Abbott Laboratories ABT [XNYS] | ★★★

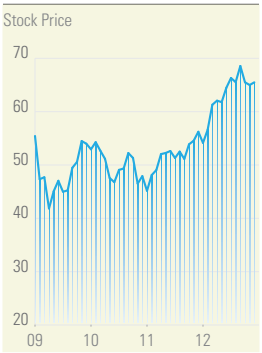
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

We see opportunities for Abbott to increase profitability.

by Debbie S. Wang
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing as of Jan 15, 2013.
Rating as of Jan 15, 2013.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Thesis Jan. 08, 2013

New Abbott faces the task of whipping a flabby company into shape. After removing the contributions of AbbVie, we now have a clearer picture of how profitable the remaining segments--nutritionals, devices, diagnostics, and established pharmaceuticals--really are. The picture is not pretty. Even though Abbott competes in businesses that are characterized by attractive margins, it appears to lag key rivals on profitability measures.

Abbott's cost structure reflects a poor combination of its individual segments. For example, Abbott's consolidated gross margin around 54% is comparable with Roche's RHHBY gross margin in diagnostics--one of the lower-margin businesses in Roche's portfolio--despite significant contributions from coronary stents and pediatric nutritionals, where competitive gross margin is 60%-65%. On the other hand, new Abbott's consolidated operating expenses are on par with those of medical devices and nutritionals, which must typically spend more on sales and marketing than the diagnostic segment. While it is not clear to us why these Abbott segments have generated such dismal margins, we suspect Humira's success may have covered a multitude of sins in the other divisions. We are heartened to see that Abbott has already taken some steps to improve efficiency, including streamlining its distribution channels and building facilities in lower-cost locations like China and India. Management has already committed to raising margins in the nutritionals business by at least 500 basis points by the end of 2015. We think this emphasis on margin improvement should pay off over the next five years.

We think the nutritional business is one of the moatiest parts of new Abbott, where it wields a leadership position in this highly consolidated market that is estimated to be $35 billion worldwide. Aside from strength in developed markets, the firm faces brighter growth prospects in emerging markets, where the growth of middle-class families has spurred demand for pediatric and adult nutrition products. Thanks to the strong Similac and Ensure brands, Abbott is in an advantageous position to introduce new formulations, line extensions, and penetrate new markets. We also note that Abbott made substantial investments early on to build out its infrastructure in emerging markets. The firm should reap the rewards of this investment as it expands the nutritional business.

These building blocks and experience with nutritionals should also play out well when applied to Abbott's established pharmaceutical product segment, which is mainly sold outside the United States. This business, frequently called branded generics, operates more like a consumer business than traditional branded drugs. For example, Abbott's branded generics will mainly be sold in less developed markets that often lack a well-developed infrastructure for distribution. Instead, Abbott must sell its products directly to pharmacy chains and physicians. As a result, brand recognition and reputation are key factors that Abbott can leverage. Selling to a fragmented market also translates into less pricing pressure for Abbott. This could change over the longer term once more emerging markets turn to the tender system that characterizes developed nations. However, that change remains far off.

We think Abbott can tread water with its device segment, but the jury is still out on its ability to innovate in this area. Abbott has demonstrated its competence at launching next-generation products that are the lifeblood of the device business, but we are less enthusiastic about its attempts at greater leaps of innovation. For example, Abbott recently obtained Food and Drug Adminstration clearance for its Xience Xpedition stent. Considering the quick product cycles and relatively high interchangeability of various drug-coated stents, it is critical for Abbott to continue rolling out next-generation stents on time to ward off price declines and defend its leadership position in coronary stents. We are confident that Abbott can keep the next-generation products rolling in vascular and diabetes (mainly glucose monitors and test strips).

Abbott Laboratories ABT [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Johnson & Johnson	USD	200,556	65,921	15,665	8,504
Mead Johnson Nutrition Company	USD	14,057	3,832	826	556
Boston Scientific, Inc.	USD	8,938	7,276	-3,815	-4,022
C.R. Bard, Inc.	USD	8,396	2,947	507	516

On the other hand, we are skeptical about the ABSORB resorbable stent and MitraClip for mitral valve regurgitation. Although management has touted these products as examples of Abbott's innovation, we think they have limited potential through the midterm. After nearly selling its diagnostics division to General Electric GE in 2007, Abbott turned around and decided to invest in the business again. As a result, the firm has been able to maintain a substantial presence in the immunoassay segment, but it has yet to make significant inroads in the growing molecular diagnostics market. While we are confident that Abbott can defend its position in the core diagnostics category, we think it faces an uphill battle in the molecular realm.

Valuation, Growth and Profitability

We have pegged new Abbott's valuation at $34 per share. We assume the firm will increase revenue at an average of 4.8% annually through 2016, fueled by strength in pediatric nutrition, adult nutrition outside the U.S., molecular diagnostics, and vascular sales. Importantly, we see much potential to improve the profitability of Abbott's remaining businesses, and this turns out to be the key factor in our valuation. On a consolidated basis, Abbott's gross margin significantly trails that of its key competitors in various business segments. The good news is that Abbott competes in several markets that offer relatively high margins, including nutritionals, branded generic drugs, and cardiovascular devices. Additionally, Abbott has already begun efforts to improve productivity and efficiency, as it streamlines distribution channels and builds new facilities in lower-cost locations like China and India. We expect Abbott can partially close that gross margin gap and project 500 basis points of improvement over the next four years. While this would still leave Abbott's profitability lagging key rivals in various business segments, it would offer a substantial boost to Abbott's gross profit that could drop to the bottom line. We do not expect much reduction of selling and marketing expenses because the firm will need to maintain and enhance the distribution infrastructure it has built out for penetration of emerging markets for its nutritionals and established pharma products, in particular. Additionally, Abbott will need to fortify its salesforce for the device business, which is usually a relatively expensive proposition, and investment in advertising and merchandising is also key to the nutritional segment.

Risk

Like any company involved with medical technology, Abbott is vulnerable to the threat of revolutionary innovation from competitors. This is particularly an issue with its medical devices and diagnostic business. Product quality issues or recalls could damage the firm's brands and its relationships with medical professionals. With hospital customers and payers tightening purse strings, Abbott could see greater pricing pressure. Finally, Abbott operates under the scrutiny of the FDA (as well as other regulatory agencies overseas), which can lead to delays in product approvals or production.

Bulls Say

- Abbott's Xience stent remains a powerhouse in the drug-eluting stent market, thanks to its well-established record of safety and efficacy.
- Aggressive cost-cutting plans should propel Abbott's bottom-line growth much quicker than top-line growth.
- Abbott's investments in building out its emerging-markets infrastructure should give the firm a head-start in penetrating those geographies.
- Abbott enjoys the benefits of its extensive roster of well-known, reputable nutritional brands.

Bears Say

- Clinical data on drug-eluting stents and alternative therapies have put a crimp in percutaneous coronary procedures, as medical therapy and coronary bypass have

Abbott Laboratories ABT [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

gained favor.

- Abbott faces an uphill battle in the diagnostics arena where it must go head-to-head against market leader Roche, along with energetic upstarts like Qiagen and Hologic.
- Considering the heterogeneity involved in mitral valve disease, we are skeptical MitraClip will move beyond niche use for certain inoperable patients.
- Abbott's nutritional segment is unlikely to see much growth in the developed markets.

Financial Overview

Financial Health:Now that Abbott has spun off its proprietary pharmaceutical business, the firm received proceeds that were largely used to tender debt. It is now sitting on approximately $2 billion in net debt, leading to financial leverage that is manageable at 1.9. Abbott's stable cash flows should easily meet interest expenses with ample reserves left for share repurchases, increases to dividends, and small acquisitions.

Company Overview

Profile: Abbott manufactures and markets medical devices, blood glucose monitoring kits, nutritional health-care products, diagnostic products and equipment, and branded generic drugs. Products include coronary stents, catheters, infant formula, nutritional liquids for adults, vessel closure devices, and LASIK equipment. Abbott derives approximately 60% of sales outside the United States.

Management: Overall, we rate Abbott's stewardship as standard. While the company has made some impressive acquisitions over the past decade, including Knoll, which was purchased for $6.9 billion in 2001 and brought in Humira, several of the more recent acquisitions, such as Advanced Medical Optics and Piramal, remain promising but have yet to fully match up to the purchase prices. Now that proprietary pharma products have been spun off, we hope management's new focus on the remaining businesses will result in greater efficiency and profitability. We'll be watching carefully to see if Abbott is able to realize the potential of the acquisitions it has made.

Miles White took the helm as CEO in 1998 and chairman of the board the following year. His tenure with Abbott dating back to 1984 provides the experience needed in handling the many operating lines of the company. We find it somewhat worrisome that White allowed the non-AbbVie related businesses to become flabby on his watch, and we will be looking for evidence that he is improving the efficiency of operations in 2013. The 11-member board is heavily weighted toward independents and former executives of other publicly traded firms in the Chicago area. There's room for improvement in compensation policies--moving away from benchmarks involving adjusted earnings per share and EBIT to other measures focused on return on invested capital.

Abbott Laboratories ABT [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

Analyst Notes

Abbott Posts In Line 3Q with Continued Strong Humira Growth; Company Split on Track for Jan. 1 Oct. 17, 2012

Abbott ABT reported third-quarter results that largely matched our expectations as well as consensus expectations and we don't expect any significant changes to our fair value estimate of $70. On the top line, total sales came in a little light, increasing 4% operationally versus the prior-year period as immunology drug Humira and testosterone drug AndroGel posted solid gains offsetting expected weakness in the vascular business. On the bottom line, earnings per share slightly exceeded expectations, increasing 10% year over year, outpacing sales growth largely because of a higher-than-expected gross margin, which we believe was driven by efficiency improvements. Additionally, Abbott tightened its full-year 2012 earnings per share guidance range to $5.06-$5.08 from $5.00-$5.10, which we expect the company to easily meet and likely exceed based on strong year-to-date results.

In the quarter, sales growth largely came in as expected with continued strong growth from nutritionals, Humira, and testosterone gel AndroGel. The strength of these products helped to offset weakness from Abbott's vascular business, which lost some royalty payments from Promus sales. However, we expect the weakness in the vascular business will dissipate toward the end of the year as Abbott gains traction with its recently launched bioresorbable scaffold in Europe. Also, we continue to believe Humira will post double-digit growth over the next two years based on the drug's leading efficacy and safety profile, despite new competition likely from Pfizer's PFE oral rheumatoid arthritis drug tofacitinib in November. We expect Pfizer's competing drug will initially target patients who don't respond to Humira or another anti-TNF alpha therapy.

On the earnings front, Abbott continues to make solid strides in increasing its efficiency. Gross margins increased more than 300 basis points year over year, largely driven by the impact of foreign exchange rates and efficiency improvements. However, we don't expect this trend to continue through 2013 because the patent losses on high-margin cardiovascular drugs Tricor and Niaspan will likely weigh on profitability for the company. Cuts in marketing and support for these drugs should partially offset some of the expected gross margin impact from the loss of exclusivity.

Regarding the split of the company into two separate firms, everything looks on track for the completion of the split by the end of the year. On the capital structure front, it appears AbbVie will likely carry the bulk of the current Abbott debt, which makes sense to us given the stronger cash flows from the AbbVie business. Also, based on the stronger cash flows, AbbVie will pay out a higher dividend of $1.60 per share (assuming similar share count of AbbVie relative to current Abbott) versus the future Abbott's dividend of $0.56. The total dividend of the two future entities is 6% higher than the current dividend of Abbott. While we expected the dividend of AbbVie to be higher, we were surprised by the significantly higher tax rate to support it (22%, up from our expectations of 12%) as the firm would need to bring more-than-expected overseas cash back to the U.S. to support this dividend boost.

Pipeline Setback for Abbott with Minor Drug Bardoxolone, No Change to Fair Value Estimate Oct. 18, 2012

Abbott ABT and partner Reata Pharmaceuticals announced the discontinuation of a Phase III study with bardoxolone in chronic kidney disease due to serious adverse events and mortality in the bardoxolone treatment arm. Due to the critical side effects, we believe there is little chance that the

Abbott Laboratories ABT [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

Analyst Notes (continued)

drug will now reach the market. However, we don't expect any changes to our fair value estimate for Abbott based on this pipeline setback, since Abbott only controlled international rights (excluding Asia) for the drug. Further, we had only assumed a 65% chance of approval for the drug and potential peak sales of $1 billion by 2021, which resulted in an immaterial contribution to our fair value estimate. Additionally, we believe the recent weakness in Abbott's share price is more attributable to comments made on yesterday's third-quarter conference call that suggested a higher-than-expected tax rate (22% versus our expectations of 12%) for AbbVie as well as a lower than expected outlook for AbbVie sales (flat to down over the next couple years versus our expectations of 3% growth annually through 2014).

FDA Approves Pfizer's Likely Next Blockbuster Tofacitinib in Rheumatoid Arthritis Nov. 07, 2012

The Food and Drug Administration approved Pfizer's PFE rheumatoid arthritis drug tofacitinib (branded as Xeljanz) at the 5-milligram dosage level as second-line therapy (after failing methotrexate or having intolerance to methotrexate). While the second-line setting (competing with anti-TNF alpha therapies like Abbott's ABT Humira or Amgen's AMGN Enbrel) is a positive surprise for Pfizer, the approval of only the 5 mg dose is a negative, as the 10 mg dose showed better efficacy in clinical studies. We believe access to earlier-stage patients largely counters the negative impact of the limited, low-dose approval, and we don't expect any changes to our fair value estimate for Pfizer. Additionally, we don't expect any changes to our fair value estimate for Abbott based on the approval and increased competitive threat to the firm's leading drug Humira.

The approval of tofacitinib in the second-line setting greatly improves the competitive landscape for the drug. While we believe rheumatologists will continue to primarily prescribe anti-TNF alpha drugs in the second-line setting, due to comfort with their long–term data supporting efficacy and safety, we expect Pfizer to continue to publish longer-term extension data that should in time drive tofacitinib's penetration in new second-line patients. Also, for less severe patients, tofacitinib's oral dosing should be more appealing than injections of anti-TNF alphas. Further, approval in the second-line setting will probably make tofacitinib the drug of choice for patients failing anti-TNF alpha drugs.

The lack of approval for the 10 mg version of tofacitinib will slightly hurt the drug's competitive positioning. As a reminder, the 5 mg dose of tofacitinib failed to hit the primary structural endpoint (mTTS change from baseline) in the Phase III SOLO study while the 10 mg dose was successful. Given the importance that rheumatologists place on structural endpoints, the lack of a 10 mg dose will hurt Pfizer's ability to market tofacitinib. Other Phase III data showed better efficacy results with the 10 mg dose as well. We believe that increased side effects with the 10 mg dose kept the FDA from approving the higher dose. Despite this setback, the 5 mg dose showed very good data across Pfizer's robust Phase III development program and should drive the drug into blockbuster status.

Abbott's Breakup Yields Two Less Competitive Companies Nov. 15, 2012

Abbott Laboratories' ABT decision to break into two pieces has yielded two companies with inferior competitive dynamics and approximately the same sum-of-the-parts valuation. We value the new Abbott and AbbVie at $34 and $38 per share, respectively, which is a slight increase to our current fair value estimate of $70 per share for Abbott, which we plan to raise to $72 based on the independent valuation of the two pieces. However, we believe each company

Abbott Laboratories ABT [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

Analyst Notes (continued)

formed out of the breakup of Abbott is less competitively positioned, and we are assigning narrow moats to both the new Abbott and AbbVie.

We have pegged post-split Abbott's valuation at $34 per share. We assume the firm will increase revenue at an average of 4.8% annually through 2016, fueled by strength in pediatric nutrition, adult nutrition outside the United States, molecular diagnostics, and vascular sales. Importantly, we see much potential to improve the profitability of Abbott's remaining businesses, and this turns out to be the key factor in our valuation. On a consolidated basis, Abbott's gross margin significantly trails that of its key competitors in various business segments. The good news is that Abbott competes in several markets that offer relatively high margins, including nutritionals, branded generic drugs, and cardiovascular devices. Additionally, Abbott has already begun efforts to improve productivity and efficiency, as it streamlines distribution channels and build new facilities in lower-cost locations like China and India. We expect Abbott can partially close that gross margin gap and project 500 basis points of improvement over the next four years. While this would still leave Abbott's profitability lagging key rivals in various business segments, it would offer a substantial boost to Abbott's gross profit that could drop to the bottom line. We do not expect much reduction of selling and marketing expenses because the firm will need to maintain and enhance the distribution infrastructure it has built out for penetration of emerging markets for its nutritionals and established pharma products, in particular. Moreover, Abbott will need to fortify its salesforce for the device business, which is usually a relatively expensive proposition, and investment in advertising and merchandising is also key to the nutritionals segment.

We believe the new Abbott has a narrow moat. After stripping out Humira's patent protection and the difficulty of replicating biologics, new Abbott's remaining four businesses largely reflect narrow moats. In most cases, Abbott is one of three or four competitors that dominate the market, including nutritionals, glucose monitors, coronary stents, and immunoassays. In these markets, Abbott enjoys the benefits of efficient scale and participates in rational oligopolies. Abbott's Similac, Ensure, and various drug brands are also competitive advantages in the nutritional and overseas branded generic drug markets. Finally, Abbott relies on extensive intellectual property to ward off competitors in the device and diagnostic segments.

We value AbbVie at $38 per share, or close to $60 billion in market capitalization. Accounting for more than half of AbbVie's projected 2012 sales, Humira is the key driver of its valuation and outlook. We believe Humira's leading efficacy and relatively clean side effect profile in underpenetrated treatment areas, including rheumatoid arthritis, psoriasis, and inflammatory bowel disease, will drive an 11% five-year compound annual growth rate for the drug. However, we expect Humira sales will begin to decline approximately 20% beginning in 2018 as generic biologics increase and greater branded competition intensifies, which lowers our 10-year CAGR for the drug to negative 4%. Aside from Humira, AbbVie holds several drugs that are losing patent protection over the next five years, which offsets the near-term Humira growth and results in a total sales five-year CAGR of 5%.

We believe AbbVie supports a narrow moat based on patent-protected drugs, economies of scale, intellectual intangibles, and a powerful salesforce. As is the case for most drug firms, the core of AbbVie's moat lies in its portfolio of patent-protected drugs. However, unlike AbbVie's Big Pharma peers, which tend to carry wide moats, one drug (Humira) represents the majority of AbbVie's sales (50%) and

Abbott Laboratories ABT [XNYS] | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
33.02 USD	34.00 USD	27.20 USD	42.50 USD	Low	Narrow	Standard	AA-	Drug Manufacturers - Major

Analyst Notes (continued)

profits (greater than 70%). As a result of both emerging branded competition to Humira in the immediate term and a potential generic biosimilar threat in 2017-18, we believe excess returns are likely to persist for 10 years, but we cannot be highly certain of this 10-year outlook, which would be needed for a wide moat rating. Further supporting our narrow moat rating, AbbVie holds a relatively weak pipeline with a high concentration of new drugs in the very competitive hepatitis C market. A stronger pipeline and a more diverse product lineup would be needed for a wide moat rating. Nevertheless, AbbVie derives enormous cash flows from its current product portfolio to fund ongoing discovery and development of the next generation of drugs. The large cash flows create an economy of scale that enables AbbVie to fund the average $800 million required for a new drug.

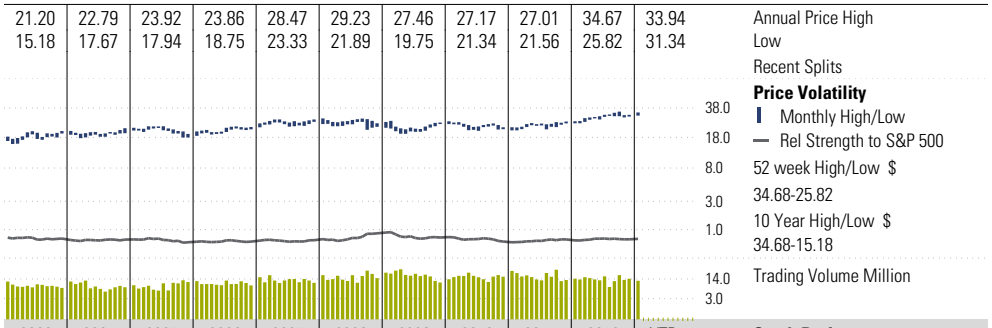
Abbott Laboratories(USD) ABT

Last Close $	Sales $Mil	Mkt Cap $Mil	Industry	Currency
$33.36	$39,414	$52,731	Drug Manufacturers - Major	USD

Abbott Laboratories is engaged in the discovery, development, manufacture, and sale of a broad and a line of health care products.

Morningstar Rating	Fair Value Uncertainty	Fair Value	Economic Moat	Style	Sector
★★★	Low	$34.00	Narrow	Large Value	

As of 01-14-2013



Annual Price High
Low
Recent Splits
Price Volatility
Monthly High/Low
Rel Strength to S&P 500
52 week High/Low $
34.68-25.82
10 Year High/Low $
34.68-15.18
Trading Volume Million

100 Abbott Park Road
Abbott Park, IL 60064-6400
Phone: +1 847 937-6100
Website: http://www.abbott.com

Growth Rates Compound Annual

Grade: B	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	10.5	9.6	11.6	9.1
Operating Income %	-5.5	0.3	23.0	11.8
Earnings/Share %	1.7	-0.2	21.9	11.8
Dividends %	9.3	10.2	10.1	8.7
Book Value/Share %	6.2	11.4	11.2	10.3
Stock Total Return	29.1	10.8	5.5	8.6
+/- Industry	7.5	-0.9	-0.1	2.7
+/- Market	12.4	-0.2	2.5	1.8

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	25.3	23.8	17.2	20.7
Return on Assets %	10.6	9.9	8.2	8.5
Revenue/Employee $K	433.1	409.6	—	1090.4
Fixed Asset Turns	4.9	4.2	3.8	7.0
Inventory Turns	4.2	4.4*	2.6	13.4
Gross Margin %	62.2	57.7	71.0	43.8
Operating Margin %	19.7	17.9	22.3	19.3
Net Margin %	16.6	14.9	16.4	13.3
Free Cash Flow/Rev %	19.1	18.9	20.9	12.0
R&D/Rev %	10.6	9.9	14.8	—

Financial Position (USD)

Grade: A	12-11 $Mil	09-12 $Mil
Cash	6813	7997
Inventories	3284	3814
Receivables	7684	6949
Current Assets	23769	27264
Fixed Assets	7874	7961
Intangibles	25695	24669
Total Assets	60277	63258
Payables	2990	3123
Short-Term Debt	3375	4225
Current Liabilities	15480	16286
Long-Term Debt	12040	12055
Total Liabilities	35837	36244
Total Equity	24440	27014

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	8.1	16.6	16.8	15.0
Forward P/E	5.6	—	—	13.1
Price/Cash Flow	5.7	10.5	10.7	9.2
Price/Free Cash Flow	7.0	12.5	13.2	75.1
Dividend Yield %	5.0	3.1	3.7	2.3
Price/Book	2.0	3.8	2.9	2.1
Price/Sales	1.3	2.5	2.7	2.5
PEG Ratio	0.7	—	—	1.7

*3Yr Avg data is displayed in place of 5 Yr Avg

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD	Stock Performance
18.9	8.8	-13.2	26.5	17.9	-2.4	4.1	-8.1	21.3	20.1	6.9	Total Return %
-9.8	-2.0	-18.1	10.7	12.4	34.5	-22.4	-23.1	19.2	4.1	3.7	+/- Market
3.3	13.0	-15.4	12.3	14.5	14.9	-11.2	-11.4	5.7	4.8	2.4	+/- Industry
2.1	2.2	2.8	2.4	2.3	2.6	2.9	3.6	3.3	3.1	5.0	Dividend Yield %
32756	34762	29266	35772	41516	39621	40071	35463	41912	49538	52731	Market Cap $Mil
2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**TTM**	**Financials (USD)**
15280	17280	19680	22338	22476	25914	29528	30765	35167	38851	39414	Revenue $Mil
55.4	55.0	54.9	52.4	56.3	55.9	57.3	57.1	58.3	60.0	62.2	Gross Margin %
3152	2974	3898	4362	2042	4579	5694	6236	6088	5752	7752	Oper Income $Mil
20.6	17.2	19.8	19.5	9.1	17.7	19.3	20.3	17.3	14.8	19.7	Operating Margin %
2794	2753	3236	3372	1717	3606	4881	5746	4626	4728	6528	Net Income $Mil
1.78	1.75	2.02	2.16	1.12	2.31	3.03	3.69	2.96	3.01	4.11	Earnings Per Share $
0.92	0.97	1.03	1.09	1.16	1.27	1.41	1.56	1.72	1.88	1.98	Dividends $
1573	1572	1571	1564	1537	1560	1561	1547	1556	1567	1588	Shares Mil
6.83	8.36	9.20	9.29	9.16	11.51	11.27	14.73	14.66	15.69	17.09	Book Value Per Share $
3992	3553	4467	5174	5329	5184	6995	7275	8736	8970	9213	Oper Cash Flow $Mil
-1105	-1050	-1292	-1207	-1338	-1656	-1288	-1089	-1015	-1492	-1684	Cap Spending $Mil
2887	2503	3175	3967	3991	3528	5707	6186	7721	7479	7529	Free Cash Flow $Mil
2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**TTM**	**Profitability**
11.8	11.0	11.8	11.7	5.3	9.5	11.9	12.1	8.2	7.8	10.6	Return on Assets %
28.3	23.2	23.6	23.5	12.1	22.7	27.7	28.5	20.3	20.1	25.3	Return on Equity %
0.64	0.69	0.72	0.77	0.69	0.68	0.72	0.65	0.62	0.64	0.64	Asset Turnover
18.3	15.9	16.4	15.1	7.6	13.9	16.5	18.7	13.2	12.2	16.6	Net Margin %
2.3	2.0	2.0	2.0	2.6	2.2	2.4	2.3	2.7	2.5	2.3	Financial Leverage
2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**09-12**	**Financial Health (USD)**
4274	3452	4788	4572	7010	9488	8713	11266	12524	12040	12055	Long-Term Debt $Mil
10665	13072	14326	14415	14054	17779	17480	22856	22677	24440	27014	Total Equity $Mil
0.40	0.26	0.33	0.32	0.50	0.53	0.50	0.49	0.55	0.49	0.45	Debt/Equity
2120	2651	3909	3971	-669	4939	5451	10264	5055	8289	10978	Working Capital $Mil
2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**TTM**	**Valuation**
26.7	23.1	18.2	43.5	24.3	17.6	14.6	16.2	18.7	15.9	8.1	Price/Earnings
0.0	0.0	—	—	0.0	0.0	0.0	0.0	—	0.0	0.5	P/E vs. Market
3.7	3.7	2.8	3.3	3.4	2.8	2.7	2.1	2.3	2.6	1.3	Price/Sales
5.6	5.1	4.2	5.3	4.9	4.7	3.7	3.3	3.6	3.8	2.0	Price/Book
19.6	16.6	11.9	14.1	16.9	11.3	11.5	8.5	9.8	11.3	5.7	Price/Cash Flow

Quarterly Results (USD)

Revenue $Mil	Dec	Mar	Jun	Sep
Most Recent	10377.0	9456.0	9807.0	9773.0
Previous	9967.0	9040.0	9616.0	9816.0
Rev Growth %	**Dec**	**Mar**	**Jun**	**Sep**
Most Recent	4.1	4.6	2.0	-0.4
Previous	13.4	17.4	9.0	13.2
Earnings Per Share $	**Dec**	**Mar**	**Jun**	**Sep**
Most Recent	1.03	0.78	1.08	1.21
Previous	0.92	0.55	1.23	0.19

Close Competitors

	Mkt Cap $Mil	Rev $Mil	P/E	ROE%
Johnson & Johnson	201083	65921	23.9	13.6
Mead Johnson Nutrition Company	14108	3832	25.5	—

Major Fund Holders

	% of shares
American Funds Capital Inc Bldr A	1.37
American Funds Invmt Co of Amer A	1.31
Vanguard Total Stock Mkt Idx Inv	1.28

MORNINGSTAR®

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

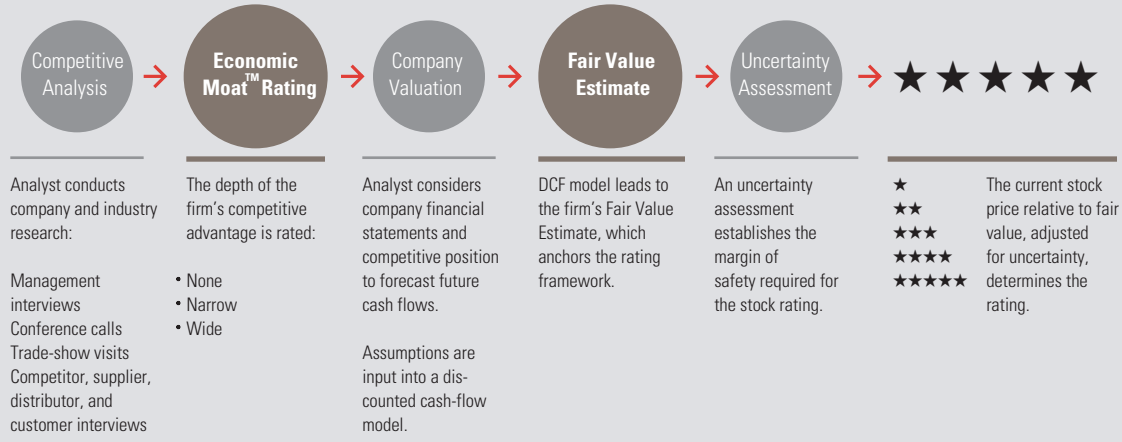
Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

Morningstar Research Methodology for Valuing Companies



MORNINGSTAR®

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.