

# The WOOF Pack

## Consolidation in US Pet Care



Source: [www.queenmobs.com](http://www.queenmobs.com)



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Source: [www.sheknows.com](http://www.sheknows.com)

### Companies

Henry Schein Inc.  
Heska Corporation  
Patterson Companies  
Zoetis Inc.

Ticker	Price	Exchange
HSIC	- \$157.13	- NASDAQ
HSKA	- 75.00	- "
PDCO	- 40.31	- "
ZTS	- 53.39	- "

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*-Please Refer To Important Disclosures On The Last Page Of This Report-*



**US Pet Care Market**



Source: Nicoleangeleen.com, zazzle.com, dogbreedslist.info, fanpop.com

The US pet care market totaled \$62.8 billion in 2016, up 4.1% from \$60.3 billion in 2015 according to the American Pet Products Association (APPA). There are currently 78 million dogs, 86 million cats, and 7.5 million horses across US households. These pets are served by approximately 55,000 veterinarians across 26,000 hospitals and clinics. Nearly 80 million households in the US, or approximately 65% of all households, own a pet, up from 56% in 1988. Today, more US households today have a dog (44.2%) or a cat (34.9%) than have a child under 25 years old (33.7%).

**Table 1 US Pet Care Market**

(\$ in billions)			
<b>Product Class</b>	<b>2016 Sales</b>	<b>2015 Sales</b>	<b>Growth</b>
Pet Food	\$24.0	\$23.1	4.2%
Veterinary Care	15.9	15.4	3.2
Supplies/OTC Medication	15.0	14.3	4.9
Live Animal Purchase	2.1	2.1	---
Other	5.7	5.4	5.9
<b>Total</b>	<b>\$62.8</b>	<b>\$60.3</b>	<b>4.1%</b>

Source: American Pet Products Association and Gabelli & Company estimates

Healthcare for pets is being driven by improving standards for animal health and new technologies. Both pets and their owners are living longer due to an increased focus on healthcare, and pet ownership remains on the rise. The American Pet Products Association (APPA) estimates that baby boomers account for 37% of all pet owners in the US. The primary market driver in the US is growth in spending per pet. The most recent APPA survey found that dog owners spend \$786 per year annually on surgical and routine veterinary care, up 20% from four years ago (4.7% CAGR). In addition to routine vaccines and medications for flea & tick, new specialty drugs for skin conditions, gastrointestinal disorders, inflammatory disease, and cancer are becoming the new standard of care. In the pet food market, premium-priced products offering all-natural ingredients or specialized formulas for different life stages or dietary needs are becoming more commonplace.

**Table 2 US Pet Ownership Statistics**

<i>(in millions)</i>	<b># Pets Owned</b>	<b># Household w/ Pet</b>	<b>% of US Households</b>
<b>Dogs</b>	77.8	54.4	44.2%
<b>Cats</b>	85.8	42.9	34.9
<b>Horses</b>	7.5	2.5	2.0

Source: 2015-2016 APPA National Pet Owners Survey, US Census Bureau

**Consolidation in US Pet Care**

Consolidation within the US pet care market remains active with seven large (\$2+ billion) deals totaling \$46 billion over the past three years. The most recent deal is Mars Inc.'s announced acquisition of VCA Inc., a leading operator of veterinary hospitals and clinics, for \$9.1 billion. At 18.2x trailing EBITDA, the valuation is consistent with the 15-20x trailing EBITDA range for deals in the US pet care sector. We note that these premium multiples have been seen across the pet care spectrum, including pharmaceuticals, pet food, distributors, and now veterinary hospitals.

We believe that the attractive fundamentals of the pet care industry have supported M&A activity at these valuations. The pet care market has shown resistance to economic downturns in a manner similar to human healthcare as several surveys have found that over 90% of pet owners consider their pet to be a member of the family. The industry also benefits from being almost exclusively cash pay, with minimal impact from third-party insurance (pet insurance accounts for approximately 1% of the market) and no reliance on Medicare, Obamacare or other government payer programs. This makes the industry unlikely to be a target of additional government regulation or a threatening tweet from the President-elect. We expect these favorable trends to continue and to support further consolidation within the industry.

**Table 3 US Pet Care Acquisitions Involving Public Companies**

(\$ in millions)							TTM Results		Multiples	
Date	Target	Buyer	Pet Subsector	Price	Revenue	EBITDA	Revenue	EBITDA		
Jan 2017	VCA Inc.	Mars Inc.	Vet hospital	\$9,100	\$2,530	\$500	3.6 x	18.2 x		
Jun 2016	Merial	Boehringer	Pharma	€11,400	€2,515	€670	4.5	17.0		
Apr "	Putney	Dechra	"	\$200	\$50		4.0			
Mar 2015	Big Heart Pet Brands	J.M. Smucker	Pet food	5,900	2,300	\$395	2.6	14.9		
Feb "	Abbott Animal Health	Zoetis	Pharma	255	80		3.2			
Jan "	MWI Veterinary	AmerisourceBergen	Distribution	2,500	2,981	130	0.8	19.2		
" "	Sentinel Brand	Virbac	Pharma	410	90		4.6			
Dec 2014	PetSmart	BC Partners	Retail	8,700	7,112	965	1.2	9.0		
Nov "	Novartis Animal Health	Eli Lilly	Pharma	5,400	1,100	255	4.9	21.2		
Aug "	Pethealth	Fairfax Financial	Insurance	100	48	5	2.1	20.0		
Apr "	P&G Pet Brands	Mars Inc.	Pet food	2,900	1,390	190	2.1	15.3		
<b>Average</b>							<b>3.1 x</b>	<b>16.9 x</b>		

Source: Company filings and Gabelli & Company estimates

**Market Outperformance in 2016, Outlook for 2017**

US pet care stocks were among the top stock performers in 2016. The 14-largest companies saw an average return of 36.6% in 2016 vs. 9.5% for the S&P 500 and -4.4% for the S&P healthcare index. Pure-play companion animal companies were among the top performers while more diversified companies with exposure to the livestock market (Zoetis) or other healthcare end markets (Henry Schein and Patterson) were among the worst performers.

We expect the underperformers of 2016 to be outperformers in 2017. Among veterinary pharmaceutical manufacturers, we continue to recommend market leader Zoetis as our favorite name. For the distributors, we recommend both Patterson and Henry Schein as opportunities to gain exposure to both the veterinary and dental markets. Among the diagnostic companies, we have a Hold recommendation on Heska due to valuation. HSKA shares rose 85% in 2016, making the company the second-best performer among US pet care companies and the top performer among pure-play animal health companies.

**Table 4 2016 Performance for Pet Care Stocks**

<b>Company</b>	<b>Ticker</b>	<b>Pet Subsector</b>	<b>2016 Performance</b>
Central Garden and Pet Co.	CENT	Food/supplies	+144.7%
Heska Corp.	HSKA	Diagnostics	85.1
IDEXX Laboratories	IDXX	"	60.8
Trupanion	TRUP	Health insurance	59.0
PetMed Express	PETS	Online retail	39.0
Aratana Therapeutics	PETX	Biotechnology	28.7
Blue Buffalo Pet Products	BUFF	Food	28.5
Kindred Biosciences	KIN	Biotechnology	25.0
VCA Antech	WOOF	Veterinary hospitals	24.8
Freshpet	FRPT	Food	19.6
Zoetis	ZTS	Pharmaceuticals	12.6
Henry Schein	HSIC	Distribution	- 4.1
Abaxis	ABAX	Diagnostics	- 4.2
Patterson Companies	PDCO	Distribution	- 7.1
<b>Average Pet Care</b>			<b>+36.6%</b>

Source: Public company stock price data, Gabelli & Company estimates

**Companies mentioned:**

Abaxis, Inc.	(ABAX – NASDAQ)	IDEXX Laboratories, Inc. (IDXX – NASDAQ)
AmerisourceBergen Corp.	(ABC – NYSE)	The J.M. Smucker Co. (SJM – NYSE)
Aratana Therapeutics, Inc.	(PETX – NASDAQ)	Kindred Biosciences, Inc. (KIN – NASDAQ)
Blue Buffalo Pet Products Inc.	(BUFF – " )	Novartis AG (NVS – NYSE)
Central Garden & Pet Co.	(CENT - " )	Patterson Companies, Inc. (PDCO – NASDAQ)
Dechra Pharmaceuticals plc	(DPH – LSE)	PetMed Express (PETS - " )
Eli Lilly & Co.	(LLY – NYSE)	Trupanion, Inc. (TRUP - " )
Freshpet, Inc.	(FRPT – NASDAQ)	VCA Inc. (WOOF - " )
Henry Schein, Inc.	(HSIC - " )	Zoetis Inc. (ZTS – NYSE)
HeskaCorp.	(HSKA - " )	

I, **Kevin Kedra**, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst’s personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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**Ratings**

Analysts’ ratings are largely (but not always) determined by our “private market value,” or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

We prepared this report as a matter of general information. We do not intend for this report to be a complete description of any security or company and it is not an offer or solicitation to buy or sell any security. All facts and statistics are from sources we believe to be reliable, but we do not guarantee their accuracy. We do not undertake to advise you of changes in our opinion or information. Unless otherwise noted, all stock prices reflect the closing price on the business day immediately prior to the date of this report. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

As of December 31, 2016, our affiliates beneficially own on behalf of their investment advisory clients or otherwise approximately 1.97% of Patterson Companies, 1.76% of IDEXX, 1.23% of Heska Corporation and less than 1% of all other companies mentioned. Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. The analyst, who wrote this report, or members of his household, owns no shares of the above mentioned companies.

Table 5

Pet Care Industry Grid

<i>(in millions, except per share data)</i>		<b>Henry Schein</b> (Nasdaq: HSIC) Melville, NY		<b>Heska</b> (Nasdaq: HSKA) Loveland, CO		<b>Patterson Companies</b> (Nasdaq: PDCO) St. Paul, MN		<b>Zoetis</b> (NYSE: ZTS) Parsippany, NJ	
12-Month High/Low		\$ 183.00	\$142.64	\$ 78.00	\$ 26.25	\$ 50.40	\$ 36.46	\$ 54.72	\$ 38.26
<b>Capitalization</b>		FYE December 31,		FYE December 31,		FYE April 30,		FYE December 31,	
Balance Sheet as of:		9/30/2016		9/30/2016		10/29/2016		9/30/2016	
Shares Outstanding		80.6		6.9		99.1		493.8	
Options/Converts		<u>0.5</u>		<u>0.5</u>		<u>0.0</u>		<u>0.0</u>	
Fully Diluted Shares Outstanding		81.1		7.4		99.1		493.8	
Price as of 12-Jan-17		\$157.13		\$75.00		\$40.31		\$53.39	
<b>Equity Market Capitalization</b>		\$ 12,742.6		\$ 557.6		\$ 3,993.9		\$ 26,365.7	
+ Total Debt and Preferred Stock		1,068.6		2.0		1,193.8		4,467.0	
+ Minority Interest		571.4		0.0		0.0		0.0	
- Cash and Equivalents		(76.2)		(9.2)		(110.8)		(651.0)	
<b>Total Enterprise Value (TEV)</b>		\$ 14,306.4		\$ 550.4		\$ 5,076.9		\$ 30,181.7	
<b>Consolidated:</b>									
<b>Net Revenues</b>	2018P	\$ 12,549.2	4.4%	\$ 156.7	10.5%	\$ 5,974.8	2.9%	\$ 5,410.0	5.2%
<i>Growth</i>	2017P	12,019.4	4.8%	141.8	13.0%	5,806.7	2.7%	5,144.8	5.0%
	2016E	\$ 11,463.6	7.8%	125.5	19.9%	\$ 5,655.8	5.0%	4,899.4	2.8%
<b>EBITDA</b>	2018P	\$ 1,177.8	9.4%	\$ 28.8	18.4%	\$ 446.3	7.5%	\$ 2,124.6	39.3%
<i>Margin</i>	2017P	1,076.1	9.0%	23.5	16.6%	438.1	7.5%	1,951.0	37.9%
	2016E	\$ 983.6	8.6%	19.0	15.1%	\$ 421.7	7.5%	1,739.3	35.5%
<b>EPS - Cont. Ops</b>	2018P	\$8.25	13.0%	\$2.02	24.8%	\$2.60	6.1%	\$2.65	15.2%
<i>Growth</i>	2017P	7.30	11.5%	1.62	14.2%	2.45	6.5%	2.30	17.9%
	2016E	\$6.55	9.9%	1.42	91.5%	\$2.30	-6.7%	1.95	10.1%
<b>P/E</b>	2018P	19.0 x		37.1 x		15.5 x		20.1 x	
	2017P	21.5		46.3		16.5		23.2	
	2016E	24.0		52.9		17.5		27.4	
<b>TEV/EBITDA</b>	2018P	12.1 x		19.1 x		11.4 x		14.2 x	
	2017P	13.3		23.4		11.6		15.5	
	2016E	14.5		29.0		12.0		17.4	
<b>Private Market Value</b>	2018P	\$208	24.5%	\$ 71	-5.6%	\$59	31.4%	\$82	35.0%
	2017P	\$184	14.6%	\$ 64	-18.1%	\$56	28.4%	\$73	26.8%
	2016E	\$162	3.3%	\$ 56	-33.5%	\$53	23.4%	\$63	15.3%

Source: Company filings and Gabelli & Company estimates

**Henry Schein, Inc. (HSIC - \$157.13 - NASDAQ)**

**Best in Class - Buy**

<u>Year</u>	<u>EPS</u> <sup>(a)</sup>	<u>P/E</u>	<u>PMV</u>		
2018P	\$8.25	19.0x	\$208	Dividend: None	Current Return: Nil
2017P	7.30	21.5	184	Shares O/S: 80.6 million	
2016E	6.55	24.0	162	52-Week Range: \$183.00 - \$142.64	
2015A	5.96	26.4	--		

(a) Adjusted EPS excluding certain restructuring and one-time items

**COMPANY OVERVIEW**

Henry Schein, Inc., based in Melville, NY, is a leading global distributor of supplies, equipment, and value-added technology services for the dental, veterinary and medical markets.

We recommend Henry Schein as the best-run company in its peer group:

- *Bouncing back from 2016.* HSIC shares fell -4.1% in 2016, making the stock one of the worst performers in the dental and veterinary sector. The decline was driven by overall weakness in healthcare stocks and a mid-year earnings guidance cut (\$0.05 per share reduction to high-end) due to softness in the US dental market. While there is still uncertainty in the US dental market heading into 2017, we have confidence in management's ability to grow the business and increase market share. We expect the company to earn \$7.30 per share in 2017, at the high-end of the guidance (\$7.17-7.30 per share), and to grow earnings to \$10.25 per share by 2020.
- *Sirona opportunity.* In November 2016, competitor Patterson Companies announced that the company would not extend its exclusive US relationship with Sirona beyond September 2017. If Sirona elects to open US distribution of its products, including the CEREC CAD/CAM system, to Henry Schein, we believe this could be a catalyst that would allow HSIC to take market share from its primary competitor. We note that HSIC currently distributes CEREC and other Sirona products outside the US.
- *Attractive end markets and valuation.* We view the dental and veterinary markets as attractive given its stable growth rates, cash-pay nature, and premium acquisition multiples that are supported by recent deal activity. With valuation at a reasonable 13.3x 2017 EBITDA (vs. 15-20x acquisition multiples) and 21.5x 2017 EPS of \$7.30 per share (vs. 20-28 P/E trading range over past three years), we believe now is the right time to buy Henry Schein. We expect the company to maintain its annual double-digit EPS growth through the end of decade, consistent with the company's historical track record of outperformance. HSIC currently trades at a 25% discount to our 2018 PMV of \$208 per share.

**Table 6**

**Henry Schein, Inc.  
 Income Statement  
 2014A – 2021P**

(\$ in millions except per share)

<u>FYE 12/31</u>	<u>2014A</u>	<u>2015A</u>	<u>2016E</u>	<u>2017P</u>	<u>2018P</u>	<u>2019P</u>	<u>2020P</u>	<u>2021P</u>
Revenue	\$ 10,371	\$ 10,630	\$ 11,464	\$ 12,019	\$ 12,549	\$ 13,146	\$ 13,800	\$ 14,408
% Growth	8.5%	2.5%	7.8%	4.8%	4.4%	4.8%	5.0%	4.4%
EBITDA	\$ 867	\$ 928	\$ 984	\$ 1,076	\$ 1,178	\$ 1,287	\$ 1,393	\$ 1,498
% Margin	8.4%	8.7%	8.6%	9.0%	9.4%	9.8%	10.1%	10.4%
Diluted EPS	\$5.44	\$5.96	\$6.55	\$7.30	\$8.25	\$9.25	\$10.25	\$11.30
% Growth	8.0%	9.6%	9.9%	11.5%	13.0%	12.1%	10.8%	10.2%

Source: Company filings and Gabelli & Company estimates

Table 7

**Henry Schein, Inc.**  
**Private Market Value Analysis**  
**2016-2021P**

(\$ in millions except per share)	<u>2016E</u>	<u>2017P</u>	<u>2018P</u>	<u>2019P</u>	<u>2020P</u>	<u>2021P</u>
<b>Revenue</b>	<b>\$ 11,464</b>	<b>\$ 12,019</b>	<b>\$ 12,549</b>	<b>\$ 13,146</b>	<b>\$ 13,800</b>	<b>\$ 14,408</b>
EBITDA	984	1,076	1,178	1,287	1,393	1,498
Valuation Multiple	15 x	15 x	15 x	15 x	15 x	15 x
Total Private Market Value	\$ 14,755	\$ 16,141	\$ 17,668	\$ 19,299	\$ 20,889	\$ 22,470
Less: Net Debt	(714)	(541)	(290)	(19)	319	717
Less: Minority Interest (a)	(571)	(571)	(571)	(571)	(571)	(571)
Less: Option Payments (b)	(236)	(270)	(309)	(351)	(394)	(439)
Equity Private Market Value	\$ 13,233	\$ 14,758	\$ 16,498	\$ 18,357	\$ 20,243	\$ 22,177
Shares Outstanding	81	80	79	78	77	76
<b>PMV per share</b>	<b>\$162</b>	<b>\$184</b>	<b>\$208</b>	<b>\$235</b>	<b>\$262</b>	<b>\$290</b>
Current Market - Discount to PMV	3%	15%	25%	33%	40%	46%

(a) Carrying value of non-controlling minority interests, including Butler Animal Health Supply

(b) After-tax payments to buy out options at PMV

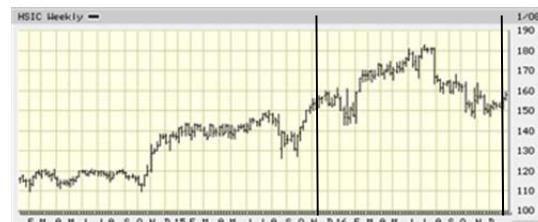
Source: Company filings and Gabelli & Company estimates

**Other Companies Mentioned:**

Dentsply Sirona (XRAY – NASDAQ)

Patterson Companies (PDCO – " )

**Henry Schein Price Performance**



Source: Public data. As of January 13, 2014 HSIC was rated a BUY, changed to a HOLD on November 6, 2015 and a BUY on January 10, 2017

I, **Kevin Kedra**, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

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A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

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**Patterson Companies, Inc. (PDCO - \$40.31 - NASDAQ)**

**Moving On - Buy**

<u>FYE 4/30</u> <sup>(a)</sup>	<u>EPS</u> <sup>(b)</sup>	<u>P/E</u>	<u>PMV</u>		
2018P	\$2.60	15.5x	\$59	Dividend: \$0.96	Current Return: 2.4%
2017P	2.45	16.5	56	Shares O/S: 99.1million	
2016E	2.30	17.5	53	52-Week Range: \$50.40 - \$36.46	
2015A	2.47	16.3	--		

(a) Fiscal year ending on April 30 of the subsequent calendar year, i.e. "2016E" ends 4/30/2017

(b) Adjusted EPS excluding certain restructuring, amortization, discontinued operations, and certain one-time items

**COMPANY OVERVIEW**

Patterson Companies, Inc., headquartered in St. Paul, MN, is a leading distributor of supplies and equipment to dental and veterinary practitioners.

We recommend Patterson as a value play on the veterinary and dental markets as the company's trading multiples are among the lowest in its peer group:

- *Worst performer in 2016.* PDCO was the worst performing stock among both veterinary and dental companies with a -7.1% decline in 2016. The weakness was driven by a poor fiscal Q2 earnings report and outlook that included the company's decision not to extend its exclusive relationship with Sirona. The company lowered its adjusted EPS guidance for fiscal 2016 by \$0.35 per share to a range of \$2.25-2.35 per share.
- *Pressure from both sides.* While softness in the US dental market has been a concern for several quarters, Patterson also reported pressure in its veterinary business on its Q2 earnings call in November. The company attributed margin pressure within its veterinary segment to consolidation among pharmaceutical manufacturers, a surprising contention given that consolidation has been occurring over the past several years. We expect the company to manage this pressure heading into fiscal 2017.
- *Resetting the base.* Since the company's Q2 earnings in November, we have reset our expectations for Patterson. We estimate adjusted EPS of \$2.30 in fiscal 2016, growing to \$2.45 in fiscal 2017 and continuing to grow annually at mid-single digits through the end of the decade. Patterson's trading multiples of 11.6x 2017 EBITDA and 16.5x 2017 adjusted EPS are among the lowest in both the dental and veterinary sectors. We recommend shares of PDCO, which currently trade at a 28% discount to our 2017 PMV of \$56 per share.

**Table 8**

**Patterson Companies  
 Income Statement  
 2014A – 2020P**

(\$ in millions, except per share data)

<u>FYE 4/30</u> (a)	<u>2014A</u>	<u>2015A</u> (b)	<u>2016E</u>	<u>2017P</u>	<u>2018P</u>	<u>2019P</u>	<u>2020P</u>	<u>5-Year CAGR</u>
Revenues	\$ 4,375	\$ 5,387	\$ 5,656	\$ 5,807	\$ 5,975	\$ 6,224	\$ 6,447	3.7%
% Growth	7.7%	23.1%	5.0%	2.7%	2.9%	4.2%	3.6%	
EBITDA	429	453	422	438	446	475	499	2.0%
% Margins	9.8%	8.4%	7.5%	7.5%	7.5%	7.6%	7.7%	
Diluted EPS	\$2.27	\$2.47	\$2.30	\$2.45	\$2.60	\$2.85	\$3.10	4.7%
% Growth	7.8%	8.7%	-6.7%	6.5%	6.1%	9.6%	8.8%	

(a) For the fiscal year ending April 30 of the subsequent calendar year

(b) Beyond 2014, excludes certain restructuring, amortization, discontinued ops, and other one-time or non-cash costs

Source: Company filings and Gabelli & Company estimates

Table 9

**Patterson Companies  
Private Market Value Analysis  
2016-2020P**

*(\$ in millions except per share data)*

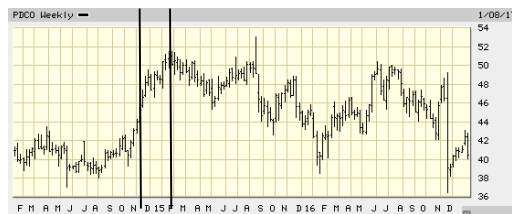
<b>FYE 4/30 (a)</b>	<b>2016E</b>	<b>2017P</b>	<b>2018P</b>	<b>2019P</b>	<b>2020P</b>
<b>Dental - Revenue</b>	\$ 2,439	\$ 2,415	\$ 2,415	\$ 2,487	\$ 2,562
EBITDA	311	309	309	327	342
Valuation Multiple	14 x	14 x	14 x	14 x	14 x
Dental PMV	\$ 4,357	\$ 4,332	\$ 4,320	\$ 4,580	\$ 4,781
<b>Veterinary - Revenue</b>	\$ 3,169	\$ 3,343	\$ 3,510	\$ 3,685	\$ 3,833
EBITDA	111	129	138	148	157
Valuation Multiple	15	15	15	15	15
Veterinary PMV	\$ 1,658	\$ 1,931	\$ 2,066	\$ 2,220	\$ 2,361
<b>Total Private Market Value</b>	\$ 6,015	\$ 6,263	\$ 6,386	\$ 6,800	\$ 7,142
Less: Net Debt	(1,014)	(1,051)	(1,088)	(1,141)	(1,194)
Less: Option Payments (b)	(40)	(44)	(46)	(51)	(56)
<b>Equity Private Market Value</b>	\$ 4,960	\$ 5,168	\$ 5,252	\$ 5,609	\$ 5,892
Shares Outstanding	94	92	89	87	84
<b>PMV per share</b>	<b>\$53</b>	<b>\$56</b>	<b>\$59</b>	<b>\$65</b>	<b>\$70</b>
<i>Current Market - Discount to PMV</i>	<i>23%</i>	<i>28%</i>	<i>31%</i>	<i>38%</i>	<i>42%</i>

(a) Fiscal year ending in April of the following calendar year

(b) After tax payments to buy out options at PMV

Source: Company filings and Gabelli & Company estimates

**Patterson Companies Price Performance**



Source: Public data. As of January 13, 2014 PDCO was rated BUY, changed to a HOLD on November 21, 2014 and a BUY on January 13, 2015

I, **Kevin Kedra**, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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**Zoetis, Inc. (ZTS - \$53.39 - NYSE)**

**Bringing Biotech to Pets - Buy**

Year	EPS <sup>(a)</sup>	P/E	PMV	Dividend: \$0.42	Current Return: 0.8%
2018P	\$2.65	20.1x	\$82	Shares O/S: 493.8 million	
2017P	2.30	23.2	73	52-Week Range: \$54.72 - \$38.26	
2016E	1.95	27.4	63		
2015A	1.77	30.1	--		

(a) Adjusted EPS excluding certain amortization, restructuring and one-time items

**COMPANY OVERVIEW**

Zoetis, located in Parsippany, NJ, is the world's largest animal health company, with medicines for both production and companion animals.

We continue to recommend Zoetis as one of the fastest growing animal health companies, driven by new specialty products in the companion animal market.

- *Bringing biotech to pets.* Over the past four quarters, Zoetis has grown its companion animal business by 14% (including 20% growth in the US). Leading this growth has been Apoquel, a blockbuster new treatment for atopic dermatitis in dogs. Zoetis expects Apoquel sales to exceed \$300 million in 2017. Additional growth drivers for 2017 and beyond include Simparica, a monthly chewable that competes in the \$2.5 billion flea and tick market, and Cytoint, a monoclonal antibody targeting IL-31 for the treatment of atopic dermatitis. Zoetis received a license for Cytoint from the USDA in December 2016.
- *Eye on consolidation.* Zoetis' net debt of \$3.8 billion represents 2.2x estimated 2016 adjusted EBITDA. This gives the company flexibility on capital allocation. Zoetis' board authorized a \$1.5 billion multi-year share repurchase program in December 2016, but we also expect the company to seek acquisition opportunities. In particular, we believe that the company could pursue deals in the diagnostics sector or potentially acquire Bayer's animal health business if that asset were to become available.
- *Updating estimates.* We are lowering our adjusted EPS estimates by \$0.05 per share beginning in 2017 to reflect foreign exchange rates (particularly the weaker Euro). We now expect 2017 adjusted EPS of \$2.30 per share, growing to \$2.65 per share in 2018. Aside from currency, the underlying fundamentals of Zoetis' business and the animal health industry remain strong. We continue to expect ZTS to grow adjusted EPS at a mid-teens annual rate through the end of the decade. With this growth rate and the company's global leadership position, we believe that Zoetis deserves a premium multiple. We recommend ZTS shares, which trade at 14.2x 2018 EBITDA, 20.1x 2018 adjusted EPS, and at a 35% discount to our 2018 PMV of \$82 per share.

**Table 10**

**Zoetis Inc.  
 Income Statement  
 2014A – 2021P**

(\$ in millions, except per share data)

<u>FYE 12/31</u>	<u>2014A</u>	<u>2015A</u>	<u>2016E</u>	<u>2017P</u>	<u>2018P</u>	<u>2019P</u>	<u>2020P</u>	<u>2021P</u>
Net Sales	\$ 4,785	\$ 4,765	\$ 4,899	\$ 5,145	\$ 5,410	\$ 5,689	\$ 5,976	\$ 6,261
% Growth	4.9%	-0.4%	2.8%	5.0%	5.2%	5.2%	5.1%	4.8%
EBITDA	1,345	1,477	1,739	1,951	2,125	2,345	2,568	2,738
% Margin	28.1%	31.0%	35.5%	37.9%	39.3%	41.2%	43.0%	43.7%
Adjusted EPS (a)	\$1.57	\$1.77	\$1.95	\$2.30	\$2.65	\$3.05	\$3.45	\$3.80
% Growth	11.0%	12.5%	10.1%	17.9%	15.2%	15.1%	13.1%	10.1%

(a) Adjusted EPS, excludes certain non-cash items, restructuring, and certain one-time items

Source: Company filings and Gabelli & Company estimates

Table 11

**Zoetis Inc.**  
**Private Market Value Analysis**  
**2016 – 2021P**

*(\$ in millions, except per share data)*

<u>FYE 12/31</u>	<u>2016E</u>	<u>2017P</u>	<u>2018P</u>	<u>2019P</u>	<u>2020P</u>	<u>2021P</u>
Production	\$ 2,878	\$ 2,960	\$ 3,104	\$ 3,255	\$ 3,416	\$ 3,574
Companion	1,967	2,128	2,248	2,374	2,499	2,625
Other	55	57	58	60	61	62
<b>Total Revenue</b>	<b>\$ 4,899</b>	<b>\$ 5,145</b>	<b>\$ 5,410</b>	<b>\$ 5,689</b>	<b>\$ 5,976</b>	<b>\$ 6,261</b>
EBITDA	1,739	1,951	2,125	2,345	2,568	2,738
Valuation Multiple	20 x	20 x	20 x	20 x	20 x	20 x
Total Private Market Value	\$ 34,786	\$ 39,019	\$ 42,492	\$ 46,900	\$ 51,367	\$ 54,768
Less: Net Debt	(3,590)	(3,068)	(2,266)	(1,288)	(124)	1,193
Less: Option Payments (a)	(65)	(82)	(98)	(118)	(139)	(157)
Equity Private Market Value	\$ 31,132	\$ 35,869	\$ 40,127	\$ 45,494	\$ 51,104	\$ 55,805
Shares Outstanding	494	492	489	487	485	483
<b>PMV Per Share</b>	<b>\$63</b>	<b>\$73</b>	<b>\$82</b>	<b>\$93</b>	<b>\$105</b>	<b>\$116</b>
<i>Current Market - Discount to PM</i>	<i>15.3%</i>	<i>26.8%</i>	<i>35.0%</i>	<i>42.9%</i>	<i>49.4%</i>	<i>53.8%</i>

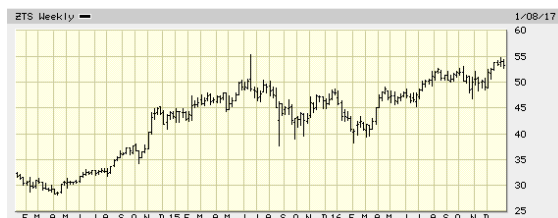
(a) After-tax payments to buy out options at PMV

Source: Company filings and Gabelli & Company estimates

**Companies Mentioned:**

Bayer AG (BAYN – Xetra)

**Zoetis Price Performance**



Source: Public data. As of January 13, 2014 ZTS was rated a BUY.

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**Heska, Inc. (HSKA - \$75.00- NASDAQ)**

**WOOF, WOOF Update - Hold**

Year	Sales(\$Mils)	TEV to Sales	PMV		
2018P	\$158	3.6x	\$71	Dividend: None	Current Return: Nil
2017P	142	4.0	64	Shares O/S: 6.9 million	
2016E	126	4.5	56	52-Week Range: \$78.00 - \$26.25	
2015A	105	5.4	---		

**COMPANY OVERVIEW**

Headquartered in Loveland, CO, Heska Corp. is a developer, manufacturer and marketer of veterinary products. Its two business segments are core companion animal health (CCA) and other vaccines, pharmaceuticals and products (OVP). Its CCA segment (80% of revenues) includes products sold to veterinarians for canine and feline use such as blood testing instruments and supplies, digital imaging products, software and services and other single-use products. Its OVP segment (20% of revenues) provides private label vaccine and pharmaceutical production, primarily cattle, to other animal health manufacturers such as Elanco. In March 2014, Heska named a new CEO, Kevin Wilson, who is bringing “a renewed focus” to Heska along with a new strategy to drive growth.

**Reason For Comment**

We are providing an update on Heska Corp. in light of the announced acquisition of VCA Inc. (WOOF) by Mars Inc.

- Mars is acquiring WOOF for \$9.1B, representing more than 18x 2016 EBITDA and 16x 2017 EBITDA. This also equates to 3.6x 2016 revenue and 31.0x 2016 P/E. This deal provides another data point of consolidation within the animal health market for a premium EBITDA multiple. We note that veterinary diagnostic providers typically trade at even higher multiples than veterinary providers.
- 2016 was Heska’s third consecutive year of double-digit sales growth driven by both its segments, CCA and OVP. We expect Heska to drive double-digit sales growth over the next few years as it continues to gain new customers and increase its installed base. We expect management to continue to rollout new product offerings and add selectively to its sales force.
- With its robust sales growth, Heska has leveraged its fixed costs and grown its operating profits, having increased its EBITDA from \$1.1 million in 2013 to an estimated \$19 million in 2016. As its sales continue to growth double digits, we expect margins will continue to improve by at least 100bps annually, absent any significant R&D investment.
- As Heska’s stock price has more than quadrupled since our Dec. 2014 initiation, we maintain our Hold recommendation on Heska. We continue to view Heska as one of the best run companies in the veterinary market; however based on our 2018 PMV of \$71 per share, we would look for a more attractive entry point that provides a margin of safety.

**Table 12**

**Table 1**

*(\$ in millions except per share data)*

**Heska Corp.**

**Heska Corp.**

**Earnings Model (2015-2020P)**

**15-'20**

	2015A	2016E	2017P	2018P	2019P	2020P	CAGR
Revenues	\$104.6	\$125.5	\$141.8	\$156.7	\$173.4	\$191.9	12.9 %
EBITDA	12.8	19.0	23.5	28.8	33.6	39.0	25.1
Diluted EPS (1)	0.74	1.40	1.60	2.00	2.40	2.75	30.1
TEV/EBITDA	44.5x	29.9x	24.1x	19.7x	16.9x	14.6x	
P/E Multiple	101.3	53.6	46.9	37.5	31.3	27.3	
TEV to Revenues	5.4	4.5	4.0	3.6	3.3	3.0	

1) 2016 EPS benefiting from FASB-ASU 2016-09 by an estimated \$0.20.

Source: Company data and Gabelli & Company estimates.

Table 13

**Heska Corporation**  
**Private Market Value Model**  
**2014A-2020P**

<i>(\$ In millions, except per share data)</i>	<b>2014A</b>	<b>2015A</b>	<b>2016E</b>	<b>2017P</b>	<b>2018P</b>	<b>2019P</b>	<b>2020P</b>	<b>15-'20 CAGR</b>
Revenue	\$89.8	\$104.6	\$125.5	\$141.8	\$156.7	\$173.4	\$191.9	12.9%
EBITDA	6.5	12.8	19.0	23.5	28.8	33.6	39.0	25.1%
Valuation Multiple (x Revenue)	3.5	3.5	3.5	3.5	3.5	3.5	3.5	
Total Private Market Value	\$314.4	\$366.1	\$439.1	\$496.2	\$548.4	\$606.7	\$671.8	
Plus: Net Cash	5.1	6.5	17.3	27.1	48.8	75.8	108.9	
Less: Minority Interest (a)	(15.5)	(13.6)	(15.8)	0.0	0.0	0.0	0.0	
Less: Restricted Stock (b)	(21.1)	(23.1)	(28.3)	(32.8)	(36.9)	(41.6)	(46.9)	
Equity Private Market Value	282.9	335.9	412.3	490.6	560.3	640.9	733.8	
Shares Outstanding	6.4	7.1	7.3	7.7	7.9	8.2	8.4	
<b>PMV Per Share</b>	<b>\$44</b>	<b>\$47</b>	<b>\$56</b>	<b>\$64</b>	<b>\$71</b>	<b>\$78</b>	<b>\$87</b>	
Current Market - Discount to PMV	-69.9%	-57.9%	-33.5%	-18.1%	-6.5%	4.1%	13.8%	

(a) Assumes Heska Imaging minority interest acquired for \$13.6 million in early 2017 with 55% in stock (10% discount to 2016 PMV), 45% cash.  
(b) Payment to option holders at PMV, net of taxes.

Source: Company data and Gabelli & Company estimates.

**Other Companies Mentioned:**

VCA Inc (WOOF – NASDAQ)

**Heska Corporation – Price Performance**



Source: Public data. As of December 12, 2014 HSKA was rated a BUY and changed to a HOLD on August 4, 2016

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