
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

**For the quarterly period ended
June 30, 2019**

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13
OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number: 001-35797

Zoetis Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

46-0696167

(I.R.S. Employer Identification No.)

10 Sylvan Way, Parsippany, New Jersey

(Address of principal executive offices)

07054

(Zip Code)

(973)-822-7000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	ZTS	New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ **Accelerated filer** ☐ **Non-accelerated filer** ☐ **Smaller reporting company** ☐ **Emerging growth company** ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

At August 2, 2019, there were 24,333,301 shares of common stock outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ZOETIS INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(MILLIONS OF DOLLARS AND SHARES, EXCEPT PER SHARE DATA)	2019	2018	2019	2018
Revenue	\$ 1,547	\$ 1,415	\$ 3,002	\$ 2,781
Costs and expenses:				
Cost of sales	465	447	983	894
Selling, general and administrative expenses	406	359	775	697
Research and development expenses	111	102	213	199
Amortization of intangible assets	39	23	77	46
Restructuring charges and certain acquisition-related costs	22	5	27	7
Interest expense, net of capitalized interest	55	46	111	93
Other (income)/deductions—net	(6)	(4)	(20)	(9)
Income before provision for taxes on income	455	437	836	854
Provision for taxes on income	84	55	153	122
Net income before allocation to noncontrolling interests	371	382	683	732
Less: Net loss attributable to noncontrolling interests	—	(2)	—	(4)
Net income attributable to Zoetis Inc.	\$ 371	\$ 384	\$ 683	\$ 736
Earnings per share attributable to Zoetis Inc. stockholders:				
Basic	\$ 0.77	\$ 0.79	\$ 1.43	\$ 1.52
Diluted	\$ 0.77	\$ 0.79	\$ 1.41	\$ 1.51
Weighted-average common shares outstanding:				
Basic	478.8	483.8	479.2	484.8
Diluted	482.3	487.5	482.7	488.6
Dividends declared per common share	\$ 0.164	\$ 0.126	\$ 0.328	\$ 0.252

See notes to condensed consolidated financial statements.

ZOETIS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Net income before allocation to noncontrolling interests	\$ 371	\$ 382	\$ 683	\$ 732
Other comprehensive income, net of taxes and reclassification adjustments:				
Unrealized losses on derivatives for cash flow hedges, net	1	—	1	—
Foreign currency translation adjustments, net	(72)	(115)	(41)	(38)
Total other comprehensive income, net of tax	(71)	(115)	(40)	(38)
Comprehensive income before allocation to noncontrolling interests	300	267	643	694
Less: Comprehensive loss attributable to noncontrolling interests	—	(3)	—	(4)
Comprehensive income attributable to Zoetis Inc.	\$ 300	\$ 270	\$ 643	\$ 698

See notes to condensed consolidated financial statements.

ZOETIS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2019	December 31, 2018
(MILLIONS OF DOLLARS, EXCEPT SHARE AND PER SHARE DATA)	(Unaudited)	
Assets		
Cash and cash equivalents ^(a)	\$ 1,755	\$ 1,602
Short term investments	25	99
Accounts receivable, less allowance for doubtful accounts of \$26 in 2019 and \$24 in 2018	994	1,036
Inventories	1,404	1,391
Other current assets	306	271
Total current assets	4,484	4,399
Property, plant and equipment, less accumulated depreciation of \$1,685 in 2019 and \$1,599 in 2018	1,739	1,658
Operating lease right of use assets	195	—
Goodwill	2,505	2,519
Identifiable intangible assets, less accumulated amortization	1,916	2,046
Noncurrent deferred tax assets	60	61
Other noncurrent assets	87	94
Total assets	\$ 10,986	\$ 10,777
Liabilities and Equity		
Short-term borrowings	\$ —	\$ 9
Accounts payable	290	313
Dividends payable	78	79
Accrued expenses	443	487
Accrued compensation and related items	178	266
Income taxes payable	31	35
Other current liabilities	55	34
Total current liabilities	1,075	1,223
Long-term debt, net of discount and issuance costs	6,446	6,443
Noncurrent deferred tax liabilities	446	474
Operating lease liabilities	169	—
Other taxes payable	251	265
Other noncurrent liabilities	188	187
Total liabilities	8,575	8,592
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, \$0.01 par value: 1,000,000,000 authorized, none issued	—	—
Common stock, \$0.01 par value: 6,000,000,000 authorized; 501,891,243 and 501,891,243 shares issued; 477,821,280 and 479,562,326 shares outstanding at June 30, 2019, and December 31, 2018, respectively	5	5
Treasury stock, at cost, 24,069,963 and 22,328,917 shares of common stock at June 30, 2019, and December 31, 2018, respectively	(1,732)	(1,487)
Additional paid-in capital	1,019	1,026
Retained earnings	3,788	3,270
Accumulated other comprehensive loss	(669)	(629)
Total equity	2,411	2,185
Total liabilities and equity	\$ 10,986	\$ 10,777

^(a) As of June 30, 2019, and December 31, 2018, includes \$4 million and \$5 million, respectively, of restricted cash.

ZOETIS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(UNAUDITED)

Three months ended June 30, 2019										
(MILLIONS OF DOLLARS AND SHARES)	Zoetis							Equity		Total Equity
	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Attributable to Noncontrolling Interests		
	Shares ^(a)	Amount	Shares ^(a)	Amount						
Balance, March 31, 2019	501.89	\$ 5	22.87	\$ (1,593)	\$ 1,008	\$ 3,495	\$ (598)	\$ —	\$ 2,317	
Net income	—	—	—	—	—	371	—	—	371	
Other comprehensive loss	—	—	—	—	—	—	(71)	—	(71)	
Share-based compensation awards	—	—	(0.24)	11	11	—	—	—	22	
Treasury stock acquired	—	—	1.44	(150)	—	—	—	—	(150)	
Dividends declared	—	—	—	—	—	(78)	—	—	(78)	
Balance, June 30, 2019	501.89	\$ 5	24.07	\$ (1,732)	\$ 1,019	\$ 3,788	\$ (669)	\$ —	\$ 2,411	
Three months ended June 30, 2018										
(MILLIONS OF DOLLARS AND SHARES)	Zoetis							Equity		Total Equity
	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Attributable to Noncontrolling Interests		
	Shares ^(a)	Amount	Shares ^(a)	Amount						
Balance, March 31, 2018	501.89	\$ 5	17.17	\$ (1,005)	\$ 990	\$ 2,399	\$ (429)	\$ 15	\$ 1,975	
Net income/(loss)	—	—	—	—	—	384	—	(2)	382	
Other comprehensive loss	—	—	—	—	—	—	(114)	(1)	(115)	
Share-based compensation awards	—	—	(0.12)	5	11	—	—	—	16	
Treasury stock acquired	—	—	2.55	(215)	—	—	—	—	(215)	
Dividends declared	—	—	—	—	—	(61)	—	—	(61)	
Balance, June 30, 2018	501.89	\$ 5	19.60	\$ (1,215)	\$ 1,001	\$ 2,722	\$ (543)	\$ 12	\$ 1,982	

^(a) Shares may not add due to rounding.

See notes to condensed consolidated financial statements.

ZOETIS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY - Continued
(UNAUDITED)

Six months ended June 30, 2019										
(MILLIONS OF DOLLARS AND SHARES)	Zoetis							Equity Attributable to Noncontrolling Interests	Total Equity	
	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss			
	Shares ^(a)	Amount	Shares ^(a)	Amount						
Balance, December 31, 2018	501.89	\$ 5	22.33	\$ (1,487)	\$ 1,026	\$ 3,270	\$ (629)	\$ —	\$ 2,185	
Net income	—	—	—	—	—	683	—	—	683	
Other comprehensive loss	—	—	—	—	—	—	(40)	—	(40)	
Share-based compensation awards	—	—	(1.38)	55	(8)	(8)	—	—	39	
Treasury stock acquired	—	—	3.12	(300)	—	—	—	—	(300)	
Employee benefit plan contribution from Pfizer Inc. ^(b)	—	—	—	—	1	—	—	—	1	
Dividends declared	—	—	—	—	—	(157)	—	—	(157)	
Balance, June 30, 2019	501.89	\$ 5	24.07	\$ (1,732)	\$ 1,019	\$ 3,788	\$ (669)	\$ —	\$ 2,411	
Six months ended June 30, 2018										
(MILLIONS OF DOLLARS AND SHARES)	Zoetis							Equity Attributable to Noncontrolling Interests	Total Equity	
	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss			
	Shares ^(a)	Amount	Shares ^(a)	Amount						
Balance, December 31, 2017	501.89	\$ 5	15.76	\$ (852)	\$ 1,013	\$ 2,109	\$ (505)	\$ 16	\$ 1,786	
Net income/(loss)	—	—	—	—	—	736	—	(4)	732	
Other comprehensive loss	—	—	—	—	—	—	(38)	—	(38)	
Share-based compensation awards	—	—	(1.11)	42	(13)	(1)	—	—	28	
Treasury stock acquired	—	—	4.95	(405)	—	—	—	—	(405)	
Employee benefit plan contribution from Pfizer Inc. ^(b)	—	—	—	—	1	—	—	—	1	
Dividends declared	—	—	—	—	—	(122)	—	—	(122)	
Balance, June 30, 2018	501.89	\$ 5	19.60	\$ (1,215)	\$ 1,001	\$ 2,722	\$ (543)	\$ 12	\$ 1,982	

^(a) Shares may not add due to rounding.

^(b) Represents contributed capital from Pfizer Inc. associated with service credit continuation for certain Zoetis Inc. employees in Pfizer Inc.'s U.S. qualified defined benefit and U.S. retiree medical plans.

ZOETIS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(MILLIONS OF DOLLARS)	Six Months Ended	
	June 30,	
	2019	2018
Operating Activities		
Net income before allocation to noncontrolling interests	\$ 683	\$ 732
Adjustments to reconcile net income before noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization expense	196	123
Share-based compensation expense	35	22
Asset write-offs and asset impairments	1	7
Provision for losses on inventory	29	25
Deferred taxes ^(a)	(22)	(155)
Employee benefit plan contribution from Pfizer Inc.	1	1
Other non-cash adjustments	—	11
Other changes in assets and liabilities, net of acquisitions and divestitures		
Accounts receivable	29	(9)
Inventories	(50)	(23)
Other assets	(35)	(63)
Accounts payable	(22)	(28)
Other liabilities	(119)	(75)
Other tax accounts, net ^(a)	(19)	88
Net cash provided by operating activities	707	656
Investing Activities		
Purchases of property, plant and equipment	(166)	(126)
Proceeds from maturities and redemptions of investments	76	—
Net proceeds from sales of assets	—	8
Other investing activities	8	(3)
Net cash used in investing activities	(82)	(121)
Financing Activities		
Decrease in short-term borrowings, net	(9)	—
Payment of contingent consideration related to previously acquired assets	(8)	(12)
Share-based compensation-related proceeds, net of taxes paid on withholding shares	5	6
Purchases of treasury stock	(300)	(405)
Cash dividends paid	(157)	(122)
Net cash used in financing activities	(469)	(533)
Effect of exchange-rate changes on cash and cash equivalents	(3)	(8)
Net increase in cash and cash equivalents	153	(6)
Cash and cash equivalents at beginning of period	1,602	1,564
Cash and cash equivalents at end of period	\$ 1,755	\$ 1,558
Supplemental cash flow information		
Cash paid during the period for:		
Income taxes	\$ 212	\$ 221
Interest, net of capitalized interest	123	96
Non-cash transactions:		
Capital expenditures	9	3
Dividends declared, not paid	78	61

^(a) For 2018, reflects the reclassification of the one-time mandatory deemed repatriation tax from *Noncurrent deferred tax liabilities* to *Income taxes payable* and *Other taxes payable* to properly reflect the liability, which became a fixed obligation in 2018 payable over eight years.

See notes to condensed consolidated financial statements.

ZOETIS INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Organization

Zoetis Inc. (including its subsidiaries, collectively, Zoetis, the company, we, us or our) is a global leader in the discovery, development, manufacture and commercialization of animal health medicines, vaccines and diagnostic products with a focus on both livestock and companion animals. We organize and operate our business in two geographic regions: the United States (U.S.) and International.

We directly market our products in approximately 45 countries across North America, Europe, Africa, Asia, Australia and South America. Our products are sold in more than 100 countries, including developed markets and emerging markets. We have a diversified business, marketing products across eight core species: cattle, swine, poultry, sheep and fish (collectively, livestock) and dogs, cats and horses (collectively, companion animals); and within six major product categories: anti-infectives, vaccines, parasiticides, medicated feed additives, animal health diagnostics and other pharmaceuticals.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements were prepared following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States of America (U.S. GAAP) can be condensed or omitted. Balance sheet amounts and operating results for subsidiaries operating outside the United States are as of and for the six-month periods ended May 31, 2019, and May 31, 2018.

Revenue, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be representative of those for the full year.

We are responsible for the unaudited condensed consolidated financial statements included in this Form 10-Q. The condensed consolidated financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results. The information included in this interim report should be read in conjunction with the financial statements and accompanying notes included in our 2018 Annual Report on Form 10-K.

3. Accounting Standards

Recently Adopted Accounting Standards

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02, *Income Statement - Reporting Comprehensive Income*, (Topic 220): *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* (ASU 2018-02), which permits companies to reclassify from accumulated other comprehensive income to retained earnings stranded tax effects resulting from the new federal corporate income tax rate. In the period of adoption, a company may choose to either apply the amendments retrospectively to each period in which the effect of the change in federal income tax rate is recognized or to apply the amendments in that reporting period. We adopted the new standard as of January 1, 2019, the required effective date. The company has elected to not reclassify the stranded income tax effects from accumulated other comprehensive income to retained earnings as the amount is insignificant.

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842), which supersedes FASB Topic 840, *Leases* (Topic 840) which requires lessees to recognize most leases on the balance sheet with a corresponding right of use asset. Leases will be classified as financing or operating which will drive the expense recognition pattern. For lessees, the income statement presentation and expense recognition pattern for financing and operating leases is similar to the current model for capital and operating leases, respectively. Companies may elect to exclude short-term leases. The update also requires additional disclosures that will better enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. We adopted the new standard as of January 1, 2019, the required effective date, using the effective date transition method. As permitted under the effective date transition method, financial information and disclosure for periods prior to the date of initial application will not be updated. An adjustment to opening retained earnings was not required in conjunction with our adoption. For additional information, see *Note 10. Leases*.

We have elected not to reassess whether expired or existing contracts contain leases, nor did we reassess the classification of existing leases as of the adoption date. We did not use hindsight in our assessment of lease terms as of the effective date.

Recently Issued Accounting Standards

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software* (Topic 350-40), an accounting standards update which expands the scope of costs associated with cloud computing arrangements that must be capitalized. Under the new guidance, costs associated with implementing a cloud computing arrangement that is a service contract must be capitalized and expensed over the term of the hosting arrangement. We will adopt this guidance as of January 1, 2020, the required effective date, and are currently assessing the potential impact that the standard will have on our consolidated financial statements.

4. Revenue

A. Revenue from Product Sales

We offer a diversified portfolio of products which allows us to capitalize on local and regional customer needs. Generally, our products are promoted to veterinarians and livestock producers by our sales organization which includes sales representatives and technical and veterinary operations specialists, and then sold directly by us or through distributors. The depth of our product portfolio enables us to address the varying needs of customers in different species and geographies. Many of our top selling product lines are distributed across both of our operating segments, leveraging our research and development (R&D) operations and manufacturing and supply chain network.

Over the course of our history, we have focused on developing a diverse portfolio of animal health products, including medicines, vaccines and diagnostics, complemented by biodevices, genetic tests and a range of services. We refer to a single product in all brands, or its dosage forms for all species, as a product line. We have approximately 300 comprehensive product lines, including products for both livestock and companion animals across each of our major product categories.

In the third quarter of 2018, the company modified the list of major product categories to include a category for animal health diagnostics, which was previously included within other non-pharmaceutical products. The prior period presentation has been revised to reflect the new product categories.

Our major product categories are:

- **vaccines:** biological preparations that help prevent diseases of the respiratory, gastrointestinal and reproductive tracts or induce a specific immune response;
- **other pharmaceutical products:** allergy and dermatology, pain and sedation, antiemetic, reproductive, and oncology products;
- **anti-infectives:** products that prevent, kill or slow the growth of bacteria, fungi or protozoa;
- **parasiticides:** products that prevent or eliminate external and internal parasites such as fleas, ticks and worms;
- **medicated feed additives:** products added to animal feed that provide medicines to livestock; and
- **animal health diagnostics:** portable blood and urine analysis systems and point-of-care diagnostic products, including instruments and reagents, rapid immunoassay tests, reference laboratory kits and blood glucose monitors.

Our remaining revenue is derived from other non-pharmaceutical product categories, such as nutritionals and agribusiness, as well as products and services in complementary areas, including biodevices and genetic tests.

Our livestock products primarily help prevent or treat diseases and conditions to enable the cost-effective production of safe, high-quality animal protein. Human population growth and increasing standards of living are important long-term growth drivers for our livestock products in three major ways. First, population growth and increasing standards of living drive increased demand for improved nutrition, particularly animal protein. Second, population growth leads to increased natural resource constraints driving a need for enhanced productivity. Finally, as standards of living improve, there is increased focus on food quality and safety.

Our companion animal products help extend and improve the quality of life for pets; increase convenience and compliance for pet owners; and help veterinarians improve the quality of their care and the efficiency of their businesses. Growth in the companion animal medicines, vaccines and diagnostics sector is driven by economic development, related increases in disposable income and increases in pet ownership and spending on pet care. Companion animals are also living longer, receiving increased medical treatment and benefiting from advances in animal health medicines and vaccines.

The following tables present our revenue disaggregated by geographic area, species, and major product category.

Revenue by geographic area

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
United States	\$ 780	\$ 677	\$ 1,498	\$ 1,311
Australia	49	51	97	99
Brazil	74	68	134	138
Canada	54	56	95	96
China	56	60	116	124
France	27	30	59	63
Germany	39	38	76	76
Italy	28	26	56	53
Japan	41	39	78	80
Mexico	30	26	58	50
Spain	30	30	57	55
United Kingdom	42	36	99	88
Other developed markets	88	89	172	168
Other emerging markets	184	179	363	364
	1,522	1,405	2,958	2,765
Contract manufacturing & human health diagnostics	25	10	44	16
Total Revenue	\$ 1,547	\$ 1,415	\$ 3,002	\$ 2,781

Revenue by major species

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
U.S.				
Livestock	\$ 280	\$ 271	\$ 553	\$ 563
Companion animal	500	406	945	748
	780	677	1,498	1,311
International				
Livestock	444	463	878	941
Companion animal	298	265	582	513
	742	728	1,460	1,454
Contract manufacturing & human health diagnostics	25	10	44	16
Total Revenue	\$ 1,547	\$ 1,415	\$ 3,002	\$ 2,781

Revenue by species

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Livestock:				
Cattle	\$ 379	\$ 396	\$ 759	\$ 812
Swine	158	165	307	340
Poultry	143	129	282	265
Fish	25	24	48	46
Other	19	20	35	41
	724	734	1,431	1,504
Companion Animal:				
Dogs and Cats	754	630	1,442	1,179
Horses	44	41	85	82
	798	671	1,527	1,261
Contract manufacturing & human health diagnostics	25	10	44	16
Total Revenue	\$ 1,547	\$ 1,415	\$ 3,002	\$ 2,781

Revenue by major product category

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Vaccines	\$ 370	\$ 371	\$ 728	\$ 727
Other pharmaceuticals	372	337	721	656
Anti-infectives	293	286	579	583
Parasiticides	266	245	497	436
Medicated feed additives	115	114	227	251
Animal health diagnostics	65	12	125	23
Other non-pharmaceuticals	41	40	81	89
	1,522	1,405	2,958	2,765
Contract manufacturing & human health diagnostics	25	10	44	16
Total Revenue	\$ 1,547	\$ 1,415	\$ 3,002	\$ 2,781

B. Revenue from Contracts with Customers

Contract liabilities reflected within *Other current liabilities* as of December 31, 2018 and December 31, 2017, and subsequently recognized as revenue during the first six months of 2019 and 2018 were approximately \$4 million and \$2 million, respectively. Contract liabilities as of June 30, 2019 and December 31, 2018 were approximately \$11 million and \$9 million, respectively.

Estimated future revenue expected to be generated from long-term contracts with unsatisfied performance obligations as of June 30, 2019 is not material.

5. Acquisitions and Divestitures

Acquisition of Abaxis, Inc.

On July 31, 2018, we completed the acquisition of Abaxis, Inc. (Abaxis), a California corporation and a leader in the development, manufacture and marketing of diagnostic instruments for veterinary point-of-care services. We acquired all of the outstanding common shares of Abaxis for \$83.00 per share in cash resulting in Abaxis becoming our wholly owned subsidiary. The acquisition enhances our presence in animal health diagnostics.

The acquisition date fair value of the consideration transferred was approximately \$1,962 million, which consisted of the following:

(MILLIONS OF DOLLARS)	Amounts
Cash paid to Abaxis' shareholders ^(a)	\$ 1,898
Cash paid for equity awards attributable to pre-merger services ^(b)	54
Fair value of Zoetis equity awards issued in exchange for outstanding Abaxis equity awards pertaining to pre-merger service ^(c)	10
Total consideration	\$ 1,962

^(a) Represents cash paid for cancellation and conversion of each outstanding share of Abaxis' common stock at the acquisition date.

^(b) Represents cash paid for cancellation and settlement of restricted stock awards that fully vested in July 2018 as a result of service or pre-existing change-in-control provisions and termination provisions. Includes certain awards that were settled in cash during the first quarter of 2019.

^(c) Represents the fair value of replacement awards issued for Abaxis equity awards outstanding immediately before the acquisition and attributable to the service period prior to the acquisition. The previous Abaxis equity awards were converted into the Zoetis equity awards at an exchange ratio based on the closing prices of shares of Zoetis common stock and Abaxis common stock for ten full trading days before the closing of the acquisition.

The acquisition has been accounted for as a business combination with the assets acquired and liabilities assumed measured at fair value as of the acquisition date, primarily using Level 3 inputs, except for investments in debt securities which were valued using Level 2 inputs.

During the six months ended June 30, 2019, the company recorded additional measurement period adjustments which were made to reflect the facts and circumstances in existence as of the acquisition date. These adjustments include a reduction to *Identifiable intangible assets* and *Noncurrent deferred tax liabilities* of \$1 million each with a corresponding offset to goodwill. These measurement period adjustments were primarily attributable to changes in preliminary valuation assumptions, including market participant estimates of cash flows as well as other initial estimates and the finalization of legal entity fair values. The valuation was finalized during the second quarter of 2019. The final fair values allocated to Abaxis' assets and liabilities as of the acquisition date, are reflected in the table below.

(MILLIONS OF DOLLARS)	Amounts
Cash and cash equivalents	\$ 64
Short term investments ^(a)	107
Accounts receivable ^(b)	30
Inventories ^(c)	79
Other current assets	6
Property, plant and equipment ^(d)	54
Identifiable intangible assets ^(e)	894
Other noncurrent assets	29
Accounts payable	(21)
Accrued compensation and related items	(10)
Other current liabilities	(22)
Other noncurrent liabilities	(11)
Noncurrent deferred tax liabilities ^(f)	(214)
Total net assets acquired	985
Goodwill ^(g)	977
Total consideration	\$ 1,962

^(a) Short term investments include investments in debt securities that are classified as available-for-sale and measured at fair value.

^(b) The fair value approximates the gross contractual amount of accounts receivable. The contractual amount not expected to be collected is immaterial.

^(c) Acquired inventory is comprised of finished goods, work in process and raw materials. The fair value of finished goods was determined based on net realizable value adjusted for the costs of the selling effort, a reasonable profit allowance for the selling effort, and estimated holding costs. The fair value of work in process was determined based on net realizable value adjusted for costs to complete the manufacturing process, costs of the selling effort, a reasonable profit allowance for the remaining manufacturing and selling effort, and an estimate of holding costs. The fair value of raw materials was determined to approximate book value.

^(d) Property, plant and equipment is comprised of machinery and equipment, furniture and fixtures, computer equipment, leasehold improvements and construction in progress. The fair value was primarily determined using a reproduction/replacement cost approach which measures the value of an asset by estimating the cost to acquire or construct comparable assets adjusted for age and condition of the asset.

^(e) Identifiable intangible assets primarily consist of developed technology rights, customer relationships, and trademarks and tradenames. The fair value of identifiable intangible assets is determined using the income approach, which includes a forecast of expected future cash flows. For additional information regarding identifiable intangible assets, see *Note 12. Goodwill and Other Intangible Assets*.

^(f) The acquisition was structured as a stock purchase and therefore we assumed the historical tax basis of Abaxis' assets and liabilities. The deferred tax effects resulting from the acquisition include the expected federal, state, and foreign tax consequences associated with temporary differences between the fair values of the assets acquired and liabilities assumed and the respective tax basis. The components of the Abaxis net deferred tax liability are included within amounts reported in *Note 8. Income Taxes*.

^(g) Goodwill represents the excess of consideration transferred over the fair values of the assets acquired and liabilities assumed. It is allocated to our existing reportable segments and is primarily attributable to the future potential of the technology platforms, as well as cost and revenue synergies including

market share capture, elimination of cost redundancies and gain of cost efficiencies, and intangible assets such as assembled workforce which are not separately recognizable. The primary strategic purpose of the acquisition was to enhance the company's existing product portfolio by strengthening Zoetis' presence in veterinary diagnostics. The goodwill recorded is not deductible for tax purposes.

The company incurred acquisition related costs of approximately \$22 million and \$27 million for the three and six months ended June 30, 2019, respectively, which are included within *Restructuring charges and certain acquisition-related costs* on our condensed consolidated statements of income.

Supplemental Pro Forma Information (Unaudited):

The following table provides unaudited supplemental pro forma financial information as if the acquisition of Abaxis had occurred on January 1, 2017.

	Three Months Ended		Six Months Ended	
(MILLIONS OF DOLLARS)	June 30, 2018		June 30, 2018	
Revenue	\$	1,483	\$	2,916
Net income attributable to Zoetis Inc.		353		676

The supplemental pro forma financial information has been prepared using the acquisition method of accounting and is based on the historical financial information of Zoetis and Abaxis. The supplemental pro forma financial information does not necessarily represent what the combined company's revenue or results of operations would have been had the acquisition been completed on January 1, 2017, nor do they intend to be a projection of future operating results of the combined company. It also does not reflect any operating efficiencies or potential cost savings that might be achieved from synergies of combining Zoetis and Abaxis.

The unaudited supplemental pro forma financial information reflects primarily the following pro forma adjustments:

- Additional amortization expense of \$31 million for the three months ended June 30, 2018 and \$64 million for the six months ended June 30, 2018, related to the fair value of identified intangible assets acquired.
- Additional depreciation expense of \$1 million for the three months ended June 30, 2018 and \$2 million for the six months ended June 30, 2018, related to the fair value adjustments to property, plant and equipment acquired.
- Additional interest expense and amortization of debt issuance costs for the debt issuance to finance the acquisition, resulting in \$14 million added for the three months ended June 30, 2018 and \$29 million added for the six months ended June 30, 2018.
- Adjustment related to the post merger share-based compensation expense of the replacement awards is \$2 million for the three months ended June 30, 2018 and \$5 million for the six months ended June 30, 2018.
- Applicable tax impact of the above adjustments based on the statutory tax rates in the various jurisdictions where the adjustments are expected to be incurred.

6. Restructuring Charges and Other Costs Associated with Acquisitions, Cost-Reduction and Productivity Initiatives

In connection with our cost-reduction/productivity initiatives, we typically incur costs and charges associated with site closings and other facility rationalization actions, workforce reductions and the expansion of shared services, including the development of global systems. In connection with our acquisition activity, we typically incur costs and charges associated with executing the transactions, integrating the acquired operations, which may include expenditures for consulting and the integration of systems and processes, product transfers and restructuring the consolidated company, which may include charges related to employees, assets and activities that will not continue in the consolidated company. All operating functions can be impacted by these actions, including sales and marketing, manufacturing and R&D, as well as functions such as business technology, shared services and corporate operations.

During 2015, we launched a comprehensive operational efficiency program and a supply network strategy initiative. These initiatives focused on reducing complexity in our product portfolios, changing our selling approach in certain markets, reducing our presence in certain countries, and selling certain manufacturing sites over a long term period. As part of these initiatives, we reduced certain positions through divestitures, normal attrition and involuntary terminations.

The components of costs incurred in connection with restructuring initiatives, acquisitions and cost-reduction/productivity initiatives are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Restructuring charges and certain acquisition-related costs:				
Integration costs ^(a)	\$ 8	\$ —	\$ 9	\$ 1
Restructuring charges ^{(b)(c)} :				
Employee termination costs	14	4	18	5
Exit costs	—	1	—	1
Total Restructuring charges and certain acquisition-related costs	\$ 22	\$ 5	\$ 27	\$ 7

^(a) Integration costs represent external, incremental costs directly related to integrating acquired businesses and primarily include expenditures for consulting and the integration of systems and processes, as well as product transfer costs.

^(b) The restructuring charges for the three and six months ended June 30, 2019 primarily relate to the acquisition of Abaxis.

The restructuring charges for the three and six months ended June 30, 2018 primarily relate to employee termination costs in Europe as a result of initiatives to better align our organizational structure and employee termination costs and exit costs as a result of our operational efficiency initiative and supply network strategy initiative.

^(c) The restructuring charges are associated with the following:

- For the three months ended June 30, 2019, Manufacturing/research/corporate of \$14 million.
- For the three months ended June 30, 2018, International of \$4 million and Manufacturing/research/corporate of \$1 million.
- For the six months ended June 30, 2019, Manufacturing/research/corporate of \$18 million.
- For the six months ended June 30, 2018, International of \$4 million and Manufacturing/research/corporate of \$2 million.

The components of, and changes in, our restructuring accruals are as follows:

(MILLIONS OF DOLLARS)	Accrual ^(a)
Balance, December 31, 2018 ^(b)	\$ 45
Provision	18
Utilization and other^(c)	(25)
Balance, June 30, 2019^(b)	\$ 38

^(a) Changes in our restructuring accrual represents employee termination costs.

^(b) At June 30, 2019, and December 31, 2018, included in *Accrued expenses* (\$12 million and \$27 million, respectively) and *Other noncurrent liabilities* (\$26 million and \$18 million, respectively).

^(c) Includes adjustments for foreign currency translation.

7. Other (Income)/Deductions—Net

The components of *Other (income)/deductions—net* are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Royalty-related income	\$ (3)	\$ (6)	\$ (8)	\$ (13)
Interest income	(9)	(8)	(19)	(14)
Foreign currency loss ^(a)	7	9	7	17
Other, net	(1)	1	—	1
Other (income)/deductions—net	\$ (6)	\$ (4)	\$ (20)	\$ (9)

^(a) Primarily driven by costs related to hedging and exposures to certain emerging market currencies.

8. Income Taxes

A. Taxes on Income

Our effective tax rate was 18.5% for the three months ended June 30, 2019, compared with 12.6% for the three months ended June 30, 2018. The higher effective tax rate for the three months ended June 30, 2019, was primarily attributable to:

- a \$33 million net discrete tax benefit recorded in the second quarter of 2018, associated with a measurement-period adjustment related to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings pursuant to the Tax Cuts and Jobs Act (the Tax Act) enacted on December 22, 2017;
- the impact of the global intangible low taxed income (GILTI) tax, a new provision of the Tax Act, which became effective for the company in the first quarter of 2019; and
- changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings from operations and repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and operating fluctuations in the normal course of business and the impact of non-deductible items,

partially offset by:

- an \$8 million net discrete tax benefit recorded in the second quarter of 2019; and
- a \$2 million and \$1 million discrete tax benefit recorded in the second quarter of 2019 and 2018, respectively, related to the excess tax benefits for share-based payments.

Our effective tax rate was 18.3% for the six months ended June 30, 2019, compared with 14.3% for the six months ended June 30, 2018. The higher effective tax rate for the six months ended June 30, 2019, was primarily attributable to:

- a \$35 million net discrete tax benefit recorded in the first half of 2018, associated with a measurement-period adjustment related to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings pursuant to the Tax Act enacted on December 22, 2017;
- the impact of the GILTI tax, a new provision of the Tax Act, which became effective for the company in the first quarter of 2019;
- changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings from operations and repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and operating fluctuations in the normal course of business and the impact of non-deductible items; and
- a \$4 million and \$8 million discrete tax benefit recorded in the first half of 2019 and 2018, respectively, related to a remeasurement of deferred taxes as a result of a change in non-U.S. statutory tax rates,

partially offset by:

- a \$16 million net discrete tax benefit recorded in the first half of 2019; and
- a \$15 million and \$8 million discrete tax benefit recorded in the first half of 2019 and 2018, respectively, related to the excess tax benefits for share-based payments.

B. Deferred Taxes

As of June 30, 2019, the total net deferred income tax liability of \$386 million is included in *Noncurrent deferred tax assets* (\$60 million) and *Noncurrent deferred tax liabilities* (\$446 million).

As of December 31, 2018, the total net deferred income tax liability of \$413 million is included in *Noncurrent deferred tax assets* (\$61 million) and *Noncurrent deferred tax liabilities* (\$474 million).

C. Tax Contingencies

As of June 30, 2019, the tax liabilities associated with uncertain tax positions of \$177 million (exclusive of interest and penalties related to uncertain tax positions of \$11 million) are included in *Noncurrent deferred tax assets* (\$3 million) and *Other taxes payable* (\$174 million).

As of December 31, 2018, the tax liabilities associated with uncertain tax positions of \$185 million (exclusive of interest and penalties related to uncertain tax positions of \$11 million) are included in *Noncurrent deferred tax assets* (\$3 million) and *Other taxes payable* (\$182 million).

Our tax liabilities for uncertain tax positions relate primarily to issues common among multinational corporations. Any settlements or statute of limitations expirations could result in a significant decrease in our uncertain tax positions. Substantially all of these unrecognized tax benefits, if recognized, would impact our effective income tax rate. We do not expect that within the next twelve months any of our uncertain tax positions could significantly decrease as a result of settlements with taxing authorities or the expiration of the statutes of limitations. Our assessments are based on estimates and assumptions that have been deemed reasonable by management, but our estimates of uncertain tax positions and potential tax benefits may not be representative of actual outcomes, and any variation from such estimates could materially affect our financial statements in the period of settlement or when the statutes of limitations expire, as we treat these events as discrete items in the period of resolution. Finalizing audits with the relevant taxing authorities can include formal administrative and legal proceedings, and, as a result, it is difficult to estimate the timing and range of possible changes related to our uncertain tax positions, and such changes could be significant.

9. Financial Instruments

A. Debt

Credit Facilities

In December 2016, we entered into an amended and restated revolving credit agreement with a syndicate of banks providing for a multi-year \$1.0 billion senior unsecured revolving credit facility (the credit facility). In December 2018, the maturity for the amended and restated revolving credit agreement was extended through December 2023. Subject to certain conditions, we have the right to increase the credit facility to up to \$1.5 billion. The credit facility contains a financial covenant requiring us to not exceed a maximum total leverage ratio (the ratio of consolidated net debt as of the end of the period to consolidated Earnings Before Interest, Income Taxes, Depreciation and Amortization (EBITDA) for such period) of 3.50:1. Upon entering into a material acquisition, the maximum total leverage ratio increases to 4.00:1, and extends until the fourth full consecutive fiscal quarter ended immediately following the consummation of a material acquisition. The credit facility also contains a clause which adds back to Adjusted Consolidated EBITDA, any operational efficiency restructuring charge (defined as charges recorded by the company during the period commencing on October 1, 2016 and ending December 31, 2019, related to operational efficiency initiatives), provided that for any twelve-month period such charges added back to Adjusted Consolidated EBITDA shall not exceed \$100 million in the aggregate.

The credit facility also contains a financial covenant requiring that we maintain a minimum interest coverage ratio (the ratio of EBITDA at the end of the period to interest expense for such period) of 3.50:1. In addition, the credit facility contains other customary covenants.

We were in compliance with all financial covenants as of June 30, 2019, and December 31, 2018. There were no amounts drawn under the credit facility as of June 30, 2019, or December 31, 2018.

We have additional lines of credit and other credit arrangements with a group of banks and other financial intermediaries for general corporate purposes. We maintain cash and cash equivalent balances in excess of our outstanding short-term borrowings. As of June 30, 2019, we had access to \$73 million of lines of credit which expire at various times through 2019 and are generally renewed annually. There were no borrowings outstanding related to these facilities as of June 30, 2019 and \$9 million of borrowings outstanding related to these facilities as of December 31, 2018.

Commercial Paper Program

In February 2013, we entered into a commercial paper program with a capacity of up to \$1.0 billion. As of June 30, 2019, and December 31, 2018, there was no commercial paper outstanding under this program.

Senior Notes and Other Long-Term Debt

On August 20, 2018, we issued \$1.5 billion aggregate principal amount of our senior notes (2018 senior notes), with an original issue discount of \$4 million. These notes are comprised of \$300 million aggregate principal amount of floating rate senior notes due 2021 (the "2018 floating rate senior notes"), and \$300 million aggregate principal amount of 3.250% senior notes due 2021, \$500 million aggregate principal amount of 3.900% senior notes due 2028 and \$400 million aggregate principal amount of 4.450% senior notes due 2048 (collectively, the "2018 fixed rate senior notes"). Net proceeds from this offering were partially used to pay down and terminate a revolving credit agreement and repay outstanding commercial paper, which were borrowed to finance a portion of the cash consideration for the acquisition of Abaxis (see *Note 5. Acquisitions and Divestitures*). The remainder of the net proceeds will be used for general corporate purposes.

On September 12, 2017, we issued \$1.25 billion aggregate principal amount of our senior notes (2017 senior notes), with an original issue discount of \$7 million. These notes are comprised of \$750 million aggregate principal amount of 3.000% senior notes due 2027 and \$500 million aggregate principal amount of 3.950% senior notes due 2047. Net proceeds from this offering were partially used in October 2017 to repay, prior to maturity, the aggregate principal amount of \$750 million, and a make-whole amount and accrued interest of \$4 million, of our 1.875% senior notes due 2018. The remainder of the net proceeds were used for general corporate purposes.

On November 13, 2015, we issued \$1.25 billion aggregate principal amount of our senior notes (2015 senior notes), with an original issue discount of \$2 million. On January 28, 2013, we issued \$3.65 billion aggregate principal amount of our senior notes (the 2013 senior notes offering) in a private placement, with an original issue discount of \$10 million.

The 2013, 2015, 2017 and 2018 senior notes are governed by an indenture and supplemental indenture (collectively, the indenture) between us and Deutsche Bank Trust Company Americas, as trustee. The indenture contains certain covenants, including limitations on our and certain of our subsidiaries' ability to incur liens or engage in sale-leaseback transactions. The indenture also contains restrictions on our ability to consolidate, merge or sell substantially all of our assets. In addition, the indenture contains other customary terms, including certain events of default, upon the occurrence of which the 2013, 2015, 2017 and 2018 senior notes may be declared immediately due and payable.

Pursuant to the indenture, we are able to redeem the 2013, 2015 and 2017 senior notes and the 2018 fixed rate senior notes or any series, in whole or in part, at any time by paying a "make whole" premium, plus accrued and unpaid interest to, but excluding, the date of redemption. The 2018 floating rate senior notes are not redeemable at our option prior to their maturity date. Pursuant to our tax matters agreement with Pfizer, we will not be permitted to redeem the 2013 senior notes due 2023 pursuant to this optional redemption provision, except under limited circumstances. Upon the occurrence of a change of control of us and a downgrade of the 2013, 2015, 2017 and 2018 senior notes below an investment grade rating by each of Moody's Investors Service, Inc. and Standard & Poor's Ratings Services, we are, in certain circumstances, required to make an offer to repurchase all of the outstanding 2013, 2015, 2017 and 2018 senior notes at a price equal to 101% of the aggregate principal amount of the 2013, 2015, 2017 and 2018 senior notes together with accrued and unpaid interest to, but excluding, the date of repurchase.

The components of our long-term debt are as follows:

(MILLIONS OF DOLLARS)	June 30, 2019	December 31, 2018
3.450% 2015 senior notes due 2020	\$ 500	\$ 500
2018 floating rate (three-month USD LIBOR plus 0.44%) senior notes due 2021	300	300
3.250% 2018 senior notes due 2021	300	300
3.250% 2013 senior notes due 2023	1,350	1,350
4.500% 2015 senior notes due 2025	750	750
3.000% 2017 senior notes due 2027	750	750
3.900% 2018 senior notes due 2028	500	500
4.700% 2013 senior notes due 2043	1,150	1,150
3.950% 2017 senior notes due 2047	500	500
4.450% 2018 senior notes due 2048	400	400
	6,500	6,500
Unamortized debt discount / debt issuance costs	(54)	(57)
<i>Long-term debt, net of discount and issuance costs</i>	<i>\$ 6,446</i>	<i>\$ 6,443</i>

The fair value of our long-term debt was \$6,940 million and \$6,474 million as of June 30, 2019, and December 31, 2018, respectively, and has been determined using a third-party matrix-pricing model that uses significant inputs derived from, or corroborated by, observable market data and Zoetis' credit rating (Level 2 inputs).

The principal amount of long-term debt outstanding, as of June 30, 2019, matures in the following years:

(MILLIONS OF DOLLARS)	2020	2021	2022	2023	After 2023	Total
Maturities	\$ 500	\$ 600	\$ —	\$ 1,350	\$ 4,050	\$ 6,500

Interest Expense

Interest expense, net of capitalized interest, was \$55 million and \$111 million, for the three and six months ended June 30, 2019, respectively and \$46 million and \$93 million for the three and six months ended June 30, 2018, respectively. Capitalized interest expense was \$6 million and \$3 million for the three and six months ended June 30, 2019, respectively and \$2 million and \$4 million for the three and six months ended June 30, 2018, respectively.

B. Investments

As part of the acquisition of Abaxis, we acquired short and long-term investments in debt securities (see *Note 5. Acquisitions and Divestitures*). These investments are classified as available-for-sale securities and, therefore, are measured at fair value at each reporting date. The changes in fair value are recognized in *Accumulated other comprehensive income/(loss)*. We utilized Level 2 inputs such as observable quoted prices for similar assets and liabilities in active markets and observable quoted prices for identical or similar assets in markets that are not very active.

The investment securities portfolio consists of debt securities that are investment grade. Information on investments in the debt securities, including the contractual maturities, or as necessary, the estimated maturities, of the available-for-sale securities is as follows:

(MILLIONS OF DOLLARS)	Gross Unrealized							
	As of June 30, 2019				As of December 31, 2018			
	Amortized Cost	Gains	Losses	Fair Value	Amortized Cost	Gains	Losses	Fair Value
Available-for-sale debt securities								
Municipal Bonds	\$ 1	\$ —	\$ —	\$ 1	\$ 1	\$ —	\$ —	\$ 1
Corporate Bonds	24	—	—	24	100	—	—	100
Total debt securities	\$ 25	\$ —	\$ —	\$ 25	\$ 101	\$ —	\$ —	\$ 101

(MILLIONS OF DOLLARS)	Maturities by Period ^(a)							
	As of June 30, 2019				As of December 31, 2018			
	Within 1 year	Over 1 to 5 years	Over 5 years	Total	Within 1 year	Over 1 to 5 years	Over 5 years	Total
Available-for-sale debt securities								
Municipal Bonds	\$ 1	\$ —	\$ —	\$ 1	\$ 1	\$ —	\$ —	\$ 1
Corporate Bonds	24	—	—	24	98	2	—	100
Total debt securities	\$ 25	\$ —	\$ —	\$ 25	\$ 99	\$ 2	\$ —	\$ 101

^(a) Long term investments are included in *Other noncurrent assets*.

C. Derivative Financial Instruments

Foreign Exchange Risk

A significant portion of our revenue, earnings and net investment in foreign affiliates is exposed to changes in foreign exchange rates. We seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities. Depending on market conditions, foreign exchange risk is also managed through the use of various derivative financial instruments. These derivative financial instruments serve to manage the exposure of our net investment in certain foreign operations to changes in foreign exchange rates and protect net income against the impact of translation into U.S. dollars of certain foreign exchange-denominated transactions.

All derivative financial instruments used to manage foreign currency risk are measured at fair value and are reported as assets or liabilities on the condensed consolidated balance sheet. The derivative financial instruments primarily offset exposures in the Australian dollar, British pound, Canadian dollar, Chinese yuan, euro, and Japanese yen. Changes in fair value are reported in earnings or in *Accumulated other comprehensive income/(loss)*, depending on the nature and purpose of the financial instrument, as follows:

- For foreign exchange contracts not designated as hedging instruments, we recognize the gains and losses on forward-exchange contracts that are used to offset the same foreign currency assets or liabilities immediately into earnings along with the earnings impact of the items they generally offset. These contracts essentially take the opposite currency position of that reflected in the month-end balance sheet to counterbalance the effect of any currency movement. The aggregate notional amount of foreign exchange derivative financial instruments offsetting foreign currency exposures was \$1.2 billion and \$1.3 billion, as of June 30, 2019, and December 31, 2018, respectively. The vast majority of the foreign exchange derivative financial instruments mature within 60 days and all mature within three years.
- For cross-currency interest rate swaps, which are designated as a hedge against our net investment in foreign operations, changes in the fair value are recorded as a component of cumulative translation adjustment within *Accumulated other comprehensive loss* and reclassified into earnings when the foreign investment is sold or substantially liquidated. Gains and losses excluded from the assessment of hedge effectiveness are recognized in earnings (*Interest expense—net of capitalized interest*). The cash flows from these contracts are reflected within the investing section of our *condensed consolidated statement of cash flows*. The aggregate notional amount of cross-currency interest rate swap contracts was 507 million euro and 25 million swiss francs as of June 30, 2019, and 400 million euro as of December 31, 2018, with various terms of up to six years.

Interest Rate Risk

The company may use interest rate swap contracts on certain investing and borrowing transactions to manage its net exposure to interest rates and to reduce its overall cost of borrowing. In anticipation of issuing fixed-rate debt, we may use forward-starting interest rate swaps that are designated as cash flow hedges to hedge against changes in interest rates that could impact expected future issuances of debt. Unrealized gains or losses on the forward-starting interest rate swaps are reported in *Accumulated other comprehensive loss* and are recognized in earnings over the life of the future fixed-rate notes. When the company discontinues hedge accounting because it is no longer probable that an anticipated transaction will occur within the originally expected period of execution, or within an additional two-month period thereafter, changes to fair value accumulated in other comprehensive income are recognized immediately in earnings.

There were no outstanding interest rate swap contracts as of June 30, 2019 and December 31, 2018.

Fair Value of Derivative Instruments

The classification and fair values of derivative instruments are as follows:

		Fair Value of Derivatives	
		June 30, 2019	December 31, 2018
(MILLIONS OF DOLLARS)	Balance Sheet Location		
Derivatives Not Designated as Hedging Instruments			
Foreign currency forward-exchange contracts	Other current assets	\$ 9	\$ 6
Foreign currency forward-exchange contracts	Other current liabilities	(6)	(7)
Total derivatives not designated as hedging instruments		\$ 3	\$ (1)
Derivatives Designated as Hedging Instruments:			
Cross-currency interest rate swap contracts	Other current assets	\$ 3	\$ 3
Cross-currency interest rate swap contracts	Other current liabilities	(2)	—
Cross-currency interest rate swap contracts	Other non-current assets	14	8
Total derivatives designated as hedging instruments		15	11
Total derivatives		\$ 18	\$ 10

The company's cross-currency interest rate swaps are subject to master netting arrangements to mitigate credit risk by permitting net settlement of transactions with the same counterparty. We may also enter into collateral security arrangements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds. At June 30, 2019, there was \$8 million of collateral received related to the long-term cross-currency interest rate swaps.

We use a market approach in valuing financial instruments on a recurring basis. Our derivative financial instruments are measured at fair value on a recurring basis using Level 2 inputs in the calculation of fair value.

The amounts of net gains on derivative instruments not designated as hedging instruments, recorded in *Other (income)/deductions—net*, are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Foreign currency forward-exchange contracts	\$ 8	\$ 10	\$ 4	\$ —

These amounts were substantially offset in *Other (income)/deductions—net* by the effect of changing exchange rates on the underlying foreign currency exposures.

The amounts of unrecognized net gains on cross-currency interest rate swap contracts, recorded, net of tax, in *Accumulated other comprehensive income/(loss)*, are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Cross-currency interest rate swap contracts	\$ (4)	\$ 1	\$ 14	\$ 1

Gains on cross-currency interest rate swap contracts, recognized within *Interest expense, net of capitalized interest*, are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Cross-currency interest rate swap contracts	\$ 4	\$ 1	\$ 8	\$ 1

The net amount of deferred gains related to derivative instruments designated as cash flow hedges that is expected to be reclassified from *Accumulated other comprehensive loss* into earnings over the next 12 months is insignificant.

10. Leases

We have facilities, vehicles and equipment under various non-cancellable operating leases with third parties. These leases generally have remaining terms ranging from one to 15 years, inclusive of renewal options that are reasonably certain of exercise.

Supplemental information for operating leases is as follows:

(MILLIONS OF DOLLARS, EXCEPT LEASE TERM AND DISCOUNT RATE AMOUNTS)	As of June 30, 2019
Supplemental Balance Sheet information for operating leases	
Operating lease right of use assets	\$ 195
Operating lease liabilities	
Operating lease liabilities - current	\$ 36
Operating lease liabilities - noncurrent	169
Total operating lease liabilities	\$ 205
Weighted-average remaining lease term—operating leases (years)	7.37
Weighted-average discount rate—operating leases	3.75%

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Supplemental Income Statement information for operating leases		
Operating lease expense	\$ 10	\$ 19
Variable lease payments not included in the measurement of lease liabilities	4	8
Short-term lease payments not included in the measurement of lease liabilities	3	6
Supplemental Cash Flow information for operating leases		
Cash paid for amounts included in the measurement of lease liabilities	\$ 10	\$ 19
Lease obligations obtained in exchange for right-of-use assets (non-cash)	47	223

Future minimum lease payments under non-cancellable operating lease contracts as of June 30, 2019, are as follows:

(MILLIONS OF DOLLARS)	2019 ^(a)	2020	2021	2022	2023	After 2023	Total Lease Payments	Less: Imputed Interest	Total
Maturities	\$ 22	\$ 40	\$ 34	\$ 30	\$ 25	\$ 85	\$ 236	\$ (31)	\$ 205

^(a) 2019 excludes the six months ended June 30, 2019.

Future minimum lease payments under non-cancellable operating lease contracts as of December 31, 2018, in accordance with the superceded leasing standard, are as follows:

(MILLIONS OF DOLLARS)	2019	2020	2021	2022	2023	After 2023	Total
Maturities	\$ 38	\$ 30	\$ 24	\$ 21	\$ 15	\$ 45	\$ 173

Total rent expense, net of sublease rental income, in accordance with the superceded leasing standard, was approximately \$45 million in 2018.

Lease Accounting Policy

Below are the significant accounting policies updated as of January 1, 2019, as a result of the adoption of the new lease accounting guidance. For additional information, see *Note 3. Accounting Standards*.

We determine if a contract contains a lease at inception. Our current portfolio includes only operating leases which are recorded as a right of use asset, as of the lease commencement date, in an amount equal to the present value of future payments over the lease term. We have elected not to recognize right of use assets and lease liabilities for short-term leases of vehicles and equipment with a lease term of twelve months or less.

Options to extend or terminate a lease are considered in the lease term to the extent that the option is reasonably certain of exercise. A corresponding lease liability is recorded within *other current liabilities* and *operating lease liabilities*. The present value of future payments is discounted using the rate implicit in the lease, when available. When the implicit rate is not available, as is frequently the case with our lease portfolio, the present value is calculated using our incremental borrowing rate, as determined as of the commencement date. The incremental borrowing rate represents the rate of interest that we would expect to pay on a collateralized basis to borrow an amount equal to the lease

payments under similar terms. As we do not borrow on a collateralized basis, our non-collateralized borrowing rate is used as an input in deriving the incremental borrowing rate.

Fixed lease payments are recognized on straight-line basis over the lease term, while variable payments are recognized in the period incurred. Variable lease payments include real estate taxes and charges for other nonlease services due to lessors that are not dependent on an index or rate and utilization based charges associated with fleet vehicles.

Our real estate and fleet lease contracts may include fixed consideration attributable to both lease and non-lease components, including non-lease services provided by the vendor, which are accounted for as a single fixed minimum payment. For leases of certain classes of machinery and equipment, contract consideration is allocated to lease and non-lease components on the basis of relative standalone price.

11. Inventories

The components of inventory are as follows:

(MILLIONS OF DOLLARS)	June 30, 2019	December 31, 2018
Finished goods	\$ 684	\$ 744
Work-in-process	527	481
Raw materials and supplies	193	166
<i>Inventories</i>	<i>\$ 1,404</i>	<i>\$ 1,391</i>

12. Goodwill and Other Intangible Assets

A. Goodwill

The components of, and changes in, the carrying amount of goodwill are as follows:

(MILLIONS OF DOLLARS)	U.S.	International	Total
Balance, December 31, 2018	\$ 1,265	\$ 1,254	\$ 2,519
Other ^(a)	—	(14)	(14)
Balance, June 30, 2019	\$ 1,265	\$ 1,240	\$ 2,505

^(a) Includes measurement period adjustments related to the acquisition of Abaxis and adjustments for foreign currency translation.

The gross goodwill balance was \$3,041 million and \$3,055 million as of June 30, 2019, and December 31, 2018, respectively. Accumulated goodwill impairment losses were \$536 million as of June 30, 2019, and December 31, 2018.

B. Other Intangible Assets

The components of identifiable intangible assets are as follows:

(MILLIONS OF DOLLARS)	As of June 30, 2019			As of December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Identifiable Intangible Assets Less Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Identifiable Intangible Assets Less Accumulated Amortization
Finite-lived intangible assets:						
Developed technology rights ^(a)	\$ 1,887	\$ (590)	\$ 1,297	\$ 1,854	\$ (523)	\$ 1,331
Brands	212	(160)	52	212	(154)	58
Trademarks and trade names ^(a)	166	(54)	112	166	(51)	115
Other	410	(213)	197	412	(178)	234
Total finite-lived intangible assets	2,675	(1,017)	1,658	2,644	(906)	1,738
Indefinite-lived intangible assets:						
In-process research and development	147	—	147	197	—	197
Brands	37	—	37	37	—	37
Trademarks and trade names	67	—	67	67	—	67
Product rights	7	—	7	7	—	7
Total indefinite-lived intangible assets	258	—	258	308	—	308
Identifiable intangible assets	\$ 2,933	\$ (1,017)	\$ 1,916	\$ 2,952	\$ (906)	\$ 2,046

^(a) In connection with the acquisition of Abaxis in 2018, the company recorded \$894 million of intangible assets, as shown in the table below, representing the fair value at the acquisition date. See *Note 5. Acquisitions and Divestitures* for additional information.

(MILLIONS OF DOLLARS)	Gross Carrying Amount	Weighted-average Life (years)
Finite-lived intangible assets:		
Developed technology rights	\$ 610	10
Trademarks and tradenames	104	20
Other	180	4
Total	\$ 894	

C. Amortization

Amortization expense related to finite-lived acquired intangible assets that contribute to our ability to sell, manufacture, research, market and distribute products, compounds and intellectual property is included in *Amortization of intangible assets* as it benefits multiple business functions. Amortization expense related to finite-lived acquired intangible assets that are associated with a single function is included in *Cost of sales, Selling, general and administrative expenses* or *Research and development expenses*, as appropriate. Total amortization expense for finite-lived intangible assets was \$58 million and \$116 million for the three and six months ended June 30, 2019, respectively, and \$26 million and \$51 million for the three and six months ended June 30, 2018, respectively.

13. Share-based Payments

The company may grant a variety of share-based payments under the Zoetis 2013 Equity and Incentive Plan (the Equity Plan) to our employees and non-employee directors. The principal types of share-based awards available under the Equity Plan may include, but are not limited to, stock options, restricted stock and restricted stock units (RSUs), deferred stock units (DSUs), performance-vesting restricted stock units (PSUs) and other equity-based or cash-based awards.

The components of share-based compensation expense are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Stock options / stock appreciation rights	\$ 2	\$ 3	\$ 5	\$ 5
RSUs / DSUs ^{(a)(b)}	12	6	24	13
PSUs	3	2	6	4
Share-based compensation expense—total ^(c)	\$ 17	\$ 11	\$ 35	\$ 22

- (a) For the three and six months ended June 30, 2019, includes share-based compensation expense of \$4 million and \$9 million, respectively related to the acquisition of Abaxis, for the post-merger service period. For additional details, see *Note 5. Acquisitions and Divestitures*.
- (b) Includes additional share-based compensation expense as a result of accelerated vesting of outstanding RSUs of terminated employees in connection with the acquisition of Abaxis, for the three and six months ended June 30, 2019, of approximately \$2 million and \$4 million, respectively, which is included in *Restructuring charges and certain acquisition-related costs*.
- (c) Amounts capitalized to inventory were \$1 million for both the three and six months ended June 30, 2019 and insignificant for both the three and six months ended June 30, 2018.

During the six months ended June 30, 2019, the company granted 444,789 stock options with a weighted-average exercise price of \$87.77 per stock option and a weighted-average fair value of \$21.82 per stock option. The fair-value based method for valuing each Zoetis stock option grant on the grant date uses the Black-Scholes-Merton option-pricing model, which incorporates a number of valuation assumptions. The weighted-average fair value was estimated based on the following assumptions: risk-free interest rate of 2.57%; expected dividend yield of 0.75%; expected stock price volatility of 23.08%; and expected term of 5.7 years. In general, stock options vest after three years of continuous service and the values determined through this fair-value based method generally are amortized on a straight-line basis over the vesting term into *Cost of sales, Selling, general and administrative expenses, or Research and development expenses*, as appropriate.

During the six months ended June 30, 2019, the company granted 358,999 RSUs, with a weighted-average grant date fair value of \$87.63 per RSU. RSUs are accounted for using a fair-value-based method that utilizes the closing price of Zoetis common stock on the date of grant. In general, RSUs vest after three years of continuous service from the grant date and the values generally are amortized on a straight-line basis over the vesting term into *Cost of sales, Selling, general and administrative expenses, or Research and development expenses*, as appropriate.

During the six months ended June 30, 2019, the company granted 190,170 PSUs with a weighted-average grant date fair value of \$101.51 per PSU. PSUs are accounted for using a Monte Carlo simulation model. The units underlying the PSUs will be earned and vested over a three-year performance period, based upon the total shareholder return of the company in comparison to the total shareholder return of the companies comprising the S&P 500 stock market index at the start of the performance period, excluding companies that during the performance period are acquired or no longer publicly traded (Relative TSR). The weighted-average fair value was estimated based on volatility assumptions of Zoetis common stock and an average of the S&P 500 companies, which were 20.3% and 25.3%, respectively. Depending on the company's Relative TSR performance at the end of the performance period, the recipient may earn from 0% to 200% of the target number of units. Vested units are settled in shares of the company's common stock. PSU values are amortized on a straight-line basis over the vesting term into *Cost of sales, Selling, general and administrative expenses, or Research and development expenses*, as appropriate.

14. Stockholders' Equity

Zoetis is authorized to issue 6 billion shares of common stock and 1 billion shares of preferred stock.

In December 2016, the company's Board of Directors authorized a \$1.5 billion share repurchase program. As of June 30, 2019, there was approximately \$1 million remaining under this authorization. In December 2018, the company's Board of Directors authorized an additional \$2.0 billion share repurchase program, all of which is remaining under this authorization. Purchases of Zoetis shares may be made at the discretion of management, depending on market conditions and business needs.

Accumulated other comprehensive income/(loss)

Changes, net of tax, in accumulated other comprehensive loss, excluding noncontrolling interests, were as follows:

(MILLIONS OF DOLLARS)	Cash Flow Hedges	Currency Translation Adjustments		Benefit Plans	Accumulated Other Comprehensive (Loss)/Income
		Net Investment Hedges	Other Currency Translation Adj		
Balance, December 31, 2017	\$ (3)	\$ —	\$ (487)	\$ (15)	\$ (505)
Other comprehensive income, net of tax	—	—	(38)	—	(38)
Balance, June 30, 2018	\$ (3)	\$ —	\$ (525)	\$ (15)	\$ (543)
Balance, December 31, 2018	\$ (4)	\$ 10	\$ (621)	\$ (14)	\$ (629)
Other comprehensive income, net of tax	1	4	(45)	—	(40)
Balance, June 30, 2019	\$ (3)	\$ 14	\$ (666)	\$ (14)	\$ (669)

15. Earnings per Share

The following table presents the calculation of basic and diluted earnings per share:

(MILLIONS OF DOLLARS AND SHARES, EXCEPT PER SHARE DATA)	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Numerator				
Net income before allocation to noncontrolling interests	\$ 371	\$ 382	\$ 683	\$ 732
Less: Net loss attributable to noncontrolling interests	—	(2)	—	(4)
Net income attributable to Zoetis Inc.	\$ 371	\$ 384	\$ 683	\$ 736
Denominator				
Weighted-average common shares outstanding	478.8	483.8	479.2	484.8
Common stock equivalents: stock options, RSUs, PSUs and DSUs	3.5	3.7	3.5	3.8
Weighted-average common and potential dilutive shares outstanding	482.3	487.5	482.7	488.6
Earnings per share attributable to Zoetis Inc. stockholders—basic	\$ 0.77	\$ 0.79	\$ 1.43	\$ 1.52
Earnings per share attributable to Zoetis Inc. stockholders—diluted	\$ 0.77	\$ 0.79	\$ 1.41	\$ 1.51

The number of stock options outstanding under the company's Equity Plan that were excluded from the computation of diluted earnings per share, as the effect would have been antidilutive, were de minimis and \$1 million for the three months ended June 30, 2019 and June 30, 2018, respectively and de minimis for the six months ended June 30, 2019 and June 30, 2018, respectively.

16. Commitments and Contingencies

We and certain of our subsidiaries are subject to numerous contingencies arising in the ordinary course of business. For a discussion of our tax contingencies, see *Note 8. Income Taxes*.

A. Legal Proceedings

Our non-tax contingencies include, among others, the following:

- Product liability and other product-related litigation, which can include injury, consumer, off-label promotion, antitrust and breach of contract claims.
- Commercial and other matters, which can include product-pricing claims and environmental claims and proceedings.
- Patent litigation, which typically involves challenges to the coverage and/or validity of our patents or those of third parties on various products or processes.
- Government investigations, which can involve regulation by national, state and local government agencies in the United States and in other countries.

Certain of these contingencies could result in losses, including damages, fines and/or civil penalties, and/or criminal charges, which could be substantial.

We believe that we have strong defenses in these types of matters, but litigation is inherently unpredictable and excessive verdicts do occur. We do not believe that any of these matters will have a material adverse effect on our financial position. However, we could incur judgments, enter into settlements or revise our expectations regarding the outcome of certain matters, and such developments could have a material adverse effect on our results of operations or cash flows in the period in which the amounts are paid.

We have accrued for losses that are both probable and reasonably estimable. Substantially all of these contingencies are subject to significant uncertainties and, therefore, determining the likelihood of a loss and/or the measurement of any loss can be complex. Consequently, we are unable to estimate the range of reasonably possible loss in excess of amounts accrued. Our assessments are based on estimates and assumptions that have been deemed reasonable by management, but the assessment process relies on estimates and assumptions that may prove to be incomplete or inaccurate, and unanticipated events and circumstances may occur that might cause us to change those estimates and assumptions.

Amounts recorded for legal and environmental contingencies can result from a complex series of judgments about future events and uncertainties and can rely on estimates and assumptions.

The principal matters to which we are a party are discussed below. In determining whether a pending matter is significant for financial reporting and disclosure purposes, we consider both quantitative and qualitative factors in order to assess materiality, such as, among other things, the amount of damages and the nature of any other relief sought in the proceeding, if such damages and other relief are specified; our view of the merits of the claims and of the strength of our defenses; whether the action purports to be a class action and our view of the likelihood that a class will be certified by the court; the jurisdiction in which the proceeding is pending; any experience that we or, to our

knowledge, other companies have had in similar proceedings; whether disclosure of the action would be important to a reader of our financial statements, including whether disclosure might change a reader's judgment about our financial statements in light of all of the information about the company that is available to the reader; the potential impact of the proceeding on our reputation; and the extent of public interest in the matter. In addition, with respect to patent matters, we consider, among other things, the financial significance of the product protected by the patent.

Ulianopolis, Brazil

In February 2012, the Municipality of Ulianopolis (State of Para, Brazil) filed a complaint against Fort Dodge Saúde Animal Ltda. (FDSAL), a Zoetis entity, and five other large companies alleging that waste sent to a local waste incineration facility for destruction, but that was not ultimately destroyed as the facility lost its operating permit, caused environmental impacts requiring cleanup.

The Municipality is seeking recovery of cleanup costs purportedly related to FDSAL's share of all waste accumulated at the incineration facility awaiting destruction, and compensatory damages to be allocated among the six defendants. We believe we have strong arguments against the claim, including defense strategies against any claim of joint and several liability.

At the request of the Municipal prosecutor, in April 2012, the lawsuit was suspended for one year. Since that time, the prosecutor has initiated investigations into the Municipality's actions in the matter as well as the efforts undertaken by the six defendants to remove and dispose of their individual waste from the incineration facility. On October 3, 2014, the Municipal prosecutor announced that the investigation remained ongoing and outlined the terms of a proposed Term of Reference (a document that establishes the minimum elements to be addressed in the preparation of an Environmental Impact Assessment), under which the companies would be liable to withdraw the waste and remediate the area. On March 5, 2015, we presented our response to the prosecutor's proposed Term of Reference, arguing that the proposed terms were overly general in nature and expressing our interest in discussing alternatives to address the matter. The prosecutor agreed to consider our request to engage a technical consultant to conduct an environmental diagnostic of the contaminated area. On May 29, 2015, we, in conjunction with the other defendant companies, submitted a draft cooperation agreement to the prosecutor, which outlined the proposed terms and conditions for the engagement of a technical consultant to conduct the environmental diagnostic. On August 19, 2016, the parties and the prosecutor agreed to engage the services of a third-party consultant to conduct a limited environmental assessment of the site. The site assessment was conducted during June 2017, and a written report summarizing the results of the assessment was provided to the parties and the prosecutor in November 2017. The report noted that waste is still present on the site and that further (Phase II) environmental assessments are needed before a plan to manage that remaining waste can be prepared. On April 1, 2019, the defendants met with the Prosecutor to discuss the conclusions set forth in the written report. Following that discussion, on April 10, 2019, the Prosecutor issued a procedural order requesting that the defendants prepare and submit a technical proposal outlining the steps needed to conduct the additional Phase II environmental assessments. The defendants will present the technical proposal to the Prosecutor in August 2019.

Lascadoil Contamination in Animal Feed

An investigation by the U.S. Food and Drug Administration (FDA) and the Michigan Department of Agriculture is ongoing to determine how lascadoil, oil for industrial use, made its way into the feed supply of certain turkey and hog feed mills in Michigan. The contaminated feed is believed to have caused the deaths of approximately 50,000 turkeys and the contamination (but not death) of at least 20,000 hogs in August 2014. While it remains an open question as to how the lascadoil made its way into the animal feed, the allegations are that lascadoil intended to be sold for reuse as biofuel was inadvertently sold to producers of soy oil, who in turn, unknowingly sold the contaminated soy oil to fat recycling vendors, who then sold the contaminated soy oil to feed mills for use in animal feed. Indeed, related to the FDA investigation, Shur-Green Farms LLC, a producer of soy oil, recalled certain batches of soy oil allegedly contaminated with lascadoil on October 13, 2014.

During the course of its investigation, the FDA identified the process used to manufacture Zoetis' Avatec® (lasalocid sodium) and Bovatec® (lasalocid sodium) products as one possible source of the lascadoil, since lascadoil contains small amounts of lasalocid, the active ingredient found in both products. Zoetis has historically sold any and all industrial lascadoil byproduct to an environmental company specializing in waste disposal. The environmental company is contractually obligated to incinerate the lascadoil or resell it for use in biofuel. Under the terms of the agreement, the environmental company is expressly prohibited from reselling the lascadoil to be used as a component in food. The FDA inspected the Zoetis site where Avatec and Bovatec are manufactured, and found no evidence that Zoetis was involved in the contamination of the animal feed.

On March 10, 2015, plaintiffs Restaurant Recycling, LLC (Restaurant Recycling) and Superior Feed Ingredients, LLC (Superior), both of whom are in the fat recycling business, filed a complaint in the Seventeenth Circuit Court for the State of Michigan against Shur-Green Farms alleging negligence and breach of warranty claims arising from their purchase of soy oil allegedly contaminated with lascadoil. Plaintiffs resold the allegedly contaminated soy oil to turkey feed mills for use in feed ingredient. Plaintiffs also named Zoetis as a defendant in the complaint alleging that Zoetis failed to properly manufacture its products and breached an implied warranty that the soy oil was fit for use at turkey and hog mills. Zoetis was served with the complaint on June 3, 2015, and we filed our answer, denying all allegations, on July 15, 2015. On August 10, 2015, several of the turkey feed mills filed a joint complaint against Restaurant Recycling, Superior, Shur-Green Farms and others, alleging claims for negligence, misrepresentation, and breach of warranty, arising out of their alleged purchase and use of the contaminated soy oil. The complaint raises only one count against Zoetis for negligence. We filed an answer to the complaint on November 2, 2015, denying the allegation. On May 16, 2016, two additional turkey producers filed a complaint in the Seventeenth Circuit Court for the State of Michigan against the company, Restaurant Recycling, Superior, Shur-Green Farms and others, alleging claims for negligence and breach of warranties. We filed an answer to the complaint on June 20, 2016, denying the allegations. The Court has consolidated all three cases in Michigan for purposes of discovery and disposition. On July 28, 2017, we filed a motion for summary disposition on the grounds that no genuine issues of material fact exist and that Zoetis is entitled to judgment as a matter of law. On October 19, 2017, the Court granted our motion and dismissed all claims against Zoetis. On October 31, 2017, the plaintiffs filed motions for reconsideration of the Court's decision granting summary disposition. The Court, denied all such motions on December 6, 2017, for the same reasons cited in the Court's original decision. On December

27, 2017, the plaintiffs filed a request with the Michigan Court of Appeals seeking an interlocutory (or interim) appeal of the lower Court's decision, which we opposed on January 17, 2018. On July 5, 2018, the Court of Appeals denied the plaintiffs' request for an interlocutory appeal. The case has been remanded back to the lower Court, where it will proceed to trial (unless settled) without Zoetis. The plaintiffs will have the option to seek an appeal of the lower Court's decision granting Zoetis' motion for summary disposition after the final adjudication of the case.

Other Matters

On February 14, 2019, the General Court of the European Union (General Court) annulled the January 11, 2016 decision of the European Commission (EC) that selective tax advantages granted by Belgium under its "excess profit" tax scheme constitute illegal state aid. On April 26, 2019, the EC announced that it will appeal the decision of the General Court. Due to the uncertainty with respect to the outcome of the appeal to be filed by the EC, the company has not reflected any potential benefits associated with the decision of the General Court in its consolidated financial statements as of June 30, 2019. We will continue to monitor the developments of the appeal and its ultimate resolution.

The European Commission published a decision on alleged competition law infringements by several human health pharmaceutical companies on June 19, 2013. One of the involved legal entities is Alpharma LLC (previously having the name Zoetis Products LLC). Alpharma LLC's involvement is solely related to its human health activities prior to Pfizer's acquisition of King/Alpharma. Zoetis paid a fine in the amount of Euro 11 million (approximately \$14 million) and was reimbursed in full by Pfizer in accordance with the Global Separation Agreement between Pfizer and Zoetis, which provides that Pfizer is obligated to indemnify Zoetis for any liabilities arising out of claims not related to its animal health assets. We filed an appeal of the decision on September 6, 2013, to the General Court of the European Union. On September 8, 2016, the General Court upheld the decision of the European Commission. On November 25, 2016, we filed an appeal to the Court of Justice of the European Union. On January 24, 2019, the Court heard oral argument on the merits of the appeal, and we now await the Court's decision.

B. Guarantees and Indemnifications

In the ordinary course of business and in connection with the sale of assets and businesses, we indemnify our counterparties against certain liabilities that may arise in connection with the transaction or related to activities prior to the transaction. These indemnifications typically pertain to environmental, tax, employee and/or product-related matters and patent-infringement claims. If the indemnified party were to make a successful claim pursuant to the terms of the indemnification, we would be required to reimburse the loss. These indemnifications are generally subject to threshold amounts, specified claim periods and other restrictions and limitations. Historically, we have not paid significant amounts under these provisions and, as of June 30, 2019, recorded amounts for the estimated fair value of these indemnifications were not significant.

17. Segment Information

Operating Segments

We manage our operations through two geographic operating segments: the United States and International. Each operating segment has responsibility for its commercial activities. Within each of these operating segments, we offer a diversified product portfolio, including vaccines, parasiticides, anti-infectives, medicated feed additives, animal health diagnostics and other pharmaceuticals, for both livestock and companion animal customers. Our chief operating decision maker uses the revenue and earnings of the two operating segments, among other factors, for performance evaluation and resource allocation.

Other Costs and Business Activities

Certain costs are not allocated to our operating segment results, such as costs associated with the following:

- *Other business activities*, includes our Client Supply Services (CSS) contract manufacturing results, our human health diagnostics business, and expenses associated with our dedicated veterinary medicine research and development organization, research alliances, U.S. regulatory affairs and other operations focused on the development of our products. Other R&D-related costs associated with non-U.S. market and regulatory activities are generally included in the international commercial segment.
- *Corporate*, includes platform functions such as business technology, facilities, legal, finance, human resources, business development, and communications, among others. These costs also include compensation costs and other miscellaneous operating expenses not charged to our operating segments, as well as interest income and expense.
- Certain transactions and events such as (i) *Purchase accounting adjustments*, where we incur expenses associated with the amortization of fair value adjustments to inventory, intangible assets and property, plant and equipment; (ii) *Acquisition-related activities*, where we incur costs associated with acquiring and integrating newly acquired businesses, such as transaction costs and integration costs; and (iii) *Certain significant items*, which comprise substantive, unusual items that, either as a result of their nature or size, would not be expected to occur as part of our normal business on a regular basis, such as certain costs related to becoming an independent public company, restructuring charges and implementation costs associated with our cost-reduction/productivity initiatives that are not associated with an acquisition, certain asset impairment charges, certain legal and commercial settlements and the impact of divestiture-related gains and losses.
- *Other unallocated* includes (i) certain overhead expenses associated with our global manufacturing operations not charged to our operating segments; (ii) certain costs associated with business technology and finance that specifically support our global manufacturing operations; (iii) certain supply chain and global logistics costs; and (iv) procurement costs.

Segment Assets

We manage our assets on a total company basis, not by operating segment. Therefore, our chief operating decision maker does not regularly review any asset information by operating segment and, accordingly, we do not report asset information by operating segment.

(MILLIONS OF DOLLARS)	Earnings		Depreciation and Amortization ^(a)	
	Three Months Ended		Three Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
U.S.				
Revenue	\$ 780	\$ 677		
Cost of sales	158	140		
Gross profit	622	537		
Gross margin	79.7%	79.3%		
Operating expenses	127	116		
Other (income)/deductions	—	—		
U.S. Earnings	495	421	\$ 9	\$ 8
International				
Revenue ^(b)	742	728		
Cost of sales	218	229		
Gross profit	524	499		
Gross margin	70.6%	68.5%		
Operating expenses	146	147		
Other (income)/deductions	—	2		
International Earnings	378	350	12	12
Total operating segments	873	771	21	20
Other business activities	(79)	(82)	6	6
Reconciling Items:				
Corporate	(178)	(139)	16	14
Purchase accounting adjustments	(58)	(23)	55	22
Acquisition-related costs	(22)	—	—	—
Certain significant items ^(c)	(3)	(7)	—	—
Other unallocated	(78)	(83)	—	1
Total Earnings^(d)	\$ 455	\$ 437	\$ 98	\$ 63

^(a) Certain production facilities are shared. Depreciation and amortization is allocated to the reportable operating segments based on estimates of where the benefits of the related assets are realized.

^(b) Revenue denominated in euros was \$184 million and \$191 million for the three months ended June 30, 2019, and June 30, 2018, respectively.

^(c) For the three months ended June 30, 2019, primarily represents product transfer costs and consulting fees related to our supply network strategy.

For the three months ended June 30, 2018 primarily represents: (i) employee termination costs of \$1 million related to our operational efficiency initiative, (ii) consulting fees and exit costs of \$3 million related to our supply network strategy, and (iii) employee termination costs of \$3 million in Europe as a result of initiatives to better align our organization structure.

^(d) Defined as income before provision for taxes on income.

(MILLIONS OF DOLLARS)	Earnings		Depreciation and Amortization ^(a)	
	Six Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
U.S.				
Revenue	\$ 1,498	\$ 1,311		
Cost of sales	305	280		
Gross profit	1,193	1,031		
Gross margin	79.6%	78.6%		
Operating expenses	237	212		
Other (income)/deductions	—	—		
U.S. Earnings	956	819	\$ 19	\$ 16
International				
Revenue ^(b)	1,460	1,454		
Cost of sales	428	463		
Gross profit	1,032	991		
Gross margin	70.7%	68.2%		
Operating expenses	278	280		
Other (income)/deductions	—	3		
International Earnings	754	708	25	23
Total operating segments	1,710	1,527	44	39
Other business activities	(159)	(163)	11	11
Reconciling Items:				
Corporate	(340)	(292)	30	27
Purchase accounting adjustments	(124)	(46)	110	45
Acquisition-related costs	(27)	(1)	—	—
Certain significant items ^(c)	(73)	(10)	—	—
Other unallocated	(151)	(161)	1	1
Total Earnings^(d)	\$ 836	\$ 854	\$ 196	\$ 123

^(a) Certain production facilities are shared. Depreciation and amortization is allocated to the reportable operating segments based on estimates of where the benefits of the related assets are realized.

^(b) Revenue denominated in euros was \$365 million and \$375 million for the six months ended June 30, 2019, and June 30, 2018, respectively.

^(c) For the six months ended June 30, 2019, primarily represents a change in estimate related to inventory costing of \$68 million, and product transfer costs and consulting fees of \$5 million related to our supply network strategy.

For the six months ended June 30, 2018, primarily represents: (i) employee termination costs of \$1 million related to our operational efficiency initiative, (ii) consulting fees, employee termination costs and exit costs of \$5 million related to our supply network strategy, and (iii) employee termination costs of \$3 million in Europe as a result of initiatives to better align our organization structure, and (iv) a charge of \$1 million related to the implementation of new accounting guidance as a result of the enactment of the Tax Act.

^(d) Defined as income before provision for taxes on income.

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
Zoetis Inc.:

Results of Review of Interim Financial Information

We have reviewed the condensed consolidated balance sheet of Zoetis Inc. and subsidiaries (the Company) as of June 30, 2019, the related condensed consolidated statements of income, comprehensive income, equity for the three-month and six-month periods ended June 30, 2019 and June 30, 2018, the related condensed consolidated statements of cash flows for the six-month periods ended June 30, 2019 and June 30, 2018 and the related notes (collectively, the consolidated interim financial information). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial information for it to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of December 31, 2018, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated February 14, 2019, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2018, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

This consolidated interim financial information is the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our reviews in accordance with the standards of the PCAOB. A review of consolidated interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/ KPMG LLP
Short Hills, New Jersey
August 6, 2019

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview of our business

We are a global leader in the discovery, development, manufacture and commercialization of animal health medicines, vaccines, and diagnostic products with a focus on both livestock and companion animals. For more than 65 years, we have been committed to enhancing the health of animals and bringing solutions to our customers who raise and care for them.

We manage our operations through two geographic operating segments: the United States (U.S.) and International. Within each of these operating segments, we offer a diversified product portfolio for both livestock and companion animal customers in order to capitalize on local and regional trends and customer needs. See Notes to Condensed Consolidated Financial Statements — *Note 17. Segment Information*.

We directly market our products to veterinarians and livestock producers located in approximately 45 countries in developed and emerging markets across North America, Europe, Africa, Asia, Australia and South America, and are a market leader in nearly all of the major regions in which we operate. In markets where we do not have a direct commercial presence, we generally contract with distributors that provide logistics and sales and marketing support for our products.

We believe our investments in one of the industry's largest sales organizations, including our extensive network of technical and veterinary operations specialists, our high-quality manufacturing and reliability of supply, and our long track record of developing products that meet customer needs, has led to enduring and valued relationships with our customers. Our research and development (R&D) efforts enable us to deliver innovative products to address unmet needs and evolve our product lines so they remain relevant for our customers.

A summary of our 2019 performance compared with the comparable 2018 period follows:

(MILLIONS OF DOLLARS)	Three Months Ended June 30,		% Change		
			Related to		
	2019	2018	Total	Foreign Exchange	Operational ^(a)
Revenue	\$ 1,547	\$ 1,415	9	(5)	14
Net income attributable to Zoetis	371	384	(3)	—	(3)
Adjusted net income ^(a)	436	375	16	(1)	17

(MILLIONS OF DOLLARS)	Six Months Ended June 30,		% Change		
			Related to		
	2019	2018	Total	Foreign Exchange	Operational ^(a)
Revenue	\$ 3,002	\$ 2,781	8	(4)	12
Net income attributable to Zoetis	683	736	(7)	(1)	(6)
Adjusted net income ^(a)	860	740	16	(2)	18

^(a) Operational growth and adjusted net income are non-GAAP financial measures. See the *Non-GAAP financial measures* section of this Management's Discussion and Analysis (MD&A) for more information.

Our operating environment

For a description of our operating environment, including factors which could materially affect our business, financial condition, or future results, see "Our Operating Environment" in the MD&A of our 2018 Annual Report on Form 10-K. Set forth below are updates to certain of the factors disclosed in our 2018 Form 10-K.

Quarterly Variability of Financial Results

Our quarterly financial results are subject to variability related to a number of factors including but not limited to: weather patterns, herd management decisions, economic conditions, regulatory actions, competitive dynamics, disease outbreaks, product and geographic mix, timing of price increases and timing of investment decisions.

Disease Outbreaks

Sales of our livestock products could be adversely affected by the outbreak of disease carried by animals. Outbreaks of disease may reduce regional or global sales of particular animal-derived food products or result in reduced exports of such products, either due to heightened export restrictions or import prohibitions, which may reduce demand for our products. Also, the outbreak of any highly contagious disease near our main production sites could require us to immediately halt production of our products at such sites or force us to incur substantial expenses in procuring raw materials or products elsewhere. Alternatively, sales of products that treat specific disease outbreaks may increase.

Foreign Exchange Rates

Significant portions of our revenue and costs are exposed to changes in foreign exchange rates. Our products are sold in more than 100 countries and, as a result, our revenue is influenced by changes in foreign exchange rates. For the six months ended June 30, 2019, approximately 45% of our revenue was denominated in foreign currencies. We seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities. As we operate in multiple foreign currencies, including the euro, Brazilian real, Chinese renminbi, Canadian dollar, Australian dollar, U.K. pound and other currencies, changes in those currencies relative to the U.S. dollar will impact our revenue, cost of goods and expenses, and consequently, net income. Exchange rate fluctuations may also have an impact beyond our reported financial results and directly impact operations. These fluctuations may affect the ability to buy and sell our goods and services between markets impacted by significant exchange rate variances. For the six months ended June 30, 2019, approximately 55% of our total revenue was in U.S. dollars. Our year-over-year total revenue growth was unfavorably impacted by approximately 4% from changes in foreign currency values relative to the U.S. dollar.

Non-GAAP financial measures

We report information in accordance with U.S. generally accepted accounting principles (GAAP). Management also measures performance using non-GAAP financial measures that may exclude certain amounts from the most directly comparable GAAP measure. Despite the importance of these measures to management in goal setting and performance measurement, non-GAAP financial measures have no standardized meaning prescribed by U.S. GAAP and, therefore, have limits in their usefulness to investors and may not be comparable to the calculation of similar measures of other companies. We present certain identified non-GAAP measures solely to provide investors with useful information to more fully understand how management assesses performance.

Operational Growth

We believe that it is important to not only understand overall revenue and earnings growth, but also “operational growth.” Operational growth is a non-GAAP financial measure defined as revenue or earnings growth excluding the impact of foreign exchange. This measure provides information on the change in revenue and earnings as if foreign currency exchange rates had not changed between the current and prior periods to facilitate a period-to-period comparison. We believe this non-GAAP measure provides a useful comparison to previous periods for the company and investors, but should not be viewed as a substitute for U.S. GAAP reported growth.

Adjusted Net Income and Adjusted Earnings Per Share

Adjusted net income and the corresponding adjusted earnings per share (EPS) are non-GAAP financial measures of performance used by management. We believe these financial measures are useful supplemental information to investors when considered together with our U.S. GAAP financial measures. We report adjusted net income to portray the results of our major operations, and the discovery, development, manufacture and commercialization of our products, prior to considering certain income statement elements. We define adjusted net income and adjusted EPS as net income attributable to Zoetis and EPS before the impact of purchase accounting adjustments, acquisition-related costs and certain significant items.

We recognize that, as an internal measure of performance, the adjusted net income and adjusted EPS measures have limitations, and we do not restrict our performance management process solely to these metrics. A limitation of the adjusted net income and adjusted EPS measures is that they provide a view of our operations without including all events during a period, such as the effects of an acquisition or amortization of purchased intangibles, and do not provide a comparable view of our performance to other companies. The adjusted net income and adjusted EPS measures are not, and should not be viewed as, a substitute for U.S. GAAP reported net income attributable to Zoetis and reported EPS. See the *Adjusted Net Income* section below for more information.

Analysis of the condensed consolidated statements of income

The following discussion and analysis of our statements of income should be read along with our condensed consolidated financial statements and the notes thereto included elsewhere in *Part I—Item 1* of this Quarterly Report on Form 10-Q.

	Three Months Ended				Six Months Ended			
	June 30,		%		June 30,		%	
(MILLIONS OF DOLLARS)	2019	2018	Change		2019	2018	Change	
Revenue	\$ 1,547	\$ 1,415	9	\$	3,002	\$ 2,781	8	
Costs and expenses:								
Cost of sales	465	447	4		983	894	10	
<i>% of revenue</i>	30.1%	31.6%			32.7%	32.1%		
Selling, general and administrative expenses	406	359	13		775	697	11	
<i>% of revenue</i>	26%	25%			26%	25%		
Research and development expenses	111	102	9		213	199	7	
<i>% of revenue</i>	7%	7%			7%	7%		
Amortization of intangible assets	39	23	70		77	46	67	
Restructuring charges and certain acquisition-related costs	22	5	*		27	7	*	
Interest expense, net of capitalized interest	55	46	20		111	93	19	
Other (income)/deductions—net	(6)	(4)	50		(20)	(9)	*	
Income before provision for taxes on income	455	437	4		836	854	(2)	
<i>% of revenue</i>	29%	31%			28%	31%		
Provision for taxes on income	84	55	53		153	122	25	
<i>Effective tax rate</i>	18.5%	12.6%			18.3%	14.3%		
Net income before allocation to noncontrolling interests	371	382	(3)		683	732	(7)	
Less: Net loss attributable to noncontrolling interests	—	(2)	(100)		—	(4)	(100)	
Net income attributable to Zoetis	\$ 371	\$ 384	(3)	\$	683	\$ 736	(7)	
<i>% of revenue</i>	24%	27%			23%	26%		

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Revenue

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Total revenue increased by \$132 million, or 9%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, an increase of \$192 million, or 14%, on an operational basis. Operational revenue growth was comprised primarily of the following:

- the acquisition of Abaxis which contributed approximately 5%;
- increased volume from in-line products of approximately 4%, primarily driven by our key dermatology products of approximately 2%;
- price growth of approximately 4%; and
- volume growth from new products of approximately 1%.

Foreign exchange decreased reported revenue growth by approximately 5%.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Total revenue increased by \$221 million, or 8%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, an increase of \$339 million, or 12%, on an operational basis. Operational revenue growth was comprised primarily of the following:

- the acquisition of Abaxis which contributed approximately 5%;
- price growth of approximately 4%;
- increased volume from in-line products of approximately 2%, primarily driven by our key dermatology products; and
- volume growth from new products of approximately 1%.

Foreign exchange decreased reported revenue growth by approximately 4%.

Costs and Expenses

Cost of sales

(MILLIONS OF DOLLARS)	Three Months Ended			Six Months Ended		
	June 30,		% Change	June 30,		% Change
	2019	2018		2019	2018	
Cost of sales	\$ 465	\$ 447	4	\$ 983	\$ 894	10
% of revenue	30.1%	31.6%		32.7%	32.1%	

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Cost of sales as a percentage of revenue decreased from 31.6% to 30.1% in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, primarily as a result of:

- favorable foreign exchange;
- price increases;
- favorable product mix;
- continued cost improvements and efficiencies in our manufacturing network,

partially offset by:

- the inclusion of Abaxis.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Cost of sales as a percentage of revenue increased from 32.1% to 32.7% in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, primarily as a result of:

- a change in estimate related to inventory costing; and
- the inclusion of Abaxis,

partially offset by:

- price increases;
- favorable foreign exchange;
- favorable product mix; and
- continued cost improvements and efficiencies in our manufacturing network.

Selling, general and administrative expenses

(MILLIONS OF DOLLARS)	Three Months Ended			Six Months Ended		
	June 30,		% Change	June 30,		% Change
	2019	2018		2019	2018	
Selling, general and administrative expenses	\$ 406	\$ 359	13	\$ 775	\$ 697	11
% of revenue	26%	25%		26%	25%	

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Selling, general & administrative (SG&A) expenses increased by \$47 million, or 13%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, primarily as a result of:

- the inclusion of Abaxis; and
- an increase in certain compensation-related expenses,

partially offset by:

- favorable foreign exchange.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Selling, general & administrative (SG&A) expenses increased by \$78 million, or 11%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, primarily as a result of:

- the inclusion of Abaxis; and
- an increase in certain compensation-related expenses,

partially offset by:

- favorable foreign exchange.

Research and development expenses

(MILLIONS OF DOLLARS)	Three Months Ended			%	Six Months Ended			%
	June 30,		Change		June 30,		Change	
	2019	2018			2019	2018		
Research and development expenses	\$ 111	\$ 102	9	\$ 213	\$ 199	7		
% of revenue	7%	7%		7%	7%			

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

R&D expenses increased by \$9 million, or 9%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, primarily as a result of:

- increased spending driven by project investments;
- the inclusion of Abaxis; and
- an increase in certain compensation-related expenses,

partially offset by:

- favorable foreign exchange.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

R&D expenses increased by \$14 million, or 7%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, primarily as a result of:

- increased spending driven by project investments;
- the inclusion of Abaxis; and
- an increase in certain compensation-related expenses,

partially offset by:

- favorable foreign exchange.

Amortization of intangible assets

	Three Months Ended				Six Months Ended			
	June 30,			%	June 30,			%
(MILLIONS OF DOLLARS)	2019	2018		Change	2019	2018		Change
Amortization of intangible assets	\$ 39	\$ 23		70	\$ 77	\$ 46		67

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Amortization of intangible assets increased by \$16 million, or 70%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018 as a result of certain intangible assets acquired in July 2018 as part of the acquisition of Abaxis.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Amortization of intangible assets increased by \$31 million, or 67%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018 as a result of certain intangible assets acquired in July 2018 as part of the acquisition of Abaxis.

Restructuring charges and certain acquisition-related costs

(MILLIONS OF DOLLARS)	Three Months Ended			%	Six Months Ended			%
	June 30,		Change		June 30,		Change	
	2019	2018			2019	2018		
Restructuring charges and certain acquisition-related costs	\$ 22	\$ 5	*	\$ 27	\$ 7	*		

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Our acquisition-related costs primarily relate to restructuring charges for employees, assets and activities that will not continue in the future, as well as integration costs. The majority of these net restructuring charges are related to termination costs, but we also exited a number of distributor and other contracts and performed certain facility rationalization efforts. Our integration costs are generally comprised of consulting costs related to the integration of systems and processes, as well as product transfer costs.

For additional information regarding restructuring charges and acquisition-related costs, see Notes to Condensed Consolidated Financial Statements— *Note 6. Restructuring Charges and Other Costs Associated with Acquisitions, Cost-Reduction and Productivity Initiatives.*

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Restructuring charges and certain acquisition-related costs increased by \$17 million in the three months ended June 30, 2019 compared with the three months ended June 30, 2018, primarily due to integration costs and employee termination costs incurred in the three months ended June 30, 2019, as a result of the acquisition of Abaxis in the third quarter of 2018.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Restructuring charges and certain acquisition-related costs increased by \$20 million in the six months ended June 30, 2019 compared with the six months ended June 30, 2018, primarily due to integration costs and employee termination costs incurred in the six months ended June 30, 2019, as a result of the acquisition of Abaxis in the third quarter of 2018.

Interest expense, net of capitalized interest

(MILLIONS OF DOLLARS)	Three Months Ended			%	Six Months Ended			%
	June 30,				June 30,			
	2019	2018	Change		2019	2018	Change	
Interest expense, net of capitalized interest	\$ 55	\$ 46	20	\$	\$ 111	\$ 93	19	

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Interest expense, net of capitalized interest, increased by \$9 million, or 20% in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, as a result of the issuance of \$1.5 billion aggregate principal amount of our senior notes in August 2018.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Interest expense, net of capitalized interest, increased by \$18 million, or 19% in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, as a result of the issuance of \$1.5 billion aggregate principal amount of our senior notes in August 2018.

Other (income)/deductions—net

(MILLIONS OF DOLLARS)	Three Months Ended			%	Six Months Ended			%
	June 30,				June 30,			
	2019	2018	Change		2019	2018	Change	
Other (income)/deductions—net	\$ (6)	\$ (4)	50	\$	\$ (20)	\$ (9)	*	

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

The change in *Other (income)/deductions—net* from income of \$4 million in the three months ended June 30, 2018, to income of \$6 million in the three months ended June 30, 2019, is primarily a result of higher interest income due to higher short-term interest rates and higher cash balances for the three months ended June 30, 2019.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

The change in *Other (income)/deductions—net* from income of \$9 million in the six months ended June 30, 2018, to income of \$20 million in the six months ended June 30, 2019, is primarily a result of higher interest income due to higher short-term interest rates and higher cash balances for the six months ended June 30, 2019, as well as higher foreign currency losses for the six months ended June 30, 2018.

Provision for taxes on income

(MILLIONS OF DOLLARS)	Three Months Ended			%	Six Months Ended			%
	June 30,				June 30,			
	2019	2018	Change		2019	2018	Change	
Provision for taxes on income	\$ 84	\$ 55	53	\$	\$ 153	\$ 122	25	
Effective tax rate	18.5%	12.6%			18.3%	14.3%		

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Our effective tax rate was 18.5% for the three months ended June 30, 2019, compared with 12.6% for the three months ended June 30, 2018. The higher effective tax rate for the three months ended June 30, 2019, was primarily attributable to:

- a \$33 million net discrete tax benefit recorded in the second quarter of 2018, associated with a measurement-period adjustment related to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings pursuant to the Tax Act enacted on December 22, 2017;
- the impact of the GILTI tax, a new provision of the Tax Act, which became effective for the company in the first quarter of 2019; and
- changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings from operations and repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and operating fluctuations in the normal course of business and the impact of non-deductible items,

partially offset by:

- an \$8 million net discrete tax benefit recorded in the second quarter of 2019; and
- a \$2 million and \$1 million discrete tax benefit recorded in the second quarter of 2019 and 2018, respectively, related to the excess tax benefits for share-based payments.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Our effective tax rate was 18.3% for the six months ended June 30, 2019, compared with 14.3% for the six months ended June 30, 2018. The higher effective tax rate for the six months ended June 30, 2019, was primarily attributable to:

- a \$35 million net discrete tax benefit recorded in the first half of 2018, associated with a measurement-period adjustment related to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings pursuant to the Tax Act enacted on December 22, 2017;
- the impact of the GILTI tax, a new provision of the Tax Act, which became effective for the company in the first quarter of 2019;
- changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings from operations and repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and operating fluctuations in the normal course of business and the impact of non-deductible items; and
- a \$4 million and \$8 million discrete tax benefit recorded in the first half of 2019 and 2018, respectively, related to a remeasurement of deferred taxes as a result of a change in non-U.S. statutory tax rates,

partially offset by:

- a \$16 million net discrete tax benefit recorded in the first half of 2019; and
- a \$15 million and \$8 million discrete tax benefit recorded in the first half of 2019 and 2018, respectively, related to the excess tax benefits for share-based payments.

Operating Segment Results

On a global basis, the mix of revenue between livestock and companion animal products was as follows:

(MILLIONS OF DOLLARS)	Three Months Ended June 30,		% Change		
			Total	Related to	
	2019	2018		Foreign Exchange	Operational
U.S.					
Livestock	\$ 280	\$ 271	3	—	3
Companion animal	500	406	23	—	23
	780	677	15	—	15
International					
Livestock	444	463	(4)	(8)	4
Companion animal	298	265	12	(9)	21
	742	728	2	(8)	10
Total					
Livestock	724	734	(1)	(4)	3
Companion animal	798	671	19	(3)	22
Contract manufacturing & human health diagnostics	25	10	*	*	*
	\$ 1,547	\$ 1,415	9	(5)	14

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

(MILLIONS OF DOLLARS)	Six Months Ended June 30,		% Change		
			Total	Related to	
	2019	2018		Foreign Exchange	Operational
U.S.					
Livestock	\$ 553	\$ 563	(2)	—	(2)
Companion animal	945	748	26	—	26
	1,498	1,311	14	—	14
International					
Livestock	878	941	(7)	(8)	1
Companion animal	582	513	13	(9)	22
	1,460	1,454	—	(8)	8
Total					
Livestock	1,431	1,504	(5)	(5)	—
Companion animal	1,527	1,261	21	(4)	25
Contract manufacturing & human health diagnostics	44	16	*	*	*
	\$ 3,002	\$ 2,781	8	(4)	12

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Earnings by segment and the operational and foreign exchange changes versus the comparable prior year period were as follows:

(MILLIONS OF DOLLARS)	Three Months Ended		% Change		
			Related to		
	June 30, 2019	2018	Total	Foreign Exchange	Operational
<u>U.S.</u>					
Revenue	\$ 780	\$ 677	15	—	15
Cost of Sales	158	140	13	—	13
Gross Profit	622	537	16	—	16
Gross Margin	79.7%	79.3%			
Operating Expenses	127	116	9	—	9
Other (income)/deductions	—	—	—	—	—
U.S. Earnings	495	421	18	—	18
<u>International</u>					
Revenue	742	728	2	(8)	10
Cost of Sales	218	229	(5)	(13)	8
Gross Profit	524	499	5	(6)	11
Gross Margin	70.6%	68.5%			
Operating Expenses	146	147	(1)	(10)	9
Other (income)/deductions	—	2	*	*	*
International Earnings	378	350	8	(4)	12
Total operating segments	873	771	13	(2)	15
Other business activities	(79)	(82)	(4)		
Reconciling Items:					
Corporate	(178)	(139)	28		
Purchase accounting adjustments	(58)	(23)	*		
Acquisition-related costs	(22)	—	*		
Certain significant items	(3)	(7)	(57)		
Other unallocated	(78)	(83)	(6)		
Income before provision for taxes on income	\$ 455	\$ 437	4		

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

(MILLIONS OF DOLLARS)	Six Months Ended		% Change		
			Related to		
	June 30,		Total	Foreign Exchange	Operational
	2019	2018			
U.S.					
Revenue	\$ 1,498	\$ 1,311	14	—	14
Cost of Sales	305	280	9	—	9
Gross Profit	1,193	1,031	16	—	16
Gross Margin	79.6%	78.6%			
Operating Expenses	237	212	12	—	12
Other (income)/deductions	—	—	—	—	—
U.S. Earnings	956	819	17	—	17
International					
Revenue	1,460	1,454	—	(8)	8
Cost of Sales	428	463	(8)	(12)	4
Gross Profit	1,032	991	4	(7)	11
Gross Margin	70.7%	68.2%			
Operating Expenses	278	280	(1)	(10)	9
Other (income)/deductions	—	3	*	*	*
International Earnings	754	708	6	(5)	11
Total operating segments	1,710	1,527	12	(2)	14
Other business activities	(159)	(163)	(2)		
Reconciling Items:					
Corporate	(340)	(292)	16		
Purchase accounting adjustments	(124)	(46)	*		
Acquisition-related costs	(27)	(1)	*		
Certain significant items	(73)	(10)	*		
Other unallocated	(151)	(161)	(6)		
Income before provision for taxes on income	\$ 836	\$ 854	(2)		

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

U.S. operating segment

U.S. segment revenue increased by \$103 million, or 15%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, reflecting growth of approximately \$94 million in companion animal products and growth of approximately \$9 million in livestock products.

- Companion animal revenue growth was driven primarily by the inclusion of Abaxis, the key dermatology portfolio, and a number of in-line products including Simparica[®], Clavamox[®], Cerenia[®] and ProHeart 6[®].
- Livestock revenue increased primarily due to growth in sales of poultry products, driven by increased sales of alternatives to antibiotic medicated feed additive products. Swine product sales grew as a result of promotional activity, offset by a decline in sales of cattle products.

U.S. segment earnings increased by \$74 million, or 18%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, primarily due to revenue growth and improved gross margins, partially offset by higher operating expenses.

International operating segment

International segment revenue increased by \$14 million, or 2%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018. Operational revenue increased by \$73 million, or 10%, driven by growth of approximately \$56 million in companion animal products and increases of approximately \$17 million in livestock products.

- Companion animal operational revenue growth resulted primarily from increased sales of the key dermatology portfolio across multiple international markets, growth of parasiticide products, including Simparica® and Stronghold Plus®, and the inclusion of Abaxis.
- Livestock operational revenue increased, driven by growth in poultry products due to sales of vaccines and medicated feed additives, and growth in cattle products driven by the prior year impact of the national trucking strike in Brazil. Swine products were flat despite the negative impact of African Swine Fever in China.

Additionally, International segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$59 million, or 8%, primarily driven by the depreciation of the euro, Brazilian real, Argentine peso, Australian dollar, Chinese renminbi and Turkish lira.

International segment earnings increased by \$28 million, or 8%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018. Operational earnings growth was \$44 million, or 12%, primarily due to higher revenue and improved gross margin, partially offset by higher operating expenses.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

U.S. operating segment

U.S. segment revenue increased by \$187 million, or 14%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, reflecting growth of approximately \$197 million in companion animal products and declines of approximately \$10 million in livestock products.

- Companion animal revenue growth was driven primarily by the inclusion of Abaxis, increased sales of the key dermatology portfolio and a number of in-line products including Simparica®, Revolution®/Revolution Plus, Cerenia® and Proheart 6®.
- Livestock revenue declined due to decreased sales of cattle and swine products, offset by increases in poultry products. Cattle and swine products were both impacted by the timing of distributor purchasing patterns for medicated feed additive products. For poultry, growth was driven by increased sales of alternatives to antibiotic medicated feed additive products.

U.S. segment earnings increased by \$137 million, or 17%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, primarily due to revenue growth and improved gross margins, partially offset by higher operating expenses.

International operating segment

International segment revenue increased by \$6 million, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018. Operational revenue increased by \$123 million, or 8%, driven by growth of approximately \$112 million in companion animal products and growth of approximately \$11 million in livestock products.

- Companion animal operational revenue growth resulted primarily from increased sales of the key dermatology portfolio across multiple international markets, growth of parasiticide products, including Simparica® and Stronghold Plus®, and the inclusion of Abaxis.
- Livestock operational revenue growth was driven by increased sales in poultry and cattle. Poultry products increased due to sales of vaccines and medicated feed additives. Cattle products also contributed to growth driven by the prior year impact of the national trucking strike in Brazil, partially offset by a reduction in customer inventory in Brazil. Swine products declined due to the negative impact of African Swine Fever in China.

Additionally, International segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$117 million, or 8%, primarily driven by the depreciation of the euro, Brazilian real, Argentine peso, Turkish lira, Australian dollar and U.K. pound.

International segment earnings increased by \$46 million, or 6%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018. Operational earnings growth was \$81 million, or 11%, primarily due to higher revenue and improved gross margin, partially offset by higher operating expenses.

Other business activities

Other business activities includes our Client Supply Services (CSS) contract manufacturing results, our human health diagnostics business and expenses associated with our dedicated veterinary medicine research and development organization, research alliances, U.S. regulatory affairs and other operations focused on the development of our products. Other R&D-related costs associated with non-U.S. market and regulatory activities are generally included in the International segment.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Other business activities net loss decreased by \$3 million, or 4%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, reflecting revenue from the acquired Abaxis human health diagnostic business, partially offset by an increase in R&D costs due to an increase in project investments, the inclusion of Abaxis expenses and compensation-related costs.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Other business activities net loss decreased by \$4 million, or 2%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, reflecting revenue from the acquired Abaxis human health diagnostic business, partially offset by an increase in R&D costs due to an increase in project investments, the inclusion of Abaxis expenses and compensation-related costs.

Reconciling items

Reconciling items include certain costs that are not allocated to our operating segments results, such as costs associated with the following:

- **Corporate**, which includes certain costs associated with business technology, facilities, legal, finance, human resources, business development and communications, among others. These costs also include certain compensation costs, certain procurement costs, and other miscellaneous operating expenses that are not charged to our operating segments, as well as interest income and expense;
- Certain transactions and events such as (i) **Purchase accounting adjustments**, which includes expenses associated with the amortization of fair value adjustments to inventory, intangible assets, and property, plant and equipment; (ii) **Acquisition-related activities**, which includes costs for acquisition and integration; and (iii) **Certain significant items**, which includes non-acquisition-related restructuring charges, certain asset impairment charges, certain legal and commercial settlements, and costs associated with cost reduction/productivity initiatives; and
- **Other unallocated**, which includes (i) certain overhead expenses associated with our global manufacturing operations not charged to our operating segments; (ii) certain costs associated with business technology and finance that specifically support our global manufacturing operations; (iii) certain supply chain and global logistics costs; and (iv) certain procurement costs.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Corporate expenses increased by \$39 million, or 28%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, primarily due to higher interest expense, net of capitalized interest, associated with the additional debt issued in August 2018, an increase in certain compensation costs not allocated to our operating segments and consulting charges, partially offset by favorable foreign exchange.

Other unallocated expenses declined by \$5 million, or 6%, in the three months ended June 30, 2019, compared with the three months ended June 30, 2018, primarily due to the favorable impact of foreign exchange, partially offset by inventory charges and the inclusion of Abaxis expenses.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Corporate expenses increased by \$48 million, or 16%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, primarily due to higher interest expense, net of capitalized interest, associated with the additional debt issued in August 2018, consulting charges, and an increase in certain compensation costs not allocated to our operating segments, partially offset by favorable foreign exchange.

Other unallocated expenses declined by \$10 million, or 6%, in the six months ended June 30, 2019, compared with the six months ended June 30, 2018, primarily due to the favorable impact of foreign exchange, partially offset by the inclusion of Abaxis expenses and inventory charges.

See Notes to Condensed Consolidated Financial Statements—*Note 17. Segment Information* for further information.

Adjusted net income

General description of adjusted net income (a non-GAAP financial measure)

Adjusted net income is an alternative view of performance used by management, and we believe that investors' understanding of our performance is enhanced by disclosing this performance measure. The adjusted net income measure is an important internal measurement for us. Additionally, we measure our overall performance on this basis in conjunction with other performance metrics. The following are examples of how the adjusted net income measure is utilized:

- senior management receives a monthly analysis of our operating results that is prepared on an adjusted net income basis;
- our annual budgets are prepared on an adjusted net income basis; and
- other goal setting and performance measurements.

Purchase accounting adjustments

Adjusted net income is calculated prior to considering certain significant purchase accounting impacts that result from business combinations and net asset acquisitions. These impacts, primarily associated with the acquisition of Abaxis (acquired in July 2018), the Pharmaq business (acquired in November 2015), certain assets of Abbott Animal Health (acquired in February 2015), King Animal Health (KAH) (acquired in 2011), Fort Dodge Animal Health (FDAH) (acquired in 2009), and Pharmacia Animal Health business (acquired in 2003), include amortization related to the increase in fair value of the acquired finite-lived intangible assets and depreciation related to the increase/decrease to fair value of the acquired fixed assets. Therefore, the adjusted net income measure includes the revenue earned upon the sale of the acquired products without considering the aforementioned significant charges.

While certain purchase accounting adjustments can occur through 20 or more years, this presentation provides an alternative view of our performance that is used by management to internally assess business performance. We believe the elimination of amortization attributable to acquired intangible assets provides management and investors an alternative view of our business results by providing a degree of parity to internally developed intangible assets for which R&D costs previously have been expensed.

A completely accurate comparison of internally developed intangible assets and acquired intangible assets cannot be achieved through adjusted net income. These components of adjusted net income are derived solely from the impact of the items listed above. We have not factored in the impact of any other differences in experience that might have occurred if we had discovered and developed those intangible assets on our own, and this approach does not intend to be representative of the results that would have occurred in those circumstances. For example, our R&D costs in total, and in the periods presented, may have been different; our speed to commercialization and resulting revenue, if any, may have been different; or our costs to manufacture may have been different. In addition, our marketing efforts may have been received differently by our customers. As such, in total, there can be no assurance that our adjusted net income amounts would have been the same as presented had we discovered and developed the acquired intangible assets.

Acquisition-related costs

Adjusted net income is calculated prior to considering transaction and integration costs associated with significant business combinations or net asset acquisitions because these costs are unique to each transaction and represent costs that were incurred to acquire and integrate certain businesses as a result of the acquisition decision. We have made no adjustments for the resulting synergies.

We believe that viewing income prior to considering these charges provides investors with a useful additional perspective because the significant costs incurred in a business combination result primarily from the need to eliminate duplicate assets, activities or employees—a natural result of acquiring a fully integrated set of activities. For this reason, we believe that the costs incurred to convert disparate systems, to close duplicative facilities or to eliminate duplicate positions (for example, in the context of a business combination) can be viewed differently from those costs incurred in the ordinary course of business.

The integration costs associated with a business combination may occur over several years, with the more significant impacts generally ending within three years of the transaction. Because of the need for certain external approvals for some actions, the span of time needed to achieve certain restructuring and integration activities can be lengthy. For example, due to the regulated nature of the animal health medicines and vaccines business, the closure of excess facilities can take several years, as all manufacturing changes are subject to extensive validation and testing and must be approved by the FDA and/or other regulatory authorities.

Certain significant items

Adjusted net income is calculated excluding certain significant items. Certain significant items represent substantive, unusual items that are evaluated on an individual basis. Such evaluation considers both the quantitative and the qualitative aspect of their unusual nature. Unusual, in this context, may represent items that are not part of our ongoing business; items that, either as a result of their nature or size, we would not expect to occur as part of our normal business on a regular basis; items that would be nonrecurring; or items that relate to products that we no longer sell. While not all-inclusive, examples of items that could be included as certain significant items would be costs related to a major non-acquisition-related restructuring charge and associated implementation costs for a program that is specific in nature with a defined term, such as those related to our non-acquisition-related cost-reduction and productivity initiatives; amounts related to disposals of products or facilities that do not qualify as discontinued operations as defined by U.S. GAAP; certain intangible asset impairments; adjustments related to the resolution of certain tax positions; significant currency devaluation; the impact of adopting certain significant, event-driven tax legislation; or charges related to legal matters. See Notes to Condensed Consolidated Financial Statements—*Note 16. Commitments and Contingencies*. Our normal, ongoing defense costs or settlements of and accruals on legal matters made in the normal course of our business would not be considered certain significant items.

Reconciliation

A reconciliation of net income attributable to Zoetis, as reported under U.S. GAAP, to adjusted net income follows:

(MILLIONS OF DOLLARS)	Three Months Ended			Six Months Ended		
	June 30,		%	June 30,		%
	2019	2018		2019	2018	
GAAP reported net income attributable to Zoetis	\$ 371	\$ 384	(3)	\$ 683	\$ 736	(7)
Purchase accounting adjustments—net of tax	45	19	*	91	31	*
Acquisition-related costs—net of tax	18	—	*	22	1	*
Certain significant items—net of tax	2	(28)	*	64	(28)	*
Non-GAAP adjusted net income ^(a)	\$ 436	\$ 375	16	\$ 860	\$ 740	16

*Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

^(a) The effective tax rate on adjusted pretax income is 19.0% and 20.1% for the three months ended June 30, 2019, and June 30, 2018, respectively. The lower effective tax rate for the three months ended June 30, 2019, compared with the three months ended June 30, 2018, was primarily attributable to (i) changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs, (ii) an \$8 million net discrete tax benefit recorded in the second quarter of 2019, (iii) a \$2 million and \$1 million discrete tax benefit recorded in the second quarter of 2019 and 2018, respectively,

related to the excess tax benefits for share-based payments; partially offset by the impact of the GILTI tax, a new provision to the Tax Act, which became effective for the company in the first quarter of 2019.

The effective tax rate on adjusted pretax income is 18.9% and 19.2% for the six months ended June 30, 2019, and June 30, 2018, respectively. The lower effective tax rate for the six months ended June 30, 2019, compared with the six months ended June 30, 2018, was primarily attributable to (i) changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs, (ii) a \$9 million net discrete tax benefit recorded in the first half of 2019, related to changes in other tax items, (iii) a \$15 million and \$8 million discrete tax benefit recorded in the first half of 2019 and 2018, respectively, related to the excess tax benefits for share-based payments; partially offset by the impact of the GILTI tax, a new provision to the Tax Act, which became effective for the company in the first quarter of 2019.

A reconciliation of reported diluted earnings per share (EPS), as reported under U.S. GAAP, to non-GAAP adjusted diluted EPS follows:

	Three Months Ended			%	Six Months Ended			%		
	June 30,		Change		June 30,		Change			
	2019	2018			2019	2018				
Earnings per share—diluted ^(a) :										
GAAP reported EPS attributable to Zoetis—diluted	\$	0.77	\$	0.79	(3)	\$	1.41	\$	1.51	(7)
Purchase accounting adjustments—net of tax		0.09		0.04	*		0.19		0.06	*
Acquisition-related costs—net of tax		0.04		—	*		0.05		—	*
Certain significant items—net of tax		—		(0.06)	*		0.13		(0.06)	*
Non-GAAP adjusted EPS—diluted	\$	0.90	\$	0.77	17	\$	1.78	\$	1.51	18

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

^(a) Diluted earnings per share was computed using the weighted-average common shares outstanding during the period plus the common stock equivalents related to stock options, restricted stock units, performance-vesting restricted stock units and deferred stock units.

Adjusted net income includes the following charges for each of the periods presented:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(MILLIONS OF DOLLARS)	2019	2018	2019	2018
Interest expense, net of capitalized interest	\$ 55	\$ 46	\$ 111	\$ 93
Interest income	9	8	19	14
Income taxes	102	94	200	175
Depreciation	37	37	75	70
Amortization	6	4	11	8

Adjusted net income, as shown above, excludes the following items:

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Purchase accounting adjustments:				
Amortization and depreciation ^(a)	\$ 52	\$ 21	\$ 104	\$ 42
Cost of sales ^(b)	5	2	19	4
Research & development	1	—	1	—
Total purchase accounting adjustments—pre-tax	58	23	124	46
Income taxes ^(c)	13	4	33	15
Total purchase accounting adjustments—net of tax	45	19	91	31
Acquisition-related costs:				
Integration costs	8	—	9	1
Restructuring costs	14	—	18	—
Total acquisition-related costs—pre-tax	22	—	27	1
Income taxes	4	—	5	—
Total acquisition-related costs—net of tax	18	—	22	1
Certain significant items:				
Operational efficiency initiative ^(d)	—	1	—	1
Supply network strategy ^(d)	3	3	5	5
Other restructuring charges and cost-reduction/productivity initiatives ^(e)	—	3	—	3
Other ^(f)	—	—	68	1
Total certain significant items—pre-tax	3	7	73	10
Income taxes ^(c)	1	35	9	38
Total certain significant items—net of tax	2	(28)	64	(28)
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	\$ 65	\$ (9)	\$ 177	\$ 4

Certain amounts may reflect rounding adjustments.

^(a) Amortization and depreciation expenses related to *Purchase accounting adjustments* with respect to identifiable intangible assets and property, plant and equipment.

^(b) Amortization and depreciation expense, as well as fair value adjustments to acquired inventory.

^(c) Income taxes include the tax effect of the associated pre-tax amounts, calculated by determining the jurisdictional location of the pre-tax amounts and applying that jurisdiction's applicable tax rate.

Income taxes in *Purchase accounting adjustments* also includes a tax benefit related to a remeasurement of deferred taxes as a result of a change in non-U.S. statutory tax rates, for both the six months ended June 30, 2019, and June 30, 2018.

Income taxes in *Certain significant items* also includes a net tax benefit related to a measurement-period adjustment to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings, pursuant to the Tax Act, for the three and six months ended June 30, 2018.

^(d) Represents consulting fees, product transfer costs, employee termination costs and exit costs related to cost-reduction and productivity initiatives.

^(e) For the three and six months ended June 30, 2018, represents employee termination costs in Europe as a result of initiatives to better align our organizational structure.

^(f) For the six months ended June 30, 2019, primarily represents a change in estimate related to inventory costing.

The classification of the above items excluded from adjusted net income are as follows:

(MILLIONS OF DOLLARS)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2019	2018	2019	2018
Cost of sales:				
Purchase accounting adjustments	\$ 5	\$ 2	\$ 19	\$ 4
Consulting fees	3	2	5	3
Other	—	—	68	—
<i>Total Cost of sales</i>	8	4	92	7
Selling, general & administrative expenses:				
Purchase accounting adjustments	18	2	36	3
Other	—	—	—	1
<i>Total Selling, general & administrative expenses</i>	18	2	36	4
Research & development expenses:				
Purchase accounting adjustments	1	—	1	1
<i>Total Research & development expenses</i>	1	—	1	1
Amortization of intangible assets:				
Purchase accounting adjustments	34	19	68	38
<i>Total Amortization of intangible assets</i>	34	19	68	38
Restructuring charges/(reversals) and certain acquisition-related costs:				
Integration costs	8	—	9	1
Employee termination costs	14	4	18	5
Exit costs	—	1	—	1
<i>Total Restructuring charges/(reversals) and certain acquisition-related costs</i>	22	5	27	7
Provision for taxes on income	18	39	47	53
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	\$ 65	\$ (9)	\$ 177	\$ 4

Certain amounts may reflect rounding adjustments.

Analysis of the condensed consolidated statements of comprehensive income

Substantially all changes in other comprehensive income for the periods presented are related to foreign currency translation adjustments. These changes result from the strengthening or weakening of the U.S. dollar as compared to the currencies in the countries in which we do business. The gains and losses associated with these changes are deferred on the balance sheet in *Accumulated other comprehensive loss* until realized.

Analysis of the condensed consolidated balance sheets

June 30, 2019 vs. December 31, 2018

For a discussion about the changes in *Cash and cash equivalents*, *Short-term borrowings*, and *Long-term debt, net of discount and issuance costs*, see “Analysis of financial condition, liquidity and capital resources” below.

Short-term investments decreased as a result of maturities of debt securities.

Other current assets increased primarily as a result of the timing of income tax payments.

The net change in *Operating lease right of use assets*, and *Operating lease liability* relates to the adoption of the new lease accounting standard, which became effective January 1, 2019. See Notes to Condensed Consolidated Financial Statements—*Note 3. Accounting Standards* and *Note 10. Leases*.

Identifiable intangible assets, less accumulated amortization decreased due to amortization expense and the impact of foreign exchange.

Accounts payable decreased as a result of the timing of payments.

Accrued expenses decreased primarily as a result of payment of accrued expenses, including accrued interest and employee termination costs associated with the acquisition of Abaxis.

Accrued compensation and related items decreased primarily due to payment of 2018 annual bonuses to eligible employees and 2018 employee savings plan contributions, partially offset by the pro rata accrual of similar items for 2019.

The net changes in *Noncurrent deferred tax assets*, *Noncurrent deferred tax liabilities*, *Income taxes payable* and *Other taxes payable* primarily reflect adjustments to the accrual for the income tax provision, and the impact of the remeasurement of deferred taxes as a result of a change in tax rates.

Other current liabilities increased primarily due to short-term lease liabilities as a result of the adoption of the new lease accounting standard, which became effective January 1, 2019, partially offset by the payments of contingent consideration related to the 2016 acquisition of certain intangible assets related to our livestock product portfolio and the 2018 acquisition of a manufacturing business in Ireland. See Notes to Condensed Consolidated Financial Statements—*Note 3. Accounting Standards* and *Note 10. Leases*.

For an analysis of the changes in *Total Equity*, see the Condensed Consolidated Statements of Equity and Notes to Condensed Consolidated Financial Statements—*Note 14. Stockholders' Equity*.

Analysis of the condensed consolidated statements of cash flows

	Six Months Ended		
	June 30,		%
(MILLIONS OF DOLLARS)	2019	2018	Change
Net cash provided by (used in):			
Operating activities	\$ 707	\$ 656	8
Investing activities	(82)	(121)	(32)
Financing activities	(469)	(533)	(12)
Effect of exchange-rate changes on cash and cash equivalents	(3)	(8)	(63)
Net increase (decrease) in cash and cash equivalents	\$ 153	\$ (6)	*

*Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Operating activities

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Net cash provided by operating activities was \$707 million for the six months ended June 30, 2019, and \$656 million for the six months ended June 30, 2018. The increase in net income after non-cash adjustments was partially offset by timing of payments in the ordinary course of business.

Investing activities

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Our net cash used in investing activities was \$82 million for the six months ended June 30, 2019, compared with net cash used in investing activities of \$121 million for the six months ended June 30, 2018. The net cash used in investing activities for 2019 was primarily due to purchases of property, plant and equipment, partially offset by proceeds from maturities of debt securities and proceeds from cross-currency interest rate swaps. The net cash used in investing activities for 2018 was primarily due to purchases of property, plant and equipment, partially offset by additional proceeds from the 2017 sale of our manufacturing site in Guarulhos, Brazil.

Financing activities

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Our net cash used in financing activities was \$469 million for the six months ended June 30, 2019, compared with net cash used in financing activities of \$533 million for the six months ended June 30, 2018. The net cash used in financing activities for 2019 was primarily attributable to the purchase of treasury shares, the payment of dividends, the payment of short-term borrowings, and the payments of contingent consideration related to the 2016 acquisition of certain intangible assets related to our livestock product portfolio and the 2018 acquisition of a manufacturing business in Ireland. The net cash used in financing activities for 2018 was primarily attributable to the purchase of treasury shares and the payment of dividends.

Analysis of financial condition, liquidity and capital resources

While we believe our cash and cash equivalents on hand, our operating cash flows and our existing financing arrangements will be sufficient to support our future cash needs, this may be subject to the environment in which we operate. Risks to our ability to meet future funding requirements include global economic conditions described in the following paragraph.

Global financial markets may be impacted by macroeconomic, business and financial volatility. As markets change, we will continue to monitor our liquidity position, but there can be no assurance that a challenging economic environment or an economic downturn will not impact our liquidity or our ability to obtain future financing.

Selected measures of liquidity and capital resources

Certain relevant measures of our liquidity and capital resources follow:

(MILLIONS OF DOLLARS)	June 30, 2019	December 31, 2018
Cash and cash equivalents	\$ 1,755	\$ 1,602
Accounts receivable, net ^(a)	994	1,036
Long-term debt, net of discount and issuance costs	6,446	6,443
Working capital	3,409	3,176
Ratio of current assets to current liabilities	4.17:1	3.60:1

^(a) Accounts receivable are usually collected over a period of 45 to 75 days. For the six months ended June 30, 2019, compared with December 31, 2018, the number of days that accounts receivables are outstanding remained approximately the same. We regularly monitor our accounts receivable for collectability, particularly in markets where economic conditions remain uncertain. We believe that our allowance for doubtful accounts is appropriate. Our assessment is based on such factors as past due aging, historical and expected collection patterns, the financial condition of our customers, the robust nature of our credit and collection practices and the economic environment.

For additional information about the sources and uses of our funds, see the *Analysis of the condensed consolidated balance sheets* and *Analysis of the condensed consolidated statements of cash flows* sections of this MD&A.

Credit facility and other lines of credit

In December 2016, we entered into an amended and restated revolving credit agreement with a syndicate of banks providing for a multi-year \$1.0 billion senior unsecured revolving credit facility (the credit facility). In December 2018, the maturity for the amended and restated credit facility was extended through December 2023. Subject to certain conditions, we have the right to increase the credit facility to up to \$1.5 billion. The credit facility contains a financial covenant requiring us to not exceed a maximum total leverage ratio (the ratio of consolidated net debt as of the end of the period to consolidated Earnings Before Interest, Income Taxes, Depreciation and Amortization (EBITDA) for such period) of 3.50:1. Upon entering into a material acquisition, the maximum total leverage ratio increases to 4.00:1, and extends until the fourth full consecutive fiscal quarter ended immediately following the consummation of a material acquisition. The credit facility also contains a clause which adds back to Adjusted Consolidated EBITDA, any operational efficiency restructuring charge (defined as charges recorded by the company during the period commencing on October 1, 2016 and ending December 31, 2019, related to operational efficiency initiatives), provided that for any twelve-month period such charges added back to Adjusted Consolidated EBITDA shall not exceed \$100 million in the aggregate.

The credit facility also contains a financial covenant requiring that we maintain a minimum interest coverage ratio (the ratio of EBITDA at the end of the period to interest expense for such period) of 3.50:1. In addition, the credit facility contains other customary covenants.

We were in compliance with all financial covenants as of June 30, 2019 and December 31, 2018. There were no amounts drawn under the credit facility as of June 30, 2019 or December 31, 2018.

We have additional lines of credit and other credit arrangements with a group of banks and other financial intermediaries for general corporate purposes. We maintain cash and cash equivalent balances in excess of our outstanding short-term borrowings. As of June 30, 2019, we had access to \$73 million of lines of credit which expire at various times through 2019, and are generally renewed annually. There were no borrowings outstanding related to these facilities as of June 30, 2019 and \$9 million of borrowings outstanding related to these facilities as of December 31, 2018.

Domestic and international short-term funds

Many of our operations are conducted outside the United States. The amount of funds held in the United States will fluctuate due to the timing of receipts and payments in the ordinary course of business and due to other reasons, such as business development activities. As part of our ongoing liquidity assessments, we regularly monitor the mix of U.S. and international cash flows (both inflows and outflows). Actual repatriation of overseas funds can result in additional U.S. and local income taxes, such as U.S. state income taxes, local withholding taxes, and taxes on currency gains and losses.

Global economic conditions

Challenging economic conditions in recent years have not had, nor do we anticipate that it will have, a significant impact on our liquidity. Due to our operating cash flows, financial assets, access to capital markets and available lines of credit and revolving credit agreements, we continue to believe that we have the ability to meet our liquidity needs for the foreseeable future. As markets change, we continue to monitor our liquidity position. There can be no assurance that a challenging economic environment or an economic downturn would not impact our ability to obtain financing in the future.

Debt

On August 20, 2018, we issued \$1.5 billion aggregate principal amount of our senior notes (2018 senior notes), with an original issue discount of \$4 million. These notes are comprised of \$300 million aggregate principal amount of floating rate senior notes due 2021 (the "2018 floating rate senior notes"), and \$300 million aggregate principal amount of 3.250% senior notes due 2021, \$500 million aggregate principal amount of 3.900% senior notes due 2028 and \$400 million aggregate principal amount of 4.450% senior notes due 2048 (collectively, the "2018 fixed rate senior notes"). Net proceeds from this offering were partially used to pay down and terminate a revolving credit agreement and repay outstanding commercial paper, which were borrowed to finance a portion of the cash consideration for the acquisition of Abaxis (see Notes to

Condensed Consolidated Financial Statements— *Note 5. Acquisitions and Divestitures*). The remainder of the net proceeds will be used for general corporate purposes.

On September 12, 2017, we issued \$1.25 billion aggregate principal amount of our senior notes (2017 senior notes), with an original issue discount of \$7 million. These notes are comprised of \$750 million aggregate principal amount of 3.000% senior notes due 2027 and \$500 million aggregate principal amount of 3.950% senior notes due 2047. Net proceeds from this offering were partially used in October 2017 to repay, prior to maturity, the aggregate principal amount of \$750 million, and a make-whole amount and accrued interest of \$4 million, of our 1.875% senior notes due 2018. The remainder of the net proceeds were used for general corporate purposes.

On November 13, 2015, we issued \$1.25 billion aggregate principal amount of our senior notes (2015 senior notes), with an original issue discount of \$2 million. On January 28, 2013, we issued \$3.65 billion aggregate principal amount of our senior notes (2013 senior notes) in a private placement, with an original issue discount of \$10 million.

The 2013, 2015, 2017 and 2018 senior notes are governed by an indenture and supplemental indenture (collectively, the indenture) between us and Deutsche Bank Trust Company Americas, as trustee. The indenture contains certain covenants, including limitations on our and certain of our subsidiaries' ability to incur liens or engage in sale lease-back transactions. The indenture also contains restrictions on our ability to consolidate, merge or sell substantially all of our assets. In addition, the indenture contains other customary terms, including certain events of default, upon the occurrence of which (if not cured or waived), the 2013, 2015, 2017 and 2018 senior notes may be declared immediately due and payable.

Pursuant to the indenture, we are able to redeem the 2013, 2015 and 2017 senior notes and the 2018 fixed rate senior notes of any series, in whole or in part, at any time by paying a "make whole" premium, plus accrued and unpaid interest to, but excluding, the date of redemption. Pursuant to our tax matters agreement with Pfizer, we will not be permitted to redeem the 2013 senior notes due 2023 pursuant to this optional redemption provision, except under limited circumstances. Upon the occurrence of a change of control of us and a downgrade of the 2013, 2015, 2017 and 2018 senior notes below an investment grade rating by each of Moody's Investors Service, Inc. and Standard & Poor's Ratings Services, we are, in certain circumstances, required to make an offer to repurchase all of the outstanding 2013, 2015, 2017 and 2018 senior notes at a price equal to 101% of the aggregate principal amount of the 2013, 2015, 2017 and 2018 senior notes together with accrued and unpaid interest to, but excluding, the date of repurchase.

The components of our long-term debt follow:

Description	Principal Amount	Interest Rate	Terms
2015 Senior Notes due 2020	\$500 million	3.450%	Interest due semi annually, not subject to amortization, aggregate principal due on November 13, 2020
2018 Floating Rate Senior Notes due 2021	\$300 million	Three-month USD LIBOR plus 0.44%	Interest due quarterly, not subject to amortization, aggregate principal due on August 20, 2021
2018 Senior Notes due 2021	\$300 million	3.250%	Interest due semi annually, not subject to amortization, aggregate principal due on August 20, 2021
2013 Senior Notes due 2023	\$1,350 million	3.250%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2023
2015 Senior Notes due 2025	\$750 million	4.500%	Interest due semi annually, not subject to amortization, aggregate principal due on November 13, 2025
2017 Senior Notes due 2027	\$750 million	3.000%	Interest due semi annually, not subject to amortization, aggregate principal due on September 12, 2027
2018 Senior Notes due 2028	\$500 million	3.900%	Interest due semi annually, not subject to amortization, aggregate principal due on August 20, 2028
2013 Senior Notes due 2043	\$1,150 million	4.700%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2043
2017 Senior Notes due 2047	\$500 million	3.950%	Interest due semi annually, not subject to amortization, aggregate principal due on September 12, 2047
2018 Senior Notes due 2048	\$400 million	4.450%	Interest due semi annually, not subject to amortization, aggregate principal due on August 20, 2048

Credit Ratings

Two major corporate debt-rating organizations, Moody's and S&P, assign ratings to our short-term and long-term debt. A security rating is not a recommendation to buy, sell or hold securities and the rating is subject to revision or withdrawal at any time by the rating organization. Each rating should be evaluated independently of any other rating.

The following table provides the current ratings assigned by these rating agencies to our commercial paper and senior unsecured non-credit-enhanced long-term debt:

Name of Rating Agency	Commercial Paper	Long-term Debt		Date of Last Action
	Rating	Rating	Outlook	
Moody's	P-2	Baa1	Stable	August 2017
S&P	A-2	BBB	Stable	December 2016

Share Repurchase Program

In December 2016, the company's Board of Directors authorized a \$1.5 billion share repurchase program. As of June 30, 2019, there was approximately \$1 million remaining under this authorization. In December 2018, the company's Board of Directors authorized an additional \$2.0 billion share repurchase program, all of which is remaining under this authorization. Purchases of Zoetis shares may be made at the discretion of management, depending on market conditions and business needs. Share repurchases may be executed through various means, including open market or privately negotiated transactions. During the first six months of 2019, approximately 3 million shares were repurchased.

Off-balance sheet arrangements

In the ordinary course of business and in connection with the sale of assets and businesses, we may indemnify our counterparties against certain liabilities that may arise in connection with a transaction or that are related to activities prior to a transaction. These indemnifications typically pertain to environmental, tax, employee and/or product-related matters, and patent-infringement claims. If the indemnified party were to make a successful claim pursuant to the terms of the indemnification, we would be required to reimburse the loss. These indemnifications are generally subject to threshold amounts, specified claim periods and other restrictions and limitations. Historically, we have not paid significant amounts under these provisions and, as of June 30, 2019, or December 31, 2018, recorded amounts for the estimated fair value of these indemnifications are not significant.

New accounting standards

Recently Issued Accounting Standards Not Adopted as of June 30, 2019

A description of recently issued accounting standards is contained in *Note 3. Accounting Standards* of the Notes to Condensed Consolidated Financial Statements.

Forward-looking statements and factors that may affect future results

This report contains “forward-looking” statements. We generally identify forward-looking statements by using words such as “anticipate,” “estimate,” “could,” “expect,” “intend,” “project,” “plan,” “predict,” “believe,” “seek,” “continue,” “outlook,” “objective,” “target,” “may,” “might,” “will,” “should,” “can have,” “likely” or the negative version of these words or comparable words or by using future dates in connection with any discussion of future performance, actions or events.

In particular, forward-looking statements include statements relating to our 2019 financial guidance, future actions, business plans or prospects, prospective products, product approvals or products under development, product supply disruptions, R&D costs, timing and likelihood of success, future operating or financial performance, future results of current and anticipated products and services, strategies, sales efforts, expenses, production efficiencies, production margins, anticipated timing of generic market entries, integration of acquired businesses, interest rates, tax rates, changes in tax regimes and laws, foreign exchange rates, growth in emerging markets, the outcome of contingencies, such as legal proceedings, plans related to share repurchases and dividends, government regulation and financial results. These statements are not guarantees of future performance, actions or events. Forward-looking statements are subject to risks and uncertainties, many of which are beyond our control, and are based on assumptions that could prove to be inaccurate. Among the factors that could cause actual results to differ materially from past results and future plans and projected future results are the following:

- unanticipated safety, quality or efficacy concerns about our products;
- issues with any of our top products;
- failure of our R&D, acquisition and licensing efforts to generate new products and product lifecycle innovations;
- the possible impact and timing of competing products, including generic alternatives, on our products and our ability to compete against such products;
- disruptive innovations and advances in medical practices and technologies;
- consolidation of our customers and distributors;
- changes in the distribution channel for companion animal products;
- failure to successfully acquire businesses, license rights or products, integrate businesses, form and manage alliances or divest businesses;

- restrictions and bans on the use of and consumer preferences regarding antibacterials in food-producing animals;
- perceived adverse effects on human health linked to the consumption of food derived from animals that utilize our products;
- adverse global economic conditions;
- increased regulation or decreased governmental support relating to the raising, processing or consumption of food-producing animals;
- fluctuations in foreign exchange rates and potential currency controls;
- changes in tax laws and regulations;
- legal factors, including product liability claims, antitrust litigation and governmental investigations, including tax disputes, environmental concerns, commercial disputes and patent disputes with branded and generic competitors, any of which could preclude commercialization of products or negatively affect the profitability of existing products;
- failure to protect our intellectual property rights or to operate our business without infringing the intellectual property rights of others;
- product launch delays, inventory shortages, recalls or unanticipated costs caused by manufacturing problems and capacity imbalances;
- an outbreak of infectious disease carried by animals;
- adverse weather conditions and the availability of natural resources;
- the economic, political, legal and business environment of the foreign jurisdictions in which we do business;
- a cyber-attack, information security breach or other misappropriation of our data;
- quarterly fluctuations in demand and costs;
- governmental laws and regulations affecting domestic and foreign operations, including without limitation, tax obligations and changes affecting the tax treatment by the United States of income earned outside the United States that may result from pending and possible future proposals; and
- governmental laws and regulations affecting our interactions with veterinary healthcare providers.

However, there may also be other risks that we are unable to predict at this time. These risks or uncertainties may cause actual results to differ materially from those contemplated by a forward-looking statement. You should not put undue reliance on forward-looking statements. Forward-looking statements speak only as of the date on which they are made. We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law or by the rules and regulations of the SEC. You are advised, however, to consult any further disclosures we make on related subjects in our Form 10-Q and 8-K reports and our other filings with the SEC. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the above to be a complete discussion of all potential risks or uncertainties.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

A significant portion of our revenue and costs are exposed to changes in foreign exchange rates. In addition, our outstanding borrowings may be subject to risk from changes in interest rates and foreign exchange rates. The overall objective of our financial risk management program is to seek to minimize the impact of foreign exchange rate movements and interest rate movements on our earnings. We manage these financial exposures through operational means and by using certain financial instruments. These practices may change as economic conditions change.

Foreign exchange risk

Our primary net foreign currency translation exposures are the Australian dollar, Brazilian real, Canadian dollar, Chinese yuan, euro, and U.K. pound. We seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities.

Foreign exchange risk is also managed through the use of foreign currency forward-exchange contracts. These contracts are used to offset the potential earnings effects from mostly intercompany short-term foreign currency assets and liabilities that arise from operations.

Our financial instrument holdings at June 30, 2019, were analyzed to determine their sensitivity to foreign exchange rate changes. The fair values of these instruments were determined using Level 2 inputs. The sensitivity analysis of changes in the fair value of all foreign currency forward-exchange contracts at June 30, 2019, indicates that if the U.S. dollar were to appreciate against all other currencies by 10%, the fair value of these contracts would increase by \$19 million, and if the U.S. dollar were to weaken against all other currencies by 10%, the fair value of these contracts would decrease by \$23 million. For additional details, see Notes to Condensed Consolidated Financial Statements— *Note 9C. Financial Instruments: Derivative Financial Instruments*.

Interest rate risk

Our outstanding debt balances are predominantly fixed rate debt. While changes in interest rates will have no impact on the interest we pay on our fixed rate debt, interest on our \$300 million aggregate principal amount of 2018 Floating Rate Senior Notes due 2021, as well as interest on our commercial paper and revolving credit facility will be exposed to interest rate fluctuations. At June 30, 2019, there were no commercial paper borrowings outstanding and no outstanding principal balance under our revolving credit facility. See Notes to Condensed Consolidated Financial Statements— *Note 9C. Financial Instruments: Derivative Financial Instruments*.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation as of June 30, 2019, the company's Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures are effective at a reasonable level of assurance in alerting them in a timely manner to material information required to be disclosed in our periodic reports filed with the SEC.

Changes in Internal Control over Financial Reporting

On July 31, 2018, the company completed the acquisition of Abaxis, Inc. (Abaxis). In our 2018 Annual Report on Form 10-K, we excluded Abaxis from our evaluation of internal control over financial reporting. Since the acquisition, Zoetis has extended its oversight and monitoring processes that support our internal control over financial reporting, as well as its disclosure controls and procedures, and we continue to integrate the acquired operations of Abaxis. Except for changes in internal control over financial reporting relating to the integration of Abaxis, there has not been any change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

The information required by this Item is incorporated herein by reference to Notes to Condensed Consolidated Financial Statements—*Note 16. Commitments and Contingencies* in *Part I—Item 1*, of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in the "Our Operating Environment" and "Forward-Looking Statements and Factors That May Affect Future Results" sections of the MD&A and in Part I, Item 1A. "Risk Factors," of our 2018 Annual Report on Form 10-K, which could materially affect our business, financial condition, or future results and which are incorporated by reference herein. Set forth below are updates to certain of the risk factors disclosed in our 2018 Annual Report on Form 10-K.

Risks related to our business and industry

An outbreak of infectious disease carried by animals could negatively affect the sale and production of our products.

Sales of our livestock products could be materially adversely affected by the outbreak of disease carried by animals, which could lead to the widespread death or precautionary destruction of animals as well as the reduced consumption and demand for animal protein. In addition, outbreaks of disease carried by animals may reduce regional or global sales of particular animal-derived food products or result in reduced exports of such products, either due to heightened export restrictions or import prohibitions, which may reduce demand for our products due to reduced herd or flock sizes. In recent years, outbreaks of various diseases, including African Swine Fever, avian influenza, foot-and-mouth disease, bovine spongiform encephalopathy (otherwise known as BSE or mad cow disease) and porcine epidemic diarrhea virus (otherwise known as PEDv), have impacted the animal health business. For example, recent outbreaks of African Swine Fever have seriously impacted swine herds primarily in China and certain Southeast Asian countries, and as a result sales of our swine products there have been negatively impacted. The further spread of African Swine Fever within China, and its continued expansion to other countries, could further impact the size of swine herds globally and therefore the demand for our swine products, and if widespread, could have a material impact on our financial results. The discovery of additional cases of any of these, or new, diseases may result in additional restrictions on animal proteins, reduced herd sizes, or reduced demand for, animal protein, which may have a material adverse effect on our operating results and financial condition. Also, the outbreak of any highly contagious disease near our main production sites could require us to immediately halt production of our products at such sites or force us to incur substantial expenses in procuring raw materials or products elsewhere.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information with respect to the shares of the company's common stock repurchased during the quarter ended June 30, 2019:

	Issuer Purchases of Equity Securities			
	Total Number of Shares Purchased ^(a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs
April 1 - April 30, 2019	502,214	\$101.02	500,938	\$2,100,310,546
May 1 - May 31, 2019	632,228	\$101.86	616,946	\$2,037,490,146
June 1 - June 30, 2019	334,824	\$110.94	329,739	\$2,000,686,521
	<u>1,469,266</u>	<u>\$103.64</u>	<u>1,447,623</u>	<u>\$2,000,686,521</u>

^(a) The company repurchased 21,643 shares during the three-month period ended June 30, 2019, that were not part of the publicly announced share repurchase authorization. These shares were reacquired from employees to satisfy tax withholding requirements on the vesting of restricted shares from equity-based awards.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit 3.1	Restated Certificate of Incorporation of the Registrant, effective as of May 13, 2014 (incorporated by reference to Exhibit 3.1 to Zoetis Inc.'s Quarterly Report on Form 10-Q filed on November 10, 2014 (File No. 001-35797))
Exhibit 3.2	By-laws of the Registrant, amended and restated as of February 19, 2016 (incorporated by reference to Exhibit 3.2 to Zoetis Inc.'s 2015 Annual Report on Form 10-K filed on February 24, 2016 (File No. 001-35797))
Exhibit 15	Accountants' Acknowledgment
Exhibit 31.1	Chief Executive Officer—Certification pursuant to Sarbanes-Oxley Act of 2002 Section 302
Exhibit 31.2	Chief Financial Officer—Certification pursuant to Sarbanes-Oxley Act of 2002 Section 302
Exhibit 32.1	Chief Executive Officer—Certification pursuant to Sarbanes-Oxley Act of 2002 Section 906
Exhibit 32.2	Chief Financial Officer—Certification pursuant to Sarbanes-Oxley Act of 2002 Section 906
EX-101.INS	Inline XBRL INSTANCE DOCUMENT
EX-101.SCH	Inline XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT
EX-101.CAL	Inline XBRL TAXONOMY EXTENSION CALCULATION LINKBASE DOCUMENT
EX-101.LAB	Inline XBRL TAXONOMY EXTENSION LABEL LINKBASE DOCUMENT
EX-101.PRE	Inline XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE DOCUMENT
EX-101.DEF	Inline XBRL TAXONOMY EXTENSION DEFINITION LINKBASE DOCUMENT
EX-104	Cover Page Interactive Data File (formatted as Inline XBRL)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Zoetis Inc.

August 6, 2019

By: /S/ JUAN RAMÓN ALAIX
Juan Ramón Alaix
Chief Executive Officer and Director

August 6, 2019

By: /S/ GLENN DAVID
Glenn David
Executive Vice President and
Chief Financial Officer

ACCOUNTANTS' ACKNOWLEDGEMENT

August 6, 2019

Zoetis Inc.
Parsippany, New Jersey

Re: Registration Statements (Nos. 333-186367, 333-189573, 333-200073, and 333-226481) on Form S-8 and (No. 333-226450) on Form S-3

With respect to the subject registration statements, we acknowledge our awareness of the use therein of our report dated August 6, 2019 related to our review of consolidated interim financial information.

Pursuant to Rule 436 under the Securities Act of 1933 ("the Act"), such report is not considered part of a registration statement prepared or certified by an independent registered public accounting firm, or a report prepared or certified by an independent registered public accounting firm within the meaning of Sections 7 and 11 of the Act.

/s/ KPMG LLP
Short Hills, New Jersey

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Juan Ramón Alaix, certify that:

1. I have reviewed this Quarterly Report of Zoetis Inc. on Form 10-Q for the period ending June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 6, 2019

By: /s/ JUAN RAMÓN ALAIX

Juan Ramón Alaix
Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Glenn David, certify that:

1. I have reviewed this Quarterly Report of Zoetis Inc. on Form 10-Q for the period ending June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 6, 2019

By: /s/ GLENN DAVID

Glenn David

Executive Vice President and
Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. §1350, I, Juan Ramón Alaix, Chief Executive Officer, hereby certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of Zoetis Inc. for the period ended June 30, 2019 (the "Report") (1) fully complies with Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Zoetis Inc.

August 6, 2019

By: /s/ JUAN RAMÓN ALAIX

Juan Ramón Alaix

Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. §1350, I, Glenn David, Executive Vice President and Chief Financial Officer, hereby certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of Zoetis Inc. for the period ended June 30, 2019 (the “Report”) (1) fully complies with Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Zoetis Inc.

August 6, 2019

By: /s/ GLENN DAVID
 Glenn David
 Executive Vice President and
 Chief Financial Officer