NORTHEAST UTILITIES
Form 4
October 03, 2007

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
GRAHAM JOHN G

(Last) (First) (Middle)

C/O NORTHEAST UTILITIES, 107 SELDEN STREET

(Street)

BERLIN, CT 06037

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
NORTHEAST UTILITIES [NU]

3. Date of Earliest Transaction (Month/Day/Year)
10/01/2007

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
_____ Officer (give title below) __X__ Other (specify below)
Trustee

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Shares, $5.00 par value	10/01/2007		A		86	A	$ 28.99	20,415 (1)	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
GRAHAM JOHN G C/O NORTHEAST UTILITIES 107 SELDEN STREET BERLIN, CT 06037				Trustee

Signatures

John G. Graham By: O. Kay Comendul/POA	10/03/2007
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Includes restricted share units receipt of which has been deferred, shares receipt of which has been deferred, and reinvested dividend equivalents thereon.

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372

$
8

$
7

International

Revenue[b]

726

615

Cost of sales

234

213

Gross profit

492

402

Gross margin

67.8
%

65.4
%

Operating expenses

133

114

Other (income)/deductions

1

(3
)

International Earnings

358

291

11

11

Explanation of Responses:

Total operating segments

756

663

19

18

Other business activities

(81
)

(74
)

5

6

Reconciling Items:

Corporate

(153
)

(143
)

13

12

Purchase accounting adjustments

(23
)

(22
)

23

22

Acquisition-related costs

(1
)

—

—

—

Certain significant items[c]

(3
)

(4
)

—

2

Other unallocated

Explanation of Responses:

(78
)

(83
)

—

2

Total Earnings[d]

$
417

$
337

$
60

$
62

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

(b) Revenue denominated in euros was $184 million and $148 million for the three months ended March 31, 2018, and April 2, 2017, respectively.

(c) For the three months ended March 31, 2018, Certain significant items primarily includes: (i) employee termination costs of $1 million, and consulting fees of $1 million, related to our supply network strategy, and (ii) a charge of $1 million related to the implementation of new accounting guidance as a result of the enactment of the Tax Act.

For the three months ended April 2, 2017, Certain significant items primarily includes: (i) a $1 million reversal of previously accrued employee termination costs, accelerated depreciation charges of $1 million, and consulting fees of $2 million, related to our operational efficiency initiative and supply network strategy, and (ii) charges of $2 million associated with changes to our operating model.

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

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Report of Independent Registered Public Accounting Firm
To the Stockholders and Board of Directors
Zoetis, Inc.:

Results of Review of Interim Financial Information

We have reviewed the condensed consolidated balance sheet of Zoetis, Inc. and subsidiaries (the Company) as of March 31, 2018, the related condensed consolidated statements of income, comprehensive income, equity and cash flows for the three-month periods ended March 31, 2018 and April 2, 2017, and the related notes (collectively, the consolidated interim financial information). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial information for it to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of December 31, 2017, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated February 15, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

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

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

/s/ KPMG LLP
Short Hills, New Jersey
May 2, 2018

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

Overview of our business

We are a global leader in the discovery, development, manufacture and commercialization of animal health medicines and vaccines, with a focus on both livestock and companion animals. For more than 60 years we have been committed to enhancing the health of animals and bringing solutions to our customers who raise and care for them.

We manage our operations through two geographic operating segments: the United States (U.S.) and International. Within each of these operating segments, we offer a diversified product portfolio for both livestock and companion animal customers in order to capitalize on local and regional trends and customer needs. See Notes to Condensed Consolidated Financial Statements— Note 16. Segment Information.

We directly market our products to veterinarians and livestock producers located in approximately 45 countries across North America, Europe, Africa, Asia, Australia and South America, and are a market leader in nearly all of the major regions in which we operate. Through our efforts to establish an early and direct presence in many emerging markets, such as Brazil, China and Mexico, we believe we are one of the largest animal health medicines and vaccines businesses as measured by revenue across emerging markets as a whole. In markets where we do not have a direct commercial presence, we generally contract with distributors that provide logistics and sales and marketing support for our products.

We believe our investments in 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 research and development (R&D) efforts enable us to deliver innovative products to address unmet needs and evolve our product lines so they remain relevant for our customers. Additionally, our management team’s focus on improving operational and cost efficiencies increases the likelihood of achieving our core growth strategies and enhancing long-term value for our shareholders.

A summary of our 2018 performance compared with the comparable 2017 period follows:

			% Change		
	Three Months Ended			Related to	
	March 31,	April 2,		Foreign	
(MILLIONS OF DOLLARS)	2018	2017	Total	Exchange	Operational[(a)]
Revenue	$1,366	$1,231	11	4	7
Net income attributable to Zoetis	352	238	48	8	40
Adjusted net income[(a)]	365	261	40	6	34

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

Our operating environment

For a description of our operating environment, including factors which could materially affect our business, financial condition, or future results, see "Our Operating Environment" in the MD&A of our 2017 Annual Report on Form 10-K. Set forth below are updates to certain of the factors disclosed in our 2017 Form 10-K.

Quarterly Variability of Financial Results

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

Disease outbreaks

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

Foreign exchange rates

Significant portions of our revenue and costs are exposed to changes in foreign exchange rates. Our products are sold in more than 100 countries and, as a result, our revenue is influenced by changes in foreign exchange rates. For the three months ended March 31, 2018, approximately 51% of our revenue was denominated in foreign currencies. We seek to manage our foreign exchange risk, in part, through operational means, including managing same-currency revenue in relation to same-currency costs and same-currency assets in relation to same-currency liabilities. As we operate in multiple foreign currencies, including the Australian dollar, Brazilian real, Canadian dollar, Chinese yuan, euro, U.K. pound and other currencies, changes in those currencies relative to the U.S. dollar will impact our revenue, cost of goods and expenses, and consequently, net income. Exchange rate fluctuations may also have an impact beyond our reported financial results and directly impact operations. These fluctuations may affect the ability to buy and sell our goods and services between markets impacted by significant exchange

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rate variances. For the three months ended March 31, 2018, approximately 49% of our total revenue was in U.S. dollars. Our year-over-year revenue growth was favorably impacted by approximately 4% from changes in foreign currency values relative to the U.S. dollar.

Non-GAAP financial measures

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

Operational Growth

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

Adjusted Net Income and Adjusted Earnings Per Share

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

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

Analysis of the condensed consolidated statements of income

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018		April 2, 2017		% Change	
Revenue	$1,366		$1,231		11	
Costs and expenses:						
Cost of sales[(a)]	447		443		1	
% of revenue	32.7	%	36.0	%		
Selling, general and administrative expenses[(a)]	338		309		9	
% of revenue	25	%	25	%		
Research and development expenses[(a)]	97		90		8	
% of revenue	7	%	7	%		
Amortization of intangible assets[(a)]	23		22		5	
Restructuring charges/(reversals) and certain acquisition-related costs	2		(1	)	*	
Interest expense, net of capitalized interest	47		41		15	
Other (income)/deductions—net	(5	)	(10	)	(50	)
Income before provision for taxes on income	417		337		24	
% of revenue	31	%	27	%		
Provision for taxes on income	67		98		(32	)
Effective tax rate	16.1	%	29.1	%		
Net income before allocation to noncontrolling interests	350		239		46	
Less: Net income attributable to noncontrolling interests	(2	)	1		*	
Net income attributable to Zoetis	$352		$238		48	
% of revenue	26	%	19	%		

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

(a) Amortization expense related to finite-lived acquired intangible assets that contribute to our ability to sell, manufacture, research, market and distribute products, compounds and intellectual property is included in Amortization of intangible assets as these intangible assets benefit multiple business functions. Amortization expense related to finite-lived acquired intangible assets that are associated with a single function is included in Cost of sales, Selling, general and administrative expenses or Research and development expenses, as appropriate.

Revenue

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Total revenue increased by $135 million, or 11%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, an increase of $88 million, or 7%, on an operational basis. Operational revenue growth was comprised primarily of the following:

- increased volume from our in-line products contributed approximately 3%, including 2% from our key dermatology products;
- volume growth from new products contributed approximately 2%; and
- price comprised 2%.

Foreign exchange increased reported revenue growth by approximately 4%.

Costs and Expenses

Cost of sales

Three Months Ended

(MILLIONS OF DOLLARS)	March 31, 2018	April 2, 2017	% Change
Cost of sales	$447	$443	1
% of revenue	32.7 %	36.0 %	

Certain amounts and percentages may reflect rounding adjustments.

Explanation of Responses:

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Three months ended March 31, 2018 vs. three months ended April 2, 2017
Cost of sales as a percentage of revenue decreased from 36.0% to 32.7% in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, primarily as a result of:
- continued cost improvements and efficiencies in our manufacturing network,

partially offset by:
- unfavorable foreign exchange.

Selling, general and administrative expenses

	Three Months Ended		
(MILLIONS OF DOLLARS)	March 31, 2018	April 2, 2017	% Change
Selling, general and administrative expenses	$338	$309	9
% of revenue	25 %	25 %	

Certain amounts and percentages may reflect rounding adjustments.
Three months ended March 31, 2018 vs. three months ended April 2, 2017
Selling, general & administrative (SG&A) expenses increased by $29 million, or 9%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, primarily as a result of:
- an increase in certain compensation-related expenses;
- unfavorable foreign exchange;
- higher professional services and consulting charges; and
- higher advertising and promotional spending associated with new products.

Research and development expenses

	Three Months Ended		
(MILLIONS OF DOLLARS)	March 31, 2018	April 2, 2017	% Change
Research and development expenses	$97	$90	8
% of revenue	7 %	7 %	

Certain amounts and percentages may reflect rounding adjustments.
Three months ended March 31, 2018 vs. three months ended April 2, 2017
R&D expenses increased by $7 million, or 8%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, primarily as a result of:
- unfavorable foreign exchange;
- increased headcount driven by project investments;
- an increase in certain compensation-related expenses; and
- the inclusion of the Irish biologic therapeutics business acquired in 2017.

Amortization of intangible assets

	Three Months Ended		
(MILLIONS OF DOLLARS)	March 31, 2018	April 2, 2017	% Change
Amortization of intangible assets	$23	$ 22	5

Certain amounts and percentages may reflect rounding adjustments.
Three months ended March 31, 2018 vs. three months ended April 2, 2017

Amortization of intangible assets increased by $1 million, or 5%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017.

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Restructuring charges/(reversals) and certain acquisition-related costs

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017	% Change
Restructuring charges/(reversals) and certain acquisition-related costs	$2	$ (1)	*

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

During 2015, we launched a comprehensive operational efficiency program, which was incremental to the previously announced supply network strategy. These initiatives focused on reducing complexity in our product portfolios, changing our selling approach in certain markets, reducing our presence in certain countries, and exiting manufacturing sites over a long term period. We have also continued to optimize our resource allocation and efficiency by reducing resources associated with non-customer facing activities and operating more efficiently as a result of less internal complexity and more standardization of processes. As part of these initiatives, we planned to reduce certain positions through divestitures, normal attrition and involuntary terminations by approximately 2,800, subject to consultations with works councils and unions in certain countries. Including divestitures, as of March 31, 2018, approximately 2,600 positions have been eliminated as part of these initiatives. The comprehensive operational efficiency program was substantially completed as of December 31, 2017. We expect to complete the supply network strategy over the next several years.

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

For additional information regarding restructuring charges and acquisition-related costs, see Notes to Condensed Consolidated Financial Statements— Note 5. Restructuring Charges and Other Costs Associated with Acquisitions and Cost-Reduction/Productivity Initiatives.

Three months ended March 31, 2018 vs. three months ended April 2, 2017

The change in restructuring charges and certain acquisition-related costs from a $1 million reversal in the three months ended April 2, 2017, to $2 million in the three months ended March 31, 2018, is primarily the result of higher employee termination costs as a result of our supply network strategy, in addition to integration costs.

Interest expense, net of capitalized interest

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017	% Change
Interest expense, net of capitalized interest	$47	$ 41	15

Certain amounts and percentages may reflect rounding adjustments.

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Interest expense, net of capitalized interest, increased by $6 million, or 15% in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, as a result of the issuance of $1.25 billion aggregate principal amount of our senior notes in September 2017.

Other (income)/deductions—net

Three
Months

(MILLIONS OF DOLLARS)	Ended March 31, 2018	April 2, 2017	% Change
Other (income)/deductions—net	$(5)	$(10)	(50)

Certain amounts and percentages may reflect rounding adjustments.

Three months ended March 31, 2018 vs. three months ended April 2, 2017

The change in Other (income)/deductions—net from income of $10 million in the three months ended April 2, 2017, to income of $5 million in the three months ended March 31, 2018, is primarily a result of higher foreign currency losses, primarily driven by costs related to hedging and exposures to certain emerging market currencies.

Provision for taxes on income

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017	% Change
Provision for taxes on income	$67	$98	(32)
Effective tax rate	16.1%	29.1%	

Certain amounts and percentages may reflect rounding adjustments.

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On December 22, 2017, the Tax Cuts and Jobs Act (the Tax Act) was enacted which, among other changes, reduced the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. The Tax Act made broad and complex changes to the U.S. tax code and it will take time to fully analyze the impact of the changes. Based on the information available at that time, and the current interpretation of the Tax Act, for the year ended December 31, 2017 the company was able to make a reasonable estimate and recorded an initial provisional net tax expense of $212 million related to the one-time mandatory deemed repatriation tax, payable over eight years, partially offset by the remeasurement of the deferred tax assets and liabilities, as of the date of enactment, due to the reduction in the U.S. federal corporate tax rate. Pursuant to the Staff Accounting Bulletin published by the Securities and Exchange Commission on December 22, 2017, addressing the challenges in accounting for the effects of the Tax Act in the period of enactment, companies must report provisional amounts for those specific income tax effects of the Tax Act for which the accounting is incomplete but a reasonable estimate can be determined. Those provisional amounts will be subject to adjustment during a measurement period of up to one year from the enactment date (measurement-period adjustment). Pursuant to this guidance, the estimated impact of the Tax Act was based on a preliminary review of the new tax law and projected future financial results and is subject to revision based upon further analysis and interpretation of the Tax Act and to the extent that future results differ from currently available projections.

Three months ended March 31, 2018 vs. three months ended April 2, 2017

The effective tax rate was 16.1% for the three months ended March 31, 2018, compared with 29.1% for the three months ended April 2, 2017. The lower effective tax rate for the three months ended March 31, 2018, was primarily attributable to:

- reduction of the U.S. federal corporate income tax rate, effective January 1, 2018, pursuant to the Tax Act;
- changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings from operations and repatriation costs. The jurisdictional mix of earnings can vary as a result of repatriation decisions and operating fluctuations in the normal course of business and the impact of non-deductible items;
- a $8 million and $5 million discrete tax benefit recorded in the first quarter of 2018 and 2017, respectively, related to the excess tax benefits for share-based payments;
- a $8 million and $3 million discrete tax benefit recorded in the first quarter of 2018 and 2017, respectively, related to a remeasurement of deferred taxes as a result of a change in non-U.S. statutory tax rates; and
- a $2 million net discrete tax benefit recorded in the first quarter of 2018, associated with a measurement-period adjustment related to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings pursuant to the Tax Act enacted on December 22, 2017.

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Operating Segment Results

In the first quarter of 2018, the company realigned certain management responsibilities. These changes did not impact the determination of our operating segments, however they resulted in the reallocation of certain costs between segments. These changes primarily include the following: i) R&D costs related to our aquaculture business which were previously reported in Other business activities are now reported in the international commercial segment results, and ii) certain other miscellaneous costs which were previously reported in Corporate are now reported in the international commercial segment results.

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

	Three Months Ended		% Change		
				Related to	
	March 31,	April 2,		Foreign	
(MILLIONS OF DOLLARS)	2018	2017	Total	Exchange	Operational
U.S.					
Livestock	$292	$282	4	—	4
Companion animal	342	323	6	—	6
	634	605	5	—	5
International					
Livestock	478	421	14	7	7
Companion animal	248	194	28	9	19
	726	615	18	7	11
Total					
Livestock	770	703	10	4	6
Companion animal	590	517	14	3	11
Contract manufacturing	6	11	(45)	10	(55)
	$1,366	$1,231	11	4	7

Certain amounts and percentages may reflect rounding adjustments.

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017	% Change Total	Related to Foreign Exchange	Operational
U.S.					
Revenue	$634	$605	5	—	5
Cost of Sales	140	137	2	—	2
Gross Profit	494	468	6	—	6
Gross Margin	77.9 %	77.4 %			
Operating Expenses	96	96	—	—	—
Other (income)/deductions	—	—	—	—	—
U.S. Earnings	398	372	7	—	7
International					
Revenue	726	615	18	7	11
Cost of Sales	234	213	10	6	4
Gross Profit	492	402	22	8	14
Gross Margin	67.8 %	65.4 %			
Operating Expenses	133	114	17	8	9
Other (income)/deductions	1	(3)	*	*	*
International Earnings	358	291	23	8	15
Total operating segments	756	663	14	3	11
Other business activities	(81)	(74)	9		
Reconciling Items:					
Corporate	(153)	(143)	7		
Purchase accounting adjustments	(23)	(22)	5		
Acquisition-related costs	(1)	—	*		
Certain significant items	(3)	(4)	(25)		
Other unallocated	(78)	(83)	(6)		
Income before provision for taxes on income	$417	$337	24		

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Three months ended March 31, 2018 vs. three months ended April 2, 2017

U.S. operating segment

U.S. segment revenue increased by $29 million, or 5%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, reflecting growth of approximately $19 million in companion animal products and growth of approximately $10 million in livestock products.

- Companion animal revenue growth was driven primarily by increased sales in our dermatology portfolio, as well as new products. Growth was tempered by lower sales of certain in-line products due to expected competition.
- Livestock revenue increased primarily due to higher sales of cattle and poultry products and a return to growth in our swine business. Growth of cattle products was driven by favorable market conditions in the beef market, including higher feedlot placements and variable weather conditions, which drove higher disease risk and incidence. Growth

was partially offset by unfavorable market conditions in dairy, including declining producer profitability due to low milk prices. For poultry, growth was driven by increased sales of medicated feed additive products.

U.S. segment earnings increased by $26 million, or 7%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, primarily due to revenue growth and improved gross margins.

International operating segment

International segment revenue increased by $111 million, or 18%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017. Operational revenue increased by $65 million, or 11%, driven by growth of approximately $37 million in companion animal products and growth of approximately $28 million in livestock products.

- Companion animal revenue growth resulted primarily from increased sales across multiple international markets of our dermatology portfolio, and new products including Simparica®, as well as growth in vaccines in China.
- Livestock growth was driven primarily by strong performance in poultry and cattle products. Growth in poultry products was driven by increased sales of medicated feed additives, primarily in emerging markets. Cattle products grew due to the colder weather increasing treatments and strong demand for vaccines in Mexico. Strong demand in other emerging markets also contributed to growth.

Additionally, segment revenue was favorably impacted by foreign exchange, which increased revenue by approximately $46 million, or 7%, primarily driven by the appreciation of the euro, U.K. pound, Chinese renminbi, Mexican peso and Australian dollar.

International segment earnings increased by $67 million, or 23%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017. Operational earnings growth was $43 million, or 15%, primarily due to higher revenue and improved gross margin, partially offset by higher operating expenses.

Other business activities

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

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Other business activities net loss increased by $7 million, or 9%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, reflecting unfavorable foreign exchange, an increase in R&D project investments, compensation-related costs, and the inclusion of the Irish biologic therapeutics business acquired in 2017.

Reconciling items

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

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

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Corporate expenses increased by $10 million, or 7%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, primarily due to an increase in certain compensation costs not allocated to our operating segments.

Other unallocated expenses declined by $5 million, or 6%, in the three months ended March 31, 2018, compared with the three months ended April 2, 2017, primarily due to continued cost improvements and efficiencies in our manufacturing network, and lower global manufacturing and supply costs, partially offset by the unfavorable impact of foreign exchange.

See Notes to Condensed Consolidated Financial Statements—Note 16. Segment Information for further information.

Adjusted net income

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

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

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

Purchase accounting adjustments

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

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

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

Acquisition-related costs

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

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

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

Certain significant items

Adjusted net income is calculated 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; significant currency devaluation; the impact of adopting certain significant, event-driven tax legislation; or charges related to legal matters. See Notes to Condensed Consolidated Financial Statements—Note 15. Commitments and Contingencies. Our normal, ongoing defense costs or settlements of and accruals on legal matters made in the normal course of our business would not be considered certain significant items.

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Reconciliation

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017	% Change
GAAP reported net income attributable to Zoetis	$352	$238	48
Purchase accounting adjustments—net of tax	12	19	(37)
Acquisition-related costs—net of tax	1	—	*
Certain significant items—net of tax	—	4	(100)
Non-GAAP adjusted net income[(a)]	$365	$261	40

*Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

(a) The effective tax rate on adjusted pretax income is 18.2% and 27.8% for the three months ended March 31, 2018, and April 2, 2017, respectively. The lower effective tax rate for the three months ended March 31, 2018, compared with the three months ended April 2, 2017, was primarily attributable to (i) the reduction of the U.S. federal corporate income tax rate from 35% to 21%, effective January 1, 2018, pursuant to the Tax Act, (ii) changes in the jurisdictional mix of earnings, which includes the impact of the location of earnings as well as repatriation costs, (iii) a $8 million and $5 million discrete tax benefit recorded in the first quarter of 2018 and 2017, respectively, related to the excess tax benefits for share-based payments, and (iv) a $3 million discrete tax benefit recorded in the first quarter of 2018 related to a remeasurement of deferred taxes as a result of a change in non-U.S. statutory tax rates.

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

	Three Months Ended March 31, 2018	April 2, 2017	% Change
Earnings per share—diluted[(a)]			
GAAP reported EPS attributable to Zoetis—diluted	$0.72	$0.48	50
Purchase accounting adjustments—net of tax	0.03	0.04	(25)
Acquisition-related costs—net of tax	—	—	—
Certain significant items—net of tax	—	0.01	(100)
Non-GAAP adjusted EPS—diluted	$0.75	$0.53	42

Certain amounts and percentages may reflect rounding adjustments.

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

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017

Interest expense, net of capitalized interest	$47	$ 41
Interest income	6	2
Income taxes	81	101
Depreciation	33	34
Amortization	4	4

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017
Purchase accounting adjustments:		
Amortization and depreciation[a]	$21	$20
Cost of sales[a]	2	2
Total purchase accounting adjustments—pre-tax	23	22
Income taxes[b]	11	3
Total purchase accounting adjustments—net of tax	12	19
Acquisition-related costs:		
Integration costs	1	—
Total acquisition-related costs—pre-tax	1	—
Income taxes[b]	—	—
Total acquisition-related costs—net of tax	1	—
Certain significant items:		
Operational efficiency initiative[c]	—	(1)
Supply network strategy[d]	2	3
Other[e]	1	2
Total certain significant items—pre-tax	3	4
Income taxes[b]	3	—
Total certain significant items—net of tax	—	4
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	$13	$23

Certain amounts may reflect rounding adjustments.

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

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

Income taxes in Purchase accounting adjustments for the three months ended March 31, 2018, also includes a tax benefit related to the remeasurement of deferred taxes as a result of a change in non-U.S. statutory tax rates. Income taxes in Purchase accounting adjustments for the three months ended April 2, 2017, also includes a tax benefit related to the remeasurement of deferred taxes as a result of a change in tax rates and a net tax charge related to prior period tax adjustments.

Income taxes in Certain significant items for the three months ended March 31, 2018, includes a net tax benefit related to a measurement-period adjustment to the provisional one-time mandatory deemed repatriation tax on the company's undistributed non-U.S. earnings, pursuant to the Tax Act enacted on December 22, 2017. Income taxes in Certain significant items for the three months ended April 2, 2017, also includes a net charge related to the revaluation of the company’s deferred tax assets and liabilities, using the rates expected to be in place at the time of the reversal.

(c) For the three months ended April 2, 2017, represents a net reversal of previously accrued employee termination costs.

(d) For the three months ended March 31, 2018, represents consulting fees of $1 million and employee termination costs of $1 million. For the three months ended April 2, 2017, represents accelerated depreciation charges of $1 million, and consulting fees of $2 million.

(e) For the three months ended March 31, 2018, primarily represents charges related to the implementation of new accounting guidance as a result of the enactment of the Tax Act. For the three months ended April 2, 2017, represents costs associated with changes to our operating model.

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

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017
Cost of sales:		
Purchase accounting adjustments	$2	$2
Accelerated depreciation	—	1
Consulting fees	1	2
Total Cost of sales	3	5
Selling, general & administrative expenses:		
Purchase accounting adjustments	1	1
Other	1	2
Total Selling, general & administrative expenses	2	3
Research & development expenses:		
Purchase accounting adjustments	1	1
Total Research & development expenses	1	1
Amortization of intangible assets:		
Purchase accounting adjustments	19	18
Total Amortization of intangible assets	19	18
Restructuring (reversals)/ charges and certain acquisition-related costs:		
Integration costs	1	—
Employee termination costs	1	(1)
Total Restructuring (reversals)/ charges and certain acquisition-related costs	2	(1)
Provision for taxes on income	14	3
Total purchase accounting adjustments, acquisition-related costs, and certain significant items—net of tax	$13	$23

Certain amounts may reflect rounding adjustments.

Analysis of the condensed consolidated statements of comprehensive income

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

Analysis of the condensed consolidated balance sheets

March 31, 2018 vs. December 31, 2017

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

Accounts receivable, less allowance for doubtful accounts decreased as a result of the timing of customer collections.

The net changes in Deferred tax assets, Deferred tax liabilities, Income taxes payable and Other taxes payable primarily reflect adjustments to the accrual for the income tax provision for the first quarter of 2018, as well as the impact of the remeasurement of deferred taxes as a result of a change in tax rates. See Notes to Condensed

Consolidated Financial Statements— Note 7. Income Taxes.
Accounts payable decreased as a result of the timing of payments.
Accrued compensation and related items decreased primarily due to payment of 2017 annual bonuses to eligible employees and 2017 employee savings plan contributions, partially offset by the pro rata accrual of similar items for 2018.
Accrued expenses and Other current liabilities decreased primarily as a result of payment of accrued expenses, including accrued interest and accrued contract rebates.
For an analysis of the changes in Total Equity, see the Condensed Consolidated Statements of Equity and Notes to Condensed Consolidated Financial Statements— Note 13. Stockholders' Equity.

Analysis of the condensed consolidated statements of cash flows

(MILLIONS OF DOLLARS)	Three Months Ended March 31, 2018	April 2, 2017	% Change
Net cash provided by (used in):			
Operating activities	$389	$119	*
Investing activities	(45)	(48)	(6)
Financing activities	(262)	(176)	49
Effect of exchange-rate changes on cash and cash equivalents	8	7	14
Net increase (decrease) in cash and cash equivalents	$90	$(98)	*

* Calculation not meaningful.

Certain amounts and percentages may reflect rounding adjustments.

Operating activities

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Net cash provided by operating activities was $389 million for the three months ended March 31, 2018, compared with net cash provided by operating activities of $119 million for the three months ended April 2, 2017. The increase in operating cash flows was primarily attributable to higher income before allocation to noncontrolling interests and the timing of receipts and payments in the ordinary course of business.

Investing activities

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Our net cash used in investing activities was $45 million for the three months ended March 31, 2018, compared with net cash used in investing activities of $48 million for the three months ended April 2, 2017. The net cash used in investing activities for 2018 was due primarily to purchases of property, plant and equipment, partially offset by proceeds from the 2017 sale of our manufacturing site in Guarulhos, Brazil. The net cash used in investing activities for 2017 was due primarily to purchases of property, plant and equipment, the acquisition of a Norwegian fish vaccination company, and an investment related to a European livestock monitoring company.

Financing activities

Three months ended March 31, 2018 vs. three months ended April 2, 2017

Our net cash used in financing activities was $262 million for the three months ended March 31, 2018, compared with net cash used in financing activities of $176 million for the three months ended April 2, 2017. The net cash used in financing activities for 2018 and 2017 was primarily attributable to the purchase of treasury shares and the payment of dividends.

Analysis of financial condition, liquidity and capital resources

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

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

Selected measures of liquidity and capital resources

Certain relevant measures of our liquidity and capital resources follow:

(MILLIONS OF DOLLARS)	March 31, 2018	December 31, 2017
Cash and cash equivalents	$1,654	$ 1,564
Accounts receivable, net[(a)]	943	998

Long-term debt	4,954	4,953
Working capital	3,267	3,123
Ratio of current assets to current liabilities	4.27:1	3.85:1

(a) Accounts receivable are usually collected over a period of 60 to 90 days. For the three months ended March 31, 2018, compared with December 31, 2017, the number of days that accounts receivables are outstanding remained approximately the same. We regularly monitor our accounts receivable for collectability, particularly in markets where economic conditions remain uncertain. We believe that our allowance for doubtful accounts is appropriate. Our assessment is based on such factors as past due aging, historical and expected collection patterns, the financial condition of our customers, the robust nature of our credit and collection practices and the economic environment.

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

Credit facility and other lines of credit

In December 2016, we entered into an amended and restated revolving credit agreement with a syndicate of banks providing for a five-year $1.0 billion senior unsecured revolving credit facility (the credit facility). In December 2017, the maturity for the amended and restated revolving credit agreement was extended through December 2022. Subject to certain conditions, we have the right to increase the credit facility to up to $1.5 billion. The credit facility contains a financial covenant requiring us to not exceed a maximum total leverage ratio (the ratio of consolidated net debt as of the end of the period to consolidated Earnings Before Interest, Income Taxes, Depreciation and Amortization (EBITDA) for such period) of 3.50:1. Upon entering into a material acquisition, the maximum total leverage ratio increases to 4.00:1, and extends until the fourth full consecutive fiscal quarter ended immediately following the consummation of a material acquisition. The credit facility also contains a clause which adds back to Adjusted Consolidated EBITDA, any operational efficiency restructuring charge (defined as charges recorded by the company during the period commencing on October 1, 2016 and ending December 31, 2019, related to operational efficiency initiatives), provided that for any twelve-month period such charges added back to Adjusted Consolidated EBITDA shall not to exceed $100 million in the aggregate.

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

We were in compliance with all financial covenants as of March 31, 2018 and December 31, 2017. There were no amounts drawn under the credit facility as of March 31, 2018 or December 31, 2017.

We have additional lines of credit and other credit arrangements with a group of banks and other financial intermediaries for general corporate purposes. We maintain cash and cash equivalent balances in excess of our outstanding short-term borrowings. As of March 31, 2018, we had access to $71 million of lines of credit which expire at various times throughout 2018 and 2019 and are generally renewed annually. We did not have any borrowings outstanding related to these facilities as of March 31, 2018 and December 31, 2017.

Domestic and international short-term funds

Many of our operations are conducted outside the United States. The amount of funds held in the United States will fluctuate due to the timing of receipts and payments in the ordinary course of business and due to other reasons, such as business development activities. As part of our ongoing liquidity assessments, we regularly monitor the mix of U.S. and international cash flows (both inflows and outflows). Repatriation of overseas funds can result in additional U.S. state income taxes, foreign withholding taxes and currency gains and losses. We recorded U.S. deferred tax liabilities associated with the one-time mandatory deemed repatriation tax imposed by the Tax Act to the extent amounts earned overseas are expected to be indefinitely reinvested outside the United States, no accrual for foreign withholding taxes and currency gains and losses 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.

Debt

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

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

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

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

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The components of our long-term debt, including current portion of long-term debt, follow:

Description	Principal Amount	Interest Rate	Terms
2015 Senior Note due 2020	$500 million	3.450%	Interest due semi annually, not subject to amortization, aggregate principal due on November 13, 2020
2013 Senior Note due 2023	$1,350 million	3.250%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2023
2015 Senior Note due 2025	$750 million	4.500%	Interest due semi annually, not subject to amortization, aggregate principal due on November 13, 2025
2017 Senior Note due 2027	$750 million	3.000%	Interest due semi annually, not subject to amortization, aggregate principal due on September 12, 2027
2013 Senior Note due 2043	$1,150 million	4.700%	Interest due semi annually, not subject to amortization, aggregate principal due on February 1, 2043
2017 Senior Note due 2047	$500 million	3.950%	Interest due semi annually, not subject to amortization, aggregate principal due on September 12, 2047

Credit Ratings

Two major corporate debt-rating organizations, Moody's and S&P, assign ratings to our short-term and long-term debt. A security rating is not a recommendation to buy, sell or hold securities and the rating is subject to revision or withdrawal at any time by the rating organization. Each rating should be evaluated independently of any other rating. The following table provides the current ratings assigned by these rating agencies to our commercial paper and senior unsecured non-credit-enhanced long-term debt:

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

Share Repurchase Program

In December 2016, the company's Board of Directors authorized a $1.5 billion share repurchase program. Purchases of Zoetis shares may be made at the discretion of management, depending on market conditions and business needs. Share repurchases may be executed through various means, including open market or privately negotiated transactions. During the three months ended March 31, 2018, approximately 2 million shares were repurchased. As of March 31, 2018, there was approximately $810 million remaining under this authorization.

Off-balance sheet arrangements

In the ordinary course of business and in connection with the sale of assets and businesses, we may indemnify our counterparties against certain liabilities that may arise in connection with a transaction or that are related to activities prior to a transaction. These indemnifications typically pertain to environmental, tax, employee and/or product-related matters, and patent-infringement claims. If the indemnified party were to make a successful claim pursuant to the terms of the indemnification, we would be required to reimburse the loss. These indemnifications are generally subject to threshold amounts, specified claim periods and other restrictions and limitations. Historically, we have not paid significant amounts under these provisions and, as of March 31, 2018, or December 31, 2017, recorded amounts for the estimated fair value of these indemnifications are not significant.

New accounting standards

Recently Issued Accounting Standards Not Adopted as of March 31, 2018.

In February 2018, the FASB issued an accounting standards update which permits companies to reclassify from accumulated other comprehensive income to retained earnings stranded tax effects resulting from the new federal corporate income tax rate. In the period of adoption, a company may choose to either apply the amendments retrospectively to each period in which the effect of the change in federal income tax rate is recognized or to apply the amendments in that reporting period. The provisions of the update are effective beginning January 1, 2019 for interim and annual periods, with early adoption permitted for any interim period after issuance of the update. We are currently assessing the timing of our adoption and do not expect that the new standard will have a significant impact on our consolidated financial statements.

In August 2017, the FASB issued an accounting standards update which amends the hedge accounting recognition and presentation requirements and allows for more hedging strategies to be eligible for hedge accounting. Recognition of periodic hedge effectiveness will no longer be required for cash flow and net investment hedges and companies may elect to perform subsequent hedge effectiveness assessments qualitatively. The update also clarifies that the change in fair value of a derivative must be recorded in the same income statement line item as the earnings effect of the hedged item and introduces additional disclosure requirements including cumulative basis adjustments for fair value hedges and the effect of hedging on individual income statement line items. The provisions of the update are effective beginning January 1, 2019 for interim and annual periods with early adoption permitted for any interim period after issuance of the update. We are currently assessing the timing of our adoption as well as the potential impact that the standard will have on our consolidated financial statements.

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In February 2016, the FASB issued an accounting standards update which requires lessees to recognize most leases on the balance sheet with a corresponding right of use asset. Leases will be classified as financing or operating which will drive the expense recognition pattern. For lessees, the income statement presentation and expense recognition pattern for financing and operating leases is similar to the current model for capital and operating leases, respectively. Companies may elect to exclude short-term leases. The update also requires additional disclosures that will better enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. We plan to adopt this guidance as of January 1, 2019, the required effective date, for annual and interim reporting periods. The new standard requires a modified retrospective adoption approach, at the beginning of the earliest comparative period presented in the financial statements. We have selected a lease accounting system and are currently evaluating our lease contracts, accounting policy elections, and the impact of adoption on our consolidated financial statements. While we do not expect adoption of the standard to have a significant impact on our Consolidated Statements of Income, the impact on the assets and liabilities within our Consolidated Balance Sheet may be material.

Forward-looking statements and factors that may affect future results

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

In particular, forward-looking statements include statements relating to our 2018 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, integration of acquired businesses, interest rates, tax rates, changes in tax regimes and laws, foreign exchange rates, growth in emerging markets, the outcome of contingencies, such as legal proceedings, plans related to share repurchases and dividends, 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 based on 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;
- unanticipated safety, quality or efficacy concerns about 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 regulations;
- legal factors, including product liability claims, antitrust litigation and governmental investigations, including tax disputes, environmental concerns, commercial disputes and patent disputes with branded and generic competitors, any of which could preclude commercialization of products or negatively affect the profitability of existing products;
- failure to protect our intellectual property rights or to operate our business without infringing the intellectual property rights of others;
- an outbreak of infectious disease carried by animals;
- consolidation of our customers and distributors negatively affecting the pricing of our products;
- 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;
- the possible impact of competing products, including generic alternatives, on our products and our ability to compete against such products;

- quarterly fluctuations in demand and costs;
- governmental laws and regulations affecting domestic and foreign operations, including without limitation, tax obligations and changes affecting the tax treatment by the United States of income earned outside the United States that may result from pending and possible future proposals; and
- governmental laws and regulations affecting our interactions with veterinary healthcare providers.

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

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the SEC. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the above to be a complete discussion of all potential risks or uncertainties.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign exchange risk

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

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

Our financial instrument holdings at March 31, 2018, were analyzed to determine their sensitivity to foreign exchange rate changes. The fair values of these instruments were determined using Level 2 inputs. The sensitivity analysis of changes in the fair value of all foreign currency forward-exchange contracts at March 31, 2018, 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 $22 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 $29 million. For additional details, see Notes to Condensed Consolidated Financial Statements— Note 8B. Financial Instruments: Derivative Financial Instruments— Foreign Exchange Risk.

Interest rate risk

Our outstanding debt balances are predominantly fixed rate debt. While changes in interest rates will have no impact on the interest we pay on our fixed rate debt, interest on our commercial paper and revolving credit facility will be exposed to interest rate fluctuations. At March 31, 2018, there were no commercial paper borrowings outstanding and no outstanding principal balance under our revolving credit facility. See Notes to Condensed Consolidated Financial Statements— Note 8B. Financial Instruments: Derivative Financial Instruments— Interest Rate Risk.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation as of March 31, 2018, the company's Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures are effective at a reasonable level of assurance in alerting them in a timely manner to material information required to be disclosed in our periodic reports filed with the SEC.

Changes in Internal Control over Financial Reporting

During our most recent fiscal quarter, there has not been any change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION
Item 1. Legal Proceedings
The information required by this Item is incorporated herein by reference to Notes to Condensed Consolidated Financial Statements—Note 15. Commitments and Contingencies in Part I— Item 1, of this Quarterly Report on Form 10-Q.
Item 1A. Risk Factors
In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in the "Our Operating Environment" and "Forward-Looking Statements and Factors That May Affect Future Results" sections of the MD&A and in Part I, Item 1A. "Risk Factors," of our 2017 Annual Report on Form 10-K, which could materially affect our business, financial condition, or future results and which are incorporated by reference herein. Set forth below are updates to certain of the risk factors disclosed in our 2017 Annual Report on Form 10-K.
Risks related to tax matters
The Company could be subject to changes in its tax rates, the adoption of new U.S. or foreign tax legislation or exposure to additional tax liabilities.
The multinational nature of our business subjects us to taxation in the United States and numerous foreign jurisdictions. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. The company’s future effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation.
For example, the European Commission opened formal investigations to examine whether decisions by the tax authorities in certain European countries, including Belgium, comply with European Union rules on state aid. In the case of Belgium, the European Commission concluded on January 11, 2016, that the excess profits ruling violates the European Union’s state aid rules.
In addition, on June 20, 2016, the Member States of the European Union adopted the anti-tax-avoidance directive proposed on January 28, 2016, which is designed to provide uniform implementation of Base Erosion and Profits Shifting measures and other minimum taxation standards across Member States. The Member States are required to implement all components of the directive by January 1, 2020. Once enacted by the Member States, the results of the directive could have an impact on our effective tax rate. In October 2016, the European Union also introduced a proposal to impose a uniform set of rules on taxing corporate profits, known as the Common Consolidated Corporate Tax Base. This proposal is still under consideration and may have an impact to our effective tax rate.
On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the Tax Act) effective January 1, 2018. Some notable provisions of the Tax Act include a reduction of the corporate income tax rate from 35% to 21%, and a change from a worldwide system with deferral to a territorial tax system, which includes a one-time mandatory deemed repatriation tax, payable over eight years, on certain undistributed earnings of non-U.S. subsidiaries. As of December 31, 2017, the cumulative amount of non-U.S. undistributed earnings was approximately $4.5 billion, which includes an allocation of non-U.S. undistributed earnings as a result of the separation from Pfizer on June 24, 2013. Pursuant to the Staff Accounting Bulletin published by the Securities and Exchange Commission on December 22, 2017, addressing the challenges in accounting for the effects of the Tax Act in the period of enactment, companies must report provisional amounts for those specific income tax effects of the Tax Act for which the accounting is incomplete but a reasonable estimate can be determined. Those provisional amounts will be subject to adjustment during a measurement period of up to one year from the enactment date. The company is currently in the process of evaluating the full impact of this new legislation on its consolidated financial statements, and in the fourth quarter of 2017 recorded a provisional net charge of $212 million related to the one-time mandatory deemed repatriation tax, partially offset by the remeasurement of the deferred tax assets and liabilities, as of the date of enactment, due to the reduction in the U.S. federal corporate tax rate. A measurement-period adjustment was recorded in the first quarter of 2018 as a decrease to income tax expense of $2 million. At this time, we are properly reflecting the provision for taxes on income using all current enacted global tax laws in every jurisdiction in which we operate.
On March 29, 2017, United Kingdom (UK) Prime Minister Theresa May formally notified the European Council of the UK’s intention to withdraw from the European Union, commonly referred to as “Brexit”, under Article 50 of the

Treaty of Lisbon. The notice begins the two-year negotiation period to establish the withdrawal terms. If no agreement is reached after two years, the UK's separation still becomes effective, unless the remaining European Union members unanimously agree to an extension. At this time, the impact of Brexit to our effective tax rate is uncertain.
In addition, our effective tax rate is subject to potential risks that various taxing authorities may challenge the pricing of our cross-border arrangements and subject us to additional tax, adversely impacting our effective tax rate and our tax liability. The company is also subject to the examination of its tax returns and other tax matters by the Internal Revenue Service and other tax authorities and governmental bodies. The company regularly assesses the likelihood of an adverse outcome resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance as to the outcome of these examinations. If the company's effective tax rates were to increase, particularly in the United States or other material foreign jurisdictions, or if the ultimate determination of the company's taxes owed is for an amount in excess of amounts previously accrued, the company's operating results, cash flows and financial condition could be adversely affected.

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

The following table provides information with respect to the shares of the company’s common stock repurchased during the quarter ended
March 31, 2018:

Issuer Purchases of Equity Securities

	Total Number of Shares Purchased[(a)]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs[(b)]	Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs
January 1 - January 31, 2018	633,029	$75.50	631,875	$952,419,571
February 1- February 28, 2018	771,194	$76.82	596,977	$907,396,902
March 1 - March 31, 2018	1,191,009	$83.21	1,167,098	$810,241,428
	2,595,232	$79.43	2,395,950	$810,241,428

(a) The company repurchased 199,282 shares during the three-month period ended March 31, 2018, that were not part of the publicly announced share repurchase authorization. These shares were reacquired from employees to satisfy tax withholding requirements on the vesting of restricted shares from equity-based awards.

(b) In December 2016, the company's Board of Directors authorized the repurchase of up to $1.5 billion of our outstanding common stock.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit 3.1	Restated Certificate of Incorporation of the Registrant, effective as of May 13, 2014 (incorporated by reference to Exhibit 3.1 to Zoetis Inc.'s Quarterly Report on Form 10-Q filed on November 10, 2014 (File No. 001-35797))
Exhibit 3.2	By-laws of the Registrant, amended and restated as of February 19, 2016 (incorporated by reference to Exhibit 3.2 to Zoetis Inc.'s 2015 Annual Report on Form 10-K filed on February 24, 2016 (File No. 001-35797))
Exhibit 12	Computation of Ratio of Earnings to Fixed Charges
Exhibit 15	Accountants' Acknowledgment
Exhibit 31.1	Chief Executive Officer–Certification pursuant to Sarbanes-Oxley Act of 2002 Section 302
Exhibit 31.2	Chief Financial Officer–Certification pursuant to Sarbanes-Oxley Act of 2002 Section 302
Exhibit 32.1	Chief Executive Officer–Certification pursuant to Sarbanes-Oxley Act of 2002 Section 906
Exhibit 32.2	Chief Financial Officer–Certification pursuant to Sarbanes-Oxley Act of 2002 Section 906
EX-101.INS	INSTANCE DOCUMENT
EX-101.SCH	SCHEMA DOCUMENT
EX-101.CAL	CALCULATION LINKBASE DOCUMENT
EX-101.LAB	LABELS LINKBASE DOCUMENT
EX-101.PRE	PRESENTATION LINKBASE DOCUMENT
EX-101.DEF	DEFINITION LINKBASE DOCUMENT

Explanation of Responses:

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SIGNATURES

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

Zoetis Inc.

May 2, 2018 By: /S/ JUAN RAMÓN ALAIX
Juan Ramón Alaix
Chief Executive Officer and Director

May 2, 2018 By: /S/ GLENN DAVID
Glenn David
Executive Vice President and
Chief Financial Officer

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