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# Zoetis, Inc. (ZTS)

## Q4 2020 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Welcome to the Fourth Quarter and Full Year 2020 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 information or the Investor Relations section of zoetis.com. At this time, all participants have been placed in a listen-only mode. The floor will be opened for your questions following the presentation. [Operator Instructions]

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

## Steven Frank

*Vice President-Investor Relations, Zoetis, Inc.*

Thank you. Good morning, everyone, and welcome to the Zoetis fourth quarter and full year 2020 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 the 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, February 16th, 2021. We also cite operational results which exclude the impact of foreign exchange.

And with that, I will turn the call over to Kristin.

## Kristin C. Peck

*Chief Executive Officer & Director, Zoetis, Inc.*

Thank you, Steve. Good morning, everyone. I hope you and your loved ones are all staying healthy. As we all know, we're still experiencing hard times in many regions as COVID cases continue and new variants of the virus emerge. But I hope you share my optimism that, with progress on vaccinations and continued adherence to safety protocols, better days ahead.

The year 2020 will be remembered for COVID-19, but for Zoetis, it also reaffirms the resilience of our business, the essential nature of animal health, and the agility and dedication of our colleagues in the face of industry and personal challenges. Throughout the year, we successfully ensured colleagues safety and maintained reliable supply for our customers. We kept driving innovation and strengthening our diverse portfolio of 13 blockbusters and more than 300 product lines across eight species and seven major product categories.

We successfully launched our triple combination parasiticide, Simparica Trio. We also achieved approvals for the first-ever long-acting monoclonal antibody for osteoarthritis pain in dogs and cats, with Librela's authorization for dogs in the European Union and several other markets, and Solensia's first authorization for cats in Switzerland. We also continued to build on our vaccine portfolio in livestock with the approval of our CircoMax Myco swine vaccine in the European Union. And in poultry, we continued advancing our recombinant vector vaccines with the approval of Poulvac Procerta HVT-IBD in the US.

Meanwhile, in diagnostics, we successfully launched Vetscan Imagyst, a breakthrough platform using cloud-based artificial intelligence for veterinary clinics. We were able to do all this while staying anchored to our purpose and advancing the five long-term priorities that I set out at the beginning of the year, including sustainability, where we made important progress in our ESG programs and metric reporting. We look forward to sharing our long-term ESG goals in the coming weeks. And finally, we delivered financial results for 2020 that were in line with the guidance we provided last February before the impact of the global pandemic was known.

For the full year, we generated 9% operational growth in revenue, primarily based on new products in our companion animal business, the continued strength of our key dermatology portfolio, and growth in China. As part of our long-term value proposition, we once again grew revenues faster than the anticipated growth for 2020 and faster than the historical industry rates of 4% to 6%. As part of our value proposition, we also delivered on growing our adjusted net income faster than revenue. For the full year, we delivered operational growth of 10% in adjusted net income while adapting our operations to the pandemic and continuing investments in our pipeline and new product launches. We generated strong fourth quarter results, which Glenn will discuss in a minute, and these performance trends give us confidence in our growth drivers and strong momentum for 2021.

We expect to continue growing revenue faster than the market in 2021, driven by ongoing strength in pet care, continued expansion in markets outside the US, most notably China, and acceleration of our diagnostics portfolio penetration. We are guiding to operational growth of 9% to 11% in revenue for full year 2021. Growth expectations for the companion animal market are in the mid-single-digits and we expect Zoetis to grow significantly faster than that based on the continued uptake of Simparica Trio, the strength of our key dermatology portfolio, and the launch of monoclonal antibodies in markets outside the US.

Positive pet care trends during the pandemic, based on increased adoptions and people spending more time with their pets, should continue driving market growth in the near term. Data in the US shows visits to veterinary clinics have rebounded and the average revenue per visit has continued to increase. Over the long-term, we see these trends moderating as adoption rates normalize and people eventually return to the workplace. The specialty care regimens and chronic care treatments that began in the pandemic should continue, and our innovative portfolio across dermatology, parasiticides, pain, vaccines, and diagnostics have us well-positioned for continued growth and capturing share as these shifts occur.

In terms of livestock market, we expect low-single-digit market growth in 2021 as the impact from COVID-19 will still be felt and a number of products experience loss of exclusivity. We expect Zoetis to grow in line with the market even as we face increased headwinds from generic competition for DRAXXIN, our leading anti-infective product. We are confident we can leverage our lifecycle innovation strategies together with the overall diversity of our livestock portfolio, including swine product sales in China, to help us address the loss of exclusivity for DRAXXIN and maintain livestock growth that will support our 2021 guidance. Longer term, we will continue to invest in livestock innovations and data-driven animal agricultural solutions.

As we continue through 2021, we will be building on the progress against our five priorities: driving innovative growth; enhancing customer experience; leading in digital and data analytics; cultivating a high-performing organization; and championing a healthier, more sustainable future. Our investment plans and focus on growth for 2021 include: continuing the successful launch of Simparica Trio in the US and other markets, as well as the ongoing adoption of other new parasiticides, Revolution Plus and ProHeart 12; driving growth in dermatology through increased use of direct-to-consumer advertising and disease awareness campaigns in the US and globally. Our focus remains on growing this market and increasing customer loyalty to our innovative treatments, which we expect to help us top $1 billion in annual sales for the first time.

As noted earlier, we will be investing in the launch of the first monoclonal antibodies for osteoarthritis pain in dogs and cats in Europe in the first half of 2021 and advancing the regulatory process in the US and other markets. While we remain confident in the eventual US approval of these products based on the safety and efficacy data we submitted, at this point, we believe it is unlikely we will receive approvals for Solensia or Librela in the US in 2021. We continue to work through regulatory reviews and manufacturing inspections with the FDA and we will continue to keep you updated on this process on future calls. And finally, we're continuing our development of digital and data solutions that will support more individualized animal care and more efficient and sustainable operations for producers.

In conclusion, I'm incredibly proud of what our people accomplished in the face of such uncertainty during 2020, and it gives me great confidence in our continued success and full year guidance for 2021. As we navigate through recovery from the global pandemic and capitalize on the growth opportunities we see ahead, my optimism comes from what drove us over the last year: the resilience and essential nature of the animal health industry; the diversity, innovation, and market leadership of our portfolio; and the agility and passion of our colleagues to face any challenge.

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

## Glenn C. David

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

Thank you, Kristin, and good morning, everyone. We had another exceptional year with revenue of $6.7 billion and adjusted net income of $1.8 billion, both exceeding the high end of our November full year guidance range. Full year revenue grew 9% operationally and 7% on a reported basis, with adjusted net income increasing 10% operationally and 5% on a reported basis. Going deeper into the numbers, price contributed 2% to full year operational revenue growth with volume contributing 7%. Volume growth consisted of 3% from new products, 3% from key dermatology products, and 1% from acquisitions, with other in-line products flat for the year. We again saw broad-based revenue growth with the US growing 11% and international growing 7% operationally.

The innovation we brought to the market and the diversity of our portfolio was key to our strong performance, as companion animal grew 17% while livestock was flat on a year-over-year basis. Performance in companion animal was led by our parasiticide portfolio, bolstered by the launch of Simparica Trio, which generated revenue of $170 million. This added approximately $150 million of incremental revenue and exceeded our expectations set prior to the pandemic. Sales of Simparica also grew double-digits for the year with operational revenue growth of 16%.

Our key dermatology portfolio demonstrated continued strength in 2020, growing 23% operationally, generating revenue of $925 million and increasing more than $170 million versus prior year. The COVID-19 pandemic created a difficult market environment for livestock. However, we are encouraged by the resiliency displayed in 2020. We remain optimistic that global livestock will return to modest growth in 2021 as the recovery from African swine fever in China continues and consumption patterns normalize. Operational growth in adjusted net income of 10% was driven mainly by strong revenue growth and operating margin expansion.

Now, moving on to our Q4 financial results, where we posted another strong quarter with revenue of $1.8 billion, representing an increase of 9% operationally and 8% reported. Adjusted net income of $438 million is an increase of 3% operationally and flat on a reported basis. Operational revenue grew 9%, with 2% from price and 7% from volume. Volume growth of 7% consisted of 4% from new products, 3% from key dermatology products, 1% from acquisitions, and a decline of 1% from other in-line products.

Companion animal products led the way in terms of species growth, growing 25% operationally, while livestock declined 5% operationally in the quarter. Companion animal parasiticides grew 52% in the quarter, gaining market share in the US of more than 7% within the flea, tick, and heartworm segment versus the same period in the prior year. This includes the continued adoption of Simparica Trio, which generated sales of $60 million in Q4.

Our key dermatology products, Apoquel and Cytopoint, again had significant global growth in the quarter with $257 million of revenue, representing 27% operational growth versus an extremely difficult comparative period in which key derm grew 29% for the fourth quarter of last year. Our diagnostics portfolio again made positive contributions to revenue with reference lab expansion and double-digit growth in consumable and instrument revenue. The recovery in wellness visits continued to be a catalyst for growth following the slowdown from social distancing restrictions earlier in the year.

As we noted on our previous earnings call, the early fall cattle run pulled a portion of fourth quarter sales into the third quarter, leading to a weaker quarter in cattle than we would typically expect. This was the primary driver of the 5% operational decline in livestock for the fourth quarter. For the remainder of the livestock portfolio, swine posted a second consecutive quarter of growth with the herd rebuild continuing key accounts as the market recovers from African swine fever in China. Our aquaculture business grew high-single-digits in the quarter, and along with swine, partially offset the decline in cattle and poultry.

Now, moving on to revenue growth by segment for the quarter. US revenue grew 11% with companion animal products growing 30% and livestock sales declining by 15%. For companion animal, the positive trends at the vet clinic continued in Q4, with patient visits up 2% and revenue per visit increasing by 13%. Companion animal growth in the quarter was driven by sales of our Simparica franchise as well as key dermatology products. We maintained an increased investment in direct-to-consumer advertising in both therapeutic areas and continue to see a good return on that investment.

Simparica Trio performed well again in the quarter with sales of $56 million. We remain extremely encouraged for the future growth of our product and the growth of the overall market segment as a material portion of Trio sales came from new patients to the category. Key dermatology sales were $176 million for the quarter, growing 32%, with significant growth for Apoquel and Cytopoint. Our investments to support the franchise have been instrumental in driving more patients into the clinics.

Companion animal diagnostic sales increased 22% in the quarter as a result of reference lab expansion and growth in point-of-care instruments and consumables. US livestock declined 15% in the quarter driven primarily by cattle, which had a portion of Q4 sales pulled into the third quarter as a result of the earlier movement from pasture to feedlot.

The remaining species declined as well, with COVID-19 and pricing pressure negatively impacting our swine business. Poultry declines are largely attributed to product rotation and less producer profitability, leading to reduced usage of our premium products. To summarize US performance, innovation and return on investment once again drove exceptionally strong growth in companion animal. While livestock was down in the quarter, the results were in line with our expectations.

Revenue in our international segment grew 7% operationally in the quarter. Companion animal revenue grew 17% operationally and livestock revenue grew 2% operationally. Increased sales of companion animal products resulted from growth in our parasiticide portfolio, vaccines, and key dermatology products. Parasiticide growth in the quarter was again driven by the Simparica franchise with further adoption of Simparica Trio.

In Q4, we observed a series of favorable market trends, such as increased pet ownership and medicalization rates in Asia. Overall, companion animal grew in every major market, except Italy and the UK, which had arguably the strictest lockdown protocols. Companion animal diagnostics grew 16% in the quarter led by an increase in point-of-care consumable usage.

Swine revenue grew 14% operationally, posting a third consecutive quarter of double-digit growth. Swine sales in China grew in excess of 100% for the second straight quarter. Key accounts expanded their use of vaccines and other products, as they continue to rebuild herds from smaller farms to large scale operations. China total products grew 45% operationally in the quarter and 34% operationally for 2020.

Brazil was also a significant contributor to international growth in the quarter, growing 18% operationally. For the fourth quarter and full year 2020, Brazil delivered double-digit growth in all species, except poultry, which modestly declined. Overall, our international segment delivered strong results despite the challenges presented by COVID-19. Our diversity across products and geographies enabled our international segment to again be a significant driver of growth.

Now, moving on to the rest of the P&L for the quarter. Adjusted gross margin of 67.7% fell 80 basis points on a reported basis compared to the prior year, resulting from other manufacturing costs, inventory charges, recent acquisitions, and elevated freight expense. This was partially offset by favorable product mix and price increases. Adjusted operating expenses increased 10% operationally resulting from increased advertising and promotion expense for Simparica Trio and Apoquel, partially offset by T&E savings. Return on investment from our DTC campaigns has been very favorable and will remain an important investment to support future growth of the business.

The adjusted effective tax rate for the quarter was 13.5%, a decrease of 70 basis points, driven by the impact of net discrete tax benefits, partially offset by the jurisdictional mix of earnings. And finally, adjusted net income and adjusted diluted EPS for the quarter grew 3% operationally. In December, we announced a 25% annual dividend increase, continuing our commitment to grow our dividend at or faster than the growth in adjusted net income. In addition, we resumed our share repurchase program in January with $1.4 billion of remaining capacity under the current authorization.

Now, moving on to guidance for 2021. Please note that guidance reflects foreign exchange rates as of late January. For 2021, we are projecting revenue between $7.4 billion and $7.55 billion, representing 9% to 11% operational growth. We are expecting foreign exchange favorability in 2021 of approximately 200 basis points. We expect companion animal to be the primary driver of growth in 2021 with the continued strength of our diverse parasiticide portfolio, which includes full year Simparica Trio sales.

We believe market dynamics for companion animal will remain strong in 2021, allowing for further expansion of our key dermatology products as well as our diagnostics offerings, which we anticipate will grow faster than the overall animal health market. While we expect the pace of certain trends that accelerated in 2020 to moderate, such as increased spend per visit, our view is that 2020 has established a higher base for future growth.

We anticipate livestock will return to global growth in 2021 primarily driven by more normalized food consumption patterns. Geographically, we expect total company sales growth to be relatively balanced between our US and international segments. However, we do expect continued and meaningful growth in China and other emerging markets.

I'd like to touch upon the key assumptions that underpin our expectations for revenue growth. Beginning with dermatology, our guidance does not assume a meaningful competitive entrant in 2021, and with continued investments behind the franchise, we believe revenue will exceed $1 billion for the full year. We also do not assume a triple combination product will launch in the US in 2021 to compete against Simparica Trio.

We're extremely excited about our monoclonal antibodies for pain with both Librela and Solensia having long-term blockbuster potential. However, as Kristin mentioned, while both products will launch in the first half of 2021 in the EU and other international markets, we do not currently expect either product to receive approval in the US this year.

For the remainder of the P&L, adjusted cost of sales as a percentage of revenue is expected to be approximately 30%, which is relatively consistent with our cost of sales in 2020. Adjusted SG&A expenses for the year are expected to be between $1.775 billion and $1.85 billion, with the increase from 2020 focused on supporting primary drivers of revenue growth, including recent and future product launches, key brands and recent acquisitions, and reference lab expansion in diagnostics.

Adjusted R&D expense for 2021 is expected to be between $500 million and $520 million as we remain committed to investing in pipeline opportunities for new therapies and lifecycle innovations. Adjusted interest and other income deductions is expected to be approximately $260 million, with the increase over 2020 driven by increased interest expense as well as lower interest income. Our adjusted effective tax rate for 2021 is expected to be approximately 20%. The increase in 2021 is primarily related to the impact of favorable nonrecurring discrete items that occurred in 2020. Adjusted net income is expected to be in the range of $2.08 billion to $2.13 billion, representing operational growth of 9% to 12%.

Our guidance reflects our value proposition of growing revenue in line with or faster than the market, and growing adjusted net income faster than revenue, during a year when we'll be making meaningful investments to support future growth. Consistent with 2020, we are anticipating elevated capital expenditures in 2021 to support investments in manufacturing, focused on internal sourcing of API, capacity increases, and facilities to support pipeline opportunities. We're also investing in information technology to support our recent acquisitions, as well as digital capabilities and data analytics.

Finally, we expect adjusted diluted EPS to be in the range of $4.36 to $4.46 and reported diluted EPS to be in the range of $4.02 to $4.14. While guidance represents full year expectations, we do anticipate growth will be more heavily weighted towards the first half of the year. This is largely due to full year Simparica Trio sales and a favorable comparison versus Q2 2020 as a result of COVID-19.

To summarize, 2020 was another exceptional year in which we delivered 9% operational revenue growth and 10% operational growth in adjusted net income, in a year that presented a unique set of challenges. Our guidance for 2021 highlights our ability to grow revenue organically above the market and grow adjusted net income faster than revenue, even during times of elevated investment.

Before turning it over to Q&A, I'd like to express how proud I'm of our colleagues and all we have accomplished amidst an unprecedented set of circumstances. While there is no assurance that the New Year will be without similar challenges faced in 2020, we cannot be more excited about the opportunity to again deliver on our long-term shareholder value proposition.

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

# QUESTION AND ANSWER SECTION

**Operator**: Certainly. [Operator Instructions] And we will take our first question from Jon Block with Stifel. Please go ahead.

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

Q

Thanks, guys. Good morning. Congrats on just a great 2020. I'm going to ask both upfront. For the quarter, 4Q 2020 gross margins were a bit below despite big companion animal growth. And next year, it seems like you're guiding to flattish, call it, gross margins again, despite what seems like positive mix shift. So, Glenn, can you talk about that a bit? Why are we not seeing a bit more in gross margin considering the companion animal performance and is expanding gross margin still a part of the long-term story?

And then, I'll stick with sort of guidance, just really big numbers on 2021 guidance out of the gate. You talked of livestock versus companion. Can you talk to the components of companion animal a little bit more? I don't know if I specifically heard a Trio number, but is it safe to assume Trio of $400 million plus and any other components you'd call out? Thanks, guys.

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

A

Sure, Jon. So, first, when you look at the gross margin expectation for 2021, it is relatively flat versus 2020. As you mentioned, the mix with companion animal will be beneficial as we move into 2021. Some of the offsets to that though, some of the investments that we're making in other areas such as reference labs which come at a lower margin, particularly in the early stage of their lifecycle as we're building those labs, the margins will be a little lower until they reach their full operating scale. So, that's some of the offset. So, there are some positives in terms of the companion animal mix, some offsets though with some of the longer terms we're investing making in other areas.

In terms of the drivers of companion animal growth, so obviously we do expect Trio to be a significant driver of growth for 2021. We're not putting a specific number on Trio, but we would expect that contribution from growth in 2021 to be at least as big as what we achieved in 2020. So, that will obviously be one of the drivers. Also, continued growth in our dermatology portfolio. We saw very strong performance in 2020 with 23% growth in that portfolio operationally for the year. We do expect that portfolio will exceed $1 billion as we move into 2021.

Also in companion animal diagnostics, we expect very rapid growth in diagnostics as well. In the fourth quarter, we saw 20% growth and we expect that will help carry us forward with the strong momentum that we had in the quarter into 2021, as well as strong performance that we're seeing in many of our emerging markets, such as China and Brazil. So, those are some of the factors that are driving the strong companion animal growth.

**Operator**: Our next question comes from Michael Ryskin with Bank of America. Please go ahead.

**Michael Ryskin**
*Analyst, BofA Securities, Inc.*

Q

Hey. Thanks, guys. I'm going to ask a quick two-parter. The first one is going to be on the livestock markets and just specifically on DRAXXIN. Are you starting to see some competition? I know the patent has been just rolled off, but any early comments you can tell us in terms of pricing, from competing launches, and sort of updated expectations on market share, but also what steps you're taking and how meaningful the headwind do you expect in 2021. And then, broader on livestock, we've read a lot about input costs going higher on corn and things like that, potentially pressuring producers in some markets, such as poultry and swine. How does that factor into your outlook for low-single-digit growth?

And then, second question would be just a little bit more on the companion animal expectations for 2021. Obviously, you're growing well above the market, but any thoughts on sort of in-line portfolio? You commented on Trio and you commented on strong derm strength and what you see in Librela, but just could you sort of comment on Revolution Plus and on the rest of the in-line portfolio there?

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

A

Thanks, Mike. So, starting on DRAXXIN, we are expecting a number of competitors to enter in the US market. Again, the LOE is this month, so it hasn't happened yet. I would say more probably entrants than we expected a few months ago, but we don't think that will last, obviously. I think the market will shake out, obviously, to a few. As we said previously, typically we expect to lose about 20% to 40% share over several years. In the case of DRAXXIN, given the large number of competitors, we do expect that to be faster, but we don't really expect it to be overall different. And really partly what drives that I think is we do believe that a lower price on DRAXXIN will expand the market for macrolides overall, and therefore, the market itself will grow.

We also think we're positioned well from a broad portfolio, strong technical. We do expect the price to come down in that 20% to 40%. That is an expectation. But as we said, this is all baked in right now to our guidance, so the expectations around where DRAXXIN is going to be is there. And if you look at broader livestock, you referenced some of the input costs, as you heard in some of our opening remarks, we are expecting low-single-digit growth, so a return to growth in livestock overall. And some of that will be led in the US in certain species, but a lot of that will be led outside the US. As a reminder, about 60% of our livestock business is outside of the US and we're seeing incredible growth right now in China and some other markets, Brazil, et cetera.

So, overall, we do think some of the input costs in the US will be a pressure, but given the diversity of our portfolio, looking at some large markets, our second largest market is China, our third largest market is Brazil, we do see strength in livestock there. So, we overall do believe livestock will return to low-single-digit growth in 2021 and we continue to believe it will return to normal growth in the mid-single-digit range, 4% to 6%, over the medium term.

So, Glenn, I'm not sure if you want to take the incremental question on the broad companion animal trends in 2021.

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

A

Yeah. So, the trends for companion animal remain very strong and it's really driven by the breadth of our portfolio. So, we talk a lot about the growth that we expect to see from Trio, from our derm portfolio, from our diagnostics portfolio. Also, in 2021, we'll have the launch of our monoclonal antibodies for pain in Europe as well as some other markets will also be a key contributor to growth. But then there are other products that round out the portfolio, products such as ProHeart 12, products such as Revolution Plus, also the growth that we're seeing in markets like China, where companion animal is growing very rapidly, markets like Brazil. So, there are really many areas of growth that we see and that's driven by the fact that we do have the broadest portfolio in companion animal and we're able to leverage that with our customers.

**Operator**: And our next question comes from Louise Chen with Cantor Fitzgerald. Please go ahead.

**Louise Chen**
*Analyst, Cantor Fitzgerald Securities*

Q

Hi. Thanks for taking my question. So, what are the macro factors that you see for Zoetis in 2021 as it pertains to livestock, feed prices, weather, any other headwinds or tailwinds that you see out there? Thank you.

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

A

Sure, Louise. Good to hear from you. As you look at livestock overall, we're seeing some of the macro trends as sort of a recovery in China around ASF is driving significant portion of the growth from a swine perspective. China is still going to be importing a decent amount, probably less than in 2020 from other markets around the world, sort of maintaining that. We're also hopeful that you'll see an increase in dine-out, which will send signal to the industry to expand herds.

So, I mean, 2020 was obviously hit with many different factors, but we do see both an increase in demand and in markets where our technologies have really leveraged some of the emerging markets, we're seeing significant uptick there. There will remain challenges in some of the US producers, obviously, for some of the input costs, et cetera, but we do believe you'll see more of a return to normalcy as we move into 2021 and that's why we're guiding at sort of the low-single-digit, but we do believe in the medium term, we'll be back to sort of the mid-single-digit overall.

**Operator**: And our next question comes from Erin Wright with Credit Suisse. Please go ahead.

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

Q

Hey. Thanks. I'm curious how the multi-formulation approach towards parasiticides [indiscernible] (00:34:23-00:34:30) historically on a relative basis and is the underlying cannibalization of legacy products there playing out in line with your expectations?

And then, my second question is on the new pain mAb. How should we think about the contributions from them this year in Europe or other countries? Will it be meaningful at all and how should we think about the dynamics that are impacting approval in the US? Do you still anticipate or are you still confident that these will be blockbuster products for you with the launch in the US in 2022?

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

A

Thanks, Erin. I heard the second question on mAbs, which I can answer. You were breaking up and digitizing on the first question. I think we more or less have it, so let us give it a shot and you can comment if we miss some of it. Some of it we heard. So, starting on your second question on the mAb, we were very excited to now have Librela approved and launching in the first half of this year in the EU, Brazil, Canada and Switzerland, and Solensia, we continue to expect approval in the EU in the first half this year and to be launching sort of midyear. We already do have approval on Solensia in Switzerland and we remain confident in the eventual approval based on the safety and efficacy data we submitted in the US.

But as you saw in our remarks and our release, the approval timeline has moved out a bit. We believe this has to do with the fact that this is the first monoclonal antibody approved by the FDA in animal health. Our previous one, Cytopoint, was actually USDA. It's making it a little harder for us, honestly, to predict some of the regulatory process. We're continuing to work through the regulatory process and manufacturing inspections and will continue to keep you updated. We don't think that changes the overall peak sales of this product at all, but it is a slightly different process. And I guess Glenn might have understood a little bit better. We'll try your first question. Let us know if we missed it.

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

A

Yes. Erin, I think your question was around how we're performing with the breadth of our portfolio from parasiticide with our customers and I think that's going very well in the veterinary clinics. We're really able to offer our customers a variety of options based on how they want to best treat the animals and I think that shows in the performance that we saw in the Simparica franchise in 2020. Not only did we exceed our goals for Trio with $170 million in sales in the year, but we also saw significant growth in Simparica, which really exceeded our expectations. So, we grew operationally 16% with Simparica. So, what we saw was that the advertising and driving patients into the clinic for Simparica Trio actually benefited the overall portfolio and we also saw a very positive growth in ProHeart 12 as well. So, we think the breadth of the portfolio in the parasiticides was really a benefit and our field colleagues were really able to execute very well with that portfolio.

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

A

Was that your question? Did we get it all? [indiscernible] (00:37:26) All right. You can come back in the queue, if we missed you. Sorry about that, Erin. It was a little bit digital.

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**Operator**: Okay. We'll take our next question from John Kreger with William Blair. Please go ahead.

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**John Kreger**
*Analyst, William Blair & Co. LLC*

Q

Hi. Thanks very much. Just maybe a quick follow up on the Librela and Solensia timeline in the US. Do you have a sense for how far pushed back the approval timing might be and do you think you need to collect additional clinical data?

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

A

Yeah. We don't have a great sense right now. We're still working through the regulatory and manufacturing process. We also – the FDA is going to require inspections of facilities that are outside the US. So, the exact timing of when they're going to be able to do that is a little bit uncertain. So, I don't have a great sense. If we did, we would have obviously given more specific guidance. We do not expect it to be in 2021 which is what we're being clear on now. And as soon as we know more, we'll be happy to update in future calls going forward. But unfortunately, I don't have great – again, we remain very confident that it will eventually be approved, but we need to go through and be processed with the regulator that hasn't, in animal health under CVM, approved monoclonal antibodies previously. So, it's a little bit different for us. So, this is the best we know at this point.

**John Kreger**
*Analyst, William Blair & Co. LLC*

Q

Great. Thank you. And then, a second question. Can you maybe just sort of frame the diagnostics plan for 2021? It seems like results are starting to accelerate there. Are any of the investments being focused in the livestock or should we really think about your efforts right now being concentrated with companion animal?

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

A

Sure. For 2021, our focus remains on companion animal. We're very pleased with our progress on placements, which is a really good leading indicator of usage. As you saw, we had double-digit consumable growth as well which we're quite pleased with. When we look at new products, we've added the Imagyst platform. We're excited with its first indication, obviously, in fecal. That's the AI-powered one. We're looking for additional indications there. So, the last piece there would also be reference labs. So, we're continuing to expand our US reference labs. We'll be probably adding about three to five more labs this year. So, we believe diagnostics is a core part of our portfolio. It's a market that grows at 10% plus. We're really pleased that we're starting to see some strong momentum across the different parts of it, so both reference labs as well as placements as well as consumables. So, we remain very committed to this space and are pleased with our progress over there.

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

**David Westenberg**
*Analyst, Guggenheim Securities LLC*

Q

Hi. Thank you for taking the questions and congrats on a great year. Can you give us a little bit of flavor on where Trio is taking share from? I think you mentioned there is some new to the category, but I'm just kind of trying to get a flavor, is it legacy, just regular flea and tick? What component is heartworm? And basically, what I'm trying to do is get a good sense of how big this can grow in terms of both the heartworm market and the flea and tick market.

And then, just a second related question on Trio. Is there any synergies particularly on the sales synergy from the direct-to-consumer marketing campaign that might be able to benefit maybe derm or maybe even there's a cost synergy? So, thank you very much.

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

A

Sure. So, starting on the Trio, we did see an increase in share in Q4 of 7%, so we are taking share and there are a number of places that's coming from. If you think about it, the first is new puppies, where I think we're doing quite well with new, I think, puppies. Also, new people to the category overall, I would say, people who maybe previously had gotten product over the counter are moving in, and we are taking share from some of the other established competitors in this space. So, I think we're seeing strong growth overall I would say there and pleased at our share.

As you look at the potential for the product, the two competitors, both NexGard and Bravecto are each $600 million products to date. So, we continue to believe there is significant growth. We remain under-indexed, to be honest with you, in parasiticides. So, we continue to see this as a significant part of our overall growth.

From a sense of are there synergies with derm, not really is what I would say, except for on the cost side. Obviously, we can get better buying power when we place DTC ads by leveraging the spend across both, but beyond that we don't see strong synergies honestly between the DTC on one affecting the other, unless a clinic has to carry both and things like that. But we think maybe the only synergy there is just in our buying power by leveraging the combined DTC spend.

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**Operator**: We can go to our next question from Nathan Rich with Goldman Sachs. Please go ahead.

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**Nathan Rich**
*Analyst, Goldman Sachs & Co. LLC*

Q

Hi. Good morning. Thanks for the questions. Kristin, maybe to start, what do you think the launch curve looks like for products like Librela and Solensia, obviously, a new way for vets to treat osteoarthritis and chronic pain? I guess, kind of what are your initial kind of impressions on sort of the level of demand that's out there from vets for this type of treatment and how will Librela be priced relative to existing treatments on the market? I know it can be kind of up to $100 a month here in the US. I'm sure it varies a lot by market, but just any comment on pricing would be helpful.

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

A

Sure. I think the lifecycle for Librela and Solensia and the curve will be slightly different. Librela is entering a market that's $400 million today. So, it's an established market. So, I think the ability for – people are already bringing their dogs in for OA pain. So, I think we have the opportunity with Librela to expand the number of patients, given the safety and efficacy profile and the compliance benefits of the product. I think we can also increase days on therapy which also helps us grow the market. And then, obviously, price to your point, so it is priced at a premium to many of the products on the market today. It is not – obviously, we don't have a price in the US, since we don't even have an approval yet in the US.

I think Solensia is going to be a little bit different. I think the curve is going to take a little longer, and that has to do with the fact that there really isn't a market today in most parts of the world. If you had a cat who had it, there really was no treatment, so cat owners have kind of been conditioned to not bring their cats in. We started focusing about a year ago to try to build that market, make pet owners aware what OA pain looks like in cats, and encourage them to start bringing their cats to the vet and then getting vets to treat that. We think it's a significant market, but you have to first medicalize some of these conditions and treat it.

It's significant. There are 60 million cats in the US today and really only about 40% of them have OA, but only 18% of them are really identified by vets. So, we think both are significant markets that we can grow the market. Solensia is more about creating a market and I think you can look at our success in doing that with dermatology, with Apoquel and Cytopoint. So, we are investing early, as Glenn has been talking about in some of the guidance over the last year and for 2021, in building those markets. But I would assume the curve for Librela will be much faster than the curve for Solensia as we're building a market.

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**Operator**: And our next question comes from Balaji Prasad with Barclays. Please go ahead.

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**Balaji Prasad**
*Analyst, Barclays Capital, Inc.*

Q

Hi. Good morning and congratulations on the results. A couple of questions from me, firstly, since livestock recovery this year seems to be so contingent on China and there are news of unregulated or illegal vaccines being used and [indiscernible] (00:45:07). So, I want to understand what are you seeing on the ground and how should we wrap our heads around the reherding cycle in 2021?

Second, on operating margins, considering that you will not have the dilutive impact of diagnostics that we saw in 2020, should we be looking for better operating margins, considering that revenue mix is better, livestock should be in a recovery? And if so, what are the offsets to this? Thanks.

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

A

Sure. So, when you look at overall livestock and particularly in China, so we've seen very positive performance in livestock in China this year. So, from a livestock perspective, we grew 45% in China this year and we expect continued strong performance in China in 2021 as we continue to see the herd rebuild, recovery from African swine fever, and where we're seeing that recovery is particularly in our larger accounts, and the larger accounts use more of the multinational products and our premium products. So, we've seen a really rapid acceleration of our growth. For example, in the second half of the year in swine, in particular in 2020, we grew over 100% in swine in China and we expect very positive momentum moving into 2021 and very significant growth from China in 2021.

In terms of the operating margins, there are a couple of things to look at as we move into 2021. A, number of areas of investments that we have in our SG&A really continuing to support the growth of Trio as well as the monoclonal antibodies for pain as well as dermatology. We've increased our DTC investment in 2020, particularly around Trio and derm, and we plan on continuing that in 2021 as we saw a very positive return on investment there. Obviously, we'll continue to invest in R&D and that will be an area of continued investment as we've seen a very positive return on that investment as well.

The other thing to consider when you look at the overall guidance with revenue growing 9% to 11% and income growing 9% to 12%, one of the reasons that income isn't growing more rapidly is the change in assumption in tax rate between 2020 and 2021. In 2020, our rate was 18.3%. Our guidance for 2021 is approximately 20%. If you neutralize for the impact of the tax rate, our adjusted net income would actually be growing 2% faster, so more 11% to 14%. So, we are seeing margin expansion, but the impact of the tax rate is diluting that to some degree.

**Operator**: We'll go next to Chris Schott with JPMorgan. Please go ahead.

**Chris Schott**
*Analyst, JPMorgan Securities LLC*

Q

Great. Thanks so much. Can you talk first maybe a bit about innovation on the livestock side? It seems like the market, between COVID and some other dynamics, has been kind of a bit lackluster in terms of growth for the last few years. So, what does it take to get back to mid-single-digit growth on the livestock side and what are some of the bigger innovation trends we should be watching there?

And then, my second question was just following up on the topic of margins. As we start looking out to 2022 and beyond, should we be thinking about a sustained window of higher expense growth as you get many of these new launches off the ground or has lot of that groundwork already been, I guess, invested as we go into 2020 and

2021? I'm trying to get a sense of how we should think about longer term margin expansion dynamics, assuming we continue this very healthy top line setup which seems to be playing out. Thanks so much.

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

A

Thanks, Chris. We have been talking about the fact that to really get to the mid-single-digits in a sustainable way, you're going to need innovation. I think there's a few spaces where you're already starting to see that and some that will be coming. The first is around the vector vaccine space which we've been talking about. In 2020, we launched our first one in the US for Newcastle. In 2021, we launched one for IBD. We're looking for more launches there. This is a significant market. It's about a $300 million market, growing double-digits. So, we do see vector technology in poultry which is one of the faster-growing species being an area of innovation and growth for us.

We also think more broadly that immunotherapies are going to be really important for two reasons: one, they're an alternative to antibiotics; and secondly, healthier animals are more productive. So, it also increases productivity for producers. So, I think immunotherapies, which we've been working on for a while and have a partnership with Colorado State to develop, will be important. The other sector that I think is really important to focus on is precision livestock farming, which we also think has great potential. We're leaders right now in the genetic space there, in genetic testing. We also purchased PLA, as you know. We're looking at really back-to-back individual animal care and herd monitoring, and I think that's probably the next big wave. That's probably more of a medium-term growth driver, but I think there's a number of spaces where you'll see innovation at the livestock spot, so across vectors, immunotherapies, and precision livestock farming.

I'll let Glenn take the second question on long-term margin expansion.

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

A

Yeah. So, in terms of the long-term margin expansion, I think there are a couple of factors to consider. So, for 2021, we mentioned that the gross margin is relatively flat and talked about some of the drivers of that, with some of the investments we're making in reference labs, also the impact of the DRAXXIN LOE this year on gross margin. So, as we move into 2022 and beyond, some of those impacts will be a little less and we would expect to see continued expansion in gross margin.

In terms of the overall operating expenses, beyond 2021, obviously, there will be one year where T&E normalizes when things get back to normal from COVID. But beyond that impact, we would expect that we would continue to be able to grow our expenses at a pace below that of revenue. So, we'll probably continue to grow R&D in line with revenue. That may vary in a given year based on the opportunities. But SG&A, based on the infrastructure that we have globally established, we should be able to grow that somewhere between inflation and revenue. So, we would expect to continue to see expansion there on an overall operating margin perspective.

**Operator**: Our next question will come from David Risinger with Morgan Stanley. Please go ahead.

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

Q

Yes. Thanks very much and let me add my congrats on another phenomenal year as well. So, I have two questions. First, with respect to the monoclonal antibody approval delays, so it's for both cats and dogs, but it wasn't quite clear to me whether the FDA wants more clinical data or whether there are manufacturing issues because – or manufacturing questions, because I think, Kristin, you had mentioned manufacturing. So, if you could just clarify on both of them, what the FDA issues are, whether they're clinical or manufacturing?

And then second, Zoetis' R&D has obviously been amazingly differentiated from competitors. Competitors struggle to bring blockbuster companion animal products to market even including follow-ons to Zoetis' top growth drivers over several years. And so, considering that, can you just help us understand the unique aspects of Zoetis' R&D and its ability to maintain separation from the competition? Thank you.

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

A

Sure. Thanks, Dave. With regard to the monoclonal antibodies, Librela and Solensia, it really is just working through the regulatory process and the questions that they're asking and they're requiring inspections of sites. So, at this point, we have not been asked for any clinical data, but we're still in the regulatory process is what I would say. It is the first time doing this with the FDA. So, it's just honestly a new process for both, and understandably, it's the first time they're looking at some of these types of products. So, they have a number of questions. So, it really is just going through the regulatory review process and trying to manage new manufacturing inspections which, I do know, probably – COVID is definitely affecting that a little bit, but we're just working through that. So, at this point, we have not been asked for any additional clinical data and we don't think there's any manufacturing issues at this point, we're just still working through the review process and what their expectations are.

With regards to Zoetis' R&D, what I would say is I think it's the partnership between R&D, manufacturing, and our commercial organization. It's taking those insights the commercial has of customer needs and partnering early on with R&D to develop products. I think the other thing we've done really well is partner with manufacturing to be able to scale those products and be able to bring them to market. We manufacture our own monoclonal antibodies. As you know, we've got very strong manufacturing capabilities, which is I think important for launching many of the products and scaling up at the level. We certainly learned the hard way early on in our journey about investing in that partnership when we saw some of the challenges we had supplying Apoquel. So, I think from an R&D perspective, obviously, I think we have great scientists, but I think it's the rigorous process and partnership they have with our commercial and our manufacturing colleagues, and our willingness to invest in disruptive technologies and take those risks that we've been managing over the last eight years.

Anything you'd add there, Glenn?

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

A

No. I think it's exactly what you said, Kristin. We talked about the interconnected capabilities between commercial, manufacturing and R&D, and I think that works extremely well here. Like Kristin said, identifying what the key needs are in the marketplace early on, coming up with solutions, and making sure that they're products that we're able to manufacture and we've been very successful in doing that.

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**Operator**: Our next question will come from Kathy Miner with Cowen and Company. Please go ahead.

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**Kathleen Miner**
*Analyst, Cowen and Company*

Q

Good morning. Thank you. The first question I have is related again to the monoclonals. Can you just clarify when you talked about site inspections being needed, is it correct then that either one or both of the monoclonals are manufactured outside of the US?

The second question also on the products is, is the intention to launch both the cat and dog ones at the same time, is there an advantage to doing one or the other, and we can speak just about the EU markets where you have approval? And the second question on the derm products, you've targeted $1 billion in sales for this year. Can you talk about some of the drivers behind that, is it outside of the US, is it more pets, et cetera? Thank you.

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

A

Sure. So, first of all, Kathy, great to hear from you. Secondly, on the mAbs, they're both – the manufacturing facilities are different for them, but they are outside the US. And prior approval inspections, regulators handle them differently, but they are going to be required probably for both of these products and they are both different, but they are both outside of the US. And I think your second question was around the derm sales growth, US or ex-US. It's both. We still believe we're underpenetrated outside the US. There's a same number of dogs in the US and outside the US, yet two-thirds of our sales in derm remain in the US. So, we do think there's a significant opportunity.

It has been harder to get scale outside the US historically, mostly because we've not been able to do direct-to-consumer advertising that is brand-specific. One of the investments we are going to make for the first time is doing just overall disease awareness direct-to-consumer advertising in 2021. So, we cannot be specific with brand, but in derm we really are the only product. So, hopefully, if you raise awareness around a disease and that there are treatments, you can encourage people to speak to their vet and get the best care. So, that I think is one of the reasons why international, we are hoping, will start to grow faster.

But I have to give our US team tremendous credit. They continue to grow the market. The investment in direct-to-consumer advertising, raising awareness that there are products, are bringing more pets in and getting more pets treated. And in the US, there are still 6 million dogs who need our product or need a derm solution who aren't getting one. So, we do believe there is still growth in the US, although we would expect – although I'm sure, I know last year we've seen very strong growth out of the US, we would expect over time for the US growth to start to decline in the overall growth and more of the growth to come from international, but we still believe there's significant potential in both.

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

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**Elliot Wilbur**
*Analyst, Raymond James & Associates, Inc.*

Q

Thanks. Good morning and congratulations on the strong performance of Trio in a challenging year. Kristin, just maybe want to dive in a little bit more on the launch details around the product. It seems like, obviously, one of the reasons for its relative success this year versus earlier expectations was just far less cannibalization of Simparica than originally expected. But wondering if you could just share with us additional metrics in terms of where you are with respect to clinic penetration rates, how many targeted clinics have you been able to actually reach, just additional metrics around the uptake and launch would be helpful.

Then just thinking about the product longer term, obviously, a very strong first year, and if I think about launch analogs on the human health side, I mean generally five years out, you're looking at something on the order of 6x to 10x first year sales. Not sure if that's applicable in the companion animal market, but just some thoughts in terms of maybe longer-term launch analogs with respect to the product? Thanks.

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

A

Sure. With regard to the launch of Trio, I would say, there is a lot of unique characteristics of that Trio launch: A, we launched at the height of the pandemic in the US, so I'm not sure how to compare that to other people's launches. We were slower to penetrate clinics, I would say, in Q2 and Q3, but we're quite pleased that by the end of the year, we reached all of our penetration goals. So, I think our penetration has been quite strong. Given the delay, really the outperformance was our share, once we were penetrated within the clinic, the ability to get more of the patients on our product has been really strong and that gives us good confidence as we move into 2021.

As Glenn mentioned a few minutes earlier, we are expecting a similar contribution. For starters, we'll have a Q1 where we didn't have sales last year, but with the penetration, we were able to achieve by the end of the year, which is reaching the goals we had wanted, we think if we can just get the same pull through that we had at those clinics in 2021, we'll continue to see great growth across there. We're also seeing it also pull our broader parasiticide portfolio. So, I'm not sure I would say – I would use a human health analog, but I continue to remind everybody, we remain underpenetrated in this space.

Anatara is the single biggest category in the animal health space, it's $4 billion globally with $2.5 billion in the US, continuing to see about 16% growth in Simparica beyond Trio globally, it shows there's significant opportunity here for us and it continue to grow. And we were quite pleased, if you looked at overall Anatara, we had an increase in share of 7% in Q4. So, we think we can continue to take share in this and grow it overall. So, I'm not sure it looks like human health, but with our biggest competitors already being $600 million product, I think we've got strong ability to continue to grow and to get at least our fair share in this space.

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

A

Yeah. And the only thing I would add to that in terms of the question on peak sales, what becomes challenging with peak sales is the timing of competition and that remains unknown. Obviously, for 2021, our current guidance does not expect another triple combo within the US and the timing of that will, obviously, impact what our overall peak sales could be for the product.

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**Operator**: And our next question will come from Navin Jacob with UBS. Please go ahead.

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**Sriker Nadipuram**
*Analyst, UBS Securities LLC*

Q

Hi, everyone. Thanks for taking the question. This is Sriker Nadipuram on for Navin Jacob. I just have a couple of specific questions. Can you quantify the revenue impact in 2020 of the earlier fall cattle run and do you expect this to recur – this adverse negative revenue impact, do you expect this to recur in 2021?

And then, can you quantify the difference in gross margin in diagnostics from your therapeutics portfolio or your corporate average? Thanks very much.

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

A

Yeah. So, in terms of the impact of the early fall cattle run for 2020, that did not have an impact for the year. That was just a seasonal impact between Q3 and Q4. I think you saw the very strong performance in Q3. You saw the opposite occur in Q4 of this year. And then, predicting the seasonality of that in 2021, obviously, is difficult, but we focus more on the full year, obviously, in terms of the overall impact.

In terms of gross margin for the diagnostic business, we don't specifically provide gross margins by therapeutic area or by species, but overall, we always say our companion animal business, obviously, has the higher margin. Diagnostics in general is lower than some of our key therapeutic areas.

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**Operator**: And our next question will come from David Steinberg with Jefferies. Please go ahead.

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**David Michael Steinberg**
*Analyst, Jefferies LLC*

Q

Thanks. Two questions, first is on rising pet adoptions. Obviously, one of the tailwinds from the pandemic is increased adoptions around the country and around the world. In previous comments I think you had said there are about 3.2 million adoptions annually. Just curious, now that 2020 is in the books, do you actually have any data on how many more adoptions there were last year? And the other tailwind you've called out is just the increase in dollars per vet visit. And as most pet owners get vaccinated, as they go back to work, how durable do you think both the increased dollars per visit and increased adoptions are, and is there any chance that could reverse when most people are back at the office?

And just as a follow-up question on Trio, potential Trio competition, I think, Glenn, you said no expectations for competition this year. You previously had said no competition in the first half of this year. When do you actually – I know it's murky, but when do you actually think there might be your first competitor and also what gives you such great confidence that there would not be any competition in 2021? I simply ask that because with such a successful launch, it's obviously a target for any competitors. Thanks.

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

A

Sure. With regard to pet adoption, there are 135 million pets in the US. In a typical year, you see about 3.2 million adoptions. So, even a 10% increase in that isn't going to dramatically change things, but we are seeing an increase in vet visits which we think is a positive trend and we do expect that to continue in 2021. So, as Glenn mentioned earlier, we did see a 2% increase in vet visits in Q4. We are expecting that to continue. So, I think you are seeing maybe a proportional to what was the incremental pets that were adopted. We don't have very specific numbers, but I would say, assume it's somewhere between like 2% and 10% there, it will be helpful, and I do think we're going to continue to see an increase in visits.

You asked as well about spend per visit which was incredibly strong in 2020. We don't believe it's going to remain that strong to be honest with you. We still think it will grow. If you look, generally speaking, at our space, you do – we've seen overall revenues of clinics growing in the mid- to high-single-digits on a normal year. I'm not sure what 2021 is going to look like, but assuming it's somewhere close to a normal year, we do think you're going to see strong growth overall there in spend, overall revenue at the vet clinic, both with growth in total number of visits as well as spend per visit.

With regards to the Trio question on competition, we don't have the visibility that human health has as to when we'll get competitors. To be very frank, we would have expected a competitor by now. We would have expected one in derm as well. So, we're not exactly sure what the challenge is, but we don't have a great ways of knowing other than rumor mill in the market and strategic accounts who often try to renegotiate with us when they think a competitor is entering the market which we haven't seen yet. That does not mean that someone couldn't surprise us. So, there could be, but we wanted to be clear what our guidance was based on. So, at this point, given we don't have any specific knowledge, we will assume we do not have competition in 2021, and as to when they would come, honestly, we don't really know. But to your point, these are large markets, both your question on Trio, but as well as derm, and we are expecting competition. We just at this point do not have any specific knowledge, so our guidance did not include an assumption for competition in either space.

**Operator**: And we'll take our next question from Gregg Gilbert with Truist Securities. Please go ahead.

**Gregg Gilbert**
*Analyst, Truist Securities, Inc.*

Q

Hi. Going back to the diagnostics field, Glenn, you mentioned a growth rate there, I think 20-plus-percent. Can you talk about to what degree that rate is influenced by M&A, if at all, and maybe more broadly about your strategy there? Clearly, there's an element of sort of building and catching up, but I'm also curious on sort of how you're trying to differentiate or leapfrog competition broadly from a diagnostic standpoint. And then, Glenn, are you seeing any signs of upward pressure on key input costs as the world thinks about commodity price inflation or at least the potential for it? Thanks.

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

A

So, in terms of the diagnostics growth for the quarter, like you said, we did see 20% growth in diagnostics. A part of that was driven by the reference lab acquisitions that we had. So, net of that, organic growth was around 12% to 13% in diagnostics for the quarter. So, still very positive growth in the quarter and we saw nice momentum as we moved throughout the year and we think that will carry us well into 2021.

Also, we established a much better infrastructure for diagnostics in 2020 in two ways: A, we fully integrated into our core SAP system the diagnostics business, so we now are able to provide one face to our customer in terms of billing as well as product offerings. The other thing that we did was we made significant improvements in our bidirectional connectivity, improving significantly throughout the year. At the beginning of the year, we had that connectivity to about 30%. We increased that at the end of the year to over 70%. So, we think that establishes very well as we move into 2021 as well as some of the new innovation we're bringing with the Imagyst platform as well. So, we think those are some of the key drivers as we move into 2021 as well as the continued reference lab expansion that we're embarking on. So, we're very excited about the growth that we expect to see in diagnostics in 2021.

In terms of key input costs and inflation, for us, from a manufacturing perspective, there's nothing in particular that we see particularly challenging. Obviously, for 2020, we had some elevated freight costs, because of the impact of COVID-19. That will probably continue as we move into 2021. That is embedded in our guidance, but nothing else of significant impact.

**Operator**: And there appears to be no further questions. At this time, I will turn the call back over to the speakers for any additional or closing remarks.

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

Thank you. Thanks, everybody, for your questions and your continued interest in Zoetis today. We look forward to keeping you updated on our business throughout the year and continuing to deliver the results and innovations that you and our customers expect. Thanks so much for joining us.

**Operator**: Thank you. And this does conclude today's program. Thank you for your participation. You may disconnect at any time.