06-May-2021

Zoetis, Inc. (ZTS)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the First Quarter 2021 Financial Results Conference Call and Webcast for Zoetis. Hosting the call today is Steve Frank, Vice President of Investor Relations for Zoetis. The presentation materials and additional financial tables are currently posted on the Investor Relations section of zoetis.com.

The presentation slides can be managed by you, the viewer, and will not be forwarded automatically. In addition, a replay of this call will be available approximately two hours after the conclusion of this call via dial-in or on the Investor Relations section of zoetis.com.

At this time, all participants have been placed in a listen-only mode, and the floor will be opened for your questions following the presentation. [Operator Instructions] In the interest of time, we ask that you limit yourself to one question and then queue up again with any follow-ups. [Operator Instructions]

It is now my pleasure to turn floor over to Steve Frank. Steve, you may begin.

Steven Frank

Vice President-Investor Relations, Zoetis, Inc.

Thank you, Keith. Good morning, everyone, and welcome to the Zoetis First Quarter 2021 Earnings Call. I'm joined today by Kristin Peck, our Chief Executive Officer; and Glenn David, our Chief Financial Officer.

Before we begin, I'll remind you that slides presented on this call are available on the Investor Relations section of our website and that our remarks today will include forward-looking statements and that actual results could differ materially from those projections. For a list and description of certain factors that could cause results to differ, I refer you to the forward-looking statement in today's press release and our SEC filings including, but not limited to, our annual report on Form 10-K and our reports on Form 10-Q.

Our remarks today will also include references to certain financial measures which were not prepared in accordance with Generally Accepted Accounting Principles, or US GAAP. A reconciliation of these non-GAAP financial measures to the most directly comparable US GAAP measures is included in the financial tables that accompany our earnings press release and in the company's 8-K filing dated today, Thursday, May 6, 2021. We also cite operational results which exclude the impact of foreign exchange.

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

Kristin C. Peck

Chief Executive Officer & Director, Zoetis, Inc.

Thank you, Steve, and good morning, everyone. I hope you and your loved ones are all staying healthy and able to get vaccinated for COVID-19. If not already, then soon.

We've been very fortunate in the US as vaccination rates are up and infection rates are trending down overall, but that is not the situation everywhere. In many countries, improving access to vaccines and controlling infection rates are critical hurdles for a more comprehensive global recovery. Yet, with the extraordinary measures being taken by so many, I remain optimistic about the steady progress we're making to beat this pandemic.

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I'm also very proud of what we've been able to do at Zoetis in our own small way to support the global efforts. We've been able to keep our colleagues safe, encourage and assist them with vaccinations where possible, and continue serving our customers in the care of their animals.

And we're off to a very strong start in 2021, executing on strategies for building on our innovative pet care portfolio, expanding in key markets outside the US, and accelerating our growth in diagnostics. In the first quarter, we grew our top line revenue at 21% operationally, our best quarter ever, with 25% operational growth internationally, and 19% growth in the US.

China and Brazil led our international performance with 75% and 48% operational growth, respectively, exhibiting their strength in both companion animal and livestock product sales. In total, our companion animal portfolio grew 34% operationally based on the strength of our parasiticides and dermatology products while our livestock portfolio grew 8% operationally with solid growth in cattle, swine, and fish products.

Digging deeper on pet care, it has been one year since the launch of our triple combination parasiticide, Simparica Trio. It is exceeding expectations and has been well received by customers with a 90%-plus penetration rate in our largest US corporate accounts. Simparica Trio is the latest growth catalyst for our portfolio of small animal parasiticides. After several successful innovations in the last few years, these products made up 16% of our total sales in the first quarter and include such brands as Simparica, Simparica Trio, Revolution, Stronghold, and ProHeart.

We believe the ongoing market shift to e-commerce is another boost for this category, helping to increase compliance and months on therapy, and our direct-to-consumer campaigns for Simparica and Simparica Trio continue showing a solid return on investment in markets around the world. Meanwhile, our key dermatology portfolio led by Apoquel and Cytopoint demonstrated continued double-digit growth. We are seeing excellent traction and significant growth across a range of international markets.

Our dermatology portfolio has further growth potential as we continue expanding our international customer base and seek to become a more common first-line treatment for pruritus in dogs. Veterinarians and pet owners alike appreciate the exceptional standard of care that our products can provide.

In the companion animal space, we've also continued to be pleased with our diagnostics portfolio which grew 47% operationally in the first quarter. We have grown our point of care diagnostic sales, made excellent progress on improving our connectivity solutions in veterinary practices, and have seen our cloud-based VETSCAN IMAGYST platform receiving very positive customer feedback with placements exceeding expectations in the early launch. We're also making progress on our reference lab integrations and look forward to future expansions in this space, both in the US and internationally.

Our growth in livestock was driven by the performance of cattle, swine, and fish in the first quarter. Cattle product sales in the US were strong as the foodservice sector has started to recover and generic competition for DRAXXIN was later than expected. Meanwhile, swine benefited from a continued recovery from African Swine Fever in China. Thanks to the unprecedented growth in revenue and our continued financial discipline and adaptability throughout COVID-19, our adjusted net income grew 34% operationally.

Looking ahead, we are raising guidance for operational growth in full year revenue to the range of 10.5% to 12%, and while we had an unusually strong first quarter, we expect more normalized revenue growth in the second half of the year due to tougher comparative quarters and increasing generic competition for DRAXXIN. Glenn will provide more details on other guidance updates in his remarks.

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Since the beginning of the year, Zoetis has continued to advance our key priorities, including key milestones for new products and lifecycle innovations and geographic expansions for major brands. Since our last earnings announcement, we received approval in the European Union for Solensia, the first injectable monoclonal antibody for the alleviation of pain associated with osteoarthritis in cats, and it will be launching this year. Osteoarthritis is vastly underdiagnosed and undertreated today due to limited options for therapy and difficulty recognizing pain in cats.

Meanwhile, Librela, our monoclonal antibody for the alleviation of OA pain in dogs, has launched in the EU and we're seeing a great customer response from vets and dog owners who reference increased activity, social ability, and quality of life for their pets. In the US, we continue discussions with the FDA regarding our regulatory submissions and manufacturing inspections for Librela and Solensia, and we now anticipate approvals for both products in 2022, with Librela likely later in the year. We will provide updates on US revenue expectations for these products in 2022 as we get further clarity on approval timing and rollout plans.

It is also worth noting that in China, which is our second largest market in terms of revenue, Zoetis recently received approvals for several leading products, Fostera PCV MH, a one-shot vaccine for pigs; Excenel RTU EZ, a key anti-infective for cattle and swine; and Revolution Plus, our latest parasiticide for cats. We continue to strengthen our portfolio in China, one of our key catalysts for growth.

We're also maximizing our key brands with more geographic expansion. In poultry, we expanded our line of recombinant vector vaccines with approval of Poulvac Procerta HVT-ND in Canada, Brazil and several other smaller markets. And in parasiticides, we received additional approvals for Simparica Trio in Japan, Mexico, and several other smaller markets.

In terms of sustainability, we published our long-term goals in March with specific commitments to communities, animals, and the planet. We built a comprehensive and rigorous approach to our Driven to Care program and our goals include support for 10 of the 17 United Nations sustainable development goals. We will be releasing more detail on these goals and our initial progress in our sustainability report this June.

In closing, the fundamental growth drivers for our industry continue to show strong and sustainable momentum. Pet adoption trends and higher spending per visit in the US, along with increased medicalization rates in markets outside the US, all continue to bode well for significant growth in our companion animal and diagnostic portfolios globally.

We feel very confident about where our companion animal business has come over the last few years, launching innovative new products, defining new standards of treatment, and expanding our global reach. In 2014, our companion animal business was 34% of our total revenue. Last year, it had grown to 55% based on the strength of our innovation and investment in growth, and we see that continuing to expand. In livestock, the industry is in a more limited innovation cycle and we expect modest growth for the year. Livestock growth is tied closely to the pandemic and how quickly the foodservice industry recovers.

For Zoetis, we also anticipate increasing headwinds of generic competition to DRAXXIN, but we expect our lifecycle innovations and competitive strategies to help us mitigate the impact.

While US livestock may present challenges for us in the near term, I feel very positive about our catalysts for growth in pet care, diagnostics in international markets like China and Brazil. We continue to be led by our companion animal parasiticide and dermatology portfolios with more growth to come, and we see a bright future

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ahead for our monoclonal antibodies for pain. Diagnostics is accelerating its growth as we increase our global footprint, expand our reference labs, and demonstrate the potential for VETSCAN IMAGYST to veterinary clinics.

And internationally, China continues to be a market with significant growth potential, not only in swine products, but with a sizable opportunity for increased medicalization of pets. And we expect major growth to continue in Brazil across the companion animal and livestock portfolios. As always, we remain confident that Zoetis' diverse portfolio across species and geographies, our continued pipeline of innovative new products and lifecycle innovations, and the agility and commitment of our colleagues will continue driving our success in 2021 and beyond.

Now, let me hand off to Glenn who will speak more about our first quarter results and updated guidance for the full year 2021.

Glenn C. David

Chief Financial Officer & Executive Vice President, Zoetis, Inc.

Thank you, Kristin, and good morning, everyone. As Kristin mentioned, we had a very strong start to the year delivering substantial growth on a global basis and across species and therapeutic areas. Today, I'll focus my comments on our first quarter financial results, the key drivers contributing to our performance, and an update on our improved full year 2021 guidance.

In the first quarter, we generated revenue of $1.9 billion, growing 22% on a reported basis and 21% operationally. Adjusted net income of $603 million was an increase of 33% on a reported basis and 34% operationally. Operational revenue grew 21% resulting entirely from volume increases with price flat for the quarter. Volume growth of 21% includes 13% from other in-line products, 5% from new products, and 3% from key dermatology products.

Companion animal products led the way in terms of species growth, growing 34% operationally with livestock growing 8% operationally in the quarter. Performance in companion animal was driven by our parasiticide portfolio which includes sales of Simparica Trio in the US, certain European markets, Canada, Australia, and Mexico. We also saw growth in our key dermatology products, Apoquel and Cytopoint, as well as in small animal vaccines and diagnostics.

Following blockbuster sales in year one, Simparica Trio began 2021 with strong first quarter performance posting revenue of $90 million, growing sequentially each quarter since launch. The underlying dynamics that drove first quarter sales are very favorable for significant future growth such as increasing clinic penetration and robust reordering rates within penetrated clinics.

I'd again like to mention how pleased we are with the performance of our broader parasiticide portfolio, which in addition to the Simparica franchise had significant growth in the Revolution/Stronghold and ProHeart franchises as well. US market share within the flea, tick, and heartworm segment is now at an all-time high of 31%, representing an increase of more than 9% for the first quarter versus the same period in the prior year.

Global sales of our key dermatology portfolio were $245 million in the quarter, growing 24% operationally. We remain confident that key dermatology sales will exceed $1 billion this year.

Our diagnostics portfolio grew 47% in Q1, led by increases in consumable and instrument revenue. 2020 presented challenging conditions for our diagnostics business as social distancing restrictions limited our ability to enter vet clinics and increase our market share. However, our vast product portfolio, commitment to innovation,

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and ability to leverage the breadth of our medicines and vaccines portfolio has us well positioned to grow faster than the overall diagnostics market.

Livestock growth in the quarter was primarily driven by our cattle and swine businesses. Improving market conditions from the COVID-19 recovery as well as successful promotional activities led to increased sales across the cattle portfolio. In addition, later than expected timing of generic entrants led to strong first quarter sales for DRAXXIN.

Our swine portfolio grew 19% operationally as large producers continued rebuilding herds as they recover from African swine fever and created significant demand for our products. Poultry sales declined in the first quarter as producers expanded their use of lower-cost alternatives to our premium products. The decline in poultry partially tempered the growth in cattle, swine, and fish.

Now let's discuss the revenue growth by segment for the quarter. US revenue grew 19% with companion animal products growing 32% and livestock sales declining by 4%. For companion animal, pet ownership and pet spending trends remain promising. While severe weather caused a slight decline in vet clinic traffic for the quarter, revenue per visit was up more than 10%. In addition, pet ownership has increased and is trending towards a younger demographic, and younger pet owners typically spend more on pet care. This is a key driver for increased revenue per visit and creates robust demand for our diverse portfolio.

Our small animal parasiticide portfolio was the largest contributor to companion animal growth, growing 74% in the quarter. Diagnostics, key dermatology products, and small animal vaccines also contributed to growth.

Simparica Trio continues to perform well in the US with sales of $83 million. The Simparica franchise generated sales of $112 million in the quarter and is now the number two brand in the US flea, tick, and heartworm segment. Companion animal diagnostic sales increased 62% in the quarter as the continued recovery at the vet clinic and a favorable prior year comparative period led to significant growth in point-of-care consumable revenue. Key dermatology sales were $157 million for the quarter, growing 16% with significant growth for Apoquel and Cytopoint.

US livestock declined 4% in the quarter driven primarily by poultry as producers switching to lower-cost alternatives unfavorably impacted our business. Swine also declined in the quarter which is attributed almost entirely to a favorable nonrecurring government purchase which occurred in Q1 2020. Cattle grew 6% in the quarter as promotional programs and the timing of generic entrants drove growth across the product portfolio. Growth in cattle partially offset the declines in poultry and swine.

To summarize, US performance was once again strong in what remains a very favorable companion animal market environment in which we offer the broadest and most innovative product portfolio. Although livestock declined in the quarter with expectations of further declines for the year, we are encouraged by a series of foodservice trends such as increased dining out and school and business reopenings.

Revenue in our international segment grew 25% operationally in the quarter, with companion animal revenue growing 37% operationally and livestock revenue growing 17% operationally. The strength in companion animal was fueled by the continuing trends of pet adoptions, increasing standard of care by pet owners, and our investments in advertising, all of which drove growth across our parasiticide and dermatology portfolios.

Companion animal diagnostics grew 18% in the quarter, led by a 24% increase in point-of-care consumable revenue and a second consecutive quarter of double-digit increase in instrument placement revenue. We began

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early experience programs for Librela, our monoclonal antibody for alleviation of OA pain in dogs. The feedback from the programs has been extremely positive and further solidifies our view of the long-term potential of the product with an EU launch currently underway.

Our feline monoclonal antibody, Solensia, will begin early experience programs in Q2 with an EU launch to follow in the third quarter. Solensia will provide cat owners an innovative therapy to address one of the largest unmet needs in animal health.

Our international livestock business saw double-digit growth across all species with the exception of poultry, which grew low-single digits in the quarter. Swine revenue grew 29% operationally, led by growth in China of 128%, marking the third consecutive quarter with swine growth in excess of 100%. While additional outbreaks and strains of African swine fever have occurred, we believe it is contained to a specific region and a limited number of customers.

Cattle grew 11% operationally in the quarter as a result of marketing campaigns, key account penetration, and favorable export market conditions in Brazil and several other emerging markets.

Our fish portfolio delivered another strong quarter, growing 39% operationally driven by strong performance in Chile, the timing of seasonal vaccination protocols, and the 2020 acquisition of Fish Vet Group. All major markets grew in the first quarter, many in double-digits. China total sales grew 75% operationally, which in addition to the significant growth in swine, delivered 59% operational growth in companion animal. Brazil grew 48% operationally in the quarter as sales of Simparic, the leading oral parasiticide in the Brazilian market, drove a 73% operational increase in companion animal.

Overall, our international segment delivered strong results, again demonstrating the value of substantial geographic and species diversification. Our companion animal business benefited from favorable trends such as rising medicalization rates outside the US, and while swine was the largest growth driver for our international livestock business, the contributions were broad-based with growth across all species.

Now moving on to the rest of the P&L, adjusted gross margin of 71% increased 70 basis points on a reported basis compared to the prior year as a result of favorable product mix, partially offset by foreign exchange and other costs including freight. Adjusted operating expenses increased 8% operationally resulting from increased compensation-related costs and advertising and promotion expense for Simparica Trio. This was partially offset by reductions to T&E costs as a result of COVID-19.

The adjusted effective tax rate for the quarter was 19%, an increase of 230 basis points driven by a reduction in favorable discrete items compared to the prior year's comparable quarter, partially offset by the favorable impact of the jurisdictional mix of earnings.

Adjusted net income and adjusted diluted EPS grew 34% operationally for the quarter primarily driven by revenue growth.

We resumed our share repurchase program in the first quarter, repurchasing approximately $180 million worth of shares. Along with our dividend, share repurchase is a critical component of our shareholder distribution strategy. We remain in a strong liquidity position and are highly cash generative, and as a result, we expect to be able to execute on all investment priorities, including direct-to-consumer advertising, internal R&D, and external business development while still returning excess cash to shareholders.

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Now moving on to our updated guidance for 2021 which we are raising as a result of our first quarter performance, please note that our guidance reflects foreign exchange rates as of late April. For revenue, we are raising and narrowing our guidance range with projected revenue now between $7.5 billion and $7.625 billion and operational revenue growth between 10.5% and 12% for the full year versus the 9% to 11% in our February guidance. Adjusted net income is now expected to be in the range of $2.12 billion to $2.16 billion, representing operational growth of 12% to 14% compared to our prior guidance of 9% to 12%. Adjusted diluted EPS is now expected to be in the range of $4.42 to $4.51, and reported diluted EPS to be in the range of $4.08 to $4.19.

Our key assumptions for 2021 have not changed materially since the guidance we provided on our Q4 2020 call. However, our current view is that we will not face competition in the US for Simparica Trio or our key dermatology products until the second half of 2022.

On our fourth quarter call, I mentioned that we anticipated growth to be heavily weighted towards the first half of the year and I'd like to take this time to expand upon that further. We are expecting first half 2021 growth to materially outpace growth in the second half of the year, primarily resulting from Simparica Trio sales and the favorable Q2 2020 comparative period related to COVID-19. Subsequently, we expect growth to moderate in the second half of the year as a result of increased generic competition for DRAXXIN as well as challenging comparative periods when pent-up demand in the first half of 2020 worked its way through the system in the second half.

Now to summarize before we move to Q&A, we have delivered strong operational top and bottom line growth in the first quarter with significant gains in both companion animal and livestock and across nearly every therapeutic area and geography. In addition, we raised and narrowed our full year 2021 guidance. And while growth will moderate in the back half of the year for the reasons I outlined, we again expect to grow faster than the market and feel very positive about our position for sustained growth beyond this year.

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

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll take our first question today from Erin Wright with Credit Suisse. Please go ahead.

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

Q

Great. Thanks so much. Can you speak a little bit more about the underlying trends you're seeing across the US livestock business? How has that segment performed quarter-to-date? And it seems that DRAXXIN competition has played out a little bit better than your expectations, but has anything changed in terms of how you're thinking about that headwind over the course of 2021?

And then my second question is on parasiticides. It does represent a larger portion of your portfolio than it has historically. I guess how should we think about the seasonality of that business, the purchasing patterns both across retailers and in vet clinics? And did you see any sort of pull-forward outside stocking dynamics in the quarter that we should be aware of and what your guidance now assumes for Simparica Trio? Thanks.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. Thanks, Erin. Great to hear from you. As you think about US livestock, as Glenn mentioned, overall US livestock was down 4%, but there is lots of different trends in there. US cattle was up 6% in the quarter, and I think if you look at that, that was driven by later than expected entrants in the generic, so we were expecting more entrants sooner. But to your point, we don't really think it's going to end up playing out any differently by the end. And so what do I mean by that? If you look at that, we think the entrants will come. We think once they do, we'll likely end up. As you look at generics, it's normally 20% to 40% penetration, and what we said is we think that's likely what it's going to be with DRAXXIN both in the US and in the EU and really around the globe. But as you think about that, it's likely going to happen a little bit later in the year, so we did do better in the beginning of the year.

But if you look at that and you compare it to how we did internationally on DRAXXIN more specifically, so although you saw 6% growth in DRAXXIN in the US, internationally – I'm sorry, overall in DRAXXIN, internationally is actually down, and that was because we did have the multiple entrants sooner in that, so I don't think livestock really is going to play out any differently. We did see, as Glenn mentioned, a decline in poultry overall, and there is some seasonality obviously as you think about cattle, swine was down and poultry, but overall I think we continue to remind, as you look at livestock overall for us, it was up 8%. I think what often people underappreciate is that 60% of livestock is outside of the US, and although we focus a lot on US cattle, the growth that you saw in China across swine, which 128% growth and in Brazil, still meant livestock did quite well.

As you think about the parasiticides, I'll let Glenn sort of take some of that and get into some of the more specific trends.

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

A

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Yeah, so thanks, Erin. So from a parasiticide perspective, we've had a really strong quarter with the Simparica franchise, 133% growth in the franchise, great performance from Simparica Trio with $90 million in the quarter alone, and Simparica also delivering $74 million with 38% growth.

In terms of seasonality, we typically do see Q1 and particularly Q2 being the stronger quarters from a parasiticide portfolio perspective, particularly in the US. However, as we do see Simparica Trio on a ramp-up curve, the impact of that seasonality may be a little different this year as we do expect to continue to increase our clinic penetration and adoption and market share within the clinics as well. So there definitely is some seasonality within the parasiticide portfolio, but with the continued ramp-up on the product, it may not be as severe as you would typically see with an established product.

Operator: Thank you. Our next question is from Michael Ryskin with Bank of America. Please go ahead.

Michael Ryskin
Analyst, BofA Securities, Inc.

Q

Hey. Thanks, Kristin, Glenn, thanks for taking the question. I want to start on China. Just really incredible growth this quarter, obviously you highlighted some of the aspects there, African Swine Fever bounced back and then companion has been doing well there for a while, and it's nice to see that continues to grow. I'm just wondering if you could opine on how sustainable that is. I mean, that $123 million number, is that maybe a jumping-off point that we should be thinking about in terms of run rate going forward and obviously growing from that or could there have been some bulk orders, for example, in swine, as some of these producers restart their operations?

And then another question for Glenn. On the OpEx guide, I'm just wondering if you could talk through a little bit the details of what you're assuming for operating leverage in the second half. Are there any additional DTC programs for Trio? Are you restarting T&E expense, is there any inflation factoring in? Just wondering how we should think about the SG&A ramp going forward.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Thanks. Thanks, Mike. So starting with China, and I'll let Glenn take the second question, we do think this is a very sustainable growth driver in China. And really what drives that is a few things. One, I think you'll see African Swine Fever continuing the rebuild of the herd there. It is going to take a few years to rebuild that, so I think that is going to be for the next few years a sustainable growth. You saw swine grow in the quarter at 128%.

But I think what's also really important to focus on is how well companion animal did, which grew 59%. We've been launching a number of new products. As I mentioned in my opening remarks, we had the launch of Fostera PCV MH as well as Revolution Plus. So continuing to bring in new products, seeing really, really good growth across both companion animal and livestock makes us believe that China and the investments we've even talked about in building additional facilities there, growing our biologics footprint, we are very bullish on China continuing to be a sustainable growth driver for the company.

Do you want to take the question, Glenn?

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

A

Yeah, so – and just one other comment on China, Mike, to your question as well. We did have $123 million in sales. Q1 typically does tend to be the larger quarter of sales for China, so that necessarily isn't one that you

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would run off of for the rest of the year. But to Kristin's point, very excited about the growth prospects that we have for China for the year.

In terms of the OpEx, we grew 8% in OpEx in the first quarter, which is pretty indicative of what the guidance range would indicate for the year. But there will be different dynamics throughout the quarter to that. So for Q1 with the growth of 8%, that really was driven by a lot of the incremental DTC that we had for Simparica Trio in the quarter. And also, we didn't have the savings from T&E in Q1. We had the savings from T&E in Q1 because in Q1 of 2020, that was pre-COVID. We still had our elevated T&E spend.

As we move throughout the year, obviously we're not going to have that benefit, so the impact of the incremental DTC for Simparica Trio will be there, but we also increased our spending for DTC for Simparica Trio throughout the year last year.

So a number of different factors, but the overall level of growth for the year perspective is pretty similar to what we saw for the quarter.

Operator: And our next question is from Jon Block with Stifel. Please go ahead.

Jonathan David Block
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks, guys. Good morning. First one, Glenn, for you. Just seems the overall top line steps up. Do we attribute that solely to companion animal? It seems like livestock, just based on your comments, might still be in that up low-single-digit range, and maybe more specifically, is the step-up in companion just due to Trio? I mean if you annualize out the $90 million, you get to $360 million already, and it seems like that was in and around the original guidance when we think about the contribution to growth.

And then, Kristin, maybe just to pivot, can you give a little more color on what you're seeing in the poultry market? Were those lower end competitive dynamics specific to the US? Did it surface in international, maybe what's going to be Zoetis' response in coming quarters? Thanks, guys.

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

A

Sure. So, Jon, in terms of the overall top line step-up in the guidance, there are a number of factors that drove that beyond just companion animal. So obviously, very pleased with the performance of Simparica Trio and that is definitely one of the drivers for the guidance range. But as Kristin mentioned, also very strong performance in China, off to a very strong start to the year, strong performance in Brazil as well. Brazilian market grew 48% for the quarter, so that's off to a very positive start. And then our diagnostics business as well. We had 47% growth in our diagnostics business in the quarter.

So, many of our key growth drivers for the long term performed very well in the quarter which also then enabled us to raise the guidance for year. So it's across a number of different of our key strategic growth drivers that enabled us to raise that guidance.

In terms of poultry in the US, we did see some challenges this quarter as our producer customers did move to some cheaper alternatives from our anticoccidials. That is something that we'll evaluate through the year. We do expect that there will be a movement back at some point to our products, but that's something that will evolve over

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time in terms of the efficacy that they see from those cheaper alternatives compared to our more premium products.

Operator: Thank you. Our next question is from Louise Chen with Cantor Fitzgerald. Please go ahead.

Louise Chen
Analyst, Cantor Fitzgerald Securities

Q

Hi. Congratulations on the quarter, and thanks for taking my question. So I wanted to ask you how you think the animal health industry might change post-COVID, and do you still expect a headwind this year and what have you factored into your guidance for a recovery? Thank you.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure, thanks, Louise. Great to hear from you. We look at some of the trends you've seen this year and a lot of these are more sustainable in the pet care side and I think that the trends that we'll talk about in a second are a little bit different on the livestock side. What you've been seeing over the last few quarters is an increase in revenue per visit. That has been sustainable. As we looked last year at the sort of 10% – again as we talked about in Glenn's remarks, a 10% increase in revenue per visit, but driving that is there's increased pet ownership and that really has maintained. People are continuing to spend more time with their pets.

I think you see the trend of these new pets being adopted by millennials and Gen Z, and they spend more on those pets. So we see that as a trend that will continue to drive growth overall for the industry. And then these pets will ultimately age, and as all these new pets age, a lot of our chronic products will become even more relevant. I think this is also driving important growth in our diagnostics business which grew 47% in the quarter. Again, pets can't tell you what's wrong with them, so I think vets are getting really increased focus on doing diagnostic tests in a lot of these wellness visits.

As you think about livestock, I mean there's two trends to look at. One is just when will we produce more protein as people go out more? Really what you're going to need to see significant improvements here globally is an increase in travel and entertainment, and I think we're now seeing people going back to schools, maybe going back to work, maybe traveling for personal, but getting that travel and entertainment industry back up will help drive the growth in livestock globally, I think, over some of these coming quarters.

So, slightly different trends, but we continue to remain bullish and the way we see our growth is with an increasing pet care business, we see great growth in pet care from everything from our in-line, our paras, our derm, our new mAbs, looking at increased growth in China and Brazil, which again, as we've talked about, we think is sustainable, and then lastly, continued investment and growth in our diagnostics business which we're quite excited about.

Operator: Thank you. Our next question is from John Kreger with William Blair. Please go ahead.

John Kreger
Analyst, William Blair & Co. LLC

Q

Hi. Thanks very much. A question about Librela. Now that that product is launched in the EU, can you talk a little bit more about the clinical differentiation you're seeing compared to some of the existing oral alternatives?

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Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. As you probably know, we began the early experience in the EU and will be launching formally in Q2 for Librela. The early experience information that we saw was really, really positive. Both obviously that's got a strong safety profile, but the efficacy. It's working very quickly, faster than I think some of our customers expected, and they're seeing significant improvements in the quality of life and in the pain of these dogs.

So we remain very bullish that customers are looking for an alternative to the products on the market right now and we're seeing a really strong uptake in that. This is still a significant market. As you look at sort of 90 million dogs in the EU today, 40% of those dogs have OA and currently only 28% of those are treated. So the early experience data that we've seen to-date and the early launch makes us very optimistic for the success of this product, and as we mentioned before, we expect this product to be a blockbuster.

Operator: And our next question is from David Westenberg with Guggenheim Securities. Please go ahead.

David Westenberg
Analyst, Guggenheim Securities LLC

Q

Hi. Congrats on a great quarter, and thanks for taking the question. So can you remind us why there's such species-by-species differences in the US and international livestock market given that protein is inherently global?

And then for my second question, on the diagnostic portfolio, I think confirm 46%. That is a huge number, so can you talk about the components of growth of that and if some of that – or in kind of the organic growth rate there? Thank you.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Okay. I'll take the first question, and then Glenn can take the second one. Although protein is global, the dynamics are very different in each species in a few ways. One, obviously if you look at consumption, as people move into the middle class, they're generally starting with milk and then eggs, then poultry, then they move up to swine and then beef. There's also differences geographically on what people consume. Obviously China is a huge swine market. That's not true in the US where you see probably more poultry and beef, so there really are different consumption trends as well.

The other real big difference is who produces in each market and for each species, how much is exported. In the US, there's a significantly larger export market for poultry and for swine. So there's very different dynamics for each of the different species as people trade up and trade down different protein sources, as you think about where people are sourcing those protein sources, who are big export markets versus internal production, so – and it does lead to very different dynamics. The other major dynamic you should think about is that the ability for each producer to change their supply is actually quite different.

Once you have a supply of cattle, they take many years to grow. You can't all of a sudden pare back in cattle. Poultry producers can decide not to use a bunch of eggs and grow chickens which only take a few months. So it's very different in their ability to react to the market, and therefore you do see different decisions being made. As you probably saw in the papers today, there's huge demand for poultry right now, and I think poultry producers are going to have to sort of start scaling up. They can do that quickly. They can make those decisions and expand their flocks very quickly. That is a very difficult thing and takes a lot of time for a swine or a cattle producer. So that's why you sometimes see some of these different dynamics across species.

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

A

And regarding diagnostics, a very strong quarter for our diagnostics portfolio. We grew 47% in the quarter overall and that growth was really balanced from many different areas. So we saw the US grew 59% in the quarter in diagnostics with strong growth in our consumables, really pulling through the increased instrument placements that we saw last year really drove increase consumables in the quarter.

Also strong performance for our reference lab business and increased growth in our instrument revenue as well. So really strong performance in the US. And also for the US, it was an easier comparative period to Q1 of last year as well.

International, very positive growth as well, growth of 24%. Again, really driven by strong growth in consumable usage in the international markets as well as increased instrument revenue as well. So very balanced, strong growth in our diagnostics portfolio in the quarter, and we think that sets us up well for the year and we do expect that our diagnostics business will outpace the growth of the overall diagnostics market in 2021.

Operator: And our next question is from Elliot Wilbur with Raymond James. Please go ahead.

Elliot Wilbur
Analyst, Raymond James & Associates, Inc.

Q

Thanks. Good morning. A question for Glenn and Kristin. I guess with respect to expectations of additional competition on Trio and in the derm portfolio, I mean what's changed in terms of your line of sight there based on specific feedback from the channel or just the absence of any competitive noise whatsoever?

And then a question for Glenn, just thinking about SG&A trends over the balance of the year, I mean in the guidance at the midpoint on SG&A and the top line implies roughly a 300 basis point step-up. How much of that is just sort of increase in normalized baseline expenditure versus targeted investment spend, and how should we be thinking about the progression of SG&A levels over the balance of the year relative to some of the investment programs that you have budgeted? Thanks.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure, thanks, Elliot. I'll take the first question. Yes, as Glenn mentioned in his opening remarks, we are not expecting competition in the US for Simparica Trio or for our derm portfolio, Apoquel or Cytopoint, until maybe mid, second half of 2022 at the earliest to be honest with you. This is just based on our competitive intelligence, which as we said from the start is not perfect. There is not great information. But we definitely don't expect it this year, and based on what we've heard, we don't think it's in the first half of next year at the earliest.

So again, we are always prepared for competition to come. We're never exactly clear when it will be, but I think we're very optimistic that we've got at the very least this year and the first half of next year and we'll be aggressive in growing these products as we've seen. But I would remind you, certainly as you look at Simparica Trio that we've done incredibly well with Simparica and it was the third to market and we continue to grow this franchise already around the world, the Simparica franchise even with other competitors on the market.

So I don't know if there's anything you want to add there, Glenn, or you want to take the second question.

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

A

I'll move to the second question in terms of the OpEx spend and what we see. So there are a number of different areas that are driving the incremental OpEx this year. Part of it is a bit of a normalization from the COVID impact in 2020. We would expect that T&E expenditures would begin to increase particularly in the second half of the year, but also our compensation costs. As we ramped up hiring some positions that may have been on hold with the impact of COVID, it's just more difficult to fill. We are increasing our hiring really to support the strength of many of our key brands and continue the growth there.

From a DTC spending perspective, we would expect more DTC spending this year driven by a couple of different factors. A, we have Simparica Trio on the market for the full year. So we will support that with advertising expenditures for the full year as well. And we also continue to see strong growth in many of our brands such as our dermatology portfolio, and we'll continue to increase and support those brands with direct-to-consumer advertising. Not only in the US, but outside of the US as well where we are increasing our DTC spend behind many of our brands including Simparica as well as our dermatology portfolio. So there're a number of areas of spend really to support the significant revenue growth opportunities that we see not only for this year but for many years beyond.

Operator: Our next question is from Balaji Prasad with Barclays. Please go ahead.

Balaji Prasad
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning, and thanks for the questions. Just two from me. Following up on Librela, could you maybe give us some thoughts around the gross margin impact of the £40 to £50 price points that you have introduced at, and what's your internal expectations around usage of this product, how do you see it evolving while the recommendation is once a month injection. So one.

Two, on ASF, in the past, you've been quiet about ASF vaccines. We saw news flows recently that you started some trials and collaborating on it. So could you maybe take us through what the timelines around the trials are and when do you expect to be a part of the ASF vaccine program? Thanks.

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

A

Sure. So from Librela gross margin perspective, I'll start with pricing of Librela which is very important in terms of the overall profitability of the product. Now that we've launched in the EU, we have priced that product at a premium to the current therapies on the market. Really consistent with some of the other products that have brought significant innovation to some of our other categories such as dermatology. You would see Librela priced at a premium similar to that, so we would expect that Librela will be a high margin product for us, consistent with the overall companion animal portfolio which typically is above our overall gross margin level. So that will be a positive contributor to gross margin over time.

In terms of ASF and our development for vaccines, as we said before, this is a very complicated disease state. It's going to take many years to find a solution. We are active in those development studies, but it will be a multiyear timeframe before we find a solution for African Swine Fever.

Operator: We'll take our next question from Kathy Miner with Cowen and Company. Please go ahead.

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Kathleen Miner
Analyst, Cowen and Company

Q

Great. Thank you. Two questions, please. First on Librela, can you clarify I believe in your comments you said that you expected approval of Librela later in the US than Solensia. Does this reflect just filing timing or is there some other dynamic here?

And then the second question, a little bigger picture on business development. Things have been pretty quiet in terms of M&A this year. Can you comment a little bit about your outlook for the rest of 2021 and some of the areas you may be focusing on there? Thank you.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Thanks, Kathy. Yes, as we mentioned, we are expecting the approval of both Librela and Solensia in 2022. There's nothing specific about why Librela is actually later than Solensia. It has to do with filing timings and just general process on the two of those. But again, we remain quite confident and optimistic in the approval of both of those. And as we get closer, we'll be able to provide more specific guidance on revenue and launch timing, et cetera. But no, there's nothing specific as to why Librela is going to probably be later in the year than Solensia. It's just overall timing of submissions and back and forth with the regulators.

So, Glenn, do you want to take the second?

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

A

Yeah, so from an M&A perspective and our areas of focus for 2021, so business development remains a key area and part of our capital allocation strategy, and we remain focused on that. A couple of areas that we continue to pursue, consistent with what we've discussed in the past is, A, any specific geography where we may have an opportunity to gain additional share or presence in an area that we may not be at the level of market share that we are globally. Those are areas that we will continue to focus on and look to bring in additional products into our portfolio.

Also many of the areas that we've stressed as areas of strategic importance to us, whether that's an area such as precision livestock farming, genetics, diagnostics, those are areas that we will also continue to remain focused on as well as if there are early development assets as well that we believe with the strength of our R&D portfolio we can generate greater value than the existing company. So we remain focused on M&A. We evaluate many opportunities, and we will look to continue to use that as a primary area for capital allocation moving forward.

Operator: We'll take our next question from David Risinger with Morgan Stanley. Please go ahead.

David R. Risinger
Analyst, Morgan Stanley & Co. LLC

Q

Yes. Thanks very much. Hi, Kristin and team. So congrats on the exceptional performance. I think you hear my 6-year-old puppy in the background barking, and I'm wondering if you have a barking solution in the works.

Anyway, so I'm going to just move here a little bit. Hopefully my phone won't cut out. So could you provide additional details on companion animal innovation prospects beyond monoclonal antibodies for pain? It'd be helpful to understand areas of unmet need and the potential cadence of material new companion animal product

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introductions in coming years, and I know that you can only comment on this at a high level, but anything you can offer would be helpful.

And then second, given likely inflationary pressures ahead on costs, what is your plan for product price increases in companion animal and livestock? Thank you.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.
A

Thanks, David. I have to say, if you're ever on a call where we absolutely welcome your dog barking, it's this one, so no worries on that. We are quite excited with regards to our innovative portfolio in both companion animal and livestock, and as you think about companion animal, we're really focused on continuing to grow our franchise in parasiticides and look for additional products there, continuing to look at exciting areas such as additional add-ons in our dermatology portfolio. And really we think the platform of our monoclonal antibodies goes way beyond pain to be honest with you. There's lots of other chronic and other conditions we think that technology will help with, and super excited about our portfolio in diagnostics.

Really building new indications with our IMAGYST platform, our AI cloud-based diagnostics, expanding reference labs, so I think there's a really bright future as we look at continuing to expand our pet care portfolio globally.

Glenn, I don't know if you want to take the question with regards to inflation.

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

Yeah, regards to inflation and the impact it will have on pricing across our portfolio, so we do expect over the long term to continue to be able to take price increases ranging from 2% to 3% per year. This year will be a little muted in 2021 because of the impact of the DRAXXIN LOE, but beyond this year, we do expect to be able to return to that 2% to 3% average pricing.

That will vary based on the product as well as the geography. Typically our more innovative products we're able to take a little bit above that 2% to 3%. Products that have been on the market a little longer generally get a little below that 2% to 3%. And then in higher inflationary markets, we typically take pricing beyond that 2% to 3%. So we don't see any significant changes to that in the short to medium term other than the fact that in 2021 because of the impact of the DRAXXIN LOE, we'll be below that 2% to 3%.

Operator: Thank you. Our next question is from Nathan Rich with Goldman Sachs. Please go ahead.

Nathan Rich
Analyst, Goldman Sachs & Co. LLC
Q

Hi. Good morning. Thanks for the questions. Maybe going back to the launch of Librela and Solensia in Europe, I guess, Kristin, with the – given your experience with the kind of early feedback from vets, I mean has that changed your expectations around what the launch curves could look like because these are kind of new products that treat pain, so just wanted to get your kind of updated thoughts on what you think kind of uptick will look like and should we think about a launch curve maybe similar to the derm portfolio, kind of given that both of these therapies were relatively kind of innovative at their launch.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.
A

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Thanks. Yeah, I think we are very bullish with regards to the launch curves of both Librela and Solensia in the EU. I think we're now just in early experience of Solensia honestly, so it's probably a little earlier there. But again, as we said, I think, a little bit previously, I do think the launch curves are going to look different between Librela and Solensia a little bit. Librela is going to enter an established market. The great news is, the vets are already very comfortable with injectable monoclonal antibodies given Cytopoint, so I think you'll see a really nice uptick and I think we'll do very well there.

Solensia is a little different. You have to get more cats to the clinic. You have to medicalize those cats and treat them. It's a little harder to always sense OA in cats. That being said, we'll have a much better sense as we get to the next quarter since we're just beginning early experience right now. We're really bullish on this in the medium term. How fast that uptake happens, I think early experience, which is what we're in right now, will be able to better inform that as we get to the next quarter.

But the science behind it, the safety, the efficacy is really, really strong. And what's different, as we've talked about for Solensia is there really are very few alternatives for cats. So if we can build a market which I think Zoetis has demonstrated its ability to do, we're really excited. But what that launch curve will be will be better informed as we finish early experience which we're just in now.

Anything you add on that, Glenn?

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

No, I'd just echo what you said, Kristin. Very excited by the feedback that we saw with the early experience program. It does give us even greater confidence and more enthusiasm around the potential for these products in the EU and globally, and we're continuing to update our forecast based on the feedback that we get.

Operator: And our next question is from Chris Schott with JPMorgan. Please go ahead.

Chris Schott
Analyst, JPMorgan Securities LLC
Q

Great. Thanks so much for the questions. A couple ones here. Just on Trio, I guess with competition not expected until the second half of 2022, does that change how you're thinking about kind of peak market share potential for the product given you have this kind of three-year window to really establish yourself in the market prior to seeing any type of real competition here?

And then second, I know you touched on this a little bit before, but especially on livestock in general, it seems like we're off to a very strong start of the year. I know part of that is DRAXXIN. But with reopening seeming to go pretty well in most markets so far, are you feeling better about these markets than you did at the beginning of the year, or you're still a bit cautious just given kind of some of the, I guess, uneven openings that we're seeing across the world. Thanks so much.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.
A

Thanks. I'll start and let Glenn build on this. We are very optimistic on Trio. And ultimately it probably changes the curve a little bit of how fast we get that competition on the market, but I think it's important as I mentioned in my earlier comments, these products still grow even when competition enters, and I think this is something we keep underscoring. Simparica was third to market. It is growing like crazy and taking share. I think when you put the

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marketing muscle, the technical experience muscle of Zoetis behind a product, even with competition, we still expect these products to grow.

So we will probably build our share faster. But we do expect even with competition that these products and these categories will continue to grow, also bringing more people into prescription products versus some of the over-the-counter, really bringing new solutions I think will continue to grow these products in the longer term.

I don't know if you want to build anything on that and address the livestock one?

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

A

Yeah, no, just to say obviously the longer we're out in the market alone the better in terms of accelerating that peak sales curve. But to Kristin's point, this is a very large market and we do see products on the market and franchises on the market that are approaching $1 billion today, even without a triple therapy in the US. So we think there's significant opportunity for future growth for this franchise.

In terms of livestock, we are off to a strong start and we do think that the reopening trends are positive for the overall animal health industry and the growth in livestock. We're also very pleased with the performance that we've seen in many of our key markets, particularly outside of the US, markets such as China and Brazil and what we've been able to accomplish there, and we expect those trends to continue to be very positive.

Obviously we do have some dynamics, particularly to our portfolio within livestock with the impact of DRAXXIN, but overall the fundamentals in the industry are remaining positive. Profitability is up for many of our producers, which is also very encouraging for the overall industry and we think will be positive for the longer term outlook for livestock.

Operator: The next question is from Gregg Gilbert with Truist Securities. Please go ahead.

Gregory D. Fraser
Analyst, Truist Securities, Inc.

Q

Good morning, folks. This is Greg Fraser on for Gregg Gilbert. On international livestock, obviously very robust growth in the quarter, and you spoke to the dynamics in China and some other markets. Have the strong demand trends for the overall business continued in the second quarter and how are you thinking about growth for international livestock for the full year? Thank you.

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

A

Yeah, so just when you look at our overall livestock portfolio globally, we grew about 8% this quarter. As you mentioned, that was really driven by the international growth of 17%. As we said on our February call, we do expect that globally the livestock business will grow in the low-single digits. That hasn't changed materially based on the strong performance that we saw in the first quarter. So with that growth, we would expect international livestock to grow more rapidly than the US, really driven by the dynamics with China and Brazil, but still expecting low-single-digit growth for our livestock business for the year.

Operator: We'll go next to Navaan Ty with Citi. Please go ahead.

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Navaan Ty
Analyst, Citi

Q

Hi. Good morning. Actually my question has been partly answered, but could you comment on maybe the pet ownership and the average revenue per companion animal visit going forward and longer term? And remember we expected growth to moderate once we all return to the office, so do you have updated thoughts on that front? Thank you.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Sure. Thanks. As you think about pet care, we've been having a few quarters with 10% or higher revenue per visit. That has been – continued to be sustained. We think that the trend driving this is the increased pet ownership which hasn't changed. There was a little bit of a fear as we were in Q3 of last year, would a lot of these dogs be returned or cats been returned or rehomed, and we really haven't seen a significant trend there. So we think the increased pet ownership – even as people go back to work, most people are going to have flexible arrangements. They're still going to be home with their pet more than probably they were before. And they've built a bond with those pets and they've noticed things and they've built habits that we think will be sustained as we do that. And again, the other important trend here is who is owning these pets. Millennials and Gen Z who tend to spend more per pet. So we really continue to see pet ownership trends and spend per pet continuing.

I mean, is it going to be 10% every quarter? I'm not so sure. But historically just to remind you, I think it was 5% to 6% historically. So it's still a very strong growth driver overall for the industry, and I think these trends may be higher than what it historically has been on a go-forward basis, just given who's adopting the pets and the increased focus on the pet as an important part of the family.

Operator: Thank you. We'll go next to David Steinberg with Jefferies. Please go ahead.

David Michael Steinberg
Analyst, Jefferies LLC

Q

Yeah, thanks. I just had one question to follow up on potential Trio competition. A year ago, you were expecting competition, I think the second half of this year, and then you pushed it into next year and now it's second half of next year. And so I was just curious, I know you said you have limited visibility, but what do you think the sources of the delay might be? Would it be technical, manufacturing or formulation issues, or heightened regulatory issues, delays in inspection or FDA looking for different things? Just curious since you initially thought it would be relatively soon, what could be the technical or regulatory issues surrounding the potential delay in the launch of a competitor? Thanks.

Kristin C. Peck
Chief Executive Officer & Director, Zoetis, Inc.

A

Thanks, David. I have to say, you have a very good list there of potential reasons. I mean the honest answer is we don't really know why there are specific delays. Are they similar delays for different companies? It's very difficult for us to assess that. There's not a lot of great detailed information. So I mean our list of the ones that we consider were all the ones you just mentioned to be perfectly honest, but which one it is for which company, I'm not really sure. Some maybe because they want their first later, that's an example of one of the companies. But for others, it's not exactly clear to us exactly what is driving those delays. So I wish I could be a little more helpful here, but honestly we don't really know.

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Operator: It appears we have no further questions. I'll return the floor to our speakers for any closing remarks.

Kristin C. Peck

Chief Executive Officer & Director, Zoetis, Inc.

Okay. Well, thanks for your questions today and for your continued interest in Zoetis. We look forward to keeping you updated as our business throughout the year and continuing to deliver our results and innovations that you and our customers expect. So thanks so much and stay well, everybody.

Operator: And this will conclude today's program. Thanks for your participation. You may now disconnect. Have a great day.

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