Express Scripts ESRX [Nasdaq] | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
58.85 USD	73.00 USD	51.10 USD	98.55 USD	Medium	Wide	—	A-	Health Care Plans

SXC and Catalyst to Merge, Further Concentrating PBM Industry

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

Pricing data through April 17, 2012.
Rating updated as of April 17, 2012.

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

Analyst Note Apr. 18, 2012

SXC Health Solutions and Catalyst Health Solutions announced Wednesday their intention to merge. Catalyst shareholders will receive $28 in cash and 0.6606 share of SXC for every Catalyst share owned, amounting to a 28% premium to Catalyst's stock price before the deal was announced. We don't currently cover either SXC or Catalyst, but this transaction supports our thesis of continuing consolidation in the pharmacy benefit management sector. We had previously speculated that the Medco-Express Scripts merger could open the floodgates to further health plan consolidation, and this deal could be a harbinger of more acquisition activity among both pharmacy benefit managers and managed-care organizations.

Thesis Apr. 03, 2012

We expect pharmacy benefit managers like Express Scripts to enjoy a bevy of positive trends in the next several years. Industry consolidation, the aging population, a slew of patent expirations for brand-name drugs, health-care cost-containment efforts, growth in the number of people with insurance as a result of health reform, and increasing customer acceptance of mail-order pharmacies all bode well for Express Scripts. With the merger with Medco now complete, we believe Express Scripts has a wide economic moat.

PBMs administer drug benefits on behalf of clients such as employers and managed-care organizations, with the principal goal of controlling costs. Express Scripts has two primary strategies for achieving this. First, the company leverages its purchasing power to extract better prices from suppliers. Second, it encourages its members to make cost-effective pharmaceutical consumption choices, such as switching to generic drugs and preferred brands, improving therapy adherence, or using the company's mail-order pharmacy.

Express Scripts earns mid-single-digit margins. At the same time, pharmaceutical spending accounts for only around 10% of overall health-care spending. This means that Express Scripts' operating income accounts for well less than 1% of its clients' overall health-care costs. If Express Scripts can lower its clients' health-care costs by even a percentage point more than the competition, it will justify its margins and facilitate market share gains.

We believe scale provides Express Scripts with significant competitive advantages. For example, scale allows Express Scripts to extract better rebates from brand-name drugmakers, better prices from generic drugmakers, and favorable reimbursement rates with retail pharmacies. Scale also allows Express Scripts to leverage fixed costs like claims processing infrastructure and mail-order facilities. Furthermore, we think these competitive advantages are getting stronger over time as the PBM industry consolidates. Even though Express Scripts earns a return on equity north of 40% and has experienced 23% compound annual operating income growth during the past five years, smaller competitors like WellPoint and Aetna have been looking to exit this business in favor of partnering with the independent PBMs. In our view, the merger with Medco greatly enhances Express Scripts' scale advantages.

Express Scripts has a history of successfully integrating acquisitions, and we see no reason Medco will be any different, particularly since we already consider the company to be very well run. Express Scripts now has more than 100 million members and controls around 35% of U.S. pharmaceutical spending. It dwarfs second-place CVS Caremark, which is likely to find it nearly impossible to catch up, given the lack of other possible acquisition targets of size. Other suppliers and competitors--such as retail pharmacies, distributors, and smaller PBMs--risk seeing their own margins compress, to Express Scripts' benefit.

Valuation, Growth and Profitability

We estimate Express Scripts' fair value at $73 per share.

Express Scripts ESRX [Nasdaq] | ★★★★

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Express Scripts	USD	28,556	46,128	2,312	1,276
CVS Caremark Corp	USD	57,227	107,100	6,330	3,461

Morningstar data as of April 17, 2012.

As a result of the Medco purchase, we project $1.6 billion worth of pretax synergies annually by 2016 from a combination of new client wins, lower drug costs because of increased bargaining power, and administrative cost savings. Our assumed cost synergies amount to just around 1.5% of the combined entity's total costs. We project approximately $113 billion of revenue and a 7.7% operating margin by 2016. We estimate Express Scripts' cost of equity at 10.5%.

Risk
Among the biggest risks to Express Scripts are competition and regulatory change. Although Express Scripts' competitive position has improved, aggressive pricing by competitors could still hurt profitability. For example, CVS Caremark may have an incentive to underprice its PBM offering to drive more traffic to its retail stores. UnitedHealth is expected to fully in-source its PBM business in 2013, which increases the competitive threat from this MCO as well. While some health-care policy reforms could benefit Express Scripts, like generic biologics legislation and expansion of insurance coverage to 32 million of the nation's uninsured, other reforms could make it harder for Express Scripts to conduct business, such as PBM transparency requirements.

Bulls Say
- Demographic trends and growth in overall drug spending provide PBMs with a solid backdrop for growth.
- Express Scripts makes much higher margins on generic drugs, and the U.S. is in the midst of an unprecedented wave of patent expirations on blockbuster brand-name drugs.
- Some regulatory reform is beneficial for Express Scripts, such as creation of a pathway for approval of generic biologics and efforts to expand coverage to the nation's uninsured.
- The acquisition of WellPoint's NextRx PBM business boosted Express Scripts' scale and its competitive advantages. The Medco deal has transformed Express Scripts into a wide-moat company.

Bears Say
- The generics wave has driven higher margins for Express Scripts, but will largely end after 2014. The company will have to find new ways to create value for clients.
- The managed-care, retail pharmacy, and pharmaceutical manufacturing industries are all in a consolidation phase. Larger customers and suppliers have stronger bargaining positions against Express Scripts.
- Express Scripts could be hurt by aggressive pricing by competitors. For example, CVS Caremark could underprice its PBM services to drive greater traffic to its retail stores.
- Medco is a much bigger company than NextRx was, which could lead to unforeseen integration problems.

Financial Overview
Financial Health: Express Scripts took on significant new debt and issued stock to fund the NextRx purchase. However, the company quickly repaid the debt and repurchased the stock. While the Medco purchase also resulted in a temporary increase in Express Scripts' financial leverage, we expect the company to use its

substantial cash flows to rebuild the balance sheet in fairly short order. We remain comfortable with the company's financial health.

Company Overview

Profile: Express Scripts is the largest pharmacy benefit manager in the United States. Through its mail-order pharmacy and network of retail pharmacies, we expect Express Scripts to administer around 1.5 billion adjusted prescriptions in 2013.

Management: We view Express Scripts' stewardship as exemplary. The company is led by George Paz, who became CEO in 2005 and chairman of the board in 2006. Paz joined Express Scripts in 1998 as chief financial officer. During his tenure as CEO, Paz has overseen a nearly fourfold increase in Express Scripts' earnings per share. The stock has been a five-bagger during these seven years, destroying returns at PBM peers and putting Paz toward the top of the list of the best CEOs in health care, in our view. Paz will remain CEO now that the Medco merger has been consummated, although we hope the company can find room for some of Medco's upper management, as we also consider that company to be exceptionally well run. Express Scripts did an admirable job steering patients to alternative pharmacies when it excluded Walgreen from its network, resulting in minimal client disruption or attrition. We are particularly impressed by Express Scripts' capital deployment. Terms of the NextRx acquisition were originally viewed as favorable to WellPoint, but the deal ended up being highly accretive to Express Scripts. Aggressive share repurchases have also boosted shareholder value, and we expect significant value creation from the Medco deal. We are encouraged by Express Scripts' reasonable executive compensation policies. Paz's total take was $8.5 million in 2011, down 17% from the prior year. Even though earnings per share grew 19%, this was below the company's target, which prevented senior management from receiving any bonuses last year.

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Analyst Notes

Apr. 18, 2012

SXC and Catalyst to Merge, Further Concentrating PBM Industry

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Apr. 03, 2012

Express Scripts Closes Medco Acquisition, Establishes Wide Economic Moat

Express Scripts announced Monday that it has closed its merger with Medco Health Solutions. Medco shareholders will receive $28.80 in cash and 0.81 share of Express Scripts for each Medco share owned. Having accounted for expected synergies from the deal, we value Express Scripts at $73 per share, which implies an $88 fair value for Medco; we continue to recommend Express Scripts' shares. We're also raising our economic moat rating for Express Scripts to wide, as we believe the company has greatly strengthened its competitive advantage through this merger. Size is the key to gaining bargaining power over suppliers and leveraging administrative costs, and Express Scripts will be far larger than its competitors, with around 1.5 billion adjusted prescriptions. In a 3-1 vote, the Federal Trade Commission signed off on the merger, apparently without demanding any concessions. We are maintaining our A- credit rating for Express Scripts, as we believe the firm's higher financial leverage is offset by its improved competitive position.

Mar. 28, 2012

Express Scripts May Close Medco Purchase Next Week

Express Scripts and Medco announced Wednesday that they may be able to close their merger as soon as next week. As we previously indicated, we plan to raise our fair value estimate for Express Scripts to $73 and for Medco to $88. We believe the merger has the potential to create significant revenue and cost synergies. If the transaction closes as planned, it may have positive implications for Express Scripts' economic moat rating. We are maintaining our fair value estimate for Walgreen for now, as it remains unclear how the pharmacy chain will react to this development. In our opinion, Walgreen would be wise to take advantage of the temporary disruption of the merger integration to sign a new long-term deal with Express Scripts. If Walgreen chooses to walk away from Medco's business as well, we are likely to lower our fair value estimate.

We were initially skeptical that the Federal Trade Commission would allow this deal to proceed. Even now, we had been assuming just a 60% probability that the merger would succeed. We expect the new Express Scripts to have tremendous bargaining leverage over suppliers. Express Scripts has already been flexing its bargaining muscle against Walgreen, but the merger with Medco gives the pharmacy benefit manager unprecedented market power. We estimate that Express Scripts will control around 1.5 billion adjusted prescriptions in 2013, giving it approximately 40% market share. Express Scripts will be about 50% larger than its next largest competitor, CVS Caremark, and around 3 times the size of number-three

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Analyst Notes (continued)

UnitedHealth. Express Scripts will be about 8 times larger than the industry's number-four player.

We view Express Scripts' management team as one of the best in health care. The company has established a record of successful acquisitions, most recently of WellPoint's NextRx unit, and we do not anticipate significant integration headaches. Over the long run, we expect Express Scripts to wield its tremendous influence over pharmaceutical spending to pressure suppliers (generic and brand-name drugmakers, distributors, retail pharmacies) and leverage administrative costs. This should enable the company to expand its own margins while passing some savings through to customers and gaining market share. We view almost every other participant in the pharmaceutical supply chain as worse off as a result of Express Scripts' improved clout.

Despite our optimism for Express Scripts, there are some risks to the merger. Medco has historically been willing to accommodate customers to a greater extent than Express Scripts, leaving it with a number of large customized contracts where the PBM provides a limited set of services. Express Scripts has tended to prefer full-service contracts where the PBM controls most aspects of the pharmacy benefit. Express Scripts will need to become more flexible in order to retain some clients. There is a risk of client attrition during the integration, particularly as Express Scripts navigates other challenges like the exclusion of Walgreen from its pharmacy network and CVS Caremark's recent aggressive pricing. Express Scripts is greatly increasing its leverage to complete the deal, reducing its margin for error.

Mar. 13, 2012

Regulatory Approval of Medco-Express Scripts Merger Could Be More Likely

The deadline for the Federal Trade Commission to respond to the proposed merger between Express Scripts and Medco came and went Monday, with no word from the regulator as to its position. Both companies filed an 8-K to say that they had agreed to give the agency more time, but are expecting to close the merger early in the second quarter. The Wall Street Journal reported late last week that the FTC is not taking the steps necessary to build a legal case against the merger and appears likely to approve the deal with some conditions. It remains unclear whether the companies and the FTC will be able to find a compromise that satisfies both sides, but we now think the balance has shifted slightly toward approval. We anticipate increasing our assumption for the probability that the merger receives regulatory approval to 60% from 40%, which should result in an increase to our fair value estimates for both Express Scripts and Medco in the 5%-10% range. We are maintaining all other fair value estimates pending more information. The company at greatest risk of a fair value estimate decrease should the merger go through is Walgreen , since it risks being excluded from Medco's pharmacy network in addition to Express Scripts' network.

Feb. 23, 2012

Dispute With Walgreen Demonstrates Express Scripts' Expanding Economic Moat

Express Scripts reported 2011 earnings that were slightly below our expectations but still showed solid growth from the prior year. Management reaffirmed that the exclusion of Walgreen from the pharmacy network is having little adverse impact on client retention, and that the merger with Medco remains on pace for a first-half 2012 close. At recent trading levels around $53, we think Express Scripts is modestly undervalued relative to our $61 fair value

Analyst Notes (continued)

estimate. Our fair value estimate assumes a 40% probability that the Medco merger succeeds. If the merger fails, our fair value estimate would revert to $53, and we would see Express Scripts as fairly valued. If the merger succeeds, our fair value estimate would increase to around $72, leaving significant upside for investors.

Express Scripts' full-year adjusted earnings of $2.97 per share increased 19% from the prior year. Despite this solid growth, earnings were below the company's internal target, so management reports that it will receive zero bonuses for 2011. Share repurchases and margin expansion were the primary drivers of earnings growth, as revenue increased just 2.6%. The operating margin expanded 40 basis points to 5%. After several years of steady margin improvement, Express Scripts is now the most profitable of the big three pharmacy benefit managers. EBITDA per adjusted prescription came in at $3.54 for the year, compared with $3.23 for Medco and $2.93 for CVS Caremark. The share count fell 7.2% from the prior year, helped by $2.5 billion of share repurchases during 2011. The share count is now back around a seven-year low, as Express Scripts was quick to repurchase the shares issued for the NextRx acquisition.

With the transition of patients away from Walgreen now largely complete, management reiterated its 97% client retention rate for 2012, with 95% of clients moving forward without Walgreen in their pharmacy networks. In our view, this is a powerful demonstration of Express Scripts' expanding economic moat (and Walgreen's declining moat). It also shows exceptional execution on the part of management, as patient disruption was minimized during what CEO George Paz called the "largest retail market share movement in the history of pharmacy." Express Scripts even received praise from CVS Caremark on its conference call, as the head of the Caremark PBM stated, "I have to tip my hat here to our competitor Express. I think they have done an excellent job making this change very smooth for their customers. And many of the plans that I've spoken to that actually have gone through this have been very clear that this has not really been a big deal for them."

Express Scripts is due a response from the Federal Trade Commission on its merger with Medco within a month. If the merger is allowed to proceed, there is a good chance that the combined company could have a wide economic moat, in our view.

Feb. 06, 2012

FTC Rumored To Oppose the Medco/Express Scripts Deal

A Reuters article Monday claimed that key Federal Trade Commission (FTC) officials are opposed to the merger between Medco and Express Scripts, and are working to build a case against it. Both stocks declined sharply on the news. We have been assuming a 40% chance that the deal receives regulatory approval and a 60% chance that it is rejected. The article did not name a source and we are maintaining all fair value estimates pending some substantiation of this rumor.

We expected the Medco/Express Scripts merger to create considerable synergies, which were incorporated in our bull-case assumptions for both companies. Assuming the deal is rejected, we would revert to our stand-alone fair value estimates, which are $60 for Medco and $53 for Express Scripts. At current trading levels, we view both companies as about fairly valued if the deal fails or meaningfully undervalued if the merger succeeds. We are not surprised by the regulatory scrutiny. Since the merger was announced, we've consistently stated that regulators were more likely than not to reject the deal due to the high degree of consolidation in the PBM industry and the Obama

Analyst Notes (continued)

administration's view that competition between health-care payors is necessary for controlling health-care costs.

If the merger is rejected, it would be a significant positive for CVS Caremark and especially Walgreen, which recently exited Express Scripts' network. It would also be a marginal positive for AmerisourceBergen, whose largest customer is Medco. However, we are maintaining our fair value estimates for all of these companies as our relatively pessimistic take on the regulatory outlook for the merger prevented us from explicitly incorporating possible effects of the merger in our base-case forecasts.

Feb. 03, 2012

Walgreen Waves Goodbye to Express Scripts' Members, Perhaps Forever

Walgreen's January sales release showed a precipitous 7.9% decline in pharmaceutical same-store sales, as Express Scripts' PBM members abandoned the retail pharmacy chain in droves. While we had anticipated this would happen if Walgreen and Express Scripts couldn't reach an agreement by the end of last year, we had expected more of an offset from growth among other customers. Instead, it appears the Express Scripts loss was compounded in January by a relatively weak cold and flu season as well as a strengthening headwind from new generic launches. Even though the negative flu comparisons will moderate in the rest of the year, we are reducing our assumptions for both same-store sales and margins and lowering our fair value estimate for Walgreen to $35 from $37. Our fair value uncertainty remains high, as the clouds over Walgreen are as dark as ever, particularly considering the pending Express Scripts-Medco merger.

Walgreen's overall January sales declined 2.3%, while overall same-store sales declined 4.6%. Same-store front-end sales increased 1.6%, strengthening management's frequently made case that there is a low correlation between front-end and prescription sales. Same-store prescription sales declined 7.9% as prescription volumes plummeted 8.6%. The loss of Express Scripts created a 10.6% headwind to prescription sales, as Walgreen was able to retain at best 15% of these prescriptions. We had consistently stated that Walgreen's prescription retention target of 25%-75% was unrealistic. With sales falling more steeply than management had hoped, it is likely that margin contraction will also be more severe, as the company will struggle to offset so much lost revenue with cost cuts. New generic drugs and the relatively weak flu season resulted in a 2.1% and 2.4% headwind to same-store pharmacy sales, respectively, while calendar day shifts provided a 1.3% tailwind.

Our interpretation of the Walgreen-Express Scripts dispute remains the same. PBMs enjoy growing bargaining power, while retail pharmacies face fierce competitive and reimbursement pressure. Investors have likely noticed signs at most major pharmacy chains welcoming Express Scripts' customers with open arms. Walgreen bet that PBM customers would not accept a pharmacy network that excluded Walgreen, and Express Scripts called that bet. Express Scripts should feel minimal adverse impact from the dispute, while Walgreen faces sharply declining sales and margins. This reinforces our view that Express Script's economic moat is widening, while Walgreen's moat is in decline.

It appears that Walgreen has got itself in a real pickle. Pharmacy customers tend to be sticky: they are both hard to lose, and hard to win back. Many of the customers who are abandoning Walgreen now probably won't return, even if the company reaches an agreement with Express Scripts in the future. With customer disruption already in the past, Express Scripts has little reason to compromise now, so Walgreen will be lucky to even receive the reimbursement terms Express Scripts' offered originally. Worst of all, if the merger between Express Scripts and Medco is allowed to proceed, Walgreen stands to lose an even greater percentage of sales and face even more severe margin contraction. On the plus side, while Express Scripts and Medco project their combination to close within the next five months, we still believe there is only a 40% chance of the deal receiving regulatory approval.

We have been considering Walgreen's strategic alternatives, and we don't see many. The company's current approach of trying to circumvent Express Scripts and reach side deals with its clients does not appear to be working. Few clients seem willing to pay higher prices or switch PBMs to keep Walgreen in their pharmacy network. If the Express Scripts-Medco merger goes through, Walgreen could find itself in a desperate situation, with no bargaining leverage and facing a sharp profit falloff.

We can think of at least one truly bold move Walgreen could make. The company should consider a merger with its chief retail rival, CVS Caremark. While certainly a long shot in light of the companies' different cultures and high regulatory hurdles to a deal, a merger between CVS and Walgreen would both improve bargaining power relative to third-party PBMs--helping the companies defend retail profit margins--and enhance the value proposition of CVS Caremark's integrated retail-PBM model. If the Express Scripts-Medco deal can get by the Federal Trade Commission, a CVS-Walgreen tie-up would seem no less likely. The retail pharmacy business would still be much more competitive than the PBM industry, and unlike Express Scripts and Medco, CVS and Walgreen could divest individual stores to mitigate concerns about regional market share concentration.

Dec. 21, 2011

Walgreen's and Express Scripts' Game of Chicken Coming Close to a Crash

Walgreen reported weak fiscal first-quarter results, sending the shares down another 7% Wednesday morning. The stock is down more than 30% since Walgreen announced in June that it is exiting Express Scripts' pharmacy network at the end of this year, but Walgreen continues to stand its ground on its reimbursement demands. Although we are maintaining our fair value estimate, we are temporarily increasing our fair value uncertainty rating for Walgreen to high.

In our view, it is in both Walgreen's and Express Scripts' best interest to reach a compromise, and there is still some possibility of a deal before the end of the year. However, absent a new contract we see much more potential downside for Walgreen than Express Scripts, particularly if Express Scripts' proposed merger with Medco is allowed to proceed. Walgreen says it would be willing to walk away from Medco's business too, but we can hardly see how that is a serious threat. The combined Express Scripts-Medco would control around 40% of the nation's prescription volume. The only other major pharmacy benefit manager is CVS Caremark--Walgreen's largest retail competitor and a company that is aggressively trying to direct patients to its own retail stores. Walgreen increasingly looks like the odd man out.

The Walgreen-Express Scripts dispute boils down to a few simple questions, but each company has fundamentally different answers. Are there meaningful savings to be had by excluding high-cost pharmacies from PBM networks?

Walgreen says pharmacy costs vary within a tight band, but Express Scripts says potential savings are material. Are clients willing to sacrifice access to some pharmacies in exchange for lower costs? Walgreen says customers demand access to its pharmacies, but Express Scripts says their preference is for lower costs. Are clients willing to change PBMs to keep Walgreen in-network? If prescriptions are transferred to competing pharmacies, will those patients ever come back to Walgreen? In answer to both of these questions, Walgreen says yes, Express Scripts says no.

We attended CVS Caremark's investor day Tuesday in New York, and it was interesting to observe that CVS' management team seems to agree with Express Scripts on all the important points. CVS appears much more enthusiastic about the opportunity to gain share on the retail side than on the PBM side and believes clients aren't likely to abandon Express Scripts just because Walgreen isn't in the network. We agree with this assessment and believe Walgreen may have overplayed its hand.

Turning to Walgreen's first-quarter results, earnings per share increased by just a penny despite 4.7% revenue growth and a 5% reduction in the share count. This was offset by operating margin contraction to 5% from 5.4% in the prior year. While the Express Scripts loss was a mild headwind in the first quarter, the impact is likely to be felt much more strongly for the rest of the year. On the other hand, Walgreen should benefit from the huge volume of brand-name drugs facing generic competition later this year. While new generics will only compound the revenue challenge, they should provide a helpful offset to margin contraction. We project a 5.3% operating margin for the full year, although substantial cost discipline will be required from management to achieve this result.

Oct. 27, 2011

Express Scripts Winning Public Relations War With Walgreen

We are maintaining our fair value estimate for Express Scripts after the company reported third-quarter results that were in line with our expectations. The stock soared as the company announced that it expects 97% client retention next year, with 95% of its clients agreeing to exclude Walgreen from the pharmacy network in the interest of lowering costs. Although we believe there is still time for a resolution if Walgreen accepts most of Express Scripts' terms, this seems like an increasingly remote possibility. We anticipate lowering our fair value estimate for Walgreen if an agreement isn't reached soon.

Since the Walgreen-Express Scripts dispute began in June, we have consistently stated that Express Scripts has the upper hand based on its stable membership base and the nation's current obsession with lower health-care costs. We believe Walgreen overestimated the value placed by pharmacy benefit managers' clients on keeping Walgreens stores in their pharmacy networks. We believe this dispute provides strong evidence supporting our thesis that PBMs have expanding economic moats, while retail drugstores face unprecedented reimbursement and competitive pressure. According to Express Scripts, in order for its members to transfer their prescriptions from Walgreen, all they need to do is bring their empty pill bottles into one of the other 50,000-plus retail pharmacies in its network. Once these customers leave Walgreen, they may never return.

Turning to Express Scripts' third-quarter results, adjusted earnings per share (which excludes costs related to the Medco acquisition) increased 22%. Revenue increased just under 3%, so most of this growth was driven by margin

Analyst Notes (continued)

expansion, as Express Scripts continues to benefit from higher generic penetration. The overall generic penetration rate reached 74.1% in the quarter, up from 72.1%. Next quarter marks the beginning of the major 2012 patent expiration bonanza, which is likely to boost margins further. A 9% reduction in the share count also contributed to earnings growth. According to management, the Medco merger remains on track for a first-half 2012 close, although we remain skeptical that regulators will approve the deal.

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Express Scripts ESRX

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
46,128	28,556	Health Care Plans	Healthcare

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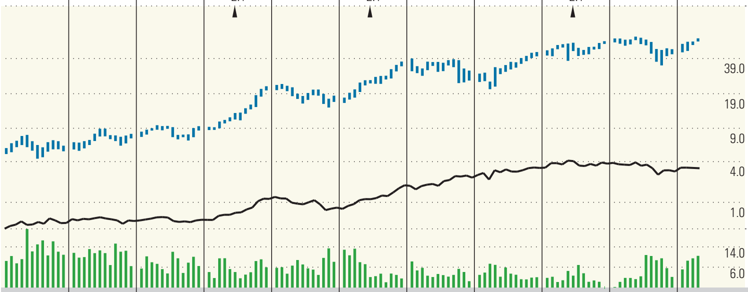
Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★★★	58.85	73.00	Medium	Wide	—

per share prices in USD

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	
8.24	9.43	10.15	22.70	23.75	37.20	39.55	44.94	55.68	60.89	58.89	Annual Price High
4.83	5.79	7.29	9.15	14.70	16.16	24.18	21.38	37.75	34.47	44.69	Low
			2:1		2:1			2:1			Recent Splits



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

52 week High/Low
60.89 - 34.47

10 Year High/Low
60.89 - 4.83

Bear-Market Rank
6 (10=worst)

Trading Volume Million

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	Stock Performance
2.7	38.3	15.1	119.3	-14.6	103.9	-24.7	57.2	25.1	-17.3	31.7	Total Return %
26.1	11.9	6.1	116.3	-28.2	100.4	13.8	33.8	12.3	-17.3	21.1	+/- Market
1.6	-9.9	-31.1	75.3	-9.2	80.8	23.4	21.6	15.2	-36.9	16.4	+/- Industry
—	—	—	—	—	—	—	—	—	—	0.0	Dividend Yield %
3743	5218	5808	12204	9697	18455	13605	23766	28542	21742	28556	Market Cap USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials
12261	13295	15115	16266	17660	18274	21978	24749	44973	46128	46128	Revenue USD Mil
6.7	6.5	6.2	7.4	8.5	9.7	9.3	9.8	6.6	7.0	7.0	Gross Margin %
372	449	493	643	824	1061	1281	1498	2071	2312	2312	Oper Income USD Mil
3.0	3.4	3.3	4.0	4.7	5.8	5.8	6.1	4.6	5.0	5.0	Operating Margin %
203	250	278	400	474	568	776	828	1181	1276	1276	Net Income USD Mil
0.32	0.40	0.45	0.67	0.84	1.08	1.54	1.56	2.17	2.53	2.53	Earnings Per Share USD
—	—	—	—	—	—	—	—	—	—	—	Dividends USD
637	631	620	596	568	528	504	532	544	505	505	Shares Mil
1.61	1.90	1.97	2.51	2.08	1.38	2.18	6.46	6.83	5.08	5.10	Book Value Per Share USD
426	458	496	793	659	827	1103	1772	2117	2192	2192	Oper Cash Flow USD Mil
-61	-53	-52	-60	-67	-75	-86	-149	-120	-144	-144	Cap Spending USD Mil
365	405	445	733	592	752	1017	1622	1998	2048	2048	Free Cash Flow USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
7.1	7.5	7.9	8.8	8.9	11.0	14.4	9.5	10.5	9.8	9.8	Return on Assets %
22.1	22.7	23.3	30.1	36.6	62.4	87.5	35.8	33.0	42.0	42.0	Return on Equity %
1.7	1.9	1.8	2.5	2.7	3.1	3.5	3.3	2.6	2.8	2.8	Net Margin %
4.30	4.02	4.31	3.58	3.33	3.53	4.08	2.84	4.00	3.53	3.53	Asset Turnover
3.2	2.9	3.0	3.8	4.5	7.5	5.1	3.4	2.9	6.3	6.3	Financial Leverage

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	12-11	Financial Health
-150	-66	-370	-137	-657	-507	-678	-1313	-976	2600	2600	Working Capital USD Mil
563	455	412	1401	1270	1760	1340	2493	2494	7076	7076	Long-Term Debt USD Mil
1003	1194	1196	1465	1125	696	1078	3552	3607	2474	2474	Total Equity USD Mil
0.56	0.38	0.34	0.96	1.13	2.53	1.24	0.70	0.69	2.86	1.38	Debt/Equity

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Valuation
18.8	21.0	21.3	31.3	21.5	32.1	17.7	27.8	24.4	17.7	23.3	Price/Earnings
—	—	—	—	—	—	—	—	—	1.0	1.5	P/E vs. Market
0.3	0.4	0.4	0.8	0.6	1.1	0.6	0.9	0.7	0.5	0.6	Price/Sales
3.7	4.4	4.8	8.3	8.6	26.5	12.6	6.7	7.9	8.8	11.6	Price/Book
9.0	11.4	11.9	15.9	15.7	23.3	12.6	13.0	13.9	10.5	13.6	Price/Cash Flow

Growth Rates Compound Annual

Grade: B	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	2.6	28.0	21.2	17.3
Operating Income %	11.6	21.8	22.9	25.6
Earnings/Share %	14.5	17.7	24.8	29.2
Dividends %	—	—	—	—
Book Value/Share %	-25.3	32.8	19.7	14.5
Stock Total Return %	6.2	25.4	21.5	22.4
+/- Industry	-13.2	-2.7	17.9	8.9
+/- Market	0.8	8.5	22.6	20.3

Profitability Analysis

Grade: D	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	42.0	52.1	17.3	22.6
Return on Assets %	9.8	11.0	6.0	9.4
Fixed Asset Turns	116.9	102.9	49.0	7.5
Inventory Turns	113.4	104.1	83.3	16.6
Revenue/Employee USD K	3515.9	2888.3*	—	1040.0
Gross Margin %	7.0	8.5	12.0	39.9
Operating Margin %	5.0	5.5	6.4	16.7
Net Margin %	2.8	3.1	3.9	11.2
Free Cash Flow/Rev %	4.4	4.8	4.0	0.1
R&D/Rev %	—	—	—	9.4

Financial Position

Grade: B	12-10 USD Mil	12-11 USD Mil
Cash	524	5620
Inventories	382	374
Receivables	1721	1916
Current Assets	2941	8058
Fixed Assets	373	416
Intangibles	7211	7107
Total Assets	10558	15607
Payables	3323	3802
Short-Term Debt	0	1000
Current Liabilities	3917	5458
Long-Term Debt	2494	7076
Total Liabilities	6951	13133
Total Equity	3607	2474

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	23.3	24.0	11.9	15.4
Forward P/E	13.3	—	—	13.5
Price/Cash Flow	13.6	14.7	9.0	7.3
Price/Free Cash Flow	14.5	15.9	11.4	17.6
Dividend Yield %	—	—	0.8	2.0
Price/Book	11.6	12.5	1.9	2.0
Price/Sales	0.6	0.8	0.5	1.2
PEG Ratio	0.8	—	—	1.9

Quarterly Results

Revenue USD Mil	Mar 11	Jun 11	Sep 11	Dec 11
Most Recent Period	11094.5	11361.4	11571.0	12101.4
Prior Year Period	11143.9	11288.8	11251.8	11294.2

Rev Growth %	Mar 11	Jun 11	Sep 11	Dec 11
Most Recent Period	-0.4	0.6	2.8	7.2
Prior Year Period	105.5	105.1	100.2	37.7

Earnings Per Share USD	Mar 11	Jun 11	Sep 11	Dec 11
Most Recent Period	0.61	0.66	0.66	0.59
Prior Year Period	0.47	0.53	0.56	0.62

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Express Scripts	28556	46128	23.3	42.0
CVS Caremark Corp	57227	107100	17.0	9.1

Major Fund Holders

	% of shares
	—
	—
	—

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

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	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	★★★★★
Analyst conducts company and industry research: • Management interviews • Conference calls • Trade-show visits • Competitor, supplier, distributor, and customer interviews	The depth of the firm's competitive advantage is rated: • None • Narrow • Wide	Analyst considers company financial statements and competitive position to forecast future cash flows. Assumptions are input into a discounted cash-flow model.	DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.	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."