July 17, 2020

VET HEALTH MARKET ENJOYING MAJOR GROWTH

A Sector Snapshot

Featured Companies:

Elanco Animal Health (NYSE - ELAN); IDEXX Labs (NASDAQ – IDXX); PetVivo (OTC - PETV); Zoetis (NYSE – ZTS)

OUR THESIS:

The Animal Health Market appears to have the wind at its back. For the purposes of this *Sector Snapshot*, we elected to focus on companies that produce proprietary and ethical drugs, diagnostics etc., that primarily cater directly to the Veterinary Health Market, rather than mass market retail. As a result, we have identified four players that are must-watch, in our view. These include industry leader **Zoetis (NYSE – ZTS)**, sector valuation leader **IDEXX Labs (NASDAA – IDXX)**, mid-sized player **Elanco (NYSE – ELAN)**, and the emerging **PetVivo Holdings (OTC – PETV)**. As of this writing, shares of Zoetis, the undisputed bellwether stock for the space trades at a market cap of $67.8 billion, while IDEXX trades at a market cap of $28.9 billion. Interestingly, while both companies trade roughly 10x 2021E revenue, IDXX trades at a whopping 57.5x next year's EPS versus 35.8x multiple for ZTS. This report seeks to make the case for the major growth ahead in this industry. However, we proffer that while ZTS and IDXX appear fully valued, considerable upside exists for smaller and under the radar players ELAN and PETV.

THE VET HEALTH MARKET: A BRIEF OVERVIEW

According to the 2019-2020 National Pet Owners Survey conducted by the American Pet Products Association (APPA), 85 million households' own pets. The core market for the segment, which includes cats and dogs, is a bit lower as over 63 million households own at least one dog, and 42 million homes own at least one cat. It is unclear how many pets are in each home, or a mix of cats and dogs. Still, this number is very large.

It is no secret that pet owners treat their pets as members of the family and spend considerable sums for their care each year. In 2019, an estimated $95.7 billion was spent on pets in the U.S. with the figure expected to grow to $99 billion in 2020. We believe, however, that this 2020 figure could be low. Since the onset of the COVID-19 pandemic, a surge in pet ownership has occurred with some shelters and rescues devoid of any adoptable pets at all, due to skyrocketing adoption rates and applications. For example, a survey by PetPoint demonstrated that from January – mid-April 2020, 1200 animal shelters reported a 700% increase in adoption and foster applications.

Of the $99 billion in estimated spending, based on the APPA forecast, half is projected to be spent on vet care and products ($30 billion), along with supplies, live animals and OTC medicines ($20 billion)---and this excludes some core lines of business in the animal health arena. As one would expect, a major downturn in veterinary services and sales occurred during 2Q20, as much of the country was on lockdown due to COVID-19. Still, rebounds in business and services in these clinics have occurred in recent weeks and we believe that this trend will continue, as pet owners "catch up." Moreover, the space is not just driven by the growth in pet ownership. A new offering, telehealth/telemedicine, is boosting veterinary revenue.

The vet telemedicine business is relatively new, and the market's participants primarily feature software companies selling vet telemedicine platforms via a SaaS model (Software as a Service) to existing veterinary practices or actual pure play firms with vets on call via text or video chat for consumers. The model for the pure play firms is to offer the telemedicine services via subscription---monthly, quarterly, semi-annually, and annual. Interestingly, it may be simultaneously supplementing previously lost in-clinic revenue and aiding new in-clinic vet meds and medical services business, such as vaccinations, diagnostics, and surgeries. It should be noted that these figures exclude the equine market which is still robust.

ZOETIS: THE LEADER OF THE PACK

Tracing its roots back 65 years, **Zoetis Inc. (NYSE – ZTS - $142.94 – NR)** is the absolute largest player in the segment, with over $6 billion in annual revenue. The Company is noted for its medicines, vaccines and diagnostic products, which are complemented by the emerging biodevices, genetic tests and precision livestock farming offerings. Zoetis serves veterinarians, livestock producers and people who raise and care for farm and companion animals. Zoetis generates sales of its products in more than 100 countries. All told, the Company addresses a $40 billion market.

The Company seeks to own and maintain #1 market share status in the largest and most important sub-segments. These include companion animals, cattle, and swine, along with pharma and other infectives. Plus, with leading status in North America, South America and Asia, Zoetis dominates the animal health space. Plus, the Company has 12 blockbuster drugs representing 1/3 of the animal health industry and a reasonably diversified revenue stream with the top 10 products accounting for 40% of total revenue.

Zoetis strives to lead in innovation and financial performance and its approach of prevention, detection and treatment seems to have worked like a charm. Add data analytics and other initiatives on top of it and it is clear no one will knock them off the hill anytime soon.

In terms of prototypical segment leader attributes, Zoetis checks all the boxes and with diversification and leadership geographically, in target markets, and products, this behemoth is in an enviable position from. Still, in our, view, it is fully valued. This sentiment may seem counter-intuitive given that the stock is only up about 8% in 2020. But Wall Street consensus expectations are for 10% top-line growth from 2020 to 2021 ($6.17B to $6.74B), and EPS growth of 19% from $3.35 to $3.99. With 35.8x EPS multiple on next year's earnings generating a PEG (Price/Earnings Growth Ratio) of 1.88 and a 10x multiple for a 10% revenue grower just seems expensive. As much as we love the segment, perhaps it rises and falls with the market but we don't believe it outperforms it.

IDEXX LABS: AN ENIGMA?

IDEXX Laboratories Inc. (NASDAQ – IDXX - $339.20 - NR) is a fast-growing company with an impressive reach. The Company prides itself as a leader in pet healthcare innovation, serving practicing veterinarians around the world with a broad range of diagnostic and information technology-based products and services. IDEXX products seek to enhance the ability of veterinarians to provide advanced medical care, improve staff efficiency and build more economically successful practices. Importantly, IDEXX is also a worldwide leader in providing diagnostic tests and information for livestock and poultry, tests for the quality and safety of water and milk, and point-of-care and laboratory diagnostics for human medicine.

Yet, when one lifts up the proverbial hood of this company, one sees a firm that generates 88% of its sales from companion animals. Thus, if ever there was a firm to benefit from the industry trends outlined above, it is IDXX. This plays right into the Company's strategy as the growth in pet ownership is also dominated by age groups ranging from millennials through Generation Z, who tend to spend $50-75 monthly on their pets. While diagnostics business in human health has dozens of specialty players, IDEXX is the leader in this segment, with an estimated 76%+of its total revenue of a recurring nature. The Company leverages its innovative strengths and assets via consistent, annual new product (test) introductions, use of AI and tools to aid in the back-end efficiency of clinical detection and reporting PoC systems and dozens of labs across the globe. It is this soup-to-nuts approach that has fostered tremendous growth for the company.

IDXX in many ways is a darling on Wall Street. How else could you justify a stock that trades nearly 58x next year's projected EPS. Here are the numbers. In 2019, top line was $2.41B and slated to grow to $2.51B in 2020 and $2.79B in 2021. EPS was $4.89 last year and the Street forecasts essentially flat results this year. Next year's EPS is projected to reach $5.90, a roughly 20% rise, or a PEG of more than 2.8x. On a year-to-date basis, the stock is up roughly 30% and given the lofty valuation, this most favored stock has no room for error. Thus, we believe it is fairly valued.

ELANCO: CONTROVERSIAL BUT ATTRACTIVE

Elanco Animal Health Inc. (NYSE – ELAN - $24.00 – NR) is a very interesting company. Here is the skinny. The company has been hit by class action lawsuits pertaining to financial disclosures earlier in the year. Putting that aside for a moment, ELAN is down 17% year-to-date primarily because of a slowdown in its core business. The company has a great deal of exposure to the livestock market versus the higher margin, higher growth companion animal health products space. Since livestock was weak, it negatively impacted the ELAN. Nonetheless, the Company is slated to close a huge $7 billion+ acquisition of Bayer Animal Health in the first week of August

This combination will result in the formation of the world's second largest animal health company with a roughly 50/50 split of business between livestock and companion animal products/revenue. Prior to closing (it just got FTC approval), some divestitures will be undertaken and that will have an impact on financials as will other charges, etc.

Today, the stock trades at a market cap of $9.5 billion. While it is likely that the integration will take a few quarters to complete given its massive size, the Street appears to believe that major growth lies ahead. Revenue is projected to grow from $2.86B in 2020 to $317% rise. EPS is slated to jump from $0.67 in 2020 to $1.02 next year. Thus, ELAN trades about 3x 2021E projected revenue and 24x 2021 estimated EPS. Both of these figures are markedly lower than both ZTS and IDXX. Even if there are some modest hiccups on the EPS side, we believe that upside exists, with lower risk, as it can probably justify a price/revenue multiple of around 4x and a P/E of 30x, which are far lower than the two bellwethers described above. We expect it will be a bumpy ride but a fruitful one.

PETVIVO: HUGE UPSIDE DUE TO INNOVATION AND LOW VALUATION

Just Getting Started

PetVivo Holdings, Inc. (OTC – PETV - $0.80 – NR) is well-positioned to emerge as the standard of care for the treatment of osteoarthritis (OA) in dogs and horses, an unmet need representing an estimated $3.2B market. OA is a condition with degenerating cartilage that creates joint stiffness from mechanical stress, resulting in pain and inflammation. *Kush®,* the Company's lead product, is a veterinarian-administered joint injection for the treatment of osteoarthritis and lameness in dogs and horses. Following its $15M R&D and product development investment, *Kush®* is set for a second half 2020 launch, with pre-production runs beginning in a few weeks in the Company's new in-house facility. In fact, *Kush®* production capacity could reach 500,000 units per year.

Given the efficacy of its treatment, affordable cost, and the emergence of new, profitable revenue streams for veterinarians, PetVivo estimates that the size of the canine and equine OA treatment markets in the U.S. and EU alone are $3.2 billion annually. Thus, PetVivo both fulfills a significant unmet need and ensures its own success by aiding the veterinary channel actively seeking additional revenue streams.

No One Trick Pony

While initially targeting canines and equines, PetVivo is an emerging biomedical device company focused on the licensing and commercialization of innovative medical devices for pets and pet therapeutics. Importantly, the Company's pipeline of products includes 17 therapeutic devices for veterinary and human clinical applications. PetVivo is leveraging investments made in the human medical device industry to commercialize therapeutics for pets. This approach accelerates the timeline to revenues for veterinary medical devices, which enter the market much earlier than the more stringently regulated pharmaceuticals. Adding what could be considered a bonus to its overall valuation, PETV recently exclusively licensed its mucoadhesive technology to a strategic partner, **Emerald Organic Products, Inc., (OTC – EMOR)** for use of CBDs in the human nutraceutical market, and plans to license products in varying therapeutic categories. Going forward, the Company will also be seeking additional licensing partners to commercialize its portfolio of proprietary human clinical therapeutics in large market sectors, including cardiovascular, orthopedic, urology and aesthetics.

New Funding, Production/Sales Milestones to Drive Valuation

Management has excelled at preparing the veterinary channel for the upcoming launch, despite the current COVID-19 pandemic. PETV has already communicated with hundreds of veterinarians around the US and in some cases sent product samples for testing. Feedback has been very positive across the board which bodes well for future market penetration.

Separately, PETV just announced a key milestone event, which is a big plus for shareholders, in our view. Ahead of the *Kush*® pre-production, PETV entered into a convertible promissory note agreement with an investor totaling $600,000. While $300,000 (for 557K shares and warrants) has already been invested the remaining 50% tranche is due upon filing of the PETV 10-K, slated to be completed in the coming weeks. The notes bear 12.5% interest and mature in March 2021. Shares are convertible at $0.28 while warrants are exercisable at $0.35.

We are not the only PETV followers that are fans of the Company's initiatives. Since our Note on June 19, 2020, the stock has more than doubled on steadily rising volume and closed at $0.80, nearly twice its $0.42 share price a month ago. Our financial projections and price target are under review but we believe that PETV could generate $10M+ in revenue sales in its first full year, which could support a valuation substantially higher well past its 52-week high of $1.00.

Judging by the valuations afforded the peer group highlighted in this snapshot, reaching our prior target of $3.00 seems a slam dunk and we believe $5.00 could potentially be justified as well. At $0.80, and with a deep pipeline of patents and products under development, PETV appears to offer the greatest upside in the publicly traded Vet/Animal Health market and is clearly the low-price alternative to the much higher priced, higher valuation peers.

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Rob Goldman founded Goldman Small Cap Research in 2009 and has over 25 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

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