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Zoetis, Inc. (ZTS)

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Erin Wright
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MANAGEMENT DISCUSSION SECTION

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Great. Thanks. Good afternoon, everybody. My name is Erin Wright. I cover Life Sciences Tools & Diagnostics at Credit Suisse. We're happy to have Zoetis with us today, and with them we have Glenn David, the EVP and CFO; as well as Kristin Peck, who is, well, upcoming CEO, as well as EVP of US Operations, as well as wearing several different many hats at Zoetis. So, we're really happy to have you here today.

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QUESTION AND ANSWER SECTION

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And just with that, given your recent announcement, I did want to ask kind of any sort of changes in strategy here, any shift with sort of the CEO transition that we should be anticipating? I know you've sent the IPO process, and I know you've done several different roles within strategy, business development. I mean, will that take more of a focus from a business development perspective? Or any shift in strategy that you could point to, that would be great.

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Sure. The good news is being part of the company from the beginning and having been in multiple roles, from manufacturing some of our global businesses to most recently the US strategy in BD is I've been a core part of the strategy we've had as a company which has been incredibly successful as if you're shareholders in the room or on the phone you would know both from our customers' perspective as well as from our shareholders' perspective. So, I don't see any major changes in strategy.

I have been spending the last month or so since I was named CEO-elect, talking to many of our stakeholders, both our shareholders, our senior leaders, many of our customers to understand as they look at the next five years, key areas they think we need to continue to focus on, areas for increased emphasis, etcetera.

Not surprisingly, the main area that we are going to continue to focus on is innovation. I think that is what has driven our top line results and our bottom line as well. Having innovative products that customers are excited about, helps carry the rest of our portfolio, increases our share of wallet, and really has been [ph] with Zoetis (02:07). So, I think that's an area that I'll continue to invest in, and certainly as we think about the continuum of care on how that looks as we think about really integrating more products and solutions in that way.

Secondly, really investing in the customer experience. One of the things that has made us unique from the start is our single focus on animal health. That has helped us innovate in the customer experience area in many ways. We sell mostly to small business owners. So, the better we can make their business more efficient, more productive, be easier to work with. Many of our competitors remain owned by large pharma where this isn't such a focus. So, we continue to believe this is a place we differentiate and investing there.

And the third area of focus, I think, as we move forward on our strategy will be really building deeper experience and capability in digital and data. Many of you know this is a core part of many of our current products on the market, whether that be in diagnostics and the software connectivity side, in precision livestock farming, but it also just makes our core business even more efficient. So, continuing to develop that and stay ahead of our competition will be an area of focus. Obviously, I have led strategy and BD. And if I didn't think we have the right strategy and BD focus, I probably would have changed it before. So, I don't think investors would expect any significant change there.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

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Okay. Great. And then I did have to ask, in the most recent quarter probably the area where we got the most feedback was on Simparica Trio. And the timing there on as well as the – you quantifying, I guess, the potential impact in 2020. I guess what assumptions are you making within that $150 million contribution that you're expecting from Simparica Trio? What feedback have you received from FDA that led you to a – what some would consider a slight delay in the approval process although still ahead of the all-important kind of flea and tick season? And how you're thinking about sort of the rollout and commercialization of that product?

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

So, in terms of the $150 million, what led us to that number, there's additional information that we get as part of the ongoing discussions, having a better sense of what the label would be. Also, we indicated on the call that we do expect to get the puppy claim.

So, understanding that, also as we work internally to get a better sense of what our pricing might be as well, that enables us to then make the projections and also getting a better sense of the timing of the launch. So as we looked at that, looked at the markets that we know that we'll be in, assuming the approval in the US, subject to approval, of course, but also in Europe and Canada, building those models out, we do expect to get an incremental $150 million in sales from Simparica Trio on top of what we would have expected with Simparica alone.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And that's a net number, correct?

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

That is a net number.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay.

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

Yes.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And how should we think about the bundling opportunity? I think that's what is somewhat underappreciated. It's not just about that Simparica Trio number alone. It's what you can do in owning that mindshare across parasiticides at the vet clinic where you haven't necessarily been the leadership type of role. This is really the first time, I mean, since I've covered you that you've had that sort of new innovative offering across parasiticides which is one of the largest segments in companion animal. How can you leverage that to better bundle across your product portfolio?

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Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

So, we think we can continue to leverage that. I think if you look at the performance this year even without having Simparica Trio, by having Revolution Plus, by having full ProHeart 12, by having Abaxis, by having the dermatology portfolio, by having Simparica, we're seeing very strong growth in our core companion animal portfolio outside of those products that get a lot of attention.

So when you add Simparica Trio into that, it just strengthens the overall portfolio that we have from a companion animal perspective, and we really believe that we can serve all of the needs of our clients; they getting a good share of their shelf space but then also, to your point, being able to bundle in providing the right pricing opportunities as well.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And speaking about the channel and distribution, how do you anticipate – will it depend on sort of the label and positioning from a competitive standpoint how you're going to distribute this, whether it'll go through distribution or traditional channels or direct or through Chewy or 1-800-Petmeds?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

So, I mean, the way we do it today we plan to continue. So currently, today, Simparica is with distribution. But to be clear, we do our own direct demand generation as we've spoken of many times before. And we make the decision of whether or not we allow our product to be sold through distribution based on whether or not if we are the only player in the space for example, dermatology, there's really no reason to pay a third-party to do anything. But when you're in a highly competitive space such as parasiticides, we found that distribution can be very helpful to ensuring, A, you're not [ph] cross detailed (06:43), so if you're the one product they don't carry, they're more than happy to sell anything but yours but also just the added might behind that.

So, we have no intention with the launch of Simparica Trio of changing that. We've also made the decision recently on a channel perspective to sell to all channels and implement minimum advertised price or MAP pricing. This was a change for Zoetis. We didn't always sell to some of these e-commerce and retail channels. We did this to protect the veterinarians who was getting undercut by gray market activity in a movement. So, our role is – most of our products 99% go through the vet and require a prescription. So, our goal is to partner with the vet but make our products available wherever the pet owner wants. So, indeed, we will plan on providing Simparica Trio through the e-commerce, as well as the retail channels when it launches as well.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And do you anticipate or how long do you anticipate that you will be potentially the only one on the market in flea, tick and heartworm combination.

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

I so wish I knew the answer to that. As many of you know, we're in a space where a number – one of our biggest competitors is private and many are owned by large pharma. They don't need to disclose these things. So, there's not a lot of visibility into that. We have a sense that we'll be first. There's not a lot of chatter on the market.

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Certainly, we've got two big conferences coming up and we would probably have heard someone was launching ahead of us, but whether or not we have 6 months on our own, 12 months, 18 months, I wish I knew the answer to that. We will operate as if we're expecting somebody within six months and be very aggressive in trying to build shares as fast as we can. But the honest answer is we have no more information than you do probably on that.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. I tried.

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

We tried, too.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And then you spoke to the alternative channels, how do you manage that? How do you manage inventory and make sure there's not like a surplus of crates of Simparica and sitting at a Costco somewhere, or how do you make sure that you don't undermine your relationships with the veterinary clinic as well?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Sure. The goal to move to do a – to provide our products at all these retail channels and online channels was to protect the vet. Basically, what was happening was people are buying our product on promotion and then reselling to many of them, and they may have been breaking even at best, but at least they had it and they sold more other things if they could get the sale of an APOQUEL, etcetera. And this is really hurting the vet and the vets made that very clear to us. By selling to all retailers but requiring if they want access to our products that they sell at a minimum advertised price ensures there's at least some margin for both the retailers and e-commerce as well for the veterinarian. So, I think you know that is really important.

We can monitor the inventory. I mean, these are sophisticated players, and they have no desire to sit on excess inventory. So, I don't think there's a big fear. We can obviously track that by retailer. I mean, before you ask, I think my next set of question is, well, do you sell direct, or do you – I mean, we work with each retailer, however, they wish. So some, we actually are selling direct to. Some will be leveraging a distributor party. So, we have a pretty – we have a very good sense right now of what their inventories are. We'll have to monitor it. A lot of this is very new for us, so monitoring what their inventories do over time, but there was no significant stocking. Obviously in Q3, and our numbers we did shift a few new customers in a month but it wasn't material for us at least.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And then heading into next year you have a very good product launch obviously with Simparica Trio you'll be ramping up in terms of expenses associated with that. What does that all entail from a commercialization standpoint? And how the mix shift alone should be favorable on a consolidated margin basis but how is that offset by incremental expenses associated with that ramps in commercialization processes? So, how should we think about margin leverage [indiscernible] (10:24)?

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Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

I know that's where you're going with that question. So, in terms of looking at margin next year and I'll start with first with revenue, right. We talked about the fact that over time we expect the market to grow between 5%to 6% with new product innovation driving about 1% to 2% of that which Simparica Trio, as well as the growth with that we would expect to see from the continued ramp up of products such Revolution Plus and ProHeart 12. We would expect that 1% to 2% to be higher, right, so we would expect to outpace the market growth in 2020 again which sets a good base from a revenue perspective.

From a gross margin perspective companion animal continuing to grow faster than livestock is a benefit for us from a gross margin perspective. The one offset to that we had a very positive impact to foreign exchange this year within our gross margin, we do not expect that to repeat in 2020. And then as you look into the expense lines, we will have investments to support the new product launches. We want to make sure we set those products up for success, not just for 2020 but for 2021 and beyond. And then also some of the other initiatives that we spoke about in terms of reference labs with the acquisition of Phoenix and some other strategic initiatives. We'll make sure that we fund those as well. All that being said, our long-term value proposition of growing income faster than revenue, we still believe applies for 2020 as well without going into specific items.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Great. And then since you mentioned the lab, I'll go there. So, I think it wasn't too long ago that you emphasized at least to me that you were not interested in going into the US reference laboratory business or it wasn't quite as appealing to you at the time. It's somewhat of a duopolistic market that's split between kind of IDEXX and VCA. And can you speak to sort of what changed? Why did the rationale change and did you see more of an opportunity from a bundling perspective or from a data perspective to make that jump into the reference laboratory business?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Sure, I can start there.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

In the US I guess in particular. Yes.

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Yeah. And I can talk a little bit as well about ex-US, but as you look at that space, when we just acquired Abaxis, it was understanding how that would integrate with our portfolio. We certainly have proven that over the last year that we can leverage that with our core portfolio. But it also became clear that there was an opportunity to be even more relevant with our customers by adding reference labs. And the focus over the last year has been, could we do that to get scale, because if we didn't think we could be a meaningful third-party player that could have that scale, it wasn't really worth entering.

And it's taken us a while to build the [ph] models (12:50) and to create a game plan where we believe that we can be a significant third-party player. Our strategy, as you saw at the beginning of announcement with the acquisition

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of Phoenix is to invest in companies – reference lab companies that have significant share in given MSAs. And again, the Phoenix has more than 50% share in the market, to create a few of these hubs through inorganic acquisitions, and then to invest organically to build spokes around that to build a significant third-party player in the US over the next 3 to 5 years.

So that will be a mixture of small inorganic and organic. And this is the same strategy we're going to focus on in international. This is one thing where, it wasn't required. We felt that we can compete without it, but we can compete even better with it. It's a very attractive market. It grows at 10% plus, and we think from a customer perspective, they're looking for a third-party player. Right now, the two competitors require very long-term contracts that many customers find very onerous and they think they're looking for a more customer-friendly, flexible, easier to work with company. And we think very much that Zoetis can be that. And so, we are excited. We obviously didn't do Phoenix as a one-off. There is a significant plan behind that. But we do say it will take us, again, 3 to 5 years. And our goal isn't to just take the 10% share they don't have. Our goal is to be a significant player in the US and international.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

I mean it's not an easy business to get into. And we've seen actually Abaxis try to do it before. And obviously they didn't – they weren't able to scale that up kind of quick enough. I guess what is sort of the game plan from a pricing and bundling perspective? What are the prospects in terms of roping into therapeutic aspects and your relationships there to kind of win new business? Some of these are long-term contracts, like 3-year-to 5-year contracts on the reference laboratory side. How do you unwind those and how long – I mean this is going to be, I assume, a long-term story from a reference lab perspective?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Yeah. No. I think that's very well said. It is a long-term story. Really, only about 15% of contracts are up in any given year, and that is a reality. Sometimes if they're at the end, you can buy them out obviously. And certainly, that's what IDEXX, and ANTECH and Abaxis has done historically. I think what's different is we already have the field force and the customer relevance and presence that Abaxis did not. So, we're already in those.

We have significant relationships. We have a very broad portfolio. And we can leverage that broad portfolio to create more creative bundling opportunities for customers than they have today, to buy things they have to buy anyway, and to be flexible as their business changes over time as long as you commit X percentage of your pharmaceutical or your vaccine business to us over time, the share of wallet, we can make sure that you can get that without the six-year commitment to accelerate your expenses and diagnostics every year.

We just have a broader portfolio to be more flexible with. So I think we really believe our direct presence with customers, the trust they have with us is what makes us different than some of the smaller companies who not only had to figure out how to build the lab, but how to get to scale quickly. We think we have some large customers we can partner with to do this overall, so.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And how much does data come into play? How much does it matter to you knowing that canine flu outbreak in Northern California can help your sales reps? I think that that's part of the rationale as well. Is that longer term part of it?

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Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Sure. I mean, that wouldn't even just be longer term. That could actually be shorter term, to be honest with you. But there is a longer-term strategy back to what I was saying around data analytics being a core driver going forward. It's about building better products long term. It's about taking the dataset you get from diagnostics, mixing it potentially with genetics and being able to create a better solution for a veterinary customer.

So, for example, if you know that an animal coming in is predisposed to a given disease, you can make sure that a given diagnostic panel is given at every wellness visit and that, with that [ph] there (16:46), they should be tested for certain things, and then maybe adding one of our therapeutics with that. So, dermatology might be a good example, but there are many. We think there's a big opportunity to leverage they're talking across the continuum of care.

Our goal is in the future to launch products that are not single products, that they're – they have a companion diagnostic, a companion genetic test, things like that. So, we really believe it's giving our veterinary customers a complete solution for a different customer journey: a wellness visit, a sick dog visit, a dermatology visit. What is the companion diagnostic? What is the therapeutic? What is the preventative? What is nutritional. With Platinum Performance, we can also add nutritionals for dermatology or joint cases, et cetera so.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And on the core Abaxis business, can you give us an update on the integration there, the combined sales force efforts and bundling, as well as SAP implementation?

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

Yeah. So, from an integration perspective for Abaxis, we're on track with our integration. One of the key things that we had to focus on was building the field force internationally. Abaxis had diagnostic specialist in the US which we've been then able to leverage with our existing field force for our core portfolio.

In international, that diagnostic specialist field force did not exist. So, we've been able to hire those colleagues, have them trained and then, they're working hand-in-hand with the existing companion animal field force reps in the international markets.

From an SAP integration perspective, we expect to have that complete in the first-half of 2020. And that will enable us to fully leverage our portfolio and go even further with the bundling. We're doing that on smaller scale today. But once we have the system implementation complete, we'll be able to do that in a much more wholesome way.

So, we're progressing 2019 was a year of integration and a year of transition for us with Abaxis. Also making significant progress on connectivity which was a key area of focus for us in terms of improving what we got from Abaxis, we expect to have that complete towards the end of the year. So, a year of significant progress this year which we think will set us up for success as we move into 2020. And we do expect the Abaxis to grow faster than the overall portfolio in 2020.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

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Okay. Great. And then, switching gears a little bit or switching to species' group. So, let's talk a little bit about livestock, in the most recent quarter, it can take a little bit of a step back, but I mean, this is a testament to you. I guess the diversification across your portfolio that companion animal was so strong in the most recent quarter to offset that. But can you speak to fundamentals that you're seeing in the production animal business? I guess, particularly as it relates to hearing, I guess, the US around herd size, feed costs, cattle feed and other relevant variables. I guess, how should we think about current trends as well as heading into next year?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.
A

So, if you look at overall beef globally, there is growth in beef globally. The US however, has not exactly been the bright spot there. And we've been signaling this for a little while. If you look at the beef market in specific, we're seeing with the weather conditions we've had in the US this year, with wet weather and staying warm. They've kept more cattle out and not move them into feed yards. And when they have entered, they've entered heavier and older which means less use of our products overall.

But the broader trend is we've been on an up cycle in the beef side for a number of years. This is – it's a cyclical industry. You're going to see it flatten out. And we do think this year, you'll see the animal health market decline, and we're going to see the number of animals sort of flatten out this year into next year.

And with no increase in animals and a lack of innovation in the industry overall on the beef side, it puts increasing pressure on price which is why you've seen the market overall become a little negative. That, in very good weather conditions and low feed cost, if you look at the price of corn, etcetera, means that you're just – there's not a great opportunity to drive growth, which is why we're focused on innovation and leveraging across our portfolio.

So, we are expecting some innovative products coming to this market, but probably not for about two years. So, we are expecting continued pressure certainly on the beef side. As you look at dairy, there has been a ray of hope in the last month or so with increasing dairy prices although I did see one of our largest dairy customers out went bankrupt this morning, Dean Foods, as many of you probably already read. But overall, dairy, if this pricing continues, if you get a US-Mexico-Canada trade agreement, which will stabilize, at least from the trade perspective a little bit, the dairy market, the dairy market could come back.

But I think the – most of our customers need to see that happen for a longer period of time before they're willing to make some significant investments and expand. So, I think dairy has some potential next year, but we are expecting continued pressure on the beef side in the US. But to your point, with the diverse portfolio, the good news is our beef business in both Brazil and Mexico are growing and we are expecting them to do well next year.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC
Q

And how quickly can we see offsets in other markets related to the African Swine Fever in China?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.
A

Sure. If you look at this last year, we've lost about $50 million of our $100 million business in China. We are expecting that to level off next year, but there's still a significant need for protein to meet China's needs. We are looking at, if you look at the recent talk, and it's really hard to get too excited till they sign a deal, between the US and China, but they are expecting if they get that deal signed, significant increase in protein. Some of that is not

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just going to come from the pork side, where there's a limited capacity currently in the US from a producer perspective.

I think you're going to see the great announcement that many of you probably read about on the chicken side, where the US has not been able to export chicken to China given the so-called avian influenza which was more of a trade argument than anything else. They now have opened that market that we'll see increased. But I think the big winner on the pork side will likely be the EU and Brazil, but I do think you're going to see increased exports from some of those markets to meet the Chinese need, but not just in pork. We think you'll see it in poultry and potentially in beef as well, but there's a host of reasons why beef will probably be a little more challenging over the near term, but I do think you're going to see some offsets.

The challenge is there's just not a lot of capacity. What China's lost, as many of you know is more than the US produces in a year, and unless you're going to build barns and people think China is going to continue to want to outsource that, your encouragement to make those large investments is not high. So, I think you're going to see it spread a little bit more both by geography as well as by species.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And you mentioned we're a couple years out from further innovation across the livestock segment and it's rare that we hear you kind of talk about so much innovation across livestock in general. What does that entail? Is it focused on alternatives for antibiotics or other areas?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

There's a number of areas we're quite excited on. One is on the antibiotics alternative, so immunomodulators, so some of the technologies you've seen in the pet care space around monoclonal antibodies, moving those into immunomodulators on the cattle side is a significant opportunity.

If you look at other species even poultry, we just announced the launch or the approval of the first vector vaccine. This is going to be a franchise that we're very excited about entering. We have not been playing in this area. We, obviously, this is a small product, the first one. But as we launch combos, etcetera, we see significant innovation in the poultry side there. We are really excited also about precision livestock farming. That's a very nascent business. But if you look at the trends in the industry, the pressure on producer productivity, the pressure on labor, some of these precision livestock farming solutions provide really exciting opportunities.

I know Glenn's spoken a lot about moving diagnostics to livestock. Again, that's probably two years out. But bringing barn side, chute side diagnostics is also a significant opportunity, so looking at genetics. And then again as we talked about before, combining all those data sets together to provide even more integrated solutions is a big opportunity across diagnostics, genetics and precision livestock farming.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. That's great. And then speaking also to monoclonal antibodies, you have an upcoming pain product on the companion animal side in feline pain, which we've tracked as one of the most critical unmet needs in animal health today. How should we think about the market opportunity here? There's no real precedent here in terms of a comparable product. And then also can you speak to kind of the pain product on the monoclonal antibody side as well.

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Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

Yes. So, in the recent quarter, we also announced not just product for feline pain but also canine pain. So, we're excited about both. And when you look at the pain market for canine currently, it's about $400 million market. So that is significant opportunity for us from the canine perspective.

On the call, we talked about the fact that there's no real established market today for feline pain. But when you look at the overall category from a canine perspective of $400 million, understanding that the feline market will be smaller, there's less of medicalized cats. So, we would expect it to be somewhat smaller than the canine market. But again, it's a significant unmet need and we think there's significant opportunity for both products.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And would both be set for a 2021 commercial launch?

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

That is the intention.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And can you give an update on your partnership with Regeneron on that front. Does that undermine any of your efforts so far from a monoclonal antibodies perspective?

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

No. We don't believe it undermines at all. If anything, it just gives us additional technology to accelerate the development of our mAbs.

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

It's more around target identification the partnership with Regeneron, so it's very synergistic and it's early stage not late stage.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And how should we think about partnerships, licensing deals that kind of stuff as opposed to necessarily your own internal kind of R&D efforts. How do you kind of think about, how kind of animal health is evolving in terms of leveraging some of those relationships now that you're more nimble as kind of a standalone company?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Sure. I mean, what's exciting is, first of all, the success of our internal R&D. I mean, if you look at Simparica or Simparica Trio we will have the only sort of large parasiticides developed in-house in an animal health company.

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So, we've been very successful but as you've probably seen a number of the partnership opportunities as an independent animal health company that we are able to do.

First, obviously you mentioned Regeneron but more recently we've announced a few other ones. One with Texas A&M with regards to building the capability to do FMD in the United States both research and manufacturing that's really important. It's very hard to get some of these biosecure facilities in the US. The second one we announced about a month ago with Colorado State looking at alternatives to antibiotics in livestock.

So, I think we are very well-positioned to be the partner of choice whether it's in pet care, the biologic space, the livestock space. We do believe innovation is going to come from many different corners. So, we are really focused whether even if you look at African Swine Fever, we have some internal programs, as well as some partnerships that we've spoken about as well in the outside. So, it will always be a mix of the two. And the key is being the partner of choice and I think, if you're a company with a potential technology or therapeutic, and you want to leverage the possibility of that molecule or that technology, we think Zoetis is going to be one of your main players that you would want to speak to.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Great. And then, lastly here, in case there's any last-minute questions. The – on atopic dermatitis side, you've built an incredible franchise there, with the product portfolio. Can you speak to sort of how momentum could potentially continue there or how we should think about the competitive landscape, obviously, your competitors have obviously seen your success there, and how you think you're going to be positioned over the next three to five years in atopic derm?

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

A

Yeah. So, when you look at the growth of atopic derm, we've seen very strong growth continuing into 2019. Just the law of large numbers, would tell you that as we move forward. The percentage growth will probably be smaller as we move forward. But still, more opportunities so we still see opportunity within US to continue to expand the market, get some more of the acute cases as well and continue to switch people from steroids and get additional share that way. But we've have had significant penetration in the US.

We've also invested a lot more this year in our direct-to-consumer advertising to continue to bring people in to the vet clinics and that's provided a very strong return. Internationally, when you look at the sales of our dermatology products between US and international, it's about 75% US, 25% international. Yet, the number of medicalized dogs is about the same. So, we think there's opportunity to continue to educate and bring more customers into the clinic once they get greater awareness of dermatitis.

In the US, we have the luxury of being able to do direct-to-consumer advertising to bring more people in. Internationally, it's going to be a little slower leveraging our direct field force to bring more patients into the market, but we do see the opportunity for continued growth internationally.

From a competition perspective, we've created a very large market. We do expect that there are people out there working on competitive products, but we're very confident in the strength of our portfolio from both an efficacy and safety perspective and also having both APOQUEL and CYTOPOINT as a unique differentiator for us.

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Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Q

And then really quickly, just the changing landscape. We've seen a recent larger merger in this space. How does that impact you? Can you benefit from sales force defections, other commotion in the space?

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

A

Well, we'll certainly look to leverage any opportunity we can if there is disruption. We don't think it really actually fundamentally changes the competitive landscape at all. Those were both well-capitalized companies. What they bought is something that's more in the OTC space which we – in the sense of over-the-counter not where it's sold, but it doesn't require a prescription. So, we don't really see the deal significantly changing the competitive landscape.

Erin Wright
Analyst, Credit Suisse Securities (USA) LLC

Okay. Great. Thank you so much. Appreciate it.

Glenn C. David
Chief Financial Officer & Executive Vice President, Zoetis, Inc.

Thank you.

Kristin C. Peck
Director, Executive Vice President & Group President, U.S. Operations, Business Development & Strategy, Zoetis, Inc.

Thank you.

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