

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

Pfizer Approaches Allergan for Early-Stage Discussions on Merging, but Deal Remains Uncertain

See Page 2 for the full Analyst Note from 29 Oct 2015

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The primary analyst covering this company does not own its stock.

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Rating updated as of 03 Nov 2015

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

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Investment Thesis 28 Jul 2015

Pfizer's foundation remains solid, based on strong cash flows generated from a basket of diverse drugs. The company's large size confers significant competitive advantages in developing new drugs. This unmatched heft, combined with a broad portfolio of patent-protected drugs, has helped Pfizer build a wide economic moat around its business.

Pfizer's size establishes one of the largest economy of scale in the pharmaceutical industry. In a business where drug development needs a lot of shots on goal to be successful, Pfizer has the financial resources and the established research power to support the development of more new drugs. Also, after many years of struggling to bring out important new drugs, Pfizer is now launching several potential blockbusters in cancer, heart disease, and immunology.

Pfizer's vast financial resources support a leading salesforce. Pfizer's commitment to postapproval studies provides its salespeople with an armamentarium of data for their marketing campaigns. Further, Pfizer's leading salesforces in emerging countries position the company to benefit from the dramatically increasing wealth in nations such as Brazil, Russia, India, China, and Turkey.

While entrenched as an industry leader, Pfizer faces challenges in the near term. In particular, the loss of Lipitor exclusivity in 2012 will continue to weigh on the growth of the company. Additionally, in 2014, Pfizer lost patent protection on blockbuster Celebrex for arthritis.

However, we believe Pfizer's operations can withstand the blitz of new generic competition, and the 2009 acquisition of Wyeth helps insulate Pfizer from any one particular patent loss. Following the merger, Pfizer has a much stronger position in the biologic industry with meningitis vaccine Prevnar and rheumatoid arthritis drug Enbrel. Biologics tend to be more resistant to generic competition due to the complexity in the structure of the drugs.

Vital Statistics

Market Cap (USD Mil)	215,672
52-Week High (USD)	36.46
52-Week Low (USD)	28.47
52-Week Total Return %	19.5
YTD Total Return %	15.0
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	3.6
5-Yr Forward EPS CAGR %	4.7
Price/Fair Value	0.92

Valuation Summary and Forecasts

	Fiscal Year:	2013	2014	2015(E)	2016(E)
Price/Earnings		13.8	13.7	15.8	14.1
EV/EBITDA		8.7	10.5	10.7	9.8
EV/EBIT		12.2	14.8	14.2	12.5
Free Cash Flow Yield %		8.4	8.0	5.9	6.1
Dividend Yield %		3.4	3.4	2.6	2.8

Financial Summary and Forecasts (USD Mil)

	Fiscal Year:	2013	2014	2015(E)	2016(E)
Revenue		51,584	49,605	48,533	53,144
Revenue YoY %		-12.6	-3.8	-2.2	9.5
EBIT		16,366	13,499	15,584	17,645
EBIT YoY %		-9.0	-17.5	15.5	13.2
Net Income, Adjusted		15,288	14,587	13,867	15,208
Net Income YoY %		-7.2	-4.6	-4.9	9.7
Diluted EPS		2.22	2.27	2.22	2.48
Diluted EPS YoY %		-4.4	2.4	-2.3	11.7
Free Cash Flow		17,068	16,038	-4,425	13,067
Free Cash Flow YoY %		-2.7	-6.0	-127.6	-395.3

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Pfizer is one of the world's largest pharmaceutical firms, with annual sales close to \$50 billion. Prescription drugs and vaccines account for close to 90% of sales. Top sellers include vaccine Prevnar 13 against meningitis, Viagra for impotence, and Lyrica for epilepsy and some types of neuropathic pain. Pfizer sells these products globally with international sales representing close to 60% of its total sales.

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Morningstar Analysis

Pfizer Approaches Allergan for Early-Stage Discussions on Merging, but Deal Remains Uncertain 29 Oct 2015

Pfizer has approached Allergan to discuss a potential merger, but given the early nature of these discussions and limited details, we are not changing our fair value estimates for either company. As Pfizer has recently completed the Hospira acquisition, we expect it to make another acquisition in the specialty pharmaceutical industry, where stock prices have fallen significantly and where Pfizer has potential to create value by leveraging its worldwide marketing and distribution infrastructure. We currently view Allergan as undervalued, and a merger would strategically fit well with Pfizer. Allergan offers healthy growth from its expanding specialty pharma portfolio, especially in attractive ophthalmology, aesthetics, and gastrointestinal therapeutic areas, which should fuel both parts of Pfizer's innovative business and established product group. Additionally, the merger would probably improve Pfizer's tax rate of 25% as the potential deal may allow an inversion for Pfizer to take advantage of Allergan's low tax rate of 15%. From a moat perspective, we think both companies support wide economic moats, and a merger wouldn't be likely to change that strong competitive profile.

Valuation, Growth and Profitability 27 Oct 2015

We are increasing our fair value estimate to \$38 from \$36 per share largely because of higher expected margins due to strong new drug launches and increased projections for the company's leading vaccine Prevnar. The expansion of the vaccine into the adult patient populations continues to create stronger-than-expected sales. During the next decade, we expect only 2% annual sales growth (including the Hospira acquisition) as new drugs offset generic competition. However, on the bottom line we project a healthier annual growth rate of 4% during the next decade as cost-cutting plans and share buybacks take shape. Over the long term, we believe the more diversified lineup of drugs should reduce the volatility of earnings. We anticipate

restructuring efforts and the elimination of duplicate positions will help alleviate some margin pressure, as high-margin products lose exclusivity. From a cost of capital perspective, we estimate Pfizer's cost of equity at 7.5% and weighted average cost of capital at 7% as well, in line with the company's peer group.

Scenario Analysis

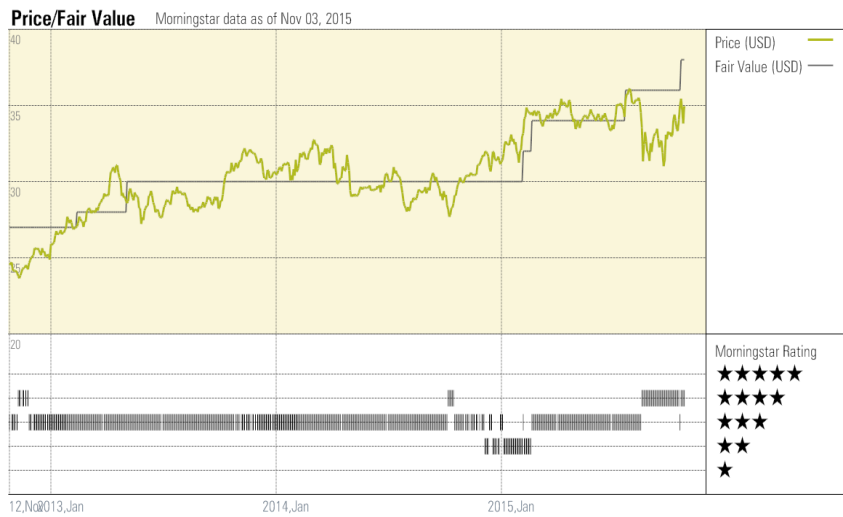
Largely based on the low volatility of cash flows from a diverse product portfolio with inelastic demand, we rate Pfizer's uncertainty as low. Our scenario analysis assumes a base-case fair value estimate of \$38, a bull case of \$47 (25% probability), while our bear case (25% probability) projects a \$31 fair value. Relative to our base case, the scenario analysis shows minor variances, hence our low uncertainty rating. The key factors affecting the scenario analysis include the degree of success of the branded drug pipeline along with the magnitude of market pressures for currently marketed drugs. Within the pipeline, the most important driver of valuation is Ibrance for cancer. Additionally, the unknown of biosimilar competition to Enbrel for immunology disease weighs on our certainty.

Economic Moat

While it's not as strong as a decade ago, we believe Pfizer maintains a wide economic moat. The strength of Pfizer's moat is based on patent-protected drugs, economies of scale, intellectual intangibles, and a powerful salesforce. The core of Pfizer's wide moat lies in its patent-protected drugs. Pfizer harnesses the enormous cash flows from its current product portfolio to fund ongoing discovery and development of the next generation of drugs. The large cash flows enjoyed by Pfizer also create an economy of scale that enables the drug giant to easily fund the average \$800 million required for a new drug. The firm's R&D engine is another strong moat contributor. During the past decades, Pfizer has created a database of intellectual insights into drug development that should help it bring new medicines to market. Further, Pfizer can use its vast cash reserves to

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tends to strive.

Despite these positive developments, major industry headwinds temper a positive outlook. In particular, the U.S. Food and Drug Administration has grown increasingly risk sensitive, approving only very safe drugs or drugs in highly needed areas like cancer. Also, insurance companies are reducing coverage for follow-on drugs, forcing drug firms to push for true innovation and reducing the power of drug firms' distribution network. The loss of distribution power in developed markets has hit Pfizer acutely as the company traditionally held one of the most powerful salesforces. Further, governments are evaluating comparative effectiveness programs and more aggressive price negotiations, increasing the bar for future innovation.

acquire the most promising technology to augment its internal R&D efforts. Lastly, Pfizer wields one of the most powerful salesforces in the world, which not only helps market internally developed drugs, but also makes the company a top-choice partner for smaller pharmaceutical firms needing help distributing their drugs.

Moat Trend

Pfizer's moat trend is stabilizing, as the company is through the worst of its patent cliff and is emerging with one of the best pipelines in years. Likely blockbuster drugs Eliquis and Xeljanz are leading Pfizer's next generation of drugs. Also, the growing contributions from vaccines should help secure sales over the long term as vaccines are much less susceptible to generic or branded competition because of the complexity of manufacturing, and their relatively low prices. Further, the company's decision to cut research and development spending by approximately 20% in 2011 without significantly damaging the productivity of the pipeline supports stronger returns on invested capital. Additionally, we expect Pfizer augment internal development efforts through more partnering with smaller biotech firms and academic universities, where innovation

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Bulls Say/Bears Say

Bulls Say

- ▶ Pfizer's pipeline productivity is improving with several successful recent launches. In particular, Pfizer's Xeljanz is a potential game-changer in rheumatoid arthritis. In addition, Pfizer's Eliquis should develop into a blockbuster in atrial fibrillation.
- ▶ The stock supports a dividend yield of over 3% and we expect the dividend payout ratio will increase during the next few years.
- ▶ The review of breaking up Pfizer's innovative core and established drug group increases the visibility of the company and creates optionality to potentially create value through cutting the firm in two.

Bears Say

- ▶ Pfizer's aggressive cost-cutting in research and development could hurt the long-term prospects of the firm as less capital is available to develop the company's pipeline.
- ▶ While through the worst of its patent cliff, Pfizer still faces major patent losses with Celebrex generic competition likely to weigh on growth in 2015.
- ▶ Several of Pfizer's late-stage pipeline drugs are entering crowded markets, which may limit market share gains.

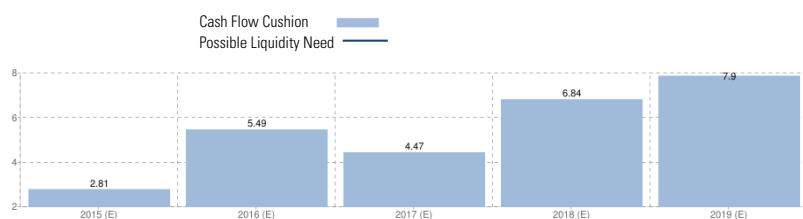
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Five Year Adjusted Cash Flow Forecast (USD Mil)

	2015(E)	2016(E)	2017(E)	2018(E)	2019(E)
Cash and Equivalents (beginning of period)	36,122	16,770	17,241	18,435	20,031
Adjusted Available Cash Flow	-15,604	7,983	8,869	9,426	9,868
Total Cash Available before Debt Service	20,518	24,753	26,110	27,861	29,899
Principal Payments	-5,561	-3,040	-4,412	-2,660	-2,413
Interest Payments	-1,100	-855	-810	-765	-720
Other Cash Obligations and Commitments	-634	-615	-624	-646	-652
Total Cash Obligations and Commitments	-7,295	-4,510	-5,846	-4,071	-3,785

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	36,122	141.6
Sum of 5-Year Adjusted Free Cash Flow	20,542	80.5
Sum of Cash and 5-Year Cash Generation	56,664	222.2
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	56,664	222.2
Sum of 5-Year Cash Commitments	-25,507	—

Financial Health

Pfizer's highly flexible financial position, with cash and investments of \$48 billion exceeding debt of \$35 billion at the end of June, has weakened modestly by our estimates after the \$17 billion Hospira transaction, which closed in early September. Also, since Pfizer's growth outlook during the next decade remains pretty weak even when considering the Hospira acquisition, we believe Pfizer still has incentive to make capital-allocation decisions that are unfriendly to debtholders. Pfizer's growth prospects would rise most significantly through a larger acquisition, which we think still remain a possible use of the firm's financial resources. Also, Pfizer may continue to increase cash returns to shareholders. It remains committed to its dividend (\$7 billion during the 12 months ended in June), and it continues to repurchase shares heavily (\$8 billion during the 12 months ended in June). As of June, the firm had \$5 billion remaining on its share-repurchase authorization. Also, of note, since much of Pfizer's financial resources are held overseas, the company may remain constrained in its access to that cash. For example, Pfizer estimates that it typically holds as much as \$10 billion of its cash and short-term investments in the U.S., which may make debt financing necessary for certain capital-allocation activities beyond that.

Enterprise Risk

Pfizer faces generic competition, an increasingly stringent FDA, and stronger managed-care negotiating power. Several of its blockbuster drugs are nearing the end of their patent-exclusivity periods. New drug development to fill these gaps has become challenging with a more risk-conscious FDA. Additionally, managed care has grown during the past two decades into a powerful entity that can negotiate lower drug prices. Although more remote, litigation risks remain, as evidenced by Merck's MRK high settlement costs involving Vioxx. Also, several of Pfizer's pipeline drugs are reaching markets behind competitors, which may increase the risk of commercialization failure.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
IAN C. READ	Director	1,408,457	05 Mar 2015	—
FRANK A. D'AMELIO		409,641	25 Feb 2015	—
DR. MIKAEL DOLSTEN		355,911	05 Mar 2015	—
GENO J. GERMANO		308,254	25 Feb 2015	—
LORETTA V. CANGIALOSI		174,611	30 Jul 2015	—
DR. FREDA C. LEWIS-HALL, M.D.		162,567	25 Feb 2015	—
SALLY SUSMAN		150,899	12 Mar 2015	—
MR JOHN DOUGLAS YOUNG		130,341	25 Feb 2015	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Stock Mkt Idx	1.78	0.93	1,509	30 Sep 2015
Vanguard Five Hundred Index Fund	1.19	1.14	1,113	30 Sep 2015
Vanguard Institutional Index Fund	1.07	1.14	-142	30 Sep 2015
SPDR® S&P 500 ETF	1.05	1.14	-904	30 Oct 2015
VA CollegeAmerica Income Fund of America	1.00	2.26	—	30 Sep 2015
Concentrated Holders				
ProFunds VP Pharmaceuticals	—	18.88	-1	30 Jun 2015
Invesco All Cap Market Neutral Fund	—	15.63	9	30 Jun 2015
ProFunds Pharmaceuticals UltraSector Fd	—	11.94	0	31 Jul 2015
JNL/Mellon Capital Dow Index Fund	0.03	10.80	-29	30 Jun 2015
iShares US Pharmaceuticals	0.04	9.47	-22	30 Oct 2015

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/Sold (k)	Portfolio Date
State Street Global Advisors (Aus) Ltd	0.94	1.13	56,990	29 Oct 2015
ARONSON+JOHNSON+ORTIZ	0.30	2.65	18,497	30 Jun 2015
State Farm Insurance Retirement Plan For U.S. Employees	0.22	2.63	17,533	31 Dec 2009
T. Rowe Price Associates, Inc.	1.65	0.70	13,407	30 Jun 2015
Pharmacia Savings Plan	0.24	13.96	12,563	31 Dec 2007
Top 5 Sellers				
MFS Investment Management K.K.	—	1.06	-60,764	30 Sep 2015
Goldman, Sachs & Co.	0.24	0.24	-26,739	30 Jun 2015
Fidelity Management and Research Company	0.44	0.13	-15,042	30 Jun 2015
BlackRock Fund Advisors	2.93	0.88	-12,072	30 Jun 2015
State Street Corp	5.12	1.13	-11,777	30 Jun 2015

Management 28 Jul 2015

We rate Pfizer's stewardship as standard. While the company has made many poor capital allocation decisions over the past decade, the current management appears to be focusing on better uses of cash, including share buybacks and dividends. However, we believe the support in developing several drugs that will be third or fourth to a new class of therapy is a poor capital allocation decision. On the M&A front, the acquisition of Hospira should strengthen Pfizer's moat in its established drug group and the acquisition price looks reasonable.

Looking back to 2010, in a surprising move, Pfizer named longtime veteran Ian Read to the CEO post, abruptly replacing Jeffrey Kindler. We believe the earlier-than-anticipated departure of Kindler was largely due to personal reasons and don't believe the transition raises any red flags. Read brings more than 30 years of experience at Pfizer to the post and was most recently in charge of the company's biopharmaceutical business. As CEO, Read has already brought his stamp to the post by signaling a strong willingness to cut R&D and buy back shares. We believe Read's leadership is bringing changes needed to increase the company's growth potential. On the reporting side, accounting transparency is not ideal, largely because of financial distortions caused by frequent acquisitions. Reconciliation between generally accepted accounting practices results and adjusted results is complex, diluting the clarity of earnings statements.

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Analyst Notes

Increasing Pfizer's Fair Value Estimate to \$38 Based on Strong Third Quarter; Pipeline Strengthens 27 Oct 2015

We are boosting our Pfizer fair value estimate to \$38 from \$36 based on strong third-quarter results that exceeded both our and consensus projections. At the current market price, Pfizer's stock looks slightly undervalued, as we believe the market doesn't fully appreciate the company's pipeline and leverage from new product launches. Additionally, we view both the strong portfolio of currently marketed drugs and a developing pipeline as solid support for the company's wide moat.

Within Pfizer's large product portfolio, several mixed product trends led to overall 4% year-over-year growth, with particularly strong sales in vaccines and cancer drugs offsetting declines from mature drugs. Notably, pneumococcal vaccine Prevnar 13 (up 44% and representing 13% of total sales) continues to outperform our expectations, and we believe the international launch in the adult patient population will support continued growth. Further, cancer drug Ibrance is generating robust growth that should continue over the next several years. The strong growing drugs are more than offsetting generic Celebrex and Zyvox competition, and we anticipate a slowing of generic headwinds in 2016.

On the pipeline front, while Pfizer's pipeline focuses on several areas of increasing competition, the potential of these markets is large enough to support several new blockbusters. In particular, cardiovascular drug bococizumab, diabetes drug ertugliflozin, and immuno-oncology drug avelumab should develop into new blockbuster opportunities.

Turning to corporate restructuring, we expect Pfizer will continue to make major acquisitions and eventually break up into two entities. As Pfizer has completed the Hospira acquisition, we expect Pfizer to make another acquisition in

the specialty pharmaceutical industry, where stock prices have fallen significantly and where Pfizer now has more potential to create value by leveraging its worldwide distribution.

Pricing Concerns in Pharma and Biotech Industries Creates Some Buying Opportunities 29 Sep 2015

The pharma and biotech sectors have recently faced significant market weakness, largely because of recent headlines about price-gouging, strong policy positions from presidential candidates, notably Hillary Clinton, and congressional investigations into drug pricing. Overall, this echoes a previous industry sell-off in the spring of 2014 when some members of Congress questioned the pricing of Gilead's Sovaldi. Valeant Pharmaceuticals received queries on Sept. 28 from politicians about the company's drug pricing on a handful of recently acquired products. While certain components of policy proposals span from highly unlikely (mandating research and development levels at drug developers) to possible (shortening the exclusivity period for biologics), our moat methodology, uncertainty ratings, debt ratings, and fair value estimates attempt to capture a particular company's risks to a variety of issues beyond drug pricing. Based on current information, we don't see any particular reason to adjust our fair value estimates for the drug companies we cover at this time. Lawsuits, changes to Medicare pricing, new tax rules, or other policy suggestions remain mostly speculative at this point, and in our view the pullback has created some opportunities.

Merck remains our most undervalued Big Pharma idea, because we believe the company's immuno-oncology franchise is underappreciated and the current valuation already appears to have taken into account the competitive threats to its top drug Januvia from the SGLT2 class.

Our favorite names in biotech remain wide-moat Amgen and

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Analyst Notes

Biogen (both on our Best Ideas list) because of their diversified portfolios and innovative pipelines. In addition, narrow-moat Biogen, which has sold off particularly hard, probably because of its high-priced drugs, is an attractive value since it is still well-protected from competition in the rare-disease space and has a compelling pipeline.

Pfizer Posts Solid 2Q, as Prevnar Sales Help Offset Generic Celebrex Competition 28 Jul 2015

Pfizer reported second-quarter results slightly ahead of both our expectations and those of consensus, largely driven by strong Prevnar vaccine sales. However, we don't expect any major changes to our \$34 fair value estimate based on the minor outperformance. At current market prices, the stock is trading close to our fair value as we believe the market appreciates Pfizer's constrained top-line growth prospects, which we peg at 2% annually over the next five years. While Pfizer's R&D productivity is improving, the new drugs largely offset patent losses. Despite the challenging growth outlook, the returns on invested capital look strong and we remain confident in the company's wide moat.

In the quarter, new product launches and expanded indications helped offset increased generic competition, leading to operational growth of 1% year over year. We expect this modest growth to continue over the long term. Vaccine sales from the expanded indication in the adult population for Prevnar led to 45% growth for Pfizer's top drug (12% of sales), which helped mitigate increased generic competition for pain drug Celebrex.

Pfizer is making strides with its pipeline, but many drugs will enter crowded markets. While recently launched cancer drug Ibrance is very well positioned in the breast cancer market, cholesterol drug bococizumab, diabetes drug ertugliflozin and cancer drug avelumab will all likely enter markets third or later, making market share gains difficult.

However, very large market sizes should still result in meaningful contributions. Longer term, new vaccines in *C. difficile* and *S. aureus* hold major potential.

Turning to income, Pfizer is continuing to manage costs well. The cost of goods sold came in below our expectations, and the company increased its guidance for full-year gross margins. We believe Pfizer continues to effectively manage its cost structure, which should lead to stable long-term margins despite patent losses on high-margin drugs.

While patent losses will continue to create headwinds for Pfizer's growth, the company is leading in the development of biosimilars, which should alleviate some of the generic headwinds in small molecule drugs. We estimate the biosimilar market will grow to \$14 billion by 2020 with Pfizer holding a leading market share. For a complete review of the biosimilar market, please see our July Healthcare Observer, "The Biosimilar Market: Underappreciated Pressure on Moats Must Be Countered By Pipelines."

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

	3-Year Hist. CAGR	Forecast					5-Year Proj. CAGR
		2012	2013	2014	2015	2016	
Growth (% YoY)							
Revenue	-9.7	-12.5	-12.6	-3.8	-2.2	9.5	3.6
EBIT	-9.4	-1.0	-9.0	-17.5	15.5	13.2	8.4
EBITDA	-11.2	-5.9	-11.0	-16.4	8.6	8.9	5.0
Net Income	-7.2	-9.8	-7.2	-4.6	-4.9	9.7	2.6
Diluted EPS	-0.7	0.0	-4.4	2.4	-2.3	11.7	4.7
Earnings Before Interest, after Tax	-3.6	22.1	1.1	-27.5	-8.8	11.0	2.3
Free Cash Flow	-9.8	-19.6	-2.7	-6.0	-127.6	-395.3	-0.9

	3-Year Hist. Avg						5-Year Proj. Avg
		2012	2013	2014	2015	2016	
Profitability							
Operating Margin %	29.8	30.5	31.7	27.2	32.1	33.2	33.2
EBITDA Margin %	42.0	43.4	44.2	38.4	42.6	42.4	41.7
Net Margin %	29.0	27.9	29.6	29.4	28.6	28.6	28.3
Free Cash Flow Margin %	31.7	29.8	33.1	32.3	-9.1	24.6	18.5
ROIC %	10.9	12.0	11.0	9.6	9.3	10.0	10.5
Adjusted ROIC %	15.5	16.8	15.8	14.1	14.6	16.6	17.5
Return on Assets %	8.5	7.8	12.3	5.4	5.3	6.5	6.9
Return on Equity %	19.4	17.8	27.9	12.4	12.6	15.5	16.2

	3-Year Hist. Avg						5-Year Proj. Avg
		2012	2013	2014	2015	2016	
Leverage							
Debt/Capital	0.33	0.32	0.32	0.34	0.34	0.33	0.31
Total Debt/EBITDA	1.66	1.46	1.60	1.93	1.67	1.47	1.39
EBITDA/Interest Expense	12.15	6.35	16.11	14.00	18.80	26.33	27.68

Valuation Summary and Forecasts

	2013	2014	2015(E)	2016(E)
Price/Fair Value	1.02	1.04	—	—
Price/Earnings	13.8	13.7	15.8	14.1
EV/EBITDA	8.7	10.5	10.7	9.8
EV/EBIT	12.2	14.8	14.2	12.5
Free Cash Flow Yield %	8.4	8.0	5.9	6.1
Dividend Yield %	3.4	3.4	2.6	2.8

Key Valuation Drivers

Cost of Equity %	7.5
Pre-Tax Cost of Debt %	5.5
Weighted Average Cost of Capital %	7.0
Long-Run Tax Rate %	31.8
Stage II EBI Growth Rate %	3.0
Stage II Investment Rate %	7.5
Perpetuity Year	20

Additional estimates and scenarios available for download at <http://select.morningstar.com>.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	88,527	36.9	14.17
Present Value Stage II	64,917	27.1	10.39
Present Value Stage III	86,473	36.0	13.84
Total Firm Value	239,917	100.0	38.39
Cash and Equivalents	36,122	—	5.78
Debt	-36,682	—	-5.87
Preferred Stock	-29	—	0.00
Other Adjustments	-12,009	—	-1.92
Equity Value	227,319	—	36.38

Projected Diluted Shares 6,249

Fair Value per Share (USD)

—

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Income Statement (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Revenue	58,986	51,584	49,605	48,533	53,144
Cost of Goods Sold	11,334	9,586	9,577	9,064	10,363
Gross Profit	47,652	41,998	40,028	39,469	42,781
Selling, General & Administrative Expenses	16,616	14,355	14,097	13,833	14,933
Research & Development	7,870	6,678	8,393	7,552	8,078
Other Operating Expense (Income)	—	—	—	-1,136	-1,147
Depreciation & Amortization (if reported separately)	5,175	4,599	4,039	3,635	3,272
Operating Income (ex charges)	17,991	16,366	13,499	15,584	17,645
Restructuring & Other Cash Charges	1,880	-361	324	1,500	1,425
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	16,111	16,727	13,175	14,084	16,220
Interest Expense	4,031	1,414	1,360	1,100	855
Interest Income	—	403	425	454	259
Pre-Tax Income	12,080	15,716	12,240	13,438	15,624
Income Tax Expense	2,562	4,306	3,120	4,674	5,080
Other After-Tax Cash Gains (Losses)	5,080	10,662	48	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	-28	-69	-32	-32	-32
(Preferred Dividends)	—	—	—	—	—
Net Income	14,570	22,003	9,136	8,732	10,512
Weighted Average Diluted Shares Outstanding	7,103	6,895	6,424	6,249	6,137
Diluted Earnings Per Share	2.05	3.19	1.42	1.40	1.71
Adjusted Net Income	16,476	15,288	14,587	13,867	15,208
Diluted Earnings Per Share (Adjusted)	2.32	2.22	2.27	2.22	2.48
Dividends Per Common Share	0.79	0.79	0.79	0.88	0.98
EBITDA	23,722	23,137	18,712	19,175	21,086
Adjusted EBITDA	25,602	22,776	19,036	20,675	22,511

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Cash and Equivalents	32,708	32,408	36,122	16,770	17,241
Investments	—	—	—	—	—
Accounts Receivable	12,378	9,357	8,669	8,909	9,755
Inventory	7,063	6,166	5,663	5,339	6,104
Deferred Tax Assets (Current)	—	4,624	4,498	4,498	4,498
Other Short Term Assets	9,266	3,689	2,750	2,750	2,750
Current Assets	61,415	56,244	57,702	38,266	40,348
Net Property Plant, and Equipment	14,461	12,397	11,762	13,559	13,665
Goodwill	44,672	42,519	42,069	57,119	56,869
Other Intangibles	46,013	39,385	35,166	31,531	28,259
Deferred Tax Assets (Long-Term)	—	1,554	1,544	1,544	1,544
Other Long-Term Operating Assets	5,088	3,596	3,513	3,513	3,513
Long-Term Non-Operating Assets	14,149	16,406	17,518	17,518	17,518
Total Assets	185,798	172,101	169,274	163,050	161,717
Accounts Payable	4,264	3,234	3,440	3,104	3,549
Short-Term Debt	6,424	6,027	5,141	4,500	4,500
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	17,931	14,105	13,050	13,050	13,050
Current Liabilities	28,619	23,366	21,631	20,654	21,099
Long-Term Debt	31,036	30,462	31,541	30,000	28,500
Deferred Tax Liabilities (Long-Term)	21,593	25,590	24,981	24,731	24,484
Other Long-Term Operating Liabilities	11,549	8,760	9,236	9,236	9,236
Long-Term Non-Operating Liabilities	11,323	7,303	10,264	10,264	10,264
Total Liabilities	104,120	95,481	97,653	94,885	93,583
Preferred Stock	39	33	29	29	29
Common Stock	448	453	455	455	455
Additional Paid-in Capital	72,608	77,283	78,977	78,977	78,977
Retained Earnings (Deficit)	54,240	69,732	72,176	75,409	79,890
(Treasury Stock)	-40,122	-67,923	-73,021	-79,710	-84,222
Other Equity	-5,953	-3,271	-7,316	-7,316	-7,316
Shareholder's Equity	81,260	76,307	71,300	67,844	67,813
Minority Interest	418	313	321	321	321
Total Equity	81,678	76,620	71,621	68,165	68,134

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Cash Flow (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Net Income	14,598	22,072	9,168	8,764	10,544
Depreciation	2,436	1,811	1,498	1,456	1,594
Amortization	5,175	4,599	4,039	3,635	3,272
Stock-Based Compensation	481	523	586	575	621
Impairment of Goodwill	—	—	—	250	250
Impairment of Other Intangibles	1,299	1,145	531	—	—
Deferred Taxes	2,198	1,703	317	-250	-247
Other Non-Cash Adjustments	-7,191	-10,791	-680	—	—
(Increase) Decrease in Accounts Receivable	275	940	148	-240	-846
(Increase) Decrease in Inventory	-631	-538	175	324	-765
Change in Other Short-Term Assets	83	-822	1,156	—	—
Increase (Decrease) in Accounts Payable	579	382	297	-336	445
Change in Other Short-Term Liabilities	-2,248	-3,340	-353	—	—
Cash From Operations	17,054	17,684	16,882	14,179	14,866
(Capital Expenditures)	-1,327	-1,206	-1,199	-1,553	-1,701
Net (Acquisitions), Asset Sales, and Disposals	-1,050	-15	-195	-17,000	—
Net Sales (Purchases) of Investments	8,438	-9,635	-4,607	—	—
Other Investing Cash Flows	93	312	347	—	—
Cash From Investing	6,154	-10,544	-5,654	-18,553	-1,701
Common Stock Issuance (or Repurchase)	-8,228	-16,290	-5,000	-6,689	-4,512
Common Stock (Dividends)	-6,534	-6,580	-6,609	-5,499	-6,031
Short-Term Debt Issuance (or Retirement)	-212	3,564	-1,838	-641	—
Long-Term Debt Issuance (or Retirement)	-1,513	2,472	2,387	-1,541	-1,500
Other Financing Cash Flows	488	1,859	1,074	-607	-653
Cash From Financing	-15,999	-14,975	-9,986	-14,978	-12,695
Exchange Rates, Discontinued Ops, etc. (net)	-2	-63	-83	—	—
Net Change in Cash	7,207	-7,898	1,159	-19,352	470

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

Company/Ticker	Price/Fair Value	Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Merck & Co Inc MRK USA	0.87	16.3	15.5	14.9	13.0	11.3	11.0	24.6	13.1	14.7	3.3	3.6	3.7	3.8	3.9	3.9
GlaxoSmithKline PLC GSK USA	0.92	14.6	18.2	16.8	27.1	18.2	16.8	28.7	NM	44.3	26.8	11.3	13.7	5.0	4.3	4.1
Eli Lilly and Co LLY USA	1.03	24.8	23.8	22.7	15.3	17.5	16.5	23.9	28.3	32.5	5.0	6.2	6.1	3.9	4.6	4.2
Average		18.6	19.2	18.1	18.5	15.7	14.8	25.7	20.7	30.5	11.7	7.0	7.8	4.2	4.3	4.1
Pfizer Inc PFE US	0.92	13.7	15.8	14.1	10.5	10.7	9.8	12.5	17.1	16.4	2.7	3.2	3.2	4.0	4.4	4.1

Returns Analysis

Company/Ticker	Last Historical Year Total Assets (Mil)	ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Merck & Co Inc MRK USA	98,335 USD	6.7	12.9	14.7	8.1	16.6	19.7	24.2	9.9	16.8	11.7	4.6	7.4	3.2	3.3	3.4
GlaxoSmithKline PLC GSK USA	40,651 GBX	8.7	11.8	14.0	9.7	13.4	16.5	49.0	134.4	27.2	6.7	17.9	3.8	3.4	4.7	3.7
Eli Lilly and Co LLY USA	37,178 USD	11.7	12.2	12.0	12.5	13.2	13.2	14.5	17.5	20.1	6.6	7.1	7.9	2.7	2.8	2.8
Average		9.0	12.3	13.6	10.1	14.4	16.5	29.2	53.9	21.4	8.3	9.9	6.4	3.1	3.6	3.3
Pfizer Inc PFE US	169,274 USD	9.6	9.3	10.0	14.1	14.6	16.6	12.4	12.6	15.5	5.4	5.3	6.5	3.4	2.6	2.8

Growth Analysis

Company/Ticker	Last Historical Year Revenue (Mil)	Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Merck & Co Inc MRK USA	42,237 USD	-4.1	-6.3	0.6	-13.1	22.4	25.0	0.1	1.9	4.1	67.0	-86.7	369.8	2.6	1.9	4.1
GlaxoSmithKline PLC GSK USA	23,006 GBX	-13.2	4.9	5.3	-39.1	38.3	11.9	-15.0	-19.3	8.6	-43.0	34.7	-65.7	4.9	—	—
Eli Lilly and Co LLY USA	19,616 USD	-15.1	1.6	7.4	-39.5	8.3	8.0	-33.0	23.6	5.3	-170.3	-33.7	-227.0	—	23.6	—
Average		-10.8	0.1	4.4	-30.6	23.0	15.0	-16.0	2.1	6.0	-48.8	-28.6	25.7	3.8	12.8	4.1
Pfizer Inc PFE US	49,605 USD	-3.8	-2.2	9.5	-17.5	15.5	13.2	2.4	-2.3	11.7	-6.0	-127.6	-395.3	—	11.1	11.7

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Merck & Co Inc MRK USA	10,215 USD	60.3	75.5	76.0	31.9	38.2	38.8	16.0	20.9	26.0	24.2	25.5	26.1	15.5	29.9	26.6
GlaxoSmithKline PLC GSK USA	4,584 GBX	68.2	68.1	67.5	22.1	27.4	28.3	15.6	20.6	21.9	19.9	15.5	16.0	17.3	-1.5	9.3
Eli Lilly and Co LLY USA	2,988 USD	74.9	78.1	76.0	25.9	27.1	26.7	18.9	20.1	20.2	15.2	18.4	18.0	16.3	16.1	13.1
Average		67.8	73.9	73.2	26.6	30.9	31.3	16.8	20.5	22.7	19.8	19.8	20.0	16.4	14.8	16.3
Pfizer Inc PFE US	14,587 USD	80.7	81.3	80.5	38.4	42.6	42.4	27.2	32.1	33.2	29.4	28.6	28.6	31.6	26.0	24.8

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Merck & Co Inc MRK USA	21,403 USD	44.0	66.1	62.4	30.6	39.8	38.4	18.4	23.2	20.6	1.6	1.9	1.7	2.0	2.3	2.3
GlaxoSmithKline PLC GSK USA	18,784 GBX	440.6	226.2	273.6	81.5	69.3	73.2	7.0	9.2	12.2	3.7	3.1	2.9	9.5	6.6	7.8
Eli Lilly and Co LLY USA	8,056 USD	52.4	61.0	59.9	34.4	37.9	37.5	34.1	33.8	28.6	1.6	1.7	1.6	2.4	2.5	2.5
Average		179.0	117.8	132.0	48.8	49.0	49.7	19.8	22.1	20.5	2.3	2.2	2.1	4.6	3.8	4.2
Pfizer Inc PFE US	36,682 USD	51.5	50.9	48.7	34.0	33.7	32.7	14.0	18.8	26.3	1.9	1.7	1.5	2.4	2.4	2.4

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Merck & Co Inc MRK USA	155,225 USD	5.37	4.94	5.13	1.77	1.70	1.67	1.47	1.51	1.49	5.81	6.69	5.99	43.4	112.7	74.2
GlaxoSmithKline PLC GSK USA	102,765 USD	0.92	2.38	1.95	1.10	1.57	1.45	0.79	1.28	1.14	1.50	2.32	1.89	139.4	42.9	169.9
Eli Lilly and Co LLY USA	90,497 USD	4.49	5.27	5.08	1.57	1.25	1.26	1.32	1.00	0.98	1.80	3.12	2.85	88.1	97.7	86.3
Average		3.59	4.20	4.05	1.48	1.51	1.46	1.19	1.26	1.20	3.04	4.04	3.58	90.3	84.4	110.1
Pfizer Inc PFE US	215,672 USD	5.62	2.68	2.81	2.67	1.85	1.91	2.41	1.59	1.62	7.03	3.73	3.83	55.7	63.0	57.4

Research Methodology for Valuing Companies

Components of Our Methodology

- ▶ Economic Moat™ Rating
- ▶ Moat Trend™ Rating
- ▶ Moat Valuation
- ▶ Three-Stage Discounted Cash Flow
- ▶ Weighted Average Cost of Capital
- ▶ Fair Value Estimate
- ▶ Scenario Analysis
- ▶ Uncertainty Ratings
- ▶ Margin of Safety
- ▶ Consider Buying/Selling
- ▶ Stewardship Rating

We believe that a company's intrinsic worth results from the future cash flows it can generate.

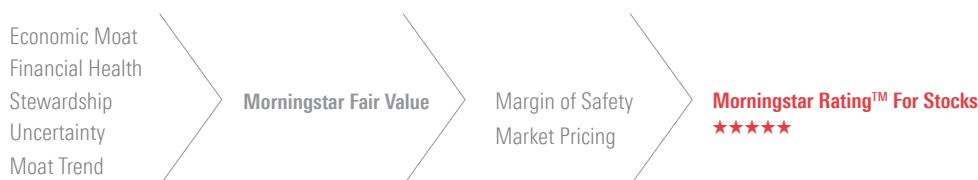
The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth. Four key components drive the Morningstar rating: our assessment of the firm's economic moat, our estimate of the stock's fair value, our uncertainty around that fair value estimate and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for

10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of “economic outperformance” that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies



Source: Morningstar, Inc.

Detailed Methodology Documents and Materials*

- ▶ Comprehensive Equity Research Methodology
- ▶ Uncertainty Methodology
- ▶ Cost of Equity Methodology
- ▶ Morningstar DCF Valuation Model
- ▶ Stewardship Rating Methodology

*Please contact a sales representative for more information.

which takes into account expectations for market real return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

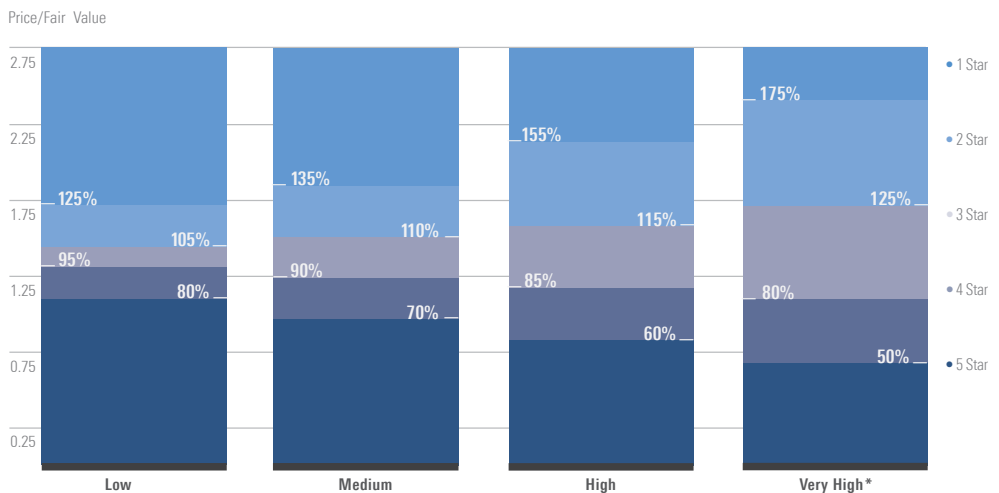
We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts model three scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts’ ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including

operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

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

Morningstar Margin of Safety and Star Rating Bands

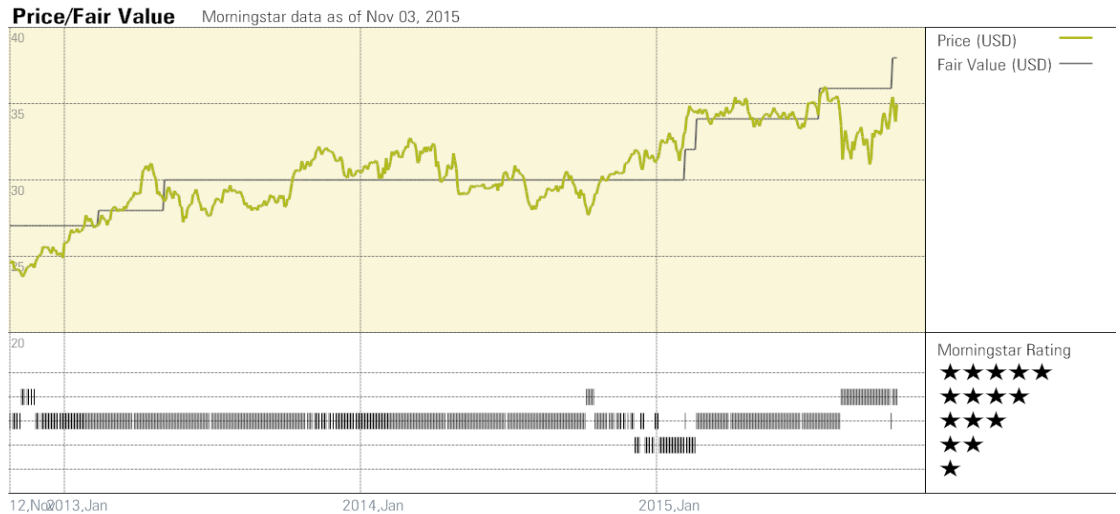


* Occasionally a stock’s uncertainty will be too high for us to estimate, in which case we label it Extreme.

Source: Morningstar, Inc.

Pfizer Inc PFE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers



Unless stated otherwise, this Research Report was prepared by the person(s) noted in their capacity as Equity Analysts employed by Morningstar, Inc., or one of its affiliates. This Report has not been made available to the issuer of the relevant financial products prior to publication.

The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate, and 4. Current market price. Further information on Morningstar's methodology is available from <http://global.morningstar.com/equitydisclosures>.

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Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
34.97 USD	38.00 USD	30.40 USD	47.50 USD	Low	Wide	Stable	Standard	Drug Manufacturers

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