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**RESEARCH NOTES**

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**PFIZER (PFE) - \$25.15**

**DECEMBER 12, 2006**

Pfizer suffered a significant setback recently when the company terminated the development of a promising new cholesterol treatment, Torcetrapib/Atorvastatin (T/A). It was hoped that T/A, the first in a new class of cardiovascular treatments, would eventually replace Pfizer's most important drug, Lipitor, which loses its full patent protection in 2011. Lipitor is the leading cholesterol drug in the world with annual sales of over \$12 billion, roughly one quarter of Pfizer's annual revenues.

The announcement of the termination of the T/A trials caught Wall Street by surprise, as Pfizer had reviewed the new drug pipeline at an analysts conference on November 30<sup>th</sup> with no indication of difficulties with T/A. Reports of increased cardiovascular risks reached Pfizer management on Saturday, December 2<sup>nd</sup>, according to reports, and led to the swift decision by management to terminate the trials. This dramatic reversal caused analysts to revise their earnings projections for Pfizer significantly, particularly for the 2010-2012 when Lipitor sales are expected to decline materially.

The hope that T/A would be a blockbuster of the magnitude of Lipitor is lost for now. It is important to note however, that drugs in Phase III trials are not assured of success, and any future revenues from T/A would not have been realized for years. While Pfizer's drug development pipeline is less promising without T/A, there are many exciting potential new products, including treatments for obesity, smoking cessation, cancer and diabetes. Pfizer develops drugs both internally and through licensing agreements and acquisitions (including, for example, the purchase of Lipitor developer Warner Lambert in 2000).

Despite this setback, Pfizer remains a leader in a highly profitable industry. In a recent Wall Street Journal piece, columnist Allan Murray quoted the former CEO of Honeywell as saying "In its worst day, the pharmaceutical business is better than any business I've ever been in." Pfizer's operating margins top 40%, and its broad array of successful products generated more than \$12 billion in free cash flow over the past year. After the sale of its consumer products division to Johnson & Johnson, Pfizer will have roughly

\$30 billion (more than \$4 per share) in cash on its balance sheet. This financial strength gives Pfizer many options for returning value to shareholders, including increased dividends, accelerated stock buybacks, and niche acquisitions to fill voids in its pipeline.

Like many large cap growth stocks, Pfizer has significantly under performed the market in recent years. And although the challenges facing the large pharmaceutical companies (development costs, generic competition, litigation risks and governmental pricing pressure) are significant, their stock prices today reflect very modest expectations. Since the end of 2000, Pfizer's earnings and dividends have more than doubled - yet its P/E Ratio has declined from 45x to 12x! In our view, Pfizer's financial strength and compelling valuation creates an outstanding long term opportunity. While the T/A disappointment and other concerns may limit upside potential for the time being, the generous and secure dividend (4% yield) should provide substantial support.

*If you have questions or comments regarding this Research Note, please click here to contact the Research Department.*

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