

✓ **Event Details**

Date: 2023-11-28
Company: Zoetis, Inc.
Ticker: ZTS-US

✓ **Company Participants**

Unverified Participant
Wetteny Joseph - Zoetis, Inc., Executive Vice President & Chief Financial Officer

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Thank you. I'm here with Zoetis, Wetteny Joseph, the CFO. So, let's kick this off.

QUESTION AND ANSWER SECTION

Unidentified speaker

Question – Unidentified speaker: Let's get started on industry. How should investors think about long-term trends in veterinary medicine and production animal? Should the slow visits in 2022 and 2023 concern investors at all in the near and longer term?

Answer – Wetteny Joseph: Look, when I think about the industry long term, we've seen some really strong tailwinds and really circular growth trends that we expect to continue long term. The prioritization and value on pet health and seeing the pet as a member of the family and we've seen studies like the Human Animal Bond Research Institute did about a-year-and-a-half ago, 13,000 pet owners and essentially we see their pet as a member of their family and 86% of them said, look, we'll spend whatever it takes if our pet needs extensive veterinary care.

So, I think those are things that underpin a lot of (00:01:02) what we've seen over the years, not just during the pandemic, but long before the pandemic, that are continuing to really drive growth across the industry. And then, this innovation that's helping to address unmet needs, that continues to drive that, right?

So, that's, long term, how we see the pet care side – pet health, of course, not just the US and Western Europe, but, of course, even emerging markets also.

On the production animal side, it's like a different dynamic, right? You had a lot of productivity driven by innovation over the years and there's continued to be investments to drive innovation in this space. But it's slightly different customer that's looking at the economics and what is the risk profile of their animals. But overall, there's a long-term need for healthy animal protein that's driven not only, again, in the Western markets like the US and Western Europe, et cetera, but across emerging markets, where you're seeing a growing middle class and more and got (00:01:55) more access to animal proteins and growing population over the next, call it, 27 or so years, the expectation is that there'll be 2 billion more people walking the planet.

And so, that's going to continue to drive a need here. And we see that end of the business in a sort of that 2% to 4% long-term growth rate expectation as we look beyond actually in the level it's been at over the years as well.

So, those are the two big underpinnings if you look at sort of what's driving trends long term.

Unidentified speaker

Question – Unidentified speaker: Got you. And in terms of 2023 visits, what degree of confidence do you have if the market is indeed labor constrained and maybe not necessarily demand constrained? And if that's the case, if it's labor constrained, should we see labor market starting to weaken? Should we see – do we see a potential for growth again in visits in 2024?

Answer – Wetteny Joseph: Yeah. Look, I think if you step back and you look at visits and what they've meant for the industry, I'd just like to put it in a context for a second. Our industry has grown between 5% and 6% over the last decade. That includes companion animal and livestock. So, livestock growing slower than companion animal. So, the companion animal is growing faster than the 5% to 6%.

And visit growth has been about 1% per year. So, this is an industry that certainly visit growth is part of it, but it's not the biggest driver and it's the innovation and the higher prioritization on pet health. Those are the things that are driving the industry growth by and large.

Now, having said that, we saw visits really increase significantly in 2021. So, the quarter we just ended, for example, had about 73 million visits in it, right. If you go back to 2019, the same quarter had 72 million. So, it's about 1 million more. But in 2021, it was 76 million. So, we had a big increase in visits that drove a lot of activity in the clinic and was a contribution to turnover in the clinics as well.

So, as they've gone back and gotten a lot more stable in terms of their labor, they've also adjusted their hours to some extent and have driven a little bit more, I would say, work/life balance across the clinics. And so, it's still hard to get a visit in most clinics around the country, right. And you see that, too, in the UK and Western Europe area.

So, by far what we're seeing is a matter of capacity in the vet clinic, more so than any sort of macro-related element that we're seeing. But that's not to say there's not some macro here, right, that would be realistic looking at the dynamics. However, they start to impact things that are a lot more discretionary first, whether it's grooming or certain type of pet foods or what have you, those things get impacted. Maybe some of the health and wellness type visits might get impacted more.

So, if you are wholly a diagnostics, you might see some impact from wellness visits, sick visits, if you will.

Unidentified speaker

Question – Unidentified speaker: Yeah.

Answer – Wetteny Joseph: And then, by the time you get to our portfolio, we have a lot of products that are treating chronic conditions, dermatology, for example. You don't treat your pet for that, when you have been, you're going to see them itch a lot more, some probably to the point of bleeding themselves, right? So, you're not going to stop a treatment that certainly is impacting the quality of life or a pain, which are products we've been launching over the last couple years outside the US and have now launched in the US. These are chronic conditions that you can visibly see very clearly.

So, we don't see as much of any impact on that end of the market. And then, retail has gotten to be a bigger contribution as well, which continues to drive that. So, in addition to what you see in the clinic, you have to factor the impact of retail, which is also helping to drive growth for us.

Unidentified speaker

Question – Unidentified speaker: It's actually a perfect segue into the next question, because I think a lot of your business actually doesn't necessarily require a visit, but it does require a script. With that in mind, how do you think you're going to – you would see that maybe impacts the scripts if you see flat growth? Would there be any impacts in maybe say next year on scripts?

Answer – Wetteny Joseph: Look, I think as I've said just now, I think the things that are more chronic type conditions or that are very visible, we don't see those having any impact in terms of how they get treated and the need for a vet to be involved to write a script. And whether they get fulfilled in a (00:06:04) clinic or on the retail side, we're seeing that impact, which has been positive for the business.

In fact, even with visits being down 1.5% in the third quarter, although keep in mind, there was one less day in the third quarter this year than the year before, but nonetheless, 1.5% down, we still had volume growth across not only in the clinics, but, obviously, in the retail as well. So, we continue to see whether you link that back to the scripts that have been written or what have you, but there's still volume growth for us even in a down clinic visit, which goes back to my prior answer as well.

Unidentified speaker

Question – Unidentified speaker: Got you. I'm just going to move one on to Q4 guidance and the – what assumption is – or can you help us ballpark the assumption on companion animal growth in that quarter, keeping in mind, I think, you do have a comp – care to quantify what the stocking was before your price increases in 2023, early 2023?

Answer – Wetteny Joseph: Yeah. Look, we've been very pleased with the performance, particularly if you look at this last quarter, 8% growth, very balanced and broad based across our portfolio, across our geographic markets, et cetera. So, that resiliency in our business and diversification is certainly something you see come through with that performance. And by the way, after the first quarter, where we did see the destocking you referred to and I'll get to that in a second, we said you would expect to see consistent growth across the rest of the year.

And you saw us plus 9% operational growth in the second quarter, 8% operational growth in the third, which leaves you basically a 7-ish if you just do the math to get to the full year guidance, which we just tightened around the same midpoint we started back in February. So, despite everything that's happened this year, we're still looking at a guidance that's very consistent operationally where we started back at the start of the year. So, that gives us a lot of confidence in terms of what we're looking at across the year.

Now, to exit the year, livestock has been growing on a year-to-date basis through Q3 6% operational. And we're saying livestock will be low-single-digit growth for the year. So, clearly there'll be a step-down and that's largely a comp point to your point earlier, when you factor the timing of supply that we had in 2022 versus what that means for 2023, but we're expecting to see a strong growth from companion animal, offsetting that again to land us into this guidance that we just issued with our third quarter results. And so, we have high confidence in that.

And here we are, we're pretty far along into the quarter. We only have one month left in the US and I'm about to wrap up the quarter internationally. So, certainly, those are the things that we see in the business. So, that does translate to a down quarter for livestock, but companion animal essentially growing double digits to land us where we said.

Unidentified speaker

Question – Unidentified speaker: Just in terms of pricing and on that comping, I mean, I think, generally speaking, we're still in an inflationary environment that is above historical norms. And so, as we move into 2024, I mean, I would probably guess that some of your prices will be up above historical norm, just given where we are in inflation, where we are with veterinary inflation. Is there any chance you could see some stocking behavior, say, in Q4 in anticipation of that? Or do you think they've really gotten normalized with it's not going to be anywhere near 2023, so maybe they don't need to do that this year?

Answer – Wetteny Joseph: Look, we won't get into too deep into 2024, but as we exit this year – by the way, there's typically some stocking that happens at the end of each year. So, 2022 late year wasn't unique. In that, there was some stocking that was done pre-price buy-ups wise. There were some additional contributions to it, because we had some supply constraints earlier in the year that kept us from running promotions that included a Trio product in the third quarter.

So, we had to include those and emphasize them in the fourth quarter more so. So, that did cause some impact here,

but in terms of pre-price buying, that happens almost every year. The question is, is there going to be – last year was a higher level than you would typically see, will this year be more an average? A little bit too early to say.

I think from a pricing standpoint, we've been running somewhere around 4%, 5%, this year and last year. Typically, we're closer to a 2% or 3%.

So, look, I think we'll come back with more detail as we come into February. But I think you can suffice it to say we'll be somewhere between those two ends, if that helps at all, because as you said, there's still, obviously, an inflationary environment out there and we have consistently and systematically taken price every year. That is something we have done in the market, not just in these inflationary times. And so, customers have come to expect that behavior from us as we look at next year.

Unidentified speaker

Question – Unidentified speaker: Checks (00:10:40) on Librela have been great. I mean, every clinic I've talked to is excited about it. They think it's going to bring in patients. I actually think this could be one of the biggest first year products in the US launches of all time and that would be my guess. I think you're ready to supply the market. Do you think this could be the biggest potential selling product of all-time in animal health?

Answer – Wetteny Joseph: Well, look, I think there are a lot of things that we look at, particularly if you go back and see how the product performed in its first year in Europe despite the supply constraints that we had there and we don't have those here in the US as we launch. By the way, across our monoclonal antibodies, we don't have any supply constraints to speak of.

So, whether you look at Solensia, which is osteoarthritis pain for cats, Librela OA for dogs or Cytosol on the dermatology side, starting about this time last year, we've really been out of allocations and able to supply the market to demand. So, we're anticipating the demand here and I won't say how big of a launch it will be compared to historical, et cetera, but it certainly was in Europe the fastest ramp to a blockbuster, I think, that we've seen historically.

So, that's very encouraging with the launch here in the US. And it's still early, but certainly as you said, the qualitative indications that we're getting from vets and pet owners, et cetera, have been very, very positive. So, we're very pleased with how things are going so far.

Unidentified speaker

Question – Unidentified speaker: Got you. I know you don't want to give up all of your strategy here, but can you talk about some of the portfolio benefits that you can see with Librela? I mean, BI just launched a parasiticide. Elanco is going to negotiate with a new parasiticide and probably a dermatology product. How strong of a position do you think you are with Librela saying, you know what, well, yeah, we're not just negotiating on parasiticides in a Trio, we're also launching in a portfolio effect.

Answer – Wetteny Joseph: Look, if you ask vets what other (00:12:36) products that are most important to them in their practice, I think you won't be surprised to see a number of Zoetis products right (00:12:43) on top of that list. And so, I think that's something that vets value and that's something that when you look at our corporate relationships in particular, et cetera, those are things that we value as well. So, that creates some room for us to work with our customers in a way that benefits their practices and certainly drive our agenda in terms of the innovation that we're coming out with.

Now, how much and how far we can take that varies depending on markets, right? So US is one thing, Europe is something else in different markets as such, but without getting into the super detail here, but certainly the importance of our products to their practices is something that we value and we value those relationships as well. We have strong relationships with corporates that I think will go a long way towards what you're talking about.

Unidentified speaker

Question – Unidentified speaker: Can you talk about how you use distribution and how you might use distribution ahead of the launch of a competitive JAK? Does Elanco hiring sales, or additional salespeople influence your use of distribution? Do you think they'll be relying heavily on distribution?

Answer – Wetteny Joseph: Look, these are factors that we look at and evaluate from time to time. I think when I look at dermatology, first of all, there's still a lot of room to grow in dermatology. And you've seen the growth rate even a decade later after we launched the product. You're seeing really strong growth not only in the US but across international markets. And so we're going to continue to put DTC and other factors behind those to drive growth there. To me, offense is always the best defense and the first defense, so that's where we're going.

The second thing I would say is long before you get into how you look at your distribution strategy, I think you have to look at your other portfolio and what you're doing and how those might help you in a competitive scenario. So for example, you have Apoquel, you have now in Apoquel chewable product, which is an important addition in lifecycle innovation, which we launched across European markets a year ago. And we're now launching, by the way, Apoquel Chewable at the same time that we're doing Librela in the US. That's an important lever, I think, in terms of how we look at that.

And then you have Cytosol where we have historically been constrained, just like other mAbs, particularly during the years of human vaccine production for COVID, we weren't able to get some of those inputs like the single use bags and other things that we need for producing. So we're not able to capitalize on the full demand profile for Cytosol, for example. That now is not the case, we are able to do that and that becomes another lever in terms of how we go about dermatology on that front. And then there's pricing and so on and then there's distribution, right.

So there are lots of ways for us to look at this depending on what the competition looks like, depending on what the label looks like. I mean, we have a decade on Apoquel, we have seven or eight years on Cytosol. That's a lot of dogs have been treated with our products and the safety profile speaks for itself. So there's a lot for us to look at without getting into too quickly into how do we do distribution, but that is a factor we think about.

Unidentified speaker

Question – Unidentified speaker: Got it. Yeah, that maybe is a good segue into the fact that Zoetis has really punched above its weight in terms of blockbusters. Why has Zoetis been kind of honestly just uniquely ahead of everyone else when it comes to blockbusters?

Answer – Wetteny Joseph: Look, I think what we – I've been in Zoetis now for about two-and-a-half years. I've really come to appreciate that there are multiple elements to what drives our success. I think the first one is truly understanding the species and understanding the disease state. There's a lot of work that's done through our R&D organization and our external partners to get underneath those in a way that's meaningful because our intent is to drive meaningful impact when we do launch products in terms of efficacy and clearly balancing that with safety to make an impact on animals and their health; so it starts there.

And then there's the commercial organization who are always involved from the very beginning around what are the needs from customers and what's going to drive traction, et cetera. And then there's the ability to scale those and continue to grow and develop those markets long after we can launch the product. And to me, the success of the company isn't just in what's done in R&D and then what's done in terms of scaling it, but long after that, continuing to drive awareness in terms of patient and understanding of vets and what the mechanism of action is and what are the applications and how much of an impact we can make. So years later, you continue to see the benefit of those things, including in dermatology, for example, where we're now north of \$1.3 billion and continue to see really strong growth. So I think it's really developing those markets is what's driving the success for us.

Unidentified speaker

Question – Unidentified speaker: Got you. Now, at your Investor Day, you showed new drugs in chronic kidney disease, kind of cardio metabolic, oncology. How should we think about innovation long term at Zoetis in terms of when Librela does start to slow down, should we be thinking about a new product filling in the gap and when it hits kind of peak sales?

Answer – Wetteny Joseph: Look, I think if you – as you heard from Rob during the Investor Day at the end of May, we have the biggest spend in terms of R&D in our space, right, call it \$600 million. And there's a balance between lifecycle innovation and net new innovation that we go after. And the intent is to try – is to drive consistent delivery of products and growth for the business. And there's a track record of doing that.

Now what is the rhythm? Is it big blockbuster and then lifecycle, lifecycle and then we work through or how does that work? I think that might vary from time to time, but the intent is to drive it consistent, delivering consistent growth. But I think when you think about lifecycle innovation, which about, on average is about 50% of our focus in our spend, that is meaningful for us as well.

So whether it's examples like I just described a moment ago with Apoquel Chewable or some of the long-acting elements for products that we already have in the portfolio, but we have long-acting elements of them in our pipeline, et cetera. Those are the things that will continue to drive for us, in addition to the net new innovations and the examples you gave are three that we shared during Investor Day, which clearly are areas that are among the highest unmet needs when you think about the companion animal space across the world. And so no surprise, we're intently working on those and are moving things along, be it through discovery and into our development, et cetera. So we feel, we feel great about what those are and the potential for them to be the next big blockbusters or \$1 billion franchises or markets that we can influence and drive.

So we're excited about the work that we're doing on those. I'm not going to get into anymore detail, anymore specificity around timing for those and how they might fit with Librela for example. But we're just getting going with Librela.

We said between Librela and Solensia, those two OA pain products for cats and dogs will be north of \$1 billion at peak. So it takes three to five years to get to what we're calling peak. And by the way, that's not the end of growth for those products, right. We're posting double-digit growth in derm 10 years later. So these products will continue to grow, we'll continue to drive market development on those products and market expansion for those products. But in that three- to five-year timeframe, we're talking north of \$1 billion. So if you lay that out over what that means for 2024, which we're not prepared to talk about exactly yet, but 2024, 2025, 2026, that does take you away. And then you can see, okay, is it a lifecycle or multiple lifecycle innovation items that are going to enter during that time or towards the end of that time? Was it some new innovation? We'll see. We'll give some more detail as we get closer to those.

Unidentified speaker

Question – Unidentified speaker: Got it. Well, one of the things I think people do underestimate is the portfolio potential for Librela. So talking to veterinarians, one of the concepts is as you get into a dog that's over 10 years in the clinic monthly, how many different conditions are you going to find and be able to treat? Is that kind of something that you think might be underappreciated and would that fit well with chronic kidney disease, cardio-metabolic drugs, or is there any other kind of drugs you could think of that could see benefits that's currently in your portfolio from Librela?

Answer – Wetteny Joseph: Yeah, look, I think that's an element that we believe can have an impact. I won't size it here or say how underappreciated it might be, but we do think there's an element of this. And it's also true on the cat side, right. I mean, coming out with Solensia as a way to treat OA pain in cats, it gives a reason for cat to show up in a clinic, so consistently month after month which it has its own challenges in terms of pet owners getting them into a cage or a crate and get them into the clinic and all that, but if you have something that treats something important and serious for them, then that starts to bring them in. So that may have carryover for other treatments and other products and diagnostics, et cetera.

So we do believe that there's more effect of those type of things and then between the two products, too, we knew Solensia was going to be a slower upper end, because you don't have the same level of protocol execution for OA pain in a cat as you do in dogs. But as Librela takes hold, then clinics are getting more and more practice of executing their protocol and they're screening for dogs and that should also carry forecast potential. So it's not just, of course, other therapeutic areas, but also within across species within the same therapeutic area, if you will, that we'll look to see how those things play out.

Unidentified speaker

Question – Unidentified speaker: One of the – and now going in production animal. I think it's actually been one of

Question – Unidentified speaker: One of the – and now going in production animal, I think it's actually been one of the only maybe less than bright spots in the Zoetis portfolio if you look at like the last five years in terms of growth, is the Draxxin headwind finally over? And is the – with the growth you've seen this year, it seems like maybe you're back to normal and in terms of industry growth, can we see that continue and maybe above market growth? I'm going to throw on that GLP-1 question. Would that be one of the offsets that would see some of that back to normal growth maybe out there?

Answer – Wetteny Joseph: Well, I won't go all the way there on GLP-1, I think it's too early to tell what impacts that may have in terms of protein consumption and all that kind of stuff. So I'll leave that one alone. But I think if you step back and look at livestock, this is a market that's growing around 3% or 4%. Historically, it's been around that you've had times with ASF hit in China that impacted it and then you had rebuilt the herd and all that. So there are some cycles that you go through, but overall it's the consistent 3% to 4% grow if you look at how it's performing, how we expect it to perform as we look out to the future.

The last couple of years, particularly in 2021 and 2022, where the peak, I would say impact or headwind for Draxxin for us is some for Zoamix as well, which is also another one that had implications over the last couple of years. We're now having gone through the first two years, as we said all along, those would be the more impact for two years. I would say it's completely over to your question, but the impact is far less than what we would have experienced relative to the overall portfolio the last couple of years. And we started to see even with some impacts for Draxxin this year, you're seeing a return to growth for livestock in 2023. Again, I won't go into details of specific for what that means for 2024 exactly. But I do believe with most of the impact on Draxxin, even if it's not all out, most of it behind us, the delta between our performance in the market will be a lot less than it has been over the last two or three years' time.

Unidentified speaker

Question – Unidentified speaker: Got you. So you've been at Zoetis for two-and-a-half years, what have been the biggest positive and negative surprises in your mind?

Answer – Wetteny Joseph: Look, it's – the point I made earlier around what makes us successful and how all these pieces come together, not only what's happening in R&D, but how well that's linked to our commercial teams and understanding truly what the customers' need and what the patient needs are. And then the scaling that we do in our manufacturing organization, all our colleagues working to do that, to deliver mAbs at scale in animal health, which is something, in my prior life, I didn't think was even – was possible. So I'm seeing it right before me. And not only that, but seeing that there's so much more potential out there to leverage that as a platform for other unmet need. Those have been the most positive things that I've kind of experienced.

All right. Oh, well, tried to – got you on the negative side, but (00:25:12)

You ran out of time.

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