

Zoetis Inc.  
Form 10-K  
March 26, 2014  
Table of Contents

---

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

(Mark One)

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35797

Zoetis Inc.

(Exact name of registrant as specified in its charter)

Delaware

46-0696167

(State or other jurisdiction of incorporation or organization)

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

100 Campus Drive, Florham Park, New Jersey

07932

(Address of principal executive offices)

(Zip Code)

(973) 822-7000

(Registrant's telephone number, including area code)

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

Title of each class

Name of each exchange on which registered

Common Stock, \$0.01 par value per share

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Edgar Filing: Zoetis Inc. - Form 10-K

Form 10-K. "

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

Large accelerated filer " Accelerated filer " Non-accelerated filer x Smaller reporting company "

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

The aggregate market value of the voting stock held by nonaffiliates of the registrant as of June 30, 2013, the last business day of the registrant's most recently completed second fiscal quarter, was \$15,445 million. The registrant has no non-voting common stock.

The number of shares outstanding of the registrant's common stock as of March 19, 2014 was 500,729,429 shares.

DOCUMENTS INCORPORATED BY REFERENCE:

---

Table of Contents

Portions of the registrant's Proxy Statement for the 2014 Annual Meeting of Shareholders to be held on May 13, 2014 (hereinafter referred to as the "2014 Proxy Statement") are incorporated into Parts II and III of this Form 10-K.

---

---

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	
<u>Overview</u>	1
<u>Operating Segments</u>	1
<u>Products</u>	2
<u>International Operations</u>	5
<u>Sales and Marketing</u>	5
<u>Customers</u>	5
<u>Research and Development</u>	6
<u>Manufacturing and Supply Chain</u>	6
<u>Competition</u>	7
<u>Intellectual Property</u>	8
<u>Regulatory</u>	8
<u>Employees</u>	10
<u>Environmental, Health and Safety</u>	10
<u>Available Information</u>	10
<u>Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012</u>	11
Item 1A. <u>Risk Factors</u>	12
Item 1B. <u>Unresolved Staff Comments</u>	27
Item 2. <u>Properties</u>	27
Item 3. <u>Legal Proceedings</u>	27
Item 4. <u>Mine Safety Disclosures</u>	27
<u>PART II</u>	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	28
Item 6. <u>Selected Financial Data</u>	29
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	31
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	60
Item 8. <u>Financial Statements and Supplementary Data</u>	62
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	106
Item 9A. <u>Controls and Procedures</u>	106
Item 9B. <u>Other Information</u>	106
<u>PART III</u>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	107
Item 11. <u>Executive Compensation</u>	107
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	107
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	107
Item 14. <u>Principal Accounting Fees and Services</u>	114
<u>PART IV</u>	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	115
<u>SIGNATURES</u>	116



Table of Contents

PART I

Item 1. Business.

Overview

Zoetis Inc. is a global leader in the discovery, development, manufacture and commercialization of animal health medicines and vaccines, with a focus on both livestock and companion animals. We market a diverse range of products across four regions: the United States, Europe/Africa/Middle East, Canada/Latin America and Asia/Pacific; eight core species: the livestock species of cattle, swine, poultry, sheep and fish, and the companion animal species of dogs, cats and horses; and five major product categories: anti-infectives, vaccines, parasiticides, medicated feed additives and other pharmaceutical products. For more than 60 years, as a business unit of Pfizer Inc. (Pfizer), and now as an independent public company, we have been committed to enhancing the health of animals and bringing solutions to our customers who raise and care for them.

We were incorporated in Delaware in July 2012. The address of our principal executive offices is 100 Campus Drive, Florham Park, New Jersey 07932. Unless the context requires otherwise, references to “Zoetis,” “the company,” “we,” “us” or “our” in this Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (2013 Annual Report) refer to Zoetis Inc., a Delaware corporation, and its subsidiaries. In addition, unless the context requires otherwise, references to “Pfizer” in this 2013 Annual Report refer to Pfizer Inc., a Delaware corporation, and its subsidiaries. Unless the context requires otherwise, statements relating to our history, for periods prior to the initial public offering (IPO), describe the history of Pfizer’s animal health business unit, although it is important to note that the net assets, operations and cash flows of Zoetis are not the same as the historical net assets, operations and cash flows of Pfizer’s animal health operating segment.

On February 1, 2013, our Class A common stock began trading on the New York Stock Exchange (NYSE) under the symbol “ZTS.” On February 6, 2013, an IPO of our Class A common stock was completed, which represented approximately 19.8% of our total outstanding shares. Prior to and in connection with the IPO, we completed a \$3.65 billion senior notes offering (senior notes offering) and Pfizer transferred to us substantially all of the assets and liabilities of their animal health business. We did not receive any of the proceeds from the IPO. We paid an amount of cash equal to substantially all of the net proceeds that we received in the senior notes offering to Pfizer prior to the completion of the IPO. In addition, immediately prior to the completion of the IPO, we and Pfizer entered into certain agreements that provide a framework for our ongoing relationship with Pfizer. On June 24, 2013, an exchange offer was completed, whereby Pfizer shareholders exchanged a portion of Pfizer common stock for Zoetis common stock, resulting in the full separation of Zoetis and the disposal of Pfizer’s entire ownership and voting interest in Zoetis. We refer to the transactions to separate our business from Pfizer, as described here and elsewhere in this 2013 Annual Report, as the “Separation.” For additional information, see Notes to Consolidated and Combined Financial Statements—Note 2. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer.

Operating Segments

The animal health medicines and vaccines market is characterized by meaningful differences in customer needs across different regions. This is due to a variety of factors, including:

- economic differences, such as standards of living in developed markets as compared to emerging markets;
- cultural differences, such as dietary preferences for different animal proteins, pet ownership preferences and pet care standards;
- epidemiological differences, such as the prevalence of certain bacterial and viral strains and disease dynamics;
- treatment differences, such as utilization of different types of medicines and vaccines, in particular high-technology products;
- environmental differences, such as seasonality, climate and the availability of arable land and fresh water; and
- regulatory differences, such as standards for product approval and manufacturing.

As a result of these differences, among other things, we organize and operate our business in four segments: the United States, Europe/Africa/Middle East, Canada/Latin America and Asia/Pacific. Within each of these operating segments, we offer a diversified product portfolio for both livestock and companion animal customers so that we can capitalize on local trends and customer needs. Our operating segments are:

United States with revenue of \$1,902 million, or 42% of total revenue for the year ended December 31, 2013. Europe/Africa/Middle East with revenue of \$1,168 million, or 25% of total revenue for the year ended December 31, 2013. Key developed markets in this segment include France, Germany and the United Kingdom. Key emerging markets in this segment include Russia, South Africa and Turkey. Canada/Latin America with revenue of \$778 million, or 17% of total revenue for the year ended December 31, 2013. The developed market in this segment is Canada. Key emerging markets in this segment include Brazil and Mexico. Asia/Pacific with revenue of \$713 million, or 16% of total revenue for the year ended December 31, 2013. Key developed markets in this segment include Australia, Japan and New Zealand. Key emerging markets in this segment include China, India and Thailand.

Table of Contents

Our 2013 reported revenue for the U.S. and top ten non-U.S. markets, based on total revenue, is as follows:

	US	Brazil	Canada	Australia	UK	France	Germany	Japan	Italy	Spain	China
Livestock	55%	85%	61%	60%	57%	65%	60%	51%	62%	75%	87%
Companion Animal	45%	15%	39%	40%	43%	35%	40%	49%	38%	25%	13%

% of 2013 reported revenue

For additional information regarding our performance in each of these operating segments and the impact of foreign exchange rates, see Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes to Consolidated and Combined Financial Statements—Note 18A. Segment, Geographic and Other Revenue Information—Segment Information.

**Products**

Since the inception of our business, we have focused on developing a broad portfolio of animal health products. We refer to a single product in all brands or its dosage forms for all species as a product line. We have comprehensive product lines for both livestock and companion animals across each of our major product categories.

Our livestock products primarily help prevent or treat diseases and conditions to enable the cost-effective production of safe, high-quality animal protein. Human population growth and increasing standards of living are important long-term growth drivers for our livestock products in three major ways. First, population growth and increasing standards of living drive increased demand for improved nutrition, particularly animal protein. Second, population growth leads to increased natural resource constraints driving a need for enhanced productivity. Finally, as standards of living improve, there is increased focus on food safety. Livestock products represented approximately 64% of our revenue for the year ended December 31, 2013.

Our companion animal products improve the quality of and extend the life of pets, increase convenience and compliance for pet owners and help veterinarians improve the quality of care they provide. Growth in the companion animal medicines and vaccines sector is driven by economic development and related increases in disposable income, increasing pet ownership, companion animals living longer, increasing medical treatment of companion animals and advances in animal health medicines and vaccines. Companion animal products represented approximately 36% of our revenue for the year ended December 31, 2013.

Our major product categories are:

- anti-infectives: products that prevent, kill or slow the growth of bacteria, fungi or protozoa;
- vaccines: biological preparations that help prevent diseases of the respiratory, gastrointestinal and reproductive tracts or induce a specific immune response;
- parasiticides: products that prevent or eliminate external and internal parasites such as fleas, ticks and worms;
- medicated feed additives: products added to animal feed that provide medicines to livestock; and
- other pharmaceutical products: pain and sedation, oncology, antiemetic, allergy and dermatology; and reproductive products.



Table of Contents

Our remaining revenue is derived from other product categories, such as nutritionals and agribusiness, as well as products and services in complementary areas, including diagnostics, genetics, devices, dairy data management, e-learning and professional consulting.

As part of our growth strategy, through our R&D group, we focus on both product lifecycle development and new chemical and biological entities. Historically, a substantial portion of our products and revenue has been the result of product lifecycle development. For example, the first product in our ceftiofur line was an anti-infective approved for treating bovine respiratory disease (BRD) in cattle that was administered via intramuscular injection. Through follow-on studies and reformulations, we have expanded the product line into additional cattle claims and administration routes, as well as other species and regions. The ceftiofur product line currently includes the brands Excede, Excenel RTU, Excenel RTU EZ, Excenel, Naxcel and Spectramast.

Examples of our first-in-class and/or best-in-class products that we have launched in the past ten years and products that we believe may represent platforms for future product lifecycle development include:

Improvac/Improvest/Vivax, a protein product that works like an immunization, is currently the only product that provides a safe and effective alternative to physical castration to manage unpleasant aromas that can occur when cooking pork; launched in Australia and New Zealand in 2004, in Brazil in 2007, in certain European countries beginning in 2008, and in the United States in 2011;

Convenia, the first single-injection anti-infective for common bacterial skin infections in cats and dogs, launched in 2006;

Palladia, the first drug to be approved by the FDA for treating cancer in dogs, launched in 2009;

Inforce<sup>TM</sup>3, the first and only respiratory vaccine for cattle that prevents respiratory disease caused by bovine respiratory syncytial virus (BRSV) while also aiding in the prevention of infectious bovine rhinotracheitis (IBR) and parainfluenza<sub>3</sub> (PI<sub>3</sub>), launched in 2010; and

Apoquel, the first Janus kinase inhibitor for use in veterinary medicine, approved for the control of pruritus associated with allergic dermatitis and the control of atopic dermatitis in dogs at least 12 months of age, successfully completed its early experience program in the United States late in 2013, and fully launched in the United States, United Kingdom, Austria and Germany in January 2014; other market launches will follow.

We pursue the development of new vaccines for emerging infectious diseases, with an operating philosophy of “first to know and fast to market.” Examples of the successful execution of this strategy include the first equine vaccine for West Nile virus in the United States and European Union, the first swine vaccine for pandemic H1N1 influenza virus in the United States and the first conditionally licensed vaccine to help reduce disease caused by the Georgia 08 variant of infectious bronchitis virus (IBV) in poultry.

In 2013, our top selling product line, the ceftiofur line, contributed approximately 7% of our revenue. The ceftiofur line and our next two top selling products, Revolution and Draxxin, contributed approximately 20% of our revenue. Our top ten product lines contributed 39% of our revenue. Our product lines and products that represented approximately 1% or more of our revenue in 2013 are as follows:

Table of Contents

## Livestock products

Product line/ product	Description	Primary species
<b>Anti-infectives</b>		
Ceftiofur injectable line	Broad-spectrum cephalosporin antibiotic active against gram-positive and gram-negative bacteria, including $\beta$ -lactamase-producing strains, with some formulations producing a single course of therapy in one injection	Cattle, sheep, swine
Draxxin	Single-dose low-volume antibiotic for the treatment and prevention of bovine and swine respiratory disease, infectious bovine keratoconjunctivitis and bovine foot rot	Cattle, swine
Spectramast	Aids in preventing and treating mastitis, delivered via intramammary administration; same active ingredient as the ceftiofur line	Cattle
Terramycin	Antibiotic for the treatment of susceptible infections	Cattle, poultry, sheep, swine
<b>Vaccines</b>		
Bovishield® line	Aids in preventing diseases, including infectious bovine rhinotracheitis (IBR), bovine viral diarrhea (BVD) Types 1 and 2, parainfluenza <sub>3</sub> (PI <sub>3</sub> ), bovine respiratory syncytial virus (BRSV), Leptospira borgpetersenii, L. pomona, L. grippotyphosa, L. canicola and L. icterohaemorrhagiae, depending on formulation	Cattle
Improvac / Improvest / Vivax	Reduces boar taint, as an alternative to surgical castration	Swine
RespiSure® line	Aids in preventing chronic pneumonia caused by Mycoplasma hyopneumoniae	Swine
Rispoval® line	Aids in preventing three key viruses involved in cattle pneumonia-BRSV, PI <sub>3</sub> and BVD-as well as other respiratory diseases, depending on formulation	Cattle
Suvaxyn® PCV / Fosteratm™ PCV	Aids in preventing porcine circovirus	Swine
<b>Parasiticides</b>		
Cydectin	Injectable or pour-on endectocide to treat and control internal and external cattle parasites, including gastrointestinal roundworms, lungworms, cattle grubs, mites and lice	Cattle, sheep
Dectomax	Injectable or pour-on endectocide, characterized by extended duration of activity, for the treatment and control of internal and external parasite infections	Cattle, swine
<b>Medicated Feed Additives</b>		
Aureomycin	Provides livestock producers control, treatment and convenience against a wide range of respiratory, enteric and reproductive diseases	Cattle, poultry, sheep, swine
BMD	Aids in preventing and controlling enteritis; and increases rate of weight gain and improves feed efficiency in poultry and swine	Poultry, swine
Lasalocid line	Controls coccidiosis in poultry (Avatec) and cattle (Bovatec) and for increased rate of weight gain and improved feed efficiency in cattle	Poultry, cattle
Lincomycin line		Swine, poultry

Edgar Filing: Zoetis Inc. - Form 10-K

Controls necrotic enteritis, increases rate of weight gain and improves feed efficiency in broiler chickens; treatment of dysentery (bloody scours), control of ileitis, treatment/reduction in severity of mycoplasmal pneumonia, increases weight gain in swine

Other

Embrex® devices

Devices for enhancing hatchery operations efficiency through in ovo detection and vaccination

Poultry

Lutalyse

For estrus control or in the induction of parturition or abortion

Cattle, swine

Orbeseal / Teatseal

Non-antibiotic intramammary infusion that prevents new intramammary infections in dairy cattle

Cattle

4 |

---

Table of Contents

## Companion animal products

Product line/ product	Description	Primary species
<b>Anti-infectives</b>		
Clavamox / Synulox	A broad-spectrum antibiotic and the first and only potentiated penicillin approved for use in dogs and cats	Cats, dogs
Convenia	Anti-infective for the treatment of common bacterial skin infections that provides a course of treatment in a single injection	Cats, dogs
<b>Vaccines</b>		
Vanguard® L4 (4-way Lepto)	Compatible with the Vanguard line and helps protect against leptospirosis caused by <i>Leptospira canicola</i> , <i>L. grippotyphosa</i> , <i>L. icterohaemorrhagiae</i> and <i>L. pomona</i>	Dogs
Vanguard line	Aids in preventing canine distemper caused by canine distemper virus, infectious canine hepatitis caused by canine adenovirus type 1, respiratory disease caused by canine adenovirus type 2, canine parainfluenza caused by canine parainfluenza virus and canine parvoviral enteritis caused by canine parvovirus	Dogs
<b>Parasiticides</b>		
Revolution / Stronghold	An antiparasitic for protection against fleas, heartworm and ear mites in cats and dogs; canine sarcoptic mites and American ticks for dogs and roundworms and hookworms for cats	Cats, dogs
ProHeart	Aids in preventing heartworm infestation	Dogs
<b>Other</b>		
Cerenia	An oral or injectable medication that prevents vomiting due to motion sickness in dogs	Dogs
Rimadyl	For the relief of pain and inflammation associated with osteoarthritis and for the control of postoperative pain associated with soft tissue and orthopedic surgeries	Dogs

## International Operations

We directly market our products in approximately 70 countries across North America, Europe, Africa, Asia, Australia and South America, and our products are sold in more than 120 countries. Operations outside of the United States accounted for 58% of our total revenue for the year ended December 31, 2013. Through our efforts to establish an early and direct presence in many emerging markets, such as Brazil, China and India, emerging markets contributed 26% of our revenue for the year ended December 31, 2013.

Our international businesses are subject, in varying degrees, to a number of risks inherent in carrying on business in other countries. These include, among other things, currency fluctuations, capital and exchange control regulations, expropriation and other restrictive government actions. See Item 1A. Risk Factors— Risks related to our international operations.

## Sales and Marketing

Our sales organization includes sales representatives and technical and veterinary operations specialists. In markets where we do not have a direct commercial presence, we generally contract with distributors that provide logistics and sales and marketing support for our products.

Our sales representatives visit our customers, including veterinarians and livestock producers, to inform, promote and sell our products and services. Our technical and veterinary operations specialists provide scientific consulting focused on disease management and herd management, training and education on diverse topics, including responsible product

use, and generally have advanced veterinary medicine degrees. These direct relationships with customers allow us to understand the needs of our customers. Additionally, our sales representatives and technical and veterinary operations specialists partner with customers to provide training and support in areas of disease awareness and treatment protocols, including through the use of our products. As a result of these relationships, our sales and consulting visits are typically longer, more meaningful and provide us with better access to customer decision makers as compared to human health. As of December 31, 2013, our sales organization consisted of approximately 3,500 employees. Our livestock and companion animal products are primarily available by prescription through a veterinarian. On a more limited basis, in certain markets, we sell certain products through local agricultural and farming retail outlets, pharmacies and pet stores. We also market our products by advertising to veterinarians, livestock producers and pet owners.

#### Customers

We sell our livestock products directly to a diverse set of livestock producers, including beef and dairy farmers as well as pork, poultry and aquaculture operations, and to veterinarians, third-party veterinary distributors and retail outlets that typically then sell the products to livestock producers. We primarily sell our companion animal products to veterinarians or to third-party veterinary distributors that typically then sell our products to veterinarians, and in each case veterinarians then typically sell our products to pet owners. Our two largest customers, both distributors, represented approximately 11% and 6%, respectively, of our revenue for the year ended December 31, 2013, and no other customer represented more than 4% of our revenue for the same period.

## Table of Contents

### Research and Development

Our research and development (R&D) operations are comprised of a dedicated veterinary medicine R&D organization, research alliances and other operations focused on the development or registration of our products. We spent \$399 million in 2013, \$409 million in 2012 and \$427 million in 2011 on R&D.

While the development of new chemical and biological entities through new product R&D continues to play an important role in our growth strategies, the majority of our R&D investment is focused on product lifecycle development. New product R&D leverages discoveries of agribusiness, academia, and other pharmaceutical and biotechnology R&D organizations. Our product lifecycle development leverages our existing product portfolio to expand our product lines by adding new species or claims, achieving approvals in new countries and creating new combinations and reformulations. Two factors -- the allocation of our R&D investment between product lifecycle development and new product research and development, and our ability to leverage both the discoveries of other industries and of our existing R&D -- generally leads to a cost-effective, efficient, sustainable and relatively predictable R&D process. In addition, our other R&D activities include the development of branded generic products, genetics and diagnostics, as well as biodevices and engineering investments for in ovo applications.

We prioritize our R&D spending on an annual basis with the goal of alignment of research and business objectives and do not disaggregate our R&D operations by research stage or by therapeutic area for purposes of managing our business. We make our strategic investments in R&D based on four criteria: strategic fit and importance to our current portfolio; technical feasibility of development and manufacture; return on investment; and the needs of customers and the market. A centralized portfolio management function links development plans with financial systems to build a comprehensive view of the status of project progression and spend without a focus on spending by research stage or by therapeutic area. This comprehensive view facilitates our ability to set targets for project timing and goals for investment efficiency.

Prior to the IPO, we entered into a R&D collaboration and license agreement with Pfizer pursuant to which we will maintain access to Pfizer's proprietary compound library and database to develop new products, subject to certain restrictions. See Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Research and development collaboration and license agreement. In addition, we are pursuing opportunities to enter into collaboration agreements and external alliances with other parties.

As of December 31, 2013, we employed approximately 1,100 employees in our global R&D operations. Our R&D headquarters is located in Kalamazoo, Michigan. We have R&D operations co-located with manufacturing sites in Melbourne, Australia; Louvain-la-Neuve, Belgium; Guarulhos, Brazil; Olot, Spain; Charles City, Iowa, U.S. and Lincoln, Nebraska, U.S. We co-locate R&D operations with manufacturing sites to facilitate the efficient transfer of production processes from our laboratories to manufacturing. In addition, we maintain R&D operations in Zaventem, Belgium; São Paulo, Brazil; Mumbai, India; and College Park, Maryland, U.S. and Durham, North Carolina, U.S. As part of the Separation, Pfizer conveyed to us its interest in each of these R&D facilities, with the exception of our Mumbai, India facility, which we expect Pfizer to transfer to us for agreed upon cash consideration, and, in the interim, we lease the facility from Pfizer. See Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Mumbai, India interim lease agreement. Each site is designed to meet the regulatory requirements for working with chemical or infectious disease agents.

Many of our research programs involve an external partnership, often with funding from a non-governmental organization or a government grant. We are generally responsible for providing technical direction and supplemental direct and indirect expertise in, as well as investment for, such external partnerships. Depending on the nature of the agreement, we may act as the commercialization partner for discoveries that originate during the period of collaborative research, or we may own or have exclusive rights to any intellectual property that enables the development of proprietary products or models.

### Manufacturing and Supply Chain

Our products are manufactured at both sites operated by us and sites operated by third-party contract manufacturing organizations, which we refer to as CMOs. We have a global manufacturing network of 28 sites, which utilizes centralized oversight of a system of 13 “anchor” and 15 “satellite” manufacturing sites to maximize cost efficiencies.

In connection with the separation from Pfizer (the Separation), 29 manufacturing sites were transferred to us. These 29 sites consisted of all of the sites operated by Pfizer that, immediately prior to the Separation, predominantly manufactured animal health products. See Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Master manufacturing and supply agreements.

Since the Separation, we have exited the Hannibal, Missouri site and are in the process of exiting the Victoria, British Columbia, Canada site, both of which are leased facilities.

Table of Contents

Our global manufacturing network is comprised of the following sites:

Anchor Sites		Satellite Sites	
Site	Location	Site	Location
Catania	Italy	Campinas	Brazil
Charles City	Iowa, U.S.	Durham	North Carolina, U.S.
Chicago Heights	Illinois, U.S.	Eagle Grove	Iowa, U.S.
Guarulhos <sup>(1)</sup>	Brazil	Hsinchu	Taiwan
Haridwar	India	Laurinburg	North Carolina, U.S.
Jilin <sup>(2)</sup>	China	Longmont	Colorado, U.S.
Kalamazoo <sup>(3)</sup>	Michigan, U.S.	Medolla	Italy
Lincoln	Nebraska, U.S.	Salisbury	Maryland, U.S.
Louvain-la-Neuve	Belgium	San Diego	California, U.S.
Melbourne	Australia	Shenzhen	China
Olot	Spain	Van Buren	Arkansas, U.S.
Suzhou	China	Victoria <sup>(4)</sup>	British Columbia, Canada
Willow Island	West Virginia, U.S.	Wellington	New Zealand
		White Hall	Illinois, U.S.
		Yantai	China

(1) This site is owned by us and leased back to Pfizer, pursuant to an arrangement by which Pfizer operates the manufacturing operations at the site for a period of time. See Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Brazil lease agreements.

(2) This site is operated by the Jilin Pfizer Guoyuan joint venture.

Prior to the Separation, Pfizer's manufacturing site in Kalamazoo manufactured both human health and animal health products. Since the Separation, we own the portions of this site that predominantly manufacture animal health products and Pfizer owns the portions of this site that predominantly manufacture human health products.

(4) We are in the process of exiting this site as a result of certain product divestitures.

We own all of these sites, with the exception of our facilities in Melbourne, Australia; Medolla, Italy; Van Buren, Arkansas, United States; San Diego, California, United States and Victoria, British Columbia, Canada, which are leased sites.

In addition to our global manufacturing network and our CMOs, Pfizer continues to manufacture products for us at 13 Pfizer sites located in 12 countries pursuant to a master manufacturing and supply agreement. Included in these 13 Pfizer sites is our facility in Guarulhos, Brazil, where Pfizer will continue its manufacturing operations for a period of time. See Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Master manufacturing and supply agreements.

Our global manufacturing and supply chain is supported by a network of CMOs. As of December 31, 2013, this network was comprised of approximately 200 CMOs, including those centrally managed as well as local CMOs. We select CMOs based on several factors: (i) their ability to reliably supply products or materials that meet our quality standards at an optimized cost; (ii) capacity; and (iii) financial efficiency analyses. Our regional and global manufacturing teams seek to ensure that all of the CMOs we use adhere to our standards of manufacturing quality and are regularly audited.

We purchase certain raw materials necessary for the commercial production of our products from a variety of third-party suppliers. We utilize distributors as a part of our global supply chain, primarily for shipping and logistics support.

We intend to continue our efficiency improvement programs in our manufacturing and supply chain organization, including Six Sigma and Lean capabilities, which are processes intended to improve manufacturing efficiency. We have strong globally managed and coordinated quality control and quality assurance programs in place at our global manufacturing network sites, and we regularly inspect and audit our global manufacturing network and CMO sites.

Competition



Although our business is the largest based on revenue in the animal health medicines and vaccines industry, we face competition in the regions in which we compete. Principal drivers of competition vary depending on the particular region, species, product category and individual product, and include new product development, quality, price, service and promotion to veterinary professionals, pet owners and livestock producers.

Our primary competitors include animal health medicines and vaccines companies such as Merck Animal Health, the animal health division of Merck & Co., Inc. (formerly known as Intervet/Schering-Plough); Merial, the animal health division of Sanofi S.A.; Elanco, the animal health division of Eli Lilly and Company; Bayer Animal Health, the animal health division of Bayer AG; Novartis Animal Health, the animal health division of Novartis AG; and Boehringer Ingelheim Animal Health, the animal health division of Boehringer Ingelheim GmbH. In addition, we compete with hundreds of other animal health product producers throughout the world.

## Table of Contents

The level of competition from generic products varies from market to market. For example, the level of generic competition is higher in Europe and certain emerging markets than in the United States. However, there is no large, well-capitalized company focused on generic animal health products that exists as a global competitor in the industry. The reasons for this include the smaller average market size of each product opportunity, the importance of direct distribution and education to veterinarians and livestock producers and the primarily self-pay nature of the business. In addition, companion animal health products are often directly prescribed and dispensed by veterinarians.

Our livestock products tend to experience lower generic competition than our companion animal products for several reasons:

livestock producers tend to be loyal to medicines and vaccines that have been demonstrated to be efficacious; as medicines and vaccines are a small portion of a livestock producer's total production costs and ineffective medicines and vaccines could result in the loss of animals, causing disproportionate harm to such producer's investment.

Therefore, we believe that livestock producers value brand name medicines and vaccines and are reluctant to try alternatives to methods that have already been proven to be reliably effective;

in livestock, equally important as the product is the technical support, which occurs through our veterinary operations support of our products and field force; and

reliable supply.

The importance of quality and safety concerns to pet owners, veterinarians and livestock producers also contributes to animal health brand loyalty. As a result, we believe that significant brand loyalty to products often continues after the loss of patent-based and regulatory exclusivity.

### Intellectual Property

Our technology, brands and other intellectual property are important elements of our business. We rely on patent, trademark, copyright and trade secret laws, as well as regulatory exclusivity periods and non-disclosure agreements to protect our intellectual property rights. Our policy is to vigorously protect, enforce and defend our rights to our intellectual property, as appropriate.

Our product portfolio enjoys the protection of approximately 4,900 granted patents and 2,100 pending patent applications, filed in more than 60 countries, with concentration in our major market countries as well as other countries with strong patent systems, such as Australia, Brazil, Canada, Europe, Japan and the United States. Many of the patents and patent applications in our portfolio are the result of our own and Pfizer's work, while other patents and patent applications in our portfolio were at least partially developed by, and are licensed to us by, third parties.

Patents for individual products extend for varying periods depending on the date of the patent filing or grant and the legal term of patents in the countries where such patents are obtained. Several patents cover the ceftiofur product line, including formulation and use patents that begin expiring in the United States in 2015, with others extending until 2024. Draxxin and Convenia are covered by patents in the United States with terms that expire in 2021 and 2023, respectively. The compound patent on doramectin, which is the active ingredient in Dectomax, an antiparasitic, expired in all regions; however, process patents and the injectable formulation patent for this product do not expire in the United States until 2020 and 2016, respectively. The compound patent on selamectin, which is the active ingredient in Revolution, a parasiticide, is expiring in the United States, Canada and Europe during 2014; however, we have process and formulation patents covering this product expiring in 2018 and 2019, respectively.

Additionally, many of our vaccine products are based on proprietary master seeds and proprietary or patented adjuvant formulations. We actively seek to protect our proprietary information, including our trade secrets and proprietary know-how, including by seeking to require our employees, consultants, advisors and partners to enter into confidentiality agreements and other arrangements upon the commencement of their employment or engagement.

In order to facilitate the Separation and allow Pfizer and our operations to continue with minimal interruption, Pfizer has licensed to us the right to use certain intellectual property rights in the animal health field. We license to Pfizer the right to use certain of our trademarks and substantially all of our other intellectual property rights in the human health field and all other fields outside of animal health. In addition, Pfizer granted us a transitional license to use certain of Pfizer's trademarks and we granted Pfizer a transitional license to use certain of our trademarks for a period of time following the completion of the IPO.

We seek to file and maintain trademarks around the world based on commercial activities in most regions where we have, or desire to have, a business presence for a particular product or service. We currently maintain more than 10,000 trademark applications and registrations in major regions, identifying goods and services dedicated to the care of livestock and companion animals.

Regulatory

The sale of animal health products is governed by the laws and regulations specific to each country in which we sell our products. To maintain compliance with these regulatory requirements, we have established processes, systems and dedicated resources with end-to-end involvement from product concept to launch and maintenance in the market. Our regulatory function actively seeks to engage in dialogue with various global agencies regarding their policies that relate to animal health products. In the majority of our markets, the relevant animal health authority is separate from those governing human medicinal products.

United States

United States Food and Drug Administration (FDA). The regulatory body that is responsible for the regulation of animal health pharmaceuticals in the United States is the Center for Veterinary Medicine (CVM), housed within the FDA. All manufacturers of animal health pharmaceuticals must show their products to be safe, effective and produced by a consistent method of manufacture as defined under the Federal

Table of Contents

Food, Drug and Cosmetic Act. The FDA's basis for approving a drug application is documented in a Freedom of Information Summary. Post-approval monitoring of products is required by law, with reports being provided to the CVM's Surveillance and Compliance group. Reports of product quality defects, adverse events or unexpected results are produced in accordance with the law. Additionally, we are required to submit all new information for a product, regardless of the source.

United States Department of Agriculture (USDA). The regulatory body in the United States for veterinary vaccines is the USDA. The USDA's Center for Veterinary Biologics is responsible for the regulation of animal health vaccines, including immunotherapeutics. All manufacturers of animal health biologicals must show their products to be pure, safe, effective and produced by a consistent method of manufacture as defined under the Virus Serum Toxin Act. Post-approval monitoring of products is required. Reports of product quality defects, adverse events or unexpected results are produced in accordance with the agency requirements.

Environmental Protection Agency (EPA). The main regulatory body in the United States for veterinary pesticides is the EPA. The EPA's Office of Pesticide Programs is responsible for the regulation of pesticide products applied to animals. All manufacturers of animal health pesticides must show their products will not cause "unreasonable adverse effects to man or the environment" as stated in the Federal Insecticide, Fungicide, and Rodenticide Act. Within the United States, pesticide products that are approved by the EPA must also be approved by individual state pesticide authorities before distribution in that state. Post-approval monitoring of products is required, with reports provided to the EPA and some state regulatory agencies.

Outside of the United States

European Union (EU). The European Medicines Agency (EMA) is a decentralized agency of the EU, located in London. The agency is responsible for the scientific evaluation of medicines developed by pharmaceutical companies for use in the EU. The agency has a veterinary review section distinct from the medical review section. The Committee for Veterinary Medicinal Products is responsible for scientific review of the submissions for pharmaceuticals and vaccines. The EMA makes the final decision on the approval of products. Once granted by the European Commission, a centralized marketing authorization is valid in all EU and European Economic Area-European Free Trade Association states. A series of Directives, Guidelines and EU Pharmacopeia Monographs provide the requirements for approval in the EU. In general, these requirements are similar to those in the United States, requiring demonstrated evidence of purity, safety, efficacy, and consistency of manufacturing processes.

Brazil. The Ministry of Agriculture, Livestock Production and Supply (MAPA) is the regulatory body in Brazil that is responsible for the regulation and control of pharmaceuticals, biologicals and medicated feed additives for animal use. MAPA's regulatory activities are conducted through the Secretary of Agricultural Defense and its Livestock Products Inspection Department. In addition, regulatory activities are conducted at a local level through the Federal Agriculture Superintendence. These activities include the inspection and licensing of both manufacturing and commercial establishments for veterinary products, as well as the submission, review and approval of pharmaceuticals, biologicals and medicated feed additives. MAPA is one of the most active regulatory agencies in Latin America, having permanent seats at several international animal health forums, such as Codex Alimentarius, World Organization for Animal Health and Committee of Veterinary Medicines for the Americas. MAPA was also invited to be a Latin American representative at International Cooperation on Harmonisation of Technical Requirements for Registration of Veterinary Medicinal Products (VICH) meetings. Several normative instructions issued by MAPA have set regulatory trends in Latin America.

Australia. The Australian Pesticides and Veterinary Medicines Authority (APVMA) is an Australian government statutory authority established in 1993 to centralize the registration of all agricultural and veterinary products into the Australian marketplace. Previously each State and Territory government had its own system of registration. The APVMA assesses applications from companies and individuals seeking registration so they can supply their product to the marketplace. Applications undergo rigorous assessment using the expertise of the APVMA's scientific staff and drawing on the technical knowledge of other relevant scientific organizations, Commonwealth government departments and state agriculture departments. If the product works as intended and the scientific data confirms that when used as directed on the product label it will have no harmful or unintended effects on people, animals, the environment or international trade, the APVMA will register the product. As well as registering new agricultural and

veterinary products, the APVMA reviews older products that have been on the market for a substantial period of time to ensure they still do the job users expect and are safe to use. The APVMA also reviews registered products when particular concerns are raised about their safety and effectiveness. The review of a product may result in confirmation of its registration, or it may see registration continue with some changes to the way the product can be used. In some cases the review may result in the registration of a product being cancelled and the product taken off the market.

Rest of world. Country-specific regulatory laws have provisions that include requirements for certain labeling, safety, efficacy and manufacturers' quality control procedures (to assure the consistency of the products), as well as company records and reports. With the exception of the EU, most other countries' regulatory agencies will generally refer to the FDA, USDA, EU and other international animal health entities, including the World Organization for Animal Health, Codex Alimentarius, in establishing standards and regulations for veterinary pharmaceuticals and vaccines.

#### Global policy and guidance

Joint FAO/WHO Expert Committee on Food Additives. The Joint FAO/WHO Expert Committee on Food Additives is an international expert scientific committee that is administered jointly by the Food and Agriculture Organization of the United Nations (FAO) and the World Health Organization (WHO). They provide a risk assessment/safety evaluation of residues of veterinary drugs in animal products, exposure and residue definition and maximum residue limit proposals for veterinary drugs. We work with them to establish acceptable safe levels of residual product in food-producing animals after treatment. This in turn enables the calculation of appropriate withdrawal times for our products prior to an animal entering the food chain.

Table of Contents

Advertising and promotion review. Promotion of prescription animal health products is controlled by regulations in many countries. These rules generally restrict advertising and promotion to those claims and uses that have been reviewed and endorsed by the applicable agency. We conduct a review of promotion material for compliance with the local and regional requirements in the markets where we sell animal health products.

Food Safety Inspection Service/generally recognized as safe. The FDA is authorized to determine the safety of substances (including “generally recognized as safe” substances, food additives and color additives), as well as prescribing safe conditions of use. However, although the FDA has the responsibility for determining the safety of substances, the Food Safety and Inspection Service, the public health agency in the USDA, still retains, under the tenets of the Federal Meat Inspection Act and the Poultry Products Inspection Act and their implementing regulations, the authority to determine that new substances and new uses of previously approved substances are suitable for use in meat and poultry products.

Employees

As of December 31, 2013, we have more than 9,800 employees worldwide, which includes approximately 4,100 employees in the United States and approximately 5,700 in other jurisdictions. Some of these employees are members of unions, works councils, trade associations or are otherwise subject to collective bargaining agreements, including approximately 50 union employees in the United States.

Environmental, Health and Safety

We are subject to various federal, state, local and foreign environmental, health and safety laws and regulations. These laws and regulations govern matters such as the emission and discharge of hazardous materials into the ground, air or water; the generation, use, storage, handling, treatment, packaging, transportation, exposure to, and disposal of hazardous and biological materials, including recordkeeping, reporting and registration requirements; and the health and safety of our employees. Due to our operations, these laws and regulations also require us to obtain, and comply with, permits, registrations or other authorizations issued by governmental authorities. These authorities can modify or revoke our permits, registrations or other authorizations and can enforce compliance through fines and injunctions. Certain environmental laws, such as the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), impose joint and several liability, without regard to fault, for cleanup costs on persons who disposed of or released hazardous substances into the environment, including at third party sites or offsite disposal locations, or that currently own or operate (or formerly owned or operated) sites where such a release occurred. In addition to clean-up actions brought by federal, state, local and foreign governmental entities, private parties could raise personal injury or other claims against us due to the presence of, or exposure to, hazardous materials on, from or otherwise relating to such a property.

We have made, and intend to continue to make, necessary expenditures for compliance with applicable environmental, health and safety laws and regulations. We are also a party to proceedings in which the primary relief sought is the cost of past and/or future remediation, or remedial measures to mitigate or remediate pollution. In connection with such proceedings, and otherwise, we are investigating and cleaning up environmental contamination from past industrial activity at certain sites, or financing other parties' completion of such activities. As a result, we incurred capital and operational expenditures in 2013 for environmental compliance purposes and for the clean-up of certain past industrial activities as follows:

- environmental-related capital expenditures - \$0.5 million; and
- other environmental-related expenditures - \$9 million

However, we may not have identified all of the potential environmental liabilities relating to our current and former properties, or those liabilities associated with off-site disposal locations. Such liability could materially adversely affect our operating results and financial condition. Furthermore, regulatory agencies are showing increasing concern over the impact of animal health products and livestock operations on the environment. This increased regulatory scrutiny may necessitate that additional time and resources be spent to address these concerns in both new and existing products.

In connection with past acquisitions and divestitures, we have undertaken certain indemnification obligations that require us, or may require us in the future, to conduct or finance environmental cleanups at sites that we no longer own or operate. We have also entered into indemnification agreements in which we are being indemnified for various

environmental cleanups; however, such indemnities are limited in both time and scope and may be further limited in the presence of new information, or may not be available at all.

While we cannot predict with certainty our future capital expenditures or operating costs for environmental compliance or remediation of contaminated sites, we have no reason to believe that they will have a material adverse effect on our operating results or financial condition.

**Available Information**

The company's internet website address is [www.zoetis.com](http://www.zoetis.com). On our website, the company makes available, free of charge, its annual, quarterly and current reports, including amendments to such reports, as soon as reasonably practicable after the company electronically files such material with, or furnishes such material to, the Securities and Exchange Commission (SEC).

Also available on our website is information relating to corporate governance and our Directors at Zoetis, including as follows: our Corporate Governance Principles; Director Qualification Standards; Zoetis Policies on Business Conduct (for all of our employees, including our Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer); Code of Business Conduct and Ethics for our Directors; ways to communicate by email with our Directors; Board Committees; and Committee Charters. We will provide any of the foregoing information

Table of Contents

without charge upon written request to our Corporate Secretary, Zoetis Inc., 100 Campus Drive, Florham Park, New Jersey 07932. Information relating to shareholder services is also available on our website.

The information contained on our website does not constitute a part of this 2013 Annual Report.

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA) requires disclosure by public companies of certain transactions involving the Government of Iran or other entities and individuals targeted by certain U.S. sanctions administered by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC). In some instances, ITRSHRA requires companies to disclose these types of transactions, even if they were permissible under U.S. law or were conducted by a non-U.S. affiliate in accordance with the local law under which such entity operates.

As a global animal health company, we conduct business in multiple jurisdictions throughout the world. During 2012, our activities included supplying life-saving medicines, nutritional supplements and other medical products for animals in Iran and Syria. United States law allows us, where required, to seek and rely on licenses issued by OFAC to supply Zoetis animal health products to customers in these countries. We ship these products pursuant to such licenses, and we conduct our activities in accordance with our internal policies, which follow requirements set forth in the laws of the United States and other applicable jurisdictions. We will continue our global activities to improve the health and well-being of animals in a manner consistent with applicable laws and our internal policies.

To our knowledge, none of our activities during 2013 are required to be disclosed pursuant to ITRSHRA, with the following possible exception:

Pursuant to U.S. government authorizations, during 2012, Zoetis (doing business as the Animal Health unit of Pfizer), and through a non-U.S. affiliate, shipped Zoetis products to authorized customers in Iran. These shipments were backed by letters of credit issued by Bank Tejarat to a non-U.S. company acquired by Pfizer in 2011. The letters of credit were issued by Bank Tejarat, and the Zoetis products were shipped to customers in Iran prior to the Bank's designation as a Specially Designated National (SDN) under Executive Order 13382. After Bank Tejarat's designation, Zoetis' non-U.S. affiliate sought payment from Bank Tejarat by presenting shipping documentation to the affiliate's bank in Europe, and, as a result, subsequently received certain payments. Not all funds related to these prior transactions were received from Bank Tejarat in 2012, and additional fund transfers consequently occurred in 2013. Pfizer previously requested and received U.S. government authorization to process and receive such funds, which were received as a result of specific sales made prior to Bank Tejarat's designation as a Specially Designated National. For funds received in 2013, our estimated gross revenue associated with these transactions were Euros 167,700. Additionally, Pfizer completed a transfer to Zoetis in 2013 of funds associated with these transactions that it had received and disclosed for 2012. Estimated gross revenue associated with those transfers was Euros 222,962. Other than as set forth in the Notes to Consolidated and Combined Financial Statements—Note 18. Segment, Geographic and Other Revenue Information, including the tables therein captioned Selected Statement of Income Information, Geographic Information and Other Revenue Information and in the table captioned Operating Segment Results in the MD&A, we do not allocate net profit on a country-by-country or activity-by-activity basis and, thus, cannot provide specific net profits ascribable to this activity. Zoetis' net profits attributable to these transactions were a fraction of the gross revenue.

We have informed our customers that in connection with future transactions with Zoetis, Bank Tejarat, and any other banks designated as Specially Designated Nationals under Executive Order 13382 or subsequent executive orders are not to be used.



## Table of Contents

### Item 1A. Risk Factors.

In addition to the other information in this 2013 Annual Report, any of the factors described below could materially adversely affect our operating results, financial condition and liquidity, which could cause the trading price of our securities to decline.

This report contains “forward-looking” statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements reflect our current views with respect to, among other things, future events and performance. We generally identify forward-looking statements by words such as “anticipate,” “estimate,” “expect,” “intend,” “project,” “plan,” “predict,” “believe,” “seek,” “continue,” “outlook,” “may,” “might,” “will,” “should,” “can have,” “likely” or other variations of these words or comparable words or by using future dates in connection with any discussion of future performance, actions or events. Forward-looking statements are based on beliefs and assumptions made by management using currently available information. These statements are not guarantees of future performance, actions or events.

In particular, forward-looking statements include statements relating to our indebtedness, our ability to make interest and principal payments on our indebtedness, our ability to satisfy the covenants contained in our indebtedness, the redemption of the notes, expectations regarding indebtedness, future use of cash and dividend payments, future actions, business plans or prospects, prospective products, product approvals or products under development, R&D costs, timing and likelihood of success, future operating or financial performance, future results of current and anticipated products and services, strategies, sales efforts, expenses, production efficiencies, production margins, interest rates, foreign exchange rates, growth in emerging markets, the outcome of contingencies, such as legal proceedings, our agreements with Pfizer, government regulation and financial results. Forward-looking statements are subject to risks and uncertainties, many of which are beyond our control, and are potentially inaccurate assumptions. However, there may also be other risks that we are unable to predict at this time. If one or more of these risks or uncertainties materialize, or if management's underlying beliefs and assumptions prove to be incorrect, actual results may differ materially from those contemplated by a forward-looking statement. You should not put undue reliance on forward-looking statements. Forward-looking statements speak only as of the date on which they are made.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Form 10-Q and 8-K reports and our other filings with the SEC. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties.

#### Risks related to our business and industry

Restrictions and bans on the use of antibacterials in food-producing animals may become more prevalent.

The issue of the potential transfer of increased antibacterials resistance in bacteria from food-producing animals to human pathogens, and the causality of that transfer, are the subject of global scientific and regulatory discussion.

Antibacterials refer to small molecules that can be used to treat or prevent bacterial infections and are a sub-categorization of the products that make up our anti-infectives and medicated feed additives portfolios. In some countries, this issue has led to government restrictions and bans on the use of specific antibacterials in some food-producing animals, regardless of the route of administration (in feed or injectable). These restrictions are more prevalent in countries where animal protein is plentiful and governments are willing to take action even when there is scientific uncertainty. Our total revenue attributable to antibacterials for livestock was approximately \$1.2 billion for the year ended December 31, 2013.

In December 2013, the FDA announced final guidance establishing procedures for the voluntary phase out in the United States over a three year period of the use of medically important antibacterials in animal feed for growth promotion in food production animals (medically important antibacterials include classes that are prescribed in animal and human health). The guidance provides for continued use of antibacterials in food producing animals for treatment, control and under certain circumstances for prevention of disease, all under the supervision of a veterinarian. Our total revenue attributable to medicated feed additives was approximately \$446 million for the year ended December 31, 2013. The FDA indicated that they took this action to help preserve the efficacy of medically important antibacterials

to treat infections in humans. Zoetis supports the FDA's efforts to voluntarily phase-out growth promotion indications for medically important antibiotics in food producing animals and will comply with procedures outlined in the December 2013 FDA guidance.

We cannot predict whether antibacterials resistance concerns will result in additional restrictions or bans, expanded regulations or public pressure to discontinue or reduce use of antibacterials in food-producing animals, which could materially adversely affect our operating results and financial condition.

Perceived adverse effects on human health linked to the consumption of food derived from animals that utilize our products could cause a decline in the sales of such products.

Our livestock business depends heavily on a healthy and growing livestock industry. If the public perceives a risk to human health from the consumption of the food derived from animals that utilize our products, there may be a decline in the production of such food products and, in turn, demand for our products. For example, livestock producers may experience decreased demand for their products or reputational harm as a result of evolving consumer views of animal rights, nutrition and health-related or other concerns. Any reputational harm to the livestock industry may also extend to companies in related industries, including our company. Adverse consumer views related to the use of one or more of our products in livestock also may result in a decrease in the use of such products and could have a material adverse effect on our operating results and financial condition.

Table of Contents

Increased regulation or decreased governmental financial support relating to the raising, processing or consumption of food-producing animals could reduce demand for our livestock products.

Companies in the livestock industries are subject to extensive and increasingly stringent regulations. If livestock producers are adversely affected by new regulations or changes to existing regulations, they may reduce herd sizes or become less profitable and, as a result, they may reduce their use of our products, which may materially adversely affect our operating results and financial condition. Furthermore, adverse regulations related, directly or indirectly, to the use of one or more of our products may injure livestock producers' market position. More stringent regulation of the livestock industry or our products could have a material adverse effect on our operating results and financial condition. Also, many food-producing companies, including livestock producers, benefit from governmental subsidies, and if such subsidies were to be reduced or eliminated, these companies may become less profitable and, as a result, may reduce their use of our products.

An outbreak of infectious disease carried by animals could negatively affect the sale and production of our products. Sales of our livestock products could be materially adversely affected by the outbreak of disease carried by animals, such as avian influenza, foot-and-mouth disease or bovine spongiform encephalopathy (otherwise known as BSE or mad cow disease) or porcine epidemic diarrhea virus (otherwise known as PEDv), which could lead to the widespread death or precautionary destruction of animals as well as the reduced consumption and demand for animal protein. In addition, outbreaks of disease carried by animals may reduce regional or global sales of particular animal-derived food products or result in reduced exports of such products, either due to heightened export restrictions or import prohibitions, which may reduce demand for our products due to reduced herd or flock sizes. For example, beginning in 2013 an outbreak of PEDv has had serious impacts on swine herds in the United States, spreading to at least 27 swine-producing states and affecting up to 30% of the sows in the United States. The continued spread of PEDv in the United States and neighboring countries could impact the size of swine herds and the demand for our swine products in these markets. In addition, in April 2012, the USDA announced that it had identified a case of BSE in California. This announcement caused certain countries to implement additional inspections of, or suspend the importation of, U.S. beef. Additionally, in December 2012, the World Animal Health Organization announced that a case of BSE had been identified in Brazil. This announcement similarly caused certain countries to suspend the importation of Brazilian beef. While the restrictions that were implemented as a result of these cases of BSE have not significantly affected demand for our products, the discovery of additional cases of BSE may result in additional restrictions related to, or reduced demand for, animal protein, which may have a material adverse effect on our operating results and financial condition. Also, the outbreak of any highly contagious disease near our main production sites could require us to immediately halt production of our products at such sites or force us to incur substantial expenses in procuring raw materials or products elsewhere.

Consolidation of our customers could negatively affect the pricing of our products.

Veterinarians and livestock producers are our primary customers. In recent years, there has been a trend towards the concentration of veterinarians in large clinics and hospitals. In addition, livestock producers, particularly swine and poultry producers, have seen recent consolidation in their industries. If these trends towards consolidation continue, these customers could attempt to improve their profitability by leveraging their buying power to obtain favorable pricing. The resulting decrease in our prices could have a material adverse effect on our operating results and financial condition.

Our business may be negatively affected by weather conditions and the availability of natural resources.

The animal health industry and demand for many of our animal health products in a particular region are affected by weather conditions, as usage of our products follows varying weather patterns and weather-related pressures from pests, such as ticks. As a result, we may experience regional and seasonal fluctuations in our results of operations. In addition, veterinary hospitals and practitioners depend on visits from and access to animals under their care. Veterinarians' patient volume and ability to operate could be adversely affected if they experience prolonged snow, ice or other weather conditions, particularly in regions not accustomed to sustained inclement weather. Furthermore, livestock producers depend on the availability of natural resources, including large supplies of fresh water. Their animals' health and their ability to operate could be adversely affected if they experience a shortage of fresh water due

to human population growth or floods, droughts or other weather conditions. In the event of adverse weather conditions or a shortage of fresh water, veterinarians or livestock producers may purchase less of our products. For example, the widespread drought that impacted the United States in 2011, 2012 and in some regions in 2013 was considered the worst in many years, impacting both the supply of corn and the availability of grazing pasture and resulting in a reduction in the total cow herd in 2013. A decrease in harvested corn may result in higher corn prices, which may impact the profitability of livestock producers of cattle, pork and poultry. Higher corn prices may contribute to reductions in herd or flock sizes that may result in reduced spending on animal health products. Reduced availability of grazing pasture may also force cattle producers to cull their herds. Fewer heads of cattle would result in reduced demand for our products. A prolonged drought could have a material adverse effect on our operating results and financial condition.

Our business is subject to risk based on global economic conditions.

Macroeconomic, business and financial disruptions could have a material adverse effect on our operating results, financial condition and liquidity. Certain of our customers and suppliers could be affected directly by an economic downturn and could face credit issues or cash flow problems that could give rise to payment delays, increased credit risk, bankruptcies and other financial hardships that could decrease the demand for our products or hinder our ability to collect amounts due from customers. For example, the economic downturns experienced in many markets across the globe have had an impact on certain of our customers and, as a result, on our operating results in those affected markets. If one or more of our large customers, including distributors discontinue their relationship with us as a result of economic conditions or otherwise, our operating results and financial condition may be materially adversely affected. In addition, economic concerns may cause some pet owners to forgo or defer visits to veterinary practices or could reduce their willingness to treat pet health conditions or even to continue to own a pet.

Table of Contents

Our business is subject to risk based on customer exposure to rising costs and reduced customer income. Feed, fuel and transportation and other key costs for livestock producers may increase or animal protein prices or sales may decrease. Either of these trends could cause deterioration in the financial condition of our livestock product customers, potentially inhibiting their ability to purchase our products or pay us for products delivered. Our livestock product customers may offset rising costs by reducing spending on our products, including by switching to lower-cost alternatives to our products. In addition, concerns about the financial resources of pet owners also could cause veterinarians to alter their treatment recommendations in favor of lower-cost alternatives to our products. These shifts could result in a decrease in sales of our companion animal products, especially in developed countries where there is a higher rate of pet ownership.

Changes in distribution channels for companion animal products could negatively impact our market share, margins and distribution of our products.

In most markets, companion animal owners typically purchase their animal health products directly from veterinarians. Companion animal owners increasingly have the option to purchase animal health products from sources other than veterinarians, such as Internet-based retailers, “big-box” retail stores or other over-the-counter distribution channels. This trend has been demonstrated by the significant shift away from the veterinarian distribution channel in the sale of flea and tick products in recent years. Companion animal owners also could decrease their reliance on, and visits to, veterinarians as they rely more on Internet-based animal health information. Because we market our companion animal prescription products through the veterinarian distribution channel, any decrease in visits to veterinarians by companion animal owners could reduce our market share for such products and materially adversely affect our operating results and financial condition. In addition, companion animal owners may substitute human health products for animal health products if human health products are deemed to be lower-cost alternatives. Legislation has also been proposed in the United States, and may be proposed in the United States or abroad in the future, that could impact the distribution channels for our companion animal products. For example, such legislation may require veterinarians to provide pet owners with written prescriptions and disclosure that the pet owner may fill prescriptions through a third party, which may further reduce the number of pet owners who purchase their animal health products directly from veterinarians. Such requirements may lead to increased use of generic alternatives to our products or the increased substitution of our products with other animal health products or human health products if such other products are deemed to be lower-cost alternatives. Many states already have regulations requiring veterinarians to provide prescriptions to pet owners upon request and the American Veterinary Medical Association has long-standing policies in place to encourage this practice.

Over time, these and other competitive conditions may increase our reliance on Internet-based retailers, “big-box” retail stores or other over-the-counter distribution channels to sell our companion animal products. We may be unable to sustain our current margins and we may not be adequately prepared or able to distribute our products if an increased portion of our sales is through these channels. Any of these events could materially adversely affect our operating results and financial condition.

The animal health industry is highly competitive.

The animal health industry is highly competitive. We believe many of our competitors are conducting R&D activities in areas served by our products and in areas in which we are developing products. Our competitors include the animal health businesses of large pharmaceutical companies and specialty animal health businesses. These competitors may have access to greater financial, marketing, technical and other resources. As a result, they may be able to devote more resources to developing, manufacturing, marketing and selling their products, initiating or withstanding substantial price competition or more readily taking advantage of acquisitions or other opportunities. In addition to competition from established market participants, new entrants to the animal health medicines and vaccines industry could substantially reduce our market share or render our products obsolete.

To the extent that any of our competitors are more successful with respect to any key competitive factor or we are forced to reduce, or are unable to raise, the price of any of our products in order to remain competitive, our operating results and financial condition could be materially adversely affected. Competitive pressure could arise from, among other things, safety and efficacy concerns, limited demand growth or a significant number of additional competitive products being introduced into a particular market, price reductions by competitors, the ability of competitors to

capitalize on their economies of scale, the ability of competitors to produce or otherwise procure animal health products at lower costs than us and the ability of competitors to access more or newer technology than us.

Generic products may be viewed as more cost-effective than our products.

We face competition from products produced by other companies, including generic alternatives to our products. We depend on patents and data exclusivity periods to provide us with exclusive marketing rights for some of our products. Our patent protection for these products extends for varying periods in accordance with the dates of filing or grant and the legal life of patents in countries in which patents are granted. The protection afforded by our patents, which varies from country to country, is limited by the following in the applicable country: the scope and applicable terms of our patents and the availability and enforcement of legal remedies. As a result, we may face competition from lower-priced generic alternatives to many of our products. Generic competitors are becoming more aggressive in terms of launching at risk before our patent rights expire, and their pricing, and generic products are an increasing percentage of overall animal health sales in certain regions. In addition, private label products may compete with our products. If animal health customers increase their use of new or existing generic or private label products, our operating results and financial condition could be materially adversely affected. We estimate that approximately 80% of our revenue in 2013 was derived from products that are either unpatented (i.e., never patented or off-patent) or covered by our patents that, while providing a competitive advantage, may not provide market exclusivity. Over the next several years, several of our products' patents will expire. For example, our compound patent on selamectin, the active ingredient in Revolution and Stronghold, expired in several countries in January 2014, which could lead to the launch of generic counterparts, if generic manufacturers are able to successfully design-around our formulation and process patents.

Table of Contents

We may not successfully acquire and integrate other businesses, license rights to technologies or products, form and manage alliances or divest businesses.

We may pursue acquisitions, technology licensing arrangements, strategic alliances or divestitures of some of our businesses as part of our business strategy. We may not complete these transactions in a timely manner, on a cost-effective basis or at all. In addition, we may be subject to regulatory constraints or limitations or other unforeseen factors that prevent us from realizing the expected benefits. Even if we are successful in making an acquisition, the products and technologies that are acquired may not be successful or may require significantly greater resources and investments than originally anticipated. We may be unable to integrate acquisitions successfully into our existing business, and we may be unable to achieve expected gross margin improvements or efficiencies. We also could incur or assume significant debt and unknown or contingent liabilities. Our reported results of operations could be negatively affected by acquisition or disposition-related charges, amortization of expenses related to intangibles and charges for impairment of long-term assets. We may be subject to litigation in connection with, or as a result of, acquisitions, dispositions, licenses or other alliances, including claims from terminated employees, customers or third parties, and we may be liable for future or existing litigation and claims related to the acquired business, disposition, license or other alliance because either we are not indemnified for such claims or the indemnification is insufficient. These effects could cause us to incur significant expenses and could materially adversely affect our operating results and financial condition.

We may not successfully implement our business strategies or achieve expected gross margin improvements. We are pursuing, and will continue to pursue, strategic initiatives that management considers critical to our long-term success, including, but not limited to, increasing sales in emerging markets, operational revenue growth through new product development and value-added product lifecycle development; improving operational efficiency through manufacturing efficiency improvement and other programs; using cash flow from operations to service or reduce debt; and expanding our complementary products and services. In addition to base revenue growth, we also have historically grown our business through Pfizer's acquisitions of large pharmaceutical companies that had animal health businesses, including the Fort Dodge Animal Health (FDAH) business of Wyeth and the Alpharma Animal Health business of King Pharmaceuticals, Inc. However, as a result of the Separation, we are no longer able to benefit from Pfizer's acquisition activity. We also have acquired or partnered with a number of smaller animal health businesses, and we intend to continue to do so in the future. There are significant risks involved with the execution of these initiatives, including significant business, economic and competitive uncertainties, many of which are outside of our control. Accordingly, we cannot predict whether we will succeed in implementing these strategic initiatives. It could take several years to realize the anticipated benefits from these initiatives, if any benefits are achieved at all. We may be unable to achieve expected gross margin improvements on our products and technologies, including those acquired and those developed internally. Additionally, our business strategy may change from time to time, which could delay our ability to implement initiatives that we believe are important to our business.

Our business could be affected adversely by labor disputes, strikes or work stoppages.

Some of our employees are members of unions, works councils, trade associations or are otherwise subject to collective bargaining agreements in certain jurisdictions, including the United States. As a result, we are subject to the risk of labor disputes, strikes, work stoppages and other labor-relations matters. We may be unable to negotiate new collective bargaining agreements on similar or more favorable terms and may experience work stoppages or other labor problems in the future at our sites. These risks may be increased by the Separation because we are no longer able to benefit from Pfizer's prior relationships and negotiations relating to such agreements. We could experience a disruption of our operations or higher ongoing labor costs, which could have a material adverse effect on our operating results and financial condition, potentially resulting in canceled orders by customers, unanticipated inventory accumulation or shortages and reduced revenue and net income. In addition, labor problems at our suppliers or CMOs could have a material adverse effect on our operating results and financial condition.

Loss of our executive officers could disrupt our operations.

We depend on the efforts of our executive officers. Our executive officers are not currently, and are not expected to be, subject to non-compete provisions. In addition, we have not entered into employment agreements with our executive officers. Any unplanned turnover or our failure to develop an adequate succession plan for one or more of

our executive officer positions could deplete our institutional knowledge base and erode our competitive advantage. The loss or limited availability of the services of one or more of our executive officers, or our inability to recruit and retain qualified executive officers in the future, could, at least temporarily, have a material adverse effect on our operating results and financial condition.

We may be required to write down goodwill or identifiable intangible assets.

Under accounting principles generally accepted in the United States of America (U.S. GAAP), if we determine goodwill or identifiable intangible assets are impaired, we will be required to write down these assets and record a non-cash impairment charge. As of December 31, 2013, we had goodwill of \$982 million and identifiable intangible assets, less accumulated amortization, of \$803 million. Identifiable intangible assets consist primarily of developed technology rights, brands, trademarks, license agreements, patents and in-process R&D.

Determining whether an impairment exists and the amount of the potential impairment involves quantitative data and qualitative criteria that are based on estimates and assumptions requiring significant management judgment. Future events or new information may change management's valuation of an intangible asset in a short amount of time. The timing and amount of impairment charges recorded in our consolidated and combined statements of income and write-downs recorded in our consolidated and combined balance sheets could vary if management's conclusions change. Any impairment of goodwill or identifiable intangible assets could have a material adverse effect on our operating results and financial position.



## Table of Contents

Our historical combined financial data is not necessarily representative of the results we would have achieved as an independent company and may not be a reliable indicator of our future results.

Our historical combined financial data for the periods prior to the IPO included in this 2013 Annual Report does not reflect the financial condition, results of operations or cash flows we would have achieved as an independent company during the periods presented or those we will achieve in the future. This is primarily the result of the following factors:

• our historical combined financial data does not reflect the Separation;

• our historical combined financial data reflects expense allocations for certain support functions that are provided on a centralized basis within Pfizer, such as expenses for business technology, facilities, legal, finance, human resources, business development, public affairs and procurement, as well as certain manufacturing and supply costs incurred by manufacturing sites that are shared with other Pfizer business units that may be higher or lower than the comparable expenses we would have actually incurred, or will incur, as an independent company;

• our cost of debt and our capital structure will be different from that reflected in our historical combined financial statements;

• significant increases may occur in our cost structure as a result of our being an independent public company,

including costs related to public company reporting, investor relations and compliance with the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act); and

• loss of economies of scale as a result of our no longer being a part of Pfizer.

Our financial condition and future results of operations will be materially different from amounts reflected in our historical combined financial statements included in this 2013 Annual Report for the periods prior to the IPO. As a result of the Separation, it may be difficult for investors to compare our future results to historical results or to evaluate our relative performance or trends in our business.

As an independent public company, we are required to expend additional time and resources to comply with rules and regulations that did not previously apply to us, and failure to comply with such rules may lead investors to lose confidence in our financial data.

As an independent public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, and regulations of the NYSE. Such requirements will increase our legal, accounting and financial compliance costs, will make some activities more difficult, time-consuming and costly and could be burdensome on our personnel, systems and resources. We are devoting significant resources to address these public company-associated requirements, including compliance programs and investor relations, as well as our financial reporting obligations. Complying with these rules and regulations has increased and will increase our legal and financial compliance costs and makes some activities more time-consuming and costly.

In particular, as a public company, our management is required to conduct an annual evaluation of our internal controls over financial reporting and include a report of management on our internal controls in our Annual Reports on Form 10-K. In addition, we will be required to have our independent registered public accounting firm attest to the effectiveness of our internal controls over financial reporting pursuant to Auditing Standard No. 5 beginning with our Annual Report on Form 10-K for the year ending December 31, 2014. If we are unable to conclude that we have effective internal controls over financial reporting, or if our registered public accounting firm is unable to provide us with an attestation and an unqualified report as to the effectiveness of our internal controls over financial reporting, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our securities.

### Risks related to research and development

Our R&D, acquisition and licensing efforts may fail to generate new products and product lifecycle developments. Our future success depends on both our existing product portfolio and our pipeline of new products, including new products that we may develop through joint ventures and products that we are able to obtain through license or acquisition. We commit substantial effort, funds and other resources to R&D, both through our own dedicated resources and through collaborations with third parties.

We may be unable to determine with accuracy when or whether any of our products now under development will be approved or launched, or we may be unable to develop, license or otherwise acquire product candidates or products. In

addition, we cannot predict whether any products, once launched, will be commercially successful or will achieve sales and revenue that are consistent with our expectations. The animal health industry is subject to regional and local trends and regulations and, as a result, products that are successful in some of our markets may not achieve similar success when introduced into new markets. Furthermore, the timing and cost of our R&D may increase, and our R&D may become less predictable. For example, changes in regulations applicable to our industry may make it more time-consuming and/or costly to research, develop and register products.

Products in the animal health industry are sometimes derived from molecules and compounds discovered or developed as part of human health research. In addition to the R&D collaboration and license agreement with Pfizer, we expect to enter into other collaboration or licensing arrangements with third parties to provide us with access to compounds and other technology for purposes of our business. Such agreements are typically complex and require time to negotiate and implement. If we enter into these arrangements, we may not be able to maintain these relationships or establish new ones in the future on acceptable terms or at all. In addition, any collaboration that we enter into may not be successful, and the success may depend on the efforts and actions of our collaborators, which we may not be able to control. If we are unable to access human health-generated molecules and compounds to conduct R&D on cost-effective terms, our ability to develop some types of new products could be limited.

## Table of Contents

Advances in veterinary medical practices and animal health technologies could negatively affect the market for our products.

The market for our products could be impacted negatively by the introduction and/or broad market acceptance of newly-developed or alternative products that address the diseases and conditions for which we sell products, including “green” or “holistic” health products or specially bred disease-resistant animals. In addition, technological breakthroughs by others may obviate our technology and reduce or eliminate the market for our products. Introduction or acceptance of such products or technologies could materially adversely affect our operating results and financial condition. Our R&D relies on evaluations in animals, which may become subject to bans or additional regulations.

As an animal health medicines and vaccines business, the evaluation of our existing and new products in animals is required to register our products. Animal testing in certain industries has been the subject of controversy and adverse publicity. Some organizations and individuals have attempted to ban animal testing or encourage the adoption of additional regulations applicable to animal testing. To the extent that the activities of such organizations and individuals are successful, our R&D, and by extension our operating results and financial condition, could be materially adversely affected. In addition, negative publicity about us or our industry could harm our reputation.

### Risks related to manufacturing

Manufacturing problems and capacity imbalances may cause product launch delays, inventory shortages, recalls or unanticipated costs.

In order to sell our products, we must be able to produce and ship our products in sufficient quantities. We have a global manufacturing network consisting of 28 manufacturing sites located in 11 countries. In addition, 13 Pfizer sites located in 12 countries manufacture certain of our products for us. Included in these 13 Pfizer sites is our facility in Guarulhos, Brazil, where Pfizer will continue its manufacturing operations for a period of time. These 13 Pfizer sites consist of sites operated by Pfizer that, immediately prior to the Separation, predominantly manufactured human health products. We also employ a network of approximately 200 CMOs. Many of our products involve complex manufacturing processes and are sole-sourced from certain manufacturing sites.

Minor deviations in our manufacturing processes, such as temperature excursions or improper package sealing, could result in delays, inventory shortages, unanticipated costs, product recalls, product liability and/or regulatory action. In addition, a number of factors could cause production interruptions, including:

- the failure of us or any of our vendors or suppliers to comply with applicable regulations and quality assurance guidelines;

- construction delays;

- equipment malfunctions;

- shortages of materials;

- labor problems;

- natural disasters;

- power outages;

- terrorist activities;

- changes in manufacturing production sites and limits to manufacturing capacity due to regulatory requirements,

- changes in types of products produced, shipping distributions or physical limitations; and

- the outbreak of any highly contagious diseases near our production sites.

These interruptions could result in launch delays, inventory shortages, recalls, unanticipated costs or issues with our agreements under which we supply third parties, which may adversely affect our operating results. For example, our manufacturing site in Medolla, Italy was damaged in an earthquake in May 2012, which resulted in production interruptions at that site.

Our manufacturing network may be unable to meet the demand for our products or we may have excess capacity if demand for our products changes. The unpredictability of a product's regulatory or commercial success or failure, the lead time necessary to construct highly technical and complex manufacturing sites, and shifting customer demand (including as a result of market conditions or entry of branded or generic competition) increase the potential for capacity imbalances. In addition, construction of sites is expensive, and our ability to recover costs will depend on the market acceptance and success of the products produced at the new sites, which is uncertain.

We rely on third parties to provide us with materials and services and are subject to increased labor and material costs. The materials used to manufacture our products may be subject to availability constraints and price volatility caused by changes in demand, weather conditions, supply conditions, government regulations, economic climate and other factors. In addition, labor costs may be subject to volatility caused by the supply of labor, governmental regulations, economic climate and other factors. Increases in the demand for, availability or the price of, materials used to manufacture our products and increases in labor costs could increase the costs to manufacture our products. We may not be able to pass all or a material portion of any higher material or labor costs on to our customers, which could materially adversely affect our operating results and financial condition.

17 |

---

Table of Contents

In addition, certain third-party suppliers are the sole source of certain materials necessary for production of our products. We may be unable to meet demand for certain of our products if any of our third-party suppliers cease or interrupt operations, fail to renew contracts with us or otherwise fail to meet their obligations to us.

Risks related to legal matters and regulation

We may incur substantial costs and receive adverse outcomes in litigation and other legal matters.

Our operating results, financial condition and liquidity could be materially adversely affected by unfavorable results in pending or future litigation matters. These matters include, among other things, allegations of violation of United States and foreign competition laws, labor laws, consumer protection laws, and environmental laws and regulations, as well as claims or litigations relating to product liability, intellectual property, securities, breach of contract and tort. In addition, changes in the interpretations of laws and regulations to which we are subject, or in legal standards in one or more of the jurisdictions in which we operate, could increase our exposure to liability. For example, in the United States, attempts have been made to allow damages for emotional distress and pain and suffering in connection with the loss of, or injury to, a companion animal. If such attempts were successful, our exposure with respect to product liability claims could increase materially.

Litigation matters, regardless of their merits or their ultimate outcomes, are costly, divert management's attention and may materially adversely affect our reputation and demand for our products. We cannot predict with certainty the eventual outcome of pending or future litigation matters. An adverse outcome of litigation or legal matters could result in our being responsible for significant damages. Any of these negative effects resulting from litigation matters could materially adversely affect our operating results and financial condition.

The misuse or off-label use of our products may harm our reputation or result in financial or other damages.

Our products have been approved for use under specific circumstances for the treatment of certain diseases and conditions in specific species. There may be increased risk of product liability if veterinarians, livestock producers, pet owners or others attempt to use our products off-label, including the use of our products in species (including humans) for which they have not been approved. For example, Ketamine, the active pharmaceutical ingredient in our Ketaset product (a nonnarcotic agent for anesthetic use in cats), is commonly abused by humans as a hallucinogen.

Furthermore, the use of our products for indications other than those indications for which our products have been approved may not be effective, which could harm our reputation and lead to an increased risk of litigation. If we are deemed by a governmental or regulatory agency to have engaged in the promotion of any of our products for off-label use, such agency could request that we modify our training or promotional materials and practices and we could be subject to significant fines and penalties, and the imposition of these sanctions could also affect our reputation and position within the industry. Any of these events could materially adversely affect our operating results and financial condition.

Animal health products are subject to unanticipated safety, quality, or efficacy concerns, which may harm our reputation.

Unanticipated safety, quality, or efficacy concerns can arise with respect to animal health products, whether or not scientifically or clinically supported, leading to product recalls, withdrawals or suspended or declining sales, as well as product liability and other claims. For example, as a result of safety concerns related to our product, PregSure BVD, in 2010, we voluntarily suspended sales of the product and withdrew the marketing authorization in the EU and, in 2011, we suspended sales and withdrew the marketing authorization for the product in New Zealand. Also, in May 2013, we were advised that the European Commission started a procedure regarding the EU marketing authorization for Suvaxyn PCV, a vaccine against porcine circovirus type 2 in swine. The initiation of the procedure followed a recall of two batches of Suvaxyn PCV as a result of higher than expected adverse reactions, reported mainly in Spain. In June 2013, we completed a root cause investigation of the higher than expected adverse reactions in these two batches, and subsequently submitted to the EMA a proposed variation to describe specific adjustments to the manufacturing process to help minimize the risk of future reactive batches. In October 2013, the EMA's Committee on Medicinal Products for Veterinary Use adopted a positive opinion as to the proposed variation and concurrently adopted an opinion concluding that no action was required at this time with regard to the EU marketing authorization for Suvaxyn PCV. Both opinions were transmitted to the European Commission according to the applicable procedure and the Commission officially advised us in January 2014 that it had adopted those positive opinions and concluded

the procedure begun in May 2013 by maintaining the marketing authorization for Suvaxyn PCV in effect. Regulatory actions based on these types of safety, quality or efficacy concerns could impact all or a significant portion of a product's sales and could, depending on the circumstances, materially adversely affect our operating results. In addition, since we depend on positive perceptions of the safety, quality and efficacy of our products, and animal health products generally, by our customers, veterinarians and end-users, any concerns as to the safety, quality or efficacy of our products, whether actual or perceived, may harm our reputation. These concerns and the related harm to our reputation could materially adversely affect our operating results and financial condition, regardless of whether such reports are accurate.

Our business is subject to substantial regulation.

We will not be able to market new products unless and until we have obtained all required regulatory approvals in each jurisdiction where we propose to market those products. Even after a product reaches market, it may be subject to re-review and may lose its approvals. In connection with the Separation, we will likely change the location of the manufacture of certain of our products and, because of these changes, may be required to obtain new regulatory approvals. Our failure to obtain approvals, delays in the approval process, or our failure to maintain approvals in any jurisdiction, may prevent us from selling products in that jurisdiction until approval or reapproval is obtained, if ever. In addition, we cannot predict the nature of future laws or regulations, nor can we determine the effect that additional laws or regulations or changes in existing laws or regulations could have on our business when and if promulgated, or the impact of changes in the interpretation of these laws and regulations, or of disparate federal, state, local and foreign regulatory schemes. Changes to such laws or regulations may include,

Table of Contents

among other things, changes to taxation requirements, such as tax-rate changes and changes affecting the taxation by the United States of income earned outside the United States.

Changes in applicable federal, state, local and foreign laws and regulations could have a material adverse effect on our operating results and financial condition. For example, regulatory agencies have recently increased their focus on the potential for vaccines to induce immunity anomalies. Absent a clear understanding of these anomalies, regulatory scrutiny of vaccines may become stricter. Additional scrutiny or regulation of our vaccine products could materially adversely affect our operating results and financial condition.

We are subject to complex environmental, health and safety laws and regulations.

We are subject to various federal, state, local and foreign environmental, health and safety laws and regulations. These laws and regulations govern matters such as the emission and discharge of hazardous materials into the ground, air or water; the generation, use, storage, handling, treatment, packaging, transportation, exposure to, and disposal of hazardous and biological materials, including recordkeeping, reporting and registration requirements; and the health and safety of our employees. Due to our operations, these laws and regulations also require us to obtain, and comply with, permits, registrations or other authorizations issued by governmental authorities. These authorities can modify or revoke our permits, registrations or other authorizations and can enforce compliance through fines and injunctions. Given the nature of our business, we have incurred, are currently incurring and may in the future incur, liabilities under CERCLA or under other federal, state, local and foreign environmental cleanup laws, with respect to our current or former sites, adjacent or nearby third-party sites, or offsite disposal locations. See Item 1. Business—Environmental, Health and Safety. The costs associated with future cleanup activities that we may be required to conduct or finance could be material. Additionally, we may become liable to third parties for damages, including personal injury and property damage, resulting from the disposal or release of hazardous materials into the environment. Such liability could materially adversely affect our operating results and financial condition. Furthermore, regulatory agencies are showing increasing concern over the impact of animal health products and livestock operations on the environment. This increased regulatory scrutiny may necessitate that additional time and resources be spent to address these concerns in both new and existing products.

Our failure to comply with the environmental, health and safety laws and regulations to which we are subject, including any permits issued thereunder, may result in environmental remediation costs, loss of permits, fines, penalties or other adverse governmental or private actions, including regulatory or judicial orders enjoining or curtailing operations or requiring corrective measures, installation of pollution control equipment or remedial measures. We could also be held liable for any and all consequences arising out of human exposure to hazardous materials or environmental damage. Environmental laws and regulations are complex, change frequently, have tended to become more stringent and stringently enforced over time and may be subject to new interpretation. We cannot assure you that our costs of complying with current and future environmental, health and safety laws, and our liabilities arising from past or future releases of, or exposure to, hazardous materials will not materially adversely affect our business, results of operations or financial condition.

Risks related to our international operations

A significant portion of our operations are conducted in foreign jurisdictions and are subject to the economic, political, legal and business environments of the countries in which we do business.

Our international operations could be limited or disrupted by any of the following:

- volatility in the international financial markets;
- compliance with governmental controls;
- difficulties enforcing contractual and intellectual property rights;
- compliance with a wide variety of laws and regulations, such as the Foreign Corrupt Practices Act and similar non-U.S. laws and regulations;
- compliance with foreign labor laws;
- burdens to comply with multiple and potentially conflicting foreign laws and regulations, including those relating to environmental, health and safety requirements;
-

changes in laws, regulations, government controls or enforcement practices with respect to our business and the businesses of our customers;  
political and social instability, including crime, civil disturbance, terrorist activities and armed conflicts;  
trade restrictions and restrictions on direct investments by foreign entities, including restrictions administered by OFAC;  
changes in tax laws and tariffs;  
costs and difficulties in staffing, managing and monitoring international operations; and  
longer payment cycles and increased exposure to counterparty risk.

The multinational nature of our business subjects us to potential risks that various taxing authorities may challenge the pricing of our cross-border arrangements and subject us to additional tax, adversely impacting our effective tax rate and our tax liability.



Table of Contents

In addition, international transactions may involve increased financial and legal risks due to differing legal systems and customs. Compliance with these requirements may prohibit the import or export of certain products and technologies or may require us to obtain a license before importing or exporting certain products or technology. A failure to comply with any of these laws, regulations or requirements could result in civil or criminal legal proceedings, monetary or non-monetary penalties, or both, disruptions to our business, limitations on our ability to import and export products and services, and damage to our reputation. In addition, variations in the pricing of our products between jurisdictions may result in the unauthorized importation of our products between jurisdictions. While the impact of these factors is difficult to predict, any of them could materially adversely affect our operating results and financial condition. Changes in any of these laws, regulations or requirements, or the political environment in a particular country, may affect our ability to engage in business transactions in certain markets, including investment, procurement and repatriation of earnings.

Foreign exchange rate fluctuations and potential currency controls affect our results of operations, as reported in our financial statements.

We conduct operations in many areas of the world, involving transactions denominated in a variety of currencies. In 2013, we generated approximately 54% of our revenue in currencies other than the U.S. dollar, principally the euro, Australian dollar and Brazilian real. We are subject to currency exchange rate risk to the extent that our costs are denominated in currencies other than those in which we earn revenue. In addition, because our financial statements are reported in U.S. dollars, changes in currency exchange rates between the U.S. dollar and other currencies have had, and will continue to have, an impact on our results of operations.

We also face risks arising from currency devaluations and the imposition of cash repatriation restrictions and exchange controls. Currency devaluations result in a diminished value of funds denominated in the currency of the country instituting the devaluation. Cash repatriation restrictions and exchange controls may limit our ability to convert foreign currencies into U.S. dollars or to remit dividends and other payments by our foreign subsidiaries or businesses located in or conducted within a country imposing restrictions or controls. While we currently have no need, and do not intend, to repatriate or convert cash held in countries that have significant restrictions or controls in place, should we need to do so to fund our operations, we may be unable to repatriate or convert such cash, or unable to do so without incurring substantial costs. We currently have substantial operations in countries that have cash repatriation restrictions or exchange controls in place, including China and Venezuela, and, if we were to need to repatriate or convert such cash, these controls and restrictions may have a material adverse effect on our operating results and financial condition.

For example, on February 13, 2013, the Venezuelan government devalued its currency from a rate of 4.3 to 6.3 Venezuelan bolivar per U.S. dollar. We incurred a foreign currency loss immediately on the devaluation as a result of remeasuring the local balance sheets and we will experience ongoing impacts to earnings as our revenue and expenses will be translated at lower rates. We cannot predict whether there will be further devaluation of the Venezuelan bolivar.

We may not be able to realize the expected benefits of our investments in emerging markets.

We have been taking steps to increase our presence in emerging markets, including by expanding our manufacturing presence, sales organization and product offerings in these markets. Failure to continue to maintain and expand our business in emerging markets could also materially adversely affect our operating results and financial condition. Some countries within emerging markets may be especially vulnerable to periods of local, regional or global economic, political or social instability or crisis. For example, our sales in certain emerging markets have suffered from extended periods of disruption due to natural disasters. Furthermore, we have also experienced lower than expected sales in certain emerging markets due to local, regional and global restrictions on banking and commercial activities in those countries. In addition, certain emerging markets have currencies that fluctuate substantially, which may impact our financial performance. For example, in the past, our revenue in certain emerging markets in Latin America have been adversely impacted by currency fluctuations and devaluations. For all these and other reasons, sales within emerging markets carry significant risks.

Risks related to intellectual property

The actual or purported intellectual property rights of third parties may negatively affect our business.

A third party may sue us or otherwise make a claim, alleging infringement or other violation of the third-party's patents, trademarks, trade dress, copyrights, trade secrets, domain names or other intellectual property rights. If we do not prevail in this type of litigation, we may be required to:

• pay monetary damages;

• obtain a license in order to continue manufacturing or marketing the affected products, which may not be available on commercially reasonable terms, or at all; or

• stop activities, including any commercial activities, relating to the affected products, which could include a recall of the affected products and/or a cessation of sales in the future.

The costs of defending an intellectual property claim could be substantial and could materially adversely affect our operating results and financial condition, even if we successfully defend such claims. The intellectual property positions of animal health medicines and vaccines businesses frequently involve complex legal and factual questions, and an issued patent does not guarantee us the right to practice the patented technology or develop, manufacture or commercialize the patented product. We cannot be certain that a competitor or other third party does not have or will not obtain rights to intellectual property that may prevent us from manufacturing, developing or marketing certain of our products, regardless of whether we believe such intellectual property rights are valid and enforceable or we believe we would be otherwise able to develop a more commercially successful product, which may harm our operating results and financial condition.

Table of Contents

If our intellectual property rights are challenged or circumvented, competitors may be able to take advantage of our research and development efforts.

Our long-term success largely depends on our ability to market technologically competitive products. We rely and expect to continue to rely on a combination of intellectual property, including patent, trademark, trade dress, copyright, trade secret, data protection, and domain name protection laws, as well as confidentiality and license agreements with our employees and others, to protect our intellectual property and proprietary rights. If we fail to obtain and maintain adequate intellectual property protection, we may not be able to prevent third parties from using our proprietary technologies or from marketing products that are very similar or identical to ours. Our currently pending or future patent applications may not result in issued patents, or be approved on a timely basis, or at all. Similarly, any term extensions that we seek may not be approved on a timely basis, if at all. In addition, our issued patents may not contain claims sufficiently broad to protect us against third parties with similar technologies or products or provide us with any competitive advantage, including exclusivity in a particular product area. The scope of our patent claims also may vary between countries, as individual countries have their own patent laws. For example, some countries only permit the issuance of patents covering a novel chemical compound itself, and its first use, and thus further methods of use for the same compound, may not be patentable. We may be subject to challenges by third parties regarding our intellectual property, including claims regarding validity, enforceability, scope and effective term. The validity, enforceability, scope and effective term of patents can be highly uncertain and often involve complex legal and factual questions and proceedings. Our ability to enforce our patents also depends on the laws of individual countries and each country's practice with respect to enforcement of intellectual property rights. In addition, if we are unable to maintain our existing license agreements or other agreements pursuant to which third parties grant us rights to intellectual property, including because such agreements expire or are terminated, our operating results and financial condition could be materially adversely affected.

In addition, patent law reform in the United States and other countries may also weaken our ability to enforce our patent rights, or make such enforcement financially unattractive. For instance, in September 2011, the United States enacted the America Invents Act, which will permit enhanced third-party actions for challenging patents and will implement a first-to-invent system. In April 2012, Australia enacted the Intellectual Property Laws Amendment (Raising the Bar) Act, which provides higher standards for obtaining patents. In September 2013, the Brazilian Patent Office challenged the validity and term of the so-called "mailbox patents" of pharmaceutical and veterinary companies which were filed in the interim period before Brazil fully implemented the Trade-Related Aspects of Intellectual Property Right (TRIPS) Agreement's patentability standards. The action of the Brazilian Patent Office potentially could shorten the duration or invalidate some of our patents. We have filed an appeal, but the decision will not be known for several years. These reforms could result in increased costs to protect our intellectual property or limit our ability to patent our products in these jurisdictions.

Additionally, certain foreign governments have indicated that compulsory licenses to patents may be granted in the case of national emergencies, which could diminish or eliminate sales and profits from those regions and materially adversely affect our operating results and financial condition.

Likewise, in the United States and other countries, we currently hold issued trademark registrations and have trademark applications pending, any of which may be the subject of a governmental or third party objection, which could prevent the maintenance or issuance of the same and thus create the potential need to rebrand or relabel a product. As our products mature, our reliance on our trademarks to differentiate us from our competitors increases and as a result, if we are unable to prevent third parties from adopting, registering or using trademarks and trade dress that infringe, dilute or otherwise violate our trademark rights, our business could be materially adversely affected.

Many of our vaccine products and other products are based on or incorporate proprietary information, including proprietary master seeds and proprietary or patented adjuvant formulations. We actively seek to protect our proprietary information, including our trade secrets and proprietary know-how, by requiring our employees, consultants, other advisors and other third parties to execute proprietary information and confidentiality agreements upon the commencement of their employment, engagement or other relationship. Despite these efforts and precautions, we may be unable to prevent a third party from copying or otherwise obtaining and using our trade secrets or our other intellectual property without authorization and legal remedies may not adequately compensate us

for the damages caused by such unauthorized use. Further, others may independently and lawfully develop substantially similar or identical products that circumvent our intellectual property by means of alternative designs or processes or otherwise.

The misappropriation and infringement of our intellectual property, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States, may occur even when we take steps to prevent it. We are currently, and expect to be in the future, party to patent lawsuits and other intellectual property rights claims that are expensive and time consuming, and if resolved adversely, could have a significant impact on our business and financial condition. In the future, we may not be able to enforce intellectual property that relates to our products for various reasons, including licensor restrictions and other restrictions imposed by third parties, or the cost of enforcing our intellectual property may outweigh the value of doing so; either of which could have a material adverse impact on our business and financial condition.

#### Risks related to information technology

We may be unable to successfully manage our online ordering sites.

In many markets around the world, such as the United States and Brazil, we provide online ordering sites to customers, often relying on third parties to host and support the application. The operation of our online business depends on our ability to maintain the efficient and uninterrupted operation of our online order-taking and fulfillment operations. Risks associated with our online business include: disruptions in telephone service or power outages; failures of the computer systems that operate our website, including inadequate system capacity, computer viruses, human error, changes in programming, security breaches, system upgrades or migration of these services to new systems; reliance on third parties for computer hardware and software as well as delivery of merchandise to our customers; rapid technology changes; credit card fraud; natural disasters or adverse weather conditions; power and network outages; changes in applicable federal and state regulations; liability

Table of Contents

for online content; and consumer privacy concerns. Problems in any one or more of these areas could have a material adverse effect on our operating results and financial condition and could damage our reputation.

We depend on sophisticated information technology and infrastructure.

We rely on various information systems to manage our operations, and we increasingly depend on third parties and applications on virtualized (cloud) infrastructure to operate and support our information technology systems. These third parties include large established vendors, as well as many small, privately owned companies. Failure by these providers to adequately service our operations or a change in control or insolvency of these providers could have an adverse effect on our business, which in turn may materially adversely affect our operating results and financial condition.

In connection with the IPO and the Separation, we have substantially changed a number of our business processes, including our financial reporting and supply chain processes. In order to support the new business processes under the terms of our transitional services agreement with Pfizer, we have made significant configuration and data changes within some of our information technology systems. If our information technology and processes are not sufficient to support our business and financial reporting functions, or if we fail to properly implement our new business processes, our financial reporting may be delayed or inaccurate and our operations may be adversely affected and, as a result, our operating results and financial condition may be materially adversely affected.

In addition, over the next few years, we expect to implement new business systems to support our operations including an enterprise resource planning system to better integrate our manufacturing, financial, commercial and business operations. Transitioning to new systems, integrating new systems into current systems or any disruptions or malfunctions (including from circumstances beyond our control) affecting our information systems could cause critical information upon which we rely to be delayed, unreliable, corrupted, insufficient or inaccessible. Any of these potential issues, individually or in aggregation, could have a material adverse effect on our operating results and financial condition.

Even if we are able to implement these systems successfully, all technology systems, despite implementation of security measures, are vulnerable to disability, failures or unauthorized access. If our information technology systems were to fail or be breached, this could materially adversely affect our ability to perform critical business functions and sensitive and confidential data could be compromised.

We may be unable to adequately protect our customers' privacy or we may fail to comply with privacy laws.

The protection of customer, employee and company data is critical and the regulatory environment surrounding information security, storage, use, processing, disclosure and privacy is demanding, with the frequent imposition of new and changing requirements. In addition, our customers expect that we will adequately protect their personal information. Any actual or perceived significant breakdown, intrusion, interruption, cyber-attack or corruption of customer, employee or company data or our failure to comply with federal, state, local and foreign privacy laws could damage our reputation and result in lost sales, fines and lawsuits. Despite our considerable efforts and technology to secure our computer network, security could be compromised, confidential information could be misappropriated or system disruptions could occur. Our systems and procedures meet the payment card industry (PCI) data security standards, which require periodic audits by independent third parties to assess compliance. Failure to comply with the security requirements or rectify a security issue may result in fines and the imposition of restrictions on our ability to accept payment by credit or debit cards. In addition, PCI is controlled by a limited number of vendors that have the ability to impose changes in PCI's fee structure and operational requirements on us without negotiation. Such changes in fees and operational requirements may result in our failure to comply with PCI security standards, as well as significant unanticipated expenses. Such failures could materially adversely affect our operating results and financial condition.

Risks related to our indebtedness

We have substantial indebtedness.

We have a significant amount of indebtedness, which could materially adversely affect our operating results, financial condition and liquidity. As of December 31, 2013, we had approximately \$3.6 billion of total unsecured indebtedness outstanding. In addition, we have entered into an agreement for a five-year revolving credit facility and a commercial paper program each with a capacity of up to \$1.0 billion. While we currently do not have any amounts drawn under

the credit facility nor any commercial paper issued under the commercial paper program, we may incur indebtedness under these arrangements in the future.

We may incur substantial additional debt from time to time to finance working capital, capital expenditures, investments or acquisitions, or for other purposes. If we do so, the risks related to our high level of debt could intensify. Specifically, our high level of debt could have important consequences, including:

- making it more difficult for us to satisfy our obligations with respect to our debt;
- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, business development or other general corporate requirements, including dividends;
- increasing our vulnerability to general adverse economic and industry conditions;
- exposing us to the risk of increased interest rates as certain of our borrowings are and may in the future be at variable rates of interest;
- limiting our flexibility in planning for and reacting to changes in the animal health industry;
- placing us at a competitive disadvantage to other, less leveraged competitors;
- impacting our effective tax rate; and

Table of Contents

increasing our cost of borrowing.

In addition, the instruments governing our indebtedness contain restrictive covenants that will limit our ability to engage in activities that may be in our long-term best interest. For example, our credit facility contains a financial covenant requiring us to not exceed a maximum total leverage ratio and covenants that, among other things, limit or restrict our and our subsidiaries' ability, subject to certain exceptions, to incur liens, merge, consolidate or sell, transfer or lease assets, transact with subsidiaries and incur priority indebtedness. Our failure to comply with such covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all our debt.

We may not be able to generate sufficient cash to service all of our indebtedness and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or refinance our debt obligations depends on our financial condition and operating performance, which are subject to prevailing economic and competitive conditions and to certain financial, business, legislative, regulatory and other factors beyond our control. We may be unable to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we could face substantial liquidity problems and could be forced to reduce or delay investments and capital expenditures, or to dispose of material assets or operations, alter our dividend policy, seek additional debt or equity capital or restructure or refinance our indebtedness. We may not be able to effect any such alternative measures on commercially reasonable terms or at all and, even if successful, those alternative actions may not allow us to meet our scheduled debt service obligations. The instruments that will govern our indebtedness may restrict our ability to dispose of assets and may restrict the use of proceeds from those dispositions and may also restrict our ability to raise debt or equity capital to be used to repay other indebtedness when it becomes due. We may not be able to consummate those dispositions or to obtain proceeds in an amount sufficient to meet any debt service obligations when due.

In addition, we conduct our operations through our subsidiaries. Accordingly, repayment of our indebtedness will depend on the generation of cash flow by our subsidiaries, including certain international subsidiaries, and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Our subsidiaries may not have any obligation to pay amounts due on our indebtedness or to make funds available for that purpose. Our subsidiaries may not be able to, or may not be permitted to, make distributions to enable us to make payments in respect of our indebtedness. Each subsidiary is a distinct legal entity, and under certain circumstances, legal, tax and contractual restrictions may limit our ability to obtain cash from our subsidiaries. In the event that we do not receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness.

Our inability to generate sufficient cash flows to satisfy our debt obligations, or to refinance our indebtedness on commercially reasonable terms or at all, may materially adversely affect our operating results, financial condition and liquidity and our ability to satisfy our obligations under our indebtedness or pay dividends on our common stock. We may not have the funds necessary to finance the change of control offer required by the indenture governing our senior notes.

Upon the occurrence of a change of control of us and a downgrade below investment grade by Moody's Investor Services, Inc. and Standard & Poor's Rating Services, we will be required to offer to repurchase all of our outstanding senior notes. We did not receive any proceeds from the sale of the \$1.0 billion aggregate principal amount of the Pfizer-owned notes and we paid an amount of cash equal to substantially all of the net proceeds that we received in the senior notes offering to Pfizer prior to the completion of the IPO. As a result of these and other factors, we may not have sufficient funds available to finance a change of control offer.

Our credit ratings may not reflect all risks of an investment in our senior notes.

The credit ratings assigned to our senior notes are limited in scope, and do not address all material risks relating to an investment in our senior notes, but rather reflect only the view of each rating agency at the time the rating is issued. There can be no assurance that such credit ratings will remain in effect for any given period of time or that a rating will not be lowered, suspended or withdrawn entirely by the applicable rating agencies, if, in such rating agency's judgment, circumstances so warrant. Credit ratings are not a recommendation to buy, sell or hold any security. Each agency's rating should be evaluated independently of any other agency's rating. Actual or anticipated changes or downgrades in our credit ratings, including any announcement that our ratings are under further review for a

downgrade, could affect the market prices of our securities and increase our borrowing costs.

Risks related to our relationship with Pfizer

We may not achieve some or all of the expected benefits of the Separation and Exchange Offer.

We may not be able to achieve the full strategic and financial benefits expected to result from the Separation and Exchange Offer, or such benefits may be delayed or not occur at all. These expected benefits include the following:

- improving strategic and operational flexibility, increasing management focus and streamlining decision-making by providing the flexibility to implement our strategic plan and to respond more effectively to different customer needs and the changing economic environment;
- allowing us to adopt the capital structure, investment policy and dividend policy best suited to our financial profile and business needs, without competing for capital with Pfizer's other businesses;
- creating an independent equity structure that will facilitate our ability to effect future acquisitions utilizing our common stock; and



Table of Contents

facilitating incentive compensation arrangements for employees more directly tied to the performance of our business, and enhancing employee hiring and retention by, among other things, improving the alignment of management and employee incentives with performance and growth objectives of our business.

We may not achieve the anticipated benefits of the Separation and Exchange Offer for a variety of reasons, which could adversely affect our operating results and financial condition.

As a result of the Separation, we have lost Pfizer's brand, reputation, capital base and other resources.

Prior to the IPO, as a business unit of Pfizer, we generally used the name "Pfizer Animal Health," and we believe the association with Pfizer and Pfizer's globally recognized brand and perceived high-quality products contributed to our ability to build relationships with our customers. Our loss of the use of the "Pfizer" name could adversely affect our ability to attract and retain customers, which could result in reduced sales of our products, and could impact our ability to attract and retain colleagues, which could result in extended vacancies in key or critical positions.

The loss of Pfizer's scale, capital base and financial strength may also prompt suppliers to reprice, modify or terminate their relationships with us. In addition, our separation from Pfizer may cause some of our existing agreements and licenses to be terminated.

Pfizer may compete with us.

Pfizer is not restricted from competing with us in the animal health business, including as a result of acquiring a company that operates an animal health business. Due to the significant resources of Pfizer, including financial resources, name recognition and know-how resulting from the previous management of our business, Pfizer could have a significant competitive advantage over us should it decide to engage in the type of business we conduct, which may cause our operating results and financial condition to be materially adversely affected.

Certain of our directors may have actual or potential conflicts of interest because of their positions with Pfizer.

Certain of our directors are employed by Pfizer or may own Pfizer common stock, options to purchase Pfizer common stock or other Pfizer equity awards. Certain of these holdings may be individually significant to these directors as compared with such director's total assets. These directors' positions at Pfizer and the ownership of any Pfizer equity or equity awards may create, or may create the appearance of, conflicts of interest when these directors are faced with decisions that could have different implications for Pfizer than for us.

Pfizer and its directors and officers have limited liability to us or our stockholders for breach of fiduciary duty.

Our certificate of incorporation provides that, subject to any contractual provision to the contrary, Pfizer will have no obligation to refrain from:

engaging in the same or similar business activities or lines of business as we do;

doing business with any of our clients or consumers; or

employing or otherwise engaging any of our officers or employees.

Under our certificate of incorporation, neither Pfizer nor any officer or director of Pfizer, except as provided in our certificate of incorporation, is liable to us or to our stockholders for breach of any fiduciary duty by reason of any of these activities.

To preserve the tax-free treatment to Pfizer and/or its stockholders of the Exchange Offer and certain related transactions, we may not be able to engage in certain transactions.

To preserve the tax-free treatment to Pfizer and/or its stockholders of the Exchange Offer and certain related transactions, under the tax matters agreement, we are restricted from taking any action that prevents such transactions from being tax-free for U.S. federal, state, local and foreign income tax purposes. These restrictions may limit our ability to pursue certain strategic transactions or engage in other transactions, including taking certain actions with respect to our 3.250% Senior Notes due 2023 and using our common stock to make acquisitions in connection with equity capital market transactions that might increase the value of our business. See Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Tax matters agreement.

We may not be able to fully realize the expected benefits of our R&D agreement with Pfizer.

Prior to the Separation, as a business unit of Pfizer, we had the ability to leverage Pfizer's proprietary compound library and database to identify, research and develop compounds suitable as new product candidates for the animal health field. As part of the Separation, we entered into an R&D collaboration and license agreement with Pfizer, which is referred to as the "R&D agreement." Pursuant to the R&D agreement, subject to certain restrictions, we have

continued access to Pfizer's compound library and database for a period of seven years from the date of the IPO and have, subject to Pfizer's approval, the possibility to exclusively license compounds from Pfizer that we develop under the R&D agreement.

While the R&D agreement is intended to supplement our post-Separation R&D capabilities, certain terms of the R&D agreement may limit our ability to achieve this expected benefit, including:

Pfizer will retain ownership of, and license to us, the intellectual property that we develop under the R&D agreement.

In many circumstances, the intellectual property we license from Pfizer will be non-exclusive as to Pfizer and third parties.

We are not assured access to Pfizer's newest programs.

Pfizer can prevent us from progressing pre-development compounds and, under certain circumstances, Pfizer may terminate our rights to a development stage compound by paying us the fair market value for such compound.

Table of Contents

The R&D agreement may be terminated before the expiration of the seven year term in certain circumstances, including if we acquire an interest in, or assets of, a human pharmaceutical business, enter into a definitive agreement relating to, or undergo, a change of control or if Pfizer acquires, or is acquired by, an animal health business. Each of the foregoing terms and Pfizer's other rights under the R&D agreement and related licenses (if any), could limit our ability to realize the expected benefits of the R&D agreement. If we fail to achieve the expected benefits of the R&D agreement, it may be more difficult, time consuming or expensive for us to develop and commercialize certain new products.

For a summary description of the terms of the R&D collaboration and license agreement, see Item 13. Certain Relationships and Related Transactions, and Director Independence— Relationship with Pfizer—Research and development collaboration and license agreement.

Pfizer's rights as licensor under the patent and know-how license could limit our ability to develop and commercialize certain products.

Under the patent and know-how license agreement (Pfizer as licensor) (the Patent and Know-How License Agreement), Pfizer licenses to us certain of its intellectual property. If we fail to comply with our obligations under this license agreement and Pfizer exercises its right to terminate it, our ability to continue to research, develop and commercialize products incorporating that intellectual property will be limited. In addition, in circumstances where Pfizer has an interest in the licensed intellectual property in connection with its human health development programs, our rights to use the licensed intellectual property are restricted and/or, in limited instances, subject to Pfizer's right to terminate such license at will. These limitations and termination rights may make it more difficult, time consuming or expensive for us to develop and commercialize certain new products, or may result in our products being later to market than those of our competitors.

For a summary description of the terms of the patent and know-how license (Pfizer as licensor), see Item 13. Certain Relationships and Related Transactions, and Director Independence—Relationship with Pfizer—Intellectual property license agreements.

We are dependent on Pfizer to prosecute, maintain and enforce certain intellectual property.

Under the Patent and Know-How License Agreement, Pfizer is responsible for filing, prosecuting and maintaining patents that Pfizer licenses to us. In the animal health field, Pfizer has the first right, and in some cases the sole right, to enforce such licensed patents, and in the human health field, subject to certain exceptions, Pfizer has the sole right to enforce the licensed patents. If Pfizer fails to fulfill its obligations or chooses to not enforce the licensed patents under this agreement, we may not be able to prevent competitors from making, using and selling competitive products, which could have an adverse effect on our business.

We have incurred and will continue to incur significant charges in connection with the Separation and incremental costs as an independent public company.

We will need to replicate or replace certain functions, systems and infrastructure to which we no longer have the same access after the Separation. We may also need to make investments or hire additional employees to operate without the same access to Pfizer's existing operational and administrative infrastructure. These initiatives may be costly to implement. Due to the scope and complexity of the underlying projects relative to these efforts, the amount of total costs could be materially higher than our estimate, and the timing of the incurrence of these costs is subject to change. Prior to the Separation, Pfizer performed or supported many important corporate functions for our company. Our combined financial statements reflect charges for these services on an allocation basis. Following the Separation, many of these services will be governed by our transitional services agreement with Pfizer. Under the transitional services agreement we are able to use these Pfizer services for a fixed term established on a service-by-service basis. However, we generally have the right to terminate a service earlier if we give notice to Pfizer. Partial reduction in the provision of any service requires Pfizer's consent. In addition, either party is able to terminate the agreement due to a material breach of the other party, upon prior written notice, subject to limited cure periods.

We pay Pfizer mutually agreed-upon fees for these services, based on Pfizer's costs of providing the services. During the two years following the IPO, the markup for these services will be 0% and, for the remainder of the term of the agreement, Pfizer may introduce a markup of 7%, which we believe is consistent with arm's length pricing for the services provided. However, since our transitional services agreement was negotiated in the context of a

parent-subsiary relationship, the terms of the agreement, including the fees charged for the services, may be higher or lower than those that would be agreed to by parties bargaining at arm's length for similar services and may be higher or lower than the costs reflected in the allocations in our historical financial statements. Third party costs are passed through to us at Pfizer's or its affiliates' cost. In addition, while these services are being provided to us by Pfizer, our operational flexibility to modify or implement changes with respect to such services or the amounts we pay for them is limited.

We may not be able to replace these services or enter into appropriate third-party agreements on terms and conditions, including cost, comparable to those that we receive from Pfizer under our transitional services agreement.

Additionally, after the agreement terminates, we may be unable to sustain the services at the same levels or obtain the same benefits as when we were receiving such services and benefits from Pfizer. When we begin to operate these functions separately, if we do not have our own adequate systems and business functions in place, or are unable to obtain them from other providers, we may not be able to operate our business effectively or at comparable costs, and our profitability may decline.

If there is a later determination that the Exchange Offer or certain related transactions are taxable for U.S. federal income tax purposes because the facts, assumptions, representations or undertakings underlying the IRS private letter ruling and/or any tax opinion are incorrect or for any other reason, we could incur significant liabilities.

Pfizer has received a private letter ruling from the IRS substantially to the effect that, among other things, the Exchange Offer will qualify as a transaction that is tax-free for U.S. federal income tax purposes under Sections 355 and 368(a)(1)(D) of the U.S. Internal Revenue Code of 1986 (the Code). Completion by Pfizer of the Exchange Offer was conditioned on, among other things, the continuing application of Pfizer's private

Table of Contents

letter ruling from the IRS and the receipt of an opinion of tax counsel, to the effect that, among other things, the Exchange Offer will qualify as a transaction that is tax-free for U.S. federal income tax purposes under Sections 355 and 368(a)(1)(D) of the Code. The ruling and the opinion rely on certain facts, assumptions, representations and undertakings from Pfizer and us regarding the past and future conduct of the companies' respective businesses and other matters. If any of these facts, assumptions, representations or undertakings are incorrect or not otherwise satisfied, Pfizer and its stockholders may not be able to rely on the ruling or the opinion of tax counsel and could be subject to significant tax liabilities. Notwithstanding the private letter ruling and opinion of tax counsel, the IRS could determine on audit that the Exchange Offer or certain related transactions are taxable if it determines that any of these facts, assumptions, representations or undertakings are not correct or have been violated or if it disagrees with the conclusions in the opinion that are not covered by the private letter ruling, or for other reasons, including as a result of certain significant changes in the stock ownership of Pfizer or us after the Exchange Offer. If the Exchange Offer or certain related transactions are determined to be taxable for U.S. federal income tax purposes, we could incur significant liabilities under applicable law or under the tax matters agreement.

Risks related to our common stock

The price of our common stock may fluctuate substantially, and you could lose all or part of your investment in Zoetis common stock as a result.

Our common stock has a limited trading history and there may be wide fluctuations in the market value of our common stock as a result of many factors. From our IPO through December 31, 2013, the sales price of our common stock as reported by the NYSE has ranged from a low sales price of \$28.81 on August 28, 2013 to a high sales price of \$35.42 on March 14, 2013. Some factors that may cause the market price of our common stock to fluctuate, in addition to the other risks mentioned in this section and in our 2013 Annual Report, are:

- our operating performance and the performance of our competitors;
- our or our competitors' press releases, other public announcements and filings with the SEC regarding new products or services, enhancements, significant contracts, acquisitions or strategic investments;
- changes in earnings estimates or recommendations by securities analysts, if any, who cover our common stock;
- changes in our investor base;
- failures to meet external expectations or management guidance;
- fluctuations in our financial results or the financial results of companies perceived to be similar to us;
- changes in our capital structure or dividend policy, including as a result of the Exchange Offer, future issuances of securities, sales of large blocks of common stock by our stockholders or the incurrence of additional debt;
- reputational issues;
- changes in general economic and market conditions in any of the regions in which we conduct our business;
- the arrival or departure of key personnel;
- the actions of speculators and financial arbitrageurs (such as hedge funds) during and after the Exchange Offer;
- changes in applicable laws, rules or regulations and other dynamics; and
- other developments or changes affecting us, our industry or our competitors.

In addition, if the market for stocks in our industry or industries related to our industry, or the stock market in general, experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition and results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

While we currently intend to pay a quarterly cash dividend to our common stockholders, we may change our dividend policy at any time.

On December 18, 2013, our Board of Directors declared the 2014 first quarter dividend of \$0.072 per share paid on March 4, 2014 to holders of record on January 30, 2014. Although we currently intend to pay a quarterly cash dividend to our common stockholders, we have no obligation to do so, and our dividend policy may change at any time without notice to our stockholders. Returns on stockholders' investments will primarily depend on the appreciation, if any, in the price of our common stock. We anticipate that we will retain most of our future earnings, if any, for use in the development and expansion of our business, repayment of indebtedness and for general corporate

purposes. The declaration and payment of dividends is at the discretion of our Board of Directors in accordance with applicable law after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, cash flows available in the United States, impact on our effective tax rate, indebtedness, legal requirements and other factors that our Board of Directors deems relevant.

Provisions in our amended and restated certificate of incorporation, amended and restated by-laws and Delaware law may prevent or delay an acquisition of us, which could decrease the trading price of our common stock.

Our amended and restated certificate of incorporation, which we refer to as “our certificate of incorporation,” and amended and restated by-laws, which we refer to as “our by-laws,” contain provisions that are intended to deter coercive takeover practices and inadequate takeover bids

## Table of Contents

and to encourage prospective acquirers to negotiate with our Board of Directors rather than to attempt a hostile takeover. These provisions include:

- a Board of Directors that is divided into three classes with staggered terms;
- rules regarding how our stockholders may present proposals or nominate directors for election at stockholder meetings;
- the right of our Board of Directors to issue preferred stock without stockholder approval; and
- limitations on the right of stockholders to remove directors.

In addition, Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. These provisions apply even if the offer may be considered beneficial by some stockholders and could delay or prevent an acquisition that our Board of Directors determines is not in our and our stockholders' best interests.

### Item 1B. Unresolved Staff Comments.

None.

### Item 2. Properties.

We have 126 owned and leased properties, amounting to approximately 8.2 million square feet, around the world for sales and marketing, customer service, regulatory compliance, R&D, manufacturing and distribution, and administrative support functions. In many locations, operations are co-located to achieve synergy and operational efficiencies. Our largest R&D facility is our owned U.S. research and development site located in Kalamazoo, Michigan, which represents approximately 1.4 million square feet. None of our other non-manufacturing sites are more than 0.2 million square feet. The largest manufacturing site in our global manufacturing network is our manufacturing site located in Kalamazoo, Michigan, which represents approximately 0.6 million square feet. No other site in our global manufacturing network is more than 0.6 million square feet. In addition, our global manufacturing network will continue to be supplemented by approximately 200 CMOs.

Our corporate headquarters are located at 100 Campus Drive, Florham Park, New Jersey 07932 and our operations extend internationally to more than 60 countries. Under the transitional services agreement we entered into with Pfizer, Pfizer granted us continued access to certain of its premises occupied by our employees prior to the IPO.

We believe that our existing properties, as supplemented by sites operated by CMOs, including Pfizer, and access to Pfizer facilities provided under the transitional services agreement are adequate for our current requirements and for our operations in the foreseeable future.

### Item 3. Legal Proceedings.

We are from time to time subject to claims and litigation arising in the ordinary course of business. These claims and litigation may include, among other things, allegations of violation of U.S. and foreign competition law, labor laws, consumer protection laws, and environmental laws and regulations, as well as claims or litigation relating to product liability, intellectual property, securities, breach of contract and tort. We operate in multiple jurisdictions and, as a result, a claim in one jurisdiction may lead to claims or regulatory penalties in other jurisdictions. We intend to defend vigorously against any pending or future claims and litigation.

At this time, in the opinion of management, the likelihood is remote that the impact of such proceedings, either individually or in the aggregate, would have a material adverse effect on our consolidated and combined results of operations, financial condition or cash flows. However, one or more unfavorable outcomes in any claim or litigation against us could have a material adverse effect for the period in which they are resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect our reputation, even if resolved in our favor.

Certain legal proceedings in which we are involved are discussed in Notes to Consolidated and Combined Financial Statements—Note 17. Commitments and Contingencies.

### Item 4. Mine Safety Disclosures.

Not applicable.

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

On January 31, 2013, our registration statement on Form S-1 (File No. 333-183254) was declared effective for the IPO, pursuant to which we registered the offering and sale of 99,015,000 shares of our Class A common stock, including 12,915,000 additional shares pursuant to the underwriters' option to purchase additional shares. The IPO was completed on February 6, 2013, at a public offering price of \$26.00 per share for an aggregate gross offering price of approximately \$2.57 billion.

Instead of selling shares of our Class A common stock directly to the underwriters for cash in the IPO, Pfizer first exchanged the shares of our Class A common stock to be sold in the IPO with certain of the underwriters, which we refer to, in such role, as the "debt-for-equity exchange parties," for outstanding indebtedness of Pfizer held by the debt-for-equity exchange parties. The debt-for-equity exchange parties then sold shares to the underwriters for cash. This debt-for-equity exchange occurred on the settlement date of the IPO immediately prior to the settlement of the debt-for-equity exchange parties' sale of the shares to the underwriters.

We did not receive any proceeds from the sale of shares of our common stock by the debt-for-equity exchange parties, including any shares sold by the debt-for-equity exchange parties in connection with the exercise of the underwriters' option to purchase additional shares.

On June 24, 2013, an exchange offer was completed, whereby Pfizer shareholders exchanged a portion of Pfizer common stock for Zoetis common stock, resulting in the full separation of Zoetis and the disposal of Pfizer's entire ownership and voting interest in Zoetis and the conversion of all outstanding shares of Class B common stock to shares of our Class A common stock, which we now refer to as our common stock. There are no shares of Class B outstanding.

Shares of our common stock are traded on the NYSE (symbol ZTS).

The following table sets forth the high and low sales price of our common stock and the cash dividends declared per share of our common stock for each quarter presented below.

	First Quarter 2013 (beginning February 1, 2013)	Second Quarter 2013	Third Quarter 2013	Fourth Quarter 2013
High	\$35.42	\$34.74	\$32.75	\$33.34
Low	\$30.47	\$29.40	\$28.81	\$30.86
Dividends	\$0.065	\$0.065	\$0.065	\$0.072

As of March 19, 2014, there were 500,729,429 shares of our common stock outstanding, held by 2,267 shareholders of record. Information about 5% beneficial owners of our common stock is incorporated by reference from the discussion under the heading Ownership of Our Common Stock in our 2014 Proxy Statement.

We did not purchase any of our equity securities, nor did we sell any securities, other than to Pfizer upon our formation, pursuant to any unregistered offering, during the period covered by this report.

## Dividend Policy

We expect to pay quarterly cash dividends to holders of our common stock, subject to the approval of our Board of Directors. On December 18, 2013, our Board of Directors declared the 2014 first quarter dividend of \$0.072 per share paid on March 4, 2014 to holders of record on January 30, 2014. On March 26, 2014, our Board of Directors declared the 2014 second quarter dividend of \$0.072 per share to be paid on June 2, 2014 to holders of record on April 27, 2014.

The declaration and payment of dividends to holders of our common stock will be at the discretion of our Board of Directors in accordance with applicable law after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, cash flows available in the United States, impact on our effective tax rate, indebtedness, legal requirements and other factors that our Board of Directors deems relevant. In addition, the instruments governing our indebtedness may limit our ability to pay dividends. Therefore, no assurance is given that we will pay any dividends to our common stockholders or as to the amount of any such dividends if our Board of Directors determines to do so.



Because we are a holding company, our ability to pay cash dividends on our common stock will depend on the receipt of dividends or other distributions from certain of our subsidiaries.

Stock Performance Graph<sup>(1)</sup>

The graph below compares the cumulative total shareholder return on an investment in our common stock, the S&P 500 Index and the S&P 500 Pharmaceuticals Index during the year ended December 31, 2013. The shareholder return shown on the graph is not necessarily indicative of future performance, and we do not make or endorse any predictions as to future shareholder returns.

The graph assumes the investment of \$100 on February 1, 2013 in our common stock, the S&P 500 Index and the S&P 500 Pharmaceuticals Index and assumes dividends, if any, are reinvested.

28 |

---

## COMPARISON OF CUMULATIVE TOTAL RETURN

Among Zoetis Inc., the S&amp;P 500 Index and the S&amp;P 500 Pharmaceuticals Index

	February 1, 2013	March 31, 2013	June 30, 2013	September 29, 2013	December 31, 2013
Zoetis Inc.	\$100	\$107.71	\$99.81	\$100.87	\$106.07
S&P 500	\$100	\$104.11	\$107.14	\$113.44	\$124.61
S&P 500 Pharmaceuticals Index	\$100	\$107.48	\$109.67	\$114.24	\$125.16

<sup>(1)</sup> This section is not “soliciting material,” is not deemed “filed” with the SEC and is not to be incorporated by reference in any filing of Zoetis under the Securities Act of 1933, as amended, or the Exchange Act whether made before or after the date hereof and irrespective of any general incorporation language contained in any such filing.

## Item 6. Selected Financial Data.

The following table sets forth our selected historical consolidated and combined financial data for the periods indicated.

The selected historical consolidated and combined statements of income data for the years ended December 31, 2013, 2012 and 2011 and the selected historical consolidated and combined balance sheet data as of December 31, 2013 and 2012 presented below have been derived from our audited consolidated and combined financial statements included in Item 8. Financial Statements and Supplementary Data. The selected historical combined balance sheet data as of December 31, 2011 and December 31, 2010, presented below has been derived from our audited combined financial statements not included in this 2013 Annual Report. The selected historical combined balance sheet data as of December 31, 2009 has been derived from unaudited combined financial information not included in this 2013 Annual Report. The revenue data for the years ended December 31, 2010 and 2009 is derived from our audited combined financial statements not included in this 2013 Annual Report.

Our consolidated and combined financial statements for the periods prior to the IPO include expense allocations for certain support functions that were provided on a centralized basis within Pfizer, such as expenses for business technology, facilities, legal, finance, human resources, and, to a lesser extent, business development, public affairs and procurement, among others, as well as certain manufacturing and supply costs incurred by manufacturing sites that were shared with other Pfizer business units, Pfizer’s global external supply group and Pfizer’s global logistics and support group. Pfizer does not routinely allocate these costs to any of its business units. These allocations were based on either a

specific identification basis or, when specific identification is not practicable, proportional cost allocation methods (e.g., using third-party sales, headcount, animal health identified manufacturing costs, etc.), depending on the nature of the services and/or costs.

The financial statements included in this 2013 Annual Report may not be indicative of our future performance and do not necessarily reflect what our financial position and results of operations would have been had we operated as an independent public company during the periods presented prior to the IPO.

You should read the selected historical consolidated and combined financial data set forth below in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated and combined financial statements and notes thereto included in Item 8. Financial Statements and Supplementary Data.

(MILLIONS, EXCEPT PER SHARE AMOUNTS)	Year Ended December 31, <sup>(a)</sup>				
	2013	2012	2011	2010	2009
Statement of income data:					
Revenue	\$4,561	\$4,336	\$4,233	\$3,582	\$2,760
Net income/(loss) attributable to Zoetis	504	436	245	110	(100 )
Balance sheet data:					
Total assets	\$6,558	\$6,262	\$5,711	\$5,284	\$5,598
Long-term obligations <sup>(b)</sup>	3,642	509	575	673	728
Other data:					
Adjusted net income <sup>(c)</sup>	\$709	\$539	\$503	\$275	\$189
Earnings per share attributable to Zoetis Inc. stockholders <sup>(d)</sup> :					
Basic	\$1.01	\$0.87	\$0.49	\$0.22	\$(0.20 )
Diluted	\$1.01	\$0.87	\$0.49	\$0.22	\$(0.20 )
Weighted average shares outstanding (in thousands):					
Basic	500,002	500,000	500,000	500,000	500,000
Diluted	500,317	500,000	500,000	500,000	500,000

Certain amounts may reflect rounding adjustments.

Starting in 2011, includes the King Animal Health (KAH), business acquired as part of Pfizer's acquisition of King Pharmaceuticals, Inc., commencing on the acquisition date of January 31, 2011. Starting in 2009, includes Fort Dodge Animal Health (FDAH) operations, acquired as part of Pfizer's acquisition of Wyeth, commencing on the acquisition date of October 15, 2009. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Comparability of historical results and our relationship with Pfizer—Recent significant acquisitions and government-mandated divestitures.

In 2009 through 2012, primarily includes an allocation of Pfizer debt that was issued to partially finance the acquisition of Wyeth (including FDAH) in 2009. The debt has been allocated on a pro-rata basis using the deemed acquisition cost of FDAH as a percentage of the total acquisition cost of Wyeth.

Adjusted net income (a non-GAAP financial measure) is defined as reported net income attributable to Zoetis excluding purchase accounting adjustments, acquisition-related costs and certain significant items. Management uses adjusted net income, among other factors, to set performance goals and to measure the performance of the overall company, as described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Adjusted net income. We believe that investors' understanding of our performance is enhanced by disclosing this performance measure. Reconciliations of U.S. GAAP reported net income attributable to Zoetis to non-GAAP adjusted net income for the years ended December 31, 2013, 2012 and 2011 are provided in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Adjusted net income. The adjusted net income measure is not, and should not be viewed as, a substitute for U.S. GAAP reported net income attributable to Zoetis.

(d)

The weighted average shares outstanding for both basic and diluted earnings per share for the years ended December 31, 2012, 2011, 2010 and 2009 was calculated using 500 million shares of common stock outstanding, which was the number of Zoetis Inc. shares outstanding at the time of the IPO, which was completed on February 6, 2013.

Table of Contents

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

## Introduction

Our management's discussion and analysis of financial condition and results of operations (MD&A) is provided to assist readers in understanding our performance, as reflected in the results of our operations, our financial condition and our cash flows. This MD&A should be read in conjunction with our consolidated and combined financial statements and notes to consolidated and combined financial statements included in Item 8. Financial Statements and Supplementary Data. The discussion in this MD&A contains a description of our historical performance for periods in which we operated as a business unit of Pfizer, as well as forward-looking statements that involve substantial risks and uncertainties. Our future results could differ materially from historical performance and from those anticipated in the forward-looking statements as a result of various factors such as those discussed in Item 1A. Risk Factors, and in the Forward-looking statements and factors that may affect future results and Comparability of historical results and our relationship with Pfizer sections of this MD&A.

This MD&A is organized as follows:

Section	Description	Page
Overview of our business	A general description of our business and the industry in which we operate. For more information regarding our business and the animal health industry, see Item 1. Business.	<u>31</u>
Our operating environment	Information regarding the animal health industry and factors that affect our company.	<u>32</u>
Our growth strategies	An explanation of our growth strategies.	<u>34</u>
Components of revenue and costs and expenses	An explanation of the components of our consolidated and combined statements of income.	<u>35</u>
Comparability of historical results and our relationship with Pfizer	Information about the limitations of the predictive value of the consolidated and combined financial statements.	<u>35</u>
Significant accounting policies and application of critical accounting estimates	Accounting policies and estimates that we consider important to understanding our consolidated and combined financial statements.	<u>37</u>
Analysis of the consolidated and combined statements of income	Consists of the following for all periods presented:	
	• Revenue: An analysis of our revenue in total, by operating segment and by species.	<u>40</u>
	• Costs and expenses: A discussion about the drivers of our costs and expenses.	<u>41</u>
Adjusted net income	• Operating segment results: A discussion of our revenue by operating segment and species and items impacting our earnings before income tax.	<u>46</u>
	A discussion of adjusted net income, an alternative view of performance used by management. Adjusted net income is a non-GAAP financial measure.	<u>50</u>
Our financial guidance for 2014	A discussion of our 2014 financial guidance.	<u>54</u>
Analysis of the consolidated and combined statements of comprehensive income	An analysis of the components of comprehensive income for all periods presented.	<u>54</u>
Analysis of the consolidated and combined balance sheets	A discussion of changes in certain balance sheet accounts for all balance sheets presented.	<u>55</u>
Analysis of the consolidated and combined statements of cash flows	An analysis of the drivers of our operating, investing and financing cash flows for all periods presented.	<u>55</u>
Analysis of financial condition, liquidity and capital resources	An analysis of our ability to meet our short-term and long-term financing needs.	<u>56</u>

New accounting standards	Accounting standards that we have recently adopted.	<u>59</u>
Forward-looking statements and factors that may affect future results	A description of the risks and uncertainties that could cause actual results to differ materially from those discussed in forward-looking statements presented in <u>60</u> this MD&A and elsewhere in this 2013 Annual Report.	

Overview of our business

We are a global leader in the discovery, development, manufacture and commercialization of animal health medicines and vaccines, with a focus on both livestock and companion animals. For more than 60 years, as a business unit of Pfizer Inc. (Pfizer) and now as an independent public company, we have been committed to enhancing the health of animals and bringing solutions to our customers who raise and care for them.

The animal health medicines and vaccines industry is characterized by meaningful differences in customer needs across different regions. As a result of these differences, among other things, we manage our operations through four geographic operating segments. Within each of these operating segments, we offer a diversified product portfolio for both livestock and companion animal customers in order to capitalize on local and regional trends and customer needs. Our four operating segments are the United States (U.S.), Europe/Africa/Middle East (EuAfME),

Table of Contents

Canada/Latin America (CLAR) and Asia/Pacific (APAC). See Notes to Consolidated and Combined Financial Statements—Note 18. Segment, Geographic and Other Revenue Information.

We directly market our products to livestock producers and veterinarians located in approximately 70 countries across North America, Europe, Africa, Asia, Australia and South America, and are a market leader in nearly all of the major regions in which we operate. Through our efforts to establish an early and direct presence in many emerging markets, such as Brazil, China and India, we believe we are the largest animal health medicines and vaccines business as measured by revenue across emerging markets as a whole. Emerging markets contributed 26% of our revenue for the year ended December 31, 2013. In markets where we do not have a direct commercial presence, we generally contract with distributors that provide logistics and sales and marketing support for our products.

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

A summary of our 2013 performance compared to the comparable 2012 and 2011 periods follows:

(MILLIONS OF DOLLARS)	Years Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Revenue	\$4,561	\$4,336	\$4,233	5	2
Net income attributable to Zoetis	504	436	245	16	78
Adjusted net income <sup>(a)</sup>	709	539	503	32	7

<sup>(a)</sup> Adjusted net income is a non-GAAP financial measure. See the Adjusted net income section of this MD&A for more information.

#### Our ownership

On February 6, 2013, an initial public offering (IPO) of our Class A common stock was completed, which represented approximately 19.8% of our total outstanding shares. On February 1, 2013, our Class A common stock began trading on the New York Stock Exchange (NYSE) under the symbol “ZTS.” Prior to and in connection with the IPO, we completed a \$3.65 billion senior notes offering (senior notes offering) and Pfizer transferred to us substantially all of the assets and liabilities of their animal health business. We paid an amount of cash equal to substantially all of the net proceeds that we received in the senior notes offering to Pfizer prior to the completion of the IPO. We did not receive any of the proceeds from the IPO. In addition, immediately prior to the completion of the IPO, we and Pfizer entered into certain agreements that provide a framework for our ongoing relationship with Pfizer. On June 24, 2013, an exchange offer was completed, whereby Pfizer shareholders exchanged a portion of Pfizer common stock for Zoetis common stock, resulting in the full separation of Zoetis and the disposal of Pfizer's entire ownership and voting interest in Zoetis. We refer to the transactions to separate our business from Pfizer, as described here and elsewhere in this 2013 Annual Report, as the “Separation.” For additional information, see Notes to Consolidated and Combined Financial Statements—Note 2. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer.

#### Our operating environment

##### Industry

The animal health industry, which focuses on both livestock and companion animals, is a growing industry that impacts billions of people worldwide. The primary livestock species for the production of animal protein are cattle (both beef and dairy), swine, poultry, sheep and fish. Livestock health and production are essential to meeting the growing demand for animal protein of a global population. Factors influencing growth in demand for livestock medicines and vaccines include:

- human population growth and increasing standards of living, particularly in many emerging markets;
- increasing demand for improved nutrition, particularly animal protein;
- natural resource constraints, such as scarcity of arable land, fresh water and increased competition for cultivated land, resulting in fewer resources that will be available to meet this increased demand for animal protein; and
- increased focus on food safety.

The primary companion animal species are dogs, cats and horses. Health professionals indicate that companion animals improve the physical and emotional well-being of pet owners. Factors influencing growth in demand for companion animal medicines and vaccines include:

- economic development and related increases in disposable income, particularly in many emerging markets;
- increasing pet ownership; and
- companion animals living longer, increasing medical treatment of companion animals and advances in companion animal medicines and vaccines.



## Table of Contents

### Product development initiatives

Our future success depends on both our existing product portfolio and our pipeline of new products, including new products that we may develop through joint ventures and products that we are able to obtain through license or acquisition. We believe we are an industry leader in animal health R&D, with a track record of generating new products and product lifecycle developments. The majority of our R&D programs focus on product lifecycle development, which is defined as R&D programs that leverage existing animal health products by adding new species or claims, achieving approvals in new markets or creating new combinations and reformulations.

### Perceptions of product quality, safety and reliability

We believe that animal health medicines and vaccines customers value high-quality manufacturing and reliability of supply. The importance of quality and safety concerns to pet owners, veterinarians and livestock producers also contributes to animal health brand loyalty, which we believe often continues after the loss of patent-based and regulatory exclusivity. We depend on positive perceptions of the safety and quality of our products, and animal health products generally, by our customers, veterinarians and end-users.

The issue of the potential transfer of increased antibacterial resistance in bacteria from food-producing animals to human pathogens, and the causality of that transfer, are the subject of global scientific and regulatory discussion. Antibacterials refer to small molecules that can be used to treat or prevent bacterial infections and are a sub-categorization of the products that make up our anti-infectives and medicated feed additives portfolios. In some countries, this issue has led to government restrictions and bans on the use of specific antibacterials in some food-producing animals, regardless of the route of administration (topical, oral, intramuscular/subcutaneous injections, or intravenous). These restrictions are more prevalent in countries where animal protein is plentiful and governments are willing to take restrictive actions even when there is scientific uncertainty. Our total revenue attributable to antibacterials for livestock was approximately \$1.2 billion for the year ended December 31, 2013.

In December 2013, the FDA announced final guidance establishing procedures for the voluntary phase out in the United States over a three year period of the use of medically important antibacterials in animal feed for growth promotion in food production animals (medically important antibacterials include classes that are prescribed in animal and human health). The guidance provides for continued use of antibacterials in food producing animals for treatment, control and under certain circumstances for prevention of disease, all under the supervision of a veterinarian. We believe the impact of this FDA guidance on our financial performance will not be significant based on the overall diversity and breadth of our product portfolio of medicines, vaccines, and diagnostics serving eight core species. We cannot predict whether antibacterials resistance concerns will result in additional restrictions or bans, expanded regulations or public pressure to discontinue or reduce use of antibacterials in food-producing animals, which could materially adversely affect our operating results and financial condition.

### The overall economic environment

In addition to industry-specific factors, we, like other businesses, continue to face the effects of the current challenging economic environment. Growth in both the livestock and companion animal sectors is driven by overall economic development and related growth, particularly in many emerging markets. Certain of our customers and suppliers have been affected directly by the economic downturn, which decreases the demand for our products and hinders our ability to collect amounts due from customers.

The cost of medicines and vaccines to our livestock producer customers is small relative to other production costs, including feed, and the use of these products is intended to improve livestock producers' economic outcomes. As a result, demand for our products has historically been more stable than demand for other production inputs. Similarly, industry sources have reported that pet owners indicated a preference for reducing spending on other aspects of their lifestyle, including entertainment, clothing and household goods, before reducing spending on pet care. While these factors have mitigated the impacts of the challenging economic environment, the impact of difficult macroeconomic conditions increases over time.

### Competition

The animal health industry is competitive. Although our business is the largest by revenue in the animal health medicines and vaccines industry, we face competition in the regions in which we operate. Principal methods of competition vary depending on the particular region, species, product category or individual product. Some of these

methods include new product development, quality, price, service and promotion to veterinary professionals, pet owners and livestock producers. Our competitors include the animal health businesses of large pharmaceutical companies and specialty animal health businesses. In addition to competition from established market participants, there could be new entrants to the animal health medicines and vaccines industry in the future. In certain markets, we also compete with companies that produce generic products, but the level of competition from generic products varies from market to market. For example, the level of generic competition is higher in Europe and certain emerging markets than in the United States.

**Weather conditions and the availability of natural resources**

The animal health industry and demand for many of our animal health products in a particular region are affected by weather conditions, as usage of our products follows varying weather patterns and weather-related pressures from pests, such as ticks. As a result, we may experience regional and seasonal fluctuations in our results of operations. In addition, veterinary hospitals and practitioners depend on visits from and access to the animals under their care. Veterinarians' patient volume and ability to operate could be adversely affected if they experience prolonged snow, ice or other weather conditions, particularly in regions not accustomed to sustained inclement weather. Furthermore, livestock producers depend on the availability of natural resources, including large supplies of fresh water. Their animals' health and their ability to operate could be adversely affected if they experience a shortage of fresh water

## Table of Contents

due to human population growth or floods, droughts or other weather conditions. In the event of adverse weather conditions or a shortage of fresh water, veterinarians and livestock producers may purchase less of our products. For example, drought conditions could negatively impact, among other things, the supply of corn and the availability of grazing pastures. A decrease in harvested corn results in higher corn prices, which could negatively impact the profitability of livestock producers of cattle, pork and poultry. Higher corn prices and reduced availability of grazing pastures contributes to reductions in herd or flock sizes that in turn results in less spending on animal health products. As such, a prolonged drought could have a material adverse impact on our operating results and financial condition. Factors influencing the magnitude and timing of effects of a drought on our performance include, but may not be limited to, weather patterns and herd management decisions. The widespread drought which impacted parts of the United States during 2011, 2012 and in some regions in 2013 was considered the worst in many years and affected our performance in the United States market in 2012 and in the first half of 2013.

### Disease outbreaks

Sales of our livestock products could be adversely affected by the outbreak of disease carried by animals. Outbreaks of disease may reduce regional or global sales of particular animal-derived food products or result in reduced exports of such products, either due to heightened export restrictions or import prohibitions, which may reduce demand for our products. Also, the outbreak of any highly contagious disease near our main production sites could require us to immediately halt production of our products at such sites or force us to incur substantial expenses in procuring raw materials or products elsewhere. Alternatively, sales of products that treat specific disease outbreaks may increase. For example, in 2012, we successfully launched a vaccine for horses against the deadly Hendra virus in Australia. In 2013, there have been several reported cases of the H7N9 avian influenza virus in China. In late March 2013, the Chinese government reported the first case of the H7N9 avian influenza virus. Since that time, over 350 cases have been detected. We are closely monitoring the developments as this situation unfolds and currently believe the impact on our 2014 global revenue will not be significant. While China continues to represent a growth opportunity for us, sales in this country represented less than 2% of our total revenue in 2013 and the majority was generated by our swine business.

In addition, since the second quarter of 2013 many producers in the United States have been experiencing an outbreak of the porcine epidemic diarrhea virus (PEDv). PEDv has existed in parts of Asia for many years. It is important to note that the virus, which affects piglets, does not create a food safety issue. We are committed to supporting pork producers in understanding and controlling PEDv, and we are partnering with the key stakeholders, including various academic institutions such as the University of Minnesota and Iowa State University. Since first reported in the United States in the second quarter, the disease has continued to spread and has now been reported in at least 27 U.S. states, Canada, Mexico, and parts of South America. According to recent reports, the outbreak has impacted up to 30% of the sows in the United States. We currently believe the impact on our 2014 revenue will not be significant. However, we are closely monitoring the evolution of this on-going outbreak and its impact on the swine industry and on our 2014 revenue.

### Foreign exchange rates

Significant portions of our revenue and costs are exposed to changes in foreign exchange rates. Our products are sold in more than 120 countries and, as a result, our revenue is influenced by changes in foreign exchange rates. In 2013, approximately 53% of our revenue was denominated in foreign currencies. Prior to the IPO, as a business unit of Pfizer and under Pfizer's global cash management system, our foreign exchange risk was managed through Pfizer. Following the Separation, we seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities. As we operate in multiple foreign currencies, including the euro, the Brazilian real, the Australian dollar and other currencies, changes in those currencies relative to the U.S. dollar will impact our revenue, cost of goods and expenses, and consequently, net income. Exchange rate fluctuations may also have an impact beyond our reported financial results and directly impact operations. These fluctuations may affect the ability to buy and sell our goods and services between markets impacted by significant exchange rate variances. In 2013, approximately 47% of our total revenue was in U.S. dollars, and our year-over-year revenue growth was unfavorably impacted by 2 percentage points from changes in foreign currency values relative to the U.S. dollar.

On February 13, 2013, the Venezuelan government devalued its currency from a rate of 4.3 to 6.3 Venezuelan bolivars per U.S. dollar. We incurred a foreign currency loss of \$9 million immediately on the devaluation as a result of remeasuring the local assets and liabilities, which is included in Other (income)/deductions—net for the year ended December 31, 2013. We will experience ongoing adverse impacts to earnings as our revenue, costs and expenses will be translated into U.S. dollars at lower rates. These impacts are not expected to be significant to our financial condition or results of operations. As of December 31, 2013, in Venezuela we had net monetary assets denominated in local currency of \$30 million. We cannot predict whether there will be further devaluation of the Venezuelan bolivar. Our growth strategies

We seek to enhance the health of animals and to bring solutions to our customers who raise and care for them. We have a global presence in both developed and emerging markets and we intend to grow our business by pursuing the following core strategies:

- leverage our direct local presence and strong customer relationships—Through our direct selling commercial model, we can deepen our understanding of our customers' businesses and can encourage the adoption of more sophisticated animal health products;
- further penetrate emerging markets—We seek to maximize our presence where economic development is driving increased demand for animal protein and increased demand for and spending on companion animals;

## Table of Contents

pursue new product research and development and value-added product lifecycle development to extend our product portfolio—New product R&D and product lifecycle development enable us to deliver innovative products to address unmet needs and evolve our product lines so they remain relevant for our customers. We seek to leverage our strong direct presence in many regions and cost-effectively develop new products;

• remain the partner of choice for access to new products and technologies—We seek to continue to support cutting-edge research and secure the right to develop and commercialize new products and technologies;

• continue to provide high-quality products and improve manufacturing production margins—We believe our manufacturing and supply chain provides us with a global platform for continued expansion, including in emerging markets, and that our quality and reliability differentiate us from our competitors; and

• expand into complementary businesses to become a more complete, trusted partner in providing solutions—We believe we have the potential to generate incremental and complementary revenue, in the areas of diagnostics, genetics, devices, dairy data management, e-learning and professional consulting, which could also enhance the loyalty of our customer base and may lead to increased product sales.

### Components of revenue and costs and expenses

Our revenue, costs and expenses are reported for the year ended December 31 for each year presented, except for operations outside the United States, for which the financial information is included in our consolidated and combined financial statements for the fiscal year ended November 30 for each year presented.

### Revenue

Our revenue is primarily derived from our diversified product portfolio of medicines and vaccines used to treat and protect livestock and companion animals. Generally, our products are promoted to veterinarians and livestock producers by our sales organization which includes sales representatives and technical and veterinary operations specialists, and then sold directly by us or through distributors. The depth of our product portfolio enables us to address the varying needs of customers in different species and geographies. In 2013, our top selling product line, the ceftiofur line, contributed approximately 7% of our revenue. The ceftiofur line and our next two top selling products, Revolution and Draxxin, contributed approximately 20% of our revenue. Our top ten selling product lines contributed approximately 39% of our revenue. For additional information regarding our products, including descriptions of our product lines that each represented approximately 1% or more of our revenue in 2013, see Item 1. Business—Products.

### Costs and expenses

Costs of sales consist primarily of cost of materials, facilities and other infrastructure used to manufacture our medicine and vaccine products and royalty expenses associated with the intellectual property of our products, when relevant.

Selling, general and administrative (SG&A) expenses consist of, among other things, the internal and external costs of marketing, promotion, advertising and shipping and handling as well as certain costs related to business technology, facilities, legal, finance, human resources, business development, public affairs and procurement.

Research and development (R&D) expenses consist primarily of project costs specific to new product R&D and product lifecycle development, overhead costs associated with R&D operations and investments that support local market clinical trials for approved indications and expenses related to regulatory approvals for our products. We do not disaggregate R&D expenses by research stage or by therapeutic area for purposes of managing our business. Amortization of intangible assets consists primarily of the amortization expense for identifiable finite-life intangible assets that have been acquired through business combinations. These assets consist of, but are not limited to, developed technology, brands and trademarks.

Restructuring charges and certain acquisition-related costs consist of all restructuring charges (those associated with acquisition activity and those associated with cost reduction/productivity initiatives), as well as costs associated with acquiring and integrating businesses. Restructuring charges are associated with employees, assets and activities that will not continue in the company. Acquisition-related costs are associated with acquiring and integrating acquired businesses, such as the King Animal Health (KAH) business in 2011 and the Fort Dodge Animal Health (FDAH) business acquired as part of Pfizer's acquisition of Wyeth in 2009, and may include transaction costs and expenditures for consulting and the integration of systems and processes.

Other (income)/deductions—net consist primarily of various items including net (gains)/losses on asset disposals, royalty-related income, foreign exchange translation (gains)/losses and certain asset impairment charges.

Comparability of historical results and our relationship with Pfizer

During the periods prior to the IPO covered by the combined financial statements in this 2013 Annual Report, we operated solely as a business unit of Pfizer. The related combined financial statements have been derived from the consolidated financial statements and accounting records of Pfizer and include allocations for direct costs and indirect costs attributable to the operations of the animal health business of Pfizer. These combined financial statements do not purport to reflect what the results of operations, comprehensive income, financial position, equity or cash flows would have been had we operated as an independent public company during the periods presented. In addition, the historical combined

Table of Contents

financial statements may not be reflective of what our results of operations, comprehensive income, financial position, equity or cash flows might be in the future as an independent public company.

For a detailed description of the basis of presentation and an understanding of the limitations of the predictive value of the historical combined financial statements, see Notes to Consolidated and Combined Financial Statements—Note 3. Basis of Presentation.

The historical balance sheets may not be comparable to the balance sheet of the standalone company, which reflects the transfer by Pfizer of substantially all of its animal health business to us. Non-comparable elements include, for example, the allocation of Pfizer debt which was not transferred, cash and cash equivalents which were transferred at a predetermined amount, and other assets and liabilities which were not transferred due to legal restrictions and other decisions taken by Pfizer.

Our historical expenses are not necessarily indicative of the expenses we incur as an independent public company. With respect to support functions, for example, for the periods prior to the IPO, our historical combined financial statements include expense allocations for certain support functions that are provided on a centralized basis within Pfizer, such as expenses for business technology, facilities, legal, finance, human resources, and, to a lesser extent, business development, public affairs and procurement, among others. As part of the Separation, pursuant to agreements with Pfizer, Pfizer provides us with some of the services related to these functions on a transitional basis in exchange for agreed-upon fees, and we are incurring other costs to replace the services and resources that will not be provided by Pfizer. As an independent public company, our total costs related to such support functions may differ from the costs that were historically allocated to us from Pfizer.

We have also incurred certain non-recurring costs related largely to becoming an independent public company, including new branding (which includes changes to the manufacturing process for required new packaging), the creation of a standalone infrastructure, the implementation of a new enterprise resource planning system, the accelerated vesting of Pfizer equity awards, site separation, certain legal registration and patent assignment costs, asset impairment charges and certain restructuring and other charges. In addition, we have incurred certain costs related to the completion of FDAH integration activities. In 2013, we incurred \$262 million of the aforementioned non-recurring costs, and we expect these costs to range between approximately \$165 million to \$185 million in 2014. These estimates exclude the impact of any depreciation or amortization of capitalized separation expenditures.

Some of our products are manufactured at sites that were retained by Pfizer or that are operated by Pfizer under a sale-leaseback arrangement. In 2013, pursuant to the master manufacturing and supply agreement with Pfizer, we purchased these products from Pfizer. The historical combined statements of income for the periods prior to the IPO include allocations of certain manufacturing and supply costs incurred by the manufacturing sites that would not have been charged to us under the master manufacturing and supply agreement with Pfizer had such agreement been in effect in the periods presented, such as operating variances, as well as purchase price and volume variances under a certain threshold. The costs allocated in the historical combined statements of income are higher than the amounts that would have been charged by Pfizer under the master manufacturing and supply agreement, had it been in effect during the periods presented, by approximately \$10 million for the year ended December 31, 2012 and approximately \$14 million for the year ended December 31, 2011. In connection with the IPO, we and Pfizer have entered into certain agreements that will provide a framework for our ongoing relationship with Pfizer. See Notes to Consolidated and Combined Financial Statements—Note 19B. Transactions and Agreements with Pfizer—Agreements with Pfizer. Following the IPO, the equity awards previously granted to our employees by Pfizer continued to vest, and service with Zoetis counted as service with Pfizer for equity award purposes. On June 24, 2013, Pfizer completed the Exchange Offer whereby Pfizer disposed of all of its shares of Zoetis common stock owned by Pfizer. Pfizer accelerated the vesting of, and in some cases the settlement of, on a pro-rata basis, outstanding Pfizer RSUs, Total Shareholder Return Units (TSRUs) and Performance Share Awards (PSAs) previously granted to our employees, subject, in each case, to the requirements of Section 409A of the U.S. Internal Revenue Code, the terms of the 2004 Pfizer Stock Plan and the applicable award agreements and any outstanding deferral elections. In addition, unvested Pfizer stock options previously granted to our employees accelerated in full, and our employees generally have the ability to exercise the stock options until the earlier of (i) June 23, 2016 (three years from Pfizer's completion of the Exchange Offer), (ii) termination of employment from Zoetis, or (iii) the expiration date of the stock option. Zoetis

employees who held Pfizer stock options and were retirement eligible as of June 24, 2013 will have the full term of the stock option to exercise.

The accelerated vesting of the outstanding Pfizer stock options, and the settlement, on a pro-rata basis, of other Pfizer equity awards, resulted in the recognition of additional expense for the year ended December 31, 2013 of \$9 million, which is included in stock-based compensation. The unvested portion of Pfizer RSUs, TSRUs and PSAs were forfeited as of the completion of the Exchange Offer. In the third quarter of 2013, Zoetis made a cash payment of approximately \$20 million to certain non-executive Zoetis employees, based on the value of the employees' forfeited Pfizer RSUs, TSRUs and PSAs (as applicable). This amount is included in the consolidated statement of income as additional compensation expense for the year ended December 31, 2013. Members of the Zoetis Executive Team did not receive a cash payment for any forfeited Pfizer RSUs, TSRUs and PSAs, but instead, in the third quarter of 2013, were granted Zoetis RSUs which were equivalent in value and vest on the same date as their forfeited Pfizer RSUs, TSRUs and PSAs.

#### Public company expenses

As a result of the IPO, we became subject to the reporting requirements of the Exchange Act and the Sarbanes-Oxley Act. We have established additional procedures and practices as an independent public company. As a result, we are incurring additional costs, including, but not limited to, internal audit, investor relations, stock administration and regulatory compliance costs.

#### Recent significant acquisitions and government-mandated divestitures

The assets, liabilities, operating results and cash flows of acquired businesses are included in our results commencing from their respective acquisition dates.



## Table of Contents

The KAH business was acquired by Pfizer as part of its acquisition of King Pharmaceuticals, Inc. (acquired on January 31, 2011), strengthening our position in the poultry business with a medicated feed additives business and other poultry products and further strengthening our position in the cattle and swine businesses. See Notes to Consolidated and Combined Financial Statements—Note 5A. Acquisitions, Divestitures and Certain Investments—Acquisition of King Animal Health. Our combined financial statements for the year ended December 31, 2011 reflect eleven months of KAH's U.S. operations and ten months of KAH's international operations.

### Delays in establishing new operating subsidiaries

Due to local regulatory and operational requirements in certain non-U.S. jurisdictions, the transfer to us of certain assets and liabilities of Pfizer's animal health business had not yet legally occurred as of the IPO date. These assets and liabilities were not material to our consolidated financial statements, individually or in the aggregate. As of December 31, 2013, all expected subsidiaries have been established and the related assets and liabilities have transferred.

### Agreements with Pfizer

On February 6, 2013, we entered into a transitional services agreement with Pfizer whereby Pfizer agreed to provide us with various corporate support services. This agreement has a service commencement date of January 1, 2013 in the United States and December 1, 2012 for our international locations. In addition, we also entered into a master manufacturing and supply agreement with Pfizer on October 1, 2012, whereby we and Pfizer agreed to manufacture and supply products to each other commencing January 1, 2013. See Notes to Consolidated and Combined Financial Statements—Note 19B. Transactions and Agreements with Pfizer: Agreements with Pfizer for more information related to these and other agreements, including the related costs.

### Significant accounting policies and application of critical accounting estimates

In presenting our financial statements in conformity with U.S. GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. For a description of our significant accounting policies, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies.

We believe that the following accounting policies are critical to an understanding of our consolidated and combined financial statements as they require the application of the most difficult, subjective and complex judgments and, therefore, could have the greatest impact on our financial statements: (i) fair value; (ii) revenue; (iii) asset impairment reviews; and (iv) contingencies.

Below are some of our more critical accounting estimates. See also Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies—Estimates and Assumptions for a discussion about the risks associated with estimates and assumptions.

#### Fair value

For a discussion about the application of fair value to our long-term debt and financial instruments, see Notes to Consolidated and Combined Financial Statements—Note 10. Financial Instruments.

For a discussion about the application of fair value to our asset impairment reviews, see Asset impairment reviews below.

#### Revenue

Our gross product revenue is subject to deductions that are generally estimated and recorded in the same period that the revenue is recognized and primarily represents sales returns and revenue incentives. For example:

for sales returns, we perform calculations in each market that incorporate the following, as appropriate: local returns policies and practices; returns as a percentage of revenue; an understanding of the reasons for past returns; estimated shelf life by product; an estimate of the amount of time between shipment and return or lag time; and any other factors that could impact the estimate of future returns, product recalls, discontinuation of products or a changing competitive environment; and

for revenue incentives, we use our historical experience with similar incentives programs to estimate the impact of such programs on revenue.

If any of our ratios, factors, assessments, experiences or judgments are not indicative or accurate predictors of our future experience, our results could be materially affected. Although the amounts recorded for these revenue

deductions are heavily dependent on estimates and assumptions, historically our adjustments to actual results have not been material. The sensitivity of our estimates can vary by program, type of customer and geographic location. Amounts recorded for revenue deductions can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For further information about the risks associated with estimates and assumptions, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies—Estimates and Assumptions.

#### Asset impairment reviews

We review all of our long-lived assets for impairment indicators throughout the year and we perform detailed testing whenever impairment indicators are present. In addition, we perform impairment testing for goodwill and indefinite-lived assets at least annually. When necessary, we record charges for impairments of long-lived assets for the amount by which the fair value is less than the carrying value of these assets.

## Table of Contents

Our impairment review processes are described below and in Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies—Amortization of Intangible Assets, Depreciation and Certain Long-Lived Assets and, for deferred tax assets, in Note 4. Significant Accounting Policies—Deferred Tax Assets and Liabilities and Income Tax Contingencies.

Examples of events or circumstances that may be indicative of impairment include:

a significant adverse change in the extent or manner in which an asset is used. For example, restrictions imposed by the regulatory authorities could affect our ability to manufacture or sell a product.

a projection or forecast that demonstrates losses or reduced profits associated with an asset. This could result, for example, from the introduction of a competitor's product that results in a significant loss of market share or the inability to achieve the previously projected revenue growth, or from the lack of acceptance of a product by customers.

Our impairment reviews of most of our long-lived assets depend heavily on the determination of fair value, as defined by U.S. GAAP, and these judgments can materially impact our results of operations. A single estimate of fair value can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies—Estimates and Assumptions.

### Intangible assets other than goodwill

We test indefinite-lived intangible assets for impairment at least annually, or more frequently if impairment indicators exist, by first assessing qualitative factors to determine whether it is more likely than not that the fair value of the indefinite-lived intangible asset is less than its carrying amount. If we conclude it is more likely than not that the fair value is less than the carrying amount, a quantitative test that compares the fair value of the indefinite-lived intangible asset with its carrying value is performed. If the fair value is less than the carrying amount, an impairment loss is recognized.

As a result of our overall intangible asset impairment review, we recognized a number of impairments of identifiable intangible assets other than goodwill.

We recorded the following identifiable intangible asset impairment charges in Restructuring charges and certain acquisition-related costs and Other (income)/deductions—net, as applicable:

In 2013, the intangible asset impairment charges reflect (i) approximately \$2 million of finite-lived developed technology rights due to a re-assessment of economic viability; (ii) approximately \$2 million of finite-lived developed technology rights and acquired in-process research and development (IPR&D) as a result of exiting a combined manufacturing and R&D facility; and (iii) approximately \$2 million related to acquired IPR&D as a result of the termination of certain development programs due to a re-assessment of their economic viability.

In 2012, the intangible asset impairment charges reflect: (i) approximately \$2 million of finite-lived companion animal developed technology rights; (ii) approximately \$1 million of finite-lived trademarks related to genetic testing services; and (iii) approximately \$2 million of finite-lived patents related to poultry technology. The intangible asset impairment charges for 2012 reflect, among other things, loss of revenue as a result of negative market conditions and, with respect to the poultry technology, a re-assessment of economic viability.

In 2011, the intangible asset impairment charges reflect: (i) approximately \$30 million of finite-lived intangible assets related to parasiticides technology as a result of declining gross margins and increased competition; (ii) approximately \$12 million of finite-lived intangible assets related to equine influenza and tetanus technology due to third-party supply issues; (iii) approximately \$10 million of finite-lived intangible assets related to genetic testing services that did not find consumer acceptance; and (iv) approximately \$17 million related to acquired IPR&D projects (acquired from Vetnax in 2010 and from FDAH in 2009), as a result of the termination of the development programs due to a re-assessment of their economic viability.

When we are required to determine the fair value of intangible assets other than goodwill, we use an income approach, specifically the multi-period excess earnings method, also known as the discounted cash flow method. We start with a forecast of all the expected net cash flows associated with the asset, which includes the application of a terminal value for indefinite-lived assets, and then we apply an asset-specific discount rate to arrive at a net present value amount.

Some of the more significant estimates and assumptions inherent in this approach include: the amount and timing of

the projected net cash flows, which includes the expected impact of competitive, legal and/or regulatory forces on the projections, the impact of technological risk associated with IPR&D assets, as well as the selection of a long-term growth rate; the discount rate, which seeks to reflect the risks inherent in the projected cash flows; foreign currency fluctuations; and the tax rate, which seeks to incorporate the geographic diversity of the projected cash flows.

While all identifiable intangible assets can be impacted by events and thus lead to impairment, in general, identifiable intangible assets that are at the highest risk of impairment include IPR&D assets (approximately \$12 million as of December 31, 2013). IPR&D assets are higher-risk assets because R&D is an inherently risky activity.

For a description of our accounting policy, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies—Amortization of Intangible Assets, Depreciation and Certain Long-Lived Assets.

Table of Contents

Goodwill

Goodwill represents the excess of the consideration transferred over the fair value of net assets of businesses purchased and is assigned to reporting units. We test goodwill for impairment on at least an annual basis, or more frequently if impairment indicators exist, by first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Some of the factors considered in the assessment include general macroeconomic conditions, conditions specific to the industry and market, cost factors which could have a significant effect on earnings or cash flows, the overall financial performance of the reporting unit, and whether there have been sustained declines in our share price. Additionally, we evaluate the extent to which the fair value exceeded the carrying value of the reporting unit at the last date a valuation was performed. If we conclude it is more likely than not that the fair value of a reporting unit is less than its carrying amount, a quantitative fair value test is performed.

In 2013, we qualitatively assessed, as of September 29, 2013, whether it is more likely than not that the respective fair values of our reporting units are less than their carrying amounts, including goodwill. Based on that assessment, we determined that this condition does not exist for all reporting units and performing a quantitative fair value test for our reporting units was not necessary. As a result, we do not believe that the risk of goodwill impairment for any of our reporting units is significant at this time.

When we are required to determine the fair value of a reporting unit, we use the income approach. The income approach is a forward-looking approach to estimating fair value and relies primarily on internal forecasts. Within the income approach, the method that we use is the discounted cash flow method. We start with a forecast of all the expected net cash flows associated with the reporting unit, which includes the application of a terminal value, and then we apply a reporting unit-specific discount rate to arrive at a net present value. Some of the more significant estimates and assumptions inherent in this approach include: the amount and timing of the projected net cash flows, which includes the expected impact of technological risk and competitive, legal and/or regulatory forces on the projections, as well as the selection of a long-term growth rate; the discount rate, which seeks to reflect the various risks inherent in the projected cash flows; and the tax rate, which seeks to incorporate the geographic diversity of the projected cash flows.

For all of our reporting units, there are a number of future events and factors that may impact future results and that could potentially have an impact on the outcome of subsequent goodwill impairment testing. For a list of these factors, see Forward-looking statements and information that may affect future results.

For a description of our accounting policy, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies—Amortization of Intangible Assets, Depreciation and Certain Long-Lived Assets.

Contingencies

For a discussion about income tax contingencies, see Notes to Consolidated and Combined Financial Statements—Note 8D. Tax Matters—Tax Contingencies.

For a discussion about legal contingencies, guarantees and indemnifications, see Notes to Consolidated and Combined Financial Statement—Note 17. Commitments and Contingencies.

Analysis of the consolidated and combined statements of income

The following discussion and analysis of our consolidated and combined statements of income should be read along with our consolidated and combined financial statements, and the notes thereto. For more information on the carve-out basis of presentation for the periods prior to the IPO, see Notes to Consolidated and Combined Financial Statements—Note 3. Basis of Presentation.

Edgar Filing: Zoetis Inc. - Form 10-K

(MILLIONS OF DOLLARS)	Year Ended December 31, <sup>(a)</sup>			% Change	
	2013	2012	2011	13/12	12/11
Revenue	\$4,561	\$4,336	\$4,233	5	2
Costs and expenses:					
Cost of sales <sup>(b)</sup>	1,669	1,563	1,652	7	(5)
% of revenue	37	% 36	% 39	%	
Selling, general and administrative expenses <sup>(b)</sup>	1,613	1,470	1,453	10	1
% of revenue	35	% 34	% 34	%	
Research and development expenses <sup>(b)</sup>	399	409	427	(2)	(4)
% of revenue	9	% 9	% 10	%	
Amortization of intangible assets	60	64	69	(6)	(7)
Restructuring charges and certain acquisition-related costs	26	135	154	(81)	(12)
Interest expense, net of capitalized interest	113	31	36	*	(14)
Other (income)/deductions—net	(9)	(46)	48	*	*
Income before provision for taxes on income	690	710	394	(3)	80
% of revenue	15	% 16	% 9	%	
Provision for taxes on income	187	274	146	(32)	88
Effective tax rate	27.1	% 38.6	% 37.1	%	
Net income before allocation to noncontrolling interests	503	436	248	15	76
Less: Net income attributable to noncontrolling interests	(1)	—	3	*	(100)
Net income attributable to Zoetis	\$504	\$436	\$245	16	78
% of revenue	11	% 10	% 6	%	

\* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

(a) Includes revenue and expenses from acquisitions from the acquisition date. See Notes to Consolidated and Combined Financial Statements—Note 5. Acquisitions, Divestitures and Certain Investments.

Exclusive of amortization of intangible assets, except as disclosed in Notes to Consolidated and Combined

(b) Financial Statements—Note 4. Significant Accounting Policies—Amortization of Intangible Assets, Depreciation and Certain Long-Lived Assets.

Revenue

Total revenue by operating segment was as follows:

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
U.S.	\$1,902	\$1,776	\$1,659	7	7
EuAfME	1,168	1,096	1,144	7	(4)
CLAR	778	769	788	1	(2)
APAC	713	695	642	3	8
Total	\$4,561	\$4,336	\$4,233	5	2

Certain amounts and percentages may reflect rounding adjustments.

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

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Livestock	\$2,931	\$2,806	\$2,778	4	1
Companion animal	1,630	1,530	1,455	7	5
Total	\$4,561	\$4,336	\$4,233	5	2

Certain amounts and percentages may reflect rounding adjustments.

2013 vs. 2012

Total revenue increased \$225 million, or 5%, in 2013 compared to 2012, with growth across all operating segments, due to higher operational revenue of \$288 million, or 7%, comprised of 5% volume and 2% price, partially offset by the unfavorable impact of foreign exchange, which decreased revenue by approximately \$63 million, or 2%.

40 |

---

Table of Contents

## 2012 vs. 2011

Total revenue increased \$103 million, or 2%, in 2012 compared to 2011, due to higher operational revenue of \$249 million, or 6%, with growth across all operating segments, which includes an incremental one month of U.S. and two months of international revenue of \$37 million, or 1%, from the KAH acquisition, partially offset by the unfavorable impact of foreign exchange, which decreased revenue by approximately \$146 million, or 4%.

## Costs and Expenses

## Cost of sales

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Cost of sales <sup>(a)</sup>	\$1,669	\$1,563	\$1,652	7	(5)
% of revenue	37	% 36	% 39	%	

Certain amounts and percentages may reflect rounding adjustments.

(a) Allocation of corporate enabling functions were: \$3 million in 2013, \$1 million in 2012, and \$3 million in 2011.

## 2013 vs. 2012

Cost of sales increased \$106 million, or 7%, in 2013 compared to 2012, primarily as a result of:

revenue growth and product and geographic mix;

additional costs of \$21 million related to becoming an independent public company, including expense of \$2 million due to the accelerated vesting of certain Pfizer equity awards and associated cash payments, as a result of the Separation;

a \$19 million charge associated with the write-offs of inventory and intercompany accounts that were transferred to us as part of the Separation from Pfizer;

higher costs associated with certain manufacturing agreements related to government-mandated divestitures from prior acquisitions; and

unfavorable foreign exchange,

partially offset by:

operational efficiencies; and

lower employee benefit costs due to the termination of the defined benefit pension plan for U.S. employees.

## 2012 vs. 2011

Cost of sales decreased \$89 million, or 5%, in 2012 compared to 2011, primarily as a result of:

the non-recurrence of approximately \$24 million of incremental purchase accounting charges in 2011 reflecting the fair value adjustments to inventory acquired from KAH that was subsequently sold in 2011;

the non-recurrence of a \$12 million inventory write-off in 2011 related to suspended sales of 3-Nitro;

favorable product mix;

increased operational efficiencies and savings associated with margin improvement initiatives, including plant network optimization, yield improvements and overall cost reductions; and

favorable foreign exchange,

partially offset by:

base revenue growth; and

the inclusion of an incremental one month of U.S. and two months of international KAH operations.

## Selling, general and administrative expenses

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Selling, general and administrative expenses <sup>(a)</sup>	\$1,613	\$1,470	\$1,453	10	1
% of revenue	35	% 34	% 34	%	

Certain amounts and percentages may reflect rounding adjustments.

(a) Allocation of corporate enabling functions were: \$24 million in 2013, \$254 million in 2012, and \$268 million in 2011.





Table of Contents

## 2013 vs. 2012

SG&A expenses increased by \$143 million, or 10%, in 2013 compared to 2012, primarily as a result of: additional costs of \$177 million related to becoming an independent public company, including expense of \$25 million due to the accelerated vesting of certain Pfizer equity awards and associated cash payments, as a result of the Separation;

a \$5 million charge associated with the write-offs of intercompany accounts that were transferred to us as part of the Separation from Pfizer; and

increased distribution expenses due to higher sales and increased temperature-controlled supply chain costs in certain regions,

partially offset by:

lower employee benefit costs due to the termination of the defined benefit pension plan for U.S. employees;

lower bad debt expense associated with improved accounts receivable collection experience; and

favorable foreign exchange.

## 2012 vs. 2011

SG&A expenses increased by \$17 million, or 1%, in 2012 compared to 2011, primarily as a result of:

the inclusion of an incremental one month of U.S. and two months of international KAH operations;

initiatives to increase our direct sales and marketing presence in certain emerging markets; and

additional costs associated with the build-up of our capabilities as an independent company,

partially offset by:

reductions in costs due to both acquisition-related synergies and cost reduction initiatives; and

favorable foreign exchange.

## Research and development expenses

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change		
	2013	2012	2011	13/12	12/11	
Research and development expenses <sup>(a)</sup>	\$399	\$409	\$427	(2	) (4	)
% of revenue	9	% 9	% 10	%		

Certain amounts and percentages may reflect rounding adjustments.

(a) Allocation of corporate enabling functions were: \$55 million in 2012 and \$64 million in 2011. There was no allocation in 2013.

## 2013 vs. 2012

R&D expenses decreased by \$10 million, or 2%, in 2013 compared to 2012, primarily as a result of:

the non-recurrence of depreciation expense incurred in 2012 related to the closing of an R&D facility in the U.K.; and

lower employee benefit costs due to the termination of the defined benefit pension plan for U.S. employees,

partially offset by:

incremental costs of \$7 million related to becoming an independent public company, including expense of \$4 million

due to the accelerated vesting of certain Pfizer equity awards and associated cash payments, as a result of the

Separation; and

an increase in the volume of R&D activities.

## 2012 vs. 2011

R&D expenses decreased \$18 million, or 4%, in 2012 compared to 2011, primarily as a result of:

a decreased allocation of enabling functions from Pfizer; and

a decrease in depreciation related to the closing of an R&D facility in the U.K.

## Amortization of intangible assets

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change		
	2013	2012	2011	13/12	12/11	
Amortization of intangible assets	\$60	\$64	\$69	(6	) (7	)

Certain amounts and percentages may reflect rounding adjustments.



Table of Contents

## 2013 vs. 2012

Amortization of intangible assets decreased by \$4 million, or 6%, in 2013 compared to 2012, which reflects the impact of certain intangible assets reaching the end of their respective useful lives.

## 2012 vs. 2011

Amortization of intangible assets decreased \$5 million, or 7%, in 2012 compared to 2011, which reflects the impact of impairments taken in 2012 and 2011.

## Restructuring charges and certain acquisition-related costs

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change		
	2013	2012	2011	13/12	12/11	
Restructuring charges and certain acquisition-related costs <sup>(a)</sup>	\$26	\$135	\$154	(81	) (12	)

Certain amounts and percentages may reflect rounding adjustments.

(a) Allocation of Restructuring charges and certain acquisition-related costs was: \$57 million in 2012 and \$70 million in 2011. There were no allocations in 2013.

We have incurred significant direct costs for restructuring and integrating acquired businesses, such as KAH on January 31, 2011 and FDAH on October 15, 2009, among others, and in connection with our ongoing cost reduction/productivity initiatives.

Our acquisition-related costs primarily related to restructuring charges for employees, assets and activities that will not continue in the future. The majority of these charges, or reversals, are related to termination costs, but we also exited a number of distributor and other contracts and performed certain facility rationalization efforts. Our integration costs are generally comprised of consulting costs related to the integration of systems and processes, as well as product transfer costs. The costs associated with our cost reduction/productivity initiatives are predominantly termination costs associated with plant closings.

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

## 2013 vs. 2012

Restructuring charges and certain acquisition-related costs decreased by \$109 million in 2013 compared to 2012, primarily as a result of:

- a \$27 million decrease in employee termination costs related to the reversal of a previously established termination reserve related to our operations in Europe;

- a decrease in integration and restructuring costs related to the KAH and FDAH acquisitions; and
- the non-recurrence of allocated charges from Pfizer,

partially offset by:

- asset impairment charges of approximately \$17 million related to one of our manufacturing facilities in the United States; and

- employee termination costs of \$2 million, exit costs of \$4 million, and accelerated depreciation of \$5 million as a result of exiting certain manufacturing and research facilities.

The aforementioned termination reserve related to our operations in Europe, was established when we were a business unit of Pfizer. For economic reasons, we revisited this restructuring action and decided to no longer implement this restructuring plan. As such, we reversed the existing reserve.

## 2012 vs. 2011

Restructuring charges and certain acquisition-related costs decreased \$19 million, or 12%, primarily as a result of:

- a \$24 million decrease in integration costs primarily related to the KAH acquisition; and

- a net \$5 million decrease in employee termination expenses which results from lower terminations related to acquisitions and the reversal of a termination reserve upon sale of a manufacturing plant, partially offset by an increase in termination costs associated with cost reduction/productivity initiatives primarily related to our operations in Europe,

partially offset by:

- \$7 million increase in asset impairment charges primarily from the allocation of the impairment of a Pfizer facility;
- \$5 million increase in exit costs primarily from the allocation of the costs incurred to exit certain Pfizer facilities.

43 |

---

Table of Contents

## Interest expense, net of capitalized interest

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Interest expense, net of capitalized interest	\$ 113	\$ 31	\$ 36	*	(14 )

\* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

2013 vs. 2012

Interest expense, net of capitalized interest, increased by \$82 million in 2013 compared to 2012, primarily due to the issuance of our senior notes on January 28, 2013. Interest expense related to allocated debt was \$2 million for 2013. Interest expense related to our long-term debt, including amortization of debt discount and fees, was \$111 million for 2013.

2012 vs. 2011

Interest expense related to allocated debt decreased by \$5 million in 2012 compared to 2011 due to a lower allocated debt balance.

## Other (income)/deductions—net

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Other (income)/deductions—net	\$(9 )	\$(46 )	\$ 48	*	*

\* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

2013 vs. 2012

The change in Other (income)/deductions—net reflects an unfavorable impact of \$37 million on income attributable to Zoetis in 2013 compared to 2012, primarily as a result of:

- the non-recurrence of income recognized in 2012 from a favorable legal settlement of \$14 million and the non-recurrence of a favorable change in estimate for an environmental-related reserve of \$7 million in 2012;
- foreign currency loss of \$9 million related to the Venezuela currency devaluation in February 2013; and
- other foreign currency losses primarily related to Argentina,

partially offset by:

- a net gain on the government-mandated sale of certain product rights in Brazil that were acquired with the FDAH acquisition in 2009; and

- lower asset impairment charges of identifiable intangible assets of approximately \$4 million.

2012 vs. 2011

The change in Other (income)/deductions—net reflects a favorable impact of \$94 million on income attributable to Zoetis in 2012 compared to 2011, primarily as a result of:

- lower asset impairment charges of identifiable intangible assets of approximately \$64 million. See Notes to Consolidated and Combined Financial Statements—Note 7. Other (Income)/Deductions—Net; and
- a favorable \$14 million settlement in 2012 regarding an intellectual property matter, as well as a \$7 million favorable change in an estimate for an environmental-related reserve.

## Provision for taxes on income

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Provision for taxes on income	\$ 187	\$ 274	\$ 146	(32 )	88
Effective tax rate	27.1	% 38.6	% 37.1	%	

Certain amounts and percentages may reflect rounding adjustments.

As of the Separation date, we operate under a standalone legal entity structure and the income tax provision in the consolidated statements of income has been calculated accordingly. For the periods prior to the Separation, the income tax provision in the combined statements of income has been calculated as if Zoetis filed a separate tax return and includes tax costs and benefits, such as uncertain tax positions, repatriation decisions and audit settlements, among

others.

44 |

---

Table of Contents

During the third quarter of 2012, Pfizer reached a settlement with the U.S. Internal Revenue Service (IRS) with respect to the audits of the Pfizer Inc. tax returns for the years 2006 through 2008. The settlement resulted in an income tax benefit to Zoetis of approximately \$29.3 million, representing tax and interest.

During the first quarter of 2011, Pfizer reached a settlement with the IRS with respect to the audits of the Wyeth tax returns for the years 2002 through 2005. The settlement resulted in an income tax benefit to Zoetis of approximately \$9.5 million, representing tax and interest.

For more information, see Notes to Consolidated and Combined Financial Statements—Note 8A. Tax Matters—Taxes on Income.

2013 vs. 2012

The lower effective tax rate in 2013 compared to 2012 is primarily due to:

the change in the jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and as a result of operating fluctuations in the normal course of business, the impact of non-deductible items and the extent and location of other income and expense items, such as restructuring charges/(benefits), asset impairments and gains and losses on asset divestitures;

incentive tax rulings in Belgium, effective December 1, 2012 through 2017, and Singapore, effective October 29, 2012 through 2016. These incentive tax rulings may be extended for another 5 and 6 years, respectively, if certain requirements are met; and

a \$2 million discrete income tax benefit during the first quarter of 2013 related to the 2012 U.S. Research and Development Tax Credit which was retroactively extended on January 3, 2013,

partially offset by:

the tax cost related to changes in uncertain tax positions, see Notes to Consolidated and Combined Financial Statements—Note 8D. Tax Matters—Tax Contingencies.

2012 vs. 2011

The higher effective tax rate in 2012 compared to 2011 is primarily due to:

the change in the jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and as a result of operating fluctuations in the normal course of business, the impact of non-deductible items and the extent and location of other income and expense items, such as restructuring charges, asset impairments and gains and losses on asset divestitures;

the tax cost related to changes in uncertain tax positions, see Notes to Consolidated and Combined Financial Statements—Note 8D. Tax Matters—Tax Contingencies;

the non-recurrence of the aforementioned \$9.5 million reduction in tax benefits, representing tax and interest, which were recorded as a result of the favorable tax audit settlement pertaining to prior years; and

the expiration of the U.S. Research and Development Tax Credit on December 31, 2011,

partially offset by:

the tax benefit resulting from the aforementioned \$29.3 million settlement in 2012 and international tax benefits of approximately \$2.7 million, representing tax and interest, resulting from the resolution of certain tax positions pertaining to prior years with various foreign tax authorities and from the lapse of certain statutes of limitations.

On January 3, 2013, the President of the United States signed into law the American Taxpayer Relief Act of 2012 (the 2012 Act), which extends the U.S. Research and Development Tax Credit for tax years 2012 and 2013, as well as other provisions. Given the enactment date of the 2012 Act, the 2012 Act had no impact on our 2012 results.



## Operating Segment Results

We believe that it is important to not only understand overall revenue and earnings growth, but also “operational growth.” Operational growth is defined as revenue or earnings growth excluding the impact of foreign exchange. On a global basis, the mix of revenue between livestock and companion animal products was as follows:

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change		12/11 <sup>(a)</sup>			
	2013	2012	2011	13/12	Related to Foreign	Operational	Total	Related to Foreign	Operational
U.S.									
Livestock	\$1,034	\$966	\$904	7	—	7	7	—	7
Companion animal	868	810	755	7	—	7	7	—	7
	1,902	1,776	1,659	7	—	7	7	—	7
EuAfME									
Livestock	777	740	777	5	1	4	(5)	(7)	2
Companion animal	391	356	367	10	2	8	(3)	(7)	4
	1,168	1,096	1,144	7	1	6	(4)	(7)	3
CLAR									
Livestock	605	603	630	—	(6)	6	(4)	(8)	4
Companion animal	173	166	158	4	(5)	9	5	(7)	12
	778	769	788	1	(5)	6	(2)	(7)	5
APAC									
Livestock	515	497	467	4	(4)	8	6	(2)	8
Companion animal	198	198	175	—	(7)	7	13	—	13
	713	695	642	3	(4)	7	8	(1)	9
Total									
Livestock	2,931	2,806	2,778	4	(2)	6	1	(4)	5
Companion animal	1,630	1,530	1,455	7	(1)	8	5	(3)	8
	\$4,561	\$4,336	\$4,233	5	(2)	7	2	(4)	6

Certain amounts and percentages may reflect rounding adjustments.

(a) The total operational growth includes an increase of 1% in 2012 versus 2011 due to the acquisition of KAH, acquired by Pfizer on January 31, 2011.

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

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change 13/12		% Change 12/11			
	2013	2012	2011	Total	Related to Exchange	Operational	Total	Related to Exchange	Operational
U.S.	\$ 1,045	\$ 921	\$ 820	13	—	13	12	—	12
EuAfME	420	375	365	12	1	11	3	(6)	)9
CLAR	266	253	275	5	(11	)16	(8	)14	)6
APAC	271	236	196	15	(3	)18	20	2	18
Total reportable segments	2,002	1,785	1,656	12	(2	)14	8	(3	)11
Other business activities	(320	)(275	)(279	) 16			(1	)	
Reconciling Items:									
Corporate	(567	)(506	)(504	) 12			—		
Purchase accounting adjustments	(48	)(52	)(82	) (8	)		(37	)	
Acquisition-related costs	(22	)(53	)(122	) (58	)		(57	)	
Certain significant items	(240	)(96	)(172	) *			(44	)	
Other unallocated	(115	)(93	)(103	) 24			(10	)	
Income before income taxes	\$ 690	\$ 710	\$ 394	(3	)		80		

\* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

2013 vs. 2012

U.S. operating segment

U.S. segment revenue increased by \$126 million, or 7%, 2013 compared to 2012, of which approximately \$68 million resulted from growth in livestock products and approximately \$58 million resulted from growth in companion animal products.

Livestock revenue growth was achieved in all species. The growth in swine products was due to continued customer acceptance of new products and the successful execution of marketing programs developed for and focused on specific brands, therapeutic categories or customer segments. Growth in sales of poultry products was due to growth in medicated feed additives, and growth in sales of cattle products was driven by improved market conditions in the second half of 2013.

Companion animal revenue growth was driven by solid growth in small animal products reflecting the benefit of realigning our field force in late 2012 to more effectively cover our customer base, the positive outcomes of new cross-portfolio pricing programs, and price increases. Growth was slightly offset by a decline in the sales of equine products reflecting a continuing contraction of the market.

U.S. segment earnings increased by \$124 million, or 13%, in 2013 compared to 2012 due to strong revenue growth and improved gross margin due to the benefit of higher prices and favorable product mix. Segment earnings growth also benefited from limited growth in operating expenses.

EuAfME operating segment

EuAfME segment revenue increased by \$72 million, or 7%, in 2013 compared to 2012. Operational revenue growth was \$61 million, or 6%, of which approximately \$32 million resulted from growth in livestock products and \$29

million resulted from growth in companion animal products.

Livestock revenue growth was primarily driven by emerging markets, particularly Russia. Additionally, growth in swine products was favorably impacted by the launch of a new swine vaccine (that prevents porcine circovirus type 2) across many markets in the region, particularly in Germany and Russia. This growth was partially offset by continuing challenging market conditions throughout Western Europe affecting the cattle portfolio.

Companion animal revenue growth was favorably impacted by increased sales of products that are related to certain third party manufacturing agreements. Additionally, sales in the UK and France increased due to the benefit of increased promotional programs. Results were partially offset by continuing adverse macroeconomic conditions throughout Western Europe.

Additionally, segment revenue was favorably impacted by foreign exchange, which increased revenue by approximately \$11 million, or 1%.

EuAfME segment earnings increased by \$45 million, or 12%, in 2013 compared to 2012. Operational earnings growth was \$41 million, or 11%, primarily driven by revenue growth and increased operating efficiencies.

#### CLAR operating segment

CLAR segment revenue increased by \$9 million, or 1%, in 2013 compared to 2012. Operational revenue growth was \$49 million, or 6%, of which approximately \$35 million resulted from growth in livestock products and \$14 million resulted from growth in companion animal product sales.

Livestock revenue growth was primarily driven by increased sales in the poultry and cattle portfolios. Growth in sales of poultry products was primarily driven by higher sales of medicated feed additives in Brazil. Increased cattle product sales were primarily due to growth in Mexico, Canada and Venezuela. This growth was partially offset by challenging market conditions affecting the cattle market in Brazil, where sales were relatively flat primarily due to increased local competition and drought conditions in certain areas of the country.

Companion animal growth was favorably impacted by an increasing companion animal market in Brazil and marketing programs in Brazil and Mexico. Gains were partially offset by lower sales of equine products as a result of a reduced number of horses in Canada.

Additionally, segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$40 million, or 5%.

CLAR segment earnings increased by \$13 million, or 5%, in 2013 compared to 2012. Operational earnings growth was \$40 million, or 16%, in 2013 compared to 2012, primarily driven by revenue growth and favorable product mix. The unfavorable foreign exchange impact was driven by the depreciation of the Brazilian Real as well as the devaluation of the Venezuela Bolivar which occurred in the first quarter of 2013.

#### APAC operating segment

APAC segment revenue increased by \$18 million, or 3%, in 2013 compared to 2012. Operational revenue growth was \$52 million, or 7%, of which approximately \$38 million resulted from growth in livestock products and approximately \$14 million resulted from growth in companion animal products.

Livestock revenue growth was driven primarily by increased sales in emerging markets across swine, poultry and cattle. Growth in sales of swine products was driven by higher demand and market penetration in China, as well as good performance in Japan which benefited from recently launched vaccines. Growth in the poultry and cattle portfolios was primarily driven by increased sales in India. Results were tempered by flat growth in Australia and New Zealand due to the impact of prolonged drought conditions on cattle and sheep herd sizes.

Companion animal revenue growth was primarily due to the successful launch of new products in Japan. Results were partially offset by declines in equine product sales in Australia due to increased competition.

Additionally, segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$34 million, or 4%.

APAC segment earnings increased by \$35 million, or 15%, in 2013 compared to 2012. Operational earnings growth was \$42 million, or 18%, in 2013 compared to 2012, primarily due to increased revenue and lower operating expenses, partially offset by the unfavorable impact of geographic and product mix.

#### 2012 vs. 2011

##### U.S. operating segment

U.S. segment revenue increased by \$117 million, or 7%, in 2012 compared 2011, of which approximately \$62 million resulted from growth in livestock products and approximately \$55 million resulted from growth in companion animal products.

Livestock product revenue growth was due principally to increased demand for premium anti-infectives in cattle as a result of continued acceptance of our products based on superior efficacy, supported by economic outcomes studies.

There was also increased demand for medicated feed additives in swine, which was partially due to increased incidence of enteric infections in late stage pigs. Additionally, revenue growth was positively impacted by our entry into a new market with the launch of an improved formulation of a swine vaccine that prevents porcine circovirus type 2. This revenue growth was partially offset by the impact of the drought in the United States.

Companion animal product revenue growth was driven by parasiticides, benefiting from an extended flea and tick season caused by unusually warm weather and by a temporary competitor supply disruption. Companion animal products also benefited from continued growth in canine vaccines and the success of targeted marketing efforts for anti-infectives and other pharmaceutical products.

U.S. segment earnings increased by \$101 million, or 12%, in 2012 compared to 2011 as a result of strong revenue growth.

EuAfME operating segment

EuAfME segment revenue decreased by \$48 million, or 4%, in 2012 compared to 2011. Operational revenue growth was \$29 million, or 3%, of which approximately \$16 million resulted from growth in livestock products and approximately \$13 million resulted from growth in companion animal products.

Livestock product revenue growth was driven by strong demand for cattle parasiticides, particularly in France and the UK, along with a continued growing demand for animal proteins in emerging markets. Additionally, the poultry product portfolio grew due to

expansion into emerging markets. Results were partially offset by continued adverse macroeconomic conditions throughout Western Europe and pressure from the ongoing restrictions on the use of certain antibacterials. Companion animal product revenue was favorably impacted by parasiticides and the launch of new branded generic products throughout the region. Revenue was also favorably impacted by equine vaccines due to a temporary competitor supply disruption. Results were partially offset by continued adverse macroeconomic conditions throughout Western Europe.

Additionally, segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$77 million, or 7%.

EuAfME segment earnings increased by \$10 million, or 3%, in 2012 compared to 2011. Operational earnings growth was \$33 million, or 9%, primarily due to increased operating efficiencies.

#### CLAR operating segment

CLAR segment revenue decreased by \$19 million, or 2% in 2012 compared to 2011. Operational revenue growth was \$42 million, or 5%, of which approximately \$23 million resulted from growth in livestock products, and approximately \$19 million resulted from growth in companion animal product sales.

Livestock product revenue was favorably impacted by the launch of an improved formulation of a swine vaccine that prevents porcine circovirus type 2. Swine vaccines also benefited from continued demand in South America for Improvac/Improvect, a product that reduces boar taint without the need for surgical castration. Additionally, marketing initiatives focused on legacy KAH products drove increased demand for poultry medicated feed additives in Brazil. Results were partially offset by the slowdown of the cattle market in Brazil due to increased competition and reduced margins for cattle producers. Additionally, certain markets within the region were impacted by the North American drought.

Companion animal product revenue growth was attributable to canine vaccines especially in Brazil. Parasiticides performed well across the region, particularly in Canada due to a temporary competitor supply disruption and an extended flea and tick season caused by unusually warm weather.

Additionally, segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$61 million, or 7%.

CLAR segment earnings declined by \$22 million, or 8% in 2012 compared to 2011. Operational earnings growth was \$16 million, or 6%, primarily due to revenue growth, partially offset by a charge related to bad debt.

#### APAC operating segment

APAC segment revenue increased by \$53 million, or 8%, in 2012 compared to 2011. Operational revenue growth was \$61 million, or 9%, of which approximately \$38 million resulted from growth in livestock products and approximately \$23 million resulted from growth in companion animal products.

Livestock product revenue was favorably impacted by the launch of an improved formulation of a swine vaccine that prevents porcine circovirus type 2, particularly in South East Asia, as well as growth in China, Australia and Japan. Increased sales force presence in China drove growth in premium priced swine products. Australia experienced growth in the dairy cattle segment due to higher sales of intramammary products. Revenue in Japan was also driven by broad growth in the poultry portfolio.

Companion animal product revenue benefited from promotional campaigns in Japan and the resulting increased adoption of our products into veterinarian treatment protocols. Australia benefited from growth in parasiticides as a result of focused sales force efforts that drove demand for these products. China experienced growth in canine vaccines due to expansion of the sales organization.

Additionally, segment revenue was unfavorably impacted by foreign exchange, which decreased revenue by approximately \$8 million, or 1%.

APAC segment earnings increased by \$40 million, or 20%, in 2012 compared to 2011. Operational earnings growth was \$36 million, or 18%, primarily due to strong revenue growth, partially offset by increased expenses due to field force expansion.

#### Other business activities

Other business activities includes expenses associated with our dedicated veterinary medicine research and development (R&D) organization, research alliances, U.S regulatory affairs and other operations focused on the

development of our products. Other R&D-related costs associated with non-U.S. market clinical trials and regulatory activities are generally included in the respective regional segment.

2013 vs. 2012

Other business activities expenses increased by \$45 million, or 16%, in 2013 compared to 2012. The increase reflects approximately \$38 million in comparable R&D expenses in 2012 previously presented as a component of Corporate and currently presented as Other business activities.

2012 vs. 2011

Other business activities expenses decreased by \$4 million, or 1%, in 2012 compared to 2011.

49 |

---

#### Reconciling items

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

Corporate, which includes costs associated with business technology, facilities, legal, finance, human resources, business development, public affairs and procurement, among others. These costs also include compensation costs and other miscellaneous operating expenses not charged to our operating segments, as well as interest income and expense;

Certain transactions and events such as (i) Purchase accounting adjustments, which includes expenses associated with the amortization of fair value adjustments to inventory, intangible assets and property, plant and equipment; (ii) Acquisition-related activities, which includes costs for restructuring and integration; and (iii) Certain significant items, which includes non-acquisition-related restructuring charges, certain asset impairment charges and costs associated with cost reduction/productivity initiatives; and

Other unallocated, which includes certain overhead expenses associated with our manufacturing operations not charged to our operating segments.

See Adjusted net income of this MD&A and Notes to Consolidated and Combined Financial Statements—Note 18. Segment, Geographic and Other Revenue Information for further information.

#### Adjusted net income

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

Adjusted net income is an alternative view of performance used by management, and we believe that investors' understanding of our performance is enhanced by disclosing this performance measure. We report adjusted net income to portray the results of our major operations, the discovery, development, manufacture and commercialization of our products, prior to considering certain income statement elements. We have defined adjusted net income as net income attributable to Zoetis before the impact of purchase accounting adjustments, acquisition-related costs and certain significant items. The adjusted net income measure is not, and should not be viewed as, a substitute for U.S. GAAP reported net income attributable to Zoetis.

The adjusted net income measure is an important internal measurement for us. We measure our overall performance on this basis in conjunction with other performance metrics. The following are examples of how the adjusted net income measure is utilized:

senior management receives a monthly analysis of our operating results that is prepared on an adjusted net income basis;

our annual budgets are prepared on an adjusted net income basis; and

other goal setting and performance measurements.

Despite the importance of this measure to management in goal setting and performance measurement, adjusted net income is a non-GAAP financial measure that has no standardized meaning prescribed by U.S. GAAP and, therefore, has limits in its usefulness to investors. Because of its non-standardized definition, adjusted net income, unlike U.S. GAAP net income, may not be comparable to the calculation of similar measures of other companies. Adjusted net income is presented to permit investors to more fully understand how management assesses performance.

We also recognize that, as an internal measure of performance, the adjusted net income measure has limitations, and we do not restrict our performance management process solely to this metric. A limitation of the adjusted net income measure is that it provides a view of our operations without including all events during a period, such as the effects of an acquisition or amortization of purchased intangibles, and does not provide a comparable view of our performance to other companies. We also use other specifically tailored tools designed to achieve the highest levels of performance.

#### Purchase accounting adjustments

Adjusted net income is calculated prior to considering certain significant purchase accounting impacts that result from business combinations and net asset acquisitions. These impacts, primarily associated with the Pharmacia Animal Health business (acquired in 2003), FDAH (acquired in 2009) and KAH (acquired in 2011), include the incremental charge to cost of sales from the sale of acquired inventory that was written up to fair value, amortization related to the increase in fair value of the acquired finite-lived intangible assets and depreciation related to the increase/decrease to



fair value of the acquired fixed assets. Therefore, the adjusted net income measure includes the revenue earned upon the sale of the acquired products without considering the aforementioned significant charges.

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

A completely accurate comparison of internally developed intangible assets and acquired intangible assets cannot be achieved through adjusted net income. These components of adjusted net income are derived solely from the impact of the items listed above. We have not factored in the impact of any other differences in experience that might have occurred if we had discovered and developed those intangible assets on our own, and this approach does not intend to be representative of the results that would have occurred in those circumstances. For example, our R&D costs in total, and in the periods presented, may have been different; our speed to commercialization and resulting revenue, if any, may have been different; or our costs to manufacture may have been different. In addition, our marketing efforts may have been received differently by

Table of Contents

our customers. As such, in total, there can be no assurance that our adjusted net income amounts would have been the same as presented had we discovered and developed the acquired intangible assets.

Acquisition-related costs

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

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

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

Certain significant items

Adjusted net income is calculated prior to considering certain significant items. Certain significant items represent substantive, unusual items that are evaluated on an individual basis. Such evaluation considers both the quantitative and the qualitative aspect of their unusual nature. Unusual, in this context, may represent items that are not part of our ongoing business; items that, either as a result of their nature or size, we would not expect to occur as part of our normal business on a regular basis; items that would be nonrecurring; or items that relate to products that we no longer sell. While not all-inclusive, examples of items that could be included as certain significant items would be costs related to becoming an independent public company, a major non-acquisition-related restructuring charge and associated implementation costs for a program that is specific in nature with a defined term, such as those related to our non-acquisition-related cost-reduction and productivity initiatives; amounts related to disposals of products or facilities that do not qualify as discontinued operations as defined by U.S. GAAP; certain intangible asset impairments; adjustments related to the resolution of certain tax positions; the impact of adopting certain significant, event-driven tax legislation; or charges related to legal matters. See Notes to Consolidated and Combined Financial Statements—Note 17. Commitments and Contingencies. Our normal, ongoing defense costs or settlements of and accruals on legal matters made in the normal course of our business would not be considered certain significant items.

Reconciliation

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

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
GAAP Reported net income attributable to Zoetis	\$504	\$436	\$245	16	78
Purchase accounting adjustments—net of tax	32	35	55	(9	) (36
Acquisition-related costs—net of tax	14	34	78	(59	) (56
Certain significant items—net of tax	159	34	125	*	(73
Non-GAAP adjusted net income <sup>(a)</sup>	\$709	\$539	\$503	32	7

\* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

<sup>(a)</sup> The effective tax rate on adjusted pretax income is 29.2%, 40.8% and 34.3% for full year 2013, 2012 and 2011, respectively. The lower effective tax rate in 2013 compared to 2012 is primarily due to incentive tax rulings in

Belgium, effective December 1, 2012, and Singapore, effective October 29, 2012, as well as changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs. In addition, we recognized a \$2 million discrete income tax benefit during the first quarter of 2013 related to the 2012 U.S. Research and Development Tax Credit which was retroactively extended on January 3, 2013. The higher effective tax rate in 2012 compared to 2011 is due to an increase in tax cost related to changes in uncertain tax positions, the non-recurrence of approximately \$9.5 million in tax benefits, representing tax and interest, which were recorded as a result of a favorable tax audit settlement pertaining to prior years, and the expiration of the U.S. Research and Development Tax Credit, partially offset by international tax benefits of approximately \$2.7 million, representing tax and interest, resulting from the resolution of certain tax positions pertaining to prior years with various foreign tax authorities and from the expiration of certain statutes of limitations.

Table of Contents

The following table provides a reconciliation of reported diluted earnings per share (EPS), as reported under U.S. GAAP, and non-GAAP adjusted diluted EPS:

	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Earnings per share—diluted <sup>(a)(b)</sup> :					
GAAP Reported net income attributable to Zoetis	\$1.01	\$0.87	\$0.49	16	78
Purchase accounting adjustments—net of tax	0.06	0.07	0.11	(14	) (36
Acquisition-related costs—net of tax	0.03	0.07	0.16	(57	) (56
Certain significant items—net of tax	0.32	0.07	0.25	*	(72
Non-GAAP adjusted net income	\$1.42	\$1.08	\$1.01	31	7

\* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

The weighted-average shares outstanding for diluted earnings per share for the period prior to the IPO was calculated using an aggregate of 500 million shares of common stock outstanding, which was the number of Zoetis

<sup>(a)</sup> Inc. shares outstanding immediately prior to the IPO. For the year ended December 31, 2013, diluted earnings per share was computed using the weighted-average common shares outstanding during the period plus the common stock equivalents related to stock options, RSUs and DSUs.

<sup>(b)</sup> EPS amounts may not add due to rounding.

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

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011
Interest	\$113	\$31	\$36
Taxes	292	372	264
Depreciation	138	119	117
Amortization	17	18	20

Table of Contents

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

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011
Purchase accounting adjustments:			
Amortization and depreciation <sup>(a)</sup>	\$46	\$48	\$48
Cost of sales <sup>(b)</sup>	2	4	34
Total purchase accounting adjustments—pretax	48	52	82
Income taxes <sup>(c)</sup>	16	17	27
Total purchase accounting adjustments—net of tax	32	35	55
Acquisition-related costs <sup>(d)</sup> :			
Transaction costs <sup>(e)</sup>	—	—	2
Integration costs <sup>(e)</sup>	22	47	71
Restructuring charges <sup>(e)</sup>	—	(4	) 41
Additional depreciation—asset restructuring	—	10	8
Total acquisition-related costs—pretax	22	53	122
Income taxes <sup>(c)</sup>	8	19	44
Total acquisition-related costs—net of tax	14	34	78
Certain significant items <sup>(g)</sup> :			
Restructuring charges (benefits) <sup>(h)</sup>	(20	) 92	40
Implementation costs and additional depreciation--asset restructuring <sup>(f)</sup>	8	23	22
Certain asset impairment charges <sup>(i)</sup>	20	—	69
Inventory write-off (in Cost of sales)	—	—	12
Net gains on sale of assets <sup>(j)</sup>	(6	) —	—
Stand-up costs <sup>(k)</sup>	206	—	—
Inventory and intercompany account write-offs <sup>(l)</sup>	24	—	—
Other <sup>(m)</sup>	8	(19	) 29
Total certain significant items—pretax	240	96	172
Income taxes <sup>(c)</sup>	81	62	47
Total certain significant items—net of tax	159	34	125
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	\$205	\$103	\$258

Certain amounts may reflect rounding adjustments.

Amortization and depreciation expense related to purchase accounting adjustments with respect to identifiable intangible assets and property, plant and equipment were distributed as follows in 2013, 2012 and 2011,

(a) respectively: \$46 million, \$49 million and \$49 million included in Amortization of intangible assets; \$1 million income, \$1 million income and \$2 million income included in Selling, general and administrative expenses; and \$1 million, \$0 million and \$1 million included in Research and development expenses.

(b) Depreciation expense included in Cost of sales. Also includes fair value adjustments of acquired inventory of \$24 million in 2011.

(c) Included in Provision for taxes on income.

Acquisition-related costs were distributed as follows in 2013, 2012 and 2011, respectively: \$0 million, \$9 million and \$6 million included in Cost of sales; \$0 million, \$1 million and \$3 million included in Selling, general and

(d) administrative expenses; \$22 million, \$43 million and \$114 million included in Restructuring charges and certain acquisition-related costs; and \$0 million, \$0 million and \$1 million income included in Other (income)/deductions—net.

Included in Restructuring charges and certain acquisition-related costs. See Notes to Consolidated and Combined

(e) Financial Statements—Note 6. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives for more information.

Amounts primarily relate to our cost-reduction/productivity initiatives and other asset restructuring. See Notes to Consolidated and Combined Financial Statements—Note 6. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives.

(f) Certain significant items were distributed as follows in 2013, 2012 and 2011, respectively: \$42 million, \$1 million and \$31 million included in Cost of sales; \$188 million, \$18 million and \$5 million included in Selling, general and administrative expenses; \$7 million, \$10 million and \$19 million included in Research and development expenses; \$4 million, \$92 million and \$40 million, included in Restructuring charges and certain acquisition-related costs; and \$1 million income, \$25 million income and \$77 million included in Other (income)/deductions—net.

(g) Represents restructuring charges incurred for our cost-reduction/productivity initiatives. The restructuring benefit in the year ended December 31, 2013 is primarily due to a \$27 million decrease in employee termination expenses related to the reversal of a previously established termination reserve related to our operations in Europe. Included in Restructuring charges and certain acquisition-related costs. See Notes to Consolidated and Combined Financial Statements—Note 6. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives for more information.

(h) Asset impairment charges primarily related to restructuring initiatives in 2013 and were distributed as follows in 2013, 2012 and 2011: \$19 million, \$0 million and \$0 million included in Restructuring charges and certain acquisition-related costs and \$1 million, \$0 million and \$69 million included in Other (income)/deductions—net. See Notes to Consolidated and Combined Financial Statements—Note 6. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives and Note 7. Other (Income)/Deductions—Net for more information.

Table of Contents

Represents the net gain on the government-mandated sale of certain product rights in Brazil in 2013 that were (i) acquired with the FDAH acquisition in 2009. Included in Other (income)/deductions—net. See Notes to Consolidated and Combined Financial Statements—Note 7. Other (Income)/Deductions—Net for more information.

Certain non-recurring costs related to becoming an independent public company, such as new branding (including changes to the manufacturing process for required new packaging), the creation of standalone systems and (k) infrastructure, site separation, accelerated vesting and associated cash payment related to certain Pfizer equity awards, and certain legal registration and patent assignment costs which were distributed as follows in 2013: \$21 million included in Cost of sales; \$177 million included in Selling, general and administrative expenses, \$7 million included in Research and development expenses, and \$1 million included in Other (income)/deductions—net.

Amounts relate to write-offs of inventory and intercompany accounts that were transferred to us as part of the Separation from Pfizer and were distributed as follows: \$19 million included in Cost of sales and \$5 million (l) included in Selling, general and administrative expenses. Because these expenses relate primarily to the periods prior to our initial public offering, we do not consider them to be reflective of our current operations and we have therefore, excluded them from our Adjusted earnings non-GAAP measure. Although fully written off in the current period, all of the adjustments relate back several years.

For 2013, primarily relates to litigation-related charges (\$5 million) and charges related to transitional manufacturing purchase agreements associated with divestitures (\$1 million). For 2012, primarily relates to income related to a favorable legal settlement for an intellectual property matter (\$14 million) and income due to a (m) change in estimate related to transitional manufacturing purchase agreements associated with divestitures (\$4 million). See Notes to Consolidated and Combined Financial Statements—Note 7. Other (Income)/Deductions—Net for more information. For 2011, primarily all reflected charges are related to transitional manufacturing purchase agreements associated with divestitures. See Notes to Consolidated and Combined Financial Statements—Note 5.

Acquisitions, Divestitures and Certain Investments for more information.

Our financial guidance for 2014

Our 2014 financial guidance is summarized below:

Selected Line Items

Revenue	\$4,650 to \$4,750 million
Adjusted cost of sales as a percentage of revenue <sup>(a)</sup>	Approximately 35.5%
Adjusted SG&A expenses <sup>(a)</sup>	\$1,430 to \$1,480 million
Adjusted R&D expenses <sup>(a)</sup>	\$390 to \$405 million
Adjusted interest expense and other (income)/deductions <sup>(a)</sup>	Approximately \$105 million
Effective tax rate on adjusted income <sup>(a)</sup>	Approximately 29%
Adjusted diluted EPS <sup>(a)</sup>	\$1.48 to \$1.54
Certain significant items <sup>(b)</sup> and acquisition-related costs	\$165 to \$185 million
Reported diluted EPS	\$1.15 to \$1.21

(a) For an understanding of adjusted net income and its components, see the Adjusted net income section of this MD&A.

(b) Includes certain nonrecurring costs related to becoming an independent public company, such as new branding (including changes to the manufacturing process for required new packaging), the creation of standalone systems and infrastructure, site separation and certain legal registration and patent assignment costs.

Full year 2014 guidance reflects late January 2014 exchange rates.

A reconciliation of 2014 adjusted net income and adjusted diluted EPS guidance to 2014 reported net income attributable to Zoetis and reported diluted EPS attributable to Zoetis common shareholders guidance follows:

(MILLION OF DOLLARS, EXCEPT PER SHARE AMOUNTS)	Full-Year 2014 Guidance	
	Net Income	Diluted EPS
Adjusted net income/diluted EPS <sup>(a)</sup> guidance	~\$740 - \$770	~\$1.48 - \$1.54
Purchase accounting adjustments	~(30)	~(0.06)

Certain significant items <sup>(b)</sup> and acquisition-related costs	~(125 - 140)	~(0.25 - 0.28)
Reported net income attributable to Zoetis Inc./diluted EPS guidance	~\$580 - \$610	~\$1.15 - \$1.21

(a) For an understanding of adjusted net income, see the Adjusted net income section of this MD&A.

Includes certain nonrecurring costs related to becoming an independent public company, such as new branding

(b) (including changes to the manufacturing process for required new packaging), the creation of standalone systems and infrastructure, site separation and certain legal registration and patent assignment costs.

Our 2014 financial guidance is subject to a number of factors and uncertainties—as described in the Forward-looking information and factors that may affect future results, Our operating environment and Our growth strategies of this MD&A and in Part I, Item 1A. Risk Factors.

Analysis of the consolidated and combined statements of comprehensive income

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



Table of Contents

Analysis of the consolidated and combined balance sheets

December 31, 2013 vs. December 31, 2012

For a discussion about the changes in Cash and cash equivalents, Short-term borrowing, including current portion of allocated long term debt, and Long-term debt, see Analysis of financial condition, liquidity and capital resources below.

Accounts receivable, less allowance for doubtful accounts increased as a result of operational increases due to higher net sales and accounts receivable from Pfizer in 2013 as a result of Pfizer no longer being a related party. See Notes to Consolidated and Combined Financial Statements— Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Adjustments Associated with the Separation.

Inventories decreased primarily as a result of Separation Adjustments. See Notes to Consolidated and Combined Financial Statements— Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Adjustments Associated with the Separation and Note 11. Inventories. The net changes in Current deferred tax assets, Noncurrent deferred tax assets, Noncurrent deferred tax liabilities and Other taxes payable primarily reflect Separation Adjustments. See Notes to Consolidated and Combined Financial Statements— Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Adjustments Associated with the Separation and Note 8. Tax Matters.

Property, plant and equipment, less accumulated depreciation increased slightly. Operational activity (depreciation and capital spending) was partially offset by Separation Adjustments. See Notes to Consolidated and Combined Financial Statements— Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Adjustments Associated with the Separation.

Accrued Compensation and related items increased primarily due to increases in sales-related bonus accruals and accrued employee savings plan contributions. See Notes to Consolidated and Combined Financial Statements— Note 14C. Benefit Plans: Defined Contribution Plans.

Dividends payable relate to the dividend declared on December 18, 2013.

Long-term debt reflects the senior notes offering. See Notes to Consolidated and Combined Financial Statements— Note 2C. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Senior Notes Offering and Note 10A. Financial Instruments: Debt.

Allocated long-term debt decreased as a result of Separation Adjustments. See Notes to Consolidated and Combined Financial Statements— Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Adjustments Associated with the Separation.

Other noncurrent liabilities increased as a result of Separation Adjustments. See Notes to Consolidated and Combined Financial Statements— Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: Adjustments Associated with the Separation.

For an analysis of the changes in Total Equity, see the Consolidated and Combined Statements of Equity.

Analysis of the consolidated and combined statements of cash flows

(MILLIONS OF DOLLARS)	Year Ended December 31,			% Change	
	2013	2012	2011	13/12	12/11
Cash provided by/(used in):					
Operating activities	\$681	\$454	\$497	50	(9 )
Investing activities	(179 )	(135 )	(449 )	33	(70 )
Financing activities	(200 )	(78 )	(30 )	*	*
Effect of exchange-rate changes on cash and cash equivalents	(9 )	(3 )	(2 )	*	50
Net increase in cash and cash equivalents	\$293	\$238	\$16	23	*

Certain amounts and percentages may reflect rounding adjustments.

\* Calculation not meaningful.

Operating activities

2013 vs. 2012

Net cash provided by operating activities was \$681 million in 2013 compared with \$454 million in 2012 and was primarily attributable to income before allocation to non-controlling interests, as adjusted for depreciation and amortization. The net change in operating assets and liabilities, net of acquisitions and divestitures and transfers with Pfizer, was primarily driven by an increase in other liabilities, reflecting higher accrued interest on long-term debt and higher accrued compensation, partially offset by higher inventory levels. In addition, net cash provided by operating activities was impacted by the timing and of receipts and payments in the ordinary course of business.

55 |

---

2012 vs. 2011

Net cash provided by operating activities was \$454 million in 2012 compared with \$497 million in 2011. This decrease in operating cash flows was primarily attributable to higher inventory balances due to increased demand, achieving higher targeted inventory levels for certain products and changes in our supply points, partially offset by the timing of receipts and payments in the ordinary course of business.

Investing activities

2013 vs. 2012

Net cash used in investing activities was \$179 million in 2013 compared to \$135 million in 2012 primarily due to increased capital investment in property, plant and equipment.

2012 vs. 2011

Net cash used in investing activities was \$135 million in 2012 compared to \$449 million in 2011. In 2011, Pfizer acquired KAH for \$345 million in cash. See Notes to Consolidated and Combined Financial Statements—Note 5A. Acquisitions, Divestitures and Certain Investments—Acquisition of King Animal Health.

Financing activities

2013 vs. 2012

Net cash used in financing activities was \$200 million in 2013 compared to \$78 million in 2012. The increase in net cash used in financing activities was primarily attributable to:

- the net transfers to Pfizer as a result of the IPO; and

- an increase in cash dividends paid,

partially offset by:

- net proceeds from long-term and short-term borrowings.

2012 vs. 2011

Net cash used in financing activities was \$78 million in 2012, compared to \$30 million in 2011. The increase in net cash used in financing activities was primarily attributable to:

- a decrease in net financing from Pfizer,

partially offset by:

- a decrease in cash dividends paid and a decrease in allocated principal payments on long-term debt.

Analysis of financial condition, liquidity and capital resources

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

As global financial markets continue their slow and sometimes uneven recovery from the 2008/2009 recession, additional macroeconomic, business and financial volatility may persist. As markets change, we will continue to monitor our liquidity position, but there can be no assurance that a challenging economic environment or an economic downturn will not impact our liquidity or our ability to obtain future financing.

Selected measures of liquidity and capital resources

Certain relevant measures of our liquidity and capital resources follow:

(MILLIONS OF DOLLARS)	December 31, 2013	December 31, 2012
Cash and cash equivalents <sup>(a)</sup>	\$610	\$317
Accounts receivable, net <sup>(b)</sup>	1,138	900
Short-term borrowings, including current portion of allocated long-term debt in 2012 <sup>(c)</sup>	15	73
Allocated long-term debt <sup>(c)</sup>	—	509
Long-term debt <sup>(d)</sup>	3,642	—
Working capital	1,942	1,741
Ratio of current assets to current liabilities	2.37:1	2.55:1

<sup>(a)</sup> Prior to our IPO, we participated in Pfizer's centralized cash management system, and generally all of our excess cash was transferred to Pfizer on a daily basis. Cash disbursements for operations and/or investing activities were

funded, as needed, by Pfizer.

561

---

Table of Contents

Accounts receivable are usually collected over a period of 60 to 90 days. For the year ended December 31, 2013 compared to the year ended December 31, 2012, the number of days that accounts receivables are outstanding remained approximately the same, excluding receivables from Pfizer, which were not reflected in our accounts receivable balances at December 31, 2012. We regularly monitor our accounts receivable for collectability, particularly in markets where economic conditions remain uncertain. We believe that our allowance for doubtful accounts is appropriate. Our assessment is based on such factors as past due aging, historical and expected collection patterns, the financial condition of our customers, the robust nature of our credit and collection practices and the economic environment.

The combined financial statements for December 31, 2012 include an allocation of long-term debt from Pfizer that was issued to partially finance the acquisition of Wyeth (including FDAH). The debt has been allocated on a pro-rata basis using the deemed acquisition cost of FDAH as a percentage of the total acquisition cost of Wyeth. After the IPO, Pfizer retained the allocated debt.

Primarily consists of \$3.65 billion aggregate principal amount of our senior notes, with an original issue discount of \$10 million. The senior notes are comprised of \$400 million aggregate principal amount of our 1.150% senior notes due 2016, \$750 million aggregate principal amount of our 1.875% senior notes due 2018, \$1.35 billion aggregate principal amount of our 3.250% Senior Notes due 2023 and \$1.15 billion aggregate principal amount of our 4.700% senior notes due 2043.

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

**Credit facility and other lines of credit**

In December 2012, we entered into a revolving credit agreement with a syndicate of banks providing for a five-year \$1.0 billion senior unsecured revolving credit facility, which became effective in February 2013 upon the completion of the IPO and which expires in December 2017. Subject to certain conditions, we have the right to increase the credit facility to up to \$1.5 billion. The credit facility contains a financial covenant requiring us to not exceed a maximum total leverage ratio (the ratio of consolidated net debt as of the end of the period to consolidated Earnings Before Interest, Income Taxes, Depreciation and Amortization (EBITDA) for such period) of 4.35:1 for fiscal year 2013, 3.95:1 for fiscal year 2014, 3.50:1 for fiscal year 2015 and 3.00:1 thereafter. The credit facility also contains a financial covenant requiring that we maintain a minimum interest coverage ratio (the ratio of EBITDA at the end of the period to interest expense for such period) of 3.50:1. In addition, the credit facility contains other customary covenants. We were in compliance with all financial covenants as of December 31, 2013. There were no borrowings outstanding as of December 31, 2013.

We have additional lines of credit with a group of banks and other financial intermediaries for general corporate purposes. We maintain cash and cash equivalent balances in excess of our outstanding short-term borrowings. As of December 31, 2013, we had access to \$69 million of lines of credit which expire at various times through 2016. As of December 31, 2013 we had \$15 million of short-term borrowings outstanding and \$2 million of long-term borrowings outstanding related to these facilities.

**Domestic and international short-term funds**

Many of our operations are conducted outside the United States. The amount of funds held in U.S. tax jurisdictions will fluctuate due to the timing of receipts and payments in the ordinary course of business and due to other reasons, such as business development activities. As part of our ongoing liquidity assessments, we regularly monitor the mix of domestic and international cash flows (both inflows and outflows). Repatriation of overseas funds can result in additional United States, federal, state and local income tax payments. We record U.S. deferred tax liabilities for certain unremitted earnings, but when amounts earned overseas are expected to be indefinitely reinvested outside the United States, no accrual for U.S. taxes is provided.

**Global economic conditions**

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

challenging economic environment or a further economic downturn would not impact our ability to obtain financing in the future.

Contractual obligations

Payments due under contractual obligations as of December 31, 2013 are set forth below:

(MILLIONS OF DOLLARS)	Total	2014	2015- 2016	2017- 2018	There- after
Long-term debt, including current portion and interest obligations <sup>(a)</sup>	\$5,742	\$117	\$630	\$962	\$4,033
Other long-term liabilities reflected on our consolidated and combined balance sheets under U.S. GAAP <sup>(b)</sup>	50	17	1	1	31
Operating lease commitments	67	18	26	13	10
Purchase obligations and other <sup>(c)</sup>	66	16	18	13	19
Benefit plans - continuing service credit obligations <sup>(d)</sup>	34	4	8	8	14
Uncertain tax positions <sup>(e)</sup>	—	—	—	—	—

Certain amounts may reflect rounding adjustments.

Long-term debt consists of senior notes and other notes. Our calculations of expected interest payments incorporate

<sup>(a)</sup> only current period assumptions for interest rates, foreign currency translation rates and Zoetis hedging strategies, see Notes to Consolidated and Combined Financial Statements—Note 10A. Financial Instruments—Debt.

<sup>(b)</sup> Includes expected payments for an obligation associated with a development and commercialization agreement, expected payments related to our unfunded U.S. supplemental (non-qualified) savings plans, deferred compensation and expected payments relating to our future benefit payments net of plan assets

Table of Contents

(included in the determination of the projected benefit obligation) for pension plans that are dedicated to Zoetis employees in the Netherlands, Germany, India and Korea, and those transferred to us from Pfizer in 2013. Excludes pension obligations associated with certain defined benefit plans outside the United States that Pfizer will transfer to us in 2014 in certain countries as described in the applicable local separation agreement or employee matters agreement. See Notes to Consolidated and Combined Financial Statements—Note 14. Benefit Plans and Note 19B. Transactions and Agreements with Pfizer—Agreements with Pfizer—Employee matters agreement. Excludes approximately \$117 million of noncurrent liabilities related to legal and environmental accruals, employee termination and exit costs, deferred income and other accruals, most of which do not represent contractual obligations. See Notes to Consolidated and Combined Financial Statements—Note 6. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives and Note 17. Commitments and Contingencies.

Includes agreements to purchase goods and services that are enforceable and legally binding and includes amounts (c) relating to advertising, information technology services, employee benefit administration services and potential milestone payments deemed reasonably likely to occur.

Includes the cost of service credit continuation for certain Zoetis employees in the Pfizer U.S. qualified defined (d) benefit pension and U.S. retiree medical plans, in accordance with the employee matters agreement. See Notes to Consolidated and Combined Financial Statements—Note 14. Benefit Plans.

Except for amounts reflected in Income taxes payable, we are unable to predict the timing of tax settlements, as tax (e) audits can involve complex issues and the resolution of those issues may span multiple years, particularly if subject to negotiation or litigation.

The table above excludes amounts for potential milestone payments unless the payments are deemed reasonably likely to occur. Payments under these agreements generally become due and payable only upon the achievement of certain development, regulatory and/or commercialization milestones, which may span several years and/or which may never occur. Our contractual obligations in the table above are not necessarily indicative of our contractual obligations in the future.

Debt

On January 28, 2013, we issued \$3.65 billion aggregate principal amount of our senior notes in a private placement, with an original issue discount of \$10 million. The senior notes are comprised of \$400 million aggregate principal amount of our 1.150% senior notes due 2016, \$750 million aggregate principal amount of our 1.875% senior notes due 2018, \$1.35 billion aggregate principal amount of our 3.250% senior notes due 2023 and \$1.15 billion aggregate principal amount of our 4.700% senior notes due 2043.

We sold \$2.65 billion aggregate principal amount of our senior notes through the initial purchasers in the senior notes offering and Pfizer transferred \$1.0 billion aggregate principal amount of our senior notes to certain of the initial purchasers, who sold such senior notes through the initial purchasers in the senior notes offering. We paid an amount of cash equal to substantially all of the net proceeds that we received in the senior notes offering to Pfizer prior to the completion of the IPO.

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

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

In connection with the senior notes offering, we entered into a registration rights agreement (the Registration Rights Agreement) with the representatives of the initial purchasers of the senior notes. Pursuant to the terms of the Registration Rights Agreement, we were obligated, among other things, to use our commercially reasonable efforts to file a registration statement with the SEC enabling holders of the senior notes to exchange the privately placed notes for publicly registered notes with substantially the same terms. We filed the registration statement with the SEC on September 13, 2013, the SEC declared the registration statement effective on September 24, 2013, and the exchange offer was completed on October 31, 2013.

The components of our long-term debt follow:

Description	Principal Amount	Interest Rate	Terms
Lines of credit	\$2 million	6.400%	Due 2016-2017
2016 Senior Note	\$400 million	1.150%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2016
2018 Senior Note	\$750 million	1.875%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2018
2023 Senior Note	\$1,350 million	3.250%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2023
2043 Senior Note	\$1,150 million	4.700%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2043

#### Credit Ratings

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



Table of Contents

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

Name of Rating Agency	Commercial			Date of Last Action
	Paper Rating	Long-term Debt Rating	Outlook	
Moody's	P-2	Baa2	Stable	January 2013
S&P	A-3	BBB-	Stable	January 2013

**Pension Obligations**

As part of the Separation, Pfizer transferred to us the net pension obligation of \$21 million associated with certain international defined benefit plans in 2013. We expect to contribute a total of approximately \$1 million to the plans in 2014. Also as part of the Separation, a net liability has been recognized for the pension obligations less the fair value of plan assets associated with additional defined benefit pension plans in certain international locations that will be transferred to us in 2014 (approximately \$21 million), in accordance with the applicable local separation agreements or employee matters agreement. We expect to contribute a total of approximately \$7 million to these additional plans in 2014.

Effective December 31, 2012, our employees ceased to participate in the Pfizer U.S. qualified defined benefit and U.S. retiree medical plans, and liabilities associated with our employees under these plans were retained by Pfizer. As part of the Separation, Pfizer is continuing to credit certain employees' service with Zoetis generally through December 31, 2017 (or termination of employment from Zoetis, if earlier) for certain early retirement benefits with respect to Pfizer's U.S. defined benefit pension and retiree medical plans. In connection with the employee matters agreement, Zoetis will be responsible for payment of three-fifths of the total cost of the service credit continuation (approximately \$38 million) for these plans. The amount of the service cost continuation payment to be paid by Zoetis to Pfizer was determined and fixed based on an actuarial assessment of the value of the grow-in benefits and will be paid in equal installments over a period of 10 years.

In 2013, Pfizer transferred to us the U.S. supplemental savings plan liability of approximately \$14 million, cash of \$9 million and a deferred tax asset of \$5 million associated with employees transferred to us as part of the Separation. For additional information, see Notes to Consolidated and Combined Financial Statements—Note 14. Benefit Plans.

**Off-balance sheet arrangements**

In the ordinary course of business and in connection with the sale of assets and businesses, we may indemnify our counterparties against certain liabilities that may arise in connection with a transaction or that are related to activities prior to a transaction. These indemnifications typically pertain to environmental, tax, employee and/or product-related matters, and patent-infringement claims. If the indemnified party were to make a successful claim pursuant to the terms of the indemnification, we would be required to reimburse the loss. These indemnifications are generally subject to threshold amounts, specified claim periods and other restrictions and limitations. Historically, we have not paid significant amounts under these provisions and, as of December 31, 2013 or December 31, 2012, recorded amounts for the estimated fair value of these indemnifications are not significant.

**New accounting standards**

For discussion of our new accounting standards, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies: New Accounting Standards.

**Recently Issued Accounting Standards, Not Adopted as of December 31, 2013**

In July 2013, the Financial Accounting Standards Board (FASB) issued an accounting standards update regarding the presentation of an unrecognized tax benefit related to a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. Under this new standard, this unrecognized tax benefit, or a portion thereof, should be presented in the financial statements as a reduction to a deferred tax asset if available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position. Otherwise, the unrecognized tax benefit should be presented in the financial statements as a separate liability. The assessment is based on the unrecognized tax benefits and deferred tax assets that exist at the reporting date. The provisions of the new standard are effective January 1, 2014 for annual and interim reporting periods and we do not expect the provisions of this standard to have a significant impact on our consolidated financial statements.

In March 2013, the Financial Accounting Standards Board (FASB) issued an accounting standards update regarding the accounting for cumulative translation adjustment (CTA) upon derecognition of assets or investment within a foreign entity. This new standard provides additional CTA accounting guidance on sales or transfers of foreign entity investments and assets as well as step acquisitions involving a foreign entity. The provisions of the new standard are effective January 1, 2014 and we do not expect the provisions of this standard to have a significant impact on our consolidated financial statements.

In February 2013, the FASB issued an accounting standards update regarding the measurement of obligations resulting from joint and several liability arrangements that may include debt agreements, other contractual obligations and settled litigation or judicial rulings. The provisions of this standard require that these obligations are measured at the amount representing the agreed upon obligation of the company as well as additional liability amounts it expects to assume on behalf of other parties in the arrangement. The provisions of the new standard are effective January 1, 2014 and we do not expect the provisions of this standard to have a significant impact on our consolidated financial statements.

## Table of Contents

### Forward-looking statements and factors that may affect future results

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

In particular, forward-looking statements include statements relating to our indebtedness, our ability to make interest and principal payments on our indebtedness, our ability to satisfy the covenants contained in our indebtedness, the redemption of the notes, new systems infrastructure stand-up, our 2014 financial guidance, future actions, business plans or prospects, prospective products, product approvals or products under development, product supply disruptions, R&D costs, timing and likelihood of success, future operating or financial performance, future results of current and anticipated products and services, strategies, sales efforts, expenses, production efficiencies, production margins, interest rates, foreign exchange rates, growth in emerging markets, the outcome of contingencies, such as legal proceedings, dividend plans, our agreements with Pfizer, government regulation and financial results. These statements are not guarantees of future performance, actions or events. Forward-looking statements are subject to risks and uncertainties, many of which are beyond our control, and are potentially inaccurate assumptions. Among the factors that could cause actual results to differ materially from past results and future plans and projected future results are the following:

- emerging restrictions and bans on the use of antibacterials in food-producing animals;
- perceived adverse effects on human health linked to the consumption of food derived from animals that utilize our products;
- increased regulation or decreased governmental support relating to the raising, processing or consumption of food-producing animals;
- fluctuations in foreign exchange rates and potential currency controls;
- changes in tax laws and regulation;
- an outbreak of infectious disease carried by animals;
- adverse weather conditions and the availability of natural resources;
- adverse global economic conditions;
- failure of our R&D, acquisition and licensing efforts to generate new products;
- quarterly fluctuations in demand and costs; and
- governmental laws and regulations affecting domestic and foreign operations, including without limitation, tax obligations and changes affecting the tax treatment by the United States of income earned outside the United States that may result from pending and possible future proposals.

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

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

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

#### Foreign exchange risk

Our primary net foreign currency translation exposures are the euro, Brazilian real and Australian dollar. Prior to the IPO, as a business unit of Pfizer and under Pfizer's global cash management system, our foreign exchange risk was

managed through Pfizer. Following the Separation, we seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities.

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

Our financial instruments at December 31, 2013 were analyzed to determine their sensitivity to foreign exchange rate changes. The fair values of these instruments were determined using Level 2 inputs. For additional details, see Notes to Consolidated and Combined Financial Statements—Note 4. Significant Accounting Policies— Fair Value. The sensitivity analysis of changes in the fair value of all foreign currency forward-exchange contracts at December 31, 2013 indicates that if the U.S. dollar were to appreciate against all other currencies by 10%, the fair value of

these contracts would increase by \$46 million, and if the U.S. dollar were to weaken against all other currencies by 10%, the fair value of these contracts would decrease by \$42 million. For additional details, see Notes to Consolidated and Combined Financial Statements—Note 10B. Financial Instruments— Derivative Financial Instruments.

Interest rate risk

Our outstanding debt balances are fixed rate debt. While changes in interest rates will have no impact on the interest we pay on our fixed rate debt, interest on our revolving credit facility will be exposed to interest rate fluctuations. At December 31, 2013, we had no outstanding principal balance under our credit facility. See Notes to Consolidated and Combined Financial Statements—Note 10. Financial Instruments.

Table of Contents

Item 8. Financial Statements and Supplementary Data.

INDEX TO FINANCIAL STATEMENTS

	Page
Audited Consolidated and Combined Financial Statements of Zoetis Inc. and Subsidiaries:	
<u>Report of Independent Registered Public Accounting Firm</u>	<u>63</u>
Consolidated and <u>Combined Statements of Income for the Year Ended December 31, 2013, 2012 and 2011</u>	<u>64</u>
Consolidated and <u>Combined Statements of Comprehensive Income for the Year Ended December 31, 2013, 2012 and 2011</u>	<u>65</u>
Consolidated and <u>Combined Balance Sheets as of December 31, 2013 and 2012</u>	<u>66</u>
Consolidated and <u>Combined Statements of Equity for the Year Ended December 31, 2013, 2012 and 2011</u>	<u>67</u>
Consolidated and <u>Combined Statements of Cash Flows for the Year Ended December 31, 2013, 2012 and 2011</u>	<u>68</u>
<u>Notes to Consolidated and Combined Financial Statements</u>	<u>69</u>
Schedule II—Valuation and Qualifying Accounts	<u>105</u>

See Notes to Consolidated and Combined Financial Statements, which are an integral part of these statements.

62 |

---

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors

Zoetis Inc.:

We have audited the accompanying consolidated balance sheet of Zoetis Inc. and subsidiaries as of December 31, 2013 and the combined balance sheet of Zoetis Inc. (the animal health business unit of Pfizer Inc.) as of December 31, 2012, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year ended December 31, 2013 and the combined statements of income, comprehensive income, equity, and cash flows for each of the years in the two-year period ended December 31, 2012. In connection with our audits of the consolidated and combined financial statements, we have also audited the related consolidated and combined financial statement schedule. These consolidated and combined financial statements and consolidated and combined financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated and combined financial statements and related consolidated and combined financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated and combined financial statements referred to above present fairly, in all material respects, the consolidated financial position of Zoetis Inc. and subsidiaries as of December 31, 2013, the combined financial position of Zoetis Inc. (the animal health business unit of Pfizer Inc.) as of December 31, 2012, the consolidated results of their operations and their cash flows for the year ended December 31, 2013, and the combined results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related consolidated and combined financial statement schedule referred to above, when considered in relation to the basic consolidated and combined financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

New York, New York

March 26, 2014

Table of ContentsZOETIS INC. AND SUBSIDIARIES  
CONSOLIDATED AND COMBINED STATEMENTS OF INCOME

(MILLIONS, EXCEPT PER SHARE DATA)	Year Ended December 31,		
	2013	2012	2011 <sup>(a)</sup>
Revenue	\$4,561	\$4,336	\$4,233
Costs and expenses:			
Cost of sales <sup>(b)</sup>	1,669	1,563	1,652
Selling, general and administrative expenses <sup>(b)</sup>	1,613	1,470	1,453
Research and development expenses <sup>(b)</sup>	399	409	427
Amortization of intangible assets	60	64	69
Restructuring charges and certain acquisition-related costs	26	135	154
Interest expense, net of capitalized interest	113	31	36
Other (income)/deductions—net	(9	) (46	) 48
Income before provision for taxes on income	690	710	394
Provision for taxes on income	187	274	146
Net income before allocation to noncontrolling interests	503	436	248
Net income/(loss) attributable to noncontrolling interests	(1	) —	3
Net income attributable to Zoetis	\$504	\$436	\$245
Earnings per share attributable to Zoetis Inc. stockholders:			
Basic	\$1.01	\$0.87	\$0.49
Diluted	\$1.01	\$0.87	\$0.49
Weighted-average common shares outstanding <sup>(c)</sup> :			
Basic	500.002	500.000	500.000
Diluted	500.317	500.000	500.000
Dividends declared per common share	0.267	—	—

<sup>(a)</sup> Includes revenue and expenses from acquisitions from the acquisition date, see Note 3. Basis of Presentation and Note 5. Acquisitions, Divestitures and Certain Investments.

<sup>(b)</sup> Exclusive of amortization of intangible assets, except as disclosed in Note 4. Significant Accounting Policies—Amortization of Intangible Assets, Depreciation and Certain Long-Lived Assets.

The weighted average shares outstanding for both basic and diluted earnings per share for the years ended December 31, 2012 and 2011 was calculated using 500 million shares of common stock outstanding, which was the number of Zoetis Inc. shares outstanding at the time of the initial public offering, which was completed on February 6, 2013. There were no Zoetis restricted stock units, deferred stock units, stock options or performance shares outstanding prior to the initial public offering.

See Notes to Consolidated and Combined Financial Statements, which are an integral part of these statements.



Table of Contents

ZOETIS INC. AND SUBSIDIARIES  
 CONSOLIDATED AND COMBINED STATEMENTS OF COMPREHENSIVE INCOME

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011 <sup>(a)</sup>
Net income before allocation to noncontrolling interests	\$503	\$436	\$248
Other comprehensive income/(loss), net of tax and reclassification adjustments <sup>(b)</sup> :			
Foreign currency translation adjustments, net	(54	) (93	) 4
Benefit plans: Actuarial gains/(losses), net	(2	) 1	5
Total other comprehensive income/(loss), net of tax	(56	) (92	) 9
Comprehensive income before allocation to noncontrolling interests	447	344	257
Comprehensive income/(loss) attributable to noncontrolling interests	(1	) —	3
Comprehensive income attributable to Zoetis	\$448	\$344	\$254

<sup>(a)</sup> Includes impacts from acquisitions from the acquisition date, see Note 3. Basis of Presentation and Note 5. Acquisitions, Divestitures and Certain Investments.

Presented net of reclassification adjustments and tax impacts, which are not significant in any period presented.

<sup>(b)</sup> Reclassification adjustments related to benefit plans are generally reclassified, as part of net periodic pension cost, into Cost of sales, Selling, general and administrative expenses, and/or Research and development expenses, as appropriate, in the consolidated and combined statements of income.

See Notes to Consolidated and Combined Financial Statements, which are an integral part of these statements.

65 |

---

Table of ContentsZOETIS INC. AND SUBSIDIARIES  
CONSOLIDATED AND COMBINED BALANCE SHEETS

(MILLIONS OF DOLLARS AND SHARES, EXCEPT PER SHARE DATA)	December 31, 2013 <sup>(a)</sup>	December 31, 2012 <sup>(a)</sup>
<b>Assets</b>		
Cash and cash equivalents	\$610	\$317
Accounts receivable, less allowance for doubtful accounts of \$31 in 2013 and \$49 in 2012	1,138	900
Inventories	1,293	1,345
Current deferred tax assets	97	101
Other current assets	219	201
Total current assets	3,357	2,864
Property, plant and equipment, less accumulated depreciation of \$1,028 in 2013 and \$1,011 in 2012	1,295	1,241
Goodwill	982	985
Identifiable intangible assets, less accumulated amortization	803	868
Noncurrent deferred tax assets	63	216
Other noncurrent assets	58	88
Total assets	\$6,558	\$6,262
<b>Liabilities and Equity</b>		
Short-term borrowings, including current portion of allocated long-term debt in 2012	\$15	\$73
Accounts payable	506	319
Accrued compensation and related items	229	194
Income taxes payable	40	30
Dividends payable	36	—
Other current liabilities	589	507
Total current liabilities	1,415	1,123
Long-term debt, net of discount	3,642	—
Allocated long-term debt	—	509
Noncurrent deferred tax liabilities	322	323
Other taxes payable	49	159
Other noncurrent liabilities	168	107
Total liabilities	5,596	2,221
Commitments and contingencies		
Business unit equity	—	4,183
Stockholders' equity:		
Common stock, \$0.01 par value: 5,000 authorized, 500 issued and outstanding	5	—
Additional paid-in capital	878	—
Retained earnings	276	—
Accumulated other comprehensive loss	(219)	(157)
Total Zoetis Inc. equity	940	4,026
Equity attributable to noncontrolling interests	22	15
Total equity	962	4,041
Total liabilities and equity	\$6,558	\$6,262

<sup>(a)</sup> The consolidated balance sheet as of December 31, 2013 has been prepared under a different basis of presentation than the combined balance sheet as of

December 31, 2012, which significantly impacts comparability. See Note 3. Basis of Presentation.

See Notes to Consolidated and Combined Financial Statements, which are an integral part of these statements.  
66 |

---

Table of Contents

ZOETIS INC. AND SUBSIDIARIES  
CONSOLIDATED AND COMBINED STATEMENTS OF EQUITY

	Zoetis				Accumulated Other Comprehensive Loss	Equity Attributable to Noncontrolling Interests	Total Equity
	Business Unit Equity <sup>(a)</sup>	Common Stock <sup>(b)</sup>	Paid-in Capital	Retained Earnings			
(MILLIONS OF DOLLARS)							
Balance, December 31, 2010	\$3,418	\$—	\$—	\$—	\$ (74 )	\$—	\$3,344
Comprehensive income	245	—	—	—	9	3	257
Share-based compensation expense	19	—	—	—	—	—	19
Investment in Jilin Pfizer Guoyuan Animal Health Co., Ltd.	—	—	—	—	—	16	16
Dividends declared and paid	(416 )	—	—	—	—	—	(416 )
Net transfers between Pfizer and noncontrolling interests	3	—	—	—	—	(3 )	—
Net transfers—Pfizer	516	—	—	—	—	—	516
Balance, December 31, 2011	\$3,785	\$—	\$—	\$—	\$ (65 )	\$ 16	\$3,736
Comprehensive income	436	—	—	—	(92 )	—	344
Share-based compensation expense	28	—	—	—	—	—	28
Dividends declared and paid	(63 )	—	—	—	—	—	(63 )
Net transfers between Pfizer and noncontrolling interests	1	—	—	—	—	(1 )	—
Net transfers—Pfizer Inc.	(4 )	—	—	—	—	—	(4 )
Balance, December 31, 2012	\$4,183	\$—	\$—	\$—	\$ (157 )	\$ 15	\$4,041
Comprehensive income	94	—	—	410	(56 )	(1 )	447
Share-based compensation expense	3	—	40	—	—	—	43
Net transfers—Pfizer Inc.	(271 )	—	—	—	—	—	(271 )
Separation adjustments <sup>(c)</sup>	414	—	29	—	(6 )	8	445
Employee benefit plan contribution from Pfizer Inc. <sup>(d)</sup>	—	—	2	—	—	—	2
Reclassification of net liability due to Pfizer Inc. <sup>(e)</sup>	(60 )	—	—	—	—	—	(60 )
Consideration paid to Pfizer Inc. in connection with the Separation <sup>(f)</sup>	—	—	(3,551 )	—	—	—	(3,551 )
Issuance of common stock to Pfizer Inc. in connection with the Separation and reclassification of Business Unit Equity <sup>(f)</sup>	(4,363 )	5	4,358	—	—	—	—
Dividends declared	—	—	—	(134 )	—	—	(134 )
Balance, December 31, 2013	\$—	\$5	\$ 878	\$276	\$ (219 )	\$ 22	\$962

- All amounts associated with Business Unit Equity relate to periods prior to the Separation. See Note 2A. The
- (a) Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— The Separation.
  - (b) As of December 31, 2013, there were 500,007,428 outstanding shares of common stock.
  - (c) For additional information, see Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer—Adjustments Associated with the Separation.
  - (d) Represents contributed capital from Pfizer Inc. associated with service credit continuation for certain Zoetis Inc. employees in Pfizer Inc.'s U.S. qualified defined benefit and U.S. retiree medical plans. See Note 14. Benefit Plans. Represents the reclassification of the Receivable from Pfizer Inc. and the Payable to Pfizer Inc. from Business Unit
  - (e) Equity as of the Separation date. See Note 2A. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— The Separation.
  - (f) Reflects the Separation transaction. See Note 2A. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— The Separation.

See Notes to Consolidated and Combined Financial Statements, which are an integral part of these statements.

67 |

---

Table of Contents
**ZOETIS INC. AND SUBSIDIARIES**  
**CONSOLIDATED AND COMBINED STATEMENTS OF CASH FLOWS**

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011
Operating Activities			
Net income before allocation to noncontrolling interests	\$ 503	\$ 436	\$ 248
Adjustments to reconcile net income before noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization expense	209	200	205
Share-based compensation expense	43	28	19
Asset write-offs and asset impairments	15	10	78
Deferred taxes	23	(74)	) 65
Employee benefit plan contribution from Pfizer Inc.	2	—	—
Other non-cash adjustments	(10	) 3	(1 )
Other changes in assets and liabilities, net of acquisitions and divestitures and transfers with Pfizer Inc.			
Accounts receivable	(99	) (65	) (85 )
Inventories	(104	) (318	) 40
Other assets	(24	) (5	) 11
Accounts payable	(82	) 96	(16 )
Other liabilities	196	62	(15 )
Other tax accounts, net	9	81	(52 )
Net cash provided by operating activities	681	454	497
Investing Activities			
Purchases of property, plant and equipment	(184	) (126	) (135 )
Net proceeds from sales of assets	9	3	34
Acquisitions, net of cash acquired	(4	) —	(345 )
Other investing activities	—	(12	) (3 )
Net cash used in investing activities	(179	) (135	) (449 )
Financing Activities			
Allocated principal payments on long-term debt	—	—	(143 )
Increase in short-term borrowings, net	16	—	—
Proceeds from issuance of long-term debt—senior notes, net of discount and fees	2,625	—	—
Consideration paid to Pfizer Inc. in connection with the Separation <sup>(a)</sup>	(2,559	) —	—
Cash dividends paid <sup>(b)</sup>	(98	) (63	) (416 )
Other net financing activities with Pfizer Inc.	(184	) (15	) 529
Net cash used in financing activities	(200	) (78	) (30 )
Effect of exchange-rate changes on cash and cash equivalents	(9	) (3	) (2 )
Net increase in cash and cash equivalents	293	238	16
Cash and cash equivalents at beginning of period	317	79	63
Cash and cash equivalents at end of period	\$ 610	\$ 317	\$ 79
Supplemental cash flow information			
Cash paid during the period for:			
Income taxes	\$ 134	\$ 276	\$ 142
Interest, net of capitalized interest	60	31	37
Non-cash transactions:			

Edgar Filing: Zoetis Inc. - Form 10-K

Contingent purchase price consideration	\$3	\$—	\$—
Dividends declared, not paid	36	—	—
Zoetis Inc. senior notes transferred to Pfizer Inc. in connection with the Separation <sup>(c)</sup>	992	—	—

- Reflects the Separation transaction. Amount is net of the non-cash portion. See Note 2A. The Separation,
- (a) Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: The Separation.
- (b) For the twelve months ended December 31, 2012 and December 31, 2011, reflects payments to other non-Zoetis Pfizer Inc. entities.
- (c) Reflects the non-cash portion of the Separation transaction. See Note 2A. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer: The Separation.

See Notes to Consolidated and Combined Financial Statements, which are an integral part of these statements.

68 |

---

Table of Contents

ZOETIS INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

1. Business Description

Zoetis Inc. (collectively, Zoetis, the company, we, us or our) is a global leader in the discovery, development, manufacture and commercialization of animal health medicines and vaccines, with a focus on both livestock and companion animals. We organize and operate our business in four geographic regions: the United States (U.S.); Europe/Africa/Middle East (EuAfME); Canada/Latin America (CLAR); and Asia/Pacific (APAC). We market our products in more than 120 countries, including developed markets and emerging markets. Our revenue is mostly generated in the U.S. and EuAfME. We have a diversified business, marketing products across eight core species: cattle, swine, poultry, sheep and fish (collectively, livestock) and dogs, cats and horses (collectively, companion animals); and within five major product categories: anti-infectives, vaccines, parasiticides, medicated feed additives and other pharmaceuticals.

2. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer

Pfizer Inc. (Pfizer) formed Zoetis to acquire, own and operate the animal health business of Pfizer. On June 24, 2013, Pfizer completed an exchange offer resulting in the full separation of Zoetis from Pfizer. For additional information, see E. Exchange Offer.

A. The Separation

In the first quarter of 2013, through a series of steps (collectively, the Separation), Pfizer transferred to us its subsidiaries holding substantially all of the assets and liabilities of its animal health business. In exchange, we transferred to Pfizer: (i) all of the issued and outstanding shares of our Class A common stock; (ii) all of the issued and outstanding shares of our Class B common stock; (iii) \$1.0 billion in senior notes (see C. Senior Notes Offering below); and (iv) an amount of cash equal to substantially all of the net proceeds received in the senior notes offering (approximately \$2.5 billion).

B. Adjustments Associated with the Separation

In connection with the Separation, certain animal health assets and liabilities included in the pre-Separation balance sheet were retained by Pfizer and certain non-animal health assets and liabilities (not included in the pre-Separation balance sheet) were transferred to Zoetis. The adjustments to the historical balance sheet of Zoetis (collectively, the Separation Adjustments) representing approximately \$445 million of net liabilities retained by Pfizer, were primarily related to the following:

The removal of inventories (approximately \$74 million), property, plant and equipment (approximately \$28 million) and miscellaneous other net liabilities (approximately \$21 million) associated with certain non-dedicated manufacturing sites that were retained by Pfizer;

The addition of property, plant and equipment (approximately \$56 million) associated with a non-dedicated manufacturing site that was transferred to us by Pfizer (and then leased back to Pfizer under operating leases), and the removal of the inventory (approximately \$46 million) and net other assets (approximately \$4 million) at that site as these assets were retained by Pfizer;

The addition of net defined benefit plan liabilities (approximately \$21 million) and deferred compensation liabilities (approximately \$4 million);

The elimination of (i) noncurrent deferred tax assets (some of which were included within noncurrent deferred tax liabilities due to jurisdictional netting) related to net operating loss and tax credit carryforwards; (ii) net tax liabilities associated with uncertain tax positions; (iii) noncurrent deferred tax liabilities related to deferred income taxes on unremitted earnings; and (iv) other allocated net tax assets, all of which (approximately \$49 million in net tax asset accounts) were retained by Pfizer;

The addition of (i) noncurrent deferred tax assets (approximately \$8 million, some of which were included within noncurrent deferred tax liabilities due to jurisdictional netting) related to net benefit plan liabilities transferred to us by Pfizer; (ii) noncurrent deferred tax assets (approximately \$2 million) related to net operating loss and tax credit carryforwards; and (iii) noncurrent deferred tax liabilities (approximately \$2 million) related to property, plant and



equipment transferred to us by Pfizer;

The elimination of allocated long-term debt (approximately \$582 million), allocated accrued interest payable (approximately \$16 million) and allocated unamortized deferred debt issuance costs (approximately \$2 million) that were retained by Pfizer;

Certain net financial assets retained by Pfizer (approximately \$45 million);

The removal of cash (approximately \$7 million), inventories (approximately \$5 million), property, plant and equipment (approximately \$8 million), miscellaneous other assets (approximately \$3 million) and other miscellaneous liabilities (approximately \$2 million) associated with non-U.S. Pfizer businesses that did not transfer to us from Pfizer;

The addition of net receivables from Pfizer (approximately \$5 million) associated with certain foreign taxes directly resulting from certain aspects of the Separation that were the responsibility of Pfizer under the terms of the tax matters agreement, see Note 8B. Tax Matters— Tax Matters Agreement;

69 |

---

## Table of Contents

The addition of (i) inventory (approximately \$15 million); (ii) net deferred tax assets (approximately \$1 million); and (iii) miscellaneous other assets (approximately \$5 million) transferred to us by Pfizer, and the removal of (i) property, plant and equipment (approximately \$2 million); (ii) miscellaneous other liabilities (approximately \$57 million), and (iii) the elimination of prepaid taxes (approximately \$4 million) that were retained by Pfizer; and

- The addition of net benefit plan liabilities (approximately \$21 million) associated with certain international plans that will be transferred from Pfizer to Zoetis in 2014. See Note 12. Benefit Plans.

The Separation Adjustment associated with Accumulated Other Comprehensive Income reflects the accumulated currency translation adjustment based on the actual legal entity structure of Zoetis.

### C. Senior Notes Offering

In connection with the Separation, on January 28, 2013, we issued \$3.65 billion aggregate principal amount of our senior notes in a private placement, with an original issue discount of \$10 million. For additional information, see Note 10A. Financial Instruments— Debt.

### D. Initial Public Offering (IPO)

After the Separation, on February 6, 2013, an IPO of 99,015,000 shares of our Class A common stock (including the exercise of the underwriters' over-allotment option) at a price of \$26.00 per share was completed. Pfizer retained the net proceeds from the IPO.

Immediately following the IPO, there were 99,015,000 outstanding shares of Class A common stock and 400,985,000 outstanding shares of Class B common stock. The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to voting and conversion rights. Following the IPO, Pfizer owned all of the outstanding shares of our Class B common stock, all of which was converted to Class A common stock in connection with the Exchange Offer. See E. Exchange Offer. There are no longer any shares of our Class B common stock outstanding.

In connection with the IPO, we entered into certain agreements that provide a framework for an ongoing relationship with Pfizer. For additional information, see Note 17B. Transactions and Agreements with Pfizer— Agreements with Pfizer.

### E. Exchange Offer

On May 22, 2013, Pfizer announced an exchange offer (the Exchange Offer) whereby Pfizer shareholders could exchange a portion of Pfizer common stock for Zoetis common stock. The Exchange Offer was completed on June 24, 2013, resulting in the full separation of Zoetis and the disposal of Pfizer's entire ownership and voting interest in Zoetis.

## 3. Basis of Presentation

The consolidated and combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). For subsidiaries operating outside the United States, the consolidated and combined financial information is included as of and for the fiscal year ended November 30 for each year presented. All significant intercompany balances and transactions between the legal entities that comprise Zoetis have been eliminated. For the years ended December 31, 2012 and 2011, balances due to or due from Pfizer have been presented as a component of Business unit equity. For those subsidiaries included in these consolidated and combined financial statements where our ownership is less than 100%, the minority interests have been shown in equity as Equity attributable to noncontrolling interests.

On January 31, 2011 (the acquisition date), Pfizer completed the tender offer for the outstanding shares of common stock of King Pharmaceuticals, Inc. (King), including the King Animal Health business (KAH), and acquired approximately 92.5% of King's outstanding shares. On February 28, 2011, Pfizer acquired all of the remaining shares of King. Commencing from the acquisition date, our combined financial statements include the assets, liabilities, operations and cash flows associated with KAH. As a result, and in accordance with our domestic and international reporting periods, our combined financial statements for the year ended December 31, 2011 reflect approximately eleven months of the U.S. operations of KAH and approximately ten months of the international operations of KAH. For additional information, see Note 5A. Acquisitions, Divestitures and Certain Investments—Acquisition of King Animal Health.

### A. Basis of Presentation Prior to the Separation

Prior to the Separation, the combined financial statements were derived from the consolidated financial statements and accounting records of Pfizer and included allocations for direct costs and indirect costs attributable to the operations of the animal health business of Pfizer. The pre-Separation financial statements and activities do not purport to reflect what the results of operations, comprehensive income/(loss), financial position, equity or cash flows would have been had we operated as an independent public company during the periods presented.

The combined statements of income for the years ended December 31, 2012 and 2011, and the pre-Separation period included in the consolidated statement of income for the year ended December 31, 2013, include allocations from certain support functions (Enabling Functions) that are provided on a centralized basis within Pfizer, such as expenses for business technology, facilities, legal, finance, human resources, and, to a lesser extent, business development, public affairs and procurement, among others, as Pfizer does not routinely allocate these costs to any of its business units. These allocations are based on either a specific identification basis or, when specific identification is not practicable, proportional allocation methods (e.g., using third-party sales, headcount, etc.), depending on the nature of the services.

Costs associated with business technology, facilities and human resources were allocated primarily using proportional allocation methods and, for legal and finance, primarily using specific identification. In all cases, for support function costs where proportional

Table of Contents

allocation methods were used, we determined whether the costs are primarily influenced by headcount (such as a significant majority of facilities and human resources costs) or by the size of the business (such as most business technology costs), and we also determined whether the associated scope of those services provided are global, regional or local. Based on those analyses, the costs were allocated based on our share of worldwide revenue, domestic revenue, international revenue, regional revenue, country revenue, worldwide headcount, country headcount or site headcount, as appropriate.

As a result, costs associated with business technology and legal that were not specifically identified were mostly allocated based on revenue drivers and, to a lesser extent, based on headcount drivers; costs associated with finance that were not specifically identified were all allocated based on revenue drivers; and costs associated with facilities and human resources that were not specifically identified were predominantly allocated based on headcount drivers. The combined statements of income for the years ended December 31, 2012 and 2011, and the pre-Separation period included in the consolidated statement of income for the year ended December 31, 2013, include allocations of certain manufacturing and supply costs incurred by manufacturing plants that are shared with other Pfizer business units.

These costs may include manufacturing variances and changes in the standard costs of inventory, among others, as Pfizer does not routinely allocate these costs to any of its business units. These allocations are based on either a specific identification basis or, when specific identification is not practicable, proportional allocation methods, such as animal health identified manufacturing costs, depending on the nature of the costs.

The combined statements of income for the years ended December 31, 2012 and 2011, and the pre-Separation period included in the consolidated statement of income for the year ended December 31, 2013, also include allocations from Pfizer for restructuring charges, integration costs, additional depreciation associated with asset restructuring and implementation costs, as Pfizer does not routinely allocate these costs to any of its business units. For additional information about allocations of restructuring charges and other costs associated with acquisitions and cost-reduction/productivity initiatives, see Note 6. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives.

The combined statements of income for the years ended December 31, 2012 and 2011, and the pre-Separation period included in the consolidated statement of income for the year ended December 31, 2013, include an allocation of share-based compensation expense and certain other compensation expense items, such as certain fringe benefit expenses, maintained on a centralized basis within Pfizer, as Pfizer does not routinely allocate these costs to any of its business units. For additional information about allocations of share-based payments, see Note 15. Share-Based Payments.

The combined balance sheets as of December 31, 2012 and 2011 reflects all of the assets and liabilities of Pfizer that are either specifically identifiable or are directly attributable to Zoetis and its operations. For benefit plans, the combined balance sheet only includes the assets and liabilities of benefit plans dedicated to animal health employees. For debt, see below.

The combined balance sheets as of December 31, 2012 and 2011 includes an allocation of long-term debt from Pfizer that was issued to partially finance the acquisition of Wyeth (including Fort Dodge Animal Health (FDAH)). The debt and associated interest-related expenses, including the effect of hedging activities, have been allocated on a pro-rata basis using the deemed acquisition cost of FDAH as a percentage of the total acquisition cost of Wyeth. No other allocations of debt have been made as none are specifically related to our operations.

The allocated expenses from Pfizer include the items noted below for the pre-Separation period in 2013 and years ended December 31, 2012 and 2011.

Enabling Functions operating expenses—\$11 million, \$310 million and \$335 million in 2013, 2012 and 2011, respectively (\$1 million and \$3 million in 2012 and 2011, respectively, in Cost of sales; \$11 million, \$254 million and \$268 million in 2013, 2012, and 2011, respectively, in Selling, general and administrative expenses; and \$55 million and \$64 million in 2012 and 2011, respectively, in Research and development expenses).

PGS manufacturing costs—approximately \$25 million and \$34 million in 2012 and 2011, respectively (in Cost of sales).

Restructuring charges and certain acquisition-related costs—\$57 million and \$70 million in 2012 and 2011, respectively (in Restructuring charges and certain acquisition-related costs).

Other costs associated with cost reduction/productivity initiatives—additional depreciation associated with asset restructuring—\$2 million, \$13 million and \$20 million in 2013, 2012, and 2011, respectively (\$2 million, \$4 million and \$1 million in 2013, 2012 and 2011, respectively, in Selling, general and administrative expenses and \$9 million and \$19 million in 2012 and 2011, respectively, in Research and development expenses).

Other costs associated with cost reduction/productivity initiatives—implementation costs—\$1 million and \$9 million in 2013 and 2012, respectively (\$1 million and \$8 million in 2013 and 2012, respectively, in Selling, general and administrative expenses and \$1 million in 2012 in Research and development expenses).

Share-based compensation expense—approximately \$3 million, \$33 million and \$25 million in 2013, 2012, and 2011, respectively (\$1 million, \$7 million and \$5 million in 2013, 2012 and 2011, respectively, in Cost of sales; \$2 million, \$21 million and \$16 million in 2013, 2012 and 2011, respectively, in Selling, general and administrative expenses; and \$5 million and \$4 million in 2012 and 2011, respectively, in Research and development expenses).

Transaction costs—approximately \$2 million in 2011 (in Restructuring charges and certain acquisition-related costs).

## Table of Contents

Compensation-related expenses—approximately \$1 million, \$12 million and \$6 million 2013, 2012 and 2011, respectively (\$5 million and \$2 million in 2012 and 2011, respectively, in Cost of sales; \$1 million, \$5 million and \$3 million in 2013, 2012 and 2011, respectively, in Selling, general and administrative expenses; and \$2 million and \$1 million in 2012 and 2011, respectively, in Research and development expenses).

Interest expense—approximately \$2 million, \$31 million and \$36 million in 2013, 2012 and 2011, respectively.

The income tax provision in the combined statement of income for the periods prior to the Separation was calculated as if Zoetis filed a separate return.

Management believes that the allocations are a reasonable reflection of the services received or the costs incurred on behalf of Zoetis and its operations and that the combined statements of income for the years ended December 31, 2012 and 2011 and the pre-Separation period included in the consolidated statement of income for the year ended December 31, 2013 reflect all of the costs of the animal health business of Pfizer.

Prior to the Separation, we participated in Pfizer's centralized cash management system and generally all excess cash was transferred to Pfizer on a daily basis. Cash disbursements for operations and/or investing activities were funded as needed by Pfizer. We had also participated in Pfizer's centralized hedging and offsetting programs. As such, in the combined statements of income for the years ended December 31, 2012 and 2011, we include the impact of Pfizer's derivative financial instruments used for offsetting changes in foreign currency rates, net of the related foreign exchange gains and losses for the portion that is deemed to be associated with the animal health operations. Such gains and losses were not material to the combined financial statements for the periods presented.

All balances and transactions among Zoetis and Pfizer and its subsidiaries, which can include dividends as well as other activities, are shown in Business unit equity in the combined balance sheets for the years ended December 31, 2012 and 2011. As the books and records of Zoetis were not kept on a separate company basis, the determination of the average net balance due to or from Pfizer is not practicable.

### B. Basis of Presentation After the Separation

The consolidated financial statements as of and for the year ended December 31, 2013 comprise the following: (i) the results of operations, comprehensive income, and cash flow amounts for the period prior to the Separation (see above), which includes allocations for direct costs and indirect costs attributable to the operations of the animal health business; and (ii) the amounts for the period after the Separation, which reflect the results of operations, comprehensive income, financial position, equity and cash flows resulting from our operation as an independent public company.

The income tax provision prepared after the Separation is based on the actual legal entity structure of Zoetis, with certain accommodations pursuant to a tax matters agreement. For additional information, see Note 19B. Transactions and Agreements with Pfizer— Agreements with Pfizer.

### 4. Significant Accounting Policies

#### New Accounting Standards

In 2013, we adopted guidance issued by the Financial Accounting Standards Board that simplifies how an entity tests indefinite-lived intangibles for impairment. The amended guidance allows companies to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. The adoption of this guidance had no impact on our financial position and results of operations.

#### Estimates and Assumptions

In preparing the consolidated and combined financial statements, we use certain estimates and assumptions that affect reported amounts and disclosures, including amounts recorded in connection with acquisitions. These estimates and underlying assumptions can impact all elements of our consolidated and combined financial statements. For example, in the consolidated and combined statements of income, in addition to estimates used in determining the allocations of costs and expenses from Pfizer, estimates are used when accounting for deductions from revenue (such as rebates, sales allowances, product returns and discounts), determining cost of sales, allocating cost in the form of depreciation and amortization, and estimating restructuring charges and the impact of contingencies. On the consolidated and combined balance sheets, estimates are used in determining the valuation and recoverability of assets, such as accounts receivables, inventories, fixed assets, goodwill and other identifiable intangible assets, and estimates are used

in determining the reported amounts of liabilities, such as taxes payable, benefit obligations, the impact of contingencies, deductions from revenue and restructuring reserves, all of which also impact the consolidated and combined statements of income.

Our estimates are often based on complex judgments, probabilities and assumptions that we believe to be reasonable but that can be inherently uncertain and unpredictable. If our estimates and assumptions are not representative of actual outcomes, our results could be materially impacted.

As future events and their effects cannot be determined with precision, our estimates and assumptions may prove to be incomplete or inaccurate, or unanticipated events and circumstances may occur that might cause us to change those estimates and assumptions. We are subject to risks and uncertainties that may cause actual results to differ from estimated amounts, such as changes in competition, litigation, legislation and regulations. We regularly evaluate our estimates and assumptions using historical experience and expectations about the future. We adjust our estimates and assumptions when facts and circumstances indicate the need for change. Those changes generally will be reflected in our consolidated and combined financial statements on a prospective basis unless they are required to be treated retrospectively under relevant

## Table of Contents

accounting standards. It is possible that others, applying reasonable judgment to the same facts and circumstances, could develop and support a range of alternative estimated amounts.

### Acquisitions

Our consolidated and combined financial statements include the operations of acquired businesses from the date of acquisition. We account for acquired businesses using the acquisition method of accounting, which requires, among other things, that most assets acquired and liabilities assumed be recognized at their estimated fair values as of the acquisition date and that the fair value of acquired in-process research and development (IPR&D) be recorded on the balance sheet. Transaction costs are expensed as incurred. Any excess of the consideration transferred over the assigned values of the net assets acquired is recorded as goodwill. When we acquire net assets that do not constitute a business as defined in U.S. GAAP, no goodwill is recognized.

Amounts recorded for acquisitions can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Foreign Currency Translation

For most of our international operations, local currencies have been determined to be the functional currencies. We translate functional currency assets and liabilities to their U.S. dollar equivalents at exchange rates in effect at the balance sheet date and we translate functional currency income and expense amounts to their U.S. dollar equivalents at average exchange rates for the period. The U.S. dollar effects that arise from changing translation rates are recorded in Other comprehensive income/(loss), net of tax. The effects of converting non-functional currency assets and liabilities into the functional currency are recorded in Other (income)/deductions—net. For operations in highly inflationary economies, we translate monetary items at rates in effect at the balance sheet date, with translation adjustments recorded in Other (income)/deductions—net, and we translate non-monetary items at historical rates.

### Revenue, Deductions from Revenue and the Allowance for Doubtful Accounts

We record revenue from product sales when the goods are shipped and title and risk of loss passes to the customer. At the time of sale, we also record estimates for a variety of deductions from revenue, such as rebates, sales allowances, product returns and discounts. Sales deductions are estimated and recorded at the time that related revenue is recorded except for sales incentives, which are estimated and recorded at the time the related revenue is recorded or when the incentive is offered, whichever is later. As applicable, our estimates are generally based on contractual terms or historical experience, adjusted as necessary to reflect our expectations about the future. Taxes collected from customers relating to product sales and remitted to governmental authorities are excluded from Revenue.

As of December 31, 2013 and 2012, accruals for sales deductions included in Other current liabilities are approximately \$153 million and \$126 million, respectively.

We also record estimates for bad debts. We periodically assess the adequacy of the allowance for doubtful accounts by evaluating the collectability of outstanding receivables based on factors such as past due history, historical and expected collection patterns, the financial condition of our customers, the robust nature of our credit and collection practices and the economic environment.

Amounts recorded for sales deductions and bad debts can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Cost of Sales and Inventories

Inventories are carried at the lower of cost or market. The cost of finished goods, work-in-process and raw materials is determined using average actual cost. We regularly review our inventories for impairment and adjustments are recorded when necessary.

### Selling, General and Administrative Expenses

Selling, general and administrative costs are expensed as incurred. Among other things, these expenses include the internal and external costs of marketing, advertising, and shipping and handling as well as certain costs related to business technology, facilities, legal, finance, human resources, business development, public affairs and procurement, among others.



Advertising expenses relating to production costs are expensed as incurred, and the costs of space in publications are expensed when the related advertising occurs. Advertising and promotion expenses totaled approximately \$143 million in 2013, \$141 million in 2012 and \$134 million in 2011.

Shipping and handling costs totaled approximately \$60 million in 2013, \$59 million in 2012 and \$66 million in 2011.

#### Research and Development Expenses

Research and development (R&D) costs are expensed as incurred. Research is the effort associated with the discovery of new knowledge that will be useful in developing a new product or in significantly improving an existing product. Development is the implementation of the research findings. Before a compound receives regulatory approval, we record upfront and milestone payments made by us to third parties under licensing arrangements as expense. Upfront payments are recorded when incurred, and milestone payments are recorded when the specific milestone has been achieved. Once a compound receives regulatory approval in a major market, we record any milestone payments in Identifiable intangible assets, less accumulated amortization and, unless the assets are determined to have an indefinite life, we amortize them on a straight-line basis over the remaining agreement term or the expected product life cycle, whichever is shorter.

## Table of Contents

### Amortization of Intangible Assets, Depreciation and Certain Long-Lived Assets

Long-lived assets include:

• Goodwill—goodwill represents the excess of the consideration transferred for an acquired business over the assigned values of its net assets. Goodwill is not amortized.

• Identifiable intangible assets, less accumulated amortization—these acquired assets are recorded at our cost. Identifiable intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives. Identifiable intangible assets with indefinite lives that are associated with marketed products are not amortized until a useful life can be determined. Identifiable intangible assets associated with IPR&D projects are not amortized until regulatory approval is obtained. The useful life of an amortizing asset generally is determined by identifying the period in which substantially all of the cash flows are expected to be generated.

• Property, plant and equipment, less accumulated depreciation—these assets are recorded at our cost and are increased by the cost of any significant improvements after purchase. Property, plant and equipment assets, other than land and construction-in-progress, are depreciated on a straight-line basis over the estimated useful life of the individual assets. Depreciation begins when the asset is ready for its intended use. For tax purposes, accelerated depreciation methods are used as allowed by tax laws.

Amortization expense related to finite-lived identifiable intangible assets that contribute to our ability to sell, manufacture, research, market and distribute products, compounds and intellectual property are included in Amortization of intangible assets as they benefit multiple business functions. Amortization expense related to intangible assets that are associated with a single function and depreciation of property, plant and equipment are included in Cost of sales, Selling, general and administrative expenses and Research and development expenses, as appropriate.

We review all of our long-lived assets for impairment indicators throughout the year and we perform detailed testing whenever impairment indicators are present. In addition, we perform impairment testing for goodwill and indefinite-lived assets at least annually. When necessary, we record charges for impairments. Specifically:

• For finite-lived identifiable intangible assets, such as developed technology rights, and for other long-lived assets, such as property, plant and equipment, whenever impairment indicators are present, we calculate the undiscounted value of the projected cash flows associated with the asset, or asset group, and compare this estimated amount to the carrying amount. If the carrying amount is found to be greater, we record an impairment loss for the excess of book value over fair value. In addition, in all cases of an impairment review, we re-evaluate the remaining useful lives of the assets and modify them, as appropriate.

• For indefinite-lived identifiable intangible assets, such as brands and IPR&D assets, we test for impairment at least annually, or more frequently if impairment indicators exist, by first assessing qualitative factors to determine whether it is more likely than not that the fair value of the indefinite-lived intangible asset is less than its carrying amount. If we conclude it is more likely than not that the fair value is less than the carrying amount, a quantitative test that compares the fair value of the indefinite-lived intangible asset with its carrying value is performed. If the fair value is less than the carrying amount, an impairment loss is recognized. We record an impairment loss, if any, for the excess of book value over fair value. In addition, in all cases of an impairment review other than for IPR&D assets, we re-evaluate whether continuing to characterize the asset as indefinite-lived is appropriate.

• For goodwill, we test for impairment on at least an annual basis, or more frequently if impairment indicators exist, by first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we conclude it is more likely than not that the fair value of a reporting unit is less than its carrying amount, a quantitative fair value test is performed. We determine the implied fair value of goodwill by subtracting the fair value of all the identifiable net assets other than goodwill from the fair value of the reporting unit and record an impairment loss for the excess, if any, of book value of goodwill over the implied fair value. We performed a qualitative assessment, as of September 29, 2013, to determine whether it is more likely than not that the respective fair values of our reporting units are less than their carrying amounts, including goodwill. Based on that assessment, we determined that this condition does not exist for all reporting units and concluded that goodwill was not impaired.

Impairment reviews can involve a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

#### Software Capitalization and Depreciation

We capitalize certain costs incurred in connection with obtaining or developing internal-use software, including payroll and payroll-related costs for employees who are directly associated with the internal-use software project, external direct costs of materials and services and interest costs while developing the software. Capitalized software costs are included in Property, plant and equipment and are amortized using the straight-line method over the estimated useful life of 5 to 10 years. Capitalization of such costs ceases when the project is substantially complete and ready for its intended purpose. Costs incurred during the preliminary project and post-implementation stages, as well as software maintenance and training costs, are expensed in the period in which they are incurred. The company capitalized \$35 million and \$3 million of internal-use software for the years ended December 31, 2013 and 2012, respectively. Depreciation expense for capitalized software was \$2 million per year in 2013, 2012 and 2011.

#### Restructuring Charges and Certain Acquisition-Related Costs

We may incur restructuring charges in connection with acquisitions when we implement plans to restructure and integrate the acquired operations or in connection with cost-reduction and productivity initiatives. Included in Restructuring charges and certain acquisition-related costs are all restructuring charges and certain costs associated with acquiring and integrating an acquired business. Transaction costs and

## Table of Contents

integration costs are expensed as incurred. Termination costs are a significant component of restructuring charges and are generally recorded when the actions are probable and estimable.

Amounts recorded for restructuring charges and other associated costs can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Earnings per Share

The weighted average common shares outstanding for both basic and diluted earnings per share for the years ended December 31, 2012 and 2011 was calculated using an aggregate of 500 million shares of common stock outstanding, which was the number of Zoetis Inc. shares outstanding at the time of the IPO. There were no Zoetis restricted stock units, stock options or performance shares outstanding prior to the IPO.

### Cash Equivalents

Cash equivalents include items almost as liquid as cash, such as certificates of deposit and time deposits with maturity periods of three months or less when purchased.

Significant investing activities that affect recognized property, plant and equipment, but that do not result in cash receipts or cash payments in the period are not included in the consolidated and combined statements of cash flows.

Purchases of property, plant and equipment in Other current liabilities or Accounts payable at December 31, 2013 and 2012 were \$16 million and \$14 million, respectively, and were insignificant at December 31, 2011.

### Fair Value

Certain assets and liabilities are required to be measured at fair value, either upon initial recognition or for subsequent accounting or reporting. For example, we use fair value extensively in the initial recognition of net assets acquired in a business combination. Fair value is estimated using an exit price approach, which requires, among other things, that we determine the price that would be received to sell an asset or paid to transfer a liability in an orderly market. The determination of an exit price is considered from the perspective of market participants, considering the highest and best use of assets and, for liabilities, assuming that the risk of non-performance will be the same before and after the transfer.

When estimating fair value, depending on the nature and complexity of the asset or liability, we may use one or all of the following approaches:

• Income approach, which is based on the present value of a future stream of net cash flows.

• Market approach, which is based on market prices and other information from market transactions involving identical or comparable assets or liabilities.

• Cost approach, which is based on the cost to acquire or construct comparable assets less an allowance for functional and/or economic obsolescence.

These fair value methodologies depend on the following types of inputs:

• Quoted prices for identical assets or liabilities in active markets (Level 1 inputs).

• Quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in markets that are not active or are directly or indirectly observable (Level 2 inputs).

• Unobservable inputs that reflect estimates and assumptions (Level 3 inputs).

A single estimate of fair value can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Accounts Receivable

The recorded amounts of accounts receivable approximate fair value because of their relatively short-term nature. As of December 31, 2013 and 2012, Accounts receivable, less allowance for doubtful accounts, of \$1,138 million and \$900 million, respectively, includes approximately \$65 million and \$43 million of other receivables, such as trade notes receivable and royalty receivables, among others.

### Deferred Tax Assets and Liabilities and Income Tax Contingencies

Deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates and laws. We provide a valuation allowance when we believe that our deferred tax assets are not recoverable based on an assessment of estimated future

taxable income that incorporates ongoing, prudent and feasible tax planning strategies.

We account for income tax contingencies using a benefit recognition model. If we consider that a tax position is more likely than not to be sustained upon audit, based solely on the technical merits of the position, we recognize the benefit. We measure the benefit by determining the amount that is greater than 50% likely of being realized upon settlement, presuming that the tax position is examined by the appropriate taxing authority that has full knowledge of all relevant information. Under the benefit recognition model, if the initial assessment fails to result in the recognition of a tax benefit, we regularly monitor our position and subsequently recognize the tax benefit: (i) if there are changes in tax law, analogous case law or there is new information that sufficiently raise the likelihood of prevailing on the technical merits of the position to more likely than not; (ii) if the statute of limitations expires; or (iii) if there is a completion of an audit resulting in a favorable settlement of that tax year with the appropriate agency. We regularly re-evaluate our tax positions based on the results of audits of federal, state and foreign income

75 |

---

## Table of Contents

tax filings, statute of limitations expirations, changes in tax law or receipt of new information that would either increase or decrease the technical merits of a position relative to the “more-likely-than-not” standard. Liabilities associated with uncertain tax positions are classified as current only when we expect to pay cash within the next 12 months. Interest and penalties, if any, are recorded in Provision for taxes on income and are classified on our consolidated and combined balance sheet with the related tax liability.

Amounts recorded for valuation allowances and income tax contingencies can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Benefit Plans

Prior to the Separation from Pfizer, employees who met certain eligibility requirements participated in various defined benefit pension plans and postretirement plans administered and sponsored by Pfizer. Generally, most of our employees were eligible to participate in Pfizer’s pension plans. The combined statements of income for the years ended December 31, 2012 and 2011 and the pre-Separation period included in the consolidated statement of income for the year ended December 31, 2013, included all of the benefit plan expenses attributable to the animal health operations of Pfizer, including expenses associated with pension plans, postretirement plans and defined contribution plans. The expenses included allocations of direct expenses, as well as expenses that were deemed attributable to the animal health operations. The combined balance sheet as of December 31, 2012 included the benefit plan assets and liabilities of only those plans that were dedicated to animal health employees. The consolidated balance sheet as of December 31, 2013 includes those dedicated plans, as well as the benefit plan assets and liabilities that were transferred to Zoetis from Pfizer as part of the Separation. All dedicated benefit plans are pension plans.

For the dedicated plans, we recognize the overfunded or underfunded status of defined benefit plans as an asset or liability on the consolidated and combined balance sheets and the obligations generally are measured at the actuarial present value of all benefits attributable to employee service rendered, as provided by the applicable benefit formula. Pension obligations may include assumptions such as long-term rate of return on plan assets, expected employee turnover, participant mortality, and future compensation levels. Plan assets are measured at fair value. Net periodic benefit costs are recognized, as required, into Cost of sales, Selling, general and administrative expenses and Research and development expenses, as appropriate.

Amounts recorded for benefit plans can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Asset Retirement Obligations

We record accruals for the legal obligations associated with the retirement of tangible long-lived assets, including obligations under the doctrine of promissory estoppel and those that are conditioned upon the occurrence of future events. These obligations generally result from the acquisition, construction, development and/or normal operation of long-lived assets. We recognize the fair value of these obligations in the period in which they are incurred by increasing the carrying amount of the related asset. Over time, we recognize expense for the accretion of the liability and for the amortization of the asset.

As of December 31, 2013 and 2012, accruals for direct asset retirement obligations included in Other current liabilities are \$0.1 million and \$0.2 million, respectively, and included in Other noncurrent liabilities are \$12 million and \$15 million, respectively.

Amounts recorded for asset retirement obligations can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

### Legal and Environmental Contingencies

We are subject to numerous contingencies arising in the ordinary course of business, such as product liability and other product-related litigation, commercial litigation, patent litigation, environmental claims and proceedings, government investigations and guarantees and indemnifications. We record accruals for these contingencies to the extent that we conclude that a loss is both probable and reasonably estimable. If some amount within a range of loss appears to be a better estimate than any other amount within the range, we accrue that amount. Alternatively, when no

amount within a range of loss appears to be a better estimate than any other amount, we accrue the lowest amount in the range. We record anticipated recoveries under existing insurance contracts when recovery is assured.

Amounts recorded for contingencies can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

#### Share-Based Payments

Our compensation programs can include share-based payment plans. All grants under share-based payment programs are accounted for at fair value and such amounts generally are amortized on a straight-line basis over the vesting term to Cost of sales, Selling, general and administrative expenses, and Research and development expenses, as appropriate.

Amounts recorded for share-based compensation can result from a complex series of judgments about future events and uncertainties and can rely heavily on estimates and assumptions. For information about the risks associated with estimates and assumptions, see Estimates and Assumptions.

Table of Contents

Business Unit Equity

Total business unit equity represents Pfizer's equity investment in Zoetis and the net amounts due to or due from Pfizer. Recorded amounts reflect capital contributions and/or dividends, as well as the results of operations and other comprehensive income/(loss) for periods prior to the IPO.

Reclassifications

Interest expense, net of capitalized interest previously presented as a component of Other (income)/deductions, net, is currently presented separately in the consolidated and combined statements of income.

5. Acquisitions, Divestitures and Certain Investments

A. Acquisition of King Animal Health

Description of the Transaction and Fair Value of Consideration Transferred

On January 31, 2011 (the acquisition date), Pfizer completed its tender offer for the outstanding shares of common stock of King, including KAH, at a purchase price of \$14.25 per share in cash and acquired approximately 92.5% of the outstanding shares. On February 28, 2011, Pfizer acquired all of the remaining shares of King for \$14.25 per share in cash. As a result, the total fair value of consideration transferred by Pfizer for King was approximately \$3.6 billion in cash (\$3.2 billion, net of cash acquired), of which we estimate that approximately \$345 million relates to KAH.

In 2011, from the acquisition date of January 31, 2011, KAH contributed \$329 million in revenue. We are unable to provide the results of operations attributable to KAH as those operations were substantially integrated by mid-2011.

B. Divestitures

On October 15, 2009, Pfizer acquired all the outstanding equity of Wyeth, including FDAH. In connection with the regulatory approval process of that acquisition, we were required to divest certain animal health assets:

In 2010, we sold certain animal health products in Europe, including intellectual property rights exclusive to Europe as well as a manufacturing facility and finished goods inventory. The product portfolio was composed of both livestock and companion animal products from both legacy Wyeth and legacy Pfizer. In connection with this divestiture, we entered into transitional manufacturing service agreements with the buyer, which included certain purchasing and investment commitments related to the divested manufacturing facility. The incremental charges associated with these commitments were included in Cost of sales (\$20 million in 2011) and Other (income)/deductions—net (\$7 million in 2011).

In mid-2013, and as a result of a government-mandated sale, we sold certain product rights acquired from legacy Wyeth in Brazil. The proceeds from the sale were approximately \$6 million, net of transactions costs, and we recognized a \$6 million gain in Other (income)/deductions—net on the sale.

All of the divestiture transactions required transitional supply and service agreements, including technology transfers, where necessary and appropriate, as well as other customary ancillary agreements.

C. Certain Investments

Formation of Jilin Pfizer Guoyuan Animal Health Co., Ltd.

In October 2011, Pfizer and Jilin Guoyuan Animal Health Company, Ltd. created a new company, Jilin Pfizer Guoyuan Animal Health Co., Ltd. (Jilin), which will focus on swine vaccine development and commercialization in China. In exchange for payments of approximately \$14 million, we acquired a 45% equity interest in Jilin. We have determined that Jilin is a variable interest entity and that Zoetis is the primary beneficiary of Jilin since Zoetis (i) has the power to direct the activities of Jilin that most significantly impact Jilin's economic performance, (ii) has the right to appoint the majority of the Board of Directors and (iii) has the obligation to absorb losses of Jilin that could potentially be significant to Jilin and the right to receive benefits from Jilin that could potentially be significant to Jilin. As such, since the formation of Jilin, we have included all of the operating results, assets, liabilities and cash flows of Jilin in our consolidated and combined financial statements. The 55% interest held by Jilin Guoyuan Animal Health Company is reflected in our consolidated and combined balance sheet as a noncontrolling interest. In connection with this investment, we recorded approximately \$3 million in Identifiable intangible assets, consisting of a manufacturing license and an industrial land-use right in China, and approximately \$10 million in Goodwill.

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

We incurred significant costs in connection with Pfizer's cost-reduction initiatives (several programs initiated since 2005), and the acquisitions of FDAH on October 15, 2009 and KAH on January 31, 2011.



For example:

in connection with the cost-reduction/productivity initiatives, we typically incur costs and charges associated with site closings and other facility rationalization actions, workforce reductions and the expansion of shared services, including the development of global systems; and

77 |

---

Table of Contents

in connection with our acquisition activity, we typically incur costs and charges associated with executing the transactions, integrating the acquired operations, which may include expenditures for consulting and the integration of systems and processes, product transfers and restructuring the consolidated company, which may include charges related to employees, assets and activities that will not continue in the consolidated company.

All operating functions can be impacted by these actions, including sales and marketing, manufacturing and R&D, as well as functions such as business technology, shared services and corporate operations.

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

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011
Restructuring charges and certain acquisition-related costs:			
Integration costs <sup>(a)</sup>	\$21	\$26	\$30
Restructuring charges (benefits) <sup>(b)</sup> :			
Employee termination costs	(23	) 49	53
Accelerated depreciation	5	—	—
Asset impairment charges	19	4	—
Exit costs	4	(1	) 1
Total direct	26	78	84
Transaction costs <sup>(c)</sup>	—	—	2
Integration costs <sup>(a)</sup>	—	21	41
Restructuring charges <sup>(b)</sup> :			
Employee termination costs	—	19	20
Asset impairment charges	—	10	7
Exit costs	—	7	—
Total allocated	—	57	70
Total Restructuring charges and certain acquisition-related costs	26	135	154
Other costs associated with cost-reduction/productivity initiatives:			
Additional depreciation associated with asset restructuring—direct	1	11	9
Additional depreciation associated with asset restructuring—allocated	2	13	20
Implementation costs—direct	—	—	3
Implementation costs—allocated	1	9	—
Total costs associated with restructuring, acquisitions and cost-reduction/productivity initiatives	\$30	\$168	\$186

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

The restructuring charges (benefits) for the year ended December 31, 2013 are primarily related to the following: When we were a business unit of Pfizer, we announced a restructuring plan related to our operations in Europe. In connection with these actions, we recorded a pre-tax charge of \$27 million to recognize employee termination costs. As a result of becoming an independent public company (no longer being a majority-owned subsidiary of Pfizer) and related economic consideration, we revisited this restructuring action and decided to no longer implement this restructuring plan. As such, we reversed the existing reserve of \$27 million in the second quarter of 2013.

We recorded asset impairment charges related to one of our manufacturing facilities of \$17 million.

We recorded restructuring charges related to the exiting of certain leased manufacturing and research facilities and recorded employee termination expenses of \$2 million, exit costs of \$4 million, and accelerated depreciation of \$5 million.

The direct restructuring charges (benefits) are associated with the following:

•

For the year ended December 31, 2013—EuAfME (\$4 million), CLAR (\$4 million) and manufacturing/research/corporate (\$3 million income).

For the year ended December 31, 2012—EuAfME (\$51 million), CLAR (\$3 million), APAC (\$1 million income) and manufacturing/research/corporate (\$1 million income).

For the year ended December 31, 2011—U.S. (\$2 million), EuAfME (\$33 million), CLAR (\$2 million), APAC (\$2 million income) and manufacturing/research/corporate (\$19 million).

(c) Transaction costs represent external costs directly related to acquiring businesses and primarily include expenditures for banking, legal, accounting and other similar services.

(d) Additional depreciation associated with asset restructuring represents the impact of changes in the estimated lives of assets involved in restructuring actions. In 2013, included in Cost of sales (\$1 million) and Selling, general and administrative expenses (\$2 million). For 2012, included in Cost of sales (\$10 million), Selling, general and administrative expenses (\$5 million) and Research and development expenses (\$9 million). For 2011, included in Cost of sales (\$6 million), Selling, general and administrative expenses (\$4 million) and Research and development expenses (\$19 million).

(e) Implementation costs—allocated represent external, incremental costs directly related to implementing cost reduction/productivity initiatives, and primarily include expenditures related to system and process standardization and the expansion of shared services. Included in Selling, general and administrative expenses.

Table of Contents

The components of and changes in our direct restructuring accruals follow:

(MILLIONS OF DOLLARS)	Employee Termination Costs	Asset Impairment Charges	Accelerated Depreciation	Exit Costs	Accrual	
Balance, December 31, 2010	\$90	\$—	\$—	\$11	\$101	
Provision/(Benefit)	53	—	—	1	54	
Utilization and other <sup>(a)</sup>	(73	) —	—	(1	) (74	)
Balance, December 31, 2011	70	—	—	11	81	
Provision/(Benefit)	49	4	—	(1	) 52	
Utilization and other <sup>(a)</sup>	(51	) (4	) —	(4	) (59	)
Balance, December 31, 2012 <sup>(b)</sup>	68	—	—	6	74	
Provision/(Benefit)	(23	) 19	5	4	5	
Utilization and other <sup>(a)</sup>	(16	) —	—	(4	) (20	)
Non-cash activity	—	(19	) (5	) —	(24	)
Separation adjustment <sup>(c)</sup>	(14	) —	—	—	(14	)
Balance, December 31, 2013 <sup>(b)</sup>	\$15	\$—	\$—	\$6	\$21	

<sup>(a)</sup> Includes adjustments for foreign currency translation.

<sup>(b)</sup> At December 31, 2013 and 2012, included in Other current liabilities (\$13 million and \$63 million, respectively) and Other noncurrent liabilities (\$8 million and \$11 million, respectively).

<sup>(c)</sup> See Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— Adjustments Associated with the Separation.

#### 7. Other (Income)/Deductions—Net

The components of Other (income)/deductions—net follow:

(MILLIONS OF DOLLARS)	Year Ended December 31,			
	2013	2012	2011	
Royalty-related income	\$(23	) \$(32	) \$(26	)
Identifiable intangible asset impairment charges <sup>(a)</sup>	1	5	69	
Net gain on sale of assets <sup>(b)</sup>	(6	) —	—	
Certain legal matters, net <sup>(c)</sup>	1	(19	) —	
Foreign currency (gain)/loss <sup>(d)</sup>	20	—	(1	)
Other, net	(2	) —	6	
Other (income)/deductions—net	\$(9	) \$(46	) \$48	

In 2012, the intangible asset impairment charges include (i) approximately \$2 million of finite-lived companion animal developed technology rights; (ii) approximately \$1 million of finite-lived trademarks related to genetic testing services; and (iii) approximately \$2 million of finite-lived patents related to poultry technology. The asset impairment charges for 2012 reflect, among other things, loss of revenue as a result of negative market conditions and, with respect to the poultry technology, a re-assessment of economic viability. In 2011, the asset impairment charges include (i) approximately \$30 million of finite-lived intangible assets related to parasiticides technology as a result of declining gross margins and increased competition; (ii) approximately \$12 million of finite-lived intangible assets related to equine influenza and tetanus technology due to third-party supply issues; (iii) approximately \$10 million of finite-lived intangible assets related to genetic testing services that did not find consumer acceptance; and (iv) approximately \$17 million related to IPR&D projects (acquired from Vetnex in 2010 and from FDAH in 2009), as a result of the termination of the development programs due to a re-assessment of economic viability.

<sup>(b)</sup> For 2013, represents the net gain on the government-mandated sale of certain product rights in Brazil that were acquired with the FDAH acquisition in 2009.

<sup>(c)</sup> For 2012, represents income from a favorable legal settlement related to an intellectual property matter (\$14 million) and a change in estimate for an environmental-related reserve due to a favorable settlement (\$7 million income) partially offset by litigation-related charges (\$2 million).

For 2013, includes a foreign currency loss of \$9 million incurred in the first quarter of 2013 related to the  
(d) Venezuela currency devaluation in February 2013 and other foreign currency losses in the fourth quarter of 2013 primarily related to Argentina.

8. Tax Matters

A. Taxes on Income

As of the Separation date, we operate under a new standalone legal entity structure. In connection with the Separation, adjustments have been made to the income tax accounts. See Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— Adjustments Associated with the Separation.

For the periods prior to the Separation presented in the combined financial statements, Zoetis did not generally file separate tax returns since Zoetis was generally included in the tax grouping of other Pfizer entities within the respective entity's tax jurisdiction. The income tax provision included in these combined financial statements has been calculated using the separate return basis, as if Zoetis filed a separate tax return.

Table of Contents

The components of Income before provision for taxes on income follow:

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011
United States	\$238	\$340	\$(239 )
International	452	370	633
Income before provision for taxes on income <sup>(a)(b)</sup>	\$690	\$710	\$394

The components of Provision for taxes on income based on the location of the taxing authorities follow:

(MILLIONS OF DOLLARS)	Year Ended December 31,		
	2013	2012	2011
United States:			
Current income taxes:			
Federal	\$63	\$132	\$(3 )
State and local	12	5	(1 )
Deferred income taxes:			
Federal	10	(7 )	(19 )
State and local	2	11	(3 )
Total U.S. tax provision/(benefit)	87	141	(26 )
International:			
Current income taxes	89	211	85
Deferred income taxes	11	(78 )	87
Total international tax provision	100	133	172
Provision for taxes on income <sup>(a)(b)(c)</sup>	\$187	\$274	\$146

(a) In 2013, the Provision for taxes on income reflects the following:

U.S. tax expense of approximately \$3 million as a result of providing U.S. deferred income taxes on certain current-year income earned outside the United States that will not be indefinitely reinvested overseas (see C. Deferred Taxes);

U.S. tax benefit related to U.S. Research and Development Tax Credit which was retroactively extended on January 3, 2013, and the U.S. Domestic Production Activities deduction;

Tax expense of approximately \$25 million related to the establishment of valuation allowance; and

Tax cost related to changes in uncertain tax positions (see D. Tax Contingencies).

(b) In 2012, the Provision for taxes on income reflects the following:

U.S. tax benefits of approximately \$29.3 million, representing tax and interest, resulting from a multi-year settlement with the U.S. Internal Revenue Service with respect to audits for the years 2006 through 2008, and international tax benefits of approximately \$2.7 million, representing tax and interest, resulting from the resolution of certain tax positions pertaining to prior years with various foreign tax authorities and from the expiration of certain statutes of limitations;

U.S. tax expense of approximately \$9 million as a result of providing U.S. deferred income taxes on certain current-year income earned outside the United States that will not be indefinitely reinvested overseas (see C. Deferred Taxes);

The expiration of the U.S. Research and Development Tax Credit on December 31, 2011; and

Tax cost related to changes in uncertain tax positions (see D. Tax Contingencies).

(c) In 2011, the Provision for taxes on income reflects the following:

U.S. tax expense of approximately \$9 million as a result of providing U.S. deferred income taxes on certain current-year income earned outside of the United States that will not be indefinitely reinvested overseas; and

U.S. tax benefits of approximately \$9.5 million, representing tax and interest, resulting from the tax benefit recorded in connection with the settlement of certain audits with the U.S. Internal Revenue Service.

#### Tax Rate Reconciliation

The reconciliation of the U.S. statutory income tax rate to our effective tax rate follows:

Year Ended December 31,

Edgar Filing: Zoetis Inc. - Form 10-K

	2013		2012		2011	
U.S. statutory income tax rate	35.0	%	35.0	%	35.0	%
State and local taxes, net of federal benefits	1.0		1.7		(0.2)	)
Taxation of non-U.S. operations <sup>(a)(b)(c)</sup>	(6.7	)	5.6		2.7	
Unrecognized tax benefits and tax settlements and resolution of certain tax positions <sup>(d)</sup>	1.1		(4.1	)	(2.4	)
U.S. healthcare legislation <sup>(e)</sup>	—		(0.4	)	0.3	
U.S. Research and Development Tax Credit and U.S. Domestic Production Activities deduction <sup>(f)</sup>	(1.2	)	(0.3	)	(2.3	)
Non-deductible / non-taxable items <sup>(g)</sup>	0.5		0.8		2.1	
All other—net	(2.6	)	0.3		1.9	
Effective tax rate	27.1	%	38.6	%	37.1	%

80 |

---

Table of Contents

For taxation of non-U.S. operations, this rate impact reflects the income tax rates and relative earnings in the locations where we do business outside of the United States, together with the cost of repatriation decisions, as well as changes in uncertain tax positions not included in the reconciling item called “Unrecognized tax benefits and tax settlements and resolution of certain tax positions”: (i) the jurisdictional mix of earnings is a component of our effective tax rate each year as tax rates outside of the U.S. are generally lower than the U.S. statutory income tax rate. The rate impact of the jurisdictional mix of earnings is influenced by the specific location of non-U.S. earnings and the level of such earnings as compared to our total earnings. This rate impact is then offset or more than offset by the cost of repatriation decisions and other U.S. tax implications of our foreign operations, which may significantly impact the taxation of non-U.S. operations; and (ii) the impact of changes in uncertain tax positions not included in the reconciling item called “Unrecognized tax benefits and tax settlements and resolution of certain tax positions” is a component of our effective tax rate each year that can result in either an increase or decrease to our effective tax rate. The jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs, can vary as a result of the repatriation decisions and as a result of operating fluctuations in the normal course of business, the impact of non-deductible items and the extent and location of other income and expense items, such as restructuring charges, asset impairments and gains and losses on asset divestitures.

The rate impact of taxation of non-U.S. operations was a decrease to our effective tax rate in 2013 due to (i) the jurisdictional mix of earnings as tax rates outside of the United States are generally lower than the U.S. statutory income tax rate; and (ii) incentive tax rulings in Belgium effective December 1, 2012 and in Singapore effective October 29, 2012. The rate impact of taxation of non-U.S. operations was an increase to our effective tax rate in 2012 and 2011 due to (i) the cost of repatriation decisions and other U.S. tax implications that more than offset the impact of the generally lower tax rates outside of the United States; (ii) the tax impact of non-deductible items in those jurisdictions; and (iii) the tax impact of changes in uncertain tax positions related to our non-U.S. operations. In 2013, the impact to the rate due to increases in uncertain tax positions was more than offset by the jurisdictional mix of earnings and other U.S. tax implications of our foreign operations described in the above footnotes. The increase in the rate in 2012 as compared to 2011 is primarily due to increases in uncertain tax positions (see D. Tax Contingencies, for current and prior period increases to uncertain tax positions), of which a significant portion relates to our non-U.S. operations.

- (d) For a discussion about unrecognized tax benefits and tax settlements and resolution of certain tax positions, see A. Taxes on Income and D. Tax Contingencies.
- (e) The decrease in the rate in 2012 primarily relates to the tax benefit recorded in connection with the establishment of deferred income tax assets related to the Medicare Part D subsidy for retiree prescription drug coverage. In 2013, the decrease in the rate was due to the benefit associated with the U.S. Research and Development Tax Credit. In 2012, no benefit from the U.S. Research and Development Tax Credit was reflected as the credit expired on December 31, 2011 and was not extended until January 2013. In all years, we received a benefit from the U.S. Domestic Production Activities deduction.
- (g) Non-deductible items include meals and entertainment expenses.

**B. Tax Matters Agreement**

In connection with the Separation, we entered into a tax matters agreement with Pfizer that governs the parties' respective rights, responsibilities and obligations with respect to tax liabilities and benefits, tax attributes, the preparation and filing of tax returns, the control of audits and other tax proceedings and other matters regarding taxes. For additional information, see below and Note 17B. Transactions and Agreements with Pfizer—Agreements with Pfizer.

In connection with this agreement and the Separation, the activity in our income tax accounts reflects Separation Adjustments, including significant adjustments to the deferred income tax asset and liability accounts and the tax liabilities associated with uncertain tax positions. For additional information, see below and Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer—Adjustments Associated with the Separation.

In general, under the agreement:



Pfizer will be responsible for any U.S. federal, state, local or foreign income taxes and any U.S. state or local non-income taxes (and any related interest, penalties or audit adjustments and including those taxes attributable to our business) reportable on a consolidated, combined or unitary return that includes Pfizer or any of its subsidiaries (and us and/or any of our subsidiaries) for any periods or portions thereof ending on or prior to December 31, 2012. We will be responsible for the portion of any such taxes for periods or portions thereof beginning on or after January 1, 2013, as would be applicable to us if we filed the relevant tax returns on a standalone basis.

We will be responsible for any U.S. federal, state, local or foreign income taxes and any U.S. state or local non-income taxes (and any related interest, penalties or audit adjustments) that are reportable on returns that include only us and/or any of our subsidiaries, for all tax periods whether before or after the completion of the Separation. Pfizer will be responsible for certain specified foreign taxes directly resulting from certain aspects of the Separation. We will not generally be entitled to receive payment from Pfizer in respect of any of our tax attributes or tax benefits or any reduction of taxes of Pfizer. Neither party's obligations under the agreement will be limited in amount or subject to any cap. The agreement also assigns responsibilities for administrative matters, such as the filing of returns, payment of taxes due, retention of records and conduct of audits, examinations or similar proceedings. In addition, the agreement provides for cooperation and information sharing with respect to tax matters.

Pfizer will be primarily responsible for preparing and filing any tax return with respect to the Pfizer affiliated group for U.S. federal income tax purposes and with respect to any consolidated, combined, unitary or similar group for U.S. state or local or foreign income tax purposes or U.S. state or local non-income tax purposes that includes Pfizer or any of its subsidiaries, including those that also include us and/or any of our subsidiaries. We will generally be responsible for preparing and filing any tax returns that include only us and/or any of our subsidiaries.

The party responsible for preparing and filing a given tax return will generally have exclusive authority to control tax contests related to any such tax return.

Table of Contents

## C. Deferred Taxes

Deferred taxes arise as a result of basis differentials between financial statement accounting and tax amounts. The components of our deferred tax assets and liabilities follow:

(MILLIONS OF DOLLARS)	December 31,	
	2013	2012
	Assets (Liabilities)	
Prepaid/deferred items	\$59	\$69
Inventories	29	9
Intangibles	(111	) (187
Property, plant and equipment	(92	) (61
Employee benefits	11	54
Restructuring and other charges	4	27
Legal and product liability reserves	13	20
Net operating loss/credit carryforwards	30	219
Unremitted earnings	(3	) (86
All other	(10	) (3
Subtotal	(70	) 61
Valuation allowance	(107	) (69
Net deferred tax liability <sup>(a)(b)</sup>	\$(177	) \$(8

2013 vs. 2012-The significant increase in the total net deferred tax liability from December 31, 2012 to December 31, 2013 is primarily attributable to the Separation Adjustments, predominantly related to deferred tax assets associated with net operating loss/credit carryforwards and deferred tax liabilities associated with unremitted earnings that were retained by Pfizer, partially offset by an increase in valuation allowances representing the amounts determined to be unrecoverable. See Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— Adjustments Associated with the Separation.

In 2013, included in Current deferred tax assets (\$97 million), Noncurrent deferred tax assets (\$63 million), Other current liabilities (\$15 million) and Noncurrent deferred tax liabilities (\$322 million). In 2012, included in Current deferred tax assets (\$101 million), Noncurrent deferred tax assets (\$216 million), Other current liabilities (\$2 million) and Noncurrent deferred tax liabilities (\$323 million).

We have carryforwards, primarily related to net operating losses, which are available to reduce future foreign and U.S. state income taxes payable with either an indefinite life or expiring at various times from 2014 to 2033.

Valuation allowances are provided when we believe that our deferred tax assets are not recoverable based on an assessment of estimated future taxable income that incorporates ongoing, prudent and feasible tax planning strategies. On the basis of this evaluation, as of December 31, 2013, a valuation allowance of \$107 million has been recorded to record only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period are reduced or increased or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as projections for growth.

In general, it is our practice and intention to permanently reinvest the majority of the earnings of the company's non U.S. subsidiaries. As of December 31, 2013, the cumulative amount of such undistributed earnings was \$1.2 billion, for which we have not provided U.S. federal income and foreign withholding taxes. As these earnings are intended to be indefinitely reinvested overseas, as of December 31, 2013, we cannot predict the time or manner of such potential repatriation. As such, it is not practicable to estimate the amount of the deferred tax liability associated with these unremitted earnings due to the complexity of its hypothetical calculation.

## D. Tax Contingencies

We are subject to income tax in many jurisdictions, and a certain degree of estimation is required in recording the assets and liabilities related to income taxes. All of our tax positions are subject to audit by the local taxing authorities in each tax jurisdiction. These tax audits can involve complex issues, interpretations and judgments and the resolution

of matters may span multiple years, particularly if subject to negotiation or litigation. Our assessments are based on estimates and assumptions that have been deemed reasonable by management, but our estimates of unrecognized tax benefits and potential tax benefits may not be representative of actual outcomes, and variation from such estimates could materially affect our financial statements in the period of settlement or when the statute of limitations expire. We treat these events as discrete items in the period of resolution.

For a description of our accounting policies associated with accounting for income tax contingencies, see Note 4. Significant Accounting Policies—Deferred Tax Assets and Liabilities and Income Tax Contingencies. For a description of the risks associated with estimates and assumptions, see Note 4. Significant Accounting Policies—Estimates and Assumptions.

Table of Contents

## Uncertain Tax Positions

As tax law is complex and often subject to varied interpretations, it is uncertain whether some of our tax positions will be sustained upon audit. As of December 31, 2013 and 2012, we had approximately \$44 million and \$112 million, respectively, in net liabilities associated with uncertain tax positions, excluding associated interest:

Tax assets associated with uncertain tax positions primarily represent our estimate of the potential tax benefits in one tax jurisdiction that could result from the payment of income taxes in another tax jurisdiction. These potential benefits generally result from cooperative efforts among taxing authorities, as required by tax treaties to minimize double taxation, commonly referred to as the competent authority process. The recoverability of these assets, which we believe to be more likely than not, is dependent upon the actual payment of taxes in one tax jurisdiction and, in some cases, the successful petition for recovery in another tax jurisdiction. As of December 31, 2013 and 2012, we had approximately \$1 million and \$32 million, respectively, in assets associated with uncertain tax positions recorded in Other noncurrent assets.

Tax liabilities associated with uncertain tax positions represent unrecognized tax benefits, which arise when the estimated benefit recorded in our financial statements differs from the amounts taken or expected to be taken in a tax return because of the uncertainties described above. These unrecognized tax benefits relate primarily to issues common among multinational corporations. Substantially all of these unrecognized tax benefits, if recognized, would impact our effective income tax rate.

The reconciliation of the beginning and ending amounts of gross unrecognized tax benefits follows:

(MILLIONS OF DOLLARS)	2013	2012	2011
Balance, January 1	\$ (144 )	\$ (114 )	\$ (93 )
Adjustments associated with the Separation <sup>(a)</sup>	115	—	—
Acquisitions <sup>(b)</sup>	—	—	(19 )
Increases based on tax positions taken during a prior period <sup>(c)</sup>	(2 )	(2 )	—
Decreases based on tax positions taken during a prior period <sup>(c)(d)</sup>	—	40	1
Decreases based on cash payments for a prior period	1	3	7
Increases based on tax positions taken during the current period <sup>(c)</sup>	(16 )	(73 )	(10 )
Decreases based on tax positions taken during the current period	—	—	—
Lapse in statute of limitations	1	2	—
Balance, December 31 <sup>(e)</sup>	\$ (45 )	\$ (144 )	\$ (114 )

The significant decrease in the total gross unrecognized tax benefits from December 31, 2012 to December 31,

<sup>(a)</sup> 2013 is primarily attributable to the elimination of net tax liabilities associated with uncertain tax positions that were retained by Pfizer. See Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— Adjustments Associated with the Separation.

<sup>(b)</sup> The amount in 2011 primarily relates to the acquisition of KAH.

<sup>(c)</sup> Primarily included in Provision for taxes on income.

<sup>(d)</sup> In all years, the decreases are primarily a result of effectively settling certain issues with the U.S. and non-U.S. tax authorities. See A. Tax Matters—Taxes on Income.

<sup>(e)</sup> In 2013, included in Noncurrent deferred tax assets (\$6 million) and Other taxes payable (\$39 million). In 2012, included in Noncurrent deferred tax assets (\$6 million) and Other taxes payable (\$138 million).

Interest related to our unrecognized tax benefits is recorded in accordance with the laws of each jurisdiction and is recorded in Provision for taxes on income in our consolidated and combined statements of income. In 2013, we recorded a net interest expense of \$3 million; in 2012, we recorded a net interest expense of \$1 million; and in 2011, interest expense was de minimis. Gross accrued interest totaled \$11 million and \$17 million as of December 31, 2013 and 2012, respectively, and were included in Other taxes payable. Accrued penalties are not significant.

## Status of Tax Audits and Potential Impact on Accruals for Uncertain Tax Positions

We are subject to taxation in the United States including various states, and foreign jurisdictions. The United States is one of our major tax jurisdictions. The 2013 tax year is our only open audit year for U.S. Federal tax purposes (see B. Tax Matters Agreement for years prior to 2013). With respect to the United States, state tax years 2006-2011 are

currently under audit.

In addition to the open audit years in the United States, we have open audit years in other major foreign tax jurisdictions, such as Canada (2009-2013), Asia-Pacific (2008-2013 primarily reflecting Australia, Japan, and Korea), Europe (2009-2013, primarily reflecting the United Kingdom, France, Italy, Spain and Germany) and Latin America (2005-2013, primarily reflecting Brazil and Mexico).

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

83 |

---

Table of Contents

## 9. Accumulated Other Comprehensive Loss

Changes, net of tax, in accumulated other comprehensive loss follow:

	Currency Translation Adjustment	Benefit Plans Actuarial Gains/(Losses)	Accumulated Other Comprehensive Loss
(MILLIONS OF DOLLARS)	Net Unrealized Losses		
Balance, December 31, 2010	\$(63 )	\$(11 )	\$(74 )
Other comprehensive loss, net of tax	4	5	9
Balance, December 31, 2011	(59 )	(6 )	(65 )
Other comprehensive loss, net of tax	(93 )	1	(92 )
Balance, December 31, 2012	(152 )	(5 )	(157 )
Other comprehensive loss, net of tax	(54 )	(2 )	(56 )
Separation adjustments <sup>(a)</sup>	(6 )	—	(6 )
Balance, December 31, 2013	\$(212 )	\$(7 )	\$(219 )

(a) See Note 2B. The Separation, Adjustments Associated with the Separation, Senior Notes Offering, Initial Public Offering and Exchange Offer— Adjustments Associated with the Separation.

## 10. Financial Instruments

The combined balance sheet for the year ended December 31, 2012 includes the financial assets and liabilities that are directly attributable to the animal health operations of Pfizer, except that the combined balance sheet also includes an allocation of long-term debt from Pfizer, see Note 3. Basis of Presentation.

## A. Debt

## Credit Facilities

In December 2012, we entered into a revolving credit agreement with a syndicate of banks providing for a five-year \$1.0 billion senior unsecured revolving credit facility (the credit facility), which became effective in February 2013 upon the completion of the IPO and expires in December 2017. Subject to certain conditions, we have the right to increase the credit facility to up to \$1.5 billion. The credit facility contains a financial covenant requiring us to not exceed a maximum total leverage ratio (the ratio of consolidated net debt as of the end of the period to consolidated Earnings Before Interest, Income Taxes, Depreciation and Amortization (EBITDA) for such period) of 4.35:1 for fiscal year 2013, 3.95:1 for fiscal year 2014, 3.50:1 for fiscal year 2015 and 3.00:1 thereafter. The credit facility also contains a financial covenant requiring that we maintain a minimum interest coverage ratio (the ratio of EBITDA at the end of the period to interest expense for such period) of 3.50:1. In addition, the credit facility contains other customary covenants. We were in compliance with all financial covenants as of December 31, 2013. There were no borrowings outstanding as of December 31, 2013.

We have additional lines of credit with a group of banks and other financial intermediaries for general corporate purposes. We maintain cash and cash equivalent balances in excess of our outstanding short-term borrowings. As of December 31, 2013, we had access to \$69 million of lines of credit which expire at various times through 2016. As of December 31, 2013, we had \$15 million of short-term borrowings outstanding and \$2 million of long-term borrowings outstanding related to these facilities.

## Commercial Paper Program

In February 2013, we entered into a commercial paper program with a capacity of up to \$1.0 billion. As of December 31, 2013, no commercial paper has been issued under this program.

## Short-Term Borrowings

There were short-term borrowings of \$15 million as of December 31, 2013 (see A. Credit Facilities). As of December 31, 2012 the current portion of allocated debt from Pfizer was \$73 million. The weighted-average interest rate on short-term borrowings outstanding, including the current portion of allocated debt, was 5.7% and 3.7% as of December 31, 2013 and December 31, 2012, respectively.

## Senior Notes Offering and Other Long-Term Debt

On January 28, 2013, we issued \$3.65 billion aggregate principal amount of our senior notes (the senior notes offering) in a private placement, with an original issue discount of \$10 million. The senior notes are comprised of \$400 million aggregate principal amount of our 1.150% senior notes due 2016, \$750 million aggregate principal amount of our 1.875% senior notes due 2018, \$1.35 billion aggregate principal amount of our 3.250% senior notes due 2023 and \$1.15 billion aggregate principal amount of our 4.700% senior notes due 2043.

We sold \$2.65 billion aggregate principal amount of our senior notes through the initial purchasers in the senior notes offering and Pfizer transferred \$1.0 billion aggregate principal amount of our senior notes to certain of the initial purchasers, who sold such senior notes in the senior notes offering.

84 |

---

Table of Contents

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

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

In connection with the senior notes offering, we entered into a registration rights agreement (Registration Rights Agreement) with the representatives of the initial purchasers of the senior notes. Pursuant to the terms of the Registration Rights Agreement, we were obligated, among other things, to use our commercially reasonable efforts to file a registration statement with the Securities and Exchange Commission (SEC) enabling holders of the senior notes to exchange the privately placed notes for publicly registered notes with substantially the same terms. We filed the registration statement with the SEC on September 13, 2013, the SEC declared the registration statement effective on September 24, 2013, and the exchange offer was completed on October 31, 2013.

The components of our long-term debt follow:

(MILLIONS OF DOLLARS)	December 31, 2013	December 31, 2012
Allocated long-term debt	\$—	\$509
Lines of credit	2	—
1.150% Senior Notes due 2016	400	—
1.875% Senior Notes due 2018	750	—
3.250% Senior Notes due 2023	1,350	—
4.700% Senior Notes due 2043	1,150	—
	3,652	509
Unamortized debt discount	(10 )	—
Long-term debt / Allocated long-term debt	\$3,642	\$509

As of December 31, 2013, the fair value of our long-term debt was \$3,526 million and has been determined using a third-party matrix-pricing model that uses significant inputs derived from or corroborated by observable market data and Zoetis' credit rating (Level 2 inputs). At December 31, 2012, the fair value of our allocated long-term debt was \$732 million, and has been determined using a third-party matrix-pricing model that uses significant inputs derived from or corroborated by observable market data and Pfizer's credit rating (Level 2 inputs). See Note 4. Significant Accounting Policies— Fair Value. The fair value of the allocated long-term debt as of December 31, 2012 does not purport to reflect the fair value that might have been determined if Zoetis had operated as an independent public company for the periods presented or if we had used Zoetis' credit rating in the calculation.

The principal amount of long-term debt outstanding as of December 31, 2013 matures in the following years:

(MILLIONS OF DOLLARS)	2014	2015	2016	2017	2018	After 2018	Total
Maturities	\$—	\$—	\$401	\$1	\$750	\$2,500	\$3,652

## Interest Expense

Interest expense, net of capitalized interest, was \$113 million for 2013, \$31 million for 2012 and \$36 million for 2011. Capitalized interest expense was \$3 million for the year ended December 31, 2013. We did not have capitalized



interest expense for the years ended December 31, 2012 and 2011.

**B. Derivative Financial Instruments**

**Foreign Exchange Risk**

A significant portion of our revenue, earnings and net investment in foreign affiliates is exposed to changes in foreign exchange rates. Prior to the IPO, as a business unit of Pfizer and under Pfizer's global cash management system, our foreign exchange risk was managed through Pfizer. Following the Separation, we seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities. Depending on market conditions, foreign exchange risk is also managed through the use of derivative financial instruments. These financial instruments serve to protect net income against the impact of the translation into U.S. dollars of certain foreign exchange-denominated transactions. As of

85 |

---

Table of Contents

December 31, 2013, the aggregate notional amount of foreign exchange derivative financial instruments offsetting foreign currency exposures was \$1.4 billion. The derivative financial instruments primarily offset exposures in