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
March 31, 2021

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	**46-0696167**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10 Sylvan Way, Parsippany, New Jersey	**07054**
(Address of principal executive offices)	(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 April 30, 2021, there were 474,766,701 shares of common stock outstanding.

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended March 31,	
(MILLIONS OF DOLLARS AND SHARES, EXCEPT PER SHARE DATA)	**2021**	2020
Revenue	**$ 1,871**	$ 1,534
Costs and expenses:		
Cost of sales	**549**	459
Selling, general and administrative expenses	**409**	389
Research and development expenses	**118**	107
Amortization of intangible assets	**40**	40
Restructuring charges and certain acquisition-related costs	**9**	9
Interest expense, net of capitalized interest	**57**	53
Other (income)/deductions—net	**2**	(20)
Income before provision for taxes on income	**687**	497
Provision for taxes on income	**129**	74
Net income before allocation to noncontrolling interests	**558**	423
Less: Net loss attributable to noncontrolling interests	**(1)**	—
Net income attributable to Zoetis Inc.	**$ 559**	$ 423
Earnings per share attributable to Zoetis Inc. stockholders:		
Basic	**$ 1.18**	$ 0.89
Diluted	**$ 1.17**	$ 0.88
Weighted-average common shares outstanding:		
Basic	**475.5**	475.6
Diluted	**477.9**	479.0
Dividends declared per common share	**$ 0.250**	$ 0.200

See notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
(MILLIONS OF DOLLARS)	**2021**	2020
Net income before allocation to noncontrolling interests	**$ 558**	$ 423
Other comprehensive income (loss), net of tax:		
Unrealized gains/(losses) on derivatives for cash flow hedges, net	**39**	(28)
Unrealized gains on derivatives for net investment hedges, net	**25**	17
Foreign currency translation adjustments, net	**33**	(44)
Total other comprehensive income (loss), net of tax	**97**	(55)
Comprehensive income before allocation to noncontrolling interests	**655**	368
Less: Comprehensive loss attributable to noncontrolling interests	**(1)**	—
Comprehensive income attributable to Zoetis Inc.	**$ 656**	$ 368

See notes to condensed consolidated financial statements.

ZOETIS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(MILLIONS OF DOLLARS, EXCEPT SHARE AND PER SHARE DATA)		**March 31, 2021** (Unaudited)		December 31, 2020
Assets				
Cash and cash equivalents[a]	**$**	**3,602**	$	3,604
Accounts receivable, less allowance for doubtful accounts of $18 in 2021 and $20 in 2020		**1,125**		1,013
Inventories		**1,700**		1,628
Other current assets		**367**		366
Total current assets		**6,794**		6,611
Property, plant and equipment, less accumulated depreciation of $2,012 in 2021 and $1,952 in 2020		**2,227**		2,202
Operating lease right of use assets		**189**		192
Goodwill		**2,707**		2,694
Identifiable intangible assets, less accumulated amortization		**1,671**		1,710
Noncurrent deferred tax assets		**100**		94
Other noncurrent assets		**108**		106
Total assets	**$**	**13,796**	$	13,609
Liabilities and Equity				
Short-term borrowings	**$**	**4**	$	4
Current portion of long-term debt		**600**		600
Accounts payable		**346**		457
Dividends payable		**119**		119
Accrued expenses		**570**		556
Accrued compensation and related items		**243**		295
Income taxes payable		**113**		46
Other current liabilities		**71**		93
Total current liabilities		**2,066**		2,170
Long-term debt, net of discount and issuance costs		**6,587**		6,595
Noncurrent deferred tax liabilities		**393**		378
Operating lease liabilities		**159**		163
Other taxes payable		**264**		260
Other noncurrent liabilities		**235**		270
Total liabilities		**9,704**		9,836
Commitments and contingencies (Note 15)				
Stockholders' equity:				
Common stock, $0.01 par value: 6,000,000,000 authorized; 501,891,243 and 501,891,243 shares issued; 474,973,405 and 475,317,751 shares outstanding at March 31, 2021, and December 31, 2020, respectively		**5**		5
Treasury stock, at cost, 26,917,838 and 26,573,492 shares of common stock at March 31, 2021, and December 31, 2020, respectively		**(2,412)**		(2,230)
Additional paid-in capital		**1,030**		1,065
Retained earnings		**6,099**		5,659
Accumulated other comprehensive loss		**(633)**		(730)
Total Zoetis Inc. equity		**4,089**		3,769
Equity attributable to noncontrolling interests		**3**		4
Total equity		**4,092**		3,773
Total liabilities and equity	**$**	**13,796**	$	13,609

[a] As of March 31, 2021 and December 31, 2020, includes $2 million of restricted cash.

See notes to condensed consolidated financial statements.

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

Three months ended March 31, 2021

	Zoetis								
	Common Stock		Treasury Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Equity Attributable to Noncontrolling	Total
(MILLIONS OF DOLLARS AND SHARES)	Shares [a]	Amount	Shares [a]	Amount	Capital	Earnings	Loss	Interests	Equity
Balance, December 31, 2020	501.9	$ 5	26.6	$ (2,230)	$ 1,065	$ 5,659	$ (730)	$ 4	$ 3,773
Net income	—	—	—	—	—	**559**	—	**(1)**	**558**
Other comprehensive income	—	—	—	—	—	—	**97**	—	**97**
Share-based compensation awards [b]	—	—	**(0.8)**	**(1)**	**(36)**	—	—	—	**(37)**
Treasury stock acquired [c]	—	—	**1.1**	**(181)**	—	—	—	—	**(181)**
Employee benefit plan contribution from Pfizer Inc. [d]	—	—	—	—	**1**	—	—	—	**1**
Dividends declared	—	—	—	—	—	**(119)**	—	—	**(119)**
Balance, March 31, 2021	**501.9**	**$ 5**	**26.9**	**$ (2,412)**	**$ 1,030**	**$ 6,099**	**$ (633)**	**$ 3**	**$ 4,092**

Three months ended March 31, 2020

	Zoetis								
	Common Stock		Treasury Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Equity Attributable to Noncontrolling	Total
(MILLIONS OF DOLLARS AND SHARES)	Shares [a]	Amount	Shares [a]	Amount	Capital	Earnings	Loss	Interests	Equity
Balance, December 31, 2019	501.9	$ 5	26.4	$ (2,042)	$ 1,044	$ 4,427	$ (726)	$ —	$ 2,708
Net income	—	—	—	—	—	423	—	—	423
Other comprehensive loss	—	—	—	—	—	—	(55)	—	(55)
Share-based compensation awards [b]	—	—	(1.2)	40	(28)	9	—	—	21
Treasury stock acquired [c]	—	—	1.8	(250)	—	—	—	—	(250)
Employee benefit plan contribution from Pfizer Inc.[d]	—	—	—	—	1	—	—	—	1
Dividends declared	—	—	—	—	—	(95)	—	—	(95)
Balance, March 31, 2020	501.9	$ 5	27.0	$ (2,252)	$ 1,017	$ 4,764	$ (781)	$ —	$ 2,753

[a] Shares may not add due to rounding.

[b] Includes the issuance of shares of Zoetis Inc. common stock and the reacquisition of shares of treasury stock associated with exercises of employee share-based awards. Also includes the reacquisition of shares of treasury stock associated with the vesting of employee share-based awards to satisfy tax withholding requirements. For additional information, see *Note 12. Share-based Payments* and *Note 13. Stockholders' Equity*.

[c] Reflects the acquisition of treasury shares in connection with the share repurchase program. For additional information, see *Note 13. Stockholders' Equity*.

[d] 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.

See notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
(MILLIONS OF DOLLARS)	**2021**	2020
Operating Activities		
Net income before allocation to noncontrolling interests	**$ 558**	$ 423
Adjustments to reconcile net income before noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization expense	**109**	110
Share-based compensation expense	**13**	16
Asset write-offs and asset impairments	**1**	—
Net gain on sale of assets	**—**	(17)
Provision for losses on inventory	**11**	13
Deferred taxes	**(13)**	(9)
Employee benefit plan contribution from Pfizer Inc.	**1**	1
Other non-cash adjustments	**4**	—
Other changes in assets and liabilities, net of acquisitions and divestitures:		
Accounts receivable	**(108)**	109
Inventories	**(84)**	(97)
Other assets	**24**	(65)
Accounts payable	**(112)**	(35)
Other liabilities	**(72)**	(128)
Other tax accounts, net	**68**	87
Net cash provided by operating activities	**400**	408
Investing Activities		
Capital expenditures	**(77)**	(94)
Other acquisitions	**(3)**	(6)
Settlement on swaps designated as net investment hedges	**17**	24
Net proceeds from sale of assets	**—**	20
Other investing activities	**—**	(1)
Net cash used in investing activities	**(63)**	(57)
Financing Activities		
Share-based compensation-related proceeds, net of taxes paid on withholding shares	**(39)**	17
Purchases of treasury stock	**(181)**	(250)
Cash dividends paid	**(119)**	(95)
Net cash used in financing activities	**(339)**	(328)
Effect of exchange-rate changes on cash and cash equivalents	**—**	(6)
Net (decrease)/increase in cash and cash equivalents	**(2)**	17
Cash and cash equivalents at beginning of period	**3,604**	1,934
Cash and cash equivalents at end of period	**$ 3,602**	$ 1,951
Supplemental cash flow information		
Cash paid during the period for:		
Income taxes	**$ 32**	$ 22
Interest, net of capitalized interest	**94**	95
Amounts included in the measurement of lease liabilities	**11**	11
Non-cash transactions:		
Capital expenditures	**3**	2
Lease obligations obtained in exchange for right-of-use assets	**7**	4
Dividends declared, not paid	**119**	95

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 animal health industry, focused on the discovery, development, manufacture and commercialization of medicines, vaccines, diagnostic products, biodevices, genetic tests and precision livestock farming technology. 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: dogs, cats and horses (collectively, companion animals) and cattle, swine, poultry, fish and sheep (collectively, livestock); and within seven major product categories: vaccines, parasiticides, anti-infectives, dermatology, other pharmaceutical products, medicated feed additives and animal health diagnostics.

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 U.S. are as of and for the three-month periods ended February 28, 2021 and February 29, 2020.

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.

Certain reclassifications of prior year information have been made to conform to the current year's presentation.

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 2020 Annual Report on Form 10-K.

3. Accounting Standards

Recently Issued Accounting Standards

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The new guidance provides temporary optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions that reference the London Interbank Offered Rate (LIBOR) or another reference rate expected to be discontinued because of reference rate reform. Adoption of the provisions of ASU 2020-04 is optional and effective as of March 12, 2020, but only available through December 31, 2022. We are currently evaluating the impact that the new guidance will have on our consolidated financial statements and related disclosures, as well as the timing of the potential adoption.

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, retailers and e-commerce outlets. 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 companion animals and livestock across each of our major 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;
- **parasiticides**: products that prevent or eliminate external and internal parasites such as fleas, ticks and worms;
- **anti-infectives**: products that prevent, kill or slow the growth of bacteria, fungi or protozoa;
- **dermatology products**: products that relieve itch associated with allergic conditions and atopic dermatitis;
- **other pharmaceutical products**: pain and sedation, antiemetic, reproductive, and oncology products;
- **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, blood glucose monitors and reference laboratory services.

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

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, deepening the human-animal bond, receiving increased medical treatment and benefiting from advances in animal health medicine, vaccines and diagnostics.

Our livestock products primarily help prevent or treat diseases and conditions to allow veterinarians and producers to care for their animals and 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 demand for improved nutrition, particularly through increased consumption of animal protein. Second, population growth leads to greater natural resource constraints driving a need for enhanced productivity. Finally, as standards of living improve and the global food chain faces increased scrutiny, there is more focus on food quality, safety, and reliability of supply.

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

Revenue by geographic area

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
United States	**$ 933**	$ 786
Australia	**57**	43
Brazil	**74**	63
Canada	**46**	40
Chile	**34**	23
China	**123**	66
France	**35**	29
Germany	**38**	34
Italy	**25**	21
Japan	**47**	41
Mexico	**33**	32
Spain	**31**	28
United Kingdom	**69**	55
Other developed markets	**111**	87
Other emerging markets	**199**	166
	1,855	1,514
Contract manufacturing & human health	**16**	20
Total Revenue	**$ 1,871**	$ 1,534

Revenue by major species

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
U.S.		
Companion animal	**$ 658**	$ 499
Livestock	**275**	287
	933	786
International		
Companion animal	**418**	298
Livestock	**504**	430
	922	728
Contract manufacturing & human health	**16**	20
Total Revenue	**$ 1,871**	$ 1,534

Revenue by species

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020
Companion Animal:		
Dogs and Cats	**$ 1,016**	$ 746
Horses	**60**	51
	1,076	797
Livestock:		
Cattle	**399**	370
Swine	**190**	157
Poultry	**131**	148
Fish	**37**	26
Sheep and other	**22**	16
	779	717
Contract manufacturing & human health	**16**	20
Total Revenue	**$ 1,871**	$ 1,534

Revenue by major product category

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020
Vaccines	**$ 413**	$ 349
Parasiticides	**390**	255
Anti-infectives	**321**	280
Dermatology	**248**	197
Other pharmaceuticals	**226**	197
Medicated feed additives	**112**	125
Animal health diagnostics	**89**	60
Other non-pharmaceuticals	**56**	51
	1,855	1,514
Contract manufacturing & human health	**16**	20
Total Revenue	**$ 1,871**	$ 1,534

B. Revenue from Contracts with Customers

Contract liabilities reflected within *Other current liabilities* as of December 31, 2020 and December 31, 2019, and subsequently recognized as revenue during the first three months of 2021 and 2020 were approximately $3 million. Contract liabilities as of March 31, 2021 and December 31, 2020 were approximately $14 million and $13 million, respectively.

Estimated future revenue expected to be generated from long-term contracts with unsatisfied performance obligations as of March 31, 2021 is not material.

5. Acquisitions and Divestitures

A. Acquisitions

Other Acquisitions

During 2020, we completed the acquisitions of Fish Vet Group, a diagnostics company for aquaculture, Virtual Recall, a veterinary engagement software company, Performance Livestock Analytics, a cloud-based technology company in the precision livestock business, and Ethos Diagnostic Science, a veterinary reference laboratory business with labs across the U.S. We also entered into an option purchase agreement as part of a research and development arrangement with a Belgian company, a variable interest entity of which Zoetis is the primary beneficiary and now consolidating within our results. These transactions did not have a significant impact on our consolidated financial statements.

B. Divestitures

During the three months ended March 31, 2020, we received cash proceeds of $20 million resulting from a payment received pursuant to an agreement related to the 2016 sale of certain U.S. manufacturing sites.

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 information technology, shared services and corporate operations.

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

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
Restructuring charges and certain acquisition-related costs:		
Integration costs[(a)]	**$ 3**	$ 6
Restructuring charges[(b)]:		
Employee termination costs	**4**	3
Exit costs	**2**	—
Total Restructuring charges and certain acquisition-related costs	**$ 9**	$ 9

(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 months ended March 31, 2021 primarily relate to employee termination and exit costs associated with cost-reduction and productivity initiatives and CEO transition-related costs.

The restructuring charges for the three months ended March 31, 2020 primarily relate to CEO transition-related costs which are associated with Manufacturing/research/corporate.

(MILLIONS OF DOLLARS)	Accrual[(a)]
Balance, December 31, 2020[(b)]	$ 21
Provision	**6**
Utilization and other[(c)]	**(5)**
Balance, March 31, 2021[(b)]	**$ 22**

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

(b) At March 31, 2021, and December 31, 2020, included in *Accrued expenses* ($6 million) and *Other noncurrent liabilities* ($16 million and $15 million, respectively).

(c) Includes adjustments for foreign currency translation.

7. Other (Income)/Deductions—Net

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

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
Royalty-related income	**$ (2)**	$ (1)
Interest income	**(1)**	(6)
Net gain on sale of assets[(a)]	**—**	(17)
Foreign currency loss[(b)]	**3**	5
Other, net	**2**	(1)
Other (income)/deductions—net	**$ 2**	**$ (20)**

(a) For the three months ended March 31, 2020, represents a net gain resulting from net cash proceeds received pursuant to an agreement related to the 2016 sale of certain U.S. manufacturing sites.

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

8. Income Taxes

A. Taxes on Income

Our effective tax rate was 18.8% for the three months ended March 31, 2021, compared with 14.9% for the three months ended March 31, 2020. The higher effective tax rate for the three months ended March 31, 2021, was primarily attributable to:

- a $13 million and a $23 million discrete tax benefit recorded in the three months ended March 31, 2021 and 2020, respectively, related to the excess tax benefits for share-based payments;
- a $6 million discrete tax benefit recorded in the three months ended March 31, 2020 related to a remeasurement of deferred taxes resulting from the integration of acquired businesses; and
- a $1 million discrete tax expense and a $3 million discrete tax benefit recorded in the three months ended March 31, 2021 and 2020, respectively, related to a remeasurement of deferred taxes as a result of changes in statutory tax rates,

partially offset by:

- 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, operating fluctuations in the normal course of business and the impact of non-deductible items and non-taxable items.

B. Deferred Taxes

As of March 31, 2021, the total net deferred income tax liability of $293 million is included in *Noncurrent deferred tax assets* ($100 million) and *Noncurrent deferred tax liabilities* ($393 million).

As of December 31, 2020, the total net deferred income tax liability of $284 million is included in *Noncurrent deferred tax assets* ($94 million) and *Noncurrent deferred tax liabilities* ($378 million).

C. Tax Contingencies

As of March 31, 2021, the net tax liabilities associated with uncertain tax positions of $192 million (exclusive of interest and penalties related to uncertain tax positions of $15 million) are included in *Noncurrent deferred tax assets* and *Other noncurrent assets* ($2 million) and *Other taxes payable* ($190 million).

As of December 31, 2020, the net tax liabilities associated with uncertain tax positions of $188 million (exclusive of interest and penalties related to uncertain tax positions of $14 million) are included in *Noncurrent deferred tax assets* and *Other noncurrent assets* ($1 million) and *Other taxes payable* ($187 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 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 March 31, 2021 and December 31, 2020. There were no amounts drawn under the credit facility as of March 31, 2021 or December 31, 2020.

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 March 31, 2021, we had access to $80 million of lines of credit which expire at various times through 2021 and are generally renewed annually. There were $4 million of borrowings outstanding related to these facilities as of March 31, 2021 and December 31, 2020.

Commercial Paper Program

In February 2013, we entered into a commercial paper program with a capacity of up to $1.0 billion. As of March 31, 2021 and December 31, 2020, there was no commercial paper outstanding under this program.

Senior Notes and Other Long-Term Debt

On May 12, 2020, we issued $1.25 billion aggregate principal amount of our senior notes (2020 senior notes), with an original issue discount of $10 million. These notes are comprised of $750 million aggregate principal amount of 2.000% senior notes due 2030 and $500 million aggregate principal amount of 3.000% senior notes due 2050. On October 13, 2020, the net proceeds were used to repay in full the aggregate principal amount of our 3.450% 2015 senior notes due 2020 and the remainder will be used for general corporate purposes.

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. 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. 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, 2018 and 2020 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, 2018 and 2020 senior notes may be declared immediately due and payable.

Pursuant to the indenture, we are able to redeem the 2013, 2015, 2017 and 2020 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, 2018 and 2020 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, 2018 and 2020 senior notes at a price equal to 101% of the aggregate principal amount of the 2013, 2015, 2017, 2018 and 2020 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)	**March 31, 2021**	December 31, 2020
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
2.000% 2020 senior notes due 2030	**750**	750
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
3.000% 2020 senior notes due 2050	**500**	500
	7,250	7,250
Unamortized debt discount / debt issuance costs	**(65)**	(66)
Less current portion of long-term debt	**600**	600
Cumulative fair value adjustment for interest rate swap contracts	**2**	11
Long-term debt, net of discount and issuance costs	**$ 6,587**	$ 6,595

The fair value of our long-term debt was $7,272 million and $7,835 million as of March 31, 2021, and December 31, 2020, 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 March 31, 2021, matures in the following years:

(MILLIONS OF DOLLARS)	2021	2022	2023	2024	2025	After 2025	Total
Maturities	$ 600	$ —	$ 1,350	$ —	$ 750	$ 4,550	$ 7,250

Interest Expense

Interest expense, net of capitalized interest, was $57 million and $53 million for the three months ended March 31, 2021 and 2020, respectively. Capitalized interest expense was $5 million and $4 million for the three months ended March 31, 2021 and 2020, respectively.

B. 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 British pound, Canadian dollar, Chinese yuan, Danish krone, 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 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 income/(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 cross-currency interest rate swap contracts have varying maturities of up to five 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.
- As of March 31, 2021, we had outstanding forward-starting interest rate swaps, having an effective date and mandatory termination date in March 2023, to hedge against interest rate exposure related principally to the anticipated future issuance of fixed-rate debt to be used primarily to refinance our 3.250% 2013 senior notes due 2023, and a forward-starting interest rate swap, having an effective date and mandatory termination date in March 2026, to hedge against interest rate exposure related principally to the anticipated future issuance of fixed-rate debt to be used primarily to refinance our 4.500% senior notes due 2025.
- We may use fixed-to-floating interest rate swaps that are designated as fair value hedges to hedge against changes in the fair value of certain fixed-rate debt attributable to changes in the benchmark LIBOR rate. These derivative instruments effectively convert a portion of the company's long-term debt from fixed rate to floating rate debt based on three-month LIBOR plus a spread. Gains or losses on the fixed to floating interest rate swaps due to changes in LIBOR are recorded in Interest expense, net of capitalized interest. Changes in the fair value of the fixed-to-floating interest rate swaps are offset by changes in the fair value of the underlying fixed rate debt. As of March 31, 2021, we had an outstanding fixed-to-floating interest rate swap that corresponds to a portion of the 3.900% 2018 senior notes due 2028. The amounts recorded during the three months ended March 31, 2021 for changes in the fair value of this hedge are not material to our consolidated financial statements.

Outstanding Positions

The aggregate notional amounts of derivative instruments are as follows:

	Notional	
(MILLIONS)	**March 31, 2021**	December 31, 2020
Foreign currency forward-exchange contracts	**$ 1,527**	$ 1,633
Cross-currency interest rate swap contracts (in foreign currency):		
Euro	**650**	650
Danish krone	**600**	600
Swiss franc	**25**	25
Forward-starting interest rate swaps	**$ 550**	$ 550
Fixed-to-floating interest rate swap contracts	**$ 150**	$ 150

Fair Value of Derivative Instruments

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

		Fair Value of Derivatives	
(MILLIONS OF DOLLARS)	Balance Sheet Location	**March 31, 2021**	December 31, 2020
Derivatives Not Designated as Hedging Instruments			
Foreign currency forward-exchange contracts	Other current assets	**$ 7**	$ 10
Foreign currency forward-exchange contracts	Other current liabilities	**(11)**	(16)
Total derivatives not designated as hedging instruments		**$ (4)**	$ (6)
Derivatives Designated as Hedging Instruments:			
Forward-starting interest rate swap contracts	Other noncurrent assets	**$ 39**	$ 6
Forward-starting interest rate swap contracts	Other noncurrent liabilities	**—**	(17)
Cross-currency interest rate swap contracts	Other current assets	**20**	2
Cross-currency interest rate swap contracts	Other noncurrent assets	**10**	5
Cross-currency interest rate swap contracts	Other current liabilities	**(3)**	(21)
Fixed-to-floating interest rate swap contracts	Other noncurrent assets	**2**	11
Total derivatives designated as hedging instruments		**68**	(14)
Total derivatives		**$ 64**	$ (20)

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 March 31, 2021, there was $30 million of collateral received related to forward-starting interest rate swap contracts and long-term cross-currency interest rate swaps recorded in *Other noncurrent assets*.

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

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
Foreign currency forward-exchange contracts	**$ (5)**	$ 6

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/(losses) on interest rate swap contracts, recorded, net of tax, in *Accumulated other comprehensive income/(loss)*, are as follows:

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
Forward-starting interest rate swap contracts	**$ 39**	$ (27)
Cross-currency interest rate swap contracts	**$ 25**	$ 17

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

	Three Months Ended **March 31,**	
(MILLIONS OF DOLLARS)	**2021**	2020
Cross-currency interest rate swap contracts	**$ 3**	$ 6

The net amount of deferred losses related to derivative instruments designated as cash flow hedges that is expected to be reclassified from *Accumulated other comprehensive income/(loss)* into earnings over the next 12 months is $1 million.

10. Inventories

The components of inventory are as follows:

(MILLIONS OF DOLLARS)		March 31, 2021		December 31, 2020
Finished goods	**$**	**803**	$	805
Work-in-process		**642**		594
Raw materials and supplies		**255**		229
Inventories	**$**	**1,700**	$	1,628

11. 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, 2020	$	1,425	$	1,269	$	2,694
Adjustments		**(1)**		**2**		**1**
Other[(a)]		—		**12**		**12**
Balance, March 31, 2021	**$**	**1,424**	**$**	**1,283**	**$**	**2,707**

[(a)] Includes adjustments for foreign currency translation.

The gross goodwill balance was $3,243 million and $3,230 million as of March 31, 2021 and December 31, 2020, respectively. Accumulated goodwill impairment losses were $536 million as of March 31, 2021 and December 31, 2020.

B. Other Intangible Assets

The components of identifiable intangible assets are as follows:

	As of March 31, 2021						As of December 31, 2020					
(MILLIONS OF DOLLARS)		**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	**$**	**1,983**	**$**	**(853)**	**$**	**1,130**	$	1,968	$	(809)	$	1,159
Brands and tradenames		**428**		**(248)**		**180**		427		(243)		184
Other		**477**		**(315)**		**162**		474		(306)		168
Total finite-lived intangible assets		**2,888**		**(1,416)**		**1,472**		2,869		(1,358)		1,511
Indefinite-lived intangible assets:												
Brands and tradenames		**104**		—		**104**		104		—		104
In-process research and development		**88**		—		**88**		88		—		88
Product rights		**7**		—		**7**		7		—		7
Total indefinite-lived intangible assets		**199**		—		**199**		199		—		199
Identifiable intangible assets	**$**	**3,087**	**$**	**(1,416)**	**$**	**1,671**	$	3,068	$	(1,358)	$	1,710

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 $51 million and $62 million for the three months ended March 31, 2021 and 2020, respectively.

12. Share-based Payments

The Zoetis 2013 Equity and Incentive Plan (the Equity Plan) provides long-term incentives 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 **March 31,** 2021	2020
Stock options / stock appreciation rights	**$ 2**	$ 3
RSUs / DSUs	**8**	8
PSUs	**3**	5
Share-based compensation expense—total[(a)]	**$ 13**	$ 16

[(a)] Amounts capitalized to inventory were insignificant for the three months ended March 31, 2021 and 2020.

During the three months ended March 31, 2021, the company granted 281,675 stock options with a weighted-average exercise price of $160.62 per stock option and a weighted-average fair value of $37.82 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 0.53%; expected dividend yield of 0.62%; expected stock price volatility of 27.97%; and expected term of 5.0 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 three months ended March 31, 2021, the company granted 225,525 RSUs, with a weighted-average grant date fair value of $160.58 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 three months ended March 31, 2021, the company granted 103,759 PSUs with a weighted-average grant date fair value of $208.81 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 28.9% and 38.1%, 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.

13. Stockholders' Equity

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

In December 2018, the company's Board of Directors authorized a $2.0 billion share repurchase program. As of March 31, 2021, there was approximately $1.2 billion remaining under this authorization. Purchases of Zoetis shares may be made at the discretion of management, depending on market conditions and business needs. The company temporarily suspended share repurchases beginning in the second quarter of 2020. In January 2021, the company resumed share repurchases under its share repurchase program.

Accumulated other comprehensive loss

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

		Currency Translation Adjustments			
(MILLIONS OF DOLLARS)	Cash Flow Hedges	Net Investment Hedges	Other Currency Translation Adjustments	Benefit Plans	Accumulated Other Comprehensive Loss
Balance, December 31, 2020	$ (15)	$ (37)	$ (655)	$ (23)	$ (730)
Other comprehensive income, net of tax	**39**	**25**	**33**	**—**	**97**
Balance, March 31, 2021	**$ 24**	**$ (12)**	**$ (622)**	**$ (23)**	**$ (633)**
Balance, December 31, 2019	$ —	$ 21	$ (724)	$ (23)	$ (726)
Other comprehensive (loss)/income, net of tax	(28)	17	(44)	—	(55)
Balance, March 31, 2020	$ (28)	$ 38	$ (768)	$ (23)	$ (781)

14. Earnings per Share

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

	Three Months Ended March 31,	
(MILLIONS OF DOLLARS AND SHARES, EXCEPT PER SHARE DATA)	**2021**	2020
Numerator		
Net income before allocation to noncontrolling interests	**$ 558**	$ 423
Less: Net loss attributable to noncontrolling interests	**(1)**	—
Net income attributable to Zoetis Inc.	**$ 559**	$ 423
Denominator		
Weighted-average common shares outstanding	**475.5**	475.6
Common stock equivalents: stock options, RSUs, PSUs and DSUs	**2.4**	3.4
Weighted-average common and potential dilutive shares outstanding	**477.9**	479.0
Earnings per share attributable to Zoetis Inc. stockholders—basic	**$ 1.18**	$ 0.89
Earnings per share attributable to Zoetis Inc. stockholders—diluted	**$ 1.17**	$ 0.88

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 for the three months ended March 31, 2021 and 2020.

15. 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 U.S. 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 presented the technical proposal to the Prosecutor on October 21, 2019. On March 3, 2020, the Prosecutor notified the defendants that he submitted the proposal to the Ministry of the Environment for its review and consideration by the Prosecutor. On July 15, 2020, the Prosecutor recommended certain amendments to the proposal for the Phase II testing. On September 28, 2020, the parties and the Prosecutor agreed to the final terms and conditions concerning the cooperation agreement with respect to the Phase II testing. We anticipate that the Phase II testing will begin in the latter part of this year or sometime next year.

Lascadoil Contamination in Animal Feed

An investigation by the U.S. Food and Drug Administration (FDA) and the Michigan Department of Agriculture into the alleged contamination of the feed supply of certain turkey and hog feed mills in Michigan led to the recall of certain batches of soy oil (intended for use as an animal feed additive) that had originated with Shur-Green Farms LLC, a producer of soy oil, and that had been contaminated with lascadoil, an industrial by-product of certain Zoetis manufacturing processes. 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. The investigation posited that Shur-Green inadvertently contaminated soy oil with lascadoil which it purchased from Zoetis for use as a bio-fuel ingredient, and then sold the contaminated soy oil to fat recycling vendors, who in turn unknowingly sold to feed mills for use in animal feed.

During the course of its investigation, the FDA identified the process used to manufacture Zoetis' Avatec® (lasalocid sodium) and Bovatec® (lasalocid sodium) products as the possible source of the lascadoil, since lascadoil contains small amounts of lasalocid, the active ingredient found in both products. Zoetis sold the industrial lascadoil byproduct to Shur-Green, through its broker, Heritage Interactive Services, LLC. Under the terms of the sale agreement, the lascadoil could only be incinerated or resold for use in biofuel and the agreement expressly prohibited the reselling of lascadoil for use 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 was remanded back to the lower Court, where it was scheduled to proceed to trial by jury. We have been advised that the remaining parties have reached an agreement to settle the dispute, and on June 24, 2020, the remaining parties jointly stipulated to the dismissal of all remaining claims. On July 13, 2020, Plaintiffs filed a claim of appeal with Michigan State Circuit

Court seeking reversal of the lower Court's decision granting Zoetis' motion for summary disposition. Plaintiffs' filed their appeal brief on October 29, 2020, and we filed our reply brief on December 3, 2020. This appeal remains pending before the Circuit Court.

Belgium Excess Profit Tax Regime

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 May 8, 2019, the EC filed an appeal to the decision of the General Court. On September 16, 2019, the EC opened separate in-depth investigations to assess whether Belgium excess profit rulings granted to 39 multinational companies, including Zoetis, constituted state aid for those companies. 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 March 31, 2021. We will continue to monitor the developments of the appeal and its ultimate resolution.

Alpharma

The EC 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. On June 4, 2020, the Advocate General issued his non-binding opinion, which largely confirmed the decision of the General Court. On March 25, 2021, the Court of Justice affirmed the decision of the General Court. Since the penalty has already been paid, no further action is needed, and the proceedings involving the EC are now concluded.

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 March 31, 2021, recorded amounts for the estimated fair value of these indemnifications were not significant.

16. Segment Information

Operating Segments

We manage our operations through two geographic operating segments: the U.S. 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, dermatology, 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.

Beginning in the first quarter of 2021, certain costs associated with information technology that specifically support our global manufacturing operations, which were previously reported in Other unallocated, are now reported in Corporate. In addition, in the first quarter of 2021, the company realigned certain management responsibilities. These changes did not impact the determination of our operating segments, however they resulted in the reallocation of certain costs between segments. These changes primarily include the following: (i) certain diagnostics costs, which were previously reported in Corporate, are now reported in our U.S. results; and (ii) certain other miscellaneous costs, which were previously reported in our U.S. results, are now reported in Corporate.

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 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 information technology, facilities, legal, finance, human resources, business development, certain diagnostic costs 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 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 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.

Selected Statement of Income Information

	Earnings		Depreciation and Amortization[a]	
	Three Months Ended March 31,		Three Months Ended March 31,	
(MILLIONS OF DOLLARS)	**2021**	2020	**2021**	2020
U.S.				
Revenue	**$ 933**	$ 786		
Cost of sales	**184**	167		
Gross profit	**749**	619		
Gross margin	**80.3 %**	78.8 %		
Operating expenses	**131**	125		
Other (income)/deductions-net	**1**	1		
U.S. Earnings	**617**	493	**$ 13**	$ 13
International				
Revenue[b]	**922**	728		
Cost of sales	**282**	224		
Gross profit	**640**	504		
Gross margin	**69.4 %**	69.2 %		
Operating expenses	**130**	125		
Other (income)/deductions-net	**—**	—		
International Earnings	**510**	379	**17**	14
Total operating segments	**1,127**	872	**30**	27
Other business activities	**(97)**	(87)	**7**	6
Reconciling Items:				
Corporate	**(230)**	(187)	**27**	22
Purchase accounting adjustments	**(44)**	(54)	**44**	54
Acquisition-related costs	**(5)**	(7)	**—**	—
Certain significant items[c]	**(8)**	11	**—**	—
Other unallocated	**(56)**	(51)	**1**	1
Total Earnings[d]	**$ 687**	$ 497	**$ 109**	$ 110

[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 $192 million and $170 million for the three months ended March 31, 2021 and 2020, respectively.

[c] For the three months ended March 31, 2021, primarily represents employee termination costs related to cost-reduction and productivity initiatives, as well as product transfer costs related to cost-reduction and productivity initiatives.

For the three months ended March 31, 2020, primarily represents a net gain resulting from net cash proceeds received pursuant to an agreement related to the 2016 sale of certain U.S. manufacturing sites of $17 million, partially offset by CEO transition-related costs of $4 million.

[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 March 31, 2021, the related condensed consolidated statements of income, comprehensive income, equity and cash flows for the three-month periods ended March 31, 2021 and March 31, 2020, 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, 2020, 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 16, 2021, 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, 2020, 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
May 6, 2021

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

Overview of our business

Zoetis is a global leader in the animal health industry, focused on the discovery, development, manufacture and commercialization of medicines, vaccines, diagnostic products, biodevices, genetic tests and precision livestock farming technology. For nearly 70 years, we have been innovating ways to predict, prevent, detect, and treat animal illness, and continue to stand by those raising and caring for animals worldwide - from livestock farmers to veterinarians and pet owners.

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 companion animal and livestock customers in order to capitalize on local and regional trends and customer needs. See Notes to Condensed Consolidated Financial Statements — *Note 16. Segment Information*.

We directly market our products to veterinarians and livestock producers located in approximately 45 countries 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. Through our efforts to establish an early and direct presence in many emerging markets, such as Brazil, Chile, China and Mexico, we believe we are one of the largest animal health medicines and vaccines businesses as measured by revenue across emerging markets as a whole. 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.

Our products include over 300 products and product lines that we sell in over 100 countries for the prediction, prevention, detection and treatment of diseases and conditions that affect various companion animal and livestock species. The diversity of our product portfolio and our global operations provides stability to our overall business. For instance, in livestock, impacts on our revenue that may result from disease outbreaks or weather conditions in a particular market or region are often offset by increased sales in other regions from exports and other species as consumers shift to other proteins.

Beginning in the first quarter of 2021, certain costs associated with information technology that specifically support our global manufacturing operations, which were previously reported in Other unallocated, are now reported in Corporate. In addition, in the first quarter of 2021, the company realigned certain management responsibilities. These changes did not impact the determination of our operating segments, however they resulted in the reallocation of certain costs between segments. These changes primarily include the following: (i) certain diagnostics costs, which were previously reported in Corporate, are now reported in our U.S. results; and (ii) certain other miscellaneous costs, which were previously reported in our U.S. results, are now reported in Corporate.

Certain reclassifications of prior year information have been made to conform to the current year's presentation.

A summary of our 2021 performance compared with the comparable 2020 period follows:

	Three Months Ended March 31,		% Change		
				Related to	
(MILLIONS OF DOLLARS)	**2021**	2020	Total	Foreign Exchange	Operational[a]
Revenue	**$ 1,871**	$ 1,534	22	1	21
Net income attributable to Zoetis	**559**	423	32	(2)	34
Adjusted net income[a]	**603**	455	33	(1)	34

[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 of Financial Condition and Results of Operations (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 2020 Annual Report on Form 10-K. Set forth below are updates to certain of the factors disclosed in our 2020 Form 10-K.

Uncertainty Relating to COVID-19

We continue to closely monitor the impact of the coronavirus (COVID-19) pandemic and the resulting global recession on all aspects of our business across geographies, including how it has and may continue to impact our customers, workforce, suppliers and vendors. We are currently designated an essential business globally and have continued physical operations with respect to research and development, manufacturing and our supply chain. As the pandemic continues to progress, the severity of the impact across markets remains uncertain as the number of cases rises and falls in various jurisdictions leading to changes in the imposition of restrictive measures intended to contain the virus.

Due to numerous uncertainties regarding the continuing COVID-19 pandemic, we are unable to fully predict the impact that it will ultimately have on our future financial position and operating results. These uncertainties include the severity of the virus, the duration of the outbreak and number of recurrences, the effectiveness of measures to contain and treat the virus, including the timing, adoption and effectiveness of widespread vaccinations, governmental, business or other actions in response to the pandemic (which could include actions that result in limitations on, or disruptions to, our manufacturing, transportation and other operations, or mandates to provide products or services), impacts on our supply chain, the effect on customer demand, or changes to our operations. We cannot predict the impact that the COVID-19 pandemic will have on our customers, vendors and suppliers;

however, any material effect on these parties could adversely impact us. In particular, our livestock customers have been, and may continue to be, negatively impacted by facility closures, reduced packing plant capacity, quarantines, travel bans and labor shortages, and the shift in protein production from foodservice to grocery, among other impacts. In addition, our companion animal customers have been, and may in the future be, negatively impacted by lack of demand for veterinary services in areas where lockdown and stay-at-home orders are in place. The impact of COVID-19 on our customers has reduced and could continue to reduce the demand for our products, which could continue to adversely impact our revenue. The health of our workforce, and our ability to meet staffing needs in our manufacturing operations and other critical functions, cannot be predicted and are vital to our operations. Further, the impacts of a prolonged global recession and the continued disruptions to, and volatility in, the credit and financial markets, as well as other unanticipated consequences, remain unknown. In order to preserve liquidity, we issued debt securities in May 2020 and we may in the future incur additional indebtedness, whether through the issuance of debt securities, drawdowns under our credit facility or otherwise. An increase in our outstanding indebtedness will result in additional interest expense.

The situation surrounding COVID-19 remains fluid, and we will continue to actively monitor the situation and may take actions that alter our business operations that we determine are in the best interests of our workforce, customers, vendors, suppliers, and other stakeholders, or as required by federal, state, or local authorities. It is not clear what the potential effects any such alterations or modifications may ultimately have on our business, including the effects on our customers, workforce, and prospects, or on our financial results for the remainder of fiscal 2021.

For further information regarding the impact of COVID-19 on the Company, please see *Item 1A, Risk Factors* on this Quarterly Report on Form 10-Q.

Quarterly Variability of Financial Results

Our quarterly financial results are subject to variability related to a number of factors including but not limited to: the impact of the COVID-19 pandemic discussed above, 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 three months ended March 31, 2021, approximately 46% 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, British 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 three months ended March 31, 2021, approximately 54% of our total revenue was in U.S. dollars. Our year-over-year total revenue growth was favorably impacted by approximately 1% 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 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.

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	Three Months Ended March 31, 2020	% Change
Revenue	**$ 1,871**	$ 1,534	22
Costs and expenses:			
Cost of sales	**549**	459	20
% of revenue	***29.3 %***	*29.9 %*	
Selling, general and administrative expenses	**409**	389	5
% of revenue	***22 %***	*25 %*	
Research and development expenses	**118**	107	10
% of revenue	***6 %***	*7 %*	
Amortization of intangible assets	**40**	40	—
Restructuring charges and certain acquisition-related costs	**9**	9	—
Interest expense, net of capitalized interest	**57**	53	8
Other (income)/deductions—net	**2**	(20)	*
Income before provision for taxes on income	**687**	497	38
% of revenue	***37 %***	*32 %*	
Provision for taxes on income	**129**	74	74
Effective tax rate	***18.8 %***	*14.9 %*	
Net income before allocation to noncontrolling interests	**558**	423	32
Less: Net loss attributable to noncontrolling interests	**(1)**	—	—
Net income attributable to Zoetis Inc.	**$ 559**	$ 423	32
% of revenue	***30 %***	*28 %*	

*Calculation not meaningful

Revenue

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Total revenue increased by $337 million, or 22%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, an increase of $325 million, or 21%, on an operational basis. Operational revenue growth was comprised primarily of the following:

- volume growth from in-line products, including key dermatology products, of approximately 16%; and
- volume growth from new products of approximately 5%.

Foreign exchange increased reported revenue growth by approximately 1%.

Costs and Expenses

Cost of sales

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	Three Months Ended March 31, 2020	% Change
Cost of sales	**$ 549**	$ 459	20
% of revenue	**29.3 %**	29.9 %	

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Cost of sales as a percentage of revenue was 29.3% in the three months ended March 31, 2021 compared with 29.9% in the three months ended March 31, 2020. The decrease was primarily as a result of:

- favorable product mix,

partially offset by:

- unfavorable foreign exchange; and
- higher freight and other charges.

Selling, general and administrative expenses

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020	% Change
Selling, general and administrative expenses	**$ 409**	$ 389	5
% of revenue	**22 %**	25 %	

Three months ended March 31, 2021 vs. three months ended March 31, 2020

SG&A expenses increased by $20 million, or 5%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, primarily as a result of:

- an increase in certain compensation-related costs;
- investments to support revenue growth;
- higher freight and logistics costs; and
- unfavorable foreign exchange,

partially offset by:

- lower travel and entertainment expenses as a result of decreases in travel and events related to the COVID-19 pandemic; and
- the reduced impact of purchase accounting adjustments.

Research and development expenses

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020	% Change
Research and development expenses	**$ 118**	$ 107	10
% of revenue	**6 %**	7 %	

Three months ended March 31, 2021 vs. three months ended March 31, 2020

R&D expenses increased by $11 million, or 10%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, primarily as a result of:

- an increase in certain compensation-related costs;
- increased spending driven by project investments; and
- unfavorable foreign exchange,

partially offset by:

- lower travel and entertainment expenses as a result of decreases in travel and events related to the COVID-19 pandemic.

Amortization of intangible assets

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020	% Change
Amortization of intangible assets	**$ 40**	$ 40	—

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Amortization of intangible assets was $40 million in the three months ended March 31, 2021 and 2020.

Restructuring charges and certain acquisition-related costs

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020	% Change
Restructuring charges and certain acquisition-related costs	**$ 9**	$ 9	—

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. Net restructuring charges are primarily related to employee termination and exit costs. 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 March 31, 2021 vs. three months ended March 31, 2020

Restructuring charges and certain acquisition-related costs were $9 million in the three months ended March 31, 2021 and 2020. Restructuring charges and certain acquisition-related costs in the three months ended March 31, 2021 consisted of employee termination and exit costs associated

with cost-reduction and productivity initiatives, integration costs related to recent acquisitions and restructuring charges related to CEO transition-related costs. Restructuring charges and certain acquisition-related costs in the three months ended March 31, 2020 consisted of integration costs related to acquisitions and restructuring charges related to CEO transition-related costs.

Interest expense, net of capitalized interest

	Three Months Ended **March 31,**		%
(MILLIONS OF DOLLARS)	**2021**	2020	Change
Interest expense, net of capitalized interest	**$ 57**	$ 53	8

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Interest expense, net of capitalized interest, increased by 8% in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, primarily as a result of the increase in long-term debt during the second quarter of 2020.

Other (income)/deductions—net

	Three Months Ended **March 31,**		%
(MILLIONS OF DOLLARS)	**2021**	2020	Change
Other (income)/deductions—net	**$ 2**	$ (20)	*

*Calculation not meaningful

Three months ended March 31, 2021 vs. three months ended March 31, 2020

The change in *Other (income)/deductions—net* is primarily as a result of a net gain of $17 million in the three months ended March 31, 2020 related to net cash proceeds received pursuant to an agreement related to the 2016 sale of certain U.S. manufacturing sites and lower interest income for the three months ended March 31, 2021 as compared to the prior year period.

Provision for taxes on income

	Three Months Ended **March 31,**		%
(MILLIONS OF DOLLARS)	**2021**	2020	Change
Provision for taxes on income	**$ 129**	$ 74	74
Effective tax rate	**18.8 %**	14.9 %	

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Our effective tax rate was 18.8% for the three months ended March 31, 2021, compared with 14.9% for the three months ended March 31, 2020. The higher effective tax rate for the three months ended March 31, 2021, was primarily attributable to:

- a $13 million and a $23 million discrete tax benefit recorded in the three months ended March 31, 2021 and 2020, respectively, related to the excess tax benefits for share-based payments;
- a $6 million discrete tax benefit recorded in the three months ended March 31, 2020 related to a remeasurement of deferred taxes resulting from the integration of acquired businesses; and
- a $1 million and a $3 million discrete tax benefit recorded in the three months ended March 31, 2021 and 2020, respectively, related to a remeasurement of deferred taxes as a result of a change in statutory tax rates,

partially offset by:

- 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, operating fluctuations in the normal course of business and the impact of non-deductible items and non-taxable items.

Operating Segment Results

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

	Three Months Ended March 31,		% Change	Related to	
(MILLIONS OF DOLLARS)	**2021**	2020	Total	Foreign Exchange	Operational
U.S.					
Companion animal	**$ 658**	$ 499	32	—	32
Livestock	**275**	287	(4)	—	(4)
	933	786	19	—	19
International					
Companion animal	**418**	298	40	3	37
Livestock	**504**	430	17	—	17
	922	728	27	2	25
Total					
Companion animal	**1,076**	797	35	1	34
Livestock	**779**	717	9	1	8
Contract manufacturing & human health	**16**	20	(20)	5	(25)
	$ 1,871	$ 1,534	22	1	21

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

	Three Months Ended March 31,		% Change	Related to	
(MILLIONS OF DOLLARS)	**2021**	2020	Total	Foreign Exchange	Operational
U.S.:					
Revenue	**$ 933**	$ 786	19	—	19
Cost of Sales	**184**	167	10	—	10
Gross Profit	**749**	619	21	—	21
Gross Margin	***80.3 %***	*78.8 %*			
Operating Expenses	**131**	125	5	—	5
Other (income)/deductions-net	**1**	1	—	—	—
U.S. Earnings	**617**	493	25	—	25
International:					
Revenue	**922**	728	27	2	25
Cost of Sales	**282**	224	26	—	26
Gross Profit	**640**	504	27	2	25
Gross Margin	***69.4 %***	*69.2 %*			
Operating Expenses	**130**	125	4	3	1
Other (income)/deductions-net	**—**	—	*	*	*
International Earnings	**510**	379	35	3	32
Total operating segments	**1,127**	872	29	1	28
Other business activities	**(97)**	(87)	11		
Reconciling Items:					
Corporate	**(230)**	(187)	23		
Purchase accounting adjustments	**(44)**	(54)	(19)		
Acquisition-related costs	**(5)**	(7)	(29)		
Certain significant items	**(8)**	11	*		
Other unallocated	**(56)**	(51)	10		
Total Earnings	**$ 687**	$ 497	38		

* Calculation not meaningful.

Three months ended March 31, 2021 vs. three months ended March 31, 2020

U.S. operating segment

U.S. segment revenue increased by $147 million, or 19%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, reflecting an increase of approximately $159 million in companion animal products, partially offset by a decrease of approximately $12 million in livestock products.

- Companion animal revenue growth was driven primarily by increased sales of parasiticides, including Simparica Trio, our new triple combination parasiticide, as well as the Revolution/Stronghold franchise. In-line product growth benefited from increased sales of our diagnostics products, the key dermatology portfolio and vaccines.
- Livestock revenue declined due to poultry and swine, partially offset by growth in cattle. Poultry declined due to lower revenue in our medicated feed additives products. The reduction in swine in the quarter was primarily due to a non-recurring government purchase in the same quarter last year. The increase in cattle stemmed from marketing and promotion efforts benefiting the portfolio of products.

U.S. segment earnings increased by $124 million, or 25%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, primarily due to revenue and gross margin growth.

International operating segment

International segment revenue increased by $194 million, or 27%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020. Operational revenue increased by $182 million, or 25%, driven by growth of approximately $110 million in companion animal products and growth of approximately $72 million in livestock products.

- Companion animal operational revenue growth resulted primarily from increased sales of our parasiticide products, including the Simparica franchise with the launch of Simparica Trio, as well as the Revolution/Stronghold franchise. Key dermatology products also contributed to growth with increased sales of Apoquel and Cytopoint, as well as vaccines.
- Livestock operational revenue growth was driven by increased sales in swine, cattle and fish. Sales of swine products grew as a result of expanding herd production in the wake of African Swine Fever in China. Growth in cattle was mainly due to the effect of marketing campaigns, key account penetration and favorable export market conditions in Brazil and other emerging markets. Fish growth was due to an increase in vaccine sales in key salmon markets, timing of vaccinations and recent acquisitions.
- Additionally, International segment revenue was favorably impacted by foreign exchange which increased revenue by approximately $12 million, or 2%, primarily driven by the euro, Chinese yuan and Australian dollar, partially offset by the Brazilian real.

International segment earnings increased by $131 million, or 35%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020. Operational earnings growth was $122 million, or 32%, primarily due to higher revenue and lower operating expenses.

Other business activities

Other business activities includes our Client Supply Services (CSS) contract manufacturing results, our human health 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 March 31, 2021 vs. three months ended March 31, 2020

Other business activities net loss increased by $10 million, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, reflecting an increase in R&D costs due to an increase in compensation-related costs, an increase in project investments and unfavorable foreign exchange, partially offset by lower travel and entertainment expenses as a result of decreases in travel and events related to the COVID-19 pandemic.

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 information 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 finance that specifically support our global manufacturing operations; (iii) certain supply chain and global logistics costs; and (iv) certain procurement costs.

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Corporate expenses increased by $43 million, or 23%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, primarily due to an increase in certain compensation-related costs, an increase in interest expense due to the May 2020 debt issuance, lower interest income, investments in information technology and unfavorable foreign exchange.

Other unallocated expenses increased by $5 million, or 10%, in the three months ended March 31, 2021, compared with the three months ended March 31, 2020, primarily due to unfavorable foreign exchange, partially offset by continued cost improvements.

See Notes to Condensed Consolidated Financial Statements—*Note 16. 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, vaccines and diagnostics 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 U.S. Food and Drug Administration 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 15. 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, as reported under U.S. GAAP, to adjusted net income follows:

(MILLIONS OF DOLLARS)	Three Months Ended **March 31,** **2021**	2020	% Change
GAAP reported net income attributable to Zoetis	**$ 559**	$ 423	32
Purchase accounting adjustments—net of tax	**34**	32	6
Acquisition-related costs—net of tax	**4**	8	(50)
Certain significant items—net of tax	**6**	(8)	*
Non-GAAP adjusted net income[(a)]	**$ 603**	$ 455	33

*Calculation not meaningful.

(a) The effective tax rate on adjusted pretax income is 19.1% and 16.8% for the three months ended March 31, 2021 and 2020, respectively. The higher effective tax rate for the three months ended March 31, 2021, compared with the three months ended March 31, 2020, was primarily attributable to a $13 million and $23 million discrete tax benefit recorded in the three months ended March 31, 2021 and 2020, respectively, related to the excess tax benefits for share-based payments, partially offset by changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings, repatriation costs, operating fluctuations in the normal course of business and the impact of non-deductible and non-taxable items.

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 **March 31,** **2021**	2020	% Change
Earnings per share—diluted[(a)]:			
GAAP reported EPS attributable to Zoetis —diluted	**$ 1.17**	$ 0.88	33
Purchase accounting adjustments—net of tax	**0.07**	0.07	—
Acquisition-related costs—net of tax	**0.01**	0.02	(50)
Certain significant items—net of tax	**0.01**	(0.02)	*
Non-GAAP adjusted EPS—diluted	**$ 1.26**	$ 0.95	33

* Calculation not meaningful.

(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:

(MILLIONS OF DOLLARS)	Three Months Ended **March 31,** **2021**	2020
Interest expense, net of capitalized interest	**$ 57**	$ 53
Interest income	**1**	6
Income taxes	**142**	92
Depreciation	**56**	47
Amortization	**9**	9

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

	Three Months Ended March 31,	
(MILLIONS OF DOLLARS)	**2021**	2020
Purchase accounting adjustments:		
Amortization and depreciation[(a)]	**$ 44**	$ 54
Total purchase accounting adjustments—pre-tax	**44**	54
Income taxes[(b)]	**10**	22
Total purchase accounting adjustments—net of tax	**34**	32
Acquisition-related costs:		
Integration costs	**3**	6
Restructuring costs	**2**	1
Total acquisition-related costs—pre-tax	**5**	7
Income taxes[(b)]	**1**	(1)
Total acquisition-related costs—net of tax	**4**	8
Certain significant items:		
Operational efficiency initiative[(c)]	**—**	(17)
Supply network strategy[(d)]	**1**	2
Other restructuring charges and cost-reduction/productivity initiatives[(e)]	**6**	2
Certain asset impairment charges	**1**	—
Other[(f)]	**—**	2
Total certain significant items—pre-tax	**8**	(11)
Income taxes[(b)]	**2**	(3)
Total certain significant items—net of tax	**6**	(8)
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	**$ 44**	$ 32

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

(b) 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 resulting from the integration of acquired businesses for the three months ended March 31, 2020, in addition to a tax benefit related to a remeasurement of deferred taxes as a result of changes in statutory tax rates, for the three months ended March 31, 2021 and 2020.

Income taxes in *Acquisition-related costs* also includes a tax charge related to a remeasurement of deferred taxes resulting from the integration of acquired businesses for the three months ended March 31, 2020.

(c) For the three months ended March 31, 2020, represents a net gain resulting from net cash proceeds pursuant to an agreement related to the 2016 sale of certain U.S. manufacturing sites.

(d) Represents product transfer costs related to cost-reduction and productivity initiatives.

(e) For the three months ended March 31, 2021, represents product transfer costs and employee termination costs related to cost-reduction and productivity initiatives and the CEO transition. For the three months ended March 31, 2020, represents employee termination costs incurred as a result of the CEO transition.

(f) For the three months ended March 31, 2020, primarily represents CEO transition-related costs.

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2021	2020
Cost of sales:		
Purchase accounting adjustments	**$ 2**	$ 2
Inventory write-offs	**1**	—
Consulting fees	**—**	2
Other	**3**	—
Total Cost of sales	**6**	4
Selling, general & administrative expenses:		
Purchase accounting adjustments	**8**	18
Other	**—**	2
Total Selling, general & administrative expenses	**8**	20
Amortization of intangible assets:		
Purchase accounting adjustments	**34**	34
Total Amortization of intangible assets	**34**	34
Restructuring charges/(reversals) and certain acquisition-related costs:		
Integration costs	**3**	6
Employee termination costs	**4**	3
Exit costs	**2**	—
Total Restructuring charges/(reversals) and certain acquisition-related costs	**9**	9
Other (income)/deductions—net:		
Net gain on sale of assets	**—**	(17)
Total Other (income)/deductions—net	**—**	(17)
Provision for taxes on income	**13**	18
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	**$ 44**	$ 32

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

March 31, 2021 vs. December 31, 2020

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.

Accounts Receivable, less allowance for doubtful accounts increased as a result of higher sales in the period primarily due to the launch of new products and the impact of foreign exchange, partially offset by the timing of customer payments and rebate credits issued to customers.

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

Accrued compensation and related items decreased primarily due to payment of 2020 annual bonuses to eligible employees and 2020 employee savings plan contributions, partially offset by the pro rata accrual of similar items for 2021.

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, the timing of income tax payments, the tax impact of various acquisitions and the impact of the remeasurement of deferred taxes as a result of changes in tax rates.

Other current liabilities and Other noncurrent liabilities decreased primarily due to the mark-to-market adjustments of derivative instruments and net investment gains related to our profit sharing plan.

For an analysis of the changes in *Total Equity*, see the Condensed Consolidated Statements of Equity and Notes to Condensed Consolidated Financial Statements— *Note 13. Stockholders' Equity*.

Analysis of the condensed consolidated statements of cash flows

	Three Months Ended March 31,		%
(MILLIONS OF DOLLARS)	**2021**	2020	Change
Net cash provided by (used in):			
Operating activities	**$ 400**	$ 408	(2)
Investing activities	**(63)**	(57)	11
Financing activities	**(339)**	(328)	3
Effect of exchange-rate changes on cash and cash equivalents	**—**	(6)	*
Net (decrease)/increase in cash and cash equivalents	**$ (2)**	$ 17	*

*Calculation not meaningful.

Operating activities

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Net cash provided by operating activities was $400 million for the three months ended March 31, 2021, and $408 million for the three months ended March 31, 2020. The decrease in operating cash flows was primarily attributable to the timing of receipts and payments in the ordinary course of business, partially offset by higher cash earnings.

Investing activities

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Our net cash used in investing activities was $63 million for the three months ended March 31, 2021, compared with net cash used in investing activities of $57 million for the three months ended March 31, 2020. The net cash used in investing activities for 2021 was primarily due to capital expenditures, partially offset by proceeds from cross-currency interest rate swaps. The net cash used in investing activities for 2020 was primarily due to capital expenditures, partially offset by proceeds from cross-currency interest rate swaps and proceeds resulting from a contingent payment received pursuant to an agreement related to the 2016 sale of certain U.S. manufacturing sites.

Financing activities

Three months ended March 31, 2021 vs. three months ended March 31, 2020

Our net cash used in financing activities was $339 million for the three months ended March 31, 2021, compared with net cash used in financing activities of $328 million for the three months ended March 31, 2020. The net cash used in financing activities for 2021 was primarily attributable to the purchase of treasury shares, the payment of dividends and taxes paid on withholding shares, partially offset by proceeds in connection with the issuance of common stock under our equity incentive plan. The net cash used in financing activities for 2020 was primarily attributable to the purchase of treasury shares and the payment of dividends, partially offset by net proceeds in connection with the issuance of common stock under our equity incentive plan.

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)	**March 31, 2021**	December 31, 2020
Cash and cash equivalents	**$ 3,602**	$ 3,604
Accounts receivable, net[(a)]	**1,125**	1,013
Short-term borrowings	**4**	4
Current portion of long-term debt	**600**	600
Long-term debt, net of discount and issuance costs	**6,587**	6,595
Working capital	**4,728**	4,441
Ratio of current assets to current liabilities	**3.29:1**	3.05:1

(a) Accounts receivable are usually collected over a period of 45 to 75 days. For the three months ended March 31, 2021, compared with December 31, 2020, the number of days that accounts receivables are outstanding remained within this range. 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 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 March 31, 2021 and December 31, 2020. There were no amounts drawn under the credit facility as of March 31, 2021 or December 31, 2020.

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 March 31, 2021, we had access to $80 million of lines of credit which expire at various times through 2021 and are generally renewed annually. There were $4 million of borrowings outstanding related to these facilities as of March 31, 2021 and December 31, 2020.

Domestic and international short-term funds

Many of our operations are conducted outside the U.S. The amount of funds held in the U.S. 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 May 12, 2020, we issued $1.25 billion aggregate principal amount of our senior notes (2020 senior notes), with an original issue discount of $10 million. These notes are comprised of $750 million aggregate principal amount of 2.000% senior notes due 2030 and $500 million aggregate principal amount of 3.000% senior notes due 2050. On October 13, 2020, the net proceeds were used to repay in full the aggregate principal amount of our 3.450% 2015 senior notes due 2020 and the remainder will be used for general corporate purposes.

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. 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. 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, 2018 and 2020 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, 2018 and 2020 senior notes may be declared immediately due and payable.

Pursuant to the indenture, we are able to redeem the 2013, 2015, 2017 and 2020 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. 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, 2018 and 2020 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, 2018 and 2020 senior notes at a price equal to 101% of the aggregate principal amount of the 2013, 2015, 2017, 2018 and 2020 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
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
2020 Senior Notes due 2030	$750 million	2.000%	Interest due semi annually, not subject to amortization, aggregate principal due on May 15, 2030
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
2020 Senior Notes due 2050	$500 million	3.000%	Interest due semi annually, not subject to amortization, aggregate principal due on May 15, 2050

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:

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

Share Repurchase Program

In December 2018, the company's Board of Directors authorized a $2.0 billion share repurchase program. As of March 31, 2021, there was approximately $1.2 billion 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. We temporarily suspended share repurchases beginning in the second quarter of 2020. In January 2021, the company resumed share repurchases under its share repurchase program. During the first three months of 2021, approximately 1.1 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 March 31, 2021, or December 31, 2020, recorded amounts for the estimated fair value of these indemnifications are not significant.

New accounting standards

Recently Issued Accounting Standards Not Adopted as of March 31, 2021

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 the impact of the COVID-19 pandemic, our 2021 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:

- the impact of the COVID-19 pandemic on our business, suppliers, customers and workforce;
- 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;
- difficulties and delays in the development or commercialization of new products;
- 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;
- acquiring or implementing new business lines or offering new products and services;
- restrictions and bans on the use of and consumer preferences regarding antibacterials in food-producing animals;
- perceived adverse effects linked to the consumption of food derived from animals that utilize our products or animals generally;
- 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 impact of climate change;
- 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 U.S. of income earned outside the U.S. 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. Such risks and uncertainties may be amplified by the COVID-19 pandemic and its impact on the global economy and our business. 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 British 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 March 31, 2021, 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 March 31, 2021, 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 less than $1 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 $5 million. For additional details, see Notes to Condensed Consolidated Financial Statements— *Note 9B. 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. Additionally, as of March 31, 2021, we held certain interest rate swap agreements that have the economic effect of modifying the fixed-interest obligations associated with our 3.900% senior notes due 2028, so that a portion of the fixed-rate interest payable on these senior notes effectively became variable based on LIBOR. At March 31, 2021, there were no commercial paper borrowings outstanding and there was no outstanding principal balance under our revolving credit facility.

By issuing the Floating Rate Notes and by entering into the aforementioned swap arrangements, we have assumed risks associated with variable interest rates based upon LIBOR. Changes in the overall level of interest rates affect the interest expense that we recognize in our Consolidated Statements of Income. An interest rate risk sensitivity analysis is used to measure interest rate risk by computing estimated changes in cash flows as a result of assumed changes in market interest rates. As of March 31, 2021, if LIBOR-based interest rates would have been higher by 100 basis points, the change would increase our interest expense during 2021 by approximately $3 million, as it relates to our fixed to floating interest rate swap agreements and floating-rate borrowings. See Notes to Condensed Consolidated Financial Statements— *Note 9. 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 March 31, 2021, 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

During our most recent fiscal quarter, 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 15. 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 2020 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 2020 Annual Report on Form 10-K.

Risks related to our business and industry

The COVID-19 pandemic has negatively affected the global economy; has disrupted our and our customers', suppliers', and vendors' operations; has significantly affected our business and operations; and may materially adversely affect our business, financial condition, results of operations and/or cash flows.

The spread of the novel coronavirus (COVID-19) has resulted in authorities implementing numerous measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter in place orders and shutdowns of non-essential businesses. While some of these restrictions have been lifted or eased in certain jurisdictions, other jurisdictions have seen increases in new COVID-19 cases, resulting in restrictions being reinstated or new restrictions being imposed.

Even though we are currently designated as an essential business and have continued physical operations with respect to manufacturing and supply chain globally, these measures have impacted and may further impact all or portions of our workforce and operations, the operations and workforce of our customers, and those of our respective vendors and suppliers. There is no certainty that measures taken by governmental authorities will be sufficient to mitigate the risks posed by the virus, and our ability to continue to perform critical functions could be harmed.

There continues to be considerable uncertainty regarding such measures and potential future measures. In particular, we, and the contract manufacturing organizations (CMOs) we work with, could be asked or ordered to perform certain activities for human health that would divert significant manufacturing and other resources away from our business and could expose us to additional liability. For example, in February 2021, the Biden Administration invoked the Defense Production Act (DPA) to require U.S. vaccine and component manufacturers to prioritize supply for the U.S. human COVID-19 vaccination program and, as a result, the supply of certain components used in several of our products was disrupted for a short while. It is still uncertain what the ultimate impact from the DPA will be. Any related component shortages or supply chain disruption may result in manufacturing or R&D delays that could materially adversely impact our revenue. Future restrictions on our access to or control over our manufacturing facilities or on our support operations or workforce, or similar limitations on our vendors or suppliers, and restrictions or disruptions of transportation, such as reduced availability of air transport, port closures and increased border controls or closures, or export bans could limit our ability to meet customer demand and have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

The COVID-19 pandemic also has and may continue to reduce demand for our products as a result of the negative impact it has had and may continue to have on our livestock and companion animal customers. Our livestock customers have been and may continue to be challenged by voluntary or mandatory facility closures, reduced packing plant capacity, travel bans and quarantines inhibiting consumption of protein and transportation of live animals, and labor shortages negatively impacting their operations. For example, a number of significant meat processing plants were closed temporarily during the COVID-19 pandemic after employees tested positive for COVID-19. In addition, our companion animal customers' businesses in certain geographies have been and may continue to be negatively impacted by reduced demand for their veterinary services. The resulting reduction in demand for our products, has negatively impacted our business, financial condition, results of operations and cash flows and may have a material adverse effect on our business, financial condition, results of operations and/or cash flows, if such demand reduction accelerates or is prolonged.

Moreover, while our research and development organization has continued to operate as an essential business, future measures imposed by governments and other authorities to try to contain the COVID-19 pandemic could impede the ability of our R&D organization to complete clinical studies required to register new products in the manner and on the timeline we anticipate and current and future product approvals may be delayed, which could have a material adverse effect on our business, financial condition, results of operations and/or cash flows.

The COVID-19 pandemic has also significantly increased economic uncertainty and has led to continued disruption and volatility in the global capital markets, which could increase the cost of capital and adversely impact access to capital. The economic impact of the ongoing COVID-19 pandemic has resulted in a global recession that may continue for an unknown period of time. In order to preserve liquidity, we issued debt securities in May 2020 and we may incur additional indebtedness, whether through the issuance of debt securities, drawdowns under our credit facility or otherwise in the future. An increase in our outstanding indebtedness will result in additional interest expense. We may also seek to conserve cash by reducing or canceling future dividends or delaying capital expenditures. Risks related to negative economic conditions are described in Part I, Item 1A. "Risk Factors," of our 2020 Annual Report on Form 10-K titled, "Our business is subject to risk based on global economic conditions."

Additionally, many of our workforce continue to work remotely as a result of the pandemic. Remote working arrangements could increase operational risks, including, but not limited to, risks associated with information technology and systems, including service interruptions, misappropriation of data, or breaches of security, any of which could have a material adverse effect on our business. Working outside of the typical work environment may also introduce additional complexity or inefficiency into our normal processes for key areas like the preparation of financial statements or marketing and sales, which could negatively impact our business. In addition, actions we have taken or may take, or decisions we have made or may make, as a consequence of the COVID-19 pandemic, including as part of the reopening process, may also result in legal claims or litigation against us.

We cannot at this time predict the full impact of the COVID-19 pandemic, but we anticipate that the COVID-19 pandemic is likely to continue to impact our business, financial condition, results of operations and/or cash flows in 2021. The impact of the COVID-19 pandemic may also exacerbate the other risks discussed in Part I, Item 1A. "Risk Factors," of our 2020 Annual Report on Form 10-K, any of which could have a material effect on us. This situation continues to change rapidly and additional impacts may arise that we are not aware of currently.

Risks related to tax matters

The Company could be subject to changes in its tax rates, the adoption of new U.S. or foreign tax legislation or exposure to additional tax liabilities.

The multinational nature of our business subjects us to taxation in the U.S. and numerous foreign jurisdictions. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. The company's future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation.

For example, on October 12, 2020, the Organisation for Economic Co-operation and Development (OECD) published a package of reports, known as the Blueprints, which provide technical details about a two-pillar approach to address the tax challenges of the digital economy. Pillar One would amend profit allocation and nexus rules to grant more taxing rights to countries where consumers are located regardless of the physical presence of the business. Pillar Two introduces common global minimum tax rules across the countries participating in the OECD Inclusive Framework. Such rules would operate through top-up taxes and other measures if a multinational group's income is not subject to a sufficient level of tax in particular jurisdictions. These two proposals combined may represent a significant change in the international tax regime. These proposals require unanimous consent and are currently in a "public comment" period. There is risk of an adverse impact to our effective tax rate as a result of these proposals, but the amount of such impact remains uncertain at this time.

Furthermore, President Biden's administration has put forth comprehensive corporate tax reform proposals which may have an adverse impact to our effective tax rate. At this time, we are properly reflecting the provision for taxes on income using all current enacted global tax laws in every jurisdiction in which we operate.

In addition, our effective tax rate is subject to potential risks that various taxing authorities may challenge the pricing of our cross-border arrangements and subject us to additional tax, adversely impacting our effective tax rate and our tax liability. The company is also subject to the examination of its tax returns and other tax matters by the Internal Revenue Service and other tax authorities and governmental bodies. The company regularly assesses the likelihood of an adverse outcome resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance as to the outcome of these examinations. If the company's effective tax rates were to increase, particularly in the U.S. or other material foreign jurisdictions, or if the ultimate determination of the company's taxes owed is for an amount in excess of amounts previously accrued, the company's operating results, cash flows and financial condition could be adversely affected.

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 March 31, 2021:

	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[(b)]	Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs
January 1 - January 31, 2021	399,256	$161.79	212,073	$1,390,188,505
February 1 - February 28, 2021	588,188	$162.33	367,495	$1,331,493,170
March 1 - March 31, 2021	580,338	$151.90	579,859	$1,243,201,592
	1,567,782	$158.33	1,159,427	$1,243,201,592

(a) The company repurchased 408,355 shares during the three-month period ended March 31, 2021, 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.

(b) The company temporarily suspended share repurchases beginning in the second quarter of 2020. In January 2021, the company resumed share repurchases under its share repurchase program.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

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 and contained in Exhibit 101)

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.

May 6, 2021	By:	/S/ KRISTIN C. PECK
		Kristin C. Peck Chief Executive Officer and Director
May 6, 2021	By:	/S/ GLENN DAVID
		Glenn David Executive Vice President and Chief Financial Officer

Exhibit 15

ACCOUNTANTS' ACKNOWLEDGEMENT

May 6, 2021

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 May 6, 2021 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

Exhibit 31.1

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

I, Kristin C. Peck, certify that:

1. I have reviewed this Quarterly Report of Zoetis Inc. on Form 10-Q for the period ending March 31, 2021 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.

May 6, 2021

By: /s/ KRISTIN C. PECK
Kristin C. Peck
Chief Executive Officer

Exhibit 31.2

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 March 31, 2021 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.

May 6, 2021

By: /s/ GLENN DAVID

Glenn David
Executive Vice President and
Chief Financial Officer

Exhibit 32.1

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, Kristin C. Peck, 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 March 31, 2021 (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.

May 6, 2021

By: /s/ KRISTIN C. PECK
Kristin C. Peck
Chief Executive Officer

Exhibit 32.2

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 March 31, 2021 (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.

May 6, 2021	By:	/s/ GLENN DAVID
		Glenn David
		Executive Vice President and
		Chief Financial Officer