

Focus Stock Report

August 12, 2009

Pfizer (PFE U\$15.83, Outperform, Target U\$21.00)

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Company Description

Pfizer (PFE) is the world's largest research-based biomedical and pharmaceutical company. With corporate headquarters in New York, the company has major research and development locations in the both the United States and U.K. and is in the business of discovering, developing, manufacturing, and selling prescription medicines for both humans and animals. Some of Pfizer's top-selling products include treatments for high blood pressure and heart failure, osteoarthritis and rheumatoid arthritis, Alzheimer's disease, infectious diseases, epilepsy, depression, and anxiety. Its best known medications include Viagra for erectile dysfunction, Celebrex for pain management, and Lipitor, its cholesterol lowering medication. In 2010, it will have 10 "blockbuster" drugs in its portfolio (drugs with more than U\$1 billion in sales annually). In 2006, Lipitor became the best selling drug in pharmaceutical history. In 2009 the drug will account for nearly 30% of the company's revenues and even a greater percentage of cash flow. The patent on Lipitor will expire in 2011 and sales of the drug are expected to halve in the following year as the market opens up to generic competition. Ranbaxy, is expected to launch a generic version of Lipitor after November 2011. This is one of the larger threats facing the company over the next few years. Most of the company's sales are made through drug wholesalers McKesson (MCK) and Cardinal Health (CAH).

On January 26, 2009, Pfizer announced that they have entered into a definitive merger agreement with Wyeth in which Pfizer will acquire Wyeth (WYE) in a cash-and-stock transaction. The acquisition is expected to close late in the third or early in the fourth quarter.

Key elements supporting recommendation

Valuation: Our investment thesis is based largely on the belief the shares are mispriced and the Wyeth acquisition is a catalyst that will likely address the valuation issue. Using

Pfizer Inc.
(PFE-NYSE)

Rating: Outperform

Risk: Medium

Summary Data (U\$)

Price (August 11/2009):	\$15.83	Fiscal Year-End:	December
12-Month Target:	\$21.00	Dividend:	\$0.64
Total Return:	37%	Yield:	4.0%
52-Week High:	\$20.13	52-Week Low:	\$11.62
2008 ROE	13.2%	Market Value (\$mil)	\$106,821

Earnings Per Share (U\$)

Annual	2007A	2008A	2009E	2010E
EPS:	\$2.15	\$2.42	\$1.99	\$2.20
P/E Multiple:	10.6x	7.4x	8.0x	7.2x

Source: Credit Suisse estimates, Bloomberg

Revenue Breakdown (US\$ millions)

	2007	2008	2009 E	2010 E	2011 E	2012 E
Cardiovascular Diseases	18,853	17,922	16,317	16,248	15,854	9,503
Central Nervous System	5,152	6,005	6,025	6,312	6,536	6,652
Inflammation	2,914	3,096	2,820	2,910	2,855	2,829
Infectious Diseases	3,552	3,931	3,688	3,666	3,810	3,938
Urology	3,010	3,204	3,183	3,393	3,559	2,765
Oncology	2,640	2,551	2,320	2,456	2,549	2,637
Other	<u>6,514</u>	<u>5,431</u>	<u>5,328</u>	<u>5,311</u>	<u>5,029</u>	<u>4,678</u>
Total Revenue	42,635	42,140	39,681	40,296	40,192	33,002
Revenue - Blockbuster Drugs						
Lipitor	12,675	12,401	11,502	11,715	11,573	5,458
Norvasc	3,001	2,244	1,924	1,615	1,368	1,232
Lyrica	1,829	2,573	2,824	3,077	3,282	3,568
Geodon	854	1,007	1,045	1,120	1,166	1,077
Celebrex	2,290	2,489	2,392	2,481	2,425	2,398
Zyvox	944	1,115	1,456	1,230	1,296	1,361
Viagra	1,764	1,934	1,896	1,949	1,979	1,253
Detrol/LA	1,190	1,214	1,162	1,180	1,195	991
Sutent	581	847	916	1,061	1,156	1,242
Zalatan/Xalcom	1,632	1,777	1,709	1,742	1,477	1,095

Source: Credit Suisse

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consensus earnings estimates, Pfizer trades at 8.10 times forecast 2009 EPS and 7.1 times forecast 2010 EPS. The shares are trading at their lowest valuation in more than three decades. Valuations across the pharmaceutical sector have contracted sharply over the last decade reflecting the many challenges faced by the industry including political risk, litigation risk, lower FDA drug approval rates, weaker pipelines, lower earnings growth, and upcoming patent expirations. Pfizer trades at a substantial discount to a number of its peers including Merck (MRK), Schering Plough (SGP), Bristol-Myers Squibb (BMY), and Novartis (NVS). Pfizer's deep discount relative to its peers reflects the company's heavy reliance on Lipitor and the upcoming patent expiration.

Industry Comparables									
Company	Ticker	Price	EPS		P/E		EPS Growth 09-10	Curr EV /EBITDA	Dividend Yield
			2009	2010	2009	2010			
Pfizer Inc.	PFE	\$15.83	\$1.97	\$2.23	8.0	7.1	13%	4.5	4.0%
Eli Lilly & Co.	LLY	\$33.67	\$4.28	\$4.54	7.9	7.4	6%	5.6	5.8%
Merck & Co.	MRK	\$30.33	\$3.24	\$3.42	9.4	8.9	6%	7.8	5.0%
Novartis AG	NVS	\$44.52	\$3.76	\$4.14	11.8	10.8	10%	n.a.	3.8%
Sanofi-Aventis	SNY	\$32.50	\$4.39	\$4.40	7.4	7.4	0%	n.a.	4.4%
Bristol-Myers Squibb Co.	BMY	\$21.97	\$1.93	\$2.15	11.4	10.2	11%	6.5	5.6%

Source: Bloomberg

Wyeth Addresses Many Issues: The acquisition of Wyeth is strategically significant in helping Pfizer deal with upcoming patent expirations by expanding its product offering and revenue base. The combined company will be one of the most diversified companies in the global health care industry, with product offerings in numerous growing therapeutic areas, a strong product pipeline, and leading scientific and manufacturing capabilities. Wyeth will strengthen or build Pfizer's presence in vaccines, antibiotics, women's health, inflammatory and cardiovascular conditions, and gastroenterology. Wyeth expands Pfizer's animal health business and brings Pfizer back into the consumer products market with brands such as Advil and Robitussin. Pfizer sold its consumer products business to Johnson & Johnson (JNJ) in 2006. The Wyeth transaction is expected to be accretive to earnings and strategically sound in that it addresses the fall off in revenue that PFE faces with the pending patent expiry of Lipitor and other remedies making them subject to generic competition.

Wyeth Cost Synergies: Management has suggested to analysts that stated synergy targets are conservative and could be exceeded in both dollars saved, and time of achievement. Annual cost savings could exceed US\$4 billion. Pfizer will look to eliminate redundancies in administration, sales, R&D, and manufacturing. The merger is likely to result in a 15% reduction in the combined workforce.

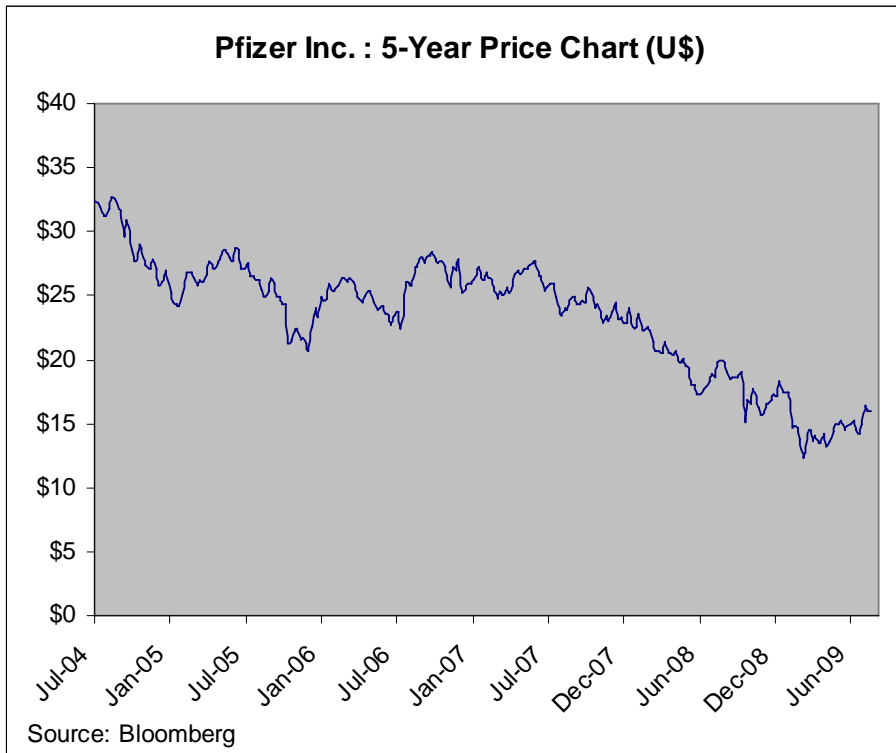
Lower Financing Costs for Wyeth: Pfizer needs to finance US\$22.5 billion in debt to close the transaction. The decline in interest rates since the deal with WYE was announced reduces the cost of financing. Pfizer's balance sheet is projected to be levered 54% debt to equity versus 48% prior to the deal. Credit Suisse forecasts that by the end of 2010, the debt/equity ratio will be back down to pre-acquisition levels.

Strategy for Existing Product Lines: Last year the company changed their organizational structure by creating five operating business units in an effort to enhance transparency and accountability. One of the units is called Established Products; according to the company's website, "established products are medicines that have lost patent exclusivity or are close to losing their exclusivity. Established products are traditionally a shrinking segment of business due to intense generic competition brought on by the loss of exclusivity (LOE) of the products. Pfizer's Established Products Business Unit is committed to stabilizing the current base business and transforming it into growth, through strategies like product enhancements and reformulations."

Earnings Prospects: Wyeth significantly improves Pfizer's revenue and earnings prospects outlook, most notably post the expiration of the Lipitor patent. That said, Credit Suisse is still forecasting an 18% year-over-year decline in EPS in 2012 as Lipitor goes ex patent. New product introduction or product line extensions could provide for better earnings prospects than are currently forecast. For the time being, this is less a story about earnings growth and more one of valuation.

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Dividend Growth Potential: Although the dividend was cut 50% when the Wyeth deal was announced, analysts expect the company to raise the dividend after the acquisition is closed and the integration is under way. Prior to the recent cut, PFE had an excellent record of dividend increases, rising at an annualized rate of 16% per year over the past 10 years. The dividend yield at the time this report was written was an attractive 4.0%.



Risks to Investment Thesis

Regulatory Risk: U.S. and foreign governmental regulations that control pricing and limit patient access to Pfizer's products represent an ongoing challenge for Pfizer and other pharmaceutical companies. Health care reform in the U.S. has been a major concern for investors. The U.S. currently spends more on health care per capita than any other country in the world. As a percentage of GDP, health care spending in the U.S. is approximately 15.3% and rising. With the cost of providing health care becoming an increasing burden, reducing costs becomes a primary goal in health care reform.

Generic Competition: The loss of patent protection opens the market for branded drugs to generic competition. Generics represent a major challenge for Pfizer and other branded pharmaceutical manufacturers as sales for the branded drug can erode very quickly. Patents on Pfizer's important products including Lipitor, Celebrex, and Detrol are constantly being challenged by generic drug makers. The loss of a patent on a major competing branded drug can indirectly affect the sales of Pfizer's products.

Acquisition and Integration Risks: The ability to successfully complete the Wyeth transaction and integrate the two businesses is a key element in our investment thesis.

Other Risks: Litigation risk, drug development risk, global economic conditions.

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The author(s) of the report own(s) securities of the following companies.

None.

The supervisors of the Portfolio Advisory Group own securities of the following companies.

None.

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