Event Details

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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

Jonathan D. Block - Analyst
Erin Wilson Wright - Analyst
Nathan Rich - Analyst
David Westenberg - Analyst
Michael Ryskin - Analyst
Brandon Vazquez - Analyst
Balaji Prasad - Analyst
Ekaterina V. Knyazkova - Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the Third 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, the replay of this call will be made available approximately two hours after the conclusion of the call via dial-in or on our 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 Third 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 statements in today's press release and our SEC filings, including but not limited to, our annual report on Form 10-K and our reports on Form 10-Q.

Our remarks today will also include references to certain financial measures, which were not prepared in accordance with Generally Accepted Accounting Principles or US GAAP. A reconciliation of these non-GAAP financial measures to the most directly comparable US GAAP measures is included in the financial tables that accompany our earnings press release and the company's 8-K filing dated today, Thursday, November 2, 2023. We also cite operational results, which exclude the impact of foreign exchange.

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

Kristin C. Peck

Thank you, Steve, and welcome, everyone, to our third quarter earnings call for 2023. We generated strong performance in the third quarter driven by our diverse companion animal portfolio of key dermatology products, pet parasiticides, monoclonal antibodies for osteoarthritis pain and diagnostics. We delivered 8% operational growth in revenue and 13% operational growth in adjusted net income, despite continued market challenges in China. We showed balanced segment growth this quarter with 8% operational growth internationally and 8% growth in the US. Our companion animal portfolio grew 11% and our livestock portfolio grew 3% operationally in 3Q, in-line with our overall expectations.

Through the first nine months of the year, we have grown our revenue 7% operationally as customers place a premium on the animal health benefits that our products delivered even in times of economic and geopolitical uncertainty. As the market leader in animal health, we compete in an essential global industry that has been resilient during various economic cycles and we continue growing above the market based on a steady pipeline of new products, lifecycle innovations and commercial execution. We are on track to achieve our full-year operational guidance and have narrowed it around the midpoint of the range as we continue to balance headwinds and tailwinds in the marketplace. We are executing well on the drivers where we have more control like the successful launch of Librela in the US while also mitigating the downside of macroeconomic declines in China, both of which were not considered in our original guidance this year.

Once again, our diverse portfolio across product categories and geographies generates durable, reliable, long-term growth. We continue to expect our key companion animal franchises to be our core catalyst for growth. We anticipate strong growth in our market-leading dermatology portfolio for the year, building on the ongoing direct-to-consumer or DTC digital campaign that supports disease and product awareness as well as the continued introduction of lifecycle innovations like Apoquel Chewable. Our Simparica franchise and broader portfolio of parasiticides continue to perform well in this increasingly competitive product category based on our innovative and highly effective products and promotional support from DTC.

In terms of new products, we're very pleased with the US launch of Librela, our canine monoclonal antibody for osteoarthritis or OA pain. This product has been very well-received by veterinarians and pet owners in the US as well as other major markets globally and we have built ample supply for continued growth in the US and elsewhere. Solensia, our monoclonal antibody for OA pain in cats has also been well-received by veterinarians in markets around the world as we look to help increase medicalization of cats. We're building awareness of this condition among cat owners and introducing our monoclonal antibody treatment through DTC campaigns as well as AI tools like Cat Pain IQ, which helps vets and pet owners use videos to identify this condition.

Our diagnostics portfolio has been showing stronger year-over-year performance in 2023 with 14% operational growth in the third quarter and we continue to refine this business to better serve customer needs across our comprehensive portfolio. For example, we're simplifying our reference lab service and operating model in the US and focusing on expanding our larger regional hubs, which can deliver one-day turnaround and have more modernized operations. We also continue to emphasize the benefits of AI technology and our virtual lab services to enhance the speed and quality of our diagnostic solutions.

With all this in mind, we are narrowing our full-year guidance for operational growth to a range of 6.5% to 7.5% in revenue and a range of 7.5% to 8.5% in adjusted net income, keeping the same midpoint as our prior guidance. Wetteny will provide more details on guidance in his remarks. We continue to see strong underlying customer demand this year and into 2024, even while recovery in China is still a notable uncertainty. The majority of those practices in the US continue to see high customer demand for veterinary services; however, labor constraints and limited hours continue to hamper their ability to meet this demand. Year-to-date, clinic visits are flat as we expected. We did see a modest decline in clinic visits this quarter in the US while clinic visit revenues and average revenue per visit were up.

Looking ahead, we remain confident in the sustainable underlying demand for animal health based on the strength of the human-animal bond, people's willingness to spend on pet health and the essential need for safe and secured food supply. We expect to receive double-digit operational growth for our companion animal portfolio this year and low single-digit operational growth in our livestock portfolio.

Before I wrap-up, I want to reiterate a theme I discussed earlier this year at Investor Day. It's the confidence we have in sustaining our key market-leading franchises across dermatology, pet parasiticides and osteoarthritis pain based on lifecycle innovations in these categories as well as the pipelines we are exploring in other areas of unmet need. We are firmly committed to investing in our portfolio as well as the DTC programs and capabilities we need to support our growth while managing cost and creating value for our shareholders.

Despite economic and geopolitical uncertainties in China and elsewhere, we believe we will continue to grow faster than the market for the remainder of 2023 and into 2024. This confidence stems from our diverse portfolio across markets and species. Our industry-leading franchises, the ongoing launch of Librela and the operational excellence and agility that our people deliver every day for our business and for our customers.

So thank you and let me hand it over to Wetteny. Wetteny?

Wetteny Joseph

Thank you, Kristin, and good morning, everyone. As Kristin mentioned, we had a strong third quarter with broad-based growth across both our US and International segments, across both companion animal and livestock portfolios and across both price and volume.

For the quarter, we're able to deliver results in-line with our expectations, even in light of continued headwinds in China. In the third quarter, we generated revenue of $2.2 billion, growing 7% on a reported basis and 8% on an operational basis. Adjusted net income of $629 million grew 11% on a reported basis and 13% on an operational basis. Of the 8% operational revenue growth, 5% is from price and 3% is from volume. Volume growth consisted of 2% from new products including our monoclonal antibodies for OA pain, Librela and Solensia and 1% from our key dermatology portfolio.

Our companion animal portfolio was the main driver of revenue growth, growing 11% operationally. Livestock also contributed with operational growth of 3% in the quarter. Companion animal growth was again driven by our innovative products with double-digit operational growth in our key dermatology portfolio, our monoclonal antibodies for OA pain, Librela and Solensia and Simparica Trio.

Our key dermatology products generated $393 million in sales globally posting growth of 14% on an operational basis, with double-digit growth in both the US and International. Globally, our monoclonal antibodies for OA pain posted $77 million in combined revenue in the quarter. Growth came primarily from our European markets as well as from the impact of new launch markets internationally.

With the October full launch of Librela in the US, our OA pain products are now available in most major markets. Simparica Trio posted global revenue of $206 million in the quarter, representing growth of 20% operationally versus the comparable 2022 period. Growth was driven by expanded DTC advertising support globally as well as some increased field force and promotional focus.

Our companion animal diagnostics portfolio reported revenue of $90 million and grew 14% operationally, with growth contributions from both the US and International. Our livestock portfolio grew 3% operationally with International growth partially offset by a slight decline in the US. Growth in livestock was driven primarily by price especially in high inflationary markets. We also saw volume growth in our poultry portfolio driven by increased usage of vaccines as well as our anticoccidial product, Zoamix, in the US.

Now moving on to revenue growth by segment for the quarter. US revenue was $1.2 billion in the quarter, growing 8% with companion animal products growing 11% and livestock sales declining 2%. On the companion animal side, while vet clinic visits declined 1.5% in the quarter, we continue to see robust clinic revenue growth, up 6% versus a year-ago. Average revenue per visit is up over 7%. On a year-to-date basis, clinic visits are flat while clinic revenue is growing 8%. These trends highlight the continued durability of pet owner willingness to spend as well as the continued impact of vet clinic staffing challenges. Our companion animal revenue growth continues to outpace veterinary clinic revenue growth due, in part, to our continued upsized growth in retail channel.

Turning to product performance, companion animal growth in the US was driven by our key dermatology portfolio, Simparica Trio and Solensia. Key dermatology product sales in the US were $260 million in the quarter, growing 13%. Cytopoint sales continue to drive growth in the quarter with vets showing a preference for injectables due to higher compliance and pet owners appreciating the longer duration of treatment. Apoquel sales were driven by growth in the retail channel as pet owners continued to rely more heavily on retail for ongoing pharmacy needs as well as retail auto-ship programs that drive higher compliance.

Our latest dermatology lifestyle innovation, Apoquel Chewable, was launched in the US in October. Apoquel Chewable has been well-received in Europe as pet owners favor the ease of chewable administration over film-coated tablets. Simparica Trio posted US sales of $184 million in the quarter, growing 17% driven by increased focus in our parasiticide promotional programs. We continue to see patient share growth in Simparica Trio even with the recent competitive launch in the triple combination space. We remain confident in our ability to compete through our superior label, strong retail channel presence and the strength of our corporate and specialty relationships.

In the US, our OA pain products posted sales of $15 million in the quarter. We continue to see solid clear penetration growth for Solensia as well as an uptick in feline clinic visits and expect to continue to drive awareness of feline OA through our DTC advertising campaigns. Librela has been well-received by early experience program participants and their patients during the third quarter. We move to a full launch in mid-October. We have been very pleased with post-launch performance thus far and are confident that we have ample supply to meet our demand expectations.

Our US companion animal diagnostics portfolio posted growth of 18% in the quarter as we continue to see positive results from the new field force we introduced last year. We saw strong placement growth in the quarter, especially on our images device. US livestock sales declined 2% in the quarter, primarily resulting from the timing of supply on certain cattle products in the prior year where we had an improved supply position and re-stocking in the channel, which drove a strong comparable quarter. The Q3 decline was partially offset by growth in our cattle productivity implant, Synovex, due to expanded label claims. The cattle decline was partially offset by growth in poultry due to vaccines and the expanded use of Zoamix, an alternative to antibiotic medicated feed additives.

Moving on to our international segment where revenue grew 8% on both a reported and operational basis in the quarter. International companion animal revenue grew 12% operationally and livestock grew 5% operationally. Increased sales of companion animal products resulted from growth in our monoclonal antibodies for OA pain, our key dermatology products and our small animal parasiticides portfolio. Growth in our OA pain products was bolstered by field force focus and DTC awareness campaigns in early launch to European markets, specifically in the UK and Germany as well as the continued uptake in markets launched earlier this year. Librela sales were $50 million internationally or 55% operational growth in the quarter, despite a slightly more difficult comparator in Q3 of 2022 due to the removal of supply constraints in our International markets. We remain confident in our ability to supply our forecasted demand for Librela.

Solensia sales were $12 million in the quarter. Our International key dermatology portfolio contributed $133 million of revenue and grew 17% operationally. We saw double-digit growth across most of our major markets and strong uptake of Apoquel Chewable. Apoquel growth was driven primarily by the delayed itch season in Europe and Canada. Cytopoint growth was driven by continued patient expansion and higher compliance in existing patients.

Our International small animal parasiticides portfolio growth of 9% operationally was driven by our Simparica franchise with Simparica posting $40 million in revenue, growing 29% operationally, driven primarily by demand generation in emerging markets. Simparica Trio posted $23 million, growing 47% on an operational basis, driven by growth in corporate account contracts. The Simparica franchise performance was partially offset by a 16% operational decline in Revolution franchise, driven by a difficult comparable period in China due to the return of supply in the prior year as well as the ongoing impact of the current economic conditions.

As Kristin mentioned, we have seen declines in China due to the ongoing economic challenges, particularly on the companion animal side, which were not fully reflected in our initial guidance. We continue to monitor economic conditions. However, we are not expecting an improvement this year or into the first-half of next year.

Our International livestock segment grew 5% operationally in the quarter, driven primarily by price increases especially in high inflationary markets. Growth was driven primarily by our cattle portfolio, which grew 8% operationally. Brazil was the largest contributor, where we have seen price growth, supply recovery in certain products as well as continued improvement in cattle industry dynamics. Additionally, the prior year was a weak comparative period due to the impact of supply disruptions and the more uncertain industry dynamic led to a lowering of channel inventories in the quarter. Our poultry business also contributed to growth in the quarter, growing 9% operationally due to increased key account penetration in emerging markets.

Now, moving on to the rest of the P&L for the quarter. Adjusted gross margin of 70.5%, improved 70 basis points on a reported basis compared to the prior year, primarily driven by the impact of price increases and lower freight charges. This was partially offset by higher manufacturing costs, inventory charges and product mix.

Adjusted operating expenses increased 7% operationally driven primarily by higher SG&A expenses, which grew 5% operationally due to higher compensation-related expenses. R&D expenses grew 13% on an operational basis in the quarter, driven by higher compensation-related expenses as well as increased project spend for our pipeline projects.

The adjusted effective tax rate for the quarter was 19.6%, a decrease of 130 basis points due to favorable jurisdictional mix of earnings and a higher benefit in the US related to foreign-derived intangible income, partially offset by lower net discrete tax benefits. And, finally, adjusted net income grew 13% operationally and adjusted diluted EPS grew 15% operationally for the quarter. Capital expenditures in the third quarter were $145 million. We now expect full-year capital expenditures to be in the range of $725 million to $750 million. In the quarter, we repurchased $250 million of Zoetis shares.

Now moving to guidance for the full-year 2023. Please note that guidance reflects foreign exchange rates as of late October, which reflect the continued strengthening of the US dollar. Beginning with revenue for the full year. Due to unfavorable foreign exchange rates, we are revising our reported revenue range while narrowing our guidance on operational revenue growth. We expect revenue between $8.475 billion and $8.55 billion with a range of 6.5% to 7.5% operational growth. Our previous guidance was 6% to 8%.

We have been pleased with our operational performance thus far. While foreign exchange headwinds have been larger than expected, our year-to-date operational revenue growth of 7% is in-line with our expectations. We expect to benefit from the approval and launch of Librela in the US, which is included in our revised guidance last quarter as well as the performance of our livestock business. However, ongoing uncertainty in China has continued to offset upside potential.

We are expecting adjusted net income to be in the range of $2.49 billion to $2.51 billion, also slightly lower driven by unfavorable foreign exchange. Operationally, we are narrowing our growth expectations to a range of 7.5% to 8.5%, previously 7% to 9%. Expected reported diluted EPS narrows to a range of $5.14 to $5.21 and adjusted diluted EPS narrows to $5.38 to $5.43.

Finally, to summarize before we go to Q&A. Our broad-based growth across species and geographies despite the challenging economic environment in China continues to highlight the resilience of our portfolio and of the animal health industry. We remain committed to growing above the industry driven by our innovative portfolio, commercial execution and multiple sources of in-line growth.

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

QUESTION AND ANSWER SECTION

Operator

Certainly. . We'll take our first question from Jon Block with Stifel. Please go ahead.

Analyst: Jonathan D. Block

Question – Jonathan D. Block: Great. Thanks, guys. Good morning. I promise one long question. So in companion animal, the overall revenue was a bit shy of what we had expected but you really had great performance, what we call sort of the Big Five products. So atopic derm, Trio, mAbs. The Big Five were all ahead of our estimates.

So maybe you guys can talk a little bit about the ongoing uptake of some of those key Big Five products, even with a more difficult consumer, right? Because people view some of those as discretionary and again the results were really strong even despite the more difficult consumer.

And then the flip-side would just be like anything to cite regarding the legacy products, right? So if you back into legacy that might have been modestly down year-over-year and a quick part B on the follow-up. Kristin, you mentioned faster growth for Zoetis than market again in 2024. I don't think we're really surprised by that. You've done that year-in and year-out, but can I push you a little bit on how we should think about for Zoetis in 2024 versus Zoetis in 2023? In other words, if we take into account the OA pain uptake, if you would, could we see accelerated growth in the company in 2024 versus 2023 when we think about all the moving parts. Thanks, guys.

Answer – Kristin C. Peck: Wow! Okay. So Jon, great question. I think there's like 20 questions in that one, so I don't know how we would do this. But let me start and then I'll let Wetteny build on it.

To your point, we had really strong growth across our franchises. And if you look at dermatology with 14% in the quarter, paras at 10%, diagnostics at 14% and the overall pain portfolio at 91%. So there really was strong growth across all those. Obviously, leading the growth there will be pain. And as you look into 2024, we see that as well as with significant optimism about where that's going to go. We're very pleased with where that launch is. These are both Librela and Solensia, two products that are very early in their lifecycle with significant growth. And I think if you really double-click, if you look at International, who already had these products in the market for a while, you're seeing great growth. Importantly, we're continuing to see really strong compliance on those products across Europe as someone who currently has a dog who is in early experience who adopt their second dose of Librela, the difference that it makes I really can't see any pet owner taking their dog off these world-leading medications.

So maybe Wetteny if you want to take on some of the detailed questions he had around derm, paras and Solensia. But to your point, we remain very optimistic looking into 2024 about the strength of our companion animal portfolio and the 11% was in-line with what we expected to be honest. But Wetteny, do you want to give more detail on some of that?

Answer – Wetteny Joseph: Yeah. Absolutely. Look, the 11% growth operationally in companion animal was right in-line with our expectations coming into the quarter and the overall growth of 8% operational, I would even say is slightly above. If you recall in the last call, we said we expect Q3 to come in somewhere between the mid- and the high-end of our growth rate, so that's roughly between 7% and 8%, so at the high-end of that. But in terms of consumer, look, as we've said time and time again, if you look at the therapeutics category, in terms of the value in pet health as well as some of the chronic conditions as Kristin mentioned, consumers have not been treating those as discretionary. Even when you see some relative softness in pet spend, it doesn't carry over into the healthcare piece in terms of therapeutics et cetera and we've seen that play out in many ways, even as I'm sure we'll get into. Clinic visits are slightly down in the quarter. Vet clinic revenue is up almost 7% and we're growing faster than that. Again, retail being a part of that and we'll get into that in a little bit more detail.

When I look at these big products as you described them, Jon, derm, Trio, mAbs all up double-digits and up across US and International. I mean our growth this quarter is broad-based. Across companion animal, livestock, US, International, price 5%, volume on 3%, so really broad-based and I think that really underscores the breadth of our products as well as our innovation and the value that consumer and pet owners place on products.

The legacy products when I look at inline, keep in mind when we talk price, we tend to see price lift in those legacy products as well but whereas (00:27:18) the volume, it wasn't down. Inline products are actually flat on the quarter year-on-year with some lift on price, so hopefully that helps.

But I share the optimism Kristin described with respect to 2024. I mean we have multiple sources of growth. Not only the Librela launch in the US. You've got continued growth across international markets for Librela and Solensia as well, and of course we'll have price as a lever in addition to inline products we just talked about. Livestock is now back to growth and we'll look at what that looks like when we come back with guidance next year, and then we expect growth across our key franchises as well in terms of derm, paras and diagnostics. So I'll cap it there. That was a long answer to a long question but we'll take the next one.

Operator

Certainly. We'll take our next question from Erin Wright with Morgan Stanley. Please go ahead.

Analyst: Erin Wilson Wright

Question – Erin Wilson Wright: Great. Thanks. On Librela, can you talk a little bit about the initial feedback for US processes? Will there be any initial clinic-level stocking? I think you said your expectations are intact there but any lumpiness quarter-to-quarter that we should be thinking about? Has anything changed in terms of your expectations there. And then as we think about margin expansion next year, given Librela won't be at critical mass so that may weigh on the gross margin but is there still some underlying operating leverage that we should think about across the business? Thanks.

Answer – Kristin C. Peck: Sure. Thanks, Erin. I'll take the first-half of the question and – well, Wetteny can take the second-half of the question. We launched in the US the early experience trial in September with 400 clinics as I mentioned. My dog, Poppy, was actually one of those dogs. We went to full launch in mid-October once we got a full dose in and that's – really the uptake was really strong. Very pleased with the results. We're obviously still in the early stages but we're seeing it very similar to what we saw in Europe. Both vets and pet owners are super excited. We made sure that we've got ample supply as both Wetteny and I mentioned because we do see this as a strong ramp as you saw what happened in International. International had a supply constraint for a while. And as soon as we opened that, we saw where that really went. So we continued to see really strong demand. Penetration is going really well in the clinics in the US and the experience is broadening.

There'll be some small initial stocking for sure in some of those clinics but I don't know that I would call that lumpiness going into next year. There definitely was obviously they stock it in. Our hope is we continue to just continue to drive that growth going forward. It is the number one selling OA pain product in Europe. We expect it to obviously be the same in the US. If you look at the US in particular, Erin, there are 26 million medicalized dogs with OA. So this is a big market that we're going after and this is a game-changing product, so we really see very strong potential with this. We think Librela will expand the market. And as we've mentioned before, we really do think Librela and Solensia alone can be a $1 billion portfolio for us and that's in a market today that was only $400 million. So I think that sort of underscores where we see growth there.

But do you want to talk about the margin expansion issue, Wetteny?

Answer – Wetteny Joseph: Sure. I will. Look, you're right, Erin, in terms of as we said. When I at mAbs at peak, once they ramp-up, they'll be additive and accretive to our gross margins. We believe there are also accretive to our contribution margin even when they are, what I would say is sub-scale in terms of getting towards their peak. So as we launch into the US, which is a large market obviously as you said. We'll see a little bit of a headwind from a gross margin perspective. But given many of the investments that we need to drive this field force et cetera already in the books, if you will, there'll be some incremental A&P and DTC and so on once we have the right level of penetration of the product clinics, but that's still going to leave room for contribution margin lift in the product. So that will be I would say a factor from a gross margin standpoint.

So we'll give more precision in terms of guidance for 2024 at the next call. But as you can read from us and what we're saying today, we're very excited about 2024. We're optimistic on 2024 given the levers I just described. So in-line with what we said at Investor Day, we expect to grow in the mid to high single-digits. I think you'll continue to see us look for margin expansion given the mix up in companion animal versus livestock but I won't give you any more specifics than that.

Operator

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

Analyst: Nathan Rich

Question – Nathan Rich: Great. Thanks so much for the question. I wanted to stick with Librela and Kristin specifically ask about how vets are diagnosing OA pain and starting dogs on therapy? You obviously talked about the large number of pets that could benefit from this but relatively few dogs on treatment. I guess anything you can share in terms of diagnosis rates for practices that were in the early experience program and where those diagnoses are coming from? Are these dogs currently on a pain product and maybe switching to Librela or are these new dogs being diagnosed. Anything there would be great.

And then a quick follow-up on the International performance of Librela. It looks like it was roughly flat sequentially on a constant currency basis. Any learnings on seasonality or anything like that on the International side now that that's been on the market for a little bit?

Answer – Kristin C. Peck: Sure. A few things I would say there. Unlike cat pain, which we can certainly talk about if someone has a question on it, dog OA pain and osteoarthritis has been diagnosed quite well by vets. This is not hard to diagnose dogs unlike cats who do not hide it. You can sense they are less active, they limp, they don't want to go upstairs. It is not hard to diagnose and a lot of these dogs are already being treated. They are being treated with our product, RIMADYL and other OA products. There's diets for this. So this is not a space where there's not a developed market, a developed protocol for diagnosis. And it's not the case in cats where we do have to really develop protocols for diagnosis.

What we saw initially is the first dogs they put on are the most symptomatic dogs where they know that like they really are really struggling. I think if you look at what we've seen in International is, as vets get more comfortable with this, they then start providing it for dogs earlier in the OA pain, which actually is even better. They have greater quality of life over time. So our experience with diagnosis is really coming out of International, which is normally, initially the dogs they first put it on are the ones suffering the most where their pet owners are begging for it. And then, over time, you move into earlier-stages of OA. But again this is not one that is hard to diagnose for vets. They have protocols to do that today so we're not really as concerned here in the diagnosis part.

I think what we really need to do and where we see growth in 2024 and beyond, in 2025 and 2026, is having vets really provide a product like Librela to dogs earlier in their disease which I think will be a good growth driver. And in International, that is definitely not the case. We're seeing phenomenal growth right now. It is definitely not flat.

But Wetteny, do you want to get into some of the specifics of the International growth situation there?

Answer – Wetteny Joseph: Yeah. Absolutely. Look, if you look at Librela, we delivered $53 million in revenues in Q3. That's 65% growth operationally. Now, if you look at the preexisting markets, they were up about 33% so that's an incremental $10 million or $11 million in the quarter year-on-year growth in the preexisting markets. And then new markets that have been launched this year is about $10 million, that includes a little bit from the US from the early experience program, so year-on-year growth.

And then sequentially I think was your question and we're still up a few million sequentially. Just keep in mind, Q3 last year as we said, we have a bit of a tougher comp for Q3 because that's when we released sort of the allocations that we're on and the supply constraints. So that is factoring a little bit but we still have 33% in the EU sort of locations, markets where we had previously launched. So that's still very robust growth despite the comp.

Operator

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

Analyst: David Westenberg

Question – David Westenberg: Hi. Thanks for taking the questions. Just on 2024 on derm, do you expect a competitive launch outside of the one we already know from Elanco? How comfortable do you feel about your decision to price Apoquel Chewables at parity with your existing products? And are there any analogs for chewables as a competitive differentiator in front of a competitive launch?

And just as a quick follow-up on the R&D. It did step down a little bit and I think you're guiding for it down. Is there anything – are we reading in it too much to say maybe there's not a new product or a significant new product in 2024 or 2025, and maybe – or reading into that too much? All right. Thank you.

Answer – Kristin C. Peck: Sure. As we look for competition in dermatology, to your question, we are expecting competition in the second half of next year. Our knowledge is that really there's only one that we're aware of at this point that we're expecting in 2024. We obviously don't know when in the second half that it would be coming but we're well-positioned for competition. As you know, we've been preparing for competition for a while. We both have Cytopoint. We have monoclonal antibodies. We have got Apoquel. We've got Chew. We've got a pipeline behind us of continued lifecycle innovations with longer duration monoclonal antibodies, other species. So dermatology is a critical portfolio for us. We're continuing to grow.

We did 14% in the quarter so we're going to end up heavily behind this to make sure that we can continue to grow both our portfolio and the market overall. And as you look at Chewable pricing, our strategy was let's move everybody to a product that's even easier that their dog likes even more that they see as a treat before you have competition, which we're expecting to be in a film-coated tablet, similar to the original Apoquel. So we do see this as a really strong defense strategy for us.

We've been seeing great. As you look at the growth in International in the quarter, it was led by the conversion to Apoquel Chewable. And in the US, a lot of the growth in derm for us was also led by retail which has done really, really well.

To your point on R&D, I'll let Wetteny take it but there's absolutely nothing going on there in the sense of any weakness in our portfolio. But Wetteny do you want to talk about sort of what drove some of that?

Answer – Wetteny Joseph: Yeah. Absolutely. Look, as Kristin just said, we remain on target with our regulatory milestones with respect to R&D. R&D spend was up about 13% year-over-year on the quarter, so clearly well-above our revenue growth rate. So what you're seeing in terms of our overall expectations for the year versus where we're landing is just a matter of timing on the spend across projects but nothing significant or notable there. Again, we continue to drive innovation, both across new innovation as well as lifecycle innovation across our portfolio and we're very excited about the progress we're making in R&D.

Answer – Kristin C. Peck: Yeah. It's mostly just timing of investments. I mean it varies quarter-to-quarter.

Answer – Wetteny Joseph: Yeah.

Operator

Thank you. We'll take our next question from Mike Ryskin with Bank of America. Please go ahead.

Analyst: Michael Ryskin

Question – Michael Ryskin: Great. Thanks for taking the question. Mostly I want to focus on Trio. You had a really solid result in the US but it's still sort of in that ramping-up phase. Can you talk a little bit about what you're see in the market between yourself and the key competitors: BI, Merck, Elanco, and specifically BI just launched NexGard PLUS. We saw a relatively surprising decline in BRAVECTO revenues from Merck. So I'm just curious any change to competitive dynamics, anything you're seeing in terms of pricing or stocking or destocking and how that impacts Trio?

And then just a follow-up on the very last question. CapEx as well, you slashed the guide this year pretty significantly. I think that I heard you say, Wetteny, $725 million to $750 million and previously it was I think $900 million to $1 billion. So just curious did that get pushed out into 2024 as well or is there any other change there? Thanks.

Answer – Kristin C. Peck: Sure. I'll take the first half of the question and see if Wetteny wants to build on it and then Wetteny if you want to handle the CapEx question.

We did see strong growth in Trio in the quarter at 20% in Q3 for Trio. It remains the number one flea, tick, heartworm in the US by revenue and really importantly it's continuing to grow share. It's up 3% in the quarter. It's also growing patient share, which was up 2% in the quarter. So we're expecting solid growth this year. Obviously, there's a new competitor. But in the Q4, I would also say to watch, we've got a challenging comp. If you look us in Q4, you remember we got back into stock and ran a number of promotions in Q4 of last year but we continue to expect strong growth for the year there, even with the destocking that we saw in the US in Q1 and the pre-price buy-in as we talked about before that you had in Q4 of 2022. So we see this as a franchise that will continue to grow.

A lot of our growth is really being driven by our auto-ship, by retail which remains very strong for us with our corporate accounts. This is also a category you do see a low switching once you get on a product. So we do believe we have the broadest portfolio but continue to see strength in Trio, so we're happy with the growth we've seen there.

But Wetteny, anything that I missed there and you want to talk about CapEx?

Answer – Wetteny Joseph: Yeah. Sure. Look, on Trio, I think you covered it well. $206 million of revenue in the quarter. That's up 20% operationally. We're very pleased with that including the patient share gains that Kristin already described.

On CapEx, yes, we did reduce our CapEx expectations for the year from about $950 million to $1 billion down to $725 million to $750 million. This is really on timing of project spend. We remain committed to the investments that we're making and this is still representing about a 25% increase in CapEx year-over-year. So as we said at Investor Day, we expect CapEx to remain elevated for the next couple years and then we'll start to bring that down sort of in the range of a growth rate that approximates our revenue growth range as you go beyond 2024 or 2025 timeframe. So again really just a matter of timing is what you're seeing from a CapEx standpoint.

Operator

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

Analyst: Brandon Vazquez

Question – Brandon Vazquez: Hi. Good morning. Thanks for taking the questions. On the companion animal side of things, it was a nice strong quarter. I think you had said, if I heard you correctly, that in 2023 you expect full-year organic growth double-digit. The question being I think you're at 7% year-to-date. I'm kind of being a little dangerous here and playing with my model live, but I think it implies kind of like a high-teens organic growth in companion animal in the fourth quarter. One, am I thinking about that correctly, and then two, what's kind of giving you the confidence that the business can do that especially I think Q4 is a little bit of more difficult year-over-year comp. Thanks.

Answer – Wetteny Joseph: Yeah. I'll be happy to take that. Look, we continue to see, as you saw this quarter, 11% operational growth in companion animal. And though we have some tough comps as Kristin just referenced with the Trio answer in a previous question, we are expecting very, very strong growth across companion animal in Q4. Keep in mind we have some comp challenges with respect to livestock, which will decelerate from what it is on a year-to-date basis about 6% to a low single-digit growth. So as you look at what's factored into the guidance that we just gave in narrowing the range but still maintaining our midpoint, if you will, you can factor that into your equation in terms of what the livestock versus companion animal mix is as we exit the year.

Operator

Thank you. We'll take our next question from Balaji Prasad with Barclays. Please go ahead.

Analyst: Balaji Prasad

Question – Balaji Prasad: Hi. Good morning. Couple of questions for me. Firstly, to the extent you can, without commenting on any 2024 guidance, can you highlight some of the macro factors and how we expect that to change, speaking – looking at the diagnostics space of consumer trends, better option, volume?

And secondly, a bit more specific. Can you speak about your Librela supply plans? You recently opened a new facility in Lincoln and what impact does it have for supply cost and margins? Thank you.

Answer – Kristin C. Peck: Sure. I'll start with the beginning and then Wetteny maybe you can build on it. We continue to see very strong macro drivers in animal health. It's really led by the humanization of pets, which is a global trend. It's also led – we continue to look at 2024 at whose adopting those pet, which is more of millennial and Gen Z, and importantly more high-income households who are really raising the standard-of-care that they want to spend on their pets. We see this as important drivers as we bring real innovation to the market with Librela, with Solensia, certainly continuing with Cytopoint, which is growing very strongly.

So we look at the drivers of pet care globally, which is really whose adopting the pets, how they want to spend on their pets and looking at revenue per clinic which continues to grow very strongly which is we're really correlated against. It's something that continues into 2024. These are strong macro drivers for us. As we've spoken about on the livestock side we really believe that market historically and we believe in the future we'll continue to grow 2% to 4% in the low single-digits. And as we've said, we were going to return to that growth rate as we started to fully lap the challenges of the Draxxin. So as you look at livestock, what's driving that is a growing middle class and more consumption of protein. With the whole (00:44:48) thing aside, which hasn't really impacted livestock or the consumption of protein globally, really because of whose really driving a lot of that growth which is middle classes across the globe and more and more people entering that and seeing and upgrading their protein. So we look at those macro drivers and we really don't see any changes as we look into not just 2024 but 2025 and 2026. And when we bring innovation to those markets, we believe we can continue to grow ahead of that.

So Wetteny, I'm not sure if I missed anything there? And if you want to take the second-half of the question.

Answer – Wetteny Joseph: No. I think you covered the macro dynamics well, Kristin. On the supply question with respect to Librela, we are very confident in our supply plans to meet the demand expectations for Librela that we have certainly for 2024 and beyond.

Mentioning the Lincoln facility, certainly in addition to both our internal capacity and third-party that we are using, we continue to invest internally, and I think if you look at Lincoln that will be a factor. I think as you go beyond 2024, with respect to supply planning for Librela and other mAbs as well, so again very confident in our ability to meet those demand expectations and we've already factored the ramp that we saw in Europe in our thinking around demand there as well.

Operator

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

Analyst: Ekaterina V. Knyazkova

Question – Ekaterina V. Knyazkova: Hey. This is Ekaterina on for Chris. Thank you so much for taking our questions. So, first, very quickly just on veterinary visits and the pressure we've been seeing there recently. Can you just remind us how sensitive Zoetis is (00:46:23) and maybe your latest thinking around how visits are going to trend maybe into 4Q and potentially into 2024, if you want to comment on that?

And then the second question is just on US cattle. Can you just elaborate a little bit more on the dynamics you saw in the quarter? Because I think one of your competitors mentioned the timing of the cattle run kind of was shifted earlier this year. Is this something that you saw as well and does that potentially create a headwind for you as you think about the fourth quarter? Thank you so much.

Answer – Kristin C. Peck: Thank you, Ekaterina. I'll take your first question then Wetteny can build on me and then take the second. The visits were flat year-to-date, which is what we have expected and we have talked about previously in the quarter. They were down around 1.5%. As we discussed, we're really not as reliant on vet visits. The better proxy for us is revenue because again remember that a lot of our products don't need to be purchased in the clinic.

As you look at both auto-ship, as you look at retail, you look at chronic medications, all of this continues to have us be a higher correlation with overall revenue growth in the clinic. So, historically, as we had talked about before, vet clinic visits are flat to maybe 1%. And as you look at where they stand to-date, they're still ahead of where they were pre-visits are flat to maybe 1%. And as you look at where they stand to date, they're still ahead of where they were pre pandemic. So we don't pay as much attention to that vet clinic visit. As you look at revenue in the clinic, our growth in companion animal was higher than even that number and that's because we're driving so much innovation there overall. So as we look at vet clinic visits, we're not as tied to that number as we continue to say.

So I don't know if there's anything I missed there Wetteny you want to build on? And then you want to take the second question?

Answer – Wetteny Joseph: Yeah. Sure. The only thing I would add on the vet clinic visits as you see our growth continues to outpace that of the clinic growth and the vet visits were not as – they're important, right, but were not as sensitive to visits because therapeutics and chronic indications tend to power us through that and you could still see volume growth even as visits are down. And then the retail piece, which has continued to grow, we've seen an additional two full percentage points as a percentage of our pet care revenues in the US each year. So we've gone from all the way to 11% from about 5% just a few years ago. So we continue to see that and the quarter was up about 35% if you look at our retail sales. So those are the factors I would add.

With respect to the cattle dynamics and livestock in general, I would say clearly we've had a very strong start to the year through the first nine months. Livestock is up about 6%. Clearly, we're signaling that will come down in the fourth quarter and that's really more of a factor of variability across quarters given the timing of supply that we had in the prior year versus the current year. The timing of when we've taken price adjustments for Draxxin for example, which impacted Q2 versus Q3 as well as Q4 this year as we're anticipating a step in that at the end of the year, so that will put some more pressure on Q4. We factored all that into our guidance that we've just issued today, which we are still in-line with our expectations that we started the year with, which is right around our midpoint, we just narrowed it. So all those are in.

With respect to cattle dynamics around – we haven't seen anything that would say there's a pronounced shift with respect to the cattle run here, but again we factored all these items into our thinking and what we've just iterated today from a guidance standpoint.

Operator

Thank you we'll take our next question from Steve Scala with TD Cowen. Please go ahead.

Unidentified speaker

Question – Unidentified speaker: Hi. This is Chris (00:49:57) on for Steve. Thanks for taking our questions. We had two. First on the US, on the parasiticide market. Can you provide an update on the estimated volume share of topicals in collars to date? And then looking ahead to 2024, what is the risk of significant pricing pressure on Trio (00:50:11) quarter? Assuming a non-inferior product label, price seems like the main lever they could leverage to grow their market share?

And then a clarifying question on US Librela. Can you please confirm that US sales was zero in Q3? And then looking ahead to Q4 do you still expect sales to be immaterial for the full-year? Thank you.

Answer – Wetteny Joseph: Yeah. Look, I'm not sure if I got the second question but I'm going to give it a shot and ask you to clarify. On the parasiticides market, we still estimate in terms of volume nearly half is still in the collars and topicals, but from a value perspective dollars were significantly leaning on the orals and prescription, as you know those are at higher price points.

I think you were asking a specific question about share for specific products within the topicals and collars and I don't have that to hand. But if it was a different question I'll ask you to clarify after I give you an answer on Librela. So Librela in the third quarter was minimal, as you know, in September, we had our early experience program. That was only about 400 clinics. It's very limited. With KOLs to get them using the product and being able to talk about it et cetera and helping with refining protocols and so on. And so the number was like $3 million in the quarter. Not meaningful at all. And given the timing of the full launch in October and with the holidays coming, it is not going to have a meaningful impact on the full-year growth, again on that point. But I'll ask you to clarify if I didn't get the question right on the paras.

Answer – Kristin C. Peck: Okay.

Operator

And it appears they have disconnected at this time.

Answer – Kristin C. Peck: Next question?

Operator

And there are no further questions at this time. And I'll turn it back to Kristin for closing remarks.

Great. Thank you, everybody. Great questions today. Once again, we want to reiterate that we remain confident in our ability to achieve our full-year guidance based on the diverse and innovative portfolio that continues to drive our success. We are firmly committed to continuing to invest in that portfolio as we look at the opportunities ahead of us through DTC and building our capabilities to support our growth but we'll also continue to manage our costs and make sure we're creating value for our shareholders.

We continue to grow faster than the market by focusing on our people and our colleagues and on operational excellence and agility. They deliver every day for our business and for our customers. So we look forward to updating you on the full-year and our long-term value proposition and hopefully seeing many of you in San Francisco at the JPMorgan Healthcare Conference to kick off 2024. Thanks, everybody.

Operator

Thank you. This does conclude today's program. Thank you for your participation. You may disconnect at any time.