103 million in revenue and grew 22% operationally. Simparica Trio also contributed to the parasiticide growth with $248 million of revenue and growth of 5% operationally. Our global companion animal diagnostics portfolio recorded $92 million in revenue in Q2, growing 12% operationally. We saw double-digit growth in the US driven by high instrument placements in the quarter and disruptions from the implementation of our new field force model that impacted the prior year. Sales of our livestock products grew 4% on an operational basis in the quarter. We saw growth across both our US and international segments driven by poultry, cattle, and fish. Now, moving on to revenue growth by segment for the quarter. US revenue was $1.2 billion in the quarter, growing 7%, with companion animal products growing 7% and livestock sales growing 5%.

As Kristin mentioned, our companion animal performance in the quarter reflects the stabilization of the distributor inventory levels that were a headwind to our growth in Q1. US vet visits were flat in the quarter. Clinic revenue growth and average revenue per visit were both up 8%. These trends are in line with expectations and continues to reflect the stabilization post-COVID. Turning to US product performance, our key dermatology product sales were $241 million for the quarter, growing 10% and benefited from higher periodic patient visits in the quarter. Cytopoint sales continue to drive growth with vets and pet owners, showing a preference for injectables. Our US small animal vaccines revenue grew 20% in the quarter driven by higher sales of our canine influenza virus vaccine due in part to a competitor back order as well as higher sales into certain corporate and strategic accounts.

Simparica Trio posted sales of $213 million in the quarter, growing 2%. Growth was driven by inpatient demand across all channels partially offset by a difficult comparison period given the timing of distributor shipments from last year during our supply challenges as well as aggressive competitive promotion in the current quarter. Our growth cadence for Trio across the year will be impacted by the timing of supply recovery in 2022 and we expect growth rate improvement in the second half. As expected, we received FDA approval for Librela in the US in May. We look forward to starting our early experience program in late Q3, with an expected November launch. Now turning to US livestock, we saw 5% growth in our livestock portfolio in the quarter primarily from our cattle business where we saw significant growth in Draxxin, resulting from a favorable comparative quarter last year when an anticipated mid-year price reduction limited sales in the quarter.

Additional US cattle growth came from Synovex which benefited from our re-implementation label claim. Our US poultry portfolio also contributed to growth of 11% based on our vaccine portfolio and an increased focus on egg-layer market. We also benefited from favorable MFA rotations at certain large producers. Moving on to our international segment where revenue was $1 billion, growing 6% on a reported basis and 11% operationally in the quarter. International companion animal revenue grew 17% operationally in the quarter while livestock revenue grew 4% operationally. Increased sales of companion animal products resulted from growth of our small animal parasiticides, our monoclonal antibodies for osteoarthritis pain, and our key dermatology products. Our international parasiticides portfolio growth was primarily driven by the Revolution franchise with $57 million in revenue, growing 52% operationally driven by the lack of supply last year which particularly impacted China in the second quarter of 2022.

Our Simparica franchise also contributed to growth with continued market share expansion especially in Latin America, Europe, and Asia. We continue to see strong adoption of Librela and Solensia. Librela generated $48 million in revenue with 89% operational growth in the quarter driven by strong growth in Europe supported by our direct-to-consumer advertising efforts in major markets and recent launches in various international markets, including Canada, Australia, Brazil and Japan. Solensia delivered $11 million of second quarter sales internationally, driven by higher demand and supported by direct-to-consumer marketing efforts. Our international key dermatology portfolio grew 22% operationally. We continue to see double digit operational growth across most of our major markets, driven by growth from and conversion to Apoquel Chewable as well as from Cytopoint with higher compliance and new patients.

Our growth also benefited from a weak comparable quarter in Japan, which was impacted by pre-price buy-ups in Q1 of last year. Moving on to our international livestock portfolio, which grew 4% on an operational basis in the quarter. Our poultry portfolio performed well, with growth driven by key account penetration and MFA rotations in core poultry markets, including Europe, the Middle East and Latin America. Our fish portfolio continues to perform well as a result of increased sales of vaccines across salmon markets in Norway and Chile. Lastly, our cattle portfolio saw gains in Turkey, Brazil and Argentina from strong price growth and the recovery of supply issues. Now, moving on to the rest of the P&L for the quarter. Adjusted gross margin of 72.4% improved 260 basis points on a reported basis compared to the prior year, resulting from favorable foreign exchange, price increases and favorable product mix. This was partially offset by higher manufacturing costs in the quarter.

Adjusted operating expenses increased 8% operationally, with both SG&A and R&D growing 8% operationally, driven primarily by head count-related compensation costs due to the timing of new hires in 2022 and the impact of annual salary increases. The lower growth in R&D expenses this quarter is reflective of the timing of spend in project investments and not a reduction in our expected R&D spend for the full year. Year-to-date adjusted R&D expenses has grown 13% operationally. The adjusted effective tax rate for the quarter was 21.5%, an increase of 80 basis points, driven by higher net discrete tax expenses in the quarter, mainly related to changes of prior year's tax positions and less favorable jurisdictional mix of earnings, partially offset by a higher benefit in the US related to foreign-derived intangible income.

And finally, adjusted net income grew 12% operationally and adjusted diluted EPS grew 14% operationally in the quarter. Capital expenditures in the second quarter were $166 million and continue to be on track with our expectations for the year. In the quarter, we repurchased $324 million of Zoetis shares. Now, moving on to guidance for the full year 2023. Please note that guidance reflects foreign exchange rates as of late July. Beginning with revenue for the full year, due to unfavorable foreign exchange, we are slightly lowering our revenue range, while maintaining our guidance on operational revenue growth. We expect revenue between $8.50 billion and $8.65 billion, representing a range of 6% to 8% operational growth. With the approval of Librela in the US, we are now including our projected sales for November and December in our guidance, which are expected to be immaterial to our overall operational growth rate.

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Their impact on a full year revenue is largely offset by potential uncertainty in China as well as broader macroeconomic conditions in certain markets. Operationally, the first half has played out largely as we expected, with 6% operational revenue growth. We expect stronger growth in the second half of the year overall, especially in our US companion animal business. In livestock, which has grown 8% year-to-date on an operational basis, we anticipate unfavorable comparisons in the second half, driven by the timing of price decreases in Draxxin in the US last year and the resumption of supply of several products after outages in the first half of 2022. We expect adjusted net income to be in the range of $2.50 billion to $2.55 billion, slightly above our previous guidance, while maintaining our previous guidance of operational growth of 7% to 9%, driven by foreign exchange favorability and cost of sales and expenses which are partially offset by unfavorability in revenue.

Reported diluted EPS increases to a range of $5.15 to $5.27, which is impacted by foreign exchange and a one-time gain from a business development deal. And finally, due to the impact of foreign exchange, we are increasing adjusted diluted EPS to be in the range of $5.37 to $5.47. Just to summarize before we go to Q&A, we saw strong broad-based growth in the second quarter, growing in both companion animal and livestock, as well as in the US and internationally with contributions from price and volume. We expect stronger growth as we move into the second half. We remain confident in our ability to deliver on our operational full year guidance commitments. We continue to see improving fundamentals in the overall industry and remain committed to delivering on our value proposition to grow revenue faster than the market and to grow adjusted net income faster than revenue.

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

QUESTION AND ANSWER SECTION

Operator

We'll take our first question from Michael Ryskin with Bank of America. Please go ahead.

Analyst: Michael Ryskin

Question – Michael Ryskin: Great. Thanks for taking the question and congrats on the quarter, Kristin and Wetteny. Look, I want to start with Trio real quickly. We've finally seen NexGard PLUS approved in the US from Boehringer Ingelheim. I just want to ask how do you see this market playing out. There's a lot of debate on the label differences, Trio versus NexGard PLUS, the six-month versus one-month worm detail as well as how it's going to be priced with the promotions being put out at the start of the launch. So what are your expectations for Trio now that the competition's finally here both for second half and for 2024? And if I could squeeze in a follow-up, I want to ask on Librela. It continues to do really well OUS; I think it's on track for over $200 million this year from OUS alone. Any learnings or changes to your assumptions now that you can take that into the US launch? Fair to say that could be incremental $75 million, $100 million to revenue next year? Thanks.

Answer – Kristin C. Peck: Sure. Thanks, Mike. I'll start with the first question and let Wetteny follow-up on Librela. Yes, as we saw, this was – the label for NexGard PLUS is largely what we expected. I think Simparica Trio clearly has a superior label and it was first-to-market. Right now, Simparica Trio is number one in companion animal paras in the US. As you look at where we are, we've had three years of demonstrated efficacy and experience with this product and we'll clearly leverage our retail auto-ship to continue that. As you look at NexGard PLUS, it obviously does not, as you saw, have heartworm from first dose; it has four ticks versus five; it doesn't yet have a label to prevent lyme; it has a lower minimum weight. So we really do think we have strength in our Simparica Trio label. We'll be aggressive obviously in competing against them. We are expecting a much stronger Q3 for the product based on comparables, so we expect a strong second half for us.

We are expecting significant promos. We've watched them do this before; this is something BI does often. So beyond the promos, we think we can be very competitive with our product based on the strength of our label, the strength of the experience with the product, our relationship clearly with the corporates and really with a very pleased pet owner whose on this product. So, obviously, we're ready for some significant competition, but we remain very confident overall in our strength in paras and we see a stronger growth obviously in the next quarter and the second half for paras overall. But, Wetteny, do you want to take his question on Librela?

Answer – Wetteny Joseph: Sure. Mike, thanks for the question. Look, we remain really on track with EU performance and we're very pleased to see $48 million of Librela revenues in the quarter, up 89% versus the prior year. We also launched the product in a number of new markets in our international segment, including Japan, Australia, Brazil, and Canada. Those contributed about $10 million to the quarter, so continue to see really strong demand for the product. And we are starting to initiate DTC campaigns which will continue to drive awareness across both Librela and Solensia in our markets. It is already, as we said last year, the number one osteoarthritis pain product in the EU. Look, we won't necessarily get into what the expectations are for next year. Obviously, we'll do that as we get into guidance for the year.

We're expecting to continue to see strong growth for Librela on the balance of the year. I will note last year, we did see a bit of an uptick in the third quarter that was as we released the allocations that we're on and we saw clinics order a bit more, that was offset in Q4 so just a little bit of dynamic between Q3 and Q4. But really, with the new markets as well as continued growth in EU, we're expecting very strong growth in the third quarter as well.

Operator

Thank you. We'll take our next question from Nathan Rich with Goldman Sachs.

Analyst: Nathan Rich

Question – Nathan Rich: Hi. Good morning. Thanks for the questions. First, Wetteny, I wanted to start with the outlook for companion. I think you had talked about it improving in the back half of the year. Was that relative to the 5% growth in the first half or was that relative to the second quarter growth which was obviously higher? Any context you can kind of provide as well on just kind of cadence 3Q versus 4Q would be helpful. And then just a follow-up on the commentary on Trio. Could you maybe just talk about the 2% operational growth and the different factors that impacted that in the quarter and then the kind of type of growth that you would expect in the back half of the year just given the competitive launch that you mentioned as well as maybe a normalization of supply? Thank you.

Answer – Wetteny Joseph: Yeah, I'd be happy to take this and see what Kristin wants to add. With respect to companion animal, as we said, and I think you saw us really reiterate our guidance from an operational perspective, 6% to 8%. Now, while livestock has seen about 8% growth in the first half, we saw 4% growth in livestock in the second quarter operationally. We are expecting, as we said in the prepared commentary, livestock to come in in the low single-digit range, so I think you can clearly see that the growth in the back half of the year is going to be significantly driven by companion animal. And as we said also, given the timing of supply in 2022, we're facing, relatively speaking, an easier comp in the US companion animal business in the third quarter versus say the fourth quarter. So I think those will play out in terms of how you get – how you map out to our guidance ranges from an operational perspective being largely driven by companion animal in the back half of the year.

I think overall, not just from a companion animal perspective, overall, I would expect the third quarter to be another strong quarter for us. I would expect us to come in somewhere between the mid and high-end of our annual range. We said after last quarter, given the distributor destocking impact, to expect normalized growth for the rest of the year, which would translate to somewhere, if you just pick the midpoint of our guidance, that would be around 8%. We came in slightly above that, really in line with our expectations on the quarter. And so you can map out what that means for the rest of the year, but I would expect Q3 to be slightly above Q4, given what I just shared from a companion animal perspective versus livestock that has a tougher comp in the third quarter, particularly in the US. Trio, like Kristin said, we're expecting very strong quarter in the third quarter despite the competitive launch which we believe to be imminent here.

Part of that is the cadence last year. I think the rhythm of supply last year clearly had an impact where we saw a bigger Q2 last year than Q3, so I think you're going to see that play out with respect to the Trio growth. And given the first-mover advantages that we have with Trio, that's been in the market for over three years and our confidence in terms of our label, et cetera, we expect to see continued growth across Trio and a strong year for the year for Trio.

Operator

Thank you. We'll take our next question from Jon Block with Stifel.

Analyst: Jonathan D. Block

Question – Jonathan D. Block: Great. Thanks, guys. Good morning. I'll ask both upfront. I guess the first one, just any color on the gross margin? Wetteny, I think the 2Q 2023 gross margin I believe might have been the best in the company's history. So maybe you could talk about the drivers there, and more importantly, are some of those drivers sustainable? And then the second question might build a little bit on a prior question which is, is Trio the modest, call it, downside driver of the implied companion animal 2023 growth, because I think I've got it right, essentially livestock went from flattish to up low-single digits. Obviously, overall operational stayed unchanged at 6% to 8%. So the implied CA came down a bit. Do we think about Trio being responsible for that and maybe just a byproduct of some of the promotions that you called out earlier? Thanks for your time.

Answer – Wetteny Joseph: Yeah. Look, with respect to gross margin, you saw 72.4% gross margin on the quarter, in Q2. That's up about 260 basis points versus last year. FX is about 200 basis points of that and clearly, we've pegged our overall guidance on FX based on where rates were at the end of July, so I'm not going to venture to forecast what that might mean. But in terms of the other components that are driving our gross margin, price and mix certainly were favorable for us. And as we've just discussed with respect to livestock having a tougher comp in the back half versus companion animal particularly in the third quarter, I'd expect price and mix to continue to contribute favorably here. The other element, of course, is really manufacturing, higher manufacturing costs. I think typically what you see is this first half is a little bit higher for us than the second half.

Part of that is the mix with respect to cattle run in the fall that tends to have a little bit of a mix down on us overall, but I would say the overall mix for the company, given the back half's strength in companion animal, is going to be – continue to be favorable. So we see that being something that we'll consistently sustain and, again, we won't get into next year's element until we get there. With respect to the second half, look, clearly, our expectations for Trio remain that we'll see strong growth contribution from Trio and we're going to see a very strong third quarter. I think some of the – and by the way, the year has played out as we said. We gave a range of 6% to 8% operationally. Sitting here today, after delivering a very strong second quarter, we remain in line with our expectations for the year at 6% to 8%. I think if you look at some of the areas that we're watching from a macro perspective, China is one of them.

I think if you look at the data coming out of China, confidence levels for consumers are low, the savings rates are very high, and so we're watching that as well as the impact it has on the Southeast Asia region, given the tourism impact that China has on that region. That's one of the areas certainly we're watching here in terms of what goes into our thinking with respect to the balance of the year.

Answer – Kristin C. Peck: Yeah. I just want to reiterate. It is not – I would not call Trio what is driving any change in the second half. I really want to emphasize what Wetteny said and what we said in our remarks. It really is, as we're looking at it, uncertainties with China, Southeast Asia, Australia, with the drought. So I mean, as always, when you run a large global company, I think the advantage of Zoetis is the diversity of our portfolio and the durability, and that's by market, that's by species, and that's by therapeutic area. So we are obviously seeing strength in a lot of areas, but obviously, uncertainties remain in China, Southeast Asia and certainly in some other markets around the world, certain ones such as if you look at, say, a Spain, et cetera, which has got high inflation and weather issues as well. So I would say, just want to be very clear, I don't think your characterization of Trio specifically or paras is the concern in the second half.

It is much more around some of these macroeconomic and geopolitical and weather uncertainties that we're seeing in certain markets.

Operator

Thank you. We'll take our next question from David Westenberg with Piper Sandler.

Analyst: David Westenberg

Question – David Westenberg: Hi. Thank you for taking the question. So can you talk about the derm market in 2024? I'm not talking necessarily about you specifically, but how you expect growth in monoclonals versus growth in small molecule with a incoming competitor. And if I could just squeeze in one really short one, just want to confirm Librela US is not in the 2023 guidance. Thank you.

Answer – Kristin C. Peck: Sure. I can start with your second. Yes, Librela US is in, as we did note obviously in

Wetteny's remarks. But to get to your question on derm and Wetteny can certainly follow-up if he wants on the derm part, on the Librela question, but we have led the way, as you know, in dermatology with both a small molecule and large molecule. We've been driving awareness through DTC. We still think there's significant market potential here in developed and emerging markets. There's still plenty of dogs that are untreated here. We're really focusing on investing in direct-to-consumer branded in the US and in some markets and unbranded outside. With that, as you're seeing this year, we're looking at the double digit growth. In Q2, we had 14% growth, with double digit growth in both products in the quarter, so real strength, and we're continuing to innovate here.

I think you saw also approval for Apoquel Chew in the US. We'll look for long-acting Cytopoint, look at species. We are expecting obviously competition. We've been expecting it for a while. We'll say again, we're expecting it in 2024. We'll see if it happens. But we really are seeing more of a preference from both the vet and the pet owner moving more to Cytopoint for compliance reasons, obviously, for ease, so I think we'll continue to see that. So we're seeing very strong growth in dermatology. Again, we're expecting double digits for the year. In the quarter, we had great strength against both, but I would like to be clear that as we're seeing which do we think will grow faster, we're seeing greater focus from the vet and the pet owner on Cytopoint being a greater driver of our overall dermatology franchise, but really expect to follow that up with strong innovation continuing in what we think is a really important space.

Wetteny, did you want to add anything on derm or his question on Librela?

Answer – Wetteny Joseph: Yeah. Look, I think clearly really strong quarter for us in derm in the second quarter and we are expecting another strong quarter and strong back half for derm across, and Cytopoint driving that as well. Just with respect to Librela, I just wanted to add a little bit of color in terms of our thinking there. Certainly, very pleased to have received approval in May, but really consistent with our expectations, we've been sharing for the last I think two or three quarters, we've been expecting an approval to come in the first half of this year followed by an early experience program and then a launch late in the year is what we've been saying. We remain on track with that. We are planning to begin the early experience program next month with the launch to follow somewhere in the November timeframe. Given the holidays and what's typically a little bit slower timeframe with respect to clinics, et cetera, we're not expecting the contribution here to be significant to the growth for the year.

And look, we continue to see great performance outside the US and we're launching in other markets as well, in line with our expectations as I shared a little bit earlier with an 89% growth rate on Librela on the quarter. So we have factored that into the guidance here, but again, not a significant contribution.

Operator

Thank you. We'll take our next question from Brandon Vazquez with William Blair.

Analyst: Brandon Vazquez

Question – Brandon Vazquez: Good morning. Thanks for taking the question. Just first on EPS and guidance. I just wanted to clarify, the beat was pretty strong in the quarter, I think about $0.09 relative to the Street, EPS at the midpoint for guidance came up 3 points. And just clarify, is that entirely – the delta between those two, is that entirely FX or is there anything else there we should be keeping in mind? And then as we think of the rest of the year, kind of following up on that guidance, I think you said 4% pricing in the quarter. Can you just remind us when some of these pricing increases came in? Does the benefit of pricing kind of slow down in the back half and does that imply any improvements in volume and guidance? Thanks.

Answer – Wetteny Joseph: Yeah, happy to answer those. As you said, we've really reflected two things in our guidance today. As we said, in fact, last quarter, FX was an area that we're watching given the volatility that we're seeing across certain currencies that we operate in, and so we've updated guidance for FX both at the revenue line which is negative. It's about 75 basis points of growth essentially on a reported basis that's impacting FX, so we reflected that here. But it's actually a positive contribution when you come down to EPS, to the tune of about $0.03. So what you're seeing there from an adjusted basis is really all FX. From a reported standpoint, we're also reflecting some gains that we saw from a couple BD deals that are elevating the reported rate from an EPS perspective.

The only other color I would add here with respect to the second half and the cadence is, again, we're expecting very strong second half from a companion animal perspective versus livestock with the comps. I think if you look at the third quarter, we probably saw a bit lower OpEx in the prior year versus the fourth quarter, so I would expect OpEx growth to be a little bit higher in Q3 versus Q4 as you look at the balance of the year. But other than that, I think price is something we typically do early in the year. There are certain markets where we may do a mid-year price increase as well. But overall, price is something that happens fairly early in the year and pretty consistent with what you're seeing in our numbers today.

Operator

Thank you. We'll take our next question from Chris Schott with JPMorgan.

Analyst: Ekaterina V. Knyazkova

Question – Ekaterina V. Knyazkova: Hi. Thank you so much. This is Ekaterina on for Chris. So, first question, on dermatology, can you just remind us where you are in terms of lifecycle management? Any additional color that you kind of see with the dermatology portfolio kind of evolving over the next several years in terms of maybe potential new mechanisms or modes of administration? And then the second question is on Europe. You obviously had a very strong quarter for companion ex-US this quarter. Can you just elaborate a bit on the trends that you're seeing there and how you see them holding up in the second half of the year? Thank you so much.

Answer – Kristin C. Peck: Sure. Thanks, Ekaterina. I'll take your questions and see if Wetteny wants to build on it. Lifecycle innovation obviously is critical in dermatology. We're quite focused on it in a number of areas. I think you saw approval in May of or in the quarter of Apoquel Chewable which we had approved outside the US but now got approved in the US. This is really important for a lot of pet owners who have trouble getting their dogs to take pills, so a chewable has real value there. We're also looking at monoclonal antibodies, looking at more long-acting in that space. We're also looking at lifecycle innovation around other species. Clearly, dermatology is a significant issue amongst many companion animals, so we'll continue to look for opportunities there. It is a big market; we will continue to lead in innovation and in lifecycle innovation across a number of different areas as I said, from small molecules to monoclonal antibodies to additional species, so we are really focused there.

As you look at Europe, I mean, I think for most companies, I would say the growth in Europe was ahead of what many of us expected for the year mostly because I think we were expecting energy to be a much bigger issue certainly through the winter, et cetera. But we've seen a great strength particularly in Northern Europe, but I would say that if you look at Southern Europe, I don't think it's performing as well as Northern Europe. They've got greater inflationary markets there as well as a number of weather issues with severe heat waves and droughts across markets like Spain. But we really see the underlying demand in Europe and Northern Europe remaining strong and we're seeing strong growth there. So I'm not sure, Wetteny, if you want to build on any of those comments?

Answer – Wetteny Joseph: Yeah. Look, I think just stepping back from a companion animal performance perspective, we continue to see strength there across our international markets, even in emerging markets. I was just in Poland recently, seeing a real uptick in terms of companion animal continuing to take hold. I think some of the innovation that we have may take some time to take hold in other markets outside the US, and it takes longer to get to those peak sales. We're continuing to see really strong derm growth across our international markets and so on, so we believe that is sustainable. The first half, we've seen really strong growth there. In terms of companion animal across international, we saw 17% operational growth in companion animal in the quarter, following a 10% growth in Q1. I would continue to expect double-digit growth, maybe not at the level we saw in Q2 in the back half for international, but continue to see double-digit growth there.

Operator

Thank you. We'll take our next question from Louise Chen with Cantor. And, Louise, your line is unmuted. Please go ahead with your question.

Analyst: Louise Chen

Question – Louise Chen: Hi. Thanks for taking my question. So wanted to ask you some of the pushes and pulls to your commitment to the mid to high single-digit revenue growth that you've talked about over the next three to five years. Thank you.

Answer – Kristin C. Peck: Sure. Thanks, Louise. We remain committed to the guidance we provided at Investor Day back in May. We really – I would start with just the resiliency of the animal health industry. The industry itself historically as you know grows at 4% to 6%. We see really strong tailwinds driving the industry over the next medium to long-term, increasing medicalization especially in emerging markets, increases in population, really the strength of the human-animal bond. We're seeing increasing willingness to pay with 86% of pet owners say they'll pay whatever it takes to take care of their pet. But really, where I think it differentiates Zoetis is innovation, our innovation across chronic diseases. We look at what we can do as we talked about some of our new franchises that we think we'll build over that time period as well. We look at an increasing global population which is obviously driving the need for more sustainable ways of producing agriculture and meats and proteins.

So we really think Zoetis will continue to outperform our market, growing 4% to 6%. Historically, we've outperformed at close to 3%. Zoetis is well-diversified and we're the innovation leader. We've got strong franchises today that are continuing to grow. Dermatology as we said, again this year, growing double digits; parasiticides; OA pain; we've got strong diagnostics; emerging markets. So we really believe the industry is very attractive and very resilient. But most importantly, I think Zoetis as a leader in innovation, will continue to drive this important space.

Operator

Thank you. We'll take our next question from Balaji Prasad with Barclays. And, Balaji, your line is open. Please go ahead.

Unidentified speaker

Question – Unidentified speaker: Oh, good morning. This is Shah (00:45:32) on for Balaji. Thanks for taking our question. A quick one on the global parasiticide market. On the Investor Day, you expect the global parasiticide market to expand from $6.3 billion in 2022 to around $10 billion to $12 billion by 2032, which implies a CAGR of around 6%. You also mentioned that Zoetis expect to grow faster than the market in this segment. So would you give us a ballpark range of the market share of Zoetis' parasiticide business in the next three to five years? How much future growth in this segment will be supported by new product launch and how much will be supported by revenue growth of Trio and Revolution Plus? Thank you.

Answer – Kristin C. Peck: Sure. Thanks for the question. I'll start and let obviously Wetteny build there. We are the leader in parasiticides. We're really proud of that. We really see this as an important franchise. We have a broad set of products from Revolution to ProHeart to Simparica to Simparica Trio. We will be continuing to innovate in this important area. It is by far, as you talked about, the largest therapeutic area in animal health.

We really see a few things. Obviously, we're going to lead with innovation. We're going to lead with innovation in products that are easy-to-use, that really meet the customer demand, as well as what our veterinarians are looking for, and we believe there's continued innovation in this space. We're looking at long-actables, we're looking at injectables, we're looking at other combinations. Controlling parasites is critical to the overall health of the animal because if you don't, it creates lots of other issues for animals. So we'll continue to grow in this important space. We think it will continue to be a major contributor to Zoetis' growth over the time period.

So I don't know, Wetteny, if you wanted to add anything there.

Answer – Wetteny Joseph: Yeah. Look, what I would say is parasiticides is the biggest sort of market segment within animal health. It's also a very competitive space. Now, if you look at triple-combination oral medications, these are relatively new standard of care and we're going to continue to see those expand the market with respect to number of doses as well from a price perspective, and this is the area that we play. We play in the oral space largely. And so I would expect us to grow faster than the market, but again it's a competitive space and we'll continue to innovate as others do as well.

Answer – Kristin C. Peck: Yeah. The only thing I'd also add there is one other growth that we haven't talked about much today is increasing compliance. I think as you look at retail and auto-ship, and injectables, I think right now, if you believe – that the research will show you the average pet is really on at best six to seven months when they should be on 12 months for many of these products. So I think if we can do a better job of driving compliance either through auto-ship on e-commerce or home delivery through the vet or as well as injectables, where you can guarantee compliance. So we think there's lots of potential growth drivers for Zoetis to continue to drive this market and take share.

Operator

Thank you. We'll take our next question from Steve Scala with TD Cowen.

Unidentified speaker

Question – Unidentified speaker: Hi. Good morning. This is Chris (00:48:36) on for Steve. We had two questions. First, on the US pet health market. You mentioned US vet visits were flat in the quarter. Is this capacity driven or is it more related to demand and weakening new patient visits and wellness visits? And then second, do you expect any headwind from the restart of student loan repayments this fall? Thank you.

Answer – Kristin C. Peck: Sure. Thanks. As you look at the vet visits, we really have seen them on average be flattish for the first half of the year. But to be clear, they're still ahead of where they were pre-pandemic. We do not see that as a demand issue. As we've talked about on previous calls, it's really more of a supply issue in the sense of the veterinary workforce challenges. We're working hard to partner with vets to help address this, certainly we're finding new efficiencies in their clinic, helping to support as we can, adding more vet techs, et cetera, financial support, you name it, to support it. But we are not seeing any concerns around demand for veterinary health care. We're really focused on making sure that the supply is there. So no, we are not seeing – we don't look at the flat vet visits and have a cause for concern.

Historically, just so you know, vet visits have been, give or take, flat to one-ish historically, so this is not really concerning. And as you look at the first half of the year, we saw a 9% increase in both average revenue per visit and revenue overall in the clinic. So we're continuing to see really strong demand for veterinary care and for our products and we don't really see that changing.

And no, on your second question on headwinds from student loan, we're not expecting that to be a significant driver for us in the back half of this year or in 2024.

Operator

Thank you. At this time, we have no further questions in queue. I'll turn the floor over to Kristin Peck for any additional or closing remarks.

Great. Thank you all for your questions today and importantly for your continued interest in Zoetis. Looking ahead, we really want to underscore that we remain confident in our full year guidance, really because of sustainable underlying demand for animal health as we just talked about, especially in uncertain times. We believe that the enduring strength of the human-animal bond, the willingness to spend on pet health and the essential need for a safe and affordable food supply are all fundamental drivers of our growth. And I believe no one in the industry has a stronger set of capabilities and colleagues when it comes to meeting these customer needs, to advancing animal care and to creating shareholder value. So we look forward to keeping you updated on our progress and thank you for your time today. Have a great day.

Operator

This does conclude the Zoetis second quarter 2023 financial results conference call and webcast. You may disconnect your line at this time and have a wonderful day.