Sanofi SA SNY (NYSE) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
38.97 USD	54.00 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Clinton's Proposed Drug Plan Doesn't Change the Pricing Power for Innovative Drugs

Updated Forecasts and Estimates from 16 Sep 2016

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

Research as of 02 Sep 2016
Estimates as of 16 Sep 2016
Pricing data through 20 Sep 2016
Rating updated as of 20 Sep 2016

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

Contents

Investment Thesis 29 Dec 2015

Sanofi's wide lineup of branded drugs and vaccines and robust pipeline create strong cash flows and a wide economic moat. Growth of existing products and new product launches should help offset weakening pricing in the insulin market.

Sanofi's existing product line boasts several top-tier drugs, including long-acting insulin Lantus. The drug's ability to work well for an entire day sets Lantus apart from other insulins. Further, given the complexity in marketing and manufacturing insulin, we don't expect major generic competition following the drug's 2015 patent loss. However, increasing branded competition and a deteriorating pricing environment will likely lead to sales declines for Lantus over the long term. Offsetting the Lantus weakness, Sanofi's vaccines, consumer products, and animal health treatments should continue to post growth as these products are less susceptible to patent losses.

Sanofi has compiled a robust group of late-stage pipeline products that complement its existing lineup and should help mitigate patent losses. We expect continued strength in the multiple sclerosis area with potential blockbusters Aubagio and Lemtrada emerging from the late-stage pipeline. In addition, diabetes drug Lyxumia looks to be a strong complement to the company's well-entrenched diabetes franchise.

The company also harnesses its research and development group to bring new drugs to emerging markets. While pricing in emerging markets is not usually as strong as in developed markets, the company can still leverage its investment in developing new drugs for developed markets by bringing the drugs to emerging markets. The rapid economic growth in emerging markets has created new geographic markets for Sanofi's drugs.

A history of acquisitions and robust cash flow from operations means Sanofi could take advantage of further growth opportunities through external collaborations. As several years have passed since the 2011 Genzyme acquisition, we expect Sanofi will continue to make acquisitions in the branded pharmaceutical and biotechnology markets.

Vital Statistics

Market Cap (USD Mil)	100,317
52-Week High (USD)	51.88
52-Week Low (USD)	37.41
52-Week Total Return %	-17.6
YTD Total Return %	-4.7
Last Fiscal Year End	31 Dec 2015
5-Yr Forward Revenue CAGR %	3.3
5-Yr Forward EPS CAGR %	1.6
Price/Fair Value	0.72

Valuation Summary and Forecasts

Fiscal Year:	2014	2015	2016(E)	2017(E)
Price/Earnings	15.7	13.5	*12.8*	*12.9*
EV/EBITDA	10.5	9.9	*9.3*	*9.6*
EV/EBIT	16.0	15.8	*14.0*	*13.6*
Free Cash Flow Yield %	6.2	6.0	*6.3*	*7.4*
Dividend Yield %	3.7	3.6	*4.2*	*4.1*

Financial Summary and Forecasts (EUR Mil)

Fiscal Year:	2014	2015	2016(E)	2017(E)
Revenue	34,109	34,861	*36,923*	*35,856*
Revenue YoY %	2.4	2.2	*5.9*	*-2.9*
EBIT	6,857	7,133	*7,195*	*7,384*
EBIT YoY %	5.8	4.0	*0.9*	*2.6*
Net Income, Adjusted	6,847	7,486	*7,005*	*6,815*
Net Income YoY %	2.9	9.3	*-6.4*	*-2.7*
Diluted EPS	2.91	3.17	*3.05*	*3.02*
Diluted EPS YoY %	4.7	8.9	*-4.0*	*-0.7*
Free Cash Flow	4,349	6,278	*5,910*	*9,091*
Free Cash Flow YoY %	-29.7	44.4	*-5.9*	*53.8*

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

Profile

Sanofi develops and markets pharmaceuticals with a concentration in oncology, cardiovascular disease, central nervous system disorders, diabetes, and vaccines. The company offers a diverse array of drugs with its highest revenue generator, Lantus, representing over 15% of total sales. About 30% of total revenue comes from the United States and 25% from Europe. Emerging markets represent the majority of the remainder of sales.

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Morningstar Analysis

Clinton's Proposed Drug Plan Doesn't Change the Pricing Power for Innovative Drugs 02 Sep 2016
We don't expect any significant fair value estimate changes in the drug group based on Democratic presidential candidate Hillary Clinton's disclosed drug pricing plan targeting unjustified price increases for older drugs. While passage of the plan in Congress would be very uncertain, if the plan were to take shape, we expect less innovative generic drugs and older branded drugs to be the focus of price controls. Further, we believe the core element of patent protection supporting drug prices is still intact, supporting our moat ratings in the pharmaceutical and biotechnology industries. Our moat ratings and valuations reflect our skeptical outlook on less innovative companies and their weaker prospects for pricing power, including our no-moat and negative trend ratings for Endo and Mallinckrodt, for example.

Parts of Clinton's proposed plan would face low chances of passage in Congress or tough implementation. In response to unjustifiable price increases for older drugs, Clinton proposes increasing supply of competitive drugs and issuing penalties, which generally go against Republican support of market driven forces. Further, if drug prices increase too much, Clinton also supports drug importation, which is generally supported by Republicans but difficult to implement through the FDA.

Less innovative drugs would face the brunt of Clinton's proposed plan. We believe smaller generic drugs with less natural competition and old branded drugs pushing for gains through pricing before generic competition would feel the most price pressure under this plan. However, most drug companies don't derive much valuation from these drugs, and most large diversified generic drug manufacturers continue to face significant competition and pricing pressure.

On a broader note, the recently introduced drug plan reinforces Clinton's message of lowering healthcare costs, but we don't expect major changes in drug pricing power, especially for innovative drugs.

However, we believe the most likely negative legislative impact to the group is giving Medicaid rebates to Medicare patients that qualify for Medicaid, which could reduce industry earnings by 5%, but we still only assign a 30% chance of this legislation passing.

Within this highly politically charged environment, Allergan, Roche and Sanofi represent a few of our most undervalued wide moat drug firms.

For a complete review of the political landscape's potential changes to the drug industry, please see our "U.S. Drug Pricing Debate Leads to Opportunities" report, where we call out the low likelihood of major changes to drug prices in response to several political initiatives.

Valuation, Growth and Profitability 30 Oct 2015
We are slightly lowering our fair value estimate to $54 from $55 per share (using an exchange rate of EUR 0.91 per $1 as of Oct. 29, 2015) due to increased competitive pressures in the insulin market. We project a five-year average annual revenue growth rate of 5%, largely driven by steady gains with consumer products and vaccines along with new product launches offsetting deteriorating pricing for the company's top drug Lantus. Following a sharp patent cliff in 2013, Sanofi faces relatively mild patent losses, and diverse operations in vaccines, animal health, consumer products, and emerging markets should lead to steady growth over the long term. Also, we expect cost-cutting to mitigate falling Lantus pricing in the U.S., resulting in minor operating margin declines over the long term. Furthermore, we estimate the company's weighted average cost of capital at 7.5%, which is in line with the company's peer group.

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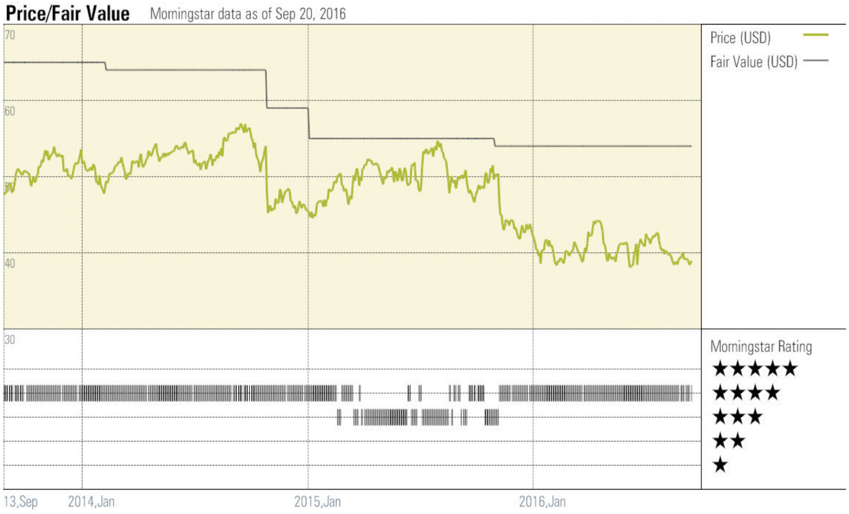
Price/Fair Value Morningstar data as of Sep 20, 2016



Scenario Analysis

Largely based on the low volatility of cash flows from a diverse and inelastic product portfolio, but with some product concentration risk with Lantus, we rate Sanofi's uncertainty as medium. Our scenario analysis assumes a base-case fair value estimate of $54 and a bull case of $73 (25% probability), while our bear case (25% probability) projects a $41 fair value. Relative to our base case, the scenario analysis shows moderate variances, hence our medium 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 Lantus, which represents over 15% of total sales. In our bear case, we reduce our projections for Lantus by 75% and cut the pipeline potential by 50%. Conversely, in our bull case, we assume slight increased projections for Lantus and a pipeline that delivers close to 100% more upside, largely driven by the new insulin Toujeo and the cholesterol-lowering drug Praluent.

Economic Moat

Patents, economies of scale, and a powerful distribution network support Sanofi's wide moat. Sanofi's patent-protected drugs carry strong pricing power, which enables the firm to generate returns on invested capital in excess of its cost of capital. Further, the patents give the company time to develop the next generation of drugs before generic competition arises. Additionally, while Sanofi holds a diversified product portfolio there is some product concentration with the company's largest drug, Lantus, representing 17% of total sales, but we expect new products will mitigate the eventual generic competition and given the complexity of manufacturing insulin, we don't expect a rapid decline in Lantus sales. Sanofi's operating structure allows for cost-cutting following patent losses to reduce the margin pressure from lost high-margin drug sales. Overall, Sanofi's established product line creates the enormous cash flows needed to fund the average $800 million in development costs per new drug. In addition, the company's powerful distribution network sets up the company as a strong partner for smaller drug companies that lack Sanofi's resources. Sanofi's entrenched rare disease drug, consumer, and vaccine franchises create added layers of competitive advantages, stemming from efficient scale in rare disease drugs, brand power in consumer, and cost advantages in the vaccines division.

Moat Trend

We believe Sanofi faces a stable moat trend. While pricing power is eroding in the company's core insulin franchise, its strong pipeline combined with stable currently marketed drugs should lead to modest growth of 4% annually over the next five years, which should support steady investment into research and development. The majority of the patent exposure facing Sanofi surrounds insulin, which has the complex biologic structure that should reduce the generic competition. On the pipeline side, we expect more than $1 billion in peak annual sales from three new drugs, including recently launched Toujeo for diabetes, and pipeline drugs Praluent for lowering cholesterol and dupilumab for immunology disorders.

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Turning to the macro environment, several headwinds face Sanofi, but the company is making solid strategic moves to address the challenges. On the negative side, the risk-sensitive U.S. Food and Drug Administration is generally only approving very safe drugs, or drugs in high-need areas such as cancer. Also, managed care and pharmacy benefit managers have consolidated over the past decade and are now using their growing size to demand lower drug prices and reduced coverage for less innovative drugs, forcing drug firms to push for true innovation and reducing the power of Sanofi's distribution networks. Further, the U.S. government is evaluating comparative effectiveness programs and more aggressive price negotiations, raising the bar for future innovation. While Sanofi faces several headwinds, the company's pipeline is focused on more innovative treatments in unmet medical areas such as immunology where payer coverage and pricing power remain strong. Outside the pipeline, the company's strong entrenchment in consumer healthcare, rare disease drugs, and vaccines gives the firm some relief from the pressures in the drug group.

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Bulls Say/Bears Say

Bulls Say

- Sanofi is launching cholesterol-lowering drug Praluent, which holds major blockbuster potential.
- Sanofi's strong entrenchment in rare-disease drugs should translate into strong pricing power in these niche diseases.
- With a strong product offering in vaccines, consumer health and insulins, Sanofi is well positioned for the fast-growing emerging markets.

Bears Say

- Sanofi's strong entrenchment in China could come under duress, as Chinese officials are aggressively reviewing drug-marketing practices.
- The patents on Lantus expire in 2014-15, and while significant generic competition is not expected due to complexities of insulin manufacturing, a major push by biosimilars could be detrimental to a key product for Sanofi.
- Pricing pressure in the diabetes market is weighing on a key franchise for Sanofi.

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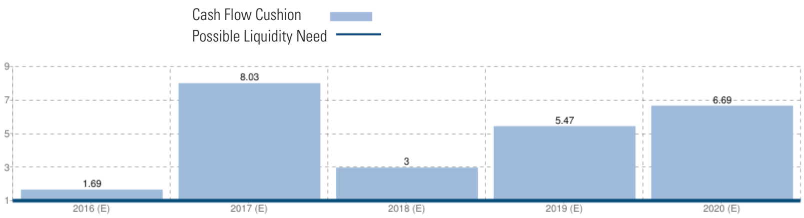
Five Year Adjusted Cash Flow Forecast (EUR Mil)

	2016(E)	2017(E)	2018(E)	2019(E)	2020(E)
Cash and Equivalents (beginning of period)	9,259	5,743	7,293	7,255	8,782
Adjusted Available Cash Flow	-935	5,691	2,847	3,483	3,619
Total Cash Available before Debt Service	8,324	11,434	10,140	10,738	12,402
Principal Payments	-4,096	-633	-2,601	-1,191	-1,096
Interest Payments	-520	-476	-451	-426	-402
Other Cash Obligations and Commitments	-321	-314	-327	-345	-355
Total Cash Obligations and Commitments	-4,937	-1,424	-3,379	-1,962	-1,853

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	EUR Millions	% of Commitments
Beginning Cash Balance	9,259	68.3
Sum of 5-Year Adjusted Free Cash Flow	14,705	108.5
Sum of Cash and 5-Year Cash Generation	23,964	176.8
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	23,964	176.8
Sum of 5-Year Cash Commitments	-13,555	—

Financial Health

Sanofi remains lightly leveraged and often operates below its own long-term leverage target of 1.0 times net debt/EBITDA. With a net debt position of only EUR 9 billion, or less than its target by our estimates at the end of September, Sanofi looks like it continues to have additional borrowing capacity. It gross debt of EUR 16 billion in debt at the end of September stands at an easily manageable 1.4 times trailing 12-month EBITDA, as well. Going forward, we expect annual free cash flow of at least EUR 6 billion during the next five years. The company pushes much of that cash out to shareholders, though. For example, during the 12 months ended in September, Sanofi paid a dividend of EUR 3.7 billion and repurchased EUR 2.1 billion of shares. Since we expect the company to keep pushing cash out to shareholders, we would not be surprised if Sanofi regularly taps the debt market to make those returns while also managing its debt obligations and keeping its net debt/EBITDA close to its target.

Creditors should note that Sanofi, as of June, owned a 22% stake in Regeneron that was recently worth around EUR 13 billion, and management has indicated a willingness to boost its stake in Regeneron to about 30%, which would cost another EUR 5 billion at recent prices and exchange rates. This transaction probably would not affect Sanofi's credit rating. However, we would see a full acquisition of that company as a potential downgrade catalyst, depending on how it was financed. Additionally, management has stated in the past that it may be interested in purchasing L'Oreal's stake in Sanofi (about 9% of the firm and 16% of the voting rights at the end of December), should it ever come up for sale. The risks of that happening in the near future appear low currently after L'Oreal did not need to sell its investment in Sanofi to repurchase its own shares from Nestle in 2014. But given L'Oreal's statement that its investment in Sanofi is not strategic, that potential transaction may remain an event risk for Sanofi's credit

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rating for the foreseeable future.

Enterprise Risk

Sanofi faces the standard risks in the pharmaceutical industry, including delayed approvals or nonapprovals from regulatory agencies, an increasingly tough managed-care environment, and patent losses. In addition, since a large percentage of sales come from Lantus, the company faces additional product specific risks from upcoming competitive drug launches from Eli Lilly and Novo Nordisk.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NA	NA	NA	NA	NA

*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
Dodge & Cox Stock Fund	1.37	2.74	1,114	30 Jun 2016
Vanguard Windsor™ II Fund	0.74	1.76	449	30 Jun 2016
Franklin Income Fund	0.70	0.97	138	30 Jun 2016
Dodge & Cox Balanced Fund	0.23	1.78	93	30 Jun 2016
Oakmark Fund	0.21	1.52	—	30 Jun 2016
Concentrated Holders				
Chou Europe Fund	—	7.32	—	30 Jun 2016
Fidelity® Select Pharmaceuticals Port	0.09	6.40	-112	31 Jul 2016
Federated Prudent Bear Fd	0.01	6.21	130	30 Jun 2016
AdvisorShares Madrona International ETF	—	6.05	—	18 Sep 2016
Delaware Healthcare Fund	0.02	5.36	—	31 Jul 2016

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Robeco Investment Management, Inc.	0.29	0.45	7,330	30 Jun 2016
Barclays Capital Securities Limited	0.09	0.38	1,826	31 Mar 2016
Dodge & Cox	2.14	2.28	1,626	30 Jun 2016
Managed Account Advisors LLC	0.13	0.10	1,420	30 Jun 2016
Hamlin Capital Management, LLC	0.05	2.75	1,355	30 Jun 2016
Top 5 Sellers				
Fidelity Management and Research Company	0.30	0.05	-2,626	30 Jun 2016
Cutler Capital Management	0.01	1.85	-2,130	30 Jun 2016
Invesco Advisers, Inc	0.25	0.18	-1,067	31 Mar 2016
Deutsche Bank AG	0.02	0.04	-923	30 Jun 2016
Morgan Stanley & Co Inc	0.04	0.07	-540	30 Jun 2016

Management 29 Dec 2015

In April 2015, Sanofi announced the appointment of Olivier Brandicourt as the next CEO, following the board's ousting of the previous CEO Chris Viehbacher in late 2014. Given Brandicourt's short tenure at the helm and no major recent capital redeployment decisions by the surrounding management, we view the company's stewardship as Standard. Brandicourt's strong industry experience should guide Sanofi well through several new product launches and pricing pressures in the insulin market. Most recently, as the head of healthcare at Bayer, Brandicourt successfully oversaw the launches of several new blockbusters, including Xarelto for atrial fibrillation and Eylea for age-related macular degeneration. These successful skills in launching new products will be needed as Sanofi prepares to launch several potential blockbusters, including cholesterol-lowering drug Praluent and long-acting insulin Toujeo. Brandicourt also brings a strong understanding of pricing pressures as the leader of Pfizer's primary care business from 2009 to 2012, a time of major pricing pressures for cholesterol drug Lipitor and several other drugs. This experience will be critical as Sanofi's top drug Lantus is facing heavy pricing pressure from payers. Supported by a French heritage, we expect Brandicourt will successfully navigate the complexities of the French culture and the assertive board of directors. The ousting of Viehbacher in late 2014 clearly showed the importance of working in step with the board of directors and remaining cognizant of the French culture. Furthermore, Brandicourt understands French politics, which should help Sanofi successfully navigate cutting costs while not disrupting the social structure of the country.

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Analyst Notes

Hampered by Insulin Pricing Pressures, Sanofi Posts Weak Second Quarter; Still Looks Undervalued 29 Jul 2016

Sanofi reported weak second-quarter results slightly below our expectations, but we don't expect any major changes to our fair value estimate and continue to view the stock as undervalued. Generic competition and weak insulin pricing led to total earnings falling 3% year over year, worse than our expected 1% gain. While we expect these headwinds will continue through 2017, Sanofi should enter 2018 with a robust growth outlook, buoyed by a strong pipeline and strong cardiovascular outcomes data for key drug Praluent. Our long-term conviction in the pipeline as well as continued strength from the vaccines, consumer, and rare disease businesses further strengthens our confidence in the valuation and the company's wide moat.

The insulin challenges in the quarter will likely persist through 2017 as competition intensifies. The company's top drug Lantus (long-acting insulin) declined 11% in the U.S. and we expect annual declines to accelerate as Eli Lilly launches a biosimilar version of the drug in December, followed by Merck likely in 2017. Also, Novo Nordisk's recently launched Tresiba will likely take share from Lantus based on significant safety advantages. Despite these headwinds, we expect Sanofi's next generation long-acting insulin Toujeo to mitigate the Lantus declines, but Toujeo's limited advantages will not completely offset our projected Lantus declines. Over the next three years, we expect Sanofi's diabetes group to fall close to 4% annually, within management's guidance range of declines between 4%-8%.

Despite weakness in the insulin business, the remaining business is well positioned. The specialty care group posted gains of 20% and now represents 14% of total sales. We expect continued strength from this group as new multiple sclerosis drugs gain market share. We also expect steady gains from the vaccine and consumer groups to offer further stability, aided by new vaccine launches and the new Boehringer Ingelheim consumer assets.

Sanofi Posts in Line First Quarter, but Concerns about Overpaying for Medivation Weigh on the Stock 29 Apr 2016

Sanofi posted first-quarter results largely matching our expectations, and we don't expect any changes to our fair value estimate. Sanofi shares look undervalued, particularly as the market looks concerned Sanofi will overpay to acquire Medivation. Further, despite weakness in the diabetes franchise, Sanofi's operating divisions collectively posted flat sales in the quarter, as the rare disease group posted excellent growth, up 21% year over year. The diversity of relatively stable cash flows from vaccines, drugs, and consumer products and the continual progress at Sanofi's pipeline reinforce our wide moat rating. On the pipeline side, we expect an inflection point with the recently launched cholesterol-lowering drug Praluent in 2018 following expected positive outcomes studies in 2017. Beyond the more than $4 billion expected from Praluent (despite the weak initial launch), we project peak annual sales in excess of $1 billion from both atopic dermatitis drug dupilumab and immunology drug sarilumab. While 2016 and 2017 will likely show little growth due to competitive pressures in the insulin market (20% of Sanofi's business), we expect the firm to post 5% sales growth annually from 2018 to 2020 as new pipeline products launch.

Beyond the quarterly results, Sanofi also announced its bid to acquire Medivation, which makes strategic sense at the right valuation. However, Medivation rejected Sanofi's close to $9 billion offer, which we view as sufficient. Further, we think Sanofi would begin to destroy shareholder value with a significantly larger bid. While Medivation holds a strong cancer drug (Xtandi for prostate cancer), the remaining

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Sanofi SA SNY (NYSE) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
38.97 USD	54.00 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Analyst Notes

pipeline looks relatively weak, and competition is emerging in the prostate cancer market from Johnson and Johnson's ARN-509 that could potentially displace Xtandi. Nevertheless, Medivation would propel Sanofi back into the cancer market, where strong pricing power should help drive long-term growth.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2013	2014	2015	*2016* (Forecast)	*2017* (Forecast)	*5-Year Proj. CAGR*
Revenue	*-1.0*	-7.4	2.4	2.2	*5.9*	*-2.9*	*3.3*
EBIT	*-2.9*	-16.8	5.8	4.0	*0.9*	*2.6*	*6.9*
EBITDA	*-2.4*	-14.2	-0.7	9.0	*-5.2*	*-3.0*	*1.1*
Net Income	*-2.5*	-17.6	2.9	9.3	*-6.4*	*-2.7*	*0.3*
Diluted EPS	*-2.3*	-18.2	4.7	8.9	*-4.0*	*-0.7*	*1.6*
Earnings Before Interest, after Tax	*-7.5*	-20.3	-2.7	2.1	*17.5*	*-3.5*	*5.9*
Free Cash Flow	*-3.9*	-12.5	-29.7	44.4	*-5.9*	*53.8*	*2.4*

Profitability	3-Year Hist. Avg	2013	2014	2015	*2016*	*2017*	*5-Year Proj. Avg*
Operating Margin %	*20.0*	19.5	20.1	20.5	*19.5*	*20.6*	*22.1*
EBITDA Margin %	*31.7*	31.6	30.7	32.7	*29.3*	*29.3*	*29.5*
Net Margin %	*20.5*	20.0	20.1	21.5	*19.0*	*19.0*	*19.0*
Free Cash Flow Margin %	*16.4*	18.6	12.8	18.0	*16.0*	*25.4*	*18.7*
ROIC %	*16.4*	16.2	16.4	16.6	*19.1*	*18.2*	*20.3*
Adjusted ROIC %	*8.1*	8.2	8.0	8.0	*9.5*	*9.3*	*10.5*
Return on Assets %	*4.2*	3.8	4.5	4.3	*4.1*	*4.5*	*5.5*
Return on Equity %	*7.3*	6.5	7.8	7.5	*7.2*	*7.9*	*9.6*

Leverage	3-Year Hist. Avg	2013	2014	2015	*2016*	*2017*	*5-Year Proj. Avg*
Debt/Capital	*0.21*	0.20	0.21	0.22	*0.21*	*0.21*	*0.20*
Total Debt/EBITDA	*1.42*	1.39	1.42	1.45	*1.36*	*1.33*	*1.18*
EBITDA/Interest Expense	*18.31*	17.21	17.30	20.41	*20.80*	*22.01*	*25.02*

Valuation Summary and Forecasts

	2014	2015	*2016(E)*	*2017(E)*
Price/Fair Value	0.77	0.79	—	—
Price/Earnings	15.7	13.5	*12.8*	*12.9*
EV/EBITDA	10.5	9.9	*9.3*	*9.6*
EV/EBIT	16.0	15.8	*14.0*	*13.6*
Free Cash Flow Yield %	6.2	6.0	*6.3*	*7.4*
Dividend Yield %	3.7	3.6	*4.2*	*4.1*

Key Valuation Drivers

Cost of Equity %	7.5
Pre-Tax Cost of Debt %	4.5
Weighted Average Cost of Capital %	7.0
Long-Run Tax Rate %	24.1
Stage II EBI Growth Rate %	4.0
Stage II Investment Rate %	16.0
Perpetuity Year	20

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

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	51,568	37.5	40.06
Present Value Stage II	33,806	24.6	26.26
Present Value Stage III	52,086	37.9	40.46
Total Firm Value	**137,460**	**100.0**	**106.79**
Cash and Equivalents	9,259	—	7.19
Debt	-16,554	—	-12.86
Preferred Stock	—	—	—
Other Adjustments	-6,652	—	-5.17
Equity Value	**123,513**	**—**	**95.95**
Projected Diluted Shares	1,287		
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.

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Morningstar Analyst Forecasts

Income Statement (EUR Mil)
Fiscal Year Ends in December

				Forecast	
	2013	2014	2015	*2016*	*2017*
Revenue	**33,306**	**34,109**	**34,861**	***36,923***	***35,856***
Cost of Goods Sold	10,990	11,029	10,919	*11,433*	*11,272*
Gross Profit	**22,316**	**23,080**	**23,942**	***25,490***	***24,583***
Selling, General & Administrative Expenses	8,602	9,107	9,382	*10,513*	*9,932*
Research & Development	4,770	4,824	5,082	*5,472*	*5,283*
Other Operating Expense (Income)	-449	-164	208	*-90*	*64*
Depreciation & Amortization (if reported separately)	2,914	2,456	2,137	*2,400*	*1,920*
Operating Income (ex charges)	**6,479**	**6,857**	**7,133**	***7,195***	***7,384***
Restructuring & Other Cash Charges	300	714	795	*750*	*750*
Impairment Charges (if reported separately)	1,387	—	767	*729*	*692*
Other Non-Cash (Income)/Charges	-314	—	-53	—	—
Operating Income (incl charges)	**5,106**	**6,143**	**5,624**	***5,716***	***5,941***
Interest Expense	612	605	559	*520*	*476*
Interest Income	109	193	178	*80*	*84*
Pre-Tax Income	**4,603**	**5,731**	**5,243**	***5,276***	***5,549***
Income Tax Expense	763	1,171	709	*1,279*	*1,332*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	35	—	-146	—	—
(Minority Interest)	-158	-170	-101	*69*	*42*
(Preferred Dividends)	—	—	—	—	—
Net Income	**3,717**	**4,390**	**4,287**	***4,067***	***4,260***
Weighted Average Diluted Shares Outstanding	1,339	1,316	1,321	*1,287*	*1,261*
Diluted Earnings Per Share	**2.78**	**3.34**	**3.25**	***3.16***	***3.38***
Adjusted Net Income	6,656	6,847	7,486	*7,005*	*6,815*
Diluted Earnings Per Share (Adjusted)	**4.97**	**5.20**	**5.67**	***5.44***	***5.40***
Dividends Per Common Share	1.57	1.60	1.64	*1.64*	*1.64*
EBITDA	**9,161**	**9,750**	**9,900**	***9,335***	***9,045***
Adjusted EBITDA	**10,534**	**10,464**	**11,409**	***10,813***	***10,487***

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38.97 USD	54.00 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)

Fiscal Year Ends in December	2013	2014	2015	*Forecast 2016*	*Forecast 2017*
Cash and Equivalents	8,442	7,559	9,259	*5,743*	*7,293*
Investments	—	—	—	—	—
Accounts Receivable	6,831	7,149	7,386	*7,486*	*7,269*
Inventory	6,352	6,562	6,516	*6,578*	*6,486*
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	2,287	2,157	1,767	*1,767*	*1,767*
Current Assets	**23,912**	**23,427**	**24,928**	***21,574***	***22,815***
Net Property Plant, and Equipment	10,182	10,396	9,943	*10,571*	*11,180*
Goodwill	37,134	39,197	39,557	*39,108*	*35,916*
Other Intangibles	15,395	14,543	12,026	*9,626*	*7,706*
Deferred Tax Assets (Long-Term)	4,154	4,860	4,714	*4,573*	*4,435*
Other Long-Term Operating Assets	—	—	—	—	—
Long-Term Non-Operating Assets	5,288	4,969	11,153	*11,153*	*11,153*
Total Assets	**96,065**	**97,392**	**102,321**	***96,604***	***93,206***
Accounts Payable	3,003	3,651	3,817	*3,602*	*3,552*
Short-Term Debt	4,176	1,538	3,436	*3,436*	*3,436*
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	6,778	7,843	9,572	*9,572*	*9,572*
Current Liabilities	**13,957**	**13,032**	**16,825**	***16,610***	***16,560***
Long-Term Debt	10,414	13,276	13,118	*11,250*	*10,500*
Deferred Tax Liabilities (Long-Term)	5,060	4,105	2,895	*2,316*	*1,853*
Other Long-Term Operating Liabilities	8,735	9,578	1,121	*1,121*	*1,121*
Long-Term Non-Operating Liabilities	885	1,133	10,152	*10,152*	*10,152*
Total Liabilities	**39,051**	**41,124**	**44,111**	***41,449***	***40,185***
Preferred Stock	—	—	—	—	—
Common Stock	—	—	—	—	—
Additional Paid-in Capital	56,885	56,120	58,049	*58,049*	*58,049*
Retained Earnings (Deficit)	—	—	—	*295*	*859*
(Treasury Stock)	—	—	—	*-3,350*	*-6,048*
Other Equity	—	—	—	—	—
Shareholder's Equity	**56,885**	**56,120**	**58,049**	***54,994***	***52,860***
Minority Interest	129	148	161	*161*	*161*
Total Equity	**57,014**	**56,268**	**58,210**	***55,155***	***53,021***

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38.97 USD	54.00 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Cash Flow (EUR Mil)

Fiscal Year Ends in December				*Forecast*	
	2013	2014	2015	*2016*	*2017*
Net Income	3,717	4,390	4,287	*3,998*	*4,217*
Depreciation	1,141	1,125	2,139	*1,218*	*1,183*
Amortization	2,914	2,482	2,137	*2,400*	*1,920*
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	1,514	170	124	*729*	*692*
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	-1,010	-1,270	-1,253	*-438*	*-326*
Other Non-Cash Adjustments	-1,457	-164	431	—	—
(Increase) Decrease in Accounts Receivable	175	-23	-493	*-100*	*216*
(Increase) Decrease in Inventory	-117	-11	-466	*-62*	*93*
Change in Other Short-Term Assets	—	—	—	—	—
Increase (Decrease) in Accounts Payable	-124	478	241	*-215*	*-51*
Change in Other Short-Term Liabilities	201	513	1,773	—	—
Cash From Operations	**6,954**	**7,690**	**8,920**	***7,531***	***7,945***
(Capital Expenditures)	-1,398	-1,557	-2,772	*-1,846*	*-1,793*
Net (Acquisitions), Asset Sales, and Disposals	174	-1,725	69	*-280*	*2,500*
Net Sales (Purchases) of Investments	-18	269	-220	—	—
Other Investing Cash Flows	-31	-447	-334	—	—
Cash From Investing	**-1,273**	**-3,460**	**-3,257**	***-2,126***	***707***
Common Stock Issuance (or Repurchase)	1,004	-1,120	573	*-3,350*	*-2,698*
Common Stock (Dividends)	-3,650	-3,676	-3,694	*-3,771*	*-3,696*
Short-Term Debt Issuance (or Retirement)	302	-324	-199	—	—
Long-Term Debt Issuance (or Retirement)	297	-52	1,545	*-1,868*	*-750*
Other Financing Cash Flows	-1,679	-8	-1,826	*69*	*42*
Cash From Financing	**-3,726**	**-5,180**	**-3,601**	***-8,920***	***-7,102***
Exchange Rates, Discontinued Ops, etc. (net)	-79	34	-232	—	—
Net Change in Cash	**1,876**	**-916**	**1,830**	***-3,516***	***1,550***

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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

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Pfizer Inc PFE USA	0.89	14.7	13.9	13.0	12.0	10.4	9.9	15.2	14.7	13.5	3.1	3.2	3.3	4.1	3.9	3.6
Novartis AG NOVN CHE	0.92	17.6	16.8	16.4	20.6	14.0	14.0	21.6	16.2	17.4	2.7	2.6	2.6	4.1	3.9	3.9
Merck & Co Inc MRK USA	0.95	14.7	16.7	15.8	12.6	12.0	11.8	13.2	15.5	15.8	3.3	4.1	4.3	3.7	4.3	4.2
Average		15.7	15.8	15.1	15.1	12.1	11.9	16.7	15.5	15.6	3.0	3.3	3.4	4.0	4.0	3.9
Sanofi SA SNY US	**0.72**	**13.5**	**12.8**	**12.9**	**9.9**	**9.3**	**9.6**	**16.7**	**15.8**	**14.6**	**1.8**	**1.6**	**1.7**	**2.9**	**2.4**	**2.5**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Pfizer Inc PFE USA	167,460 USD	14.0	16.4	18.1	9.3	10.6	11.0	10.2	17.4	19.5	4.1	6.8	7.5	3.5	3.4	3.6
Novartis AG NOVN CHE	131,556 USD	10.8	15.9	16.9	7.5	11.1	11.6	24.1	11.1	11.8	13.8	6.4	6.8	3.2	3.4	3.5
Merck & Co Inc MRK USA	101,779 USD	9.1	14.1	15.9	11.8	19.0	22.0	9.5	12.3	18.3	4.4	5.4	7.8	3.5	3.0	3.1
Average		11.3	15.5	17.0	9.5	13.6	14.9	14.6	13.6	16.5	7.4	6.2	7.4	3.4	3.3	3.4
Sanofi SA SNY US	**102,321** EUR	**16.6**	**19.1**	**18.2**	**8.0**	**9.5**	**9.3**	**7.5**	**7.2**	**7.9**	**4.3**	**4.1**	**4.5**	**3.6**	**4.2**	**4.1**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Pfizer Inc PFE USA	48,851 USD	-1.5	8.7	7.2	-3.9	31.2	9.1	-3.2	10.5	7.4	-119.4	-384.2	-89.9	7.7	2.7	7.4
Novartis AG NOVN CHE	50,387 USD	-15.0	-2.2	1.5	-27.0	23.0	1.3	-4.4	-4.5	2.4	2.8	-5.6	-7.0	-1.2	1.0	2.4
Merck & Co Inc MRK USA	39,498 USD	-6.5	0.2	2.1	-5.3	31.6	22.5	2.9	3.6	5.2	-79.2	210.5	-2.8	2.0	3.6	5.2
Average		-7.7	2.2	3.6	-12.1	28.6	11.0	-1.6	3.2	5.0	-65.3	-59.8	-33.2	2.8	2.4	5.0
Sanofi SA SNY US	**34,861** EUR	**2.2**	**5.9**	**-2.9**	**4.0**	**0.9**	**2.6**	**8.9**	**-4.0**	**-0.7**	**44.4**	**-5.9**	**53.8**	**2.8**	—	—

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Sanofi SA SNY (NYSE) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
38.97 USD	54.00 USD	Medium	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 % 2015	2016(E)	2017(E)	EBITDA Margin % 2015	2016(E)	2017(E)	Operating Margin % 2015	2016(E)	2017(E)	Net Margin % 2015	2016(E)	2017(E)	Free Cash Flow Margin % 2015	2016(E)	2017(E)
Pfizer Inc PFE USA	13,754 USD	80.3	*78.0*	*78.5*	37.1	*41.2*	*40.7*	26.6	*32.1*	*32.6*	28.2	*28.1*	*27.3*	26.9	*26.3*	*26.6*
Novartis AG NOVN CHE	12,041 USD	65.5	*72.4*	*71.6*	21.4	*31.8*	*31.4*	18.3	*23.1*	*23.0*	23.9	*22.9*	*22.9*	18.9	*24.1*	*22.2*
Merck & Co Inc MRK USA	10,195 USD	62.2	*75.9*	*75.7*	32.4	*38.6*	*38.6*	16.2	*21.3*	*25.6*	25.8	*26.2*	*26.5*	28.2	*27.8*	*26.8*
Average		69.3	*75.4*	*75.3*	30.3	*37.2*	*36.9*	20.4	*25.5*	*27.1*	26.0	*25.7*	*25.6*	24.7	*26.1*	*25.2*
Sanofi SA SNY US	**7,486** EUR	**68.7**	***69.0***	***68.6***	**32.7**	***29.3***	***29.3***	**20.5**	***19.5***	***20.6***	**21.5**	***19.0***	***19.0***	**17.6**	***15.4***	***17.2***

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity % 2015	2016(E)	2017(E)	Debt/Total Cap % 2015	2016(E)	2017(E)	EBITDA/Interest Exp. 2015	2016(E)	2017(E)	Total Debt/EBITDA 2015	2016(E)	2017(E)	Assets/Equity 2015	2016(E)	2017(E)
Pfizer Inc PFE USA	38,978 USD	60.2	*56.5*	*58.7*	37.6	*36.1*	*37.0*	15.1	*19.9*	*20.1*	2.1	*1.7*	*1.6*	2.6	*2.6*	*2.6*
Novartis AG NOVN CHE	21,931 USD	28.5	*32.5*	*30.1*	22.2	*24.5*	*23.1*	16.5	*20.2*	*20.0*	2.0	*1.6*	*1.4*	1.7	*1.7*	*1.7*
Merck & Co Inc MRK USA	26,514 USD	59.4	*62.8*	*64.5*	37.2	*38.6*	*39.2*	19.0	*20.6*	*24.2*	2.1	*1.7*	*1.7*	2.3	*2.3*	*2.4*
Average		49.4	*50.6*	*51.1*	32.3	*33.1*	*33.1*	16.9	*20.2*	*21.4*	2.1	*1.7*	*1.6*	2.2	*2.2*	*2.2*
Sanofi SA SNY US	**16,554** EUR	**28.5**	***26.7***	***26.4***	**22.2**	***21.1***	***20.9***	**20.4**	***20.8***	***22.0***	**1.5**	***1.4***	***1.3***	**1.8**	***1.8***	***1.8***

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share 2015	2016(E)	2017(E)	Current Ratio 2015	2016(E)	2017(E)	Quick Ratio 2015	2016(E)	2017(E)	Cash/Short-Term Debt 2015	2016(E)	2017(E)	Payout Ratio % 2015	2016(E)	2017(E)
Pfizer Inc PFE USA	205,080 USD	3.72	*2.78*	*0.38*	1.49	*1.45*	*0.94*	1.23	*1.16*	*0.63*	2.29	*2.27*	*0.30*	100.7	*63.0*	*59.9*
Novartis AG NOVN CHE	188,829 CHF	2.23	*3.87*	*4.03*	0.96	*1.03*	*1.04*	0.70	*0.83*	*0.84*	0.97	*1.32*	*1.37*	37.4	*78.4*	*75.5*
Merck & Co Inc MRK USA	171,277 USD	4.73	*5.43*	*6.07*	1.55	*1.67*	*1.71*	1.31	*1.49*	*1.53*	5.19	*7.21*	*6.93*	115.2	*98.1*	*72.3*
Average		3.56	*4.03*	*3.49*	1.33	*1.38*	*1.23*	1.08	*1.16*	*1.00*	2.82	*3.60*	*2.87*	84.4	*79.8*	*69.2*
Sanofi SA SNY US	**100,317** USD	**7.01**	***4.46***	***5.78***	**1.48**	***1.30***	***1.38***	**1.09**	***0.90***	***0.99***	**2.69**	***1.67***	***2.12***	**90.3**	***92.7***	***86.8***

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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar, Inc. and its affiliates ("Morningstar", "we", "our") believes 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: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our single-point star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for 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. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of 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.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working-capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total pres-

Morningstar Research Methodology for Valuing Companies

Economic Moat
Financial Health
Stewardship
Uncertainty
Moat Trend

→ **Morningstar Fair Value**

→ Margin of Safety
Market Pricing

→ **Morningstar Rating™ For Stocks**
★★★★★

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ent value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty around that fair value estimate

Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company 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.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

- ► **Low:** margin of safety for 5-star rating is a 20% discount and for 1-star rating is 25% premium.
- ► **Medium:** margin of safety for 5-star rating is a 30% discount and for 1-star rating is 35% premium.
- ► **High:** margin of safety for 5-star rating is a 40% discount and for 1-star rating is 55% premium.
- ► **Very High:** margin of safety for 5-star rating is a 50% discount and for 1-star rating is 75% premium.
- ► **Extreme:** Stock's uncertainty exceeds the parameters we have set for assigning the appropriate margin of safety.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more detail information about our methodology, please go to http://global.morningstar.com/equitydisclosures

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

Five Stars ★★★★★

We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

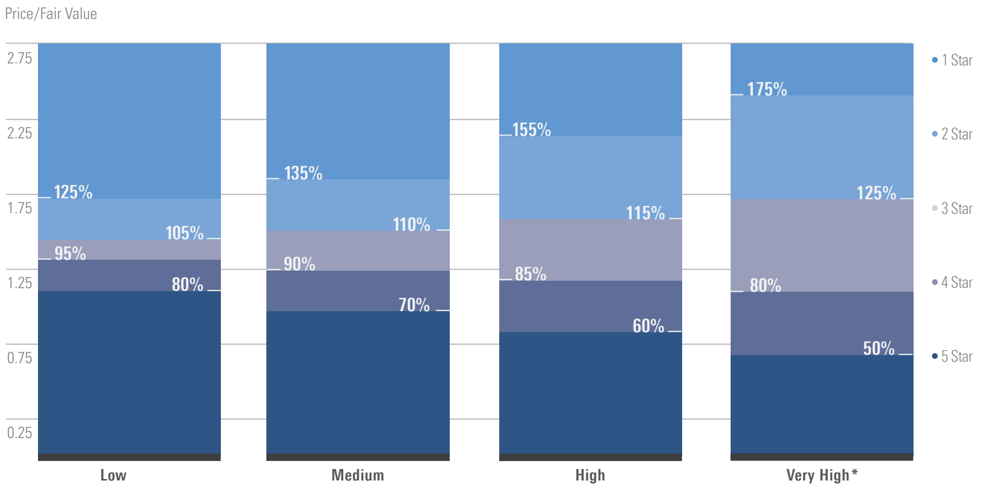
Four Stars ★★★★

We believe appreciation beyond a fair risk-adjusted return is likely.

Three Stars ★★★

Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

Morningstar Research Methodology for Valuing Companies



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

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Research Methodology for Valuing Companies

Two Stars ★★
We believe investors are likely to receive a less than fair risk-adjusted return.

One Star ★
Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions:

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

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.

Quantitative Valuation: Using the below terms, intended to denote the relationship between the security's Last Price and Morningstar's quantitative fair value estimate for that security.

- **Undervalued:** Last Price is below Morningstar's quantitative fair value estimate.
- **Farily Valued:** Last Price is in line with Morningstar's quantitative fair value estimate.
- **Overvalued:** Last Price is above Morningstar's quantitative fair value estimate.

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Please note that investments in securities are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

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Sanofi SA SNY (NYSE) | ★★★★

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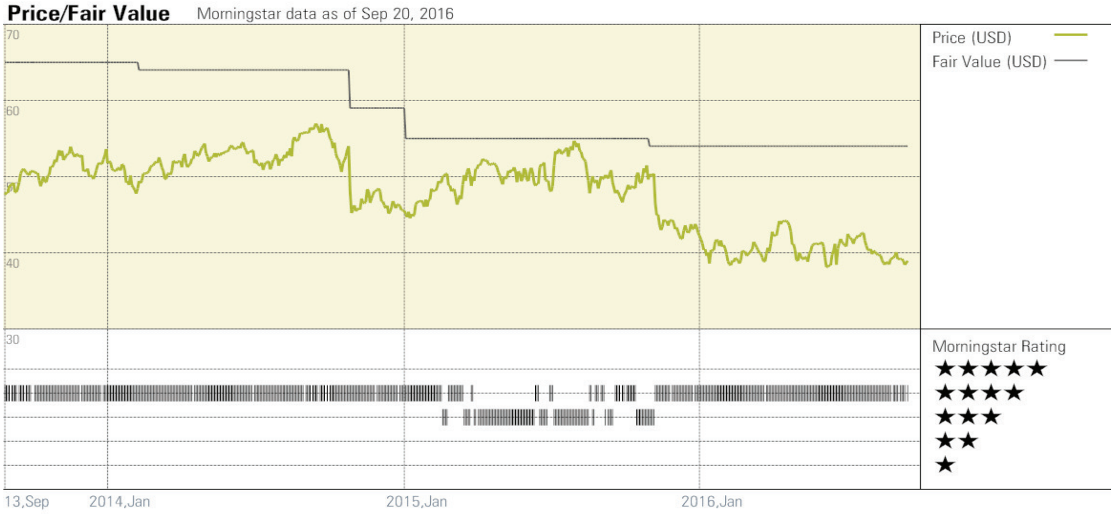

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Sanofi SA SNY (NYSE) | ★★★★

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