Abbott Laboratories ABT [NYSE] | ★★★★★

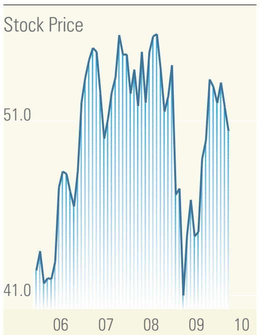
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
46.94 USD	68.00 USD	54.40 USD	85.00 USD	Low	Wide	C	AA	Drug Manufacturers - Major

Abbott to Acquire Indian Generic Operations

by Damien Conover, CFA
Senior Stock Analyst
Analysts covering this company do not own its stock.

Pricing data through May 21, 2010.
Rating updated as of May 21, 2010.

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



Analyst Note May 21, 2010 | Alex Morozov, CFA
Abbott Laboratories announced it has agreed to acquire the health-care solutions business of India-based Piramal Healthcare for $3.7 billion, which would make Abbott the largest player in the rapidly growing Indian market. While the acquisition price appears rich, we note that pharmaceutical firms are increasingly looking at generics and emerging markets in particular as key contributors to earnings growth, and the underlying growth of these areas is likely to result in higher multiples paid for companies that fit the new strategic focus of Big Pharma.

Under the terms of acquisition, Abbott will pay $2.1 billion up front and $400 million per year over the next four years beginning in 2011. The purchase price represents about 7.4 times the business' estimated 2011 sales of $500 million. This compares unfavorably with the main benchmark for acquisitions in India--the purchase of Ranbaxy by Daiichi Sankyo in 2008 for $4.2 billion, or 4.7 times sales. We're updating our model for the purchase, but a change to our fair value estimate for Abbott (if any) isn't likely to be material. Abbott estimates that the acquisition will not be dilutive to 2010 earnings, and any dilution for 2011-12 will probably be absorbed.

This purchase will make Abbott the largest player in India, with nearly 7,000 sales representatives and expected sales of close to $2.5 billion by 2020. The addition of the health-care solutions business brings in a portfolio of 350 branded generics sold exclusively in India in the respiratory, cardiovascular, and antibiotics areas. We've outlined the rationale for Big Pharma entering Indian market in our latest issue of the Healthcare Observer, and this acquisition adds more evidence to our belief that emerging markets' prominence will rise significantly over the next decade. Abbott has been aggressively expanding its footprint in these geographies, as the emerging markets theme was key in its rationale for last year's acquisition of Solvay. With close to 20% of sales currently from these markets and an established sales and manufacturing footprint, Abbott is well positioned to capitalize on the explosive growth we expect over the next few decades.

Thesis Jan. 28, 2010 | Damien Conover, CFA
On the foundation of a wide lineup of patent-protected drugs, a leading diagnostics business, a strong nutritional division, and an emerging vascular group, Abbott Laboratories has dug a wide economic moat. We expect these operating lines will continue to generate strong returns and drive growth. Further, the company's adept skills at partnerships and acquisitions will probably add to internal growth.

Existing drugs and new pipeline products should propel long-term growth, despite the 2008 patent loss on blockbuster epilepsy drug Depakote. Abbott's pharmaceutical division contains a diverse set of growing blockbusters across many therapy groups. Autoimmune agent Humira, HIV/AIDS drug Kaletra, and cardiovascular treatments Tricor and Trilipix lead the group with more than $8 billion in annual sales (26% of total sales). Humira continues to be the workhorse of the group with over 20% growth in 2009, as new indications help propel the drug. The company's active research and development efforts have created the next generation of drugs, including psoriasis treatment ABT-874 and cardiovascular drug Trilipix, both of which have blockbuster potential.

Outside the pharmaceutical group, Abbott runs top-tier diagnostic and nutritional segments that generate over 30% of total sales, helping to insulate the company from patent losses in the drug group. The diagnostic group is well positioned as disease therapy becomes more patient-specific.

Complementing the pharmaceutical, diagnostic, and nutritional segments, the firm's recently expanded vascular line is poised for rapid growth. Favorable clinical data on the company's new drug-coated stent Xience versus entrenched Boston Scientific stent Taxus should

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Abbott Laboratories	USD	72,455	31,745	6,645	5,310
Johnson & Johnson	USD	167,911	62,502	15,708	13,285
Pfizer Inc.	USD	124,218	55,892	10,966	7,932
Baxter International Inc.	USD	24,258	12,665	2,345	1,626

Morningstar data as of May 21, 2010.

result in fast market uptake. The recent successful U.S. launch of Xience is helping to moderate the 2008 Depakote patent loss.

In addition to strong internal operating lines, Abbott has a successful record of acquisitions and partnerships. The favorable acquisitions of Knoll and Kos Pharmaceuticals brought in Humira and Niaspan along with pipeline products. The acquisition of Guidant's vascular business opened the door to a new operating segment and Xience, a drug-eluting stent superior to an in-house stent. Additionally, the recent acquisitions of Advanced Medical Optics and Solvay's drug unit at favorable prices should add value over the long term. The strong record and ample cash flow raise our confidence that external growth opportunities will probably augment internal growth.

Valuation

We're maintaining our fair value estimate of $68 per share. We incorporated the recent acquisition of Solvay's drug unit into our valuation model, which didn't significantly change our valuation. Humira represents the most important driver in Abbott's valuation--we project it contributes just north of 20% to our estimate of the firm's total value. While competing drugs lurk in the near future, we continue to expect Humira to post double-digit annual growth over the next several years. Overall, over the next 10 years, we project 6% average annual sales growth, led by Humira, Xience, and acquisitions. Over the same period, we project a slight increase in operating margins, growing to the mid-20s, as cost-containment initiatives offset the patent losses on high-margin drugs. We estimate a 9% cost of equity and a similar weighted average cost of capital, which reflect the secure and robust cash flows derived from diverse operations.

Risk

While Abbott maintains diverse operations, it depends heavily on Humira and Xience for future growth. Further, the company's pipeline isn't as large as those of rivals, making any failures with late-stage candidates very costly. Also, the company faces typical industry risks including drug delays or nonapprovals, as well as an increasing aggressive generic and managed-care industry.

Bulls Say

- Strong clinical data from SPIRIT II and SPIRIT III give Xience a leg up in the drug-eluting stent market.
- Xience significantly outperformed another of Abbott's drug-eluting stents, Zomaxx, which used the same drug coating as Medtronic's new Endeavor stent. Thus, Xience could outperform Endeavor.
- New indications in Crohn's disease and psoriasis for Humira should further propel sales growth for the company's leading pharmaceutical product.
- In an industry plagued by patent exposure, Abbott faces only one major patent loss with the recent patent loss on Depakote. Further, the extended-release version accounts for 50% of Depakote sales and may hold off generics for several years with additional patents.
- The acquisition of Solvay's pharmaceutical unit brings in several new drugs, which could see dramatically increased sales potential with Abbott's powerful salesforce behind it.

Bears Say

- The acquisitions of Advanced Medical Optics, Kos

Pharmaceuticals, and the drug unit of Solvay as well as the failed divestiture of the diagnostics division to General Electric may cause integration disruptions as the company digests the multiple operating lines.
- Lack of robust internal development casts a shadow on the company's ability to create blockbusters in-house.
- Clinical data on drug-eluting stents have recently presented unclear benefits versus bare metal stents and other treatments. Stent operations and use of drug-eluting stents could fall without supportive new data.
- In an increasingly strict regulatory environment, the company's weak pipeline lacks the high number of shots on goal needed to increase the success probability of new product approvals.
- Pfizer's JAK-3 inhibitor for rheumatoid arthritis has shown strong efficacy in Phase II trials relative to Humira. If the drug holds up well in late-stage trials, it could take significant market share from Humira.

Financial Overview

Growth: Abbott maintains diverse businesses, which insulate it from the fluctuations inherent in pharmaceuticals. As a result, despite some patent expirations, we think the firm can steadily increase revenue by an industry-leading 6% on average for the next 10 years led by Humira, Xience, and acquisitions.

Profitability: We project a slight increase in operating margins for Abbott over the next 10 years. We expect cost-containment efforts will offset the patent losses on high-margin drugs.

Financial Health: Thanks to its acquisitions, Abbott holds less cash than its peers. However, Abbott's robust and relatively 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 pharmaceuticals, medical devices, blood glucose monitoring kits, and nutritional health-care products. Products include prescription drugs, coronary and carotid stents, and nutritional liquids for infants and adults. Following the Advanced Medical Optics acquisition, Abbott also markets eye-care products. Abbott generates slightly less than 60% of revenue from pharmaceuticals.

Strategy: Through a combination of acquisitions and internal growth, Abbott strives to build a leadership position across diverse heath-care businesses. Abbott has gained solid operating assets through external collaborations with the majority of its products derived from partnerships or acquisitions. The company should continue to expand its health-care operations and create synergies across segments.

Management: Miles White took the helm as CEO in 1998 and chairman of the board the following year. His tenure with the company dating back to 1984 provides the experience needed in wielding the many operating lines of the company. Under his leadership, the company executed several value-enhancing acquisitions. Overall, the company promotes solid stewardship. We like the policy of cumulative voting rights in the election of directors, as this gives more clout to minority shareholders. Compensation for top executives is well balanced between cash and equity and in line with industry practices. However, we would like the company to take a page from the major European pharmaceutical companies and split the roles of CEO and chairman.

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Analyst Notes

May 21, 2010

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Apr. 21, 2010

Reform Costs Weigh on Abbott's Strong 1Q

Abbott Laboratories reported first-quarter results that largely matched our expectations, and we're holding firm to our fair value estimate. Excluding the impact of foreign exchange rates, the company posted 11% year-over-year total sales growth, in line with our projections and partly buoyed by the acquisitions of Solvay's drug unit and Advanced Medical Optics. Earnings per share increased 11% year over year. Even though the costs of health-care reform reduced earnings per share by $0.03, the company was still able to hit the high end of its guidance for the quarter. Management reduced its full-year 2010 earnings per share outlook by $0.07, to $4.13-$4.18, largely because of the costs of reform. Excluding the $0.11 hit due to health-care reform, this guidance would have actually increased by $0.04. On the basis of a strong first quarter and our expectations for continued strength for the remainder of the year, we believe Abbott will exceed its new forecast.

Abbott's pharmaceutical division grew 9% operationally from the prior-year period, led once again by immunology

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Analyst Notes (continued)

drug Humira. While we expect Humira growth will slow from this quarter's torrid 30% year-over-year growth, we still project it will grow more than 20% for the full year as treatment penetration rates in rheumatoid arthritis, psoriasis, and Crohn's disease remain low. One potential competitive threat to Humira's long-term growth is a new class of treatment called JAK inhibitors. Pfizer should report late-stage data on its JAK inhibitor later in the year, which should provide a better picture of the class' competitive threat to Humira.

Outside of Humira, the majority of Abbott's key products generated strong results, with particular strength from cardiovascular drugs Trilipix and Tricor. We believe the switch rate to Trilipix from older drug Tricor is going well. As of the end of 2009, close to 25% of Tricor patients had switched to Trilipix. We project close to a 50% switch rate before Tricor's 2011 patent loss, given Trilipix's strong efficacy when used in combination with a statin.

The company's remaining divisions all posted solid growth, with a particularly strong gain in the vascular business. The recent Japanese launch of drug-eluting stent Xience drove the vascular business' 13% year-over-year operational growth. We project the vascular business will continue to post strong double-digit growth over the remainder of the year. However, we believe the division will slow to mid-single-digit growth after 2010. While the company's absorbable stent could reinvigorate the division's long-term potential, we need to see further confirmation of strong early-stage data before increasing our projections.

Abbott's operating costs were largely flat year over year as a percentage of total sales. Given the costs of health-care reform in the current quarter, we believe the company made slight improvements in efficiency.

Mar. 22, 2010

Congress Passes Comprehensive Health Reform

In a climactic finish to a year of debate, the House of Representatives passed comprehensive health reform legislation late Sunday night. The bill was passed by the Senate last December, and as such will head directly to President Obama for his signature without another vote. The House also passed a package of relatively small changes to the original Senate bill, which now heads to the Senate. The main details of the reform legislation haven't changed from the expectations built into our models, and we do not anticipate changing any fair value estimates as a result of this bill's passing.

According to the nonpartisan Congressional Budget Office, the final bill--including the package of changes anticipated to be passed in the Senate--is expected to reduce the number of people without health insurance by 32 million by 2019. That will still leave 23 million people uninsured, or about 8% of the nonelderly population. A significant portion of the remaining uninsured will be illegal immigrants. By 2019, the number of people receiving employer-sponsored and individual insurance is expected to decline by about 8 million, which is more than offset by 16 million new people in the Medicaid program and 24 million people purchasing private health insurance through newly established insurance exchanges.

The cost of expanding insurance coverage is estimated to be $938 billion over the next 10 years. About half of that cost is financed by spending cuts, primarily to the Medicare program. The other half is financed by increased taxes. The bill is expected to reduce federal budget deficits by $143

Analyst Notes (continued)

billion over the next 10 years and by 0.5% of gross domestic product over the subsequent 10 years.

Under the bill, most Americans will be required to carry health insurance or else will be subject to a tax penalty starting in 2014. The penalty will be phased in, but by 2016 it will be the greater of $695 per person or 2.5% of taxable household income. Anyone earning less than 133% of the federal poverty level will be eligible for Medicaid. Individuals earning between 133% and 400% of the federal poverty level will be eligible for federal subsidies that will cap their contribution to insurance premiums and cost-sharing based on a sliding scale. The bill imposes penalties on larger employers who don't offer insurance coverage and provides tax credits for certain small businesses that choose to offer health insurance.

The final bill excludes a government-run insurance option but has provisions for the government to negotiate certain plans with private insurers and to encourage the creation of nonprofit insurance co-ops. The bill creates state-based insurance exchanges where individuals and small businesses can buy standardized health insurance policies. Insurers will be forced to offer a policy to any applicant and can vary premiums based only on age, region, family composition, and tobacco use within defined ranges. Premiums cannot vary based on health status.

The bill also includes a number of provisions affecting various segments within the health-care industry, although the entire industry is expected to see a volume boost stemming from newly insured individuals entering the system. While the impact of many of these provisions is difficult to quantify precisely, health-care stocks should benefit from the improved investor sentiment due to the removal of the regulatory uncertainty surrounding its prospects. The investor focus should now shift on the sector fundamentals and the companies-specific factors, which remain attractive.

Pharmaceutical companies are the likely "net winner" of the reform. With the exception of the $85 billion fee the industry will pay over the 10-year period, most of the reform language appears favorable to drugmakers. In addition to the volume boost, the House bill rewards drug companies with a stronger patent protection for biologics and closes the "donut hole," but most importantly doesn't include any provisions that would allow the government to negotiate prices directly with pharmaceutical companies.

Device-makers are not likely to see as significant of a volume boost from the bill. Additionally, the excise tax to be imposed on this sector appears disproportionately harsh. That said, the device fee will not come into effect for several years, which should give device companies ample time to devise operating strategies to offset its impact. We are anticipating most of this industry fee will be passed on to consumers via price hikes, and even if unsuccessful, device-makers should only see a mild (ranging from low- to mid-single-digit) reduction to their valuations.

Managed care organizations (MCOs) will be negatively impacted by reductions to Medicare Advantage reimbursements, although we expected these cuts to occur even in the absence of comprehensive reform. Some of the more profitable MCOs could be negatively impacted by explicit limits on gross margins, although they should be able to offset this effect by reclassifying some administrative costs as medical costs. We expect industry taxes and fees to generally be passed on to customers. On the positive side, MCOs stand to benefit from increased demand for individual insurance. Companies that participate in Medicaid managed care programs will benefit from expanded Medicaid eligibility.

We expect drugstores and pharmaceutical and medical supply distributors to be net beneficiaries of the legislation, as they gain from increased demand for health-care goods,

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Analyst Notes (continued)

especially prescription drugs. Diagnostic companies and makers of generic drugs should also see higher utilization rates, providing strong support to these industries' growth.

Alex Morozov, CFA contributed to this note.

Jan. 27, 2010

Foreign Humira Sales Help Abbott's 4Q

Abbott Laboratories reported strong quarterly results that largely matched our expectations and we don't anticipate any changes to our fair value estimate. Excluding the impact of foreign exchange, total sales increased 8% year-over-year with surprising strength coming from international pharmaceutical sales and medical optics, partially offset by some weakness in U.S. drug sales. On the bottom line, Abbott posted $1.18 earnings per share, up 11% year-over-year and in line with our expectations. Abbott's 2010 earnings per share guidance of $4.20-$4.25 is slightly higher than our projection and the consensus outlook.

Immunology drug Humira's growth led Abbott's pharmaceuticals business. While Humira posted annual operational growth of 41% internationally in the quarter, its domestic sales only increased 3% versus the prior year period. Given the likely U.S. stocking in the fourth quarter of 2008 and, thus, unfavorable comparisons, the growth rate is not overly troubling. As a reminder, U.S. Humira sales only grew by 2% annually in the first quarter of 2009, followed by two quarters of 20% plus annual growth. Nevertheless, we expect to reduce our 2010 U.S. growth projections for Humira based on our expectations of slowing growth. However, we expect to increase our growth projections for international Humira sales based on the continued strong performance of the drug overseas.

Outside of Humira, better than expected sales of cardiovascular drug Niaspan offset declines on other cardiovascular drugs TriCor/Trilipix. Favorable data from the Arbiter-6 study reinforced the benefit of Niaspan, supporting the drug's growth in the quarter. Conversely, TriCor/Trilipix stocking in the previous year's quarter hurt the growth rate of the drugs in the current quarter.

The remaining divisions of Abbott all posted solid mid-single-digit operational annual growth in the quarter. While the nutritional business slowed a bit in the quarter, the medical optics division posted stronger than expected results.

The company's gross margin took a higher than expected hit largely due to the patent loss of the high-margin neurology drug Depakote. As a percentage of sales gross margins fell 260 basis points year-over-year. Abbott somewhat offset the gross margin decline with operational improvements to marketing and drug development costs, which fell more than 100 basis points year-over-year as a percentage of total sales. We expect Abbott's margins to stabilize and potentially improve over the next few years as the company doesn't face much patent exposure on high-margin drugs. We expect the company to continue to improve efficiencies in its marketing efforts.

Abbott Laboratories ABT

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
31,745	72,455	Drug Manufacturers - Major	Health Care

Abbott manufactures and markets pharmaceuticals, medical devices, blood glucose monitoring kits, and nutritional health-care products. Products include prescription drugs, coronary and carotid stents, and nutritional liquids for infants and adults. Following the Advanced Medical Optics acquisition, Abbott also markets eye-care products. Abbott generates slightly less than 60% of revenue from pharmaceuticals.

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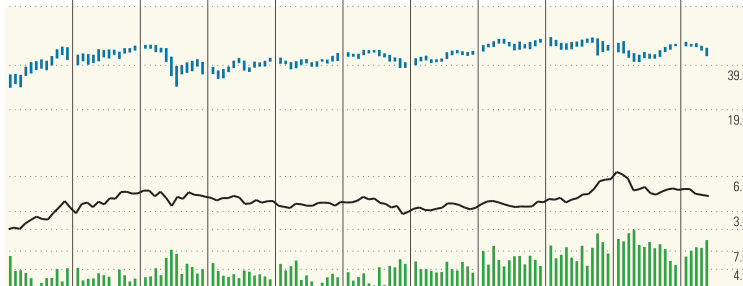
Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★★★★	46.94	68.00	Low	Wide	C

per share prices in USD

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	
52.61	53.47	54.23	44.10	47.63	50.00	49.87	59.50	61.09	57.39	56.79	Annual Price High
27.36	39.28	27.87	31.57	36.74	37.50	39.18	48.71	45.75	41.27	45.26	Low
											Recent Splits



Price Volatility
Monthly High/Low
Rel Strength to S&P 500

52 week High/Low
56.79 - 42.80

10 Year High/Low
61.09 - 27.36

Bear-Market Rank
8 (10=worst)

Trading Volume Million

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	Stock Performance
35.4	16.8	-26.6	18.9	9.3	-13.2	26.5	17.9	-2.5	4.1	-11.5	Total Return %
45.5	29.8	-3.2	-7.5	0.3	-16.2	12.9	14.4	36.0	-19.3	-9.0	+/- Market
8.9	28.8	-4.3	7.4	14.7	-13.8	15.0	18.1	15.0	-7.1	2.7	+/- Industry
1.5	1.5	2.3	2.1	2.2	2.8	2.4	2.3	2.6	2.9	3.5	Dividend Yield %
70078	80955	58461	68142	72652	61165	74763	86767	82808	83748	72455	Market Cap USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Financials
13746	16285	17685	19681	19680	22338	22476	25914	29528	30765	31745	Revenue USD Mil
54.6	52.4	51.9	51.9	54.9	52.4	56.3	55.9	57.3	57.1	57.1	Gross Margin %
3401	1894	3530	3323	3898	4362	2042	4579	5694	6236	6645	Oper Income USD Mil
24.7	11.6	20.0	16.9	19.8	19.5	9.1	17.7	19.3	20.3	20.9	Operating Margin %
2786	1550	2794	2753	3236	3372	1717	3606	4881	5746	5310	Net Income USD Mil
1.78	0.99	1.78	1.75	2.06	2.16	1.12	2.31	3.12	3.69	3.43	Earnings Per Share USD
0.74	0.82	0.92	0.97	1.03	1.09	1.16	1.27	1.41	1.56	1.60	Dividends USD
1566	1566	1573	1572	1571	1564	1537	1560	1561	1547	1548	Shares Mil
5.54	5.84	6.83	8.36	9.20	9.29	9.16	11.51	11.27	14.73	13.51	Book Value Per Share USD
3100	3567	4183	3746	4408	5174	5329	5184	7344	7275	8099	Oper Cash Flow USD Mil
-1036	-1164	-1296	-1247	-1292	-1207	-1338	-1656	-1288	-1089	-1082	Cap Spending USD Mil
2064	2403	2887	2500	3116	3967	3991	3528	6056	6186	7017	Free Cash Flow USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Profitability
18.7	8.0	11.8	10.8	11.7	11.7	5.3	9.5	11.9	12.1	10.8	Return on Assets %
34.8	17.6	28.3	23.2	23.6	23.5	12.1	22.7	27.7	28.5	27.4	Return on Equity %
20.3	9.5	15.8	14.0	16.4	15.1	7.6	13.9	16.5	18.7	16.7	Net Margin %
0.92	0.84	0.74	0.77	0.71	0.77	0.69	0.68	0.72	0.65	0.64	Asset Turnover
1.8	2.6	2.3	2.0	2.0	2.0	2.6	2.2	2.4	2.3	2.6	Financial Leverage

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	03-10	Financial Health
3079	492	2120	2651	3909	3971	-669	4939	5451	10264	2507	Working Capital USD Mil
1076	4335	4274	3452	4788	4572	7010	9488	8713	11266	10879	Long-Term Debt USD Mil
8571	9059	10665	13072	14326	14415	14054	17779	17480	22856	20860	Total Equity USD Mil
0.13	0.48	0.40	0.26	0.33	0.32	0.50	0.53	0.50	0.49	0.52	Debt/Equity

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Valuation
27.3	56.2	22.5	26.6	23.1	18.3	43.5	24.3	17.6	14.6	13.7	Price/Earnings
—	2.4	1.1	1.3	1.2	1.1	2.6	1.5	1.6	0.8	0.9	P/E vs. Market
5.5	5.4	3.6	3.7	3.7	2.8	3.3	3.4	2.8	2.7	2.3	Price/Sales
8.7	9.6	5.9	5.6	5.1	4.2	5.3	4.9	4.7	3.7	3.5	Price/Book
24.4	24.4	15.0	19.6	16.6	11.9	14.1	16.9	11.3	11.5	9.0	Price/Cash Flow

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	4.2	11.0	9.3	8.8
Operating Income %	9.5	45.1	9.8	7.1
Earnings/Share %	21.8	48.8	12.8	8.9
Dividends %	11.0	10.4	8.8	9.0
Book Value/Share %	30.8	17.2	9.9	11.7
Stock Total Return %	12.1	-4.3	1.9	5.7
+/- Industry	—	—	—	—
+/- Market	—	—	—	—

Profitability Analysis

Grade: B	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	27.4	22.9	22.0	20.7
Return on Assets %	10.8	10.1	10.3	7.8
Fixed Asset Turns	4.1	3.8	3.6	6.9
Inventory Turns	4.1	4.1	2.4	13.7
Revenue/Employee USD K	434.9	410.2*	—	796.8
Gross Margin %	57.1	55.8	72.8	41.0
Operating Margin %	20.9	17.2	20.0	13.0
Net Margin %	16.7	14.4	18.9	8.7
Free Cash Flow/Rev %	22.1	17.9	21.8	0.1
R&D/Rev %	8.9	0.1	—	10.3

Financial Position

Grade: A	12-09 USD Mil	03-10 USD Mil
Cash	8809	1567
Inventories	3265	3411
Receivables	6542	6520
Current Assets	23314	17691
Fixed Assets	7619	8060
Intangibles	19492	25671
Total Assets	52417	53359
Payables	2343	2433
Short-Term Debt	5190	6449
Current Liabilities	13049	15183
Long-Term Debt	11266	10879
Total Liabilities	29561	32499
Total Equity	22856	20860

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	13.7	23.7	10.1	15.8
Forward P/E	9.9	—	—	13.1
Price/Cash Flow	9.0	13.2	8.1	7.0
Price/Free Cash Flow	10.4	17.3	9.6	14.7
Dividend Yield %	3.5	—	1.6	1.9
Price/Book	3.5	4.6	2.1	2.0
Price/Sales	2.3	3.0	2.1	1.2
PEG Ratio	0.8	—	—	1.5

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

Quarterly Results

Revenue USD Mil	Jun 09	Sep 09	Dec 09	Mar 10
Most Recent Period	7494.9	7761.3	8790.1	7698.4
Prior Year Period	7314.0	7497.7	7950.3	6718.4

Rev Growth %	Jun 09	Sep 09	Dec 09	Mar 10
Most Recent Period	2.5	3.5	10.6	14.6
Prior Year Period	14.8	17.6	10.1	-0.7

Earnings Per Share USD	Jun 09	Sep 09	Dec 09	Mar 10
Most Recent Period	0.83	0.95	0.99	0.64
Prior Year Period	0.85	0.69	0.98	0.92

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Abbott Laboratories	72455	31745	13.7	27.4
Johnson & Johnson	167911	62502	12.8	27.5
Pfizer Inc.	124218	55892	14.3	10.6

Major Fund Holders

	% of shares
American Funds Washington Mutual A	1.28
Fidelity Contrafund	1.10
Vanguard Total Stock Mkt Idx	0.98

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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

Competitive Analysis → **Economic Moat™ Rating** → Company Valuation → **Fair Value Estimate** → Uncertainty Assessment → ★★★★★

Competitive Analysis: Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade-show visits
- Competitor, supplier, distributor, and customer interviews

Economic Moat™ Rating: The depth of the firm's competitive advantage is rated:

- None
- Narrow
- Wide

Company Valuation: Analyst considers company financial statements and competitive position to forecast future cash flows.

Assumptions are input into a discounted cash-flow model.

Fair Value Estimate: DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.

Uncertainty Assessment: An uncertainty assessment establishes the margin of safety required for the stock rating.

★★★★★: ★ ★★ ★★★ ★★★★ ★★★★★ The current stock price relative to fair value, adjusted for uncertainty, determines the rating.

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

We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."