Drug Stocks Quarterly Update

Upgrading Outlook to Positive– Stock Selection Is Key

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We are upgrading our outlook on the U.S. pharmaceuticals sector to positive owing to: (1) an improved outlook for relative earnings momentum, (2) attractive valuation, and (3) a favorable U.S. political environment.

- **Stock selection remains critical, however,** as meaningfully disparate earnings outlooks and risk/reward profiles are not captured by relatively narrow valuation dispersion.
- **Drug industry earnings appear poised to accelerate.** Although second quarter EPS growth will likely be soft (-2%, owing mostly to the SGP collapse [-71%], and PFE merger-related weakness [-9%]), the second half of 2003 should accelerate to midteens growth, which should carry through to 14% growth in 2004/2005.
- **Importantly, relative earnings momentum (REM) is now turning positive.** With consensus 2003 EPS for the S&P 500 slipping, REM has improved to neutral for full year 2003 (though positive for the remainder of the year) and is sharply positive for 2004.
- **Valuations are also attractive, in our view.** Drug stock relative valuations have eased over the last quarter from an already modest 11% premium to the S&P, to just a 1% premium today owing to significant S&P 500 valuation expansion (rising prices on modestly lowered EPS). This creates substantial downside protection for drugs with ample headroom for expansion.
- In addition, while risks remain, **likely passage of an industry-friendly Medicare prescription drug benefit makes for a favorable political environment.**
- **Other positives include the most favorable foreign exchange comparisons in a decade, improved new product flow, and more constructive leadership at the FDA.**
- Having said that, we believe **investors should not just blindly buy the group.** A meaningfully tougher pharmaceutical market combined with the exhaustion of financial flexibility for most (due mostly to recent patent expirations) could spell substantial EPS growth disparities and increased risk of big earnings misses.
- **We think four stocks in particular, WYE, PFE, MRK and BMY, are currently valued in a remarkably narrow range,** despite what we view as meaningfully different outlooks.
- **WYE (our favorite) and PFE are both rated Overweight. In our view,** WYE offers impressive, low risk EPS acceleration owing to multiple growth drivers, which should easily overpower the predictable drag from Premarin/Prempro. We think PFE possesses strong current products, an impressive (and under appreciated) pipeline, and the financial flexibility to "buy " growth if necessary with valuation that renders the "quality" argument moot.
- **BMY (Underweight)** has had a nice run on Abilify's launch and positive Erbitux developments but seems expensive given the meager growth outlook and earnings risk. **MRK (Neutral),** though unlikely to disappoint this year, seems appropriately valued for the modest long-term growth outlook.
- **LLY** (Neutral) and **SGP** (Neutral), our "hockey stick" forecasts, should return to robust growth by late 2004; however, lofty valuations with plenty of risk may cap upside for now.

Table 1: Pharmaceutical Industry—Summary Financials

Company	Ticker	JPM Rating	Price 7/14/03*	52-Wk Range	Earnings per Share 2002	2003E	2004E	Price/Earnings 2003E	2004E	Div. Yld.	Mkt. Cap. ($B)
Bristol-Myers Squibb	BMY	UW	$27.11	$29-19	$1.53#	$1.60	$1.70	17.0	15.9	4.1%	52.5
Eli Lilly	LLY	N	$67.35	$71-44	$2.55	$2.60	$3.15	25.9	21.4	2.0%	75.7
Merck & Co.	MRK	N	$61.75	$64-39	$3.14	$3.37	$3.65	18.3	16.9	2.3%	138.5
Pfizer	PFE	OW	$33.84	$37-25	$1.54	$1.73	$2.10	19.6	16.1	1.8%	269.8
Schering-Plough	SGP	N	$17.04	$26-15	$1.42	$0.50	$0.65	34.1	26.3	4.0%	25.0
Wyeth	WYE	OW	$47.47	$50-28	$2.22	$2.48	$2.84	19.1	16.7	1.9%	63.0

Source: Company reports and JPMorgan estimates. Note: JPMorgan ratings: OW = Overweight; N = Neutral; UW = Underweight.
*Data in this table as of 7/14/03's close; all other data and valuation reflect 7/10/03's closing prices unless otherwise noted. # Normalized for excessive inventory stocking.

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(All company sections include Investment Thesis, Positives and Risks, Key Issues to Watch, Summary of Earnings Estimates, Sales & Earnings Drivers, Stock Performance, Valuation, Second Quarter Outlook, Late-Stage Product Pipeline, and Upcoming Events Calendar.)

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Executive Overview

Sector Investment Thesis

Upgrading Outlook on U.S. Pharmaceuticals Sector to Positive

We have maintained a neutral outlook on the drug group since mid April 2002 (over which time the sector has underperformed the S&P 500 by 1%). For the last couple of quarters we have expressed an increasingly positive tilt, but over the last several months several factors have sufficiently improved to support a truly positive outlook. First, relative earnings momentum (REM), which we view as the most powerful predictor of drug stock performance, has improved from negative to neutral for 2003 (and is positive for the remainder of the year); second, relative valuations are more attractive, in our view; and third, the political environment in the U.S. appears far less threatening.

Key Investment Points

Drug Sector Earnings Are Beginning to Accelerate

As the EPS drag resulting from a flurry of patent expirations in 2001-2002 begins to ease (from an estimated 9% drag in 2002 to about 4% in 2003), we remain confident that drug sector earnings growth, which had slowed to +4% in 2002, is likely to accelerate to about +6% in 2003, with further acceleration to +14% in 2004-2005. Although second quarter EPS growth will likely be soft (-2%, owing mostly to the SGP collapse [-71%], and PFE merger-related weakness [-9%]), the second half of 2003 should accelerate to mid-teens growth, which should carry through to 14% growth in 2004/2005.

More Importantly, Relative Earnings Momentum Is Now Turning Positive

In our view, the most powerful predictor of drug stock performance is relative earnings momentum (REM), especially when it is positive for the drug group (positive REM has coincided with drug stock outperformance in 10 of the last 11 years it has occurred). Until recently, 2003 REM was projected to be negative as consensus projected stronger acceleration for S&P500 EPS growth than we projected for the drug group. However, the outlook from here has improved as (1) consensus 2003 S&P 500 estimates have slipped, and (2) we're past the first quarter reporting cycle, which is the weakest REM quarter of 2003. As a result, we believe REM has improved to neutral for full year 2003, positive for the remainder of the year, and sharply positive for 2004.

All This Is in the Context of Attractive Valuations

On the cautious side, we do believe that several factors argue for future relative valuations for the drug sector to be lower (on average) than *historical* levels: (1) we anticipate slightly lower growth than during the "go-go" periods of the recent past (we peg the long-term growth rate at about 11-12%); (2) we expect the pattern of that growth to be more volatile for the industry overall (primarily owing to large earnings holes left by patent expirations); and (3) we anticipate more disparate growth among the individual companies within the sector. Nevertheless, we believe current valuations provide solid downside protection and leave plenty of headroom for expansion, especially in an environment of accelerating EPS growth *and* positive REM. Drug stock relative valuations have eased over the last quarter from an already modest 11% premium to the S&P to just a 1% premium owing to significant S&P 500 valuation expansion (rising prices on modestly lowered EPS). Current valuations imply a long-term growth rate for drug sector of just 8% or so and are well

below the 21% average premium to the S&P 500 over the last 20 years. Over the last 12 years, quarters with both positive REM and below-average relative P/E have seen drug stocks outperform 10 out of 12 times.

Prescription Politics—Not Risk-Free, But Best Outlook in a Decade, in Our View

Although the political environment facing the drug industry still includes risk, on a relative basis, we view the current outlook as the most favorable in nearly 10 years. Finally, a Medicare prescription drug benefit (MPDB) appears heading for enactment, and it should be a positive for the drug industry since both the Senate and the House versions of the bill depend on the private sector to deliver the drug benefit and include no provisions (initially) for price controls. For at least the first 3-5 years, we'd expect boosts to volume and mix (i.e., more brand use, less generic) for the previously uninsured elderly to more than offset price and formulary pressures. Although AWP reform and Waxman-Hatch (generic regulation) reform are likely to be piggybacked onto the MPDB, neither appears particularly threatening to the industry. Importation also may be included, and although that represents a real *theoretical* risk, implementation seems unlikely owing to long-standing safety concerns of the FDA. State pressure on Medicaid drug spending and drug prices will, however, likely continue to intensify but, in our view, is unlikely to expand beyond the roughly 15% of the U.S. market it currently represents and thus should be a containable problem. Lastly, McClellan leadership of the FDA has been a positive for the industry thus far, especially in expediting product reviews.

Favorable FX Comparisons Provide Tailwind to Top-Line Growth

The U.S. dollar weakened another 3% in the second quarter against a typical pharmaceutical basket of currencies. This was the third consecutive devaluation quarter for the USD (it fell 2% in the first quarter and 4% during the fourth quarter 2002). On a year-over-year basis, this is expected to provide an estimated 6% boost to reported revenue growth in 2Q03, which marks this quarter as the most favorable FX comparison in the past decade. The boost to reported top-line growth should be the most evident (improving the *appearance* of quality), while the impact to the sector's bottom line should be more muted owing to the natural offset from a significant cost base outside the United States (i.e., manufacturing, R&D, and SG&A) and the use of hedging strategies. That said, hedging strategies are more likely to allow the benefits from favorable FX swings (i.e., the USD's devaluation) to flow through to the bottom line, while protecting against the exposure from unfavorable FX swings. In addition, hedging strategies often "lock in" FX for just 12 months or so. Therefore, if the current exchange rates remain, the benefits of the weakening dollar should help earnings next year.

New Product Related News Flow Should Favor Sentiment

Notably unlike last year, every company in our coverage has important new product launches under way or imminently anticipated. Many of these drugs are expected to expand category growth, and those already launched are generally doing well. This, combined with the expected easing of the generics drag, should improve investor sentiment regarding the sector's growth prospects (BMY—Abilify; LLY—Straterra and Forteo, and hopefully Cialis and Cymbalta in 2H03; MRK and SGP—Zetia; PFE—Inspra and Spiriva by year-end; and WYE—FluMist and EU launches for Prevenar and Enbrel).

However, the Industry Is MUCH Riskier – Navigate via Stock Selection

Although we do believe the investment outlook has improved for the drug industry, this is not because we anticipate significant easing of the secular pressures that are

increasing risk and squeezing growth. Global pressure on pricing will likely continue. Increasing regulatory and competitive demands should raise the stakes on R&D. Product life cycles are generally shorter. Intellectual property protection is controversial. In-licensing competition is intense, etc, Additionally, the financial flexibility that historically enabled smooth EPS growth despite bumpy revenue growth is largely gone, meaning that now top line misses will likely result in bottom line misses as well. For the sector at large, these risks seem fully discounted in group valuations. Although historically getting the sector view right was two-thirds of the drug stock investing game, we believe going forward, investors should not simply blindly buy the group. We believe increasingly disparate performance between winners and losers will make stock picking increasingly important.

Narrow Valuations – Especially Among WYE and PFE (which we like), and MRK and BMY (which we don't) Could Spell Investment Opportunity
WYE, PFE, MRK and BMY, to us, have distinctly different earnings outlooks and risk profiles, yet there is little valuation differentiation among them on our 2004E EPS (WYE – 16.8x, PFE – 16.0x, MRK – 16.7x, and BMY – 15.9x). WYE (our favorite) and PFE are both rated Overweight. We believe WYE offers impressive, low risk EPS acceleration owing to multiple growth drivers, which should easily overpower the predictable drag from Premarin. We think PFE possesses strong current products, an impressive (and under appreciated) pipeline, and the financial flexibility to "buy " growth if necessary with valuation that renders the "quality" argument moot. BMY (Underweight) has had a nice run on Abilify's launch and positive Erbitux developments but seems expensive to us given the meager growth outlook and downside risk to future EPS expectations. MRK (Neutral), though unlikely to disappoint this year, seems appropriately valued for the modest growth outlook and the looming (2006) patent expiration for Zocor.
LLY (Neutral) and SGP (Neutral) are our "hockey stick" forecasts that carry particularly high valuations (LLY – 21.3x, SGP – 26.6x 2004E EPS) as some investors seem willing to look past near-term problems and pay for potential future growth today. To us, however, although each should return to robust growth by late 2004, lofty valuations with plenty of risk relating to the timing of the upturn, and the base off which that growth occurs may cap upside for now.

Note: Exhibits supporting all of the above comments are shown in the body of this report.

Valuation and Rating Analysis

JPMorgan has a three-tier rating system that includes**: Overweight** (we expect the stock to outperform the average total return of the stocks in our coverage universe), **Neutral**, and **Underweight** (we expect the stock to underperform the average total return of the stocks in our coverage universe).

As before, our valuation methodology continues to focus on each stock's prospects relative to the sector peers under our coverage (see Table 2). We project how we expect relative valuations within the group to change over the next 12 months (i.e., how current relative valuations on 2003 estimated EPS will evolve).

Table 2: Rating Summary

Company	Price (7/10/03)	JPM Rating	Current P/E Prem./(Disc.) (on 2003E EPS) vs. Peers	JPM Expected P/E Prem./(Disc.) (on 2004E EPS) vs. Peers
Bristol-Myers Squibb	$27.10	Underweight	(14)%	(25)%
Eli Lilly	$67.08	Neutral	31%	25%
Merck	$61.04	Neutral	(8)%	(10)%
Pfizer	$33.66	Overweight	(1)%	5%
Schering-Plough	$17.20	Neutral	75%	15%
Wyeth	$47.68	Overweight	(3)%	0%

Source: JPMorgan estimates. Note: JPMorgan ratings: Overweight, Neutral, and Underweight.

Risks to Our Sector Outlook

There are many company specific and industry issues that might unfold differently than we anticipate and thus pose a risk to our individual stock investment theses, but, relative to our sector outlook the fundamental risk is that REM does not, in fact turn positive. Therefore, should S&P 500 earnings accelerate more than that projected presently by consensus, or should the drug sector earnings disappoint versus our projections, the sector's ability to outperform the S&P 500 could be limited. In addition, if the Medicare prescription drug benefit were either suddenly derailed (and thus not passed this year) or redesigned to be meaningfully more negative toward the industry, drug stocks would likely suffer.

Second Quarter 2003 Expectations

Not Much Controversy, But Expect Wide Disparities; Strong WYE Q Expected
Overall we project earnings for the sector will fall a modest 2% for the second quarter, and earnings within the sector to be widely disparate (see Table 3), with declines in growth projected for SGP and PFE, and positive but wide ranging earnings growth for WYE, MRK LLY, and BMY. LLY, PFE, and SGP have largely pre-announced second quarter results, so we expect little controversy for those, although investors are eagerly anticipating the first formal investor-targeted comments from SGP’s new CEO. Although we project overall sector revenue growth of about 6% in the second quarter (see Table 4), this may be exceeded, specifically international sales, given the significant foreign exchange benefit (the weaker U.S. dollar suggests a 6+% year-over-year FX benefit for total sales).

Within our coverage universe, we view WYE as most likely to deliver an upside earnings surprise. Although the source of that potential upside is primarily a bolus of asset sales in 2Q, it is certainly better to “beat” expectations owing to asset sales than to use such sales to just “meet” expectations (a historical criticism of WYE). Operationally, all of WYE’s key growth drivers (Protonix, Effexor XR, Enbrel, and Prevnar) are performing at full throttle, and, at least to date, the Premarin family erosion is no worse than anticipated. **PFE's** earnings could be a bit confusing owing to the impact from the integration of PHA's operations (including the destocking of Pharmacia products, especially Celebrex) and the various nonoperating charges associated with the PHA transaction, although this has been well described by management. While **MRK** should deliver earnings as per the Street's expectations, specific product trends are important. These include Fosamax (which is expected to have a wholesaler buyout), Zocor (which

could start leaking internationally owing to patent expirations), Singulair (which is strong in the U.S. owing to the allergy launch), Vioxx (still sluggish), and Cozaar (also still sluggish). **LLY** has already pre-announced 2Q earnings at the top end of its guidance (implying $0.60-0.61), and we expect investors to primarily focus on (1) management's update on the manufacturing inspections, (2) Zyprexa's sales trends and outlook, and (3) further guidance on timing of Cymbalta and Cialis launches. **SGP** has already preannounced a weak 1Q ($0.12, down 64%), and the focus will be on management's comments on the expected timing of an earnings rebound. Here we see risks skewed to the downside as we do not expect the rapid and significant cost-cutting that some are hoping for. **BMY** quarterly projections are still somewhat handicapped by unclear financial transparency (i.e., base year 2002 sales do not include de-stocking of about $550-750 million, which will artificially inflate 2003 reported growth), but year-over-year comps are relatively easy and may not reflect the challenges that lay ahead of the company (i.e., several looming patent expirations).

Table 3: Pharmaceutical EPS Summary

		2003 2Q Estimate				2003 Full Year Estimate				2004 Full Year Estimate			
	2002 EPS	JPMorgan		Consensus		JPMorgan		Consensus		JPM		Consensus	
Company	Growth	EPS	Growth	EPS	Growth	EPS	Growth	EPS	Growth	EPS	Growth	EPS	Growth
BMY	-35%	$0.38	52%	$0.38	52%	$1.60	21%	$1.60	21%	$1.70	6%	$1.68	5%
LLY	-8%	$0.61	1%	$0.60	-1%	$2.60	2%	$2.55	0%	$3.15	21%	$3.01	18%
MRK	0%	$0.83	7%	$0.84	9%	$3.37	7%	$3.41	9%	$3.65	9%	$3.71	9%
PFE	21%	$0.29	-9%	$0.29	-9%	$1.73	12%	$1.73	12%	$2.10	21%	$2.10	21%
SGP	-10%	$0.12	-71%	$0.12	-71%	$0.50	-65%	$0.49	-66%	$0.65	30%	$0.67	37%
WYE	2%	$0.52	17%	$0.47	5%	$2.48	12%	$2.46	11%	$2.84	14%	$2.77	13%
JNJ	16%	$0.69	15%	$0.69	15%	$2.63	16%	$2.63	16%	$2.98	13%	$2.97	13%
Industry	**4%**		**-2%**		**-6%**		**6%**		**6%**		**15%**		**14%**

Source: FactSet and JPMorgan estimates.

Table 4: Revenue Growth by Company

	2Q			2003		
	U.S.	Int'l	Worldwide	U.S.	Int'l	Worldwide
BMY	24%	9%	18%	10%	6%	8%
BMY[a]	17%	9%	14%	4%	6%	5%
LLY	7%	8%	7%	10%	8%	9%
MRK	7%	12%	8%	7%	9%	7%
MRK[b]	8%	12%	10%	5%	9%	7%
PFE	32%	40%	35%	30%	50%	37%
PFE[c]	8%	11%	9%	9%	12%	10%
SGP	-36%	2%	-20%	-32%	5%	-16%
WYE	3%	7%	4%	6%	9%	7%
Industry[d]	5%	9%	6%	4%	9%	6%

Source: JPMorgan estimates.

a Normalized to reflect an estimated $650MM in non-restated destocking (estimated $162.5MM/quarter).

b Ex-Medco.

c Pro forma (i.e., incl. PHA for full year and prior periods).

d Normalized for BMY, ex-Medco, and pro forma for PFE.

Table 5: Company Earnings Guidance

Company	Company Guidance 2Q/03	2003
BMY	NA	$1.60-1.65
LLY	$0.58-0.61 (pre-announced "high end")	$1.50-1.60
MRK	NA	Double digit core Rx EPS growth; 20-25% growth in Medco net income; $3.40-3.47 for MRK consolidated
PFE	$0.29	$1.73
SGP	Pre-announced $0.12	"May be less than $0.48"
WYE	“approximate” ’02 level (which was $0.45)	$2.40-2.50

Source: Company reports.

Table 6: Relative Stock Performance During the Second Quarter

		3/31/03-6/30/03		3/31//03-7/10/03	
Stock	**JPM Rating**	**Vs Peer Group**	**Vs S&P 500**	**Vs Peer Group**	**Vs S&P 500**
BMY	Underweight	21%	14%	21%	12%
WYE	Overweight	13%	6%	19%	10%
LLY	Neutral	13%	6%	10%	1%
MRK	Neutral	3%	-4%	5%	-5%
PFE	Overweight	2%	-5%	1%	-9%
SGP	Neutral	-3%	-11%	-10%	-20%
Drugs			-7%		-10%

Source: FactSet. Note: JPMorgan ratings: Overweight, Neutral, and Underweight.

Note: The peer group also includes JNJ, which underperformed by 18% during the second quarter, and by 11% from the beginning of the second quarter thru July 10.

Stock Summaries

Our Preferences in Order: WYE, PFE, MRK, LLY, SGP and BMY

WYE (Overweight)—Growth Drivers Cruising, Asset Sales Provide 2Q Icing – Our Top Pick

WYE has outperformed the peer group by 19% and the S&P 500 by 10% since the beginning of the second quarter. Although valuation still implies some skepticism, we expect WYE's EPS growth to be robust and low risk and, from this point, the best growth acceleration story in the sector. The diversified and relatively new portfolio of in-line products—Effexor XR, Protonix, Prevnar, and Enbrel—should drive 80% of the top line, which should accelerate to 10-11% growth as the difficult Premarin family comparisons annualize. Prevnar and Enbrel appear poised for strong growth, helped by increased supplies, strong current demand, and upcoming international launches (especially in the case of Prevnar). Meanwhile, competitive threats for Protonix and Effexor XR have eased, as Protonix remains the lowest priced PPI despite generic omeprazole, and LLY's Cymbalta approval is delayed (expected in late '03) and will mainly target the SSRIs (which represent about 55% of the antidepressant market), rather than Effexor XR (which represents about 9%). Growth should be further supported by FluMist, Altace, rhBMP-2, and royalties from the JNJ drug-eluting stent Cypher. Diet drug litigation and incremental news from the WHI PremPro substudies are headline risks; however, neither seems likely to threaten earnings. Cost cutting is under way, and we believe there is additional EPS cushion versus our projections (i.e., if SG&A and R&D are kept flat vs. +6%) if the top line unexpectedly disappoints. Although WYE's pipeline appears dry through 2004/05, the supply de-bottlenecking in '03 for Enbrel and Prevnar will be key in turbocharging top-line growth, in our view. We expect WYE's growth to accelerate from +12% in '03 to +14-15% in each of '04 and '05 (vs. industry average of +6% in '03, and +14% in '04 and '05).

For 2Q03, we project WYE's EPS at $0.52, up 17%, $0.05 above consensus and expected to be helped by gains from asset sales which should total an estimated $230MM pretax (or roughly $0.12 after tax, of which about $0.05-$0.07 was "expected" based on prorating management's previous guidance that full year asset sales would approximate the $330MM magnitude seen in '02 – there is no resulting change in full year estimates, but 70% of the full year targeted asset sales were complete in 2Q). We expect 4% top line growth and 330 bps decline in gross margins, driven by lower Premarin and PremPro/PremPhase sales (which carry gross margins of 92% and 86%, respectively). SG&A is projected to grow 3%, and R&D 10%. For full-year 2003, we estimate EPS at $2.48, up 12% and $0.02 above consensus (company guidance was $2.40-2.50). For 2004, we estimate 15% growth to $2.84 ($0.07 above consensus).

We rate WYE an Overweight and maintain it on the JPMorgan Focus List. We expect the stock to trade to around $57 in 12 months (previous target price established May 19 was $52), based on our assumption that WYE will trade at an average drug stock multiple (currently 19.9x on 2003 EPS), and will earn $2.84 in 2004. Given its strong earnings acceleration for the rest of 2003, as well as in 2004 and 2005 from 2003, a P/E premium could be argued for (the stock is currently at a 3% discount to the peer group), but the HRT franchise erosion, phen-fen, and "track-record" concerns may continue to weigh down on valuation.

Risks to Our Rating and Price Target. Diet drug litigation liabilities could increase and further charges taken. Bad news on Premarin (e.g., Barr/Natural Biologics' organic generic Premarin, WHI Premarin-only arm early termination) could have negative impact on sentiment and/or earnings. Manufacturing issues could affect Prevnar supplies and international launches. Our 12-month price target time frame could be jeopardized by peer group multiple contracting significantly from 19.9x and/or 2004E EPS falling short of our estimated $2.84.

PFE (Overweight)—Growth, One Way or Another

PFE has outperformed the peer group by 1% but underperformed the S&P 500 by 9% since the beginning of the second quarter. We project growth for PFE averaging 16% through '05, above both our S&P 500 (about 9%) and peer group (12%) estimates, and we view that growth as low risk, given the company's multiple blockbuster growth drivers and considerable financial flexibility (as reflected in the company's raising merger-related cost cuts by 36% to $3BN in '04E and by 60% to $4BN in '05E). Our confidence in PFE's earnings outlook is based on (1) an underappreciated pipeline, which represents a potential growth engine (even relative to PFE's size) that is well above the peer group average (potential blockbusters over next three years include Inspra, pregabalin, Spiriva, Lipitor-Norvasc, indiplon, roflumilast, Exubera, CDP 870 and lasofoxifene); (2) some credit for continued success with the best-in-class record of in-licensing and co-promotion deals (i.e., Lipitor, Celebrex, Bextra, Aricept, Exubera, Spiriva, Rebif, indiplon, and Macugen); (3) significant opportunity to leverage its industry-high cost base; and (4) impressive cash generating capability (proj. $70BN cash by '07) and a proven ability to use this financial power to "buy" growth (e.g., through in-licensing and co-promotion) if necessary. While Neurontin might lose its pending patent battle, generic competition is not likely before '04 (as assumed in our estimates). Were it to occur immediately, we estimate the EPS exposure would be about $0.05-0.06 in 2003 and $0.05 in 2004. Although EPS growth is decelerating and financial leverage and cost cuts are part of the story, we believe this is fully reflected in PFE's current low valuation (1% discount to peers despite above average growth projections).

We project Pfizer's second quarter EPS to decline 9% to $0.29 (in line with consensus and company guidance) on 35% revenue growth (9% pro forma), 290 bps gross margin erosion, 43% increase in SG&A (10% pro forma), and 40% increase in R&D (5% pro forma). 2Q results are expected to be negatively affected by issues pertaining to the transitory harmonization of practices with PHA, including adjusting PHA's wholesaler/internal inventory levels from 2.2 months to PFE's standard 0.8 months (which we estimate as a $0.06 per share hit). For 2003, we project EPS growth of 12% to $1.73 (in line with consensus and guidance). For 2004, we estimate 21% EPS growth to $2.10.

We rate PFE an Overweight and maintain it on the JPMorgan Focus List, with a 12-month target price (established May 19) of $41, which implies that 12 months from now, PFE should trade at roughly an average drug stock multiple (currently 19.9x forward year EPS) and should earn $2.10 in 2004. PFE currently trades at a 1% discount to its peers

Risks to Our Rating and Price Target. Earlier than expected generic competition for Neurontin and more severe than expected competition from rival launches (AZN's Crestor [4Q03 launch], Bayer/GSK's Levitra [2H03], LLY/ICOS's Cialis [2H03], and NVS's Prexige [2004]) could pressure earnings. Near-term pipeline products carry regulatory risk, e.g., Exubera, pregabalin. Patent expirations in 2006 and 2007 will likely squeeze growth in the out years (i.e., Zithromax [May '06],

Zoloft [June '06], Norvasc [September '07], Zyrtec [December '07]). Low-quality earnings growth with dependence on cost cuts could pressure valuation. Our 12-month price target time frame could be jeopardized by peer group multiple contracting significantly from 19.9x and/or 2004E EPS falling short of our estimated $2.10.

MRK (Neutral)—Continued Steady Performance With Little Up or Downside Potential

MRK has outperformed the peer group by 5% but underperformed the S&P 500 by 5% since the start of the second quarter. While MRK's '03 EPS guidance of double-digit core pharma growth may be a challenge, compounded by competition for Zocor (AZN's Crestor [4Q03] and generics in several EU markets [2Q03]) and generic competition for AZN's Prilosec, consensus expectations are low (near bottom of MRK's guidance), the Zetia launch is going well, and most of the key drivers (Fosamax and Cozaar) are progressing as expected (Singulair could beat on the upside owing to its new allergy indication). In the meantime, MRK's pipeline is maturing with three near-term promising launches (i.e., Zetia-Zocor [cholesterol, filing end '03], Aprepitant [depression, filing 2004], and Arcoxia [COX-2 for pain, arthritis, filing end '03]) and two longer-term, high potential prospects (i.e., MK-747 for diabetes and HPV vaccine). However, all of these longer term compounds are high risk (e.g., a novel Phase II anxiolytic was discontinued in Feb. and a PDE4 inhibitor for COPD/asthma in Apr.), have multiple competitors, and if launched may not beat the 2006 Zocor patent expiration. Furthermore, a ruling in the Fosamax once-daily appeals case should be around the corner (2H03), and while we view a generic win as unlikely, there are risks for MRK despite their earlier district court win. Although long-term EPS growth is unlikely to exceed the peer group and the 2006 Zocor patent expiration will loom increasingly large, the risk of near-term EPS disappointment appears small (as does the opportunity for an upside surprise). Based on the stock's current valuation (single-digit discount to its peers on our 2004 EPS estimate of $3.65), we see little meaningful upside potential or downside risks to MRK's stock, and although our EPS growth estimate is modest, it appears to be predictable.

Second quarter 2003 EPS is expected to grow 7% to $0.83 ($0.01 below consensus) driven by total sales growth of 8%. Medco sales are projected to grow only 7% owing to contract losses, while pharma sales (including approximately 50% of total Zetia JV sales) should grow 10%, boosted by Zocor (+16% owing to easy comp. [2Q02 buyout]), Fosamax (just +7% due to destocking), and Cozaar (+17%) sales growth, but offset by weak Vioxx (-20% owing to label change in April 2002 and highlighted CV risks) and Prinivil sales (87% decline owing to generics, which were launched in June 2002). Gross margins are forecasted to expand 20 basis points to 35.3% (modest decrease in Medco share), while SG&A and R&D are estimated to grow 10% and 8%. As a result, the operating margin is forecasted to remain unchanged at 18.8% (Merck's tax rate is projected to modestly improve 50 basis point to 29.5%). For the full year, we expect MRK's EPS to grow 7% to $3.37 ($0.04 below consensus and below MRK's guidance of $3.40-3.47). **We expect MRK's 8% relative discount to modestly worsen to a 10% discount in over the next 12 months. We continue to rate MRK Neutral.**

Risks to our Rating. To the upside, three of MRK's blockbusters (Fosamax, Cozaar, and especially Singulair) plus Zetia could beat on the upside. There are no major anticipated patent expirations until Zocor (2006), and consensus expectations are low (low end of MRK's guidance in '03), reducing the chance of a disappointment. To the downside, we believe management's guidance of double-digit Rx EPS growth in

2003 remains a challenge. Zocor faces competition from generics (ex-U.S.) and AZN's Crestor (4Q03), and Vioxx also faces a new potential challenger, NVS's Prexige (1H04), which could hinder MRK's sales growth. In addition, in our view, MRK's pipeline products are all high risk, some face multiple competitors, and most are several years away from reaching the market. Dependence on Medco could be a risk post-spinoff (2003) and a positive Fosamax patent case appeal ruling may not be as easily achieved as hoped (2H03).

LLY (Neutral)—Excellent Growth Outlook but Too Risky for the Price
LLY has outperformed the peer group by 10% and the S&P 500 by 1% since the beginning of the second quarter. In our view, LLY has the industry's best product pipeline, particularly relative to its modest size and the absence of any earnings drags from patent expirations for several years. We project EPS growth of 21% in 2004 and 2005. However, this robust growth outlook reflects our assumption that Zyprexa will steer clear from several potential risks as their impact to LLY's growth outlook would be severe since Zyprexa accounts for 34% of LLY's revenues and, we estimate, over half its profits. Zyprexa's uncertainties include (1) more intense competition from BMY's Abilify, (2) an unfavorable label change pertaining to diabetes risk, (3) reimbursement pressures from government entities (which pay for 60% of Zyprexa's U.S. revenues), and (4) a patent challenge, which appears secure, but is scheduled for trial in January 2004. We do not expect LLY's earnings growth to accelerate until 2004, as it is heavily dependent on the launch of Cymbalta, which could be delayed if LLY's manufacturing compliance issues remain unresolved. In addition, we expect the Zyprexa controversies to take at least another 2-3 quarters to resolve. Given the stock's premium valuation (28% premium on our '04E EPS), we see little risk in waiting on the sidelines as outperformance from here seems unlikely while the downside risks to Zyprexa are significant. While we remain bullish on LLY's superior long-term growth prospects, we do not view its current risk-benefit tradeoff as particularly attractive and we remain Neutral on LLY.

We project Lilly to deliver 2Q03 EPS of +1% to $0.61, which is $0.01 above consensus but in line with LLY's recently updated guidance that EPS for the quarter will be at the high end of the previously provided range of $0.58-0.61. As such, we do not expect earnings to be controversial for the quarter and expect investors to focus on (1) management's update on the manufacturing inspections, (2) Zyprexa's sales trends, and (3) further guidance on timing of Cymbalta and Cialis launches. We project revenues to grow 8%, fueled by impressive growth for Humalog (+20%), Evista (+17%), Gemzar (+16%), and Zyprexa (+11%), partly offset by declines in the Prozac franchise (-22%), Reopro (-10%), and Humulin (-8%). We also project Straterra sales at $55 million. Favorable FX is expected to boost revenue growth by about 4%. Gross margins are expected to contract 130 basis points (to 79.8%), partly owing to a $200 million increase in the manufacturing cost base to improve GMP compliance and operate expanding capacity. SG&A and R&D expenses are each projected to grow 9% during this quarter. The operating margin is projected to worsen 210 basis points to 26.4%. Lilly's tax rate is expected to remain steady at 22%. **For 2003 we project below-average EPS growth of 2% to $2.60 ($0.05 above consensus; company guidance is $2.50-2.60), but we expect that to accelerate to +21% in 2004. We expect LLY's 31% relative premium to contract slightly to 25% over the next 12 months. We rate LLY a Neutral.**

Risks to Our Rating. To the upside, LLY has one of the best pipelines in the industry with the potential to drive stronger than forecast EPS growth for several years. Additionally, Straterra is launching very well and could continue to surpass

expectations. News flow on product approvals and product filings in the second half could serve as positive stock catalysts. To the downside, Zyprexa's outlook is clouded by several controversies—i.e. competition from BMY's Abilify, cost containment pressure from state funded healthcare plans, and a generic threat to its patent challenge. Because Zyprexa accounts for a substantial part of LLY's revenues, a stumble on any front could be devastating. LLY has limited near-term financial flexibility given the need to spend behind pipeline. Cymbalta's launch is still unclear and could be delayed given its dependence on resolution of manufacturing issues.

SGP (Neutral)—Near-Term Earnings Quicksand, But Zetia Launch Strong
SGP has underperformed its peer group by 10% and the S&P 500 by 20% since the beginning of the second quarter. Although we do not expect EPS to return to 2002 EPS levels until 2006/07, potential variance to our forecast (both up and downside), particularly in the outyears, is high owing to a lack of clarity on gross margin trends, the profitability of the Zetia JV, and the extent of cost cuts, where there is significant EPS leverage. Current operating margins are abnormally compressed but will likely snap back when the allergy and hepatitis-C franchise declines end and the Zetia/Zetia-Zocor profit growth kicks in. In our view, SGP's rich valuation, however, leaves little room for short-term upside (already discounts strong Zetia growth and assumes no additional EPS downside) while news flow in the near-term could be negative (i.e., generic ribavirin and a dividend cut are both possibilities, although increasingly expected). That said, it appears that SGP's current investor base is willing to weather near-term bumps and is unlikely to sell unless the company's long-term bullish thesis (i.e., 30%+ Zetia-driven EPS growth after '03) becomes tainted.

For the second quarter 2003, we expect SGP's EPS to decline 71% to $0.12 (in line with SGP's guidance and consensus). Given that SGP has offered no new explanations for this EPS pressure (i.e., cited continuing competitive pressures for Clarinex, Nasonex, and the Hep-C franchise), given the uncertain gross margin trends and stocking levels, particularly for Rebetol, it is unclear whether or not these factors also contributed to the weakness, and thus composition of earnings could vary from our estimates. That said, we project total sales will fall 20% owing to weak Claritin franchise sales (-53% yoy change due to the Claritin Rx-to-OTC switch, generic OTC copycats, and competition from Zyrtec, Allegra, and Singulair) and weak Hepatitis-C franchise sales (-27% due to aggressive competition from Roche and Rebetol destocking). On the positive side, we expect Remicade (+64%), Temodar (+21%) and Integrilin (+17%) sales growth to remain robust as well as the Zetia launch ($85MM in gross sales for the JV). Gross margins are expected to fall 750 bps to 68.7% owing to higher COGS imposed by increased GMP compliance efforts and the drop in high margin Claritin sales. SG&A is expected to drop 5% because of SGP's streamlining and consolidation efforts, while R&D spending is projected to rise 10% owing to Zetia-related studies. As a result of all of these negative trends (although primarily the drop in sales), SGP's yoy operating margin is projected to collapse from 28.5% to 9.8% (on a sequential basis, the operating margin is expected to decline 120 bps). The tax rate is expected to fall 300 bps to 20.0% (no change sequentially). For the full year 2003, we expect SGP to earn $0.50 per share ($0.01 above consensus, and slightly above SGP's implied guidance, which suggests that earnings could potentially be less than $0.48). **Over the next 12 months, we expect SGP's relative valuation of a 75% premium to drop to a 15% premium. We continue to rate SGP Neutral.**

Risks to our Rating. To the upside, the Zetia launch is going strong and could exceed expectations, and a potential delay in the launch of generic ribavirin (expected 4Q03) could lead to a temporary near-term EPS benefit for SGP. Future costs cuts and consequent margin improvements could also be greater than anticipated. To the downside, we believe SGP's rich valuation is dependent on Zetia blockbuster success (plus uncertain Zetia JV profitability assumptions), which could fall short of our $3-4 billion 2007 sales estimate. In our view, the current negative gross margin trend (mainly owing to GMP compliance) is concerning, and future direction is uncertain, while greater competitor inroads and excess stocking could lead to further negative revisions for SGP's Clarinex and Hep-C franchises. Negative findings from state and federal investigations could lead to significant penalties for SGP, which could dilute earnings if SGP is forced to raise debt to cover any fines.

BMY (Underweight)—Slowly Rebuilding Confidence, But Risks Remain
Bristol has outperformed its peer group by 21% and the S&P 500 by 12% since the beginning of the second quarter. While post-restatement investor confidence in Bristol has steadily grown owing to the strong Abilify launch, the positive Erbitux Phase III data (2H03 filing), and the recent Reyataz approval, confusion regarding normalized base year EPS continues and variability to our forecasts persist (e.g., the wide-ranging guidance in nonrestated stocking [$550-$750MM] could lead to a +/- $0.04 EPS swing). More importantly, we do not expect Bristol's near-term growth engines, which mainly ride on Abilify (where Bristol has to pay a steep 35% royalty to Otsuka) and Plavix, to offset the lost sales from a wave of products that are expected to lose exclusivity over the next few years, beginning with Serzone, Monopril, Glucophage XR, and Taxol (EU) in 2003, followed by Glucovance and Paraplatin in 2004, Cefzil in 2005, and Pravachol in 2006. As such, our forecast does not see the clouds clearing anytime soon, despite our bullish expectations for Abilify ($2.5 billion in gross sales by 2007 [$1.6 billion after royalties to Otsuka]). We expect BMY's underlying compounded annual pharma sales growth (excluding OTN) to muddle along at just 3% thru 2007. These issues are compounded by what we believe is Bristol's limited financial flexibility (i.e., any top-line disappointment could hurt earnings) as well as by the looming Plavix patent challenge (could be resolved in 2004; generic win is unlikely in our view). But while there is little in our fundamental outlook for BMY that is encouraging, we believe that BMY enjoys downside support owing to its attractive dividend yield of 4%, which we do not believe is at risk, and the possibility of an upside surprise (such as a potential acquisition of BMY, which has been widely speculated in Wall Street Journal, Business Week, and Forbes during 2002 in unconfirmed reports).

Despite Bristol's restatement, financial transparency remains cloudy and our confidence in forward projections (particularly quarterly estimates) is low. Our estimates are subject to meaningful variability (e.g., wide ranging guidance on nonrestated stocking of $550-750MM could lead to a +/- $0.04 swing in our 2003 full-year EPS estimate and affect quarterly estimates). With this caveat in mind, for the second quarter of 2003, we expect Bristol to earn $0.37 per share ($0.01 below consensus). Total sales and medicine product sales are expected to jump 18% and 20% (excluding OTN medicine product sales are projected to grow 19%), mainly due to an easy comp owing to aggressive destocking in 2Q02, but also helped by nonrestated stocking as well as a favorable FX tailwind in 2Q03. Gross margins are expected to stay relatively flat (down 10 bps to 64.4%) owing to a steady mix of OTN and pharma sales. SG&A is projected to grow 11% to help support the Abilify launch, while R&D spending is expected to rise 6% to help support Bristol's late-stage pipeline. Owing to the rebound in sales, the operating margin is projected to

rise 230 bps to 23.9%, while BMY's tax rate is expected to fall 70 bps to 27.4%. For 2003 we expect normalized EPS to grow 5% to $1.60 (in line with consensus and at the bottom-end of management's guidance of $1.60-1.65). **Over the next 12 months, we expect BMY's relative valuation of a 14% discount to slip to a 25% discount on forward-year estimated earnings. We rate BMY an Underweight.**

Risk to our Rating. On the upside, generic entry delay and/or stronger than expected Plavix and Abilify sales could lead to EPS upside (albeit versus low expectations), which could increase investors' confidence in Bristol's turnaround story, which has been helped by recent events (e.g., strong Abilify launch, positive Erbitux Phase III data, and Reyataz approval). Whereas, ongoing market speculation of a possible acquisition as well as Bristol's strong dividend, which appears secure in our view, protects investors' downside.

Note: More detailed summaries of each company, including financial models, appear later in this report.

Table 7: Pharmaceutical Industry Summary Valuation

	Ticker	JPM Rating	Curr.	Price 7/10/03	YTD Perf. %	Calendar EPS Estimate '02[7]	Calendar EPS Estimate '03E[7]	Calendar EPS Estimate '04E	CAGR % 2-Yr ('02-04E)	CAGR % 5-Yr.[7] ('02-07E)	Calendar P/E '02	Calendar P/E '03E	Calendar P/E '04E	2003 PEG 2-Yr ('02-04E)	2003 PEG 5-Yr.[7] ('02-'07E)	Prem./(Disc.) vs. Local Index '03E	Prem./(Disc.) vs. Local Index '04E	Prem./(Disc.) vs. Regional Drug Index '03E	Prem./(Disc.) vs. Regional Drug Index '04E	Prem./(Disc.) vs. Global Drug Index '03E	Prem./(Disc.) vs. Global Drug Index '04E	Mkt Val (US $B)	Div. % Yld
United States																							
Bristol-Myers Squibb[7]	BMY	UW	US$	27.10	17%	1.53	1.60	1.70	6%	4%	17.7	16.9	15.9	3.1	3.8	(11)%	(9)%	(14)%	(7)%	(10)%	(4)%	53	4.1%
Eli Lilly	LLY	N	US$	67.08	6%	2.55	2.60	3.15	11%	16%	26.3	25.8	21.3	2.3	1.6	35%	21%	31%	25%	38%	28%	75	2.0%
Johnson & Johnson	JNJ	N	US$	51.25	(5)%	2.27	2.63	2.98	15%	13%	22.6	19.5	17.2	1.3	1.6	2%	(2)%	(1)%	1%	4%	3%	152	1.9%
Merck	MRK	N	US$	61.04	8%	3.14	3.37	3.65	8%	6%	19.4	18.1	16.7	2.3	2.8	(5)%	(5)%	(8)%	(2)%	(3)%	0%	137	2.4%
Merck Rx[9]			US$	57.04	0%	2.98	3.17	3.42	7%	7%	19.1	18.0	16.7	2.5	2.7	(6)%	(5)%	(9)%	(2)%	(4)%	0%	128	2.5%
Pfizer	PFE	OW	US$	33.66	10%	1.54	1.73	2.10	17%	13%	21.9	19.5	16.0	1.2	1.6	2%	(9)%	(1)%	(6)%	4%	(4)%	266	1.8%
Schering-Plough	SGP	N	US$	17.20	(23)%	1.42	0.50	0.65	-32%	1%	12.1	34.5	26.6	(1.1)	29.8	81%	51%	75%	56%	84%	60%	25	4.0%
Wyeth	WYE	OW	US$	47.69	28%	2.22	2.48	2.84	13%	13%	21.5	19.2	16.8	1.5	1.5	1%	(4)%	(3)%	(2)%	3%	1%	63	1.9%
JPMorgan U.S. Drug Index[1]			US$	40.67	6%	1.94	2.06	2.38	11%	11%	21.0	19.7	17.1	1.8	1.9	4%	(3)%	0%	0%	5%	3%	771	2.2%
S&P 500[2]			US$	989	12%	47.7	51.9	56.4	9%		20.7	19.1	17.5	2.2		0%	0%	(3)%	3%	2%	5%		
Europe																							
Aventis	AVEP.PA	N	€	47.50	(8)%	2.62	3.10	3.37	13%	6%	18.1	15.3	14.1	1.1	2.4	4%	13%	(13)%	(13)%	(18)%	(15)%	43	1.5%
AstraZeneca	AZN.L	N	£	25.45	15%	1.84	0.98	1.05	-25%	-8%	13.8	25.9	24.3	(1.1)	(3.5)	75%	94%	47%	51%	38%	46%	71	1.7%
GlaxoSmithKline[4]	GLXO.L	UW	£	11.86	(1)%	78.3	83.8	87.3	6%	4%	15.2	14.2	13.6	2.5	3.2	(4)%	8%	(20)%	(16)%	(24)%	(18)%	116	3.4%
H. Lundbeck A/S	LUN.CO	UW	Dkr	135	(28)%	5.60	8.14	8.69	25%	15%	24.0	16.5	15.5	0.7	1.1	12%	24%	(7)%	(4)%	(12)%	(7)%	5	0.8%
Merck KGA[3]	MRCG.F		€	22.80	(10)%	1.50	1.39	2.68	34%	21%	15.2	16.4	8.5	0.5	0.8	11%	(32)%	(7)%	(47)%	(13)%	(49)%	1	4.4%
Novartis	NOVZn.S	OW	SFr	52.40	4%	2.91	3.05	3.48	9%	12%	18.0	17.2	15.1	1.8	1.5	16%	20%	(3)%	(7)%	(8)%	(9)%	108	1.8%
Novo Nordisk	NVOb.CO	N	Dkr	230	12%	11.72	11.93	13.22	6%	10%	19.6	19.2	17.4	3.1	2.0	30%	39%	9%	8%	3%	4%	11	1.6%
Roche	ROCZg.S	N	SFr	110.0	14%	4.49	4.70	5.23	8%	8%	24.5	23.4	21.0	3.0	2.9	58%	68%	32%	30%	25%	26%	57	1.3%
Sanofi-Synthelabo	SASY.PA	N	€	52.75	(9)%	2.42	2.83	3.29	17%	16%	21.8	18.7	16.0	1.1	1.2	26%	28%	5%	(1)%	(1)%	(4)%	44	1.6%
Schering AG	SCHG.F	OW	€	42.97	4%	2.35	2.55	2.92	11%	10%	18.3	16.8	14.7	1.5	1.7	14%	18%	(5)%	(9)%	(10)%	(11)%	10	2.2%
JPMorgan Euro Drug Index[1]			€	30.36	(17)%	1.70	1.72	1.88	5%	7%	17.8	17.7	16.1	3.4	2.6	20%	29%	0%	0%	(6)%	(3)%	465	2.1%
JPMorgan Euro Drug Index[1]			US$	34.44	6%	1.93	1.95	2.13	5%	7%	17.8	17.7	16.1	3.4	2.6	20%	29%	0%	0%	(6)%	(3)%	465	2.1%
MSCI Europe			€	867	4%	43.9	58.6	69.2	26%		19.7	14.8	12.5	0.6		0%	0%	(16)%	(22)%	(21)%	(25)%		
Japan[5,6]																							
Chugai	4519.T	UW	Yen	1,449	28%	(33)	54	61	NM	NM	(43.6)	27.0	23.6	NM	NM	38%	41%	62%	49%	44%	42%	4	0.8%
Daiichi Pharm.	4505.T	N	Yen	1,675	(2)%	50	103	104	44%	30%	33.6	16.3	16.1	0.4	0.5	(16)%	(3)%	(2)%	2%	(13)%	(3)%	4	1.8%
Eisai	4523.T	OW	Yen	2,405	(10)%	140	178	197	19%	11%	17.2	13.5	12.2	0.7	1.3	(31)%	(27)%	(19)%	(23)%	(28)%	(27)%	6	1.5%
Fujisawa Pharm.	4511.T	N	Yen	2,285	(16)%	85	115	125	21%	13%	26.8	19.9	18.2	0.9	1.5	2%	9%	19%	16%	6%	10%	6	0.8%
Kyorin	4560.T	OW	Yen	1,619	(8)%	48	81	89	37%	40%	33.9	20.0	18.2	0.5	0.5	3%	9%	20%	15%	7%	9%	1	0.9%
Sankyo	4501.T	N	Yen	1,416	(5)%	77	75	67	-7%	4%	18.4	18.8	21.1	(2.8)	4.3	(4)%	26%	12%	34%	0%	27%	5	1.8%
Shionogi	4507.T	UW	Yen	1,680	0%	17	28	49	70%	54%	99.0	60.0	34.3	0.9	1.1	208%	106%	259%	117%	220%	106%	5	0.5%
Taisho	4535.T	UW	Yen	1,775	2%	110	113	115	2%	5%	16.2	15.6	15.4	6.7	3.4	(20)%	(8)%	(6)%	(2)%	(17)%	(7)%	5	1.4%
Takeda Chemical Industries	4502.T	OW	Yen	4,460	(10)%	308	306	325	3%	6%	14.5	14.6	13.7	5.3	2.5	(25)%	(18)%	(13)%	(13)%	(22)%	(18)%	34	1.5%
Tanabe	4508.T	N	Yen	890	(14)%	34	81	76	50%	29%	26.4	11.0	11.7	0.2	0.4	(44)%	(30)%	(34)%	(26)%	(41)%	(30)%	2	1.1%
Terumo	4543.T	N	Yen	2,000	22%	90	98	112	11%	16%	22.1	20.5	17.8	1.8	1.3	5%	7%	23%	13%	9%	7%	4	0.7%
Yamanouchi Pharm.	4503.T	N	Yen	3,300	(4)%	177	195	192	4%	9%	18.7	16.9	17.2	4.0	1.8	(13)%	3%	2%	9%	(10)%	3%	10	0.9%
JPM Japan Drug Index[1]			Yen	2,434	(6)%	124	146	154	11%	12%	19.6	16.7	15.8	1.5	1.4	(14)%	(5)%	0%	0%	(11)%	(5)%	87	1.3%
JPM Japan Drug Index[1]			US$	20.65	5%	1.05	1.24	1.31	11%	12%	19.6	16.7	15.8	1.5	1.4	(14)%	(5)%	0%	0%	(11)%	(5)%	87	1.3%
TOPIX			Yen	946	12%	37.1	48.6	56.7	24%		25.5	19.5	16.7	0.8		0%	0%	17%	6%	4%	0%		
Global Drug Index[1]			US$	36.08	6%	1.84	1.92	2.17	9%	10%	19.7	18.7	16.6	2.2	1.9							1,323	2.1%

Source: Company reports, FactSet, First Call, I/B/E/S, Datastream, and JPMorgan estimates for rated companies.

Note: JPMorgan ratings: OW = Overweight; N = Neutral; UW = Underweight.

1. Regional and Global Drug indices are share weighted. 2. First Call estimates used for S&P 500 EPS; I/B/E/S estimates used for FTSE 300 and TOPIX EPS. 3. For those companies not under JPM coverage (i.e., Merck KGA), I/B/E/S estimates are used. 4. EPS in pence. 5. For the Japanese companies, firm value also includes postretirement benefits. 6. For the Japanese companies, fiscal years end on March 31, hence 2003 estimates, for instance, would represent the year ending March 31, 2004. 7. BMY 2002 EPS of $1.53 reflects normalized EPS ex-inventory impact; including excess non-stated stocking, the 2002 EPS is $1.33. 8. 5-Yr ('02-'07E) for U.S. pharma, and 4-Yr ('02-'06E) for European, Japanese, and global pharma. 9. Assumes Medco trades at a 10% discount to its PBM peers on our '04 Medco EPS estimate.

Table 8: Pharmaceutical Industry Summary Performance

Company	Curr.	Price 7/10/03	52-Wk Range Low	52-Wk Range High	Performance Last Wk.	Performance Last Mth	Performance QTD	Performance YTD	Performance 12 Mths Ago	Rel. Perf. to Local Index Last Wk.	Rel. Perf. to Local Index Last Mth	Rel. Perf. to Local Index QTD	Rel. Perf. to Local Index YTD	Rel. Perf. to Local Index 12 Mths Ago	Rel. Perf. to Regional Drug Index[2] Last Wk.	Rel. Perf. to Regional Drug Index[2] Last Mth	Rel. Perf. to Regional Drug Index[2] QTD	Rel. Perf. to Regional Drug Index[2] YTD	Rel. Perf. to Regional Drug Index[2] 12 Mths Ago	Rel. Perf. To Global Drug Index Last Wk.	Rel. Perf. To Global Drug Index Last Mth	Rel. Perf. To Global Drug Index QTD	Rel. Perf. To Global Drug Index YTD	Rel. Perf. To Global Drug Index 12 Mths Ago
United States																								
Bristol-Myers Squibb	US$	27.10	19	29	(1)%	0%	28%	17%	23%	(1)%	1%	12%	5%	16%	1%	(0)%	21%	11%	10%	1%	1%	19%	6%	16%
Eli Lilly	US$	67.08	44	71	(3)%	6%	17%	6%	35%	(3)%	7%	1%	(7)%	28%	(2)%	6%	11%	(1)%	23%	(2)%	7%	8%	(6)%	28%
Johnson & Johnson	US$	51.25	41	61	(3)%	(3)%	(11)%	(5)%	1%	(4)%	(2)%	(28)%	(17)%	(6)%	(2)%	(4)%	(18)%	(11)%	(12)%	(2)%	(2)%	(21)%	(16)%	(6)%
Merck	US$	61.04	39	64	(0)%	3%	11%	8%	38%	(0)%	4%	(5)%	(5)%	31%	1%	3%	5%	2%	26%	1%	4%	2%	(4)%	31%
Pfizer	US$	33.66	25	37	(2)%	1%	8%	10%	3%	(2)%	2%	(9)%	(2)%	(3)%	(0)%	1%	1%	4%	(9)%	(0)%	2%	(1)%	(1)%	(4)%
Schering-Plough	US$	17.20	15	26	(10)%	(12)%	(4)%	(23)%	(20)%	(10)%	(11)%	(20)%	(35)%	(27)%	(8)%	(12)%	(10)%	(29)%	(33)%	(8)%	(10)%	(13)%	(34)%	(27)%
Wyeth	US$	47.69	28	50	4%	(1)%	26%	28%	31%	4%	0%	10%	15%	24%	6%	(1)%	19%	21%	19%	6%	1%	17%	16%	24%
JPM US Drug Index[1]	US$	40.67			(2)%	0%	7%	6%	12%	(2)%	1%	(10)%	(6)%	6%	0%	0%	0%	0%	0%	(0)%	2%	(3)%	(5)%	5%
S&P 500	US$	989	769	1,015	0%	(1)%	17%	12%	7%	0%	0%	0%	0%	0%	2%	(1)%	10%	6%	(6)%	2%	0%	7%	1%	(0)%
NASDAQ	US$	1,716	1,108	1,758	3%	4%	28%	28%	25%	3%	5%	11%	16%	18%	5%	4%	21%	22%	13%	5%	5%	18%	17%	18%
BTK	US$	724	397	777	6%	(3)%	41%	46%	71%	5%	(2)%	25%	33%	65%	7%	(3)%	34%	39%	59%	7%	(1)%	32%	34%	64%
HMO Index[3]	US$	554			1%	1%	20%	30%	14%	1%	2%	3%	18%	7%	3%	1%	13%	24%	2%	3%	3%	10%	19%	7%
Hospital Index[4]	US$	473			3%	(4)%	(14)%	(18)%	(45)%	2%	(3)%	(31)%	(31)%	(52)%	4%	(4)%	(21)%	(24)%	(58)%	4%	(2)%	(24)%	(30)%	(52)%
Europe																								
Aventis	€	47.50	38	70	1%	(0)%	18%	(8)%	(26)%	(0)%	(0)%	1%	(13)%	(17)%	2%	1%	7%	(4)%	(14)%	3%	1%	9%	(20)%	(33)%
AstraZeneca	£	25.45	18	27	2%	(4)%	18%	15%	9%	0%	(4)%	1%	10%	18%	2%	(3)%	7%	19%	20%	3%	(3)%	8%	3%	2%
GlaxoSmithKline	£	11.86	10	14	(4)%	(6)%	7%	(1)%	(0)%	(5)%	(6)%	(11)%	(5)%	9%	(4)%	(5)%	(4)%	4%	11%	(3)%	(4)%	(3)%	(12)%	(7)%
H. Lundbeck A/S	Dkr	134.5	102	222	2%	8%	6%	(28)%	(32)%	0%	9%	(11)%	(33)%	(24)%	2%	9%	(4)%	(24)%	(21)%	3%	10%	(3)%	(40)%	(39)%
Merck KGA	€	22.80	18	30	(3)%	(20)%	4%	(10)%	(3)%	(5)%	(20)%	(14)%	(15)%	6%	(3)%	(19)%	(7)%	(6)%	9%	(2)%	(18)%	(6)%	(22)%	(9)%
Novartis	SFr	52.40	45	67	(0)%	(2)%	5%	4%	(12)%	(2)%	(1)%	(13)%	(1)%	(3)%	(0)%	(1)%	(6)%	8%	(1)%	1%	(0)%	(5)%	(8)%	(19)%
Novo Nordisk	Dkr	229.5	161	250	(1)%	(0)%	2%	12%	4%	(2)%	(0)%	(15)%	8%	13%	(0)%	1%	(8)%	16%	16%	1%	1%	(7)%	1%	(3)%
Roche	SFr	110.0	73	120	3%	10%	36%	14%	(3)%	2%	10%	19%	10%	6%	4%	11%	25%	18%	8%	5%	11%	26%	3%	(10)%
Sanofi/Synthelabo	€	52.75	42	66	0%	0%	14%	(9)%	(8)%	(1)%	0%	(3)%	(14)%	1%	1%	1%	4%	(5)%	4%	2%	1%	5%	(21)%	(15)%
Schering AG	€	42.97	32	61	2%	(4)%	15%	4%	(20)%	0%	(4)%	(2)%	(1)%	(11)%	2%	(3)%	5%	8%	(8)%	3%	(3)%	6%	(8)%	(26)%
JPM Euro Drug Index[1]	€	30.36			(0)%	(1)%	11%	(4)%	(11)%	(2)%	(1)%	(7)%	(8)%	(3)%	0%	0%	0%	0%	0%	1%	0%	1%	(16)%	(18)%
JPM Euro Drug Index[1]	US$	34.44			(2)%	(4)%	15%	22%	2%	(3)%	(4)%	(2)%	18%	10%	(2)%	(3)%	4%	26%	13%	(0)%	(3)%	5%	11%	(5)%
MSCI Europe	€	867	676	966	2%	(0)%	17%	4%	(9)%	0%	0%	0%	0%	0%	2%	1%	7%	8%	3%	3%	1%	8%	(7)%	(16)%
Japan																								
Chugai	Yen	1,449	850	1,484	5%	10%	21%	28%	26%	2%	(2)%	(4)%	12%	31%	5%	8%	16%	31%	36%	6%	11%	11%	17%	19%
Daiichi Pharm.	Yen	1,675	1,350	2,265	4%	8%	5%	(2)%	(24)%	0%	(4)%	(19)%	(18)%	(19)%	4%	5%	0%	1%	(14)%	5%	9%	(4)%	(13)%	(31)%
Eisai	Yen	2,405	2,040	3,180	(4)%	(3)%	10%	(10)%	(20)%	(8)%	(15)%	(15)%	(26)%	(15)%	(5)%	(5)%	5%	(7)%	(10)%	(3)%	(2)%	1%	(21)%	(27)%
Fujisawa Pharm.	Yen	2,285	1,964	2,825	0%	3%	(4)%		(18)%	(3)%	(9)%	(29)%	(32)%	(13)%	0%	1%	(9)%	(14)%	(8)%	2%	4%	(14)%	(27)%	(25)%
Kyorin	Yen	1,619	1,034	2,975	0%	17%	42%	(8)%	(43)%	(3)%	5%	17%	(24)%	(38)%	0%	15%	37%	(5)%	(33)%	2%	18%	33%	(19)%	(49)%
Sankyo	Yen	1,416	1,308	1,733	(2)%	(0)%	(10)%	(5)%	(9)%	(6)%	(12)%	(35)%	(21)%	(4)%	(3)%	(3)%	(15)%	(3)%	1%	(1)%	1%	(19)%	(16)%	(16)%
Shionogi	Yen	1,680	1,103	1,818	(4)%	(5)%	5%	0%	19%	(7)%	(17)%	(20)%	(16)%	24%	(4)%	(7)%	(1)%	2%	29%	(2)%	(3)%	(5)%	(11)%	12%
Taisho	Yen	1,775	1,627	1,980	(2)%	4%	5%	2%	(6)%	(6)%	(8)%	(20)%	(14)%	(1)%	(2)%	1%	(0)%	4%	4%	(1)%	5%	(4)%	(10)%	(13)%
Takeda Chemical	Yen	4,460	3,750	5,320	(1)%	(1)%	1%	(10)%	(13)%	(4)%	(13)%	(24)%	(26)%	(8)%	(1)%	(3)%	(4)%	(8)%	(3)%	1%	0%	(9)%	(22)%	(20)%
Tanabe	Yen	890	771	1,195	7%	6%	(3)%	(14)%	(16)%	4%	(6)%	(28)%	(30)%	(11)%	7%	4%	(8)%	(12)%	(6)%	9%	8%	(13)%	(26)%	(23)%
Terumo	Yen	2,000	1,401	2,110	0%	(2)%	17%	22%	28%	(3)%	(14)%	(8)%	6%	33%	0%	(4)%	12%	24%	38%	2%	(1)%	8%	10%	21%
Yamanouchi	Yen	3,300	2,560	3,500	3%	3%	7%	(4)%	8%	(0)%	(9)%	(18)%	(20)%	13%	3%	1%	2%	(2)%	18%	5%	5%	(3)%	(15)%	1%
JPM Japan Drug Index[1]	Yen	2,434			2%	3%	6%	(3)%	(6)%	(1)%	(9)%	(19)%	(19)%	(1)%	2%	1%	1%	(1)%	4%	4%	5%	(4)%	(15)%	(13)%
JPM Japan Drug Index[1]	US$	20.65			2%	3%	7%	8%	(7)%	(1)%	(9)%	(18)%	(8)%	(2)%	2%	1%	1%	10%	3%	4%	4%	(3)%	(4)%	(14)%
TOPIX Pharma Index	Yen	1,263			0%	2%	5%	(2)%	(10)%	(3)%	(10)%	(20)%	(18)%	(5)%	0%	0%	0%	0%	0%	2%	4%	(4)%	(14)%	(17)%
NIKKEI 225	Yen	9,956	7,608	10,601	3%	12%	25%	16%	(5)%	0%	0%	0%	0%	0%	3%	10%	20%	18%	5%	5%	13%	15%	5%	(12)%
Global Drug Index[1]	US$	36.08			(1)%	(1)%	10%	11%	7%															

Sources: Company reports, FactSet, First Call, I/B/E/S, Datastream, and JPM estimates.

Note: 1. Regional and Global Drug indices are share weighted.

2. Relative performance to regional drug index is based on the JPM Drug Index for U.S. and Europe, and the TOPIX Pharma Index for Japan.

3. The HMO Index is a market-cap-weighted index including AET, CI, CVH, HNT, HUM, MME, OHP, PHSY, SIE, TGH, UNH, and WLP.

4. The Hospital Index is a market-cap-weighted index including CYH, HCA, HMA, HRC, LPNT, PRHC, SLMC, THC, TRI, and UHS.

5. QTD–Since March 31, 2003.

Industry Overview

Recent Drug Stock Performance

Drug stocks appreciated on average by 8% during the second quarter, but they still underperformed the S&P 500 by 7% during the quarter (the S&P 500 increased 15%) and have further underperformed by 3% during early July (see Figure 1).

Newsflow during the second quarter was largely positive for the sector, with the exception of a strongly negative market reaction (an overreaction in our view) to the Supreme Court decision on Maine Rx. Other than that, the quarter was particularly marked by (1) favorable first quarter results combined with the absence of any negative forward earnings guidance, (2) sudden and positive traction in the government's push for a Medicare prescription drug benefit, and (3) continued positive trends from several new product launches (LLY's Straterra, SGP/MRK's Zetia, BMY's Abilify). The most notable events for each company were as follows:

- **BMY** delivered a relatively "clean" quarter for the first time in over a year, and provided enough clarity to increase our confidence that the company may be able to achieve its full year 2003 guidance, although we still believe that this is not without risks. More importantly for BMY during the quarter is that Abilify's launch has thus far been very impressive and Erbutux phase III clinical results were sufficiently strong to refile with the FDA.

- **LLY** beat 1Q earnings on stronger than expected quality, completed FDA inspection of the Indianapolis manufacturing facilities (outcome pending), and reiterated projection of Cialis and Cymbalta approvals in 4Q/03. On the downside, Zyprexa continued to lose share in the face of an impressive launch by BMY's Abilify, and controversy about its metabolic side-effects continued. In contrast, Straterra continued to enjoy an impressive launch.

- **PFE** concluded its acquisition of PHA and substantially calmed investor skepticism about dilution risk by reiterating previous earnings guidance at its analyst meeting (for 2004), where the company also raised its estimates of cost synergies (from the PHA acquisition) by $800 million in 2004 and by $1.5 billion in 2005.

- **MRK** delivered a much better than expected first quarter, thereby increasing confidence in its near-term earnings outlook. MRK also announced the much-anticipated spin-off of Medco (expected to be completed in 3Q). Zetia continued to enjoy an impressive launch.

- **SGP** modestly beat the substantially lowered first quarter EPS expectations but provided no clarity on the future earnings outlook or on the controversy of bloated trade inventories. Separately, its two main franchises (i.e., allergy and hepatitis-C) continued to erode in the face of competition. On the positive side, Zetia continued to enjoy an impressive launch, but after the close of the second quarter, management meaningfully guided down EPS estimates again for 2003.

- **WYE** delivered a better than expected quarter, thereby re-establishing confidence in its previously provided EPS guidance for 2003 (on January 28). Negative news for its HRT franchise continued but with a modest impact to the stock. On the positive side, the company continued to execute on the supply debottlenecking for Enbrel and Prevnar, and Protonix and Effexor continued their growth trajectory.

Figure 1: Drug Stocks Performance Relative to the S&P 500 (Indexed from 12/31/02)

Source: FactSet. Note: Data through 6/30/03.
Note: Drug Stocks is a market-cap-weighted index that includes Wyeth (WYE), Bristol-Myers Squibb (BMY), Johnson & Johnson (JNJ), Eli Lilly (LLY), Merck & Co. (MRK), Pfizer (PFE), Pharmacia (PHA), and Schering-Plough (SGP).

Drug Sector Earnings—Acceleration Should Be Around the Corner

Our sector earnings projections call for modest acceleration to 6% EPS growth in 2003 (from 4% in 2002), which has been lowered from our previous estimate of 8% growth owing mostly to a reduction in PFE's 2003 estimates, which are for issues that are mostly transient (i.e., inventory and accounting harmonization specific to PHA). That said, a look at the progression of our quarterly earnings estimates in 2003 implies robust earnings acceleration in the second half of 2003.

Table 9: Quarterly EPS Growth By Company

	2002 YoY Earnings Growth				2003 YoY Earnings Growth			
	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03E	3Q03E	4Q03E
WYE	18%	25%	-28%	5%	-17%	17%	36%	20%
BMY	-3%	-30%	-29%	-15%	-29%	26%	10%	42%
JNJ	17%	17%	20%	22%	16%	15%	15%	19%
LLY	-22%	-20%	2%	13%	6%	1%	0%	3%
MRK exMedco	-1%	-3%	-4%	2%	1%	7%	5%	12%
MRK	0%	-1%	-1%	3%	7%	7%	7%	7%
PFE	17%	11%	15%	37%	17%	-9%	15%	19%
SGP	6%	0%	-29%	-19%	-71%	-71%	-51%	-60%
Industry exMedco	6%	1%	-2%	13%	-1%	-2%	12%	17%
S&P	-8%	6%	14%	15%	9%	4%	6%	13%
Quarterly REM	**-14%**	**-20%**	**-11%**	**+14%**	**-8%**	**+4%**	**+12%**	**-1%**

Source: Company reports, FactSet, and JPMorgan estimates.

Notably, looking ahead at 2004 and 2005, we expect more robust earnings acceleration to 14% growth (see Table 10), and we expect most companies in the sector (BMY and JNJ are the exceptions) to enjoy earnings acceleration in 2004 (although the degree of acceleration varies rather significantly—see Figure 10). Beginning in 2006, another flurry of patent expirations could drag sector earnings growth in 2006 and 2007 back into the single digits.

Table 10: Sources of EPS Growth—Contribution Analysis

(%)	1975-1985	1985-1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003E	2004E-2005E	2006E-2007E
Sales	10%	11%	8%	4%	6%	12%	11%	9%	10%	12%	9%	6%	6%	7%	8%	6%
COGS	3	9	3	1	2	2	4	5	6	4	5	1	(3)	(2)	1	0
SG&A	(1)	(2)	0	3	4	(2)	0	(0)	(2)	(0)	2	6	1	3	3	0
R&D	(2)	(2)	(3)	(2)	0	(1)	(1)	(2)	0	0	(1)	(2)	-1	0	1	0
Operating Income	10	16	8	6	12	11	14	12	14	16	15	11	3	8	13	6
Non-operating Inc.	0	(1)	(1)	0	(1)	(1)	2	3	3	(1)	1	(1)	0	(1)	1	2
Pretax Income	10	15	7	6	11	10	16	15	17	15	16	10	3	7	14	8
Taxes	1	3	0	1	(3)	1	0	2	(1)	0	1	1	0	0	0	0
Net Income	11	18	7	7	8	11	16	17	16	15	17	11	3	7	14	8
Share Repurchase	(1)	(1)	1	0	2	2	0	(1)	0	1	0	1	1	(1)	0	0
EPS	10%	17%	8%	7%	10%	13%	16%	16%	16%	16%	17%	11%	4%	6%	14%	8%

Margin Analysis	1975	1985	1990	1995	1997	1999	2000	2001	2002	2003E	2004E-2005E	2006E–2007E
Gross Margin %	56.1%	60.7%	68.6%	72.0%	73.3%	76.5%	77.6%	77.9%	76.9%	76.4%	77.0%	77.2%
SG&A % of Sales	33.4	35.6	37.5	36.7	36.1	35.9	35.3	33.4	32.8	32.2	30.8	30.5
R&D % of Sales	4.7	7.6	9.3	10.7	12.1	13.1	13.2	13.8	14.0	13.7	13.2	13.1
Operating Margin	18.0	17.5	21.9	24.7	25.1	27.5	29.1	30.7	30.1	30.5	33.0	33.6

Source: Company reports, FactSet, and JPMorgan estimates.

Note: Composite P&L includes BMY (normalized for inventory adjustments), JNJ, LLY, MRK (ex-Medco), PFE, SGP and WYE.

Table 11: Annual EPS Growth By Company

	2000	2001	2002	2003E	2004E	2005E
BMY	13%	-5%	-29%	21%	6%	6%
JNJ	18%	18%	19%	16%	13%	11%
LLY	16%	4%	-8%	2%	21%	21%
MRK exMedco	17%	8%	-2%	7%	8%	14%
MRK	18%	8%	0%	7%	8%	14%
PFE	24%	25%	21%	12%	21%	16%
SGP	16%	-4%	-10%	-65%	30%	46%
WYE	18%	15%	2%	12%	14%	13%
Industry exMedco	18%	12%	4%	6%	17%	14%
S&P	8%	-18%	6%	8%	9%	NA

Source: Company reports, FactSet, and JPMorgan estimates.

Patent Expirations—Pressure Should Subside Till 2006

The negative impact from patent expirations has considerably eased in 2003 (from a -9% drag in 2002 to an expected -4% in 2003) and is expected to ease further in 2004 and 2005 before another downward spike in 2006. We believe this near-term easing of the generics drag is the most significant contributor to earnings acceleration over the next couple of years—see Table 12).

Table 12: Generics Squeeze (2001-2007E)

($ in millions)

	Annual Loss in Net Profits From Drugs Going Generic						
Product (Company)	**2001**	**2002**	**2003E**	**2004E**	**2005E**	**2006E**	**2007E**
Prozac (LLY)	(418)	(754)	(72)	(29)	(54)	(31)	(18)
Taxol (BMY)	(249)	(142)	(43)	(75)	(64)	(58)	(50)
BuSpar (BMY)	(208)	(135)	(7)	(11)	(3)	(3)	0
Vasotec (MRK)	(256)	(94)	(53)	(57)	(53)	(48)	(45)
Pepcid (MRK)	(239)	(130)	(18)	(4)	(4)	(1)	(1)
Prinivil (MRK)		(127)	(214)	(32)	(8)	(3)	(3)
Mevacor (MRK)		(92)	(30)	(10)	(8)	(3)	(3)
Prilosec (MRK)		(502)	(88)	(101)	(86)	(9)	(5)
Glucophage (BMY)		(898)	(58)	(35)	(14)	(8)	(3)
Axid (LLY)		(101)	(19)	(9)	(3)	(3)	(3)
Claritin (SGP)		(252)	(792)	(27)	(6)	(6)	(6)
Monopril (BMY)			(17)	(86)	(36)	(25)	(19)
Accupril (PFE)			(85)	(123)	0	(14)	(14)
Neurontin (PFE)				(866)	(261)	(95)	(72)
Serzone (BMY)				(28)	(6)	(3)	0
Glucophage XR (BMY)				(95)	(22)	(11)	(7)
Glucovance (BMY)				(112)	(23)	(11)	(7)
Diflucan (PFE)				(118)	(250)	(80)	(40)
Premarin (WYE)					(124)	(186)	(65)
Paraplatin (BMY)					(132)	(96)	(62)
Rebetol (SGP)					(32)	(14)	(7)
Pravachol (BMY)						(433)	(289)
Zocor (MRK)						(918)	(1,075)
Zithromax (PFE)						(456)	(327)
Zoloft (PFE)						(691)	(525)
Actos (LLY)						(61)	(112)
Ellence (PFE)						(31)	(105)
Norvasc (PFE)						(195)	(379)
Prevnar (WYE)						(29)	(87)
Total est. drain in net profits	(1,396)	(3,242)	(1,505)	(1,820)	(1,192)	(3,612)	(3,406)
% of U.S. drug sector profits	-4%	-9%	-4%	-4%	-2%	-6%	-6%

Source: Company reports and JPMorgan estimates.

Note: Change to net profit contribution is calculated for each product by applying an estimated after-tax contribution % to the year-over-year fall in sales. Excludes products with <$50MM in bottom-line impact. Companies included in the definition of U.S. drug sector are WYE, BMY, LLY, JNJ, MRK (ex-Medco), PFE, and SGP.

In our view, the P&L dynamic for the industry in 2003 is for improvement of top-line growth (from +6% in 2002 to +7% in 2003) owing to a benefit from favorable FX trends, the ease of the generics squeeze (discussed above), and helped by several new drugs launches (see Table 13), but offset partly by the PHA related inventory corrections, WYE's Premarin-family declines, and SGP's Claritin collapse. Unit volume growth at 3% is expected to be slightly lower than prior-year levels, gross margins are expected to erode slightly in 2003 (a function of unfavorable FX impact and increased spending owing to heightened FDA scrutiny on manufacturing, partly offset by favorable mix), and SG&A is likely to grow slower than sales, thereby providing some EPS leverage (see Table 10). This earnings picture could deteriorate, especially if health care cost containment efforts (public or private sector) meaningfully take hold, but actual evidence signaling such a shift is still lacking today, in our view.

A unit volume growth issue, which has received great investor focus but to us is not yet cause for alarm, is weak U.S. prescription growth as implied by the IMS monthly prescription data (the most important gauge of unit volume demand trends). After finishing 2002 at 4% growth, volume growth has been an anemic +1.2% YTD thru May—however, after eliminating the impact due to unusual declines in allergy (the Claritin OTC switch) and HRT (the Premarin controversy) implied growth has been about +3.1%. Although it is possible that reimbursement changes or other secular factors (arguably even the economic slowdown) are

conspiring against growth, we believe it is equally plausible that the first two to three months were affected by transient issues such as the tough winter weather in the Northeast), a light "flu" season, or simply monthly noise. Encouragingly, volume trends have shown a leg-up in May, and for now, we still anticipate 3% unit volume growth for the year.

Contribution to growth identifies the percentage-point contribution of each P&L line item to EPS growth.

Table 13: Sources of Revenue Growth—Contribution Analysis (%)

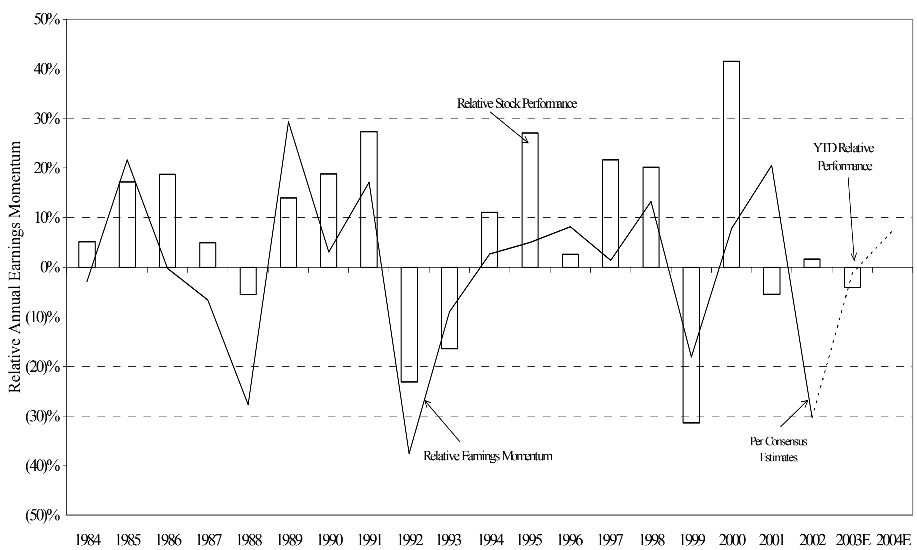
	1985-1992	1993	1994	1995	1996	1997	1998	1999	2000	2001E	2002E	2003E	2004E-2005E	2006E-2007E
Volume	2%	2%	3%	4%	5%	6%	6%	7%	6%	6%	5%	3%	4%	4%
Price	7	1	1	3	3	3	3	3	3	2	2	1	1	2
Mix	2	3	2	3	5	4	4	4	3	0	(2)	0	2	0
Underlying Growth	**11%**	**6%**	**6%**	**10%**	**13%**	**13%**	**13%**	**14%**	**12%**	**8%**	**5%**	**4%**	**7%**	**6%**
Foreign Exchange	0	(2)	0	2	(2)	(4)	(3)	(2)	(3)	(2)	1	3	1	0
Total Revenue Growth	**11%**	**4%**	**6%**	**12%**	**11%**	**9%**	**10%**	**12%**	**9%**	**6%**	**6%**	**7%**	**8%**	**6%**

Source: Company reports, IMPS America, Bureau of Labor Statistics, *Redbook*, and JPMorgan estimates.

Relative Earnings Momentum—Poised for a Positive Inflection

Relative earnings momentum (REM), which has been negative for the drug sector since the beginning of 2002, is expected to turn positive in the second quarter and remain strongly positive in 2004. Historically, REM has been a powerful determinant of relative stock performance, especially when positive. Since 1984, positive relative earnings momentum for the drug sector has occurred 11 times—and drug stocks have outperformed the S&P 500 in every one of those years except in 2001 (see Figure 2 and Table 14).

Figure 2: Pharmaceutical Industry Relative Annual Earnings Momentum vs. Relative Annual Stock Performance



Source: FactSet and JPMorgan estimates.

JPMorgan

Table 14: Pharmaceutical Industry Relative Annual Earnings Momentum and Stock Performance

(%)

	EPS Growth			Stock Performance*		
	Drug Ind.	S&P 500 (Cons.)	Relative EPS Momentum	Drug Index	S&P 500	Relative
1984	6%	8%	(3)%	7%	1%	5%
1985	15	(5)	22	44	26	17
1986	16	(4)	(0)	33	15	19
1987	26	13	(7)	7	2	5
1988	22	37	(28)	7	12	(6)
1989	12	(3)	29	41	27	14
1990	14	(4)	3	12	(7)	19
1991	20	(15)	17	54	26	27
1992	8	11	(38)	(19)	4	(23)
1993	8	19	(9)	(9)	7	(16)
1994	11	20	3	10	(2)	11
1995	13	17	5	61	34	27
1996	16	12	8	23	20	3
1997	16	10	1	53	31	22
1998	16	(2)	13	47	27	20
1999	16	15	(18)	(12)	20	(31)
2000	17	8	8	31	(10)	42
2001	11	(18)	21	(18)	(13)	(5)
2002	4	6	(31)	(22)	(23)	2
2003E	6	8	0	7	11	(4)
2004E	14	9	7			

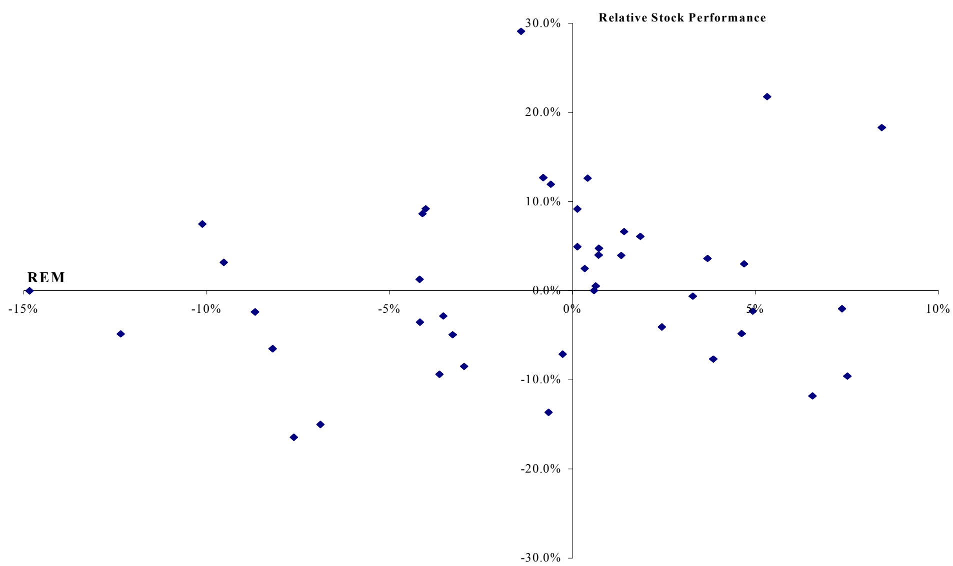
Source: FactSet, First Call, and JPMorgan estimates.

* 2003 performance is YTD as of 6/30/03.

Until recently, REM for 2003 was projected to be negative for the drug sector, as consensus projected stronger acceleration for S&P500 EPS growth than we did for the drug group. However, we think the outlook from here has improved as (1) consensus 2003 S&P 500 estimates have slipped (from projecting 10% 2003 S&P500 growth last quarter, to 8% now), and (2) we're past the first quarter reporting cycle, which we expect to be the weakest REM quarter of 2003 (see Table 9). As a result, our REM forecast has improved to positive for the remainder of the year (see Table 9), neutral for full year 2003, and sharply positive for 2004 (see Table 14).

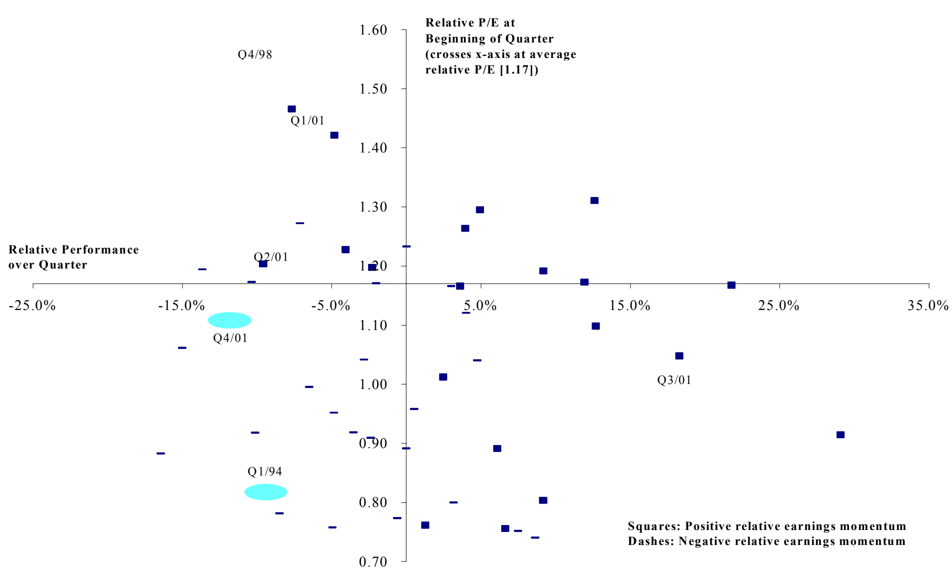
Admittedly, the predictive power of REM in determining relative stock performance is a lot less clear when analyzed at quarterly intervals than it is when viewed on an annual basis (see Figure 3**).** Since 1992, positive *quarterly* relative earnings momentum has coincided with *quarterly* drug stock outperformance 61% of the time. **However, when positive quarterly REM occurs in the context of below historical average valuations (like we expect right now) we believe the predictive power (even at quarterly intervals) is powerful (see** Figure 4**).** In the past 11+ years there have been 12 quarters where drug stocks started the quarter trading below their historical average P/E and enjoyed positive relative earnings momentum. Drug stocks outperformed in 10 of the 12 (all but 1Q94 and 4Q01).

Figure 3: Quarterly Drug Stock Performance as a Function of Quarterly REM



Source: FactSet.

Figure 4: Quarterly Drug Stock Performance as a Function of Valuation and REM



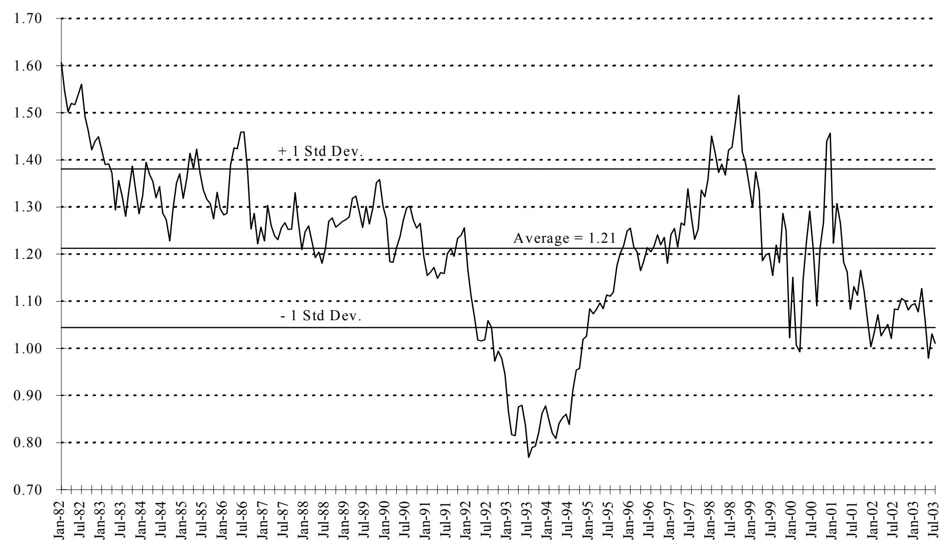
Source: FactSet.

Valuations – Solid Downside Support, Relative Expansion Likely

On the cautious side, we do believe that several factors argue for future relative valuations for the drug sector to be lower (on average) than *historical* levels: (1) we anticipate slightly lower growth than during the go-go periods of the recent past (we peg the long-term growth rate at about 11-12%); (2) we expect the pattern of that growth to be more volatile for the industry overall (primarily due to large earnings holes left by patent expirations); and (3) we anticipate more disparate growth among the individual companies within the sector. **Nevertheless, we believe current valuations provide solid downside protection and leave plenty of headroom for expansion, especially in an environment of accelerating EPS growth *and* positive REM.** Drug stock relative valuations have eased over the last quarter from an already modest 11% premium to the S&P to just a 1% premium owing to significant S&P500 valuation expansion (rising prices on modestly lowered EPS). Current valuations are well below the 21% average premium to the S&P500 over the last 20 years, and imply a long-term growth rate for drug sector of just 8% or so.

Figure 5: 1982-Present; Drug Stocks Relative P/E vs. S&P 500

(one-year forward EPS estimates)



Source: FactSet, FirstCall, and I/B/E/S. Data through 7/10/03.

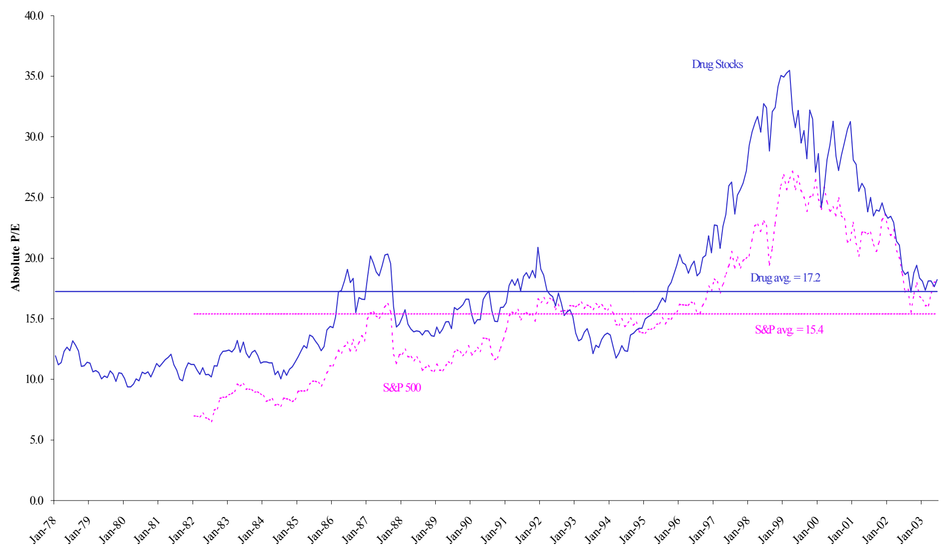
Note: Drug Stocks is a market-cap-weighted index that includes WYE, BMY, JNJ, LLY, MRK, PFE, and SGP. S&P 500 earnings estimates used in the calculation are on an operating basis as per FirstCall.

In addition, we believe drug stocks also enjoy valuation support on a variety of other levels—on an absolute P/E basis, relative to the S&P 500 based on trailing earnings, relative to competing equity sectors (specifically consumer growth), and relative to interest rates.

Absolute P/Es for Drug Stocks Are Attractive, in Our View

Drug stocks are trading at an absolute P/E of about 18.6 times their forward year estimated earnings, modestly higher than their 25-year historical average of 17.2 times (see Figure 6). Given the anticipated acceleration in sector earnings growth, we see the risk to absolute P/E contraction as low.

Figure 6: 1978-Present; Absolute P/Es—Drug Stocks & S&P 500

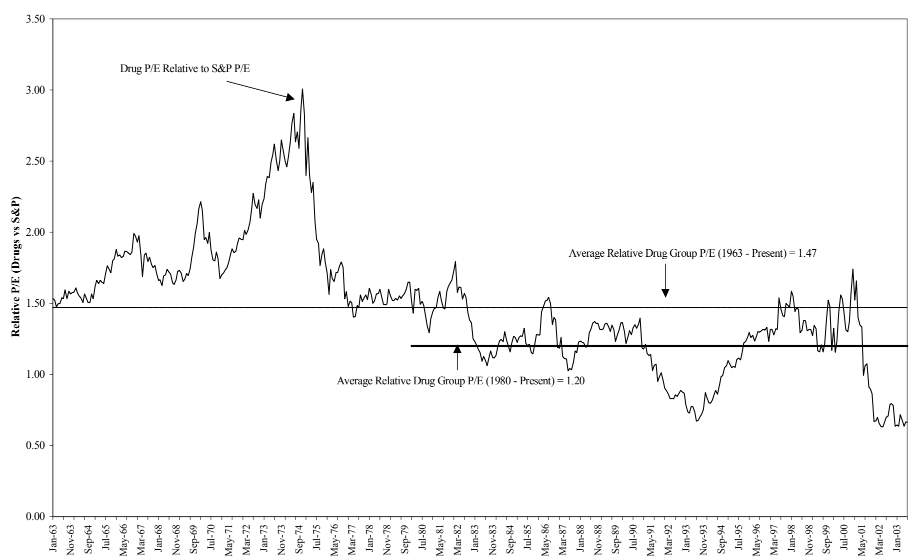


Source: FactSet and I/B/E/S. Data through 7/10/03.

Relative P/Es Based on Trailing Earnings Are at Their Historical Lows

A historical observation of relative valuation offers little conclusive evidence for a normalized relative P/E for the drug group (see Figure 7). In our admittedly qualitative view, the extreme peak of the "nifty fifty" (early 1970s) and the trough of the "Clinton health reform fears" (1992-1994) are anomalies. In light of these exceptions, relative valuation on this metric (i.e., trailing earnings) for the sector is at its historical low.

Figure 7: 1963 to Present—Drug Stocks' Relative P/E vs. S&P 500 (Trailing Earnings)



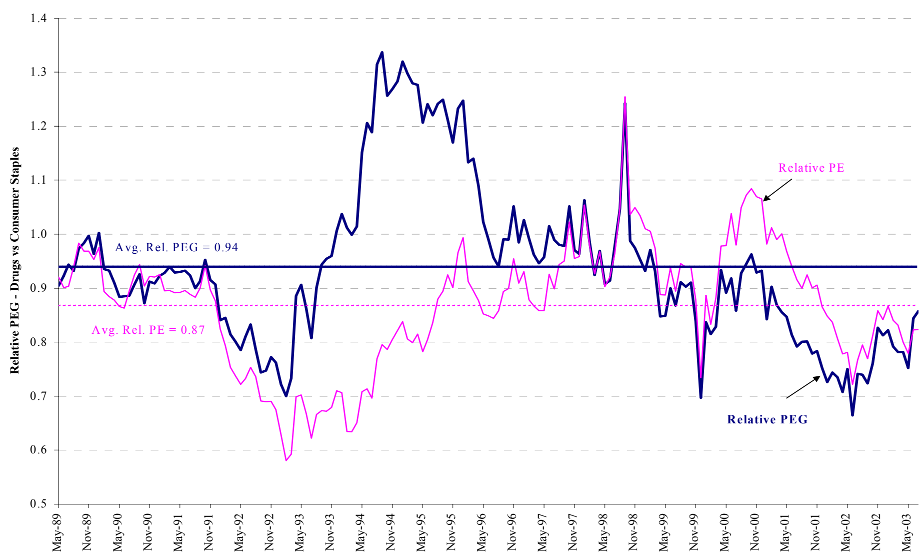
Source: FactSet. Data through 6/30/03.
Note: Drug Stocks is a market-cap-weighted index that includes WYE, BMY, JNJ, LLY, MRK, PFE, PHA, and SGP.

Drugs Stocks Are Also Attractive Relative to Consumer Staples

The relative valuation (i.e., relative P/E) of drugs stocks when compared to other defensive sectors, specifically consumer stocks, is also still below their historical average. In this

analysis, consumer staple stocks are a bundle that includes Coca Cola, Pepsi, Wal-Mart, Gillette, Procter & Gamble, Wrigleys, Colgate-Palmolive, and McDonalds. When adjusted for long-term growth (i.e., PEG), the relative valuation of drug stocks (vs. consumer staples) is also below their historical averages as shown in Figure 8. Traditionally, these sectors have traded at very similar valuations, given their defensive appeal (see Figure 9). Although the long-term growth outlook for the drug sector (admittedly a blunt and sluggish indicator) has been falling, it is still above that for consumer staples (see Figure 10); yet their valuation is lower (see Figure 9). In our view, an unlikely worst case scenario for the long-term outlook for the drug sector would be a sustained erosion in the quality and magnitude of EPS growth to levels generally attributed to consumer staples (i.e., low double-digit EPS on mid single-digit sales growth). Consequently, even under this scenario, valuations for the sector should be at least on par with those for consumer staples.

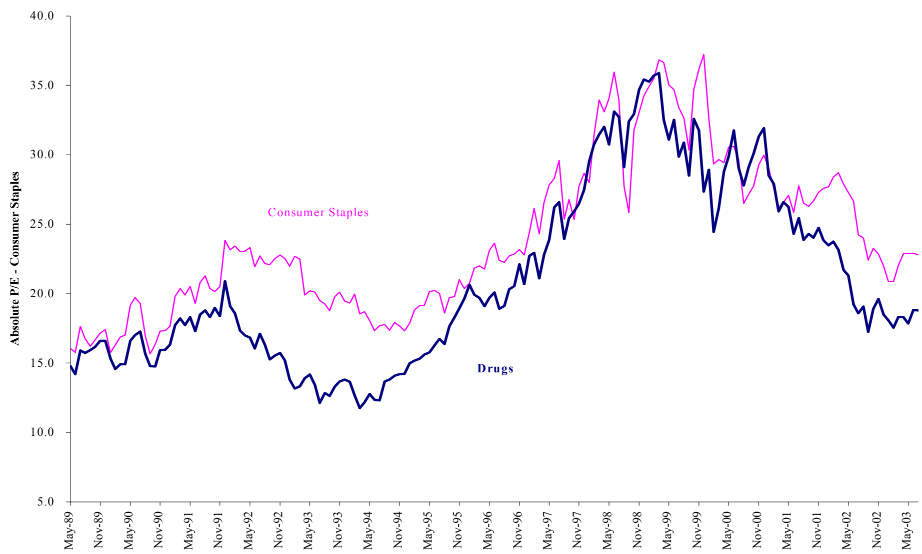
Figure 8: Relative P/E and Relative PEG Ratio—Drugs versus Consumer Staples



Source: FactSet. Data through 7/1/03.

Note: Consumer Staples portfolio includes KO, PEP, WMT, G, PG, WWY, CL, and MCD.

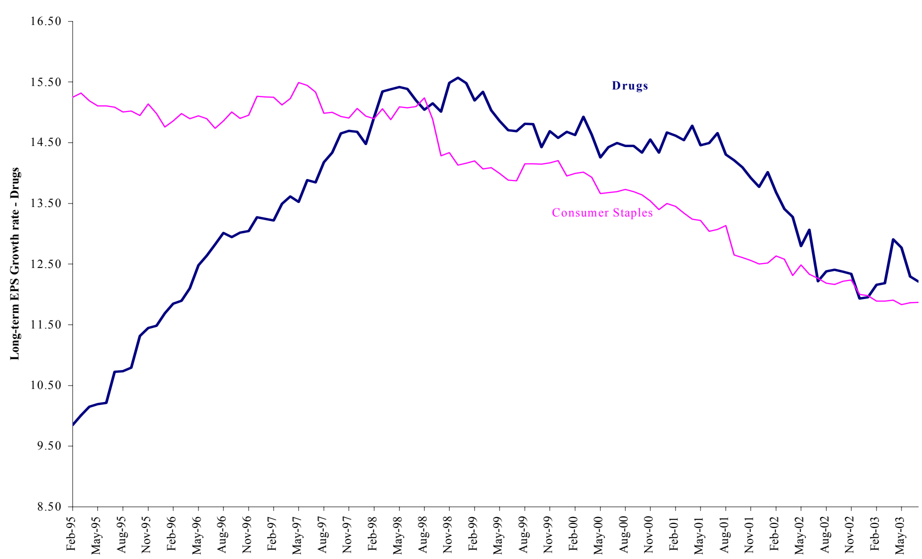
Figure 9: Absolute P/E—Drug Stocks and Consumer Staple Stocks



Source: FactSet. Data through 7/1/03.

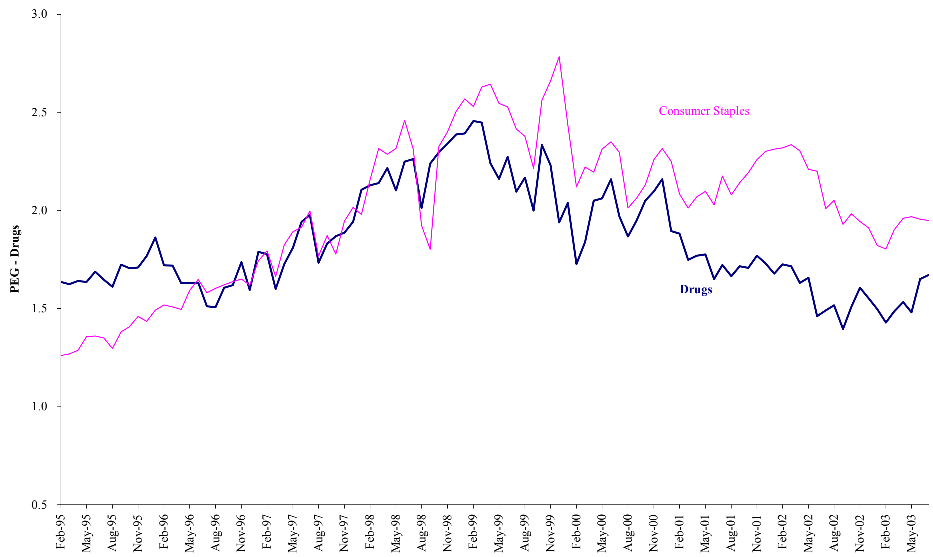
Note: Consumer Staples portfolio includes KO, PEP, WMT, G, PG, WWY, CL, and MCD.

Figure 10: Long-term EPS Growth Rate—Drug Stocks and Consumer Staple Stocks



Source: FactSet. Note: Data through 7/1/03.
Consumer Staples portfolio includes KO, PEP, WMT, G, PG, WWY, CL, and MCD.

Figure 11: P/E to Growth Ratio (PEG)—Drugs and Consumer Staples



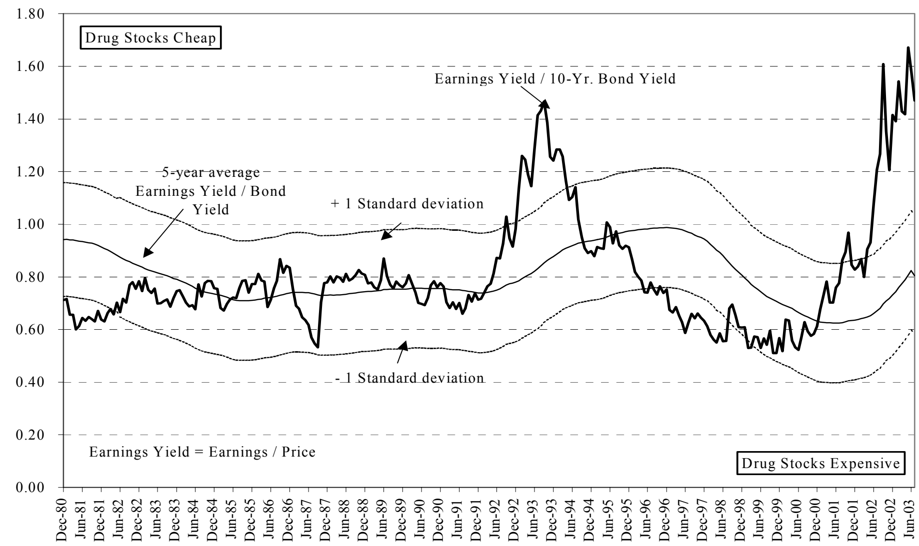
Source: FactSet. Note: Data through 7/1/03.
Consumer Staples portfolio includes KO, PEP, WMT, G, PG, WWY, CL, and MCD.

Drug Stocks Appear Inexpensive Relative to Interest Rates as Well
We do not see any interest rate risk for drug stock valuations for the foreseeable future. First, **relative to interest rates, drug stocks are less expensive today than they have been during the past 20 years** (see Figure 12**)**. The only time in the past 20 years that drug stocks have been similarly inexpensive along this metric was during 1992-1994 (the loss of pricing power and the emergence of the managed care threat—an outlook that at the time was much worse than what the industry faces today). Second, given the still benign inflation data and continued weakness in the economy, interest rates are, in general, expected to remain flat-down at least for the remainder of this year (JPMorgan's economists are projecting no rate increases at least until the first quarter of 2004).

As such, periods of rate tightening have historically been associated with valuation pressure for high P/E stocks like drug stocks (see Figure 13). This time, however, the exposure for drug stock valuations (from any upward skew for interest rates, which still appears to be several quarters away) should, in our view, be particularly benign because drug stocks today are not the high P/E stocks that they historically have been, and we therefore see no higher interest rate risk for the sector than what exists for the market.

Based on history (a five-year trailing average), drug stock valuations are currently "cheap," versus interest rates (i.e., bond yields). Valuations should therefore be less sensitive to rate hikes than earlier.

Figure 12: Ratio of Drug Index Earnings Yield to 10-Year Treasury Bond Yield



Source: FactSet, Datastream, and JPMorgan. Note: Data through 7/10/03.

Figure 13: Drug Group Earnings Yield and 10-Year Treasury Bond Yield

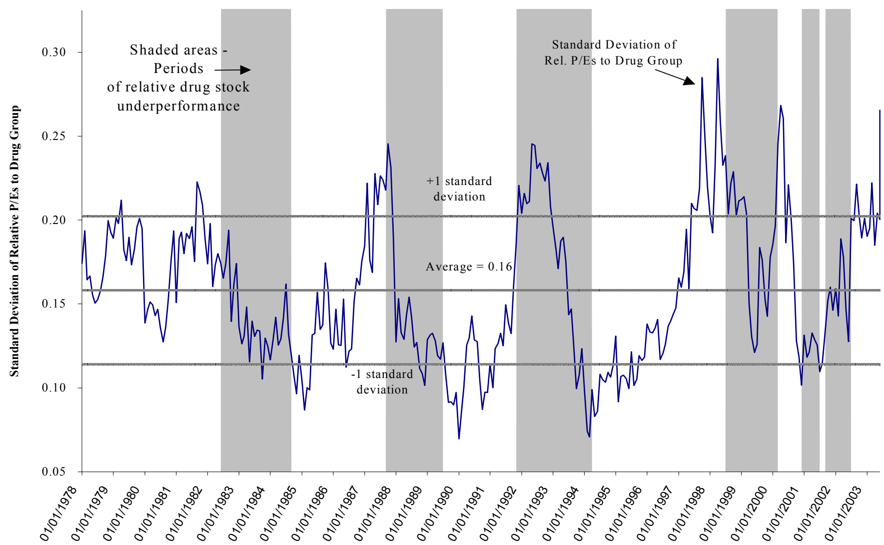
Source: FactSet and Datastream. Note: Data through 7/10/03.

Disparate Performance Should Drive More Disparate Valuation

More than ever, we expect stock selection within the group to be a key to investing. The drug industry is riskier today, and we believe there will be ever increasing separation of the winners and losers, rendering the assumption that today's weak players will regress upward to the mean as potentially flawed. In our view, reduced pricing flexibility, shorter product life cycles, intensified head-to-head competition, a tougher FDA, and more intense competition for in-licensing candidates all suggest growth is meaningfully more dependent on actual R&D productivity and pharmaceutical business savvy (strategy and execution).

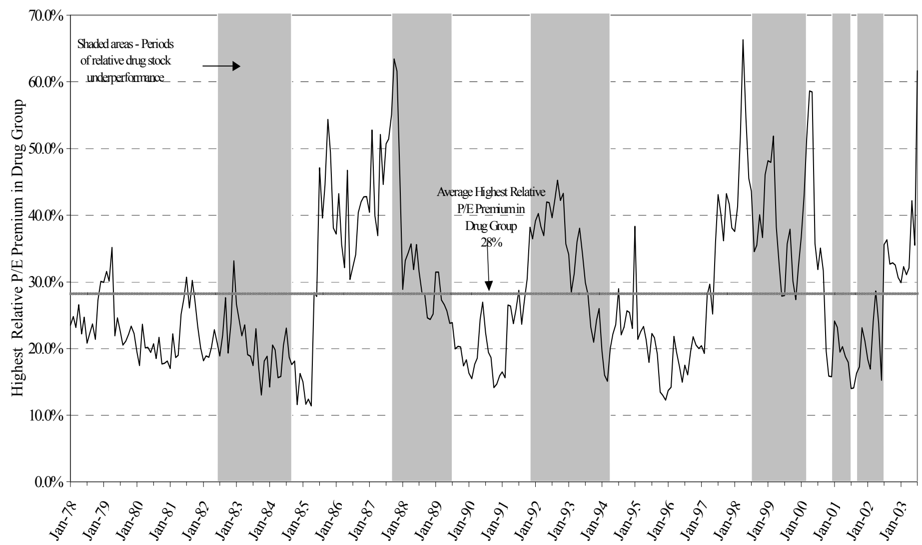
One statistical metric we employ (and have published regularly before) to assist in stock selection is the standard deviation of valuations within the group—that is, are the stocks trading within a wide or narrow band (see Figure 14). However, at this moment, we believe the statistics do not portray an accurate picture (given the small number of data points this is not a robust metric, although still often enlightening). At first glance, the valuation spread among drug stocks appears wide, close to historically peak levels. However, this "spread" is meaningfully asymmetric and is almost entirely due to the currently lofty P/E multiples enjoyed by SGP (26.6x) and LLY (21.3x) as demonstrated by Figure 15, which tracks the relative premium over time for the most expensive drug stock. In contrast, there is very little valuation difference (on our 2004E EPS) among WYE, PFE, MRK, and BMY, despite their distinctly different earnings outlooks and risk profiles (WYE – 16.8x, PFE – 16.0x, MRK – 16.7x, and BMY – 15.9x). WYE (our favorite) and PFE are both rated Overweight. We believe WYE offers impressive, low risk EPS acceleration owing to multiple growth drivers, which should easily overpower the predictable drag from Premarin. We think PFE possesses strong current products, an impressive (and underappreciated) pipeline, and the financial flexibility to "buy " growth if necessary with valuation that renders the "quality" argument moot. BMY (Underweight) has had a nice run on Abilify's launch and positive Erbitux developments but seems expensive given the meager growth outlook and downside risk to future EPS expectations. MRK (Neutral), though unlikely to disappoint this year, seems appropriately valued for the modest growth outlook and the looming (2006) patent expiration for Zocor. LLY (Neutral) and SGP (Neutral) are our "hockey stick" forecasts, which carry particularly high valuations (LLY – 21.3x, SGP – 26.6x 2004E EPS) as some investors seem willing to look past near term problems and pay for potential future growth today. To us, however, although each should return to robust growth by late 2004, lofty valuations with plenty of risk relating to the timing of the upturn, and the base off which that growth occurs, may cap upside for now.

Figure 14: Std. Dev. of Relative Individual Drug Stock P/E Premiums to Drug Group



Source: FactSet. Note: Data through 7/10/03.

Figure 15: Highest Individual Drug Stock P/E Premium to Drug Group



Source: FactSet. Note: Data through 7/10/03.

Looking forward, we believe the valuation spread within the group *should* get wider, mainly because the earnings outlook for individual stocks within the group is expected to be substantially more disparate than it has been in the past as the harsher industry environment drives wider and longer separation between the industry's winners and losers. This earnings disparity trend is already in place (see Figure 16), albeit somewhat exaggerated of late owing to the wider EPS trajectory swings from patent expirations.

Figure 16: Standard Deviation of Earnings Within Drug Sector

Source: FactSet and JPMorgan estimates.

Consequently, the importance of having an accurate sector outlook (historically over 60% of the investment decision—see Table 7**)** ***should*** **diminish over time.**

Table 15: r^2 (Coefficient of Determination) of Quarterly Stock Performance Among Drug Stocks

(1985-2002)

r^2	DRUGS	WYE	BMY	LLY	JNJ	MRK	PFE	SGP
DRUGS	1.00							
WYE	0.51	1.00						
BMY	0.65	0.27	1.00					
LLY	0.66	0.22	0.40	1.00				
JNJ	0.66	0.24	0.34	0.39	1.00			
MRK	0.77	0.33	0.48	0.43	0.45	1.00		
PFE	0.70	0.41	0.39	0.42	0.41	0.39	1.00	
SGP	0.66	0.29	0.48	0.46	0.37	0.46	0.45	1.00
simple average	0.66							

Source: FactSet. Note: Data through 2Q03.

Drug stock valuations expanded by about 3% during the second quarter (to 18.6 times forward 12-month estimated earnings), but valuations for the market (i.e., the S&P 500) expanded even more (+12%) to 18.0 times forward year estimated earnings (see Table 16).

Table 16: Drug Stock Valuations

	One-Year Forward P/E					Percent Change			
	Jun-02	**Sep-02**	**Dec-02**	**Mar-03**	**Jun-03**	**Jul-Sep**	**Oct-Dec**	**Jan-Mar**	**Apr-Jun**
Bristol-Myers Squibb (BMY)	16.8	15.9	14.5	13.0	16.6	-5%	-9%	-10%	27%
Eli Lilly (LLY)	20.3	20.2	24.0	21.8	25.2	0%	19%	-9%	15%
Merck (MRK)	15.7	13.9	16.8	15.9	17.1	-12%	21%	-5%	8%
Pfizer (PFE)	20.7	16.5	16.8	16.9	18.1	-20%	2%	1%	7%
Pharmacia (PHA)	18.8	22.8	23.7	23.7	0.0	21%	4%	0%	-100%
Schering-Plough (SGP)	15.3	14.3	20.4	22.5	25.1	-7%	43%	10%	12%
Wyeth (WYE)	18.6	12.9	15.4	15.1	17.6	-30%	19%	-1%	16%
Johnson & Johnson (JNJ)	21.9	21.7	20.7	21.6	18.7	-1%	-5%	4%	-13%
Drug Stocks	19.0	17.2	18.3	18.1	18.6	-10%	7%	-1%	3%
S&P 500	18.7	15.5	16.8	16.1	18.0	-17%	8%	-4%	12%

Source: FactSet, First Call, I/B/E/S, and JPMorgan estimates.
Note: Drug Stocks is a market-cap-weighted index that includes WYE, BMY, JNJ, LLY, MRK, PFE, PHA, and SGP. All P/Es are based on I/B/E/S consensus estimates.

Foreign Exchange—The Biggest Top-Line Boost in a Decade

The U.S. dollar weakened another 3% in the second quarter against a pharmaceutical basket of currencies. This was the third consecutive devaluation quarter for the USD (it fell 2% in the first quarter and 4% during the fourth quarter 2002 —see Figure 17). **On a year-over-year basis, this is expected to provide an estimated 6% boost to reported revenue growth in 2Q03, which marks this quarter as the most favorable (from a FX comparison perspective) in the past decade** (see Figure 18).

The boost to reported top-line growth should be the most evident (improving the *appearance* of quality), while the impact to the sector's bottom line should be more muted owing to the natural offset from a significant cost base outside the United States (i.e., manufacturing, R&D, and SG&A) and the use of hedging strategies. That said, hedging strategies are more likely to allow the benefits from favorable FX swings (i.e. the USD's devaluation) to flow through to the bottom line, while protecting against the exposure from unfavorable FX swings. In addition, hedging strategies often "lock in" FX for just 12 months or so. Therefore, if the current exchange rates remain, the benefits of the weakening dollar should help earnings next year.

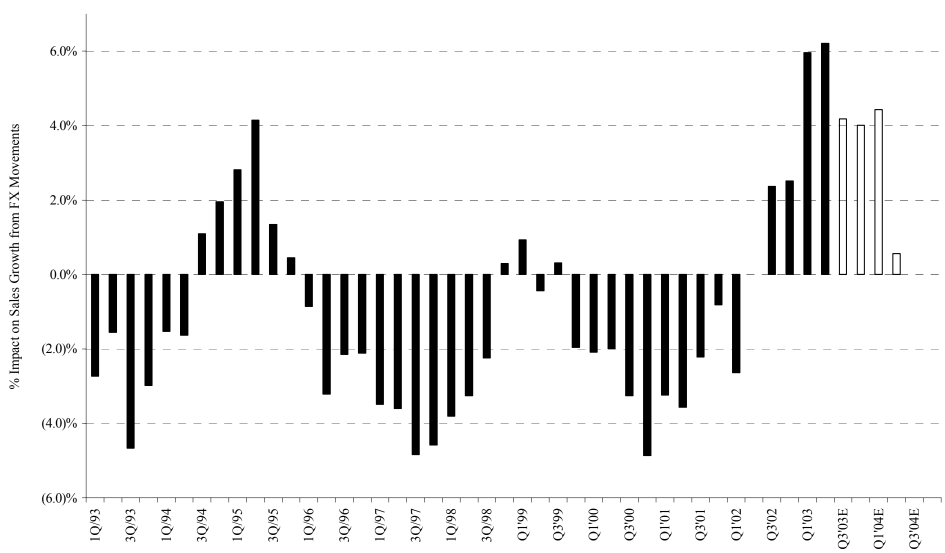
If FX remains steady from here on, we expect the FX related boost to sales to continue over the next 3-4 quarters, albeit at a slightly reduced rate of about +4% (see Figure 18).

U.S. dollar's fluctuation is nothing new for the drug sector, and generally is well managed, owing to natural cost hedges and currency hedging programs.

Figure 17: Foreign Exchange/US$ Daily Index (U.S. Drug Industry Market Basket)

Source: FactSet and JPMorgan estimates. Note: Data through 6/30/03.

Figure 18: Foreign Exchange Impact on U.S. Drug Companies' Quarterly Sales Growth



Source: FactSet and JPMorgan estimates. Note: Assumes FX rates remain constant beyond 6/30/03.

'Tis the Season for M&A (post EPS pain), But Too Speculative to Drive Investment

Historically, the catalyst for major M&A among drug companies has primarily been fear and pain relative to earnings—this is the environment we have been in. The high fragmentation and highly duplicative cost structures (administration, sales, and R&D, especially R) render the *financial* logic of these deals compelling, in our view. The ability to cut (on average) 26% of the cost base of the acquired company (range is 5-12% of combined costs) is well established (see Table 17), generally boosting the value of the acquired company's earnings flow by 40-50% or more over the three-year period of the cuts. This, of course, says nothing about the long-term strategic logic of consolidation where the debate rages on, and in our view the potential value goes meaningfully beyond the issue of "is bigger better". Nevertheless, at the very least, the financial logic generally gives a nice ride to shareholders (depending of course on deal structure, and side) and buys management time (after which they may have gotten to a better pipeline or have even greater challenges to growth). M&A speculation, in our view, plays a very big role in establishing what historically appears to be a very dependable valuation floor for drug stocks of a 20-25% discount to the peer group.

Over the last 15 years or so, major mergers have occurred at an *average* rate of about one per year. However, in a two-year window (mid '94 to mid '96) following the last significant EPS swoon for the drug industry (mid '92-mid '94) six major deals were announced (Roche/Syntex, AHP/American Cyanamid, Glaxo/Wellcome, Hoechst/Marion Merrell Dow, Pharmacia/Upjohn, and Novartis/[Ciba/Sandoz]). In our view, the multitude of issues that have to align for such deals to occur renders predicting them for investment purposes a high risk game.

Table 17: Comparative Cost Savings of Pharma Mergers

Acquiror/Target	Annc. Date	Compl. Date	Savings (US$ in MM)	% Combined Sales	% Target Sales	% Combined Expenses	% Target Expenses	Employee Reduction
Completed Mergers								
Pfizer/Pharmacia	Jul-02	Apr-03	2,500	5%	18%	8%	25%	na
Bristol-Myers Squibb/DuPont Pharma	Jun-01	Oct-01	600	3%	38%	4%	41%	70%
Glaxo Wellcome/SmithKline	Jan-00	Dec-00	1,700	6%	13%	9%	17%	na
Pharmacia/Monsanto	Dec-99	Mar-00	600	4%	7%	4%	8%	na
Pfizer/Warner-Lambert	Nov-99	Jun-00	1,600	6%	12%	7%	15%	na
Hoechst/Rhone Poulenc (formed Aventis)	Dec-98	Nov-99	1,200	7%	15%	8%	17%	na
Astra/Zeneca	Dec-98	Apr-99	1,100	7%	15%	9%	20%	13%
Sanofi/Synthelabo	Dec-98	May-99	350	6%	17%	7%	21%	na
Ciba-Geigy/Sandoz (formed Novartis)	Mar-96	Dec-96	1,520	7%	na	8%	na	12%
Pharmacia/Upjohn	Aug-95	Nov-95	500	7%	na	9%	na	12%
Glaxo/Wellcome	Jan-95	May-95	1,250	12%	35%	18%	51%	12%
American Home*/American Cyanamid	Aug-94	Dec-94	650	5%	14%	6%	16%	10%
Roche/Syntex	May-94	Nov-94	825	5%	39%	6%	49%	11%
Hoechst/Marion Merrell Dow	Feb-95	Jul-95	750	9%	25%	11%	30%	18%
Bristol-Myers/Squibb	Jul-89	Oct-89	500	6%	19%	7%	25%	10%
SmithKline/Beecham	Mar-89	Jul-89	400	6%	na	na	na	na
Mean (excluding PFE/PHA)				**6%**	**21%**	**8%**	**26%**	**19%**
Median (excluding PFE/PHA)				**6%**	**16%**	**8%**	**21%**	**12%**
Aborted Transactions								
American Home*/Warner-Lambert	Nov-99	na	1,200	4%	9%	6%	11%	na
American Home*/Monsanto	Jun-98	na	1,250-1,500	5-6%	16-20%	7-8%	23-28%	na
American Home*/SmithKline	Jan-98	na	990	4%	8%	5%	10%	na
Glaxo Wellcome/SmithKline	Jan-98	na	1,815	7%	14%	9%	18%	na

Source: Company reports and JPMorgan research. Note: Expenses = Sales - EBIT. * i.e., Wyeth.

Rx Politics—Finally, A Medicare Drug Benefit (+More)

(For full details on the host of political, legislative, and regulatory issues affecting the industry, please see our Prescription Politics report published on July 1.)

Although the political environment facing the drug industry still includes risk, on a relative basis, we view the current outlook as the most favorable in nearly 10 years. Finally, a Medicare prescription drug benefit (MPDB) appears heading for enactment, and it should be a positive for the drug industry since both the Senate and the House versions of the bill depend on the private sector to deliver the drug benefit and include no provisions (initially) for price controls. For at least the first 3-5 years, we'd expect boosts to volume and mix (i.e., more brand use, less generic) for the previously uninsured elderly to more than offset price and formulary pressures. Although AWP reform and Waxman-Hatch (generic regulation) reform are likely to be piggybacked onto the MPDB, neither appears particularly threatening to the industry. Importation also may be included, and although that represents a real *theoretical* risk, implementation seems unlikely owing to long-standing safety concerns of the FDA. State pressure on Medicaid drug spending and drug prices will likely, however, continue to intensify but, in our view, is unlikely to expand beyond the roughly 15% of the U.S. market it currently represents and thus should be a containable problem. Lastly, McClellan leadership of the FDA has been a positive for the industry thus far, especially in expediting product reviews. The FDA is seeking faster drug approval times, less "gaming" of the user-fee deadlines, improved communications and expectation-setting with the industry, and it has cracked down on institutionalized drug importation.

On MPDB, the devil's in the details, and funding and final details of the MPDB will be important:

Funding: Although Congress has already passed a federal budget resolution that would provide $400 billion over 10 years for Medicare reforms and a drug benefit, and both the House and Senate bills fall within that limit, social programs usually end up costing more than initially projected. However, even if the benefit stays within the $400 billion budgeted, with the costs of the Iraq war and reconstruction, tax cuts, and a lackluster economy, we believe the price tag is high for a budget already in a deficit, and the squeeze (on providers as well as manufacturers) could be on down the road.

MPDB final details, many of which have yet to be negotiated during the Senate-House conference and would be important to look out for, include the following:

1. **Who would pick up the Medicaid-Medicare dual eligibles: Medicaid (as in the Senate bill) or Medicare (as in the House bill)?** If the House provision wins, much pricing pressure on drug manufacturers at the state level could be lifted; however, given that it would likely be expensive for the federal government to pick up those bodies, we think it unlikely that the House provision will win.
2. **What measures would be put in place to ensure that employers remain motivated to provide retirees with drug coverage?** If the final MPDB bill is structured such that employers would have little incentive to offer retirees drug coverage, that would not only increase the cost of the drug benefit program to Medicare but increase pricing risks to drug manufacturers as well, as the current 30% of Medicare beneficiaries under employer-sponsored drug coverage become dislocated.
3. **On the fallback provisions in the Senate bill (Medicare coming in to offer a drug benefit if fewer than two private plans are available in a region), how exactly would it work?** The House does not have similar provisions, and the White House, while broadly endorsing Grassley-Baucus in a June 19 statement of administration policy, called the fallback "a government-run delivery system for prescription drugs, which could lead

to government pricing of individual drugs and government regulation of the availability of certain prescription drugs."

4. **Would private players actually step in to offer stand-alone drug benefits?** Again, the White House, in its June 19 statement, raised its doubts when it argued that a drug benefit would work best when incorporated into a comprehensive package of medical benefits.

Also, many sectors will be affected by any eventual MPDB (PBMs, insurance/HMOs/PPOs, pharma, biotech, generic drug makers, even distributors and drug stores); interplay among these sectors during the political/legislative process could affect how they fare in the final legislation.

On the commercial side, measuring the impact of any eventual legislation is still highly speculative. Final details of the legislation must still be reconciled and, far more importantly, actual changes in behavior by the elderly are very difficult to predict (i.e., who will opt for the new program and how will their drug consumption patterns change?). **However, we believe, at least initially, that the opportunity to increase unit volume and mix will more than offset pricing and formulary pressures.**

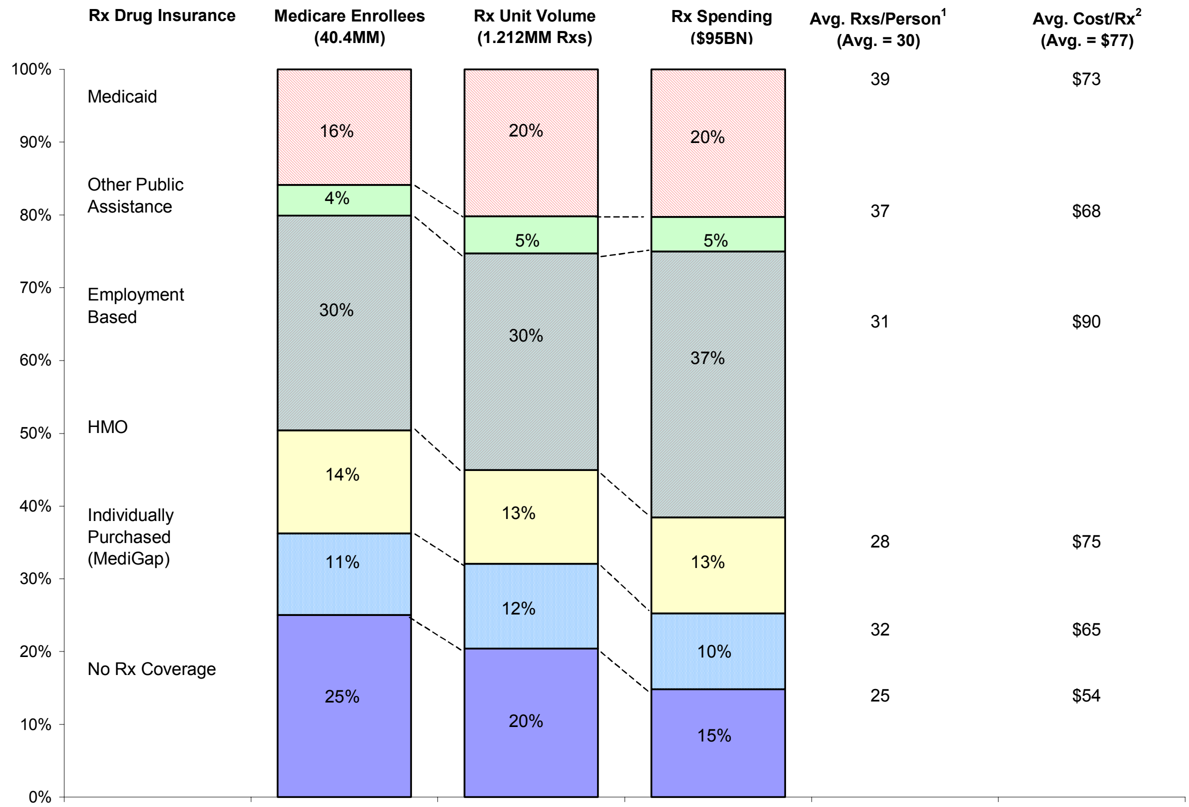
Figure 19 and Figure 20 (below) summarize analysis of prescription drug consumption patterns of the elderly based on what type of prescription drug insurance coverage currently exists. Generally speaking (and not surprisingly) individuals with better prescription drug coverage generally consume a greater volume of prescriptions and have a higher average cost per prescription. What may be somewhat surprising is the relatively high cost per Rx, even in settings that clearly get very low prices (Medicaid for instance). This, we believe, is because of the often forgotten variable of mix. When patients have no coverage, doctors will often go out of their way to prescribe a generic (i.e., more affordable) drug, even if that doctor perceives certain clinical tradeoffs in doing so. However, when prescription coverage exists, doctors more freely follow their prescribing preferences, with issues of cost taking a back seat.

On the negative side, if resulting pricing pressure (i.e., price controls, which are *not* likely in the near term) resulted in 25% discounts for all of the elderly, we would estimate the ding to U.S. pharmaceutical revenues (about 60% of total) at 5-6% (an *incremental* 12% discount—much of Medicare drug consumption is already sold through discounted channels—on the 40% of the U.S. market represented by the elderly [see Table 18]). However, this assumes no change in unit volume or mix. As an offset, if the 25% of elderly who currently lack any prescription drug coverage increased their unit volume to the average of those with coverage (i.e., 25 Rxs per year to 32) and increased their average cost per Rx to the average of those with coverage (i.e., from $54 to $83—mostly we believe due to much greater use of generics among those with no coverage), their spending on drugs would almost double, resulting in a 5-6% boost to U.S. industry revenues (an incremental 14% on the 40% of the market represented by the elderly).

To reiterate, though, this is a meaningfully oversimplified analysis of an extraordinarily complex phenomena. Changes in Rx benefit coverage, if any, to the current Medicaid and employment-based segments are still up in the air and will be critical in determining the ultimate impact. In addition, each segment in its own right is feeling budget pressure on drug spending, and each will likely continue to exert greater pressure through the usual tactics to hold down drug spending. Lastly, and perhaps most foreboding (although not in the near term), although there is virtually no hint of price controls in the MPDB today, the government is becoming a meaningfully bigger buyer of drugs. With that clout comes risk; however, with implementation of the MPDB not slated to start until 2006, the potential for fiscal crisis in the program which could be a precursor to price controls still seems to be at least six years or more down the road.

JPMorgan

Figure 19: Rx Drug Insurance: Medicare Beneficiary Drug Coverage, Usage, and Spending



Source: Congressional Budget Office (CBO) (October 2002, using Medicare data for 1999), Kaiser Family Foundation (June 2003), JPMorgan estimates.

[1] Average Rxs/person excluding those with no Rx coverage = 32.

[2] Average cost/Rx excluding those with no Rx coverage = $83.

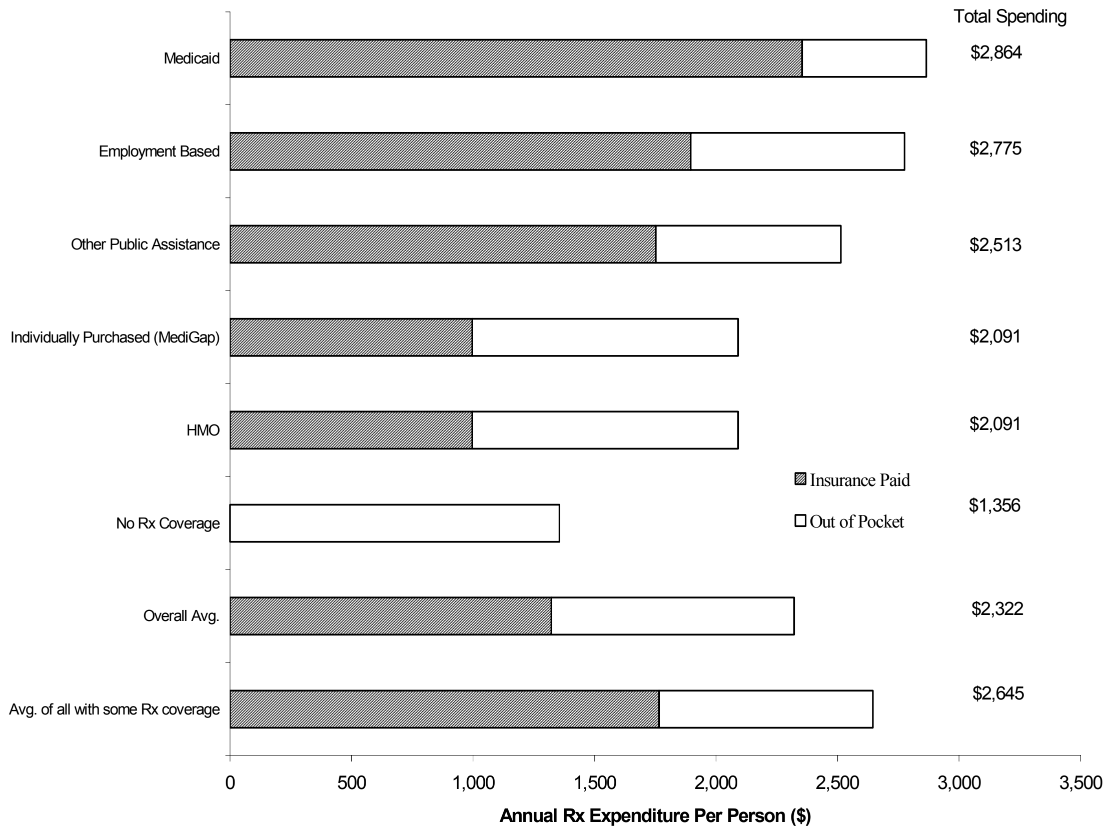
Table 18: Potential Impact of Medicare Drug Coverage Assuming a 25% Discount

Current Drug Coverage	% of Total Medicare Drug Spending	Est. Current Drug Discount	Assumed Future Mandatory Discount	Impact on Drug Pricing
No Rx Coverage	15%	0%	25%	(4)%
Employment Based	37%	15%	25%	(4)%
Medicaid	20%	20%	25%	(1)%
Other Public Assistance	5%	20%	25%	(0)%
Individually Purchased (MediGap)	10%	10%	25%	(2)%
HMO	13%	15%	25%	(1)%
Total	100%	13%	25%	(12)%
		Est. Medicare portion of U.S. drug market		X 40%
		Impact on U.S. drug revenue growth		(5)%
		U.S. portion of global drug sales		X 60%
		One-time impact on drug industry rev. growth		(3)%

Source: CBO, Kaiser Family Foundation, JPMorgan estimates.

JPMorgan

Figure 20: 2003E Average Drug Expenditure per Medicare Enrollee by Type of Rx Coverage



Source: Kaiser Family Foundation and JPMorgan estimates.

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Rating: Underweight

Bristol-Myers Squibb (BMY)

Investment Thesis

While post-restatement investor confidence in Bristol has steadily grown owing to the strong Abilify launch, the positive Erbitux Phase III data (2H03 filing), and the recent Reyataz approval, confusion regarding normalized base year EPS continues and variability to our forecasts persist (e.g., the wide-ranging guidance in non-restated stocking [$550-$750MM] could lead to a +/- $0.04 EPS swing). More importantly, we do not expect Bristol's near-term growth engines, which mainly rides on Abilify (where Bristol has to pay a steep 35% royalty to Otsuka) and Plavix, to offset the lost sales from a wave of products that are expected to lose exclusivity over the next few years, beginning with Serzone, Monopril, Glucophage XR, and Taxol (EU) in 2003, followed by Glucovance and Paraplatin in 2004, Cefzil in 2005, and Pravachol in 2006. As such, our forecast does not see the clouds clearing anytime soon, despite our bullish expectations for Abilify ($2.5 billion in gross sales by 2007 [$1.6 billion after royalties to Otsuka]), and we expect BMY's underlying compounded annual pharma sales growth (excluding OTN) to muddle along at just 3% thru 2007. These issues are compounded by what we believe is Bristol's limited financial flexibility (i.e., any top-line disappointment could hurt earnings) as well as by the looming Plavix patent challenge (could be resolved in 2004; generic win is unlikely in our view). But while there is little in our fundamental outlook for BMY that is encouraging, we believe that BMY enjoys downside support owing to its attractive dividend yield of 4%, which we do not believe is at risk, and the possibility of an upside surprise (such as an acquisition of BMY, which has been widely speculated in the Wall Street Journal, Business Week, Forbes during 2002 in unconfirmed reports).

Positives

- Dividend appears secure and yield protects downside.
- Strong Abilify launch owing to clean side effect profile.
- Generic entry delay (i.e. Monopril) could lead to near-term EPS upside, albeit temporary and vs. low expectations (consensus at low end of guidance)
- Recent events (e.g., strong Abilify launch, positive Erbitux Phase III data, Reyataz approval), combined with no new accounting nightmares should help to rebuild investor confidence
- Plavix could continue to surprise on upside.
- Market speculation of possible acquisition.

Risks

- Normalized EPS confusion continues - guidance on nonrestated stocking ($550-750MM) could lead to a +/- $0.04 EPS swing
- Near-term pipeline appears relatively weak (although Erbitux and Reyataz should help) – pressure on in-licensing to deliver
- Limited remaining ability to reposition via acquisitions, or divestitures; cash flow tighter than most, little investor appetite for any dilution
- Generic/substitution risk cloud never really clears and Plavix patent case around the corner (2004)
- Bristol's financial flexibility is limited despite lowered EPS.
- Negative news flow from multiple lawsuits and investigations.

Key Issues to Watch

- Growth trends for key drivers - Pravachol, Plavix, Avapro, Abilify - and Reyataz launch; plus pressure for a big in-licensing score.
- Erbitux filing (2H03) and development update on key pipeline products (Garenoxacin, CTLA 4Ig, Entecavir, dual PPAR)
- Generic entry/delay for Serzone, Monopril, Glucophage XR, and Taxol (EU)
- Crestor launch (4Q03) and impact on Pravachol sales

Summary of Earnings Estimates

	7/10/03 Price	1Q	2Q	3Q	4Q	FY	P/E*	Prem./(Disc.) Drug Grp*
JPMorgan	$27.10							
2002		$0.50	$0.25	$0.34	$0.24	$1.33	17.8	(15)%
2003E		$0.39	**$0.37**	**$0.42**	**$0.42**	**$1.60**	**16.9**	**(14)%**
2004E						**$1.70**	**15.9**	**(7)%**
First Call								
2003E		$0.39	**$0.38**	**$0.42**	**$0.41**	**$1.60**	**16.9**	**(14)%**
2004E						**$1.68**	**16.1**	**(6)%**

* For 2002, P/E and Prem/(Disc) are calculated using an estimated $0.20 of non'restated stocking to obtain a "normalized" EPS estimate of $1.53.

Sales & Earnings Drivers

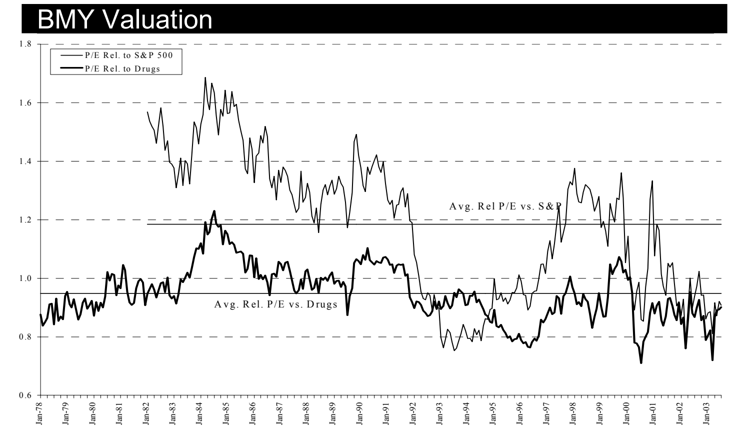
JPMorgan Est. Key Products	2002-05E CAGR	Incremental Sales 2002-05E $ mil.	% Sls Growth	Cont. to Sls
Abilify (antipsychotic)	471%	925	32%	1.6%
Erbitux (cancer)	-	200	7%	0.3%
Pravachol (cholest.)	3%	224	8%	0.4%
Plavix (stroke)	21%	1,530	52%	2.6%
Avapro (hypertension)	16%	344	12%	0.6%
Glucophage family	(40)%	(736)	(25)%	(1.2)%
Taxol (cancer)	(16)%	(367)	(13)%	(0.6)%
Paraplatin (cancer)	(12)%	(252)	(9)%	(0.4)%
OTN	21%	1,425	49%	2.4%
All other Pharma	(2)%	(470)	(16)%	(0.8)%
Other sales	1%	113	4%	0.2%
Total Sales	5%	2,936	100%	5.0%

- Total sales are expected to grow 6% from 2002 to 2005 with pharma sales growing 7% (3% excluding OTN).
- Operating margins expected to improve 230 bps to 26.0% by 2005 driven by lower SG&A (-180 bps to 27.0%) and lower R&D (-140 to 10.8%).
- Normalized EPS is expected to rise 5% in 2003, 6% in 2004, and 6% in 2005.

BMY Stock Performance

Source: FactSet. Note: All prices are indexed to 12/31/02.

BMY Valuation



Source: FactSet.

Second Quarter Outlook

Despite Bristol's restatement, financial transparency remains cloudy and our confidence in forward projections (particularly quarterly estimates) is low. Owing to this lack of clarity, we believe our estimates are subject to meaningful variability (e.g., wide ranging guidance on non-restated stocking of $550-750MM could lead to a +/- $0.04 swing in our 2003 full-year EPS estimate and affect quarterly estimates). With this caveat in mind, for the second quarter of 2003, we expect Bristol to earn $0.37 per share ($0.01 below consensus). Total sales and medicine product sales are expected to jump 18% and 20% (excluding OTN medicine product sales are projected to grow 19%), mainly due to an easy comp owing to aggressive destocking in 2Q02, but also helped by non-restated stocking as well as a favorable Fx tailwind in 2Q03. Gross margins are expected to stay relatively flat (down 10bps to 64.4%) owing to a steady mix of OTN and pharma sales. SG&A is projected to grow 11% to help support the Abilify launch, while R&D spending is expected to rise 6% to help support Bristol's late stage pipeline. Owing to the rebound in sales, the operating margin is projected to rise 230bps to 23.9%, while BMY's tax rate is expected to fall 70bps to 27.4%. For 2003, we expect normalized EPS to grow 5% to $1.60 (in line with consensus and at the bottom-end of management's guidance of $1.60-1.65).

Table 19: Bristol-Myers Squibb Summary Quarterly P&L

($ in millions, except per share data)

								% Change Year Over Year					
	2Q02	1Q03	2Q03E	3Q03E	4Q03E	2003E	2004E	1Q03	2Q03E	3Q03E	4Q03E	2003E	2004E
Pravachol	447	613	615	620	607	2,455	2,535	13%	38%	-8%	1%	8%	3%
Plavix	425	408	585	610	762	2,365	2,950	-11%	38%	38%	36%	25%	25%
Avapro	151	175	185	190	195	745	845	26%	23%	54%	13%	27%	13%
Glucophage Franchise	125	247	223	213	135	818	314	-14%	78%	12%	-23%	5%	-62%
Taxol	228	209	200	190	181	780	645	-5%	-12%	-3%	-15%	-9%	-17%
Medicines	3,479	4,054	4,171	4,248	4,375	16,848	17,439	1%	20%	9%	10%	10%	4%
Nutritionals	471	433	476	471	461	1,841	1,855	-4%	1%	6%	0%	1%	1%
Other	177	224	232	242	250	948	973	4%	31%	29%	-30%	1%	3%
Total Sales	4,127	4,711	4,879	4,961	5,086	19,637	20,267	1%	18%	9%	6%	8%	3%
Gross Margin %	64.5%	64.2%	64.4%	64.7%	64.8%	64.6%	64.3%	-4%	18%	11%	9%	8%	3%
SG&A, net % Sales	31.1%	29.6%	29.1%	26.7%	26.4%	27.9%	27.1%	19%	11%	4%	-10%	5%	0%
R&D % Sales	11.3%	10.1%	11.4%	11.1%	11.7%	11.1%	10.8%	-5%	6%	3%	-9%	-2%	0%
Operating Margins	20.6%	24.5%	23.9%	26.9%	26.7%	25.6%	26.4%	-22%	37%	24%	54%	17%	7%
Pretax Margins	17.6%	22.6%	21.7%	24.6%	24.3%	23.3%	24.2%	-26%	45%	15%	104%	19%	7%
Tax Rate	28.7%	27.3%	27.4%	27.4%	27.3%	27.4%	27.4%	-30%	39%	-12%	310%	15%	7%
Net Income	481	755	722	819	807	3,103	3,293	-23%	50%	26%	74%	21%	6%
Reported EPS	**$0.25**	**$0.39**	**$0.37**	**$0.42**	**$0.42**	**$1.60**	**$1.70**	**-22%**	**50%**	**26%**	**74%**	**21%**	**6%**

Source: Company reports and JPMorgan estimates.

Bristol-Myers Squibb Late-Stage Product Pipeline

Drug/Compound	Phase	Filing	Comments
Vanlev	Appr'ble	?	Further development highly unlikely.
Erbitux (IMC-C225)	III	2H03	Colorectal cancer
Garenoxacin	III	2003	BMS 284756, Des-quinolone antibiotic
Entecavir	III	2004/05	Nucleotide analog for hepatitis B
CTLA4 Ig	III	2004/05	Immunomodulator for rheumatoid arthritis
BMS 247550	III	2005/06	Epothilone anticancer drug
dPPAR	III	2006/07	Type 2 diabetes
LEA29Y	II	2004/05	Immunomodulator for transplant
DPC 083	II	2004/05	Next generation NNRTI for HIV
Ravuconazole	II	2004/05	Antifungal
BMS 184476	II	2005/06	Taxol analog
BMS 188797	II	2005/06	Taxol analog
Gemopatrilat	II	2006/07	Vasopeptidase inhibitor for hypertension, CHF
BMY 223131	II	2006/07	Erectile dysfunction
BMS 234303	II	2006/07	Male pattern baldness
BMS 347070	II	2006/07	COX-2 inhibitor for pain
BMS 193884	II	2006/07	Endothelin A antagonist for hypertension
BMS 214662	II	2006/07	Ras-farnesyltransferase (FT) inhibitor
DPC 906	II	2006/07	Factor Xa oral anticoagulant
CRF1 antagonist	II	2006/07	Depression
Superstatin	I	2006/07	Cholesterol reducer

Source: Company reports and JPMorgan research

Bristol-Myers Squibb Upcoming Events Calendar

Timing	Event	Comments
Wk of July 21st	2Q03 results	Expect 50% growth to $0.37 ($0.01 below cons.)
July 31	Glucovance patent expiry	Glucovance exclusivity expires on 7/31 unless the drug receives a 6mo. Pediatric extension
Sept. 16	Serzone patent expiry	Already received 6-mo. pediatric extension
Oct. 13	Glucophage XR expiry	Pediatric extension not requested.
mid-03	sNDA filing - Abilify	Acute mania for bipolar disorder
2H03	NDA filing - Erbitux	Colorectal cancer
2H03	Monopril generic entry	Patent case in litigation
2H03	CTLA4Ig patent inventorship case	Ruling expected in patent inventorship dispute involving Repligen, Univ. of MI, and Bristol
4Q03	AZN's Crestor approval	Competitor to Pravachol
4Q03	Andrx's metformin XT	Expect approval for Glucophage XR competitor
2003	NDA Filing - Garenoxacin	Des-quinolone antibiotic
Anytime	SEC & NJ Attorney General investigations	Expect results from inventory acct. investigations.

Source: Company reports and JPMorgan research.

Table 20: Bristol-Myers Squibb Annual Income Statement and Contribution to Growth

($ in millions)

									2002-2007E	
	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	Growth	Contrib. to Growth
Revenues										
Cardiovascular										
Capoten (hypertension, CHF)	$355	$285	$209	$170	$120	$85	$60	$45	(26)%	(0)%
Coumadin (anti-coagulant)	-	63	300	295	230	170	115	75	(24)	(0)
Monopril (hypertension)	404	413	426	395	240	175	130	95	(26)	(0)
Pravachol (cholesterol)	1,766	2,101	2,266	2,455	2,535	2,525	1,625	1,025	(15)	(1)
Avapro (A-II, hypertension)	361	487	586	745	845	940	1,020	1,085	13	0
Plavix (stroke)	889	1,171	1,890	2,365	2,950	3,505	4,030	4,440	19	3
Vanlev (HTN, CHF)	-	-	-	-	-	-	-	-	-	0
Other cardiovascular	191	149	154	158	160	165	170	175	3	0
Anti-Infectives										
Cefzil (oral antibiotic)	330	304	287	330	280	235	120	90	(21)	(0)
Sustiva (HIV-NNRTI)	-	68	455	560	630	695	745	780	11	0
Videx (HIV-NRTI)	207	240	262	275	280	270	245	160	(9)	(0)
Zerit (HIV-NRTI)	578	515	443	380	300	235	185	140	(21)	(0)
Maxipime (injectable antibiotic)	146	150	163	170	175	180	180	180	2	0
Megace (appetite enhancer)	150	109	33	28	18	13	13	13	(17)	(0)
Tequin (quinolone)	131	250	184	175	180	190	200	210	3	0
Reyataz (atazanavir, HIV-PI)	-	-	-	20	125	200	270	330	-	0
Ravuconazole (antifungal)	-	-	-	-	-	40	75	105	-	0
Entecavir (hepatitis B)	-	-	-	-	-	75	120	155	-	0
Garenoxacin (Des-quinolone)	-	-	-	-	40	90	150	195	-	0
DPC 083 (HIV-NNRTI)	-	-	-	-	-	50	100	145	-	0
Other anti-infective	797	685	569	567	507	467	427	387	-	0
Oncology										
Taxol	1,561	1,112	857	780	645	530	425	335	(17)	(1)
Paraplatin	654	592	727	850	780	525	340	220	(21)	(1)
Erbitux (C225, anti-cancer)	-	-	-	-	85	200	300	400	-	0
Taxol analogs	-	-	-	-	-	-	40	100	-	0
OTN (cancer drug wholesaler)	1,080	1,433	1,900	2,370	2,850	3,325	3,750	4,125	17	2
New oncology products	-	-	-	-	-	-	90	225	-	0
Other oncology	465	380	299	275	240	215	200	185	(9)	(0)
CNS										
BuSpar (anxiety, depression)	672	297	53	40	20	15	10	10	(28)	(0)
Serzone (depression)	318	334	221	75	25	15	10	10	(46)	(0)
Abilify (anti-psychotic)	-	-	5	305	625	930	1,275	1,600	-	2
Sinemet (Parkinson's)	-	30	97	67	40	25	15	10	(37)	(0)
Other CNS	185	104	54	55	55	55	55	55	0	0
Other Pharmaceuticals										
Dermatology	365	383	355	345	320	295	270	245	(7)	(0)
Glucophage (diabetes)	1,718	1,838	220	115	52	26	11	6	(51)	(0)
Glucophage XR	33	230	297	315	100	50	25	10	(49)	(0)
Metaglip	-	-	15	34	60	80	35	15	0	0
Glucovance	(4)	269	246	354	102	51	26	11	(46)	(0)
Total Glucophage	1,747	2,337	778	818	314	207	97	42	(44)	(1)
dPPAR agonist (diabetes)	-	-	-	-	-	-	-	50	-	0
CTLA 4Ig/LEA 29Y	-	-	-	-	-	75	150	220	-	0
Other Pharmaceuticals	476	216	397	330	350	360	370	380	(1)	(0)
Other New Pharmaceuticals	-	-	-	-	-	255	445	645	-	1
Total Pharmaceuticals	**13,828**	**14,208**	**13,970**	**15,398**	**15,964**	**17,332**	**17,822**	**18,687**	**6%**	**5%**
% change	10%	3%	-2%	10%	4%	9%	3%	5%		
% change (excl. OTN)	9%	0%	-6%	8%	1%	7%	0%	3%		
Medical Imaging	-	100	465	515	555	595	630	660	7	0
Other	593	612	542	590	590	590	590	590	2	0
Consumer Medicines	467	413	377	345	330	310	290	270	(6)	(0)
Total Medicine Products	14,888	15,333	15,354	16,848	17,439	18,827	19,332	20,207	6%	5%
% change	9%	8%	3%	10%	4%	8%	3%	5%		
Total ConvaTec	685	706	744	763	793	823	853	878	3	0
Total Nutritionals	1,820	1,827	1,828	1,841	1,855	1,875	1,890	1,895	1	0
Other	145	121	193	185	180	180	180	180	(1)	(0)
Total Sales (Continuing Ops)	**$17,538**	**$17,987**	**$18,119**	**$19,637**	**$20,267**	**$21,705**	**$22,255**	**$23,160**	**5%**	**5%**
% Change	6%	3%	1%	8%	3%	7%	3%	4%		

Source: Company reports and JPMorgan estimates.

Table 20: Bristol-Myers Squibb Annual Income Statement and Contribution to Growth (cont'd)

($ in millions, except per share data)

	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	2002-2007E Growth	2002-2007E Contrib. to Growth
Total Sales (Continuing Ops)	**$17,538**	**$17,987**	**$18,119**	**$19,637**	**$20,267**	**$21,705**	**$22,255**	**$23,160**	**5%**	**5%**
% Change	6%	3%	1%	8%	3%	7%	3%	4%		
Cost of Goods Sold	4,730	5,453	6,388	6,961	7,235	7,857	8,234	8,743	6	(2)
% of Sales	27.0%	30.3%	35.3%	35.5%	35.7%	36.2%	37.0%	37.8%		
Marketing, Selling, Admin.	3,852	3,894	3,923	4,045	4,033	4,276	4,262	4,377	2	2
% of Sales	22.0%	21.6%	21.7%	20.6%	19.9%	19.7%	19.2%	18.9%		
Advertising and Promotion	1,526	1,299	1,295	1,434	1,419	1,508	1,502	1,552	4	0
% of Sales	8.7%	7.2%	7.1%	7.3%	7.0%	7.0%	6.8%	6.7%		
Royalties to ImClone	-	-	-	-	33	78	117	156	-	(1)
% of Sales	0.0%	0.0%	0.0%	0.0%	0.2%	0.4%	0.5%	0.7%		
SG&A	5,378	5,193	5,218	5,479	5,485	5,862	5,881	6,085	3	2
% of Sales	30.7%	28.9%	28.8%	27.9%	27.1%	27.0%	26.4%	26.3%		
R&D	1,878	2,183	2,218	2,180	2,189	2,344	2,359	2,409	2	2
% of Sales	10.7%	12.1%	12.2%	11.1%	10.8%	10.8%	10.6%	10.4%		
Operating Income	$5,552	$5,158	$4,295	$5,017	$5,358	$5,641	$5,781	$5,924	7%	7%
Operating Margin	31.7%	28.7%	23.7%	25.6%	26.4%	26.0%	26.0%	25.6%		
Interest, net	49	(49)	(283)	(283)	(278)	(247)	(215)	(183)		
Other non-operating inc/exp	(89)	(11)	(174)	(160)	(180)	(180)	(180)	(180)		
Non-Operating Income	(40)	(60)	(457)	(443)	(458)	(427)	(395)	(363)		
Pretax Income	5,512	5,098	3,838	4,574	4,900	5,214	5,385	5,561	8%	8%
Pretax Margin	31.4%	28.3%	21.2%	23.3%	24.2%	24.0%	24.2%	24.0%		
Taxes	1,394	1,017	1,087	1,251	1,340	1,426	1,473	1,521	7	(0)
Tax Rate	25.3%	19.9%	28.3%	27.4%	27.4%	27.4%	27.4%	27.4%		
Minority Interest	97	102	178	220	267	312	354	386	17	(0)
% Change	98%	5%	75%	24%	21%	17%	13%	9%		
Net Income (excl. one-time items)	$4,021	$3,979	$2,573	$3,103	$3,293	$3,476	$3,559	$3,654	7%	7%
Net Margin	22.9%	22.1%	14.2%	15.8%	16.2%	16.0%	16.0%	15.8%		
Diluted EPS[#] (excl. one-time items)	**$2.01**	**$2.02**	**$1.33**	**$1.60**	**$1.70**	**$1.80**	**$1.85**	**$1.90**	**8%**	**8%**
% Change	16%	1%	(35)%	21%	6%	6%	3%	3%		
Non-restated stocking (est. EPS impact)	($0.05)	($0.15)	$0.20	$0.00	$0.00	$0.00	$0.00	$0.00		
Normalized EPS[*]	**$1.96**	**$1.87**	**$1.53**	**$1.60**	**$1.70**	**$1.80**	**$1.85**	**$1.90**	**5%**	**5%**
% Change	13%	(5)%	(19)%	5%	6%	6%	3%	3%		
Reported EPS (incl. one-time items)	**$1.92**	**$1.04**	**$1.05**	**$1.60**	**$1.70**	**$1.80**	**$1.85**	**$1.90**	**13%**	**13%**
% Change	14%	(46)%	1%	53%	6%	6%	3%	3%		
Diluted Shares Outstanding (MM)	1,997	1,965	1,942	1,940	1,935	1,930	1,925	1,920		

Source: Company reports and JPMorgan estimates.

[#] EPS impact due to FASB accounting rule change, which eliminates the amortization of goodwill from past and future acquisitions. The provisions for goodwill and other intangible assets are effective for years beginning on or after January 1, 2002.

[*] The normalized EPS line excludes the impact of non-restated excess stock at small distributors, which we estimate to be about $0.20 or $650M in estimated sales from 2000-01. We allocated this estimated non-restated stock to our '03 product sales forecast based on the '01 stocking mix.

Rating: Neutral

Eli Lilly (LLY)

Investment Thesis

LLY has the industry's best product pipeline in our view, particularly relative to its modest size and the absence of any earnings drags from patent expirations for several years. We project EPS growth of 21% in '04 and '05. However, this robust growth outlook reflects our assumption that Zyprexa will steer clear from several potential risks as their impact to LLY's growth outlook would be severe since Zyprexa accounts for 34% of LLY's revenues and, we estimate, over half its profits. Zyprexa's uncertainties include (1) more intense competition from BMY's Abilify, (2) an unfavorable label change pertaining to diabetes risk, (3) reimbursement pressures from government entities (which pay for 60% of Zyprexa's U.S. revenues), and (4) a patent challenge, which appears secure, but is scheduled for trial in Jan. 2004. The acceleration in LLY earnings growth is not expected until 2004, as it is heavily dependant on the launch of Cymbalta, which could be delayed if LLY's manufacturing compliance issues remain unresolved. In addition, we expect the Zyprexa controversies to take at least another 2-3 quarters to resolve. Given the stock's premium valuation (31% premium on our '03E EPS), we see little risk in waiting on the sidelines as outperformance from here seems unlikely while the downside risks to Zyprexa are significant. While we remain bullish on LLY's superior long-term growth prospects, we do not view its current risk-benefit tradeoff as particularly attractive and we remain Neutral on LLY.

Positives

- One of the best pipelines in industry, both for the short and foreseeable long term; starting in 2004, should drive strong EPS growth for several years.
- Several in-line and new products (Zyprexa, Gemzar, Humalog, Evista, and Straterra) are showing strong growth
- Management's commitment to deliver earnings as guided appears high (given poor record in 2001 and 2002).
- News flow in the 2nd half, on product approvals and product filings could serve as positive stock catalysts.

Risks

- Zyprexa's outlook is clouded by several controversies - i.e. competition from BMY's Abilify, cost containment pressure from state funded healthcare plans, and a generic threat to its patent challenge. A stumble on any front could be devastating.
- Limited financial flexibility given the need to spend behind pipeline.
- Cymbalta's launch still unclear given its dependance on resolution of manufacturing issues.
- Valuation premium appears high.
- Pipeline carries regulatory risk (though breadth is impressive).

Key Issues to Watch

- Progress update on manufacturing issues (i.e., the latest 483's issued following inspection of the Cymbalta and Zyprexa IM facilities)
- Zyprexa growth trends, the diabetes risk controversy, competition from BMY's Abilify, and a Jan. '04 patent battle.
- Progress on Cialis approval (anticipated 4Q03).

Summary of Earnings Estimates

	7/10/03 Price	1Q	2Q	3Q	4Q	FY	P/E	Prem./(Disc.) Price
JPMorgan	$67.08							
2002		$0.58	$0.61	$0.68	$0.68	$2.55	26.3	26%
2003E		**$0.61**	**$0.61**	**$0.68**	**$0.70**	**$2.60**	**25.8**	**31%**
2004E						**$3.15**	**21.3**	**25%**
First Call								
2003E		**$0.61**	**$0.60**	**$0.66**	**$0.68**	**$2.55**	**26.3**	**33%**
2004E						**$3.00**	**22.4**	**31%**

Sales & Earnings Drivers

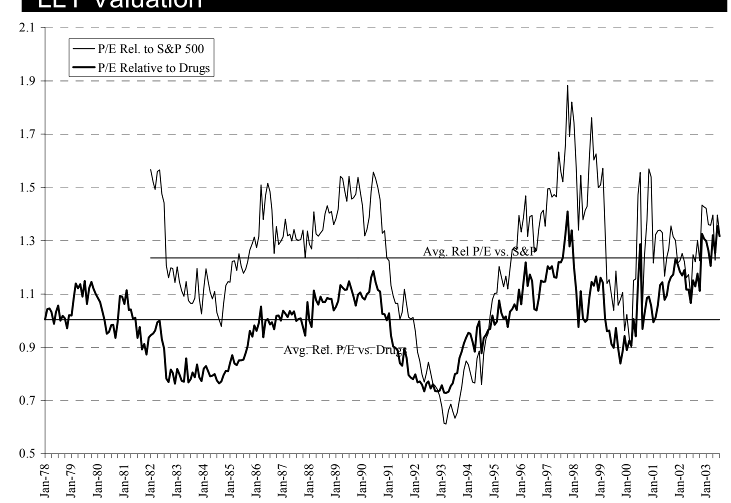
JPMorgan Ests. Key Products	2002-2005E CAGR	Incremental Sales* 2002-2005E $ mil.	% Sls Growth	Cont. to Sls
Prozac	-19%	(265)	(6)%	(0.7)%
Zyprexa	10%	1,191	26%	3.2%
Straterra (ADHD)	417%	357	8%	1.0%
Evista (SERM)	17%	478	10%	1.3%
Gemzar	12%	355	8%	0.9%
Insulin	5%	277	6%	0.7%
All other sales	19%	2,224	48%	5.9%
Total Lilly Sales	12%	4,618	100%	12.3%

- Sales are projected to grow by 9% in 2003, then accelerate to 13-14% growth in 2004-2006.
- Operating margin is expected to bottom at 28.3% in 2003 (down 170 basis points), but should bounce back by 100 basis points in 2004 and another 200 basis points by 2006.
- Earnings growth is projected at +2% in 2003, accelerating to +21% in 2004 and 2005 and +17% in 2006.

LLY Stock Performance

Source: FactSet. Note: All prices are indexed to 12/31/02.

LLY Valuation



Source: FactSet.

Second Quarter Outlook

We project Lilly to deliver 2Q03 EPS up 1% to $0.61, which is $0.01 above consensus, but in line with LLY's recently updated guidance that EPS for the quarter will be at the high end of the previously provided range of $0.58-0.61. As such, we do not expect earnings to be controversial for the quarter, and expect investors to focus on (a) management's update on the manufacturing inspections and (b) Zyprexa's sales trends. We project revenues to grow +8%, fueled by impressive growth for Humalog (+20%), Evista (+17%), Gemzar (+16%), and Zyprexa (+11%), partly offset by declines in the Prozac franchise (-22%), Reopro (-10%), and Humulin (-8%). We also project Straterra sales at $55 million. Favorable FX is expected to boost revenue growth by about 4%. Gross margins are expected to contract 130 basis points (to 79.8%), partly due to a $200 million increase in the manufacturing cost base to improve GMP compliance and operate expanding capacity. SG&A and R&D expenses are each projected to grow 9% during this quarter. The operating margin is projected to worsen 210 basis points to 26.4%. Lilly's tax rate is expected to remain steady at 22%. For 2003, EPS are projected to grow 2% to $2.60 ($0.05 above consensus; company guidance is $2.50-2.60).

Table 21: Eli Lilly Summary Quarterly P&L

($ in millions, except per share data)

								% Change Year Over Year					
	2Q/02	1Q/03	2Q/03E	3Q/03E	4Q/03E	FY2003E	FY2004E	1Q/03	2Q/03E	3Q/03E	4Q/03E	FY2003E	FY2004E
Prozac franchise	171	150	134	132	124	540	510	-13%	-22%	-22%	-14%	-18%	-6%
Zyprexa	907	958	1,010	1,050	1,067	4,085	4,500	17%	11%	8%	8%	11%	10%
Xigris	23	36	42	45	48	171	255	64%	86%	113%	39%	71%	49%
Humulin/Humalog	462	490	483	478	489	1,940	2,030	19%	4%	1%	-1%	6%	5%
Gemzar	219	234	255	235	276	1,000	1,115	18%	16%	19%	6%	14%	12%
ReoPro	101	93	91	84	82	350	350	2%	-10%	-9%	-17%	-9%	0%
Evista	188	214	220	250	266	950	1,100	20%	17%	15%	12%	16%	16%
Straterra	0	55	55	60	66	236	276	-	-	-	*	*	17%
Pharma. Prod.	2,613	2,716	2,804	2,840	3,015	11,375	12,953	14%	7%	8%	9%	10%	14%
Animal Health	163	173	171	174	206	724	760	3%	5%	4%	5%	4%	5%
Total Sales	2,775	2,889	2,975	3,014	3,221	12,099	13,713	13%	7%	8%	9%	9%	13%
Gross Margin %	81.1%	78.5%	79.8%	79.7%	79.6%	79.4%	79.9%	12%	6%	8%	7%	8%	14%
SG&A % Sales	33.0%	31.7%	33.4%	30.8%	31.5%	31.8%	31.5%	18%	9%	14%	10%	12%	12%
R&D % Sales	19.7%	18.3%	20.0%	19.3%	19.4%	19.3%	19.1%	5%	9%	10%	9%	8%	13%
Operating Margins	28.5%	28.5%	26.4%	29.6%	28.7%	28.3%	29.3%	10%	-1%	0%	4%	3%	17%
Pretax Margins	30.4%	29.3%	28.4%	31.2%	30.0%	29.8%	31.8%	5%	0%	-1%	2%	2%	21%
Tax Rate	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	5%	0%	-1%	2%	2%	21%
Net Income	659	661	659	734	754	2,808	3,401	5%	0%	-1%	2%	2%	21%
Diluted EPS	$0.61	$0.61	$0.61	$0.68	$0.70	$2.60	$3.15	6%	1%	0%	3%	2%	21%

Source: Company reports and JPMorgan estimates.

Lilly Late-Stage Product Pipeline

Drug/Compound	Phase	Filing	Comments
Cialis (IC-351)	Filed	Appr'ble	For erectile dysfunction, in JV with ICOS.
Cymbalta (duloxetine)	Filed	Appr'ble	Serotonin/noradrenaline reuptake inhibitor for depression.
duloxetine	Filed	4Q/02	Stress urinary incontinence
Alimta	III	3Q/03	For mesothelioma; NSCL cancer in '03.
Zyprexa	Filed	4Q/02	Bipolar maintenance.
Symbiax (OFC)	Filed	4Q/02	Bi-polar depression (TRD filing in '04)
Gemzar	Filed	4Q/02	Supplemental filing in EU for breast cancer
LY 333531 (PKC)	III	2004	Protein kinase C inhibitor for diabetic peripheral neuropathy.
Exenatide (ACC-2993)	III	2004/5	Synthetic Exendin-4; similar to GLP-1. Being co-developed with Amylin Pharma.
Arzoxifene	II	2005/6	SERM for osteoporosis
LY 315920	II	2004	Phospholipase A2 inhibitor for sepsis
Sivelastat	II	2005	Neutrophil elastase inhibitor for ARDS. Halted trial enrollment in Aug.'02 due to lack of efficacy. Very high risk.
LY 335979 (MDR)	II/III	2005	Multi-drug resistance modulator for cancer
mGluR2-Pro	II	2005	Glutamate receptor antagonist for GAD
CS-747	iI	2006	Anti-platelet agent (like Plavix); may offer faster and more consistent onset with lower drug/drug interaction

Source: Company reports and JPMorgan research.

Lilly Upcoming Events Calendar

Timing	Event	Comments
Jul 24 '03	2Q/03 Earnings	Project EPS of $0.61 (+1%) , $0.01 above consensus. 9:30 AM conf. call (#312-326-1019)
3Q/03	Update on mfg re-inspection	Expect details on the 483's rec'd following completion of inspection of the Cymbalta and Zyprexa mfg facilities in May.
3Q/03	NDA filing—Alimta	For mesothelioma; rolling submission ongoing
Sep 5'03	Analyst Meeting	Business update and R&D pipeline review
2H/03	EU filing	Strateraa (ADHD) and Cymbalta (depression)
2H/03	FDA approval—Cymbalta	For depression. Received approvable letter in September '02. FDA 6-mth clock started 5/'03
2H/03	FDA Approval & launch	Cialis–for erectile dysfunction. Received approvable letter in April '02—FDA asked for additional pharmacological data,
4Q/03	FDA Approval	Symbiax - for Bipolar depression
4Q/03	FDA Approval	Duloxetine - for stress urinary incontinence
4Q/03	EU regulatory Approval	Gemzar - for treating breast cancer
4Q/03	FDA Approval (sNDA)	Zyprexa - for bipolar maintenance
Jan. '04	Start of Legal trial	Zyprexa's 2011 patent is being challenged by several generic companies.

Source: Company reports and JPMorgan research.

Table 22: Eli Lilly Annual Income Statement and Contribution to Growth

($ in millions)

	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	2002-2007E Growth	2002-2007E Contrib. to Growth
Revenues										
Anti-infectives										
Ceclor	292	232	198	180	170	150	130	110	(11)%	(0)%
Vancocin	216	211	145	130	125	120	115	110	(5)	(0)
resiquimod (genital herpes)	-	-	-	-	-	-	-	-		
Other anti-infectives	403	308	235	209	220	214	204	193	(4)	(0)
Cardiovascular										
ReoPro (PTCA, stenting)	419	431	384	350	350	350	350	350	(2)	(0)
CS-747 (anti-platelet)	-	-	-	-	-	-	-	200		
Other cardiovascular	174	141	141	154	154	154	159	164	3	0
Oncology										
Gemzar (gemcitabine)	562	723	875	1,000	1,115	1,230	1,340	1,435	10	1
Alimta (pemetrexed)	-	-	-	-	80	200	310	415		1
LY 335979 (MDR)	-	-	-	-	-	-	120	300		0
ISIS 3521	-	-	-	-	-	-	-	-		0
Other oncology	21	16	19	23	25	25	25	25	6	0
Endocrine										
Humatrope (growth hormone)	303	313	329	355	365	375	385	395	4	0
Humulin (insulin)	1,137	1,061	1,004	930	875	830	795	770	(5)	(0)
Humalog (insulin)	350	628	834	1,010	1,155	1,285	1,415	1,540	13	1
Actos (alliance revenue)	220	365	380	450	520	585	480	288	(5)	(0)
LY 333531 (PKC)	-	-	-	-	-	-	65	125		0
AC 2933 (diabetes)	-	-	-	-	-	-	75	150		0
Other endocrine	76	73	70	80	60	60	65	70	0	0
Women's Health										
Evista (SERM)	522	665	822	950	1,100	1,300	1,520	1,750	16	1
Forteo (osteoporosis)	-	-	6	50	175	325	420	470		1
CNS										
Prozac (depression)	2,571	1,856	568	445	395	303	250	220	(17)	(0)
Zyprexa (schizophrenia, mania)	2,366	3,087	3,689	4,085	4,500	4,880	5,255	5,580	9	3
Cymbalta (depression, urinary incont)	-	-	-	25	350	775	1,225	1,500		2
Straterra (ADHD)	-	-	3	236	276	360	460	550		1
Other CNS	252	385	409	402	558	675	710	800	14	1
Other Pharmaceuticals										
Axid (reflux, ulcers)	326	285	113	80	65	60	55	50	(15)	(0)
Xigris (sepsis)	-	21	100	171	255	360	495	650		1
Other new	-	-	-	-	-	225	425	650		
Others	59	47	62	60	65	65	65	65	1	0
Total Pharmaceuticals	10,271	10,846	10,383	11,375	12,953	14,906	16,913	18,925	13%	12%
Percent Change	11%	6%	-4%	10%	14%	15%	13%	12%		
Animal Health	668	686	693	720	755	785	815	840	4	0
Capsules/Other	14	11	2	4	5	5	5	5	24	0
Total Sales	**10,953**	**11,543**	**11,078**	**12,099**	**13,713**	**15,696**	**17,733**	**19,770**	**12%**	**12%**
Percent Change	10%	5%	-4%	9%	13%	14%	13%	11%		

Source: Company reports and JPMorgan estimates.

Table 22: Eli Lilly Annual Income Statement and Contribution to Growth (cont'd)

($ in millions, except per share data)

									2002-2007E	
	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	Growth	Contrib. to Growth
Total Sales	10,953	11,543	11,078	12,099	13,713	15,696	17,733	19,770	12%	12%
% Change	10%	5%	-4%	9%	13%	14%	13%	11%		
Cost of Goods Sold	2,068	2,160	2,177	2,492	2,756	3,108	3,493	3,835	12	0
% of Total Sales	18.9%	18.7%	19.6%	20.6%	20.1%	19.8%	19.7%	19.4%		
SG&A	3,228	3,417	3,424	3,847	4,237	4,662	5,107	5,634		
% of Total Sales	29.5%	29.6%	30.9%	31.8%	30.9%	29.7%	28.8%	28.5%		
Co-marketing Fees	0	0	0	2	77	184	280	349		
Total SG&A	3,228	3,417	3,424	3,850	4,314	4,846	5,387	5,983	12	0
% of Total Sales	29.5%	29.6%	30.9%	31.8%	31.5%	30.9%	30.4%	30.3%		
R&D	2,019	2,235	2,149	2,330	2,625	2,940	3,295	3,645	11	1
% of Total Sales	18.4%	19.4%	19.4%	19.3%	19.1%	18.7%	18.6%	18.4%		
Operating Income	3,638	3,730	3,328	3,427	4,017	4,802	5,557	6,307	14%	14%
% of Total Sales	33.2%	32.3%	30.0%	28.3%	29.3%	30.6%	31.3%	31.9%		
Cialis sales (ICOS JV)	-	-	-	100	250	440	585	725		
Alliance Income	-	-	(38)	(55)	63	132	216	268	-	1
Interest Income	265	282	187	167	279	382	492	608	27%	2%
Interest Expense	(182)	(147)	(80)	(64)	(123)	(149)	(185)	(202)	20%	(1)%
Interest, net	82	135	107	103	155	232	306	405	30	1
Other Income/(Expense)	3	(1)	145	125	125	100	75	75		
Total Int./Other (Cont'g Ops)	86	134	214	173	343	464	598	749	28	1
Pretax Income (Cont'g Ops)	3,724	3,864	3,542	3,600	4,360	5,267	6,155	7,055	15%	15%
% to Total Sales	34%	33%	32%	30%	32%	34%	35%	36%		
Taxes	819	850	779	792	959	1,159	1,354	1,552	15	(0)
Tax Rate	22%	22%	22%	22%	22%	22%	22%	22%		
Net Income (cont. ops, pre-extraord)	$2,905	$3,014	$2,763	$2,808	$3,401	$4,108	$4,801	$5,503	15%	15%
% to Total Sales	27%	26%	25%	23%	25%	26%	27%	28%		
Diluted EPS (pre-extr'y)	**$2.65**	**$2.76**	**$2.55**	**$2.60**	**$3.15**	**$3.80**	**$4.45**	**$5.10**	**15%**	**15%**
% Change	16%	4%	-8%	2%	21%	21%	17%	15%		
Shares Outstanding (MM)—Diluted	1,098	1,091	1,085	1,080	1,080	1,080	1,080	1,080		

Source: Company reports and JPMorgan estimates.

Rating: Neutral

Merck (MRK)

Investment Thesis

While MRK's '03 EPS guidance of double-digit core pharma growth may be a challenge, compounded by competition for Zocor (AZN's Crestor [4Q03] and generics in several EU markets [2Q03]) and generic competition for AZN's Prilosec, consensus expectations are low (near bottom of MRK's guidance), the Zetia launch is going well, and most of the key drivers (Fosamax and Cozaar) are progressing as expected (Singulair could beat on the upside owing to its new allergy indication). In the meantime, MRK's pipeline is maturing with three near-term promising launches (i.e., Zetia-Zocor [cholesterol, filing end '03], Aprepitant [depression, filing 2004], and Arcoxia [COX-2 for pain, arthritis, filing end '03]) and two longer-term, high potential prospects (i.e., MK-747 for diabetes and HPV vaccine). However, all of these longer-term compounds are high risk (e.g., a novel Phase II anxiolytic was discontinued in Feb. and a PDE4 inhibitor for COPD/asthma in Apr.), have multiple competitors, and if launched may not beat the 2006 Zocor patent expiration. Furthermore, a ruling in the Fosamax once-daily appeals case is around the corner (2H03), and while we view a generic win as unlikely, there are risks for MRK despite their earlier district court win. Although long-term EPS growth is unlikely to exceed the peer group and the 2006 Zocor patent expiration will loom increasingly large, the risk of near-term EPS disappointment appears small (as does the opportunity for an upside surprise). Based on the stock's current valuation (single-digit discount to its peers on our 2004 EPS estimate of $3.65), we see little meaningful upside or downside risks to MRK's stock, and although EPS growth is modest, it appears to be predictable.

Positives

- Three robust blockbusters (Fosamax, Cozaar, and Singulair) plus strong Zetia launch (although shared with SGP)
- Singulair could beat on the upside driven by new allergy indication
- No major anticipated patent expirations until Zocor (2006)
- Consensus expectations are low (low end of MRK's guidance in '03), reducing the chance of a disappointment.

Risks

- Guidance of double-digit Rx EPS growth in '03 remains a challenge
- Zocor ex-U.S. patent expiries (2Q03) and competition from AZN's Crestor (4Q03) could hinder sales growth.
- Vioxx faces a potential new challenge, NVS's Prexige (1H04), before Arcoxia is expected to be approved (2H04).
- Pipeline products are all high risk, some face multiple competitors, and most are several years away from reaching the market.
- Dependence on Medco could be a risk post-spinoff (2003).
- Fosamax patent case appeal ruling may not be a layup (2H03)

Key Issues to Watch

- Zetia launch trajectory and AZN supply payment trend
- Ongoing growth trends for key growth drivers
- Progress on pipeline products, particularly Aprepitant (depression) and Arcoxia (Cox-II, arthritis)
- Medco spinoff (mid-2003)
- Competition from Crestor (4Q03) and Prexige (1H04)

Summary of Earnings Estimates

	7/10/03 Price	1Q	2Q	3Q	4Q	FY	P/E	Prem./(Disc.) Drug Grp
JPMorgan	$61.04							
2002		$0.71	$0.77	$0.83	$0.83	$3.14	19.4	(7)%
2003E		$0.76	**$0.83**	**$0.89**	**$0.89**	**$3.37**	**18.1**	**(8)%**
2004E						**$3.65**	**16.7**	**(2)%**
First Call								
2003E		$0.76	**$0.84**	**$0.90**	**$0.92**	**$3.41**	**17.9**	**(9)%**
2004E						**$3.71**	**16.5**	**(4)%**

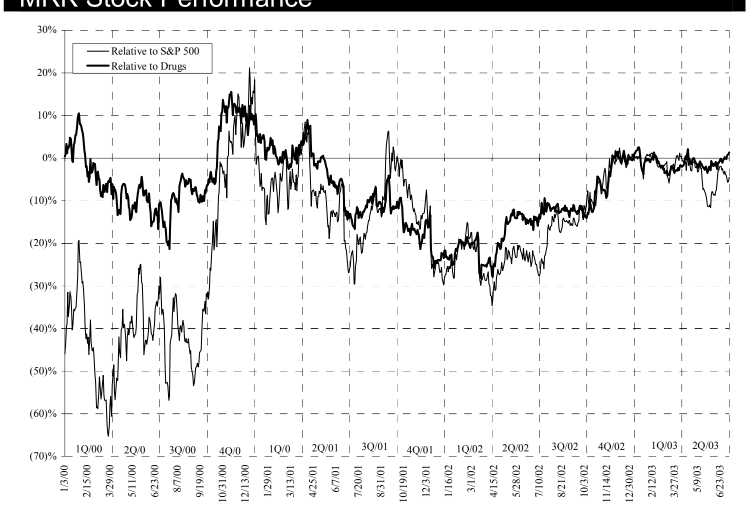
Sales & Earnings Drivers

JPMorgan Ests.	2002-05E	Incremental Net Sales 2002-2005E		
Key Products	**CAGR**	**$ mil.**	**% of Sls Grth**	**Cont. to Sls**
Products going generic*	-61%	(1,429)	-10%	-0.8%
Zocor (cholesterol)	0%	(45)	0%	0.0%
Fosamax (Osteoporosis)	19%	1,535	11%	0.9%
Cozaar (hypertension)	12%	875	6%	0.5%
Singulair (asthma)	21%	1,170	8%	0.7%
Vioxx (COX-2: arthritis)	0%	(30)	0%	0.0%
Zetia family @ 50% sls	324%	849	6%	0.5%
All Other Drugs	14%	2,949	21%	1.7%
Total Pharma**	**8%**	**5,873**	**42%**	**3.5%**
Medco	8%	8,141	58%	4.8%
Total Sales**	8%	14,014	100%	8.3%

***Includes Prinivil, Mevacor, Pepcid and Prilosec. ** Includes 50% of Zetia franchise sales**

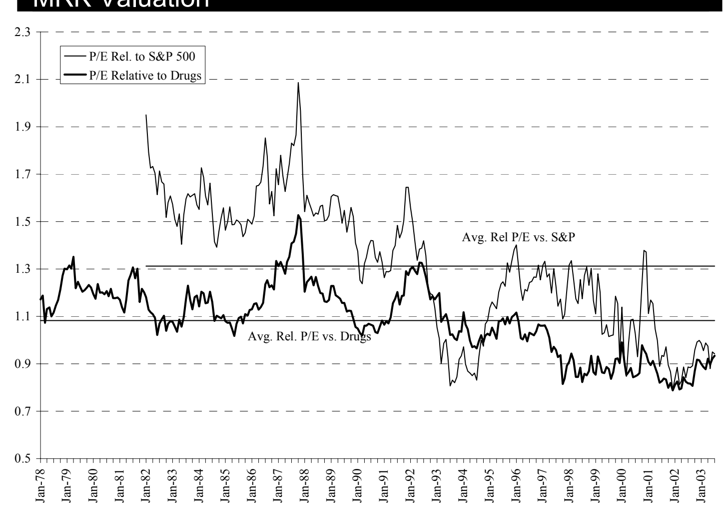
- Total sales and pharma sales are projected to increase 8% per year from 2002-05 (incl. ~50% of Zetia franchise sales).
- Est. operating margin erosion of 40 bps to 18.7% from 2002 to 2005 due to a 70 bps contraction in gross margins owing to higher Medco sales, offset by lower SG&A (-30 bps).
- For MRK's consolidated business and pharma division we project EPS growth of 7% in 2003, 8% in 2004, and 14% in 2005.

MRK Stock Performance



Source: FactSet. Note: All prices are indexed to 12/31/02.

MRK Valuation



Source: FactSet.

Second Quarter Outlook

Second quarter 2003 EPS is expected to grow 7% to $0.83 ($0.01 below consensus) driven by total sales growth of 8%. Medco sales are projected to grow only 7% owing to contract losses, while pharma sales (including ~ 50% of total Zetia JV sales) should grow 10%, boosted by Zocor (+16% owing to easy comp. [2Q02 buyout]), Fosamax (+7% due to destocking), and Cozaar (+17%) sales growth, but offset by weak Vioxx (-20% owing to label change in April 2002 and highlighted CV risks) and Prinivil sales (87% decline owing to generics, which were launched in June 2002). Gross margins are forecasted to expand 20 basis points to 35.3% (modest decrease in Medco share), while SG&A and R&D are estimated to grow 10% and 8%. As a result, the operating margin is forecasted to remain unchanged at 18.8% (Merck's tax rate is projected to modestly improve 50 basis point to 29.5%). For the full year, we expect MRK's EPS to grow 7% to $3.37 ($0.04 below consensus and below MRK's guidance of $3.40-3.47).

Table 23: Merck Summary Quarterly P&L (Net Product Sales)

($ in millions, except per share data)

								% Change Year Over Year					
	2Q02	**1Q03**	**2Q03E**	**3Q03E**	**4Q03E**	**2003E**	**2004E**	**1Q03**	**2Q03E**	**3Q03E**	**4Q03E**	**2003E**	**2004E**
Zocor	1,209	1,250	1,405	1,440	1,510	5,605	5,775	8%	16%	-2%	-13%	0%	3%
Fosamax	588	813	630	635	767	2,845	3,325	59%	7%	40%	10%	26%	17%
Cozaar	532	644	625	620	706	2,595	2,850	51%	17%	13%	3%	18%	10%
Singulair	224	473	490	475	482	1,920	2,315	13%	119%	36%	-6%	28%	21%
Vioxx	796	527	640	675	688	2,530	2,515	-12%	-20%	-11%	81%	0%	-1%
Prinivil	187	36	25	20	16	97	40	-82%	-87%	-75%	30%	-80%	-59%
Pharma. Prod.	5,191	5,717	5,694	5,678	6,000	23,089	24,540	18%	10%	3%	-1%	7%	6%
*Memo: Adj. Sls***	*5,191*	*5,738*	*5,732*	*5,732*	*6,067*	*23,269*	*24,929*	*18%*	*10%*	*4%*	*0%*	*8%*	*7%*
Medco	7,620	7,671	8,125	8,250	8,529	32,575	35,325	5%	7%	12%	9%	8%	8%
Total Sales	12,811	13,388	13,819	13,928	14,529	55,664	59,865	10%	8%	8%	4%	7%	8%
Gross Margin %	35.3%	36.9%	35.5%	35.5%	35.5%	35.8%	35.5%	18%	8%	3%	-1%	6%	8%
SG&A % Sales	11.5%	12.7%	11.8%	11.1%	11.0%	11.6%	11.7%	16%	10%	-1%	-5%	5%	8%
R&D % Sales	4.9%	5.4%	5.0%	4.8%	5.8%	5.2%	5.2%	36%	8%	-2%	1%	9%	8%
Operating Margins	18.8%	18.8%	18.8%	19.7%	18.6%	19.0%	18.6%	15%	8%	6%	0%	7%	5%
Pretax Margins	19.5%	18.4%	19.2%	20.3%	19.5%	19.4%	19.3%	6%	6%	5%	5%	5%	8%
Tax Rate	30.0%	30.6%	29.5%	29.5%	29.7%	29.8%	29.8%	8%	4%	3%	4%	5%	8%
Net Income	1,752	1,710	1,872	1,990	1,990	7,562	8,126	5%	7%	6%	5%	6%	7%
Diluted EPS	**$0.77**	**$0.76**	**$0.83**	**$0.89**	**$0.89**	**$3.37**	**$3.65**	**7%**	**7%**	**7%**	**7%**	**7%**	**8%**

Source: Company reports and JPMorgan estimates.

** Adjusted pharma sales include 45% of Zetia sales and 50% of Zetia/Zocor sales.

Merck Late-Stage Product Pipeline

Drug/Compound	Phase	Filing	Comments
Arcoxia (etoricoxib)	Refile	2H03	COX-2 inhibitor for pain and arthritis – important CV risk data
Zetia+Zocor	III	late '03	Fixed dose combo for cholesterol
Aprepitant	III	2003/04	Substance P/NK-1 antagonist for depression
Rotavirus vaccine	III	2004/05	Oral vaccine for infants
MK-767 (KRP 297)	III	2004/05	dPPAR α/γ agonist for type II diabetes.
Zoster vaccine	III	2005/06	Adult vaccine for shingles
HPV vaccine	III	2005/06	HPV vaccine to prevent cervical cancer
HIV integrase inhibitor	I	2006/07	Novel drug for HIV
HIV vaccine	I	2006/07	

Source: Company reports and JPMorgan research.

Merck Upcoming Events Calendar

Timing	Event	Comments
July 21	2Q EPS results	Expect 7% growth to $0.83 ($0.01 below cons.); 9am conf. call (913-981-5571)
1H03	Zocor ex-US patent expiry	2Q03 - UK, Germany, and other EU, mid-03 - Japan
2H03	NDA refiling-Arcoxia	COX-2 inhibitor for pain and arthritis
2H03	Fosamax once-weekly court ruling	Expect ruling in MRK's favor in patent infringement case vs. Teva and Zenith
Late '03	NDA filing-Zetia/Zocor	Fixed dose combo for cholesterol
Sept. 03	NVS' Prexige 10 mo. PDUFA	While Prexige, a Vioxx competitor, could be approved in late '03, launch is not expected until 1H04
3Q03	Medco spinoff	Contingent on market conditions
4Q03	AZN's Crestor approval	Competitor to Zocor

Source: Company reports and JPMorgan estimates.

Table 24: Merck Annual Income Statement and Contribution to Growth

($ in millions)

	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	2002-2007E Growth	2002-2007E Contrib. to Growth
Net Product Sales										
Vasotec (hypertension, heart failure)	$1,414	$957	$790	$696	$595	$500	$415	$335	-16%	0%
Prinivil (hypertension, heart failure)	762	707	480	97	40	25	20	15	(50)	(0)
Subtotal ACE Inhibitors	2,175	1,664	1,270	793	635	525	435	350	(23)	(0)
Mevacor (cholesterol)	393	274	110	57	40	25	20	15	(33)	(0)
Zocor (cholesterol)	4,428	5,272	5,580	5,605	5,775	5,535	3,895	1,975	(19)	(1)
Subtotal Cholesterol	4,820	5,546	5,690	5,662	5,815	5,560	3,915	1,990	(19)	(1)
Pepcid (ulcers)	714	287	55	22	15	8	7	6	(36)	(0)
Primaxin (antibiotic)	595	585	585	665	655	655	655	655	2	0
Hepatitis Vaccines	266	254	225	250	255	260	265	270	4	0
Viral Vaccines	510	501	555	585	610	635	660	685	4	0
HPV Vaccine	-	-	-	-	-	-	250	500	-	0
Rotateq (rotavirus vaccine)	-	-	-	-	-	95	140	185	-	0
Zoster vaccine (shingles)	-	-	-	-	-	-	35	100	-	0
Other vaccines	175	170	245	245	250	255	260	265	-	0
Proscar (prostate enlargement)	447	546	550	565	530	505	480	335	(9)	(0)
Trusopt/Cosopt (glaucoma)	348	405	425	450	470	490	510	525	4	0
Timoptic (glaucoma)	232	200	165	135	110	93	77	61	(18)	(0)
Fosamax (Osteoporosis)	1,187	1,627	2,250	2,845	3,325	3,785	4,200	4,525	15	1
Cozaar (hypertension)	1,638	1,808	2,190	2,595	2,850	3,065	3,250	3,410	9	0
Crixivan (HIV)	509	386	290	245	175	130	95	65	(26)	(0)
Propecia (baldness)	195	210	215	210	200	190	180	170	(5)	(0)
Singulair (asthma)	793	1,271	1,505	1,920	2,315	2,675	3,000	3,285	17	1
Maxalt (migraine)	176	235	295	320	340	360	375	390	6	0
Aggrastat (unst. angina)	125	115	115	105	125	140	155	165	7	0
Vioxx (COX-2: arthritis)	1,986	2,348	2,530	2,530	2,515	2,500	2,495	2,480	(0)	(0)
Arcoxia (etoricoxib—COX-2 inhibitor)	-	-	30	70	145	450	685	825	94	0
Invanz (carbapenem antibiotic)	-	-	15	55	125	200	270	325	86	0
Cancidas (anti-fungal)	-	40	105	210	260	310	365	420	32	0
Emend (Aprepitant, emesis)	-	-	-	75	300	340	340	340	-	0
Aprepitant (Substance P, depression)	-	-	-	-	25	575	875	1,150	-	0
MK-767 (KRP-297, diabetes)	-	-	-	-	-	-	100	300	-	0
PDE-4 Inhibitor (asthma/COPD)	-	-	-	-	-	-	-	-	-	0
Other New drugs	-	-	-	-	-	395	675	950	-	0
Astra Pharma Sales: Prilosec (est.)	4,234	3,694	2,730	1,060	320	100	50	25	(61)	
Nexium (est.)	-	456	1,475	1,918	2,263	2,534	2,788	3,011	15	
Atacand (est.)	119	154	215	280	345	400	450	500	18	
Plendil (est.)	191	203	185	70	40	20	10	5	(51)	
Total (incl. other)	4,544	4,507	4,605	3,328	2,968	3,054	3,298	3,541	(5)	
Net pretax revs. and supply sls (est.)	2,205	2,068	1,632	1,937	1,935	1,940	1,947	1,950	4	0
Other drugs (est.)	1,030	1,085	694	600	560	520	485	450	(8)	(0)
Total Pharmaceuticals	**20,225**	**21,351**	**21,631**	**23,089**	**24,540**	**26,656**	**27,181**	**27,127**	**5%**	**2%**
% Change	16%	6%	1%	7%	6%	9%	2%	0%		
Medco revenues	20,138	26,365	30,159	32,575	35,325	38,300	41,150	44,200	8	5
Total Merck Sales	**$40,363**	**$47,716**	**$51,790**	**$55,664**	**$59,865**	**$64,956**	**$68,331**	**$71,327**	**7%**	**7%**
% Change	23%	18%	9%	7%	8%	9%	5%	4%		

Source: Company reports and JPMorgan estimates.

Table 24: Merck Annual Income Statement and Contribution to Growth (cont'd)

($ in millions, except per share data)

									2002-2007E	
	2000	**2001**	**2002**	**2003E**	**2004E**	**2005E**	**2006E**	**2007E**	**Growth**	**Contrib. to Growth**
Total Merck Sales	**$40,363**	**$47,716**	**$51,790**	**$55,664**	**$59,865**	**$64,956**	**$68,331**	**$71,327**	**7%**	**7%**
% Change	23%	18%	9%	7%	8%	9%	5%	4%		
COGS-Other Medco Sales (Est.)	19,131	25,205	28,968	31,207	33,820	36,630	39,315	42,184	8	
% to Other Medco Sales (Est.)	95.0%	95.6%	96.1%	95.8%	95.7%	95.6%	95.5%	95.4%		
COGS-Merck Ex-Medco (Est.)	3,312	3,772	4,085	4,523	4,795	5,235	5,501	5,656	7	
% to Merck Ex-Medco Sales (Est.)	16.4%	17.7%	19.3%	19.6%	19.5%	19.6%	20.2%	20.9%		
Cost of Goods Sold	22,444	28,977	33,054	35,730	38,615	41,865	44,816	47,841	8	(4)
% to Total Sales	55.6%	60.7%	63.8%	64.2%	64.5%	64.5%	65.6%	67.1%		
SG&A	6,168	6,224	6,187	6,475	7,000	7,550	7,950	8,000	5	1
% to Total Sales	15.3%	13.0%	11.9%	11.6%	11.7%	11.6%	11.6%	11.2%		
R&D	2,344	2,456	2,677	2,910	3,135	3,375	3,555	3,550	6	0
% to Pharma Sales	11.6%	11.5%	12.4%	12.6%	12.8%	12.7%	13.1%	13.1%		
% to Sales	5.8%	5.1%	5.2%	5.2%	5.2%	5.2%	5.2%	5.0%		
Operating Income	$9,408	$10,058	$9,873	$10,549	$11,115	$12,165	$12,010	$11,937	4%	4%
Operating Margin	23.3%	21.1%	19.1%	19.0%	18.6%	18.7%	17.6%	16.7%		
Joint Ventures:										
Merck-SGP Partnership Sales	-	-	25	400	860	1,860	2,980	3,875		
Zetia	-	-	25	400	835	1,400	1,810	2,100		
Zocor-Zetia combination	-	-	-	-	25	460	1,170	1,775		
Est. Income (pre-tax)	(24)	(118)	(176)	(304)	(171)	162	590	956	40	2
Astra-MRK*/Astra USA Revenues	180	200	220	240	260	280	300	320	8	
Est. Income (after-tax)	36	40	44	48	52	56	60	64	8	0
Priority return & Accr.-AMI JV	580	580	580	580	580	580	580	580	0	0
Pasteur Merieux MSD (vaccines) Sales	541	500	545	575	600	625	650	675	4	
Est. Income (after-tax)	33	31	33	35	37	38	40	41	4	0
J&J/Merck & Chugai MSD Consumer Sales	429	395	413	400	400	400	400	400	(1)	
Est. Income (pre-tax)	11	18	25	16	16	16	16	16	(9)	(0)
Merial Animal Health Sales	1,608	1,660	1,725	1,800	1,850	1,875	1,900	1,925	2	
Est. Income (pre-tax)	129	135	138	144	148	150	152	154	2	0
Total JV Income	765	686	644	519	662	1,002	1,437	1,811	23	2
Net Interest Income/(Expense)	(14)	25	29	9	71	168	291	442	73	1
Foreign Exchange	34	4	8	10	-	-	-	-		
Goodwill & Intangibles	(319)	(330)	(205)	(220)	(215)	(210)	(205)	(200)		
Minority Interests	(309)	(291)	(214)	(202)	(200)	(200)	(200)	(200)		
Other Income/(Expense)	258	250	79	107	150	150	150	150		
Non-Operating Income/(Expense)	416	344	341	223	467	910	1,474	2,003	43	3
% of Total Sales	1.0%	0.7%	0.7%	0.4%	0.8%	1.4%	2.2%	2.8%		
Pretax Income	$9,824	$10,403	$10,213	$10,772	$11,582	$13,075	$13,484	$13,940	6%	6%
Pretax Margin	24.3%	21.8%	19.7%	19.4%	19.3%	20.1%	19.7%	19.5%		
Taxes	3,002	3,121	3,064	3,210	3,456	3,902	4,024	4,154	6	0
Tax Rate	30.6%	30.0%	30.0%	29.8%	29.8%	29.8%	29.8%	29.8%		
Net Income	$6,822	$7,282	$7,149	$7,562	$8,126	$9,174	$9,460	$9,786	6%	6%
Net Margin	16.9%	15.3%	13.8%	13.6%	13.6%	14.1%	13.8%	13.7%		
Diluted EPS#	**$2.90**	**$3.14**	**$3.14**	**$3.37**	**$3.65**	**$4.15**	**$4.30**	**$4.45**	**7%**	**7%**
% Change	18%	8%	0%	7%	8%	14%	4%	3%		
Pharma EPS	**$2.81**	**$3.04**	**$2.98**	**$3.18**	**$3.44**	**$3.91**	**$4.02**	**$4.13**	**7%**	**7%**
% Change	17%	8%	-2%	7%	8%	14%	3%	3%		
Medco EPS	**$0.09**	**$0.11**	**$0.16**	**$0.19**	**$0.21**	**$0.24**	**$0.28**	**$0.32**	**15%**	**15%**
% Change	46%	20%	44%	21%	12%	12%	15%	16%		
Diluted Share Outstanding (MM)	2,353	2,322	2,277	2,245	2,225	2,210	2,200	2,200		

Source: Company reports and JPMorgan estimates.

EPS impact due to FASB accounting rule change, which eliminates the amortization of goodwill from past and future acquisitions. The provisions for goodwill and other intangible assets are effective for years beginning on or after January 1, 2002.

Rating: Overweight

Pfizer (PFE)

Investment Thesis

We project growth for PFE averaging 16% through '05, above both S&P 500 (about 9%) and the peer group (12%), and we view that growth as low risk, given the company's multiple blockbuster growth drivers and considerable financial flexibility (as reflected in the company's raising cost savings estimates by 36% to $3BN in '04 and by 60% to $4BN in '05). Our confidence in PFE's earnings outlook is based on (1) an underappreciated pipeline which represents a potential growth engine (even relative to PFE's size) that is well above the peer group average (potential blockbusters over next three years include Inspra, pregabalin, Spiriva, Lipitor-Norvasc, indiplon, roflumilast, Exubera, CDP 870 and lasofoxifene); (2) some credit for continued success with the best-in-class record of in-licensing and co-promotion deals (i.e., Lipitor, Celebrex, Bextra, Aricept, Exubera, Spiriva, Rebif, indiplon, and Macugen); (3) significant opportunity to leverage its industry-high cost base; and (4) impressive cash generating capability (proj. $70BN cash by '07), and a proven ability to use this financial power to "buy" growth (through in-licensing/co-promotion) if necessary. While Neurontin might lose its pending patent battle, generic competition is not likely before '04 (as assumed in our estimates). Were it to occur immediately, the EPS exposure would be about $0.05-0.06 in '03 and $0.05 in '04. Although EPS growth is decelerating, and financial leverage and cost cuts are part of the story, this is in our view fully reflected in PFE's current low valuation (1% discount to peers, despite above average growth projections).

Positives

- Solid earnings outlook (16% through '05 with PHA), above both S&P 500 (about 9%) and the peer group (12%)
- Underappreciated pipeline with 9 blockbuster potential launches expected over next three years
- Industry-high infrastructure and better than "targeted" synergies from the PHA transaction should provide cushion.
- Impressive cash generating ability and proven ability to "buy" growth if and when necessary (best-in-class record of in-licensing/co-promotion)
- Low valuation makes concerns about "earnings quality" largely moot, in our view

Risks

- Current blockbusters are decelerating (i.e., Zithromax, Norvasc, Zoloft, Celebrex)
- A few blockbusters will soon face new competition—AZN's Crestor (4Q03 launch), Bayer/GSK's Levitra and LLY's Cialis (2H03), NVS's Prexige (2004)
- Uncertainty still clouding Neurontin patent and to a less extent, Norvasc
- Patent expirations in '06 and '07 put squeeze on growth (Zithromax '06, Zoloft '06, Norvasc '07, Zyrtec '07)
- Each near-term pipeline product carries regulatory risk (especially Exubera [inhaled insulin] but also pregabalin)
- Low quality earnings growth driven by cost cuts

Key Issues to Watch

- Neurontin court battles & potential summary judgment ruling
- Pregabalin filing in U.S. (2003); Inspra CHF approval and launch (4Q03); Spiriva FDA approval (filed Dec. '01)
- Competitive launches in '03: Levitra (BAY/GSK), Cialis (LLY), Crestor (AZN), amlodipine maleate (Dr. Reddy's); Prexige (NVS) in '04
- Rx trends for Lipitor, COX-2s, Norvasc, Zoloft, Zithromax, Zyrtec.

Summary of Earnings Estimates

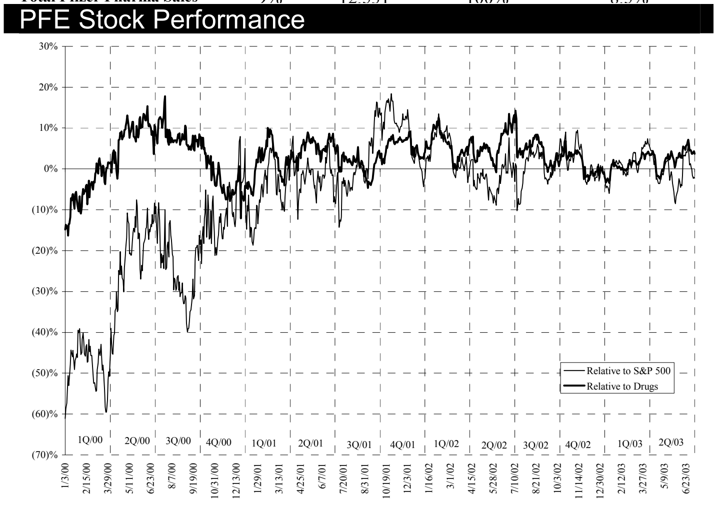
Price	7/10/03 Price	1Q	2Q	3Q	4Q	FY	P/E	Prem./(Disc.) Drug Grp
JPMorgan	$33.66							
2002A		$0.38	$0.32	$0.38	$0.46	$1.54	21.8	4%
2003E		**$0.44**	**$0.29**	**$0.44**	**$0.55**	**$1.73**	**19.4**	**(1)%**
2004E						**$2.10**	**16.0**	**(6)%**
First Call								
2003E		**$0.44**	**$0.29**	**$0.44**	**$0.55**	**$1.73**	**19.5**	**(1)%**
2004E						**$2.10**	**16.0**	**(6)%**

Sales & Earnings Drivers

JPMorgan ests. (pro forma)	'02-05E	Incremental Sales* 2002-2005E		
Key Products	**CAGR**	**$ mill.**	**% Sls Growth**	**Cont. to Sls**
Lipitor (cholesterol)	11%	2,943	23%	2.0%
COX-2s (arthritis, pain)	14%	1,753	14%	1.2%
Inspra (HTN)	-	600	5%	0.4%
Zoloft (depression)	7%	573	5%	0.4%
Viagra (impotence)	7%	415	3%	0.3%
Alliance Revenues (ex-COX-	39%	493	4%	0.3%
Pregabalin (epilepsy/neuro	-	1,875	15%	1.3%
Other Pharma Sales	4%	3,879	31%	2.6%
Total Pfizer Pharma Sales	9%	12,531	100%	8.5%

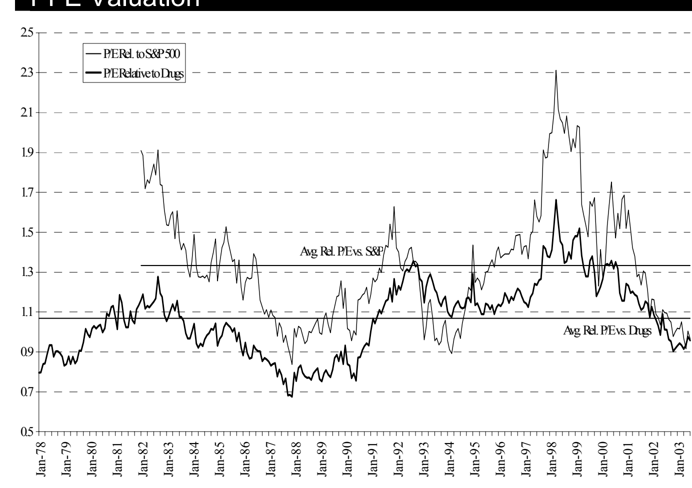
- Incorporating PHA into PFE beginning 4/16/03, we forecast 21% sales growth from 2002 to 2005 (pro-forma estimated at 9%).
- Estimated operating margin improvement of 360 bps to 41.6% by 2005, driven by merger cost cuts
- Estimated EPS growth of 16% through 2005.

PFE Stock Performance



Source: FactSet. Note: All prices are indexed to 12/31/02.

PFE Valuation



Source: FactSet.

Second Quarter Outlook

We project Pfizer's second quarter EPS to decline 9%, to $0.29 (in line with consensus and company guidance). 2Q results are expected to be negatively impacted by issues pertaining to the transitory harmonization of practices with PHA, including adjusting PHA's wholesaler/internal inventory levels from 2.2 months to PFE's standard 0.8 months (est. as a $0.06 hit). Total and pharmaceutical revenues are expected to each increase 35% (9-10% pro forma). The gross margin is expected to decline 290 bps to 83.8% (20 bps improvement pro forma), while SG&A and R&D spending are projected to increase 43% and 40%, respectively (10% and 5% pro forma, respectively). The operating margin should decline by 410 bps to 30.0% (210 bps improvement to 32.3% pro forma). For 2003, we project EPS growth of 12%, to $1.73 (in line with consensus and guidance). For 2004 (with PHA), we estimate 21% EPS growth to $2.10.

Table 25: Pfizer Summary Quarterly P&L (Incl. PHA Beginning 4/16/03)
($ in MMs, except per share data)

								% Change Year Over Year					
	2Q02	1Q/03	2Q/03E	3Q/03E	4Q/03E	FY2003E	FY2004E	1Q/03	2Q/03E	3Q/03E	4Q/03E	FY2003E	FY2004E
Lipitor	1,783	2,099	2,010	2,335	2,681	9,125	10,110	13%	13%	16%	16%	14%	11%
Norvasc	886	983	980	1,015	1,107	4,085	3,900	6%	11%	5%	4%	6%	-5%
Inspra	0	0	0	0	50	50	350	-	-	-	-	-	600%
Zoloft	574	758	635	760	857	3,010	3,230	2%	11%	16%	11%	10%	7%
Celebrex	-	-	155	730	773	1,658	3,010	-	-	-	-	-	82%
Bextra	-	-	202	330	390	922	1,655	-	-	-	-	-	79%
Geodon	48	78	85	100	112	375	500	105%	77%	75%	42%	69%	33%
Neurontin	458	624	530	630	721	2,505	995	10%	16%	11%	7%	10%	-60%
Zithromax	251	549	275	295	526	1,645	1,785	35%	10%	9%	-10%	9%	9%
Viagra	385	475	425	462	513	1,875	2,010	13%	10%	6%	4%	8%	7%
Zyrtec	302	293	340	310	347	1,290	1,430	33%	13%	12%	11%	16%	11%
Pharma. Prod.	5,876	7,217	8,293	10,542	12,000	38,052	44,807	12%	41%	60%	54%	43%	18%
Alliance Income	388	331	170	99	104	704	554	10%	-56%	-77%	-78%	-56%	-21%
Other Divisions	1,028	977	1,362	1,531	1,825	5,694	6,690	0%	32%	54%	69%	39%	17%
Total Sales	7,292	8,525	9,825	12,172	13,929	44,450	52,051	10%	35%	52%	49%	37%	17%
Gross Margin %	86.7%	87.0%	83.8%	84.2%	84.5%	84.7%	84.6%	10%	35%	55%	52%	33%	17%
SG&A % Sales	36.5%	32.2%	38.6%	43.2%	34.0%	34.8%	34.4%	8%	43%	60%	58%	43%	16%
R&D % Sales	16.9%	14.3%	17.5%	19.9%	16.2%	16.1%	15.9%	3%	40%	56%	48%	38%	16%
Cost cuts	-	-	(200)	(300)	(500)	(1,000)	(3,000)	-	-	-	-	-	-
Operating Margins	34.1%	41.0%	30.0%	35.9%	38.4%	36.3%	40.2%	14%	19%	42%	46%	31%	29%
Pretax Margins	34.9%	41.7%	30.1%	36.3%	38.9%	36.8%	41.0%	13%	16%	43%	45%	31%	31%
Tax Rate	21.0%	23.7%	21.6%	23.0%	23.5%	23.1%	23.3%	9%	20%	45%	49%	32%	32%
Net Income	2,011	2,711	2,316	3,395	4,142	12,564	16,364	14%	15%	43%	44%	30%	30%
Diluted EPS	$0.32	$0.44	$0.29	$0.44	$0.55	$1.73	$2.10	17%	(9)%	15%	19%	12%	21%

Source: Company reports and JPMorgan estimates.

Pfizer Late-Stage Product Pipeline

Drug/Compound	Phase	Filing	Comments
Spiriva	App'ble	Dec-01	Chronic obstructive pulmonary disorder (COPD); co-marketed with B.I. Chemicals
Lipitor-Norvasc	Filed	3/31/03	Cholesterol/hypertension
Inspra (eplerenone)	Filed	Apr-03	For treating CHF (priority review)
pregabalin	III	2H03	Cyclic peptide for seizures, neuropathic pain, and GAD (filed in E.U. Mar. '03)
Dynastat	III	2004	Refiling of intravenous COX-2 inhibitor for pain
indiplon	III	Early '04	Non-benzodiazepine for insomnia acting on a specific site of the GABA-A receptor
Exubera	III	2004/05	Inhaled insulin for diabetes to be co-marketed with Aventis
lasofoxifene	III	2004/05	SERM for osteoporosis
capravirine	III	2004/05	Non-nucleotide reverse transcriptase inhibitor for HIV
roflumilast	III	2004/05	U.S. filing of roflumilast, a PDE4 inhibitor for COPD and asthma (filing yearend 2003 in E.U.)
CDP-870	III	2004/05	Anti-TNFα for rheumatoid arthritis
sumanirole	III	2004/05	Dopamine antagonist for Parkinson's disease
Lipitor-torcetrapib	III	2005/06	HDL elevator/LDL lowerer
Macugen	III	2005/06	Anti-VEGF aptamer administered by intravitreal injection for wet age-related macular degeneration (AMD) and diabetic macular edema (DME)
varenicline	III	2005/06	Nicotine partial agonist for smoking cessation
Zithromax-chloroquine	III	2005/06	Malaria
PD-220390	II	2007	Alpha 2 delta ligand for sleep disorder
CP-690550	II	2007	JAK 3 inhibitor for transplant rejection
SU-11248	II	2007	VEGFR plus inhibitor for cancer
UK-427857	II	2007	CCR5 antagonist for HIV
2MD	I	NA	(w/ Deltanoid) Novel vitamin D compound for osteoporosis
DK-507k	I	NA	(w/ Daiichi) Novel once-daily broad-spectrum floroquinolone for bacterial infections

Source: Company reports and JPMorgan estimates.

Pfizer Upcoming Events Calendar

Timing	Event	Comments
Wk of 7/21	2Q03 earnings	Project 2Q03 EPS to decline 9% to $0.29 (in line with consensus and company guidance).
Aug-03	Potential competitive launch—Dr. Reddy's amlodipine maleate	Dr. Reddy's competitor product to PFE's Norvasc (amlodipine besylate) is awaiting final FDA approval and could be launched as early as Aug. '03.
2H03	Court–Neurontin	Potential summary judgment on patent litigation.
2H03	FDA filing–pregabalin	For use in neuropathic pain, epilepsy and GAD.
4Q03	FDA approval and launch–Inspra	First selective aldosterone blocker (SAB); indicated for hypertension; pending sNDA for CHF
4Q03	Competitive launch—Crestor (AZN)	"Approvable" letter received in June '02; recommended for approval by advisory committee (July 9); PDUFA deadline Aug '03.
4Q03	Competitive approval—Prexige (NVS)	COX-189 was filed in both the U.S. and the E.U. in Nov. '02. Competitor to Celebrex and Bextra.
2004	FDA filing—Dynastat	Intravenous COX-2 inhibitor for pain already launched in the E.U.; to be refiled with the FDA following a "not approvable" letter in July 2001.
1Q04	FDA approval–Lipitor-Norvasc	Cholesterol/hypertension.
2004	FDA filing—indiplon (insomnia)	Potential blockbuster in-licensed from Neurocrine could be filed in early '04.
Jun'04	Competitive data—Prexige (NVS)	Data of one-year TARGET trial (enrollment completed in Dec. '02) to be released. Primary endpoint is POBs.

Source: Company reports and JPMorgan estimates.

Table 26: Pfizer Annual Income Statement and Contribution to Growth

($ in millions)

	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	2002-2007E Growth	2002-2007E Contrib. to Growth
Revenues										
COX-2 inhibitors (arthritis, pain)				2,663	4,815	5,280	5,780	6,255	-	3
Lipitor (cholesterol)	5,030	6,449	7,972	9,125	10,110	10,915	11,720	12,540	9	2
Norvasc (hypertension, angina)	3,361	3,582	3,846	4,085	3,900	3,800	3,460	2,800	(6)	(0)
Cardura (hypertension, prostate)	795	552	531	550	565	575	585	590	2	0
Zoloft (anti-depressant)	2,140	2,364	2,742	3,010	3,230	3,315	2,110	1,195	(15)	(1)
Zithromax (macrolide antibiotic)	1,382	1,506	1,516	1,645	1,785	1,915	1,120	550	(18)	(0)
Diflucan (antifungal)	1,014	1,065	1,112	1,155	950	515	375	305	(23)	(0)
Viagra (impotence)	1,344	1,518	1,735	1,875	2,010	2,150	2,295	2,445	7	0
Zyrtec (anti-allergy)	699	990	1,115	1,290	1,430	1,575	1,685	1,775	10	0
Geodon (schizophrenia)	-	150	222	375	500	600	665	735	27	0
Neurontin (epilepsy)	1,334	1,750	2,269	2,505	995	540	375	250	(36)	(1)
Pregabalin (next Neurontin)	-	-	-	-	525	1,875	2,700	3,350	-	2
Xalatan (glaucoma)				688	1,115	1,190	1,270	1,350	-	1
Camptosar (cancer)				445	660	705	755	805	-	0
Pharmorubicin/Ellence (cancer)				263	450	510	455	270	-	0
Detrol/LA (urinary incontinence)				587	970	1,060	1,140	1,220	-	1
Zyvox (novel antibiotic)				163	290	330	365	400	-	0
Genotropin (human growth hormone)				414	650	695	740	785	-	0
Fragmin (low molecular weight				200	310	315	315	315	-	0
Inspra (HTN/CHF)				50	350	600	950	1,250	-	1
sumanirole (Parkinson's)				-	-	70	150	205	-	0
CDP 870 (rheumatoid arthritis)				-	-	275	650	975	-	0
SU-11248 (VEGFR plus inhibitor)				-	-	-	40	125	-	0
varenicline (smoking cessation)	-	-	-	-	-	125	325	525	-	0
Relpax (migraine)	-	3	16	165	225	270	310	345	85	0
Vfend (anti-fungal)	-	-	41	145	235	300	355	410	58	0
Lipitor-Norvasc (cholesterol, HTN)	-	-	-	-	450	740	1,000	1,290	-	1
Lipitor-torcetrapib (HDL, LDL)	-	-	-	-	-	-	100	650	-	0
lasofoxifene (osteoporosis)	-	-	-	-	-	125	240	435	-	0
indiplon (insomnia)	-	-	-	-	-	200	425	700	-	0
capravirine (NNRTI-HIV/AIDS)	-	-	-	-	-	90	190	275	-	0
Exubera (diabetes)	-	-	-	-	-	200	375	550	-	0
Other new pharmaceuticals				63	85	715	1,370	2,110	-	1
Other pharmaceuticals	4,310	3,757	3,575	6,590	8,202	8,291	8,255	8,200	18	2
Pharmaceutical Co-Promotions										
Aricept (Alzheimer's, from Eisai)—Est.	700	740	795	870	940	1,010	1,080	1,150	8	0
Spiriva (COPD, from B.I.)	-	-	75	150	530	925	1,325	1,650		1
roflumilast (COPD, from Altana)				-	25	250	500	800		
Rebif (MS, from Serono)				215	300	375	425	470		
Macugen (AMD, DME, from EyeTech)	-	-	-	-	-	-	100	225		
Celebrex (COX-2, from PHA)	2,614	3,114	3,050	787	-	-	-	-	(100)	(1)
Bextra (COX-2, from PHA)	-	-	470	263	-	-	-	-	(100)	(0)
Alliance Revenues (a)	1,158	1,380	1,596	704	554	787	1,050	1,310	(4)%	(0)%
Total Pharmaceuticals	22,567	25,065	28,288	38,756	45,361	50,648	53,695	57,290	15%	13%
% change	12%	11%	13%	37%	17%	12%	6%	7%		
Capsugel	407	409	436	465	485	500	515	530	4	0
Animal Health	1,051	1,021	1,119	1,589	1,850	1,915	1,975	2,035	13	0
Consumer	3,315	2,355	2,530	3,237	3,680	3,827	3,970	4,113	10	1
Confectionary	2,015	0	0	0	0	0	0	0	-	0
Other				403	675	705	735	760	-	0
Net Sales	28,197	27,471	30,777	43,746	51,497	56,808	59,840	63,418	16	15
% change	6%	-3%	12%	42%	18%	10%	5%	6%		
Total Revenues	**29,355**	**28,850**	**32,373**	**44,450**	**52,051**	**57,595**	**60,890**	**64,728**	**15%**	**15%**
% change	7%	-2%	12%	37%	17%	11%	6%	6%		

Source: Company reports and JPMorgan estimates.

Notes: (a) Pfizer's share of revenues from the alliance(s). (b) 2001 and after - Adams, Tetra, Schick, etc. become discont'd ops.
(c) 2002 and before - PFE standalone; 2003 - PFE plus PHA beginning 4/16/03; 2004 and after - PFE plus PHA.

Table 26: Pfizer Annual Income Statement and Contribution to Growth (cont'd)

($ in millions, except per share data)

									2002-2007E	
	2000	**2001**	**2002**	**2003E**	**2004E**	**2005E**	**2006E**	**2007E**	**Growth**	**Contrib. to Growth**
Total Revenues	**29,355**	**28,850**	**32,373**	**44,450**	**52,051**	**57,595**	**60,890**	**64,728**	**15%**	**15%**
% change	7%	-2%	12%	37%	17%	11%	6%	6%		
Cost of Goods	5,007	3,823	4,045	6,673	7,928	8,692	9,206	9,770	19	
% to Total Revenues	17.1%	13.3%	12.5%	15.0%	15.2%	15.1%	15.1%	15.1%		(2)
% to Net Sales	17.8%	13.9%	13.1%	15.3%	15.4%	15.3%	15.4%	15.4%		
SG&A	11,223	9,707	10,846	15,487	17,925	19,826	20,891	22,079	15	
% to Total Revenues	38.2%	33.6%	33.5%	34.8%	34.4%	34.4%	34.3%	34.1%		(0)
R&D	4,435	4,776	5,176	7,136	8,286	9,129	9,681	10,293	15	
% to Total Revenues	15.1%	16.6%	16.0%	16.1%	15.9%	15.9%	15.9%	15.9%		0
Cost Cuts	0	0	0	(1,000)	(3,000)	(4,000)	(4,000)	(4,000)		
% to Total Revenues	0.0%	0.0%	0.0%	-2.2%	-5.8%	-6.9%	-6.6%	-6.2%		
Operating Income	$8,690	$10,544	$12,306	$16,154	$20,912	$23,947	$25,111	$26,586	17%	17%
Operating Margin	29.6%	36.5%	38.0%	36.3%	40.2%	41.6%	41.2%	41.1%		
Interest Income	558	539	382	433	732	972	1,467	1,992		
Interest Expense	(386)	(266)	(251)	(375)	(449)	(488)	(456)	(446)		
Other non-operating Inc/(Expense)	64	11	65	128	145	120	120	120		
Non-Operating Income/(Exp)	236	284	196	187	428	604	1,131	1,666	53	1
Pretax Income	$8,926	$10,828	$12,502	$16,341	$21,340	$24,551	$26,242	$28,252	18%	18%
Pretax Margin	30.4%	37.5%	38.6%	36.8%	41.0%	42.6%	43.1%	43.6%		
Taxes	2,424	2,713	2,861	3,771	4,970	5,725	6,123	6,591	18	-
Tax Rate	27.2%	25.1%	22.9%	23.1%	23.3%	23.3%	23.3%	23.3%		
Minority Interests	14	14	6	6	6	6	6	6	0	-
Net Income (Excl. extraordinary)	**$6,488**	**$8,101**	**$9,635**	**$12,564**	**$16,364**	**$18,819**	**$20,113**	**$21,655**	**18%**	**18%**
Net Margin	22.1%	28.1%	29.8%	28.3%	31.4%	32.7%	33.0%	33.5%		
Diluted EPS (cont. ops, excl. extr.)	**$1.02**	**$1.27**	**$1.54**	**$1.73**	**$2.10**	**$2.42**	**$2.58**	**$2.78**	**13%**	**13%**
Percent Change	24%	25%	21%	12%	21%	16%	7%	8%		
Diluted Shares (MM)	6,368	6,361	6,241	7,250	7,781	7,781	7,781	7,781	5	(5)
Discontinued Ops (after-tax)	8	251	278	33						
Net Income (incl. discont'd ops)	6,496	8,352	9,913	12,597	16,364	18,819	20,113	21,655	17%	17%
Diluted EPS (incl. discont'd ops)	$1.02	$1.31	$1.59	$1.74	$2.10	$2.42	$2.58	$2.78	12%	12%
Percent Change	24%	29%	21%	9%	21%	15%	7%	8%		
After- Tax Extraodinary Charges (d)	(2,769)	(563)	(787)	(5,300)	(700)	(500)	0	0		
PHA gdwill amort./increm. fixed asset dep.				(1,400)	(2,100)	(2,100)	(2,100)	(2,100)		
Net Income (Incl. extraordinaries)	$3,727	$7,789	$9,126	$5,897	$13,564	$16,219	$18,013	$19,555	16%	16%
Diluted EPS (incl. extrarodinaries)	$0.59	$1.22	$1.46	$0.81	$1.74	$2.08	$2.31	$2.51	11%	11%
Percent Change	-25%	109%	19%	-44%	114%	20%	11%	9%		

Source: Company reports and JPMorgan estimates.

Notes: (a) Pfizer's share of revenues from the alliance(s). (b) 2001 and after - Adams, Tetra, Schick, etc. become discont'd ops.

(c) 2002 and before - PFE standalone; 2003 - PFE plus PHA beginning 4/16/03; 2004 and after - PFE plus PHA.

(d) 2003 includes $13BN write-off of in-process R&D from PHA acquisition.

Rating: Neutral

Schering-Plough (SGP)

Investment Thesis

Although we do not expect SGP to return to 2002 EPS levels until 2006/07, potential variance to our forecast (both up and downside), particularly in the outyears, is high owing to a lack of clarity on gross margin trends, the profitability of the Zetia JV, and the extent of cost cuts, where there is significant EPS leverage. Current operating margins are abnormally compressed but will likely snap back when the allergy and hepatitis-C franchise sales declines end and the Zetia/Zetia-Zocor profit growth kicks in. SGP's rich valuation, however, leaves little room for short-term upside (already discounts strong Zetia growth and assumes no additional EPS downside) while news flow in the near-term could be negative (i.e., generic ribavirin and a dividend cut are both possibilities, although increasingly expected). That said, it appears that SGP's current investor base is willing to weather near-term bumps and is unlikely to sell unless the long-term bullish thesis (i.e., 30%+ Zetia-driven EPS growth after '03) becomes tainted.

Positives

- Strong Zetia launch and blockbuster potential could drive 30%+ EPS growth beyond 2003 (Zetia/Zocor filing expected late '03).
- Bad news relative to generic ribavirin expected (4Q03 launch) - a potential delay could lead to temporary near-term EPS benefit·
- Future costs cuts could be greater than expected·
- Potential upside (e.g., an acquisition of SGP as speculated in the WSJ, NYT, Barron's, and others) provides potential downside protection.

Risks

- Rich valuation dependent on Zetia-blockbuster success (plus uncertain Zetia JV profitability assumptions).
- Negative gross margin trend (mainly owing to GMP compliance) is concerning - future direction is uncertain.
- Greater competitive inroads and excess stocking could lead to further negative earnings revisions for Clarinex and Hep-C franchises.
- Dividend at risk (although highlighted as a risk by management).
- R&D pipeline appears lackluster.
- Uncertain impact of findings from state and federal investigations.

Key Issues to Watch

- Zetia launch progress and trajectory
- Future earnings outlook and dividend status
- Gross margin and operating cost trends
- Inventory stocking trends, particularly for Hep-C franchise
- Ribavirin patent infringement case
- Scripts trends for Clarinex and Hep-C franchise given contracting markets and competition

Summary of Earnings Estimates

	7/10/03 Price	1Q	2Q	3Q	4Q	FY	P/E	Prem./(Disc.) Drug Grp
J.P. Morgan	$17.20							
2002		$0.41	$0.43	$0.29	$0.29	$1.42	12.1	(42)%
2003E		$0.12	**$0.12**	**$0.14**	**$0.12**	**$0.50**	**34.5**	**75%**
2004E						**$0.65**	**26.6**	**56%**
First Call								
2003E		$0.12	**$0.12**	**$0.11**	**$0.12**	**$0.49**	**35.1**	**78%**
2004E						**$0.67**	**25.7**	**50%**

Sales & Earnings Drivers

Key Products	2002-2005E CAGR	Incremental Sales 2002-2005E $ mil.	% Sls Growth*	Cont. to Sls
Claritin Franchise	-13%	(839)	97%	-2.8%
Hep-C Franchise	-27%	(1,693)	195%	-5.7%
Nasonex	-1%	(8)	1%	0.0%
Temodar	22%	222	-26%	0.7%
Remicade	32%	438	-51%	1.5%
Integrilin	15%	156	-18%	0.5%
Zetia/Zetia+Zocor	-	728	-84%	2.5%
Asmanex	-	315	-36%	1.1%
Others	-2%	(186)	21%	-0.6%
Total Revenues	-3%	(867)	100%	-2.9%

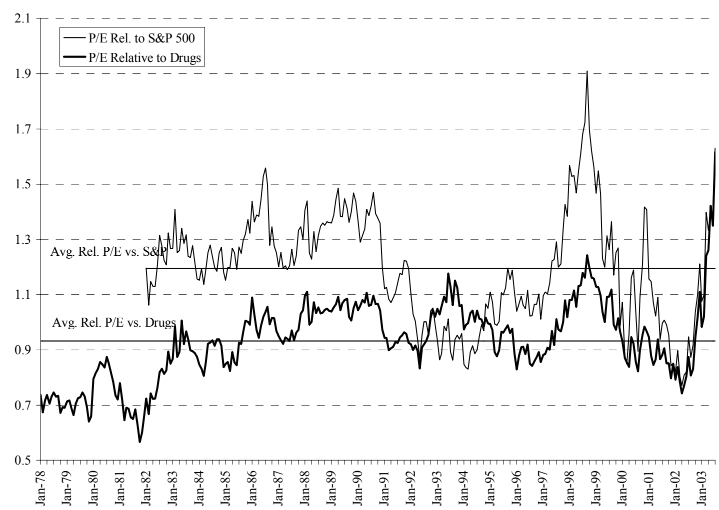
* Data not meaningful owing to the anemic revenue change (only -$2MM)

- Total sales are expected to fall -16% in 2003 and -2% in 2004, rebounding 11% in 2005. Pharma sales are expected to drop -21% in 2003, -1% in 2004, and rebound 14% in 2005.
- Operating margin projected to fall 580 bps between 2002-05 to 19.4% due to weak sales and higher COGS (+230bps to 26.9%), SG&A (+100 bps to 37.2%), and R&D (+260 bps increase to 16.6%).
- Earnings growth projected to decline 65% in 2003. In 2004 and 2005, EPS is expected to turnaround and grow 30% to $0.65 and.46% to $0.95, respectively.

SGP Stock Performance

Source: FactSet. Note: All prices are indexed to 12/31/02.

SGP Valuation



Source: FactSet.

Second Quarter Outlook

For the second quarter 2003, we expect SGP's EPS to decline 71% to $0.12 (in line with SGP's guidance and consensus). Given that SGP has offered no new explanations for this EPS pressure (i.e., cited continuing competitive pressures for Clarinex, Nasonex, and the Hep-C franchise), given the uncertain gross margin trends and stocking levels, particularly for Rebetol, it is unclear whether or not these factors also contributed to the weakness, and thus composition of earnings could vary from our estimate. That said, we estimate total sales will fall 20% owing to weak Claritin franchise sales (-53% YOY change due to the Claritin Rx-to-OTC switch, generic OTC copycats, and competition from Zyrtec, Allegra, and Singulair) and weak Hepatitis-C franchise sales (-27% due to aggressive competition from Roche and Rebetol destocking). On the positive side, we expect Remicade (+64%), Temodar (+21%) and Integrilin (+17%) sales growth to remain robust as well as the Zetia launch ($85MM in gross sales for the JV). Gross margins are expected to fall 750 bps to 68.7% owing to higher COGS imposed by increased GMP compliance efforts and the drop in high-margin Claritin sales. SG&A is expected to drop 5% because of SGP's streamlining and consolidation efforts, while R&D spending is projected to rise 10% owing to Zetia-related studies. As a result of all of these negative trends (although primarily the drop in sales), SGP's operating margin is projected to collapse from 28.5% to 9.8% (on a sequential basis, the operating margin is expected to decline 120 bps). The tax rate is expected to fall 300 bps to 20.0% (no change sequentially) due to the shift in sales to lower tax rate jurisdictions as a result of the Rx-to-OTC Claritin switch. For the full year 2003, we expect SGP to earn $0.50 ($0.01 above consensus and slightly above SGP's implied guidance, which suggests that earnings could potentially be less than $0.48).

Table 27: Schering-Plough Summary Quarterly P&L

($ in millions, except per share data)

								% Change Year Over Year					
	2Q02	1Q03	2Q03E	3Q03E	4Q03E	2003E	2004E	1Q03	2Q03E	3Q03E	4Q03E	2003E	2004E
Claritin	569	73	110	75	57	315	290	-84%	-81%	-77%	-167%	-75%	-8%
Claritin-D	223	36	30	30	20	116	95	-82%	-87%	-63%	-42%	-79%	-18%
Clarinex	173	173	205	165	157	700	800	106%	19%	1%	-11%	17%	9%
Clarinex-D	0	0	0	0	0	0	40	-	-	-	-	-	-
OTC Claritin	0	125	110	95	70	400	390	-	-	-	-33%	281%	-3%
Claritin Franchise	964	407	455	365	304	1,531	1,575	-45%	-53%	-36%	32%	-39%	3%
Intron A	66	42	38	37	33	150	95	-36%	-42%	-40%	-30%	-38%	-37%
Rebetron	21	4	3	2	1	10	5	-84%	-86%	-88%	-88%	-86%	-50%
Rebetol	335	251	225	215	184	875	400	-12%	-33%	-39%	-58%	-38%	-54%
PEG-Intron	237	219	215	195	181	810	690	22%	-9%	-28%	-45%	-20%	-15%
Hep-C Franchise	659	516	481	449	399	1,845	1,190	-7%	-27%	-36%	-51%	-33%	-36%
Nasonex	101	79	150	130	137	495	500	-43%	49%	-19%	10%	-5%	1%
Temodar	74	60	90	100	105	355	435	2%	21%	32%	53%	28%	23%
Remicade	76	114	125	135	151	525	660	90%	64%	47%	39%	56%	26%
Integrilin	78	89	91	91	92	363	415	31%	17%	18%	13%	19%	14%
Other Pharma	521	489	533	544	599	2,164	2,391	-16%	2%	17%	0%	0%	10%
Total Human Pharma	2,474	1,754	1,925	1,814	1,785	7,278	7,166	-21%	-22%	-15%	-12%	-18%	-2%
Other	359	320	341	296	317	1,274	1,249	-8%	-5%	6%	-4%	-3%	-2%
Total Sales	2,833	2,074	2,266	2,110	2,102	8,552	8,415	-19%	-20%	-13%	-11%	-16%	-2%
Gross Margin %	76.2%	68.3%	68.7%	69.3%	69.8%	69.0%	71.3%	-28%	-28%	-18%	-17%	-23%	2%
SG&A % Sales	35.1%	40.7%	41.5%	39.3%	40.1%	40.4%	39.4%	-8%	-5%	-5%	-6%	-6%	-4%
R&D % of Sales	12.6%	16.6%	17.4%	17.8%	19.6%	17.9%	17.4%	13%	10%	6%	1%	7%	-4%
Operating Margins	28.5%	11.0%	9.8%	12.2%	10.1%	10.8%	14.6%	-70%	-72%	-54%	-54%	-64%	33%
Pretax Margins	29.0%	10.4%	10.1%	12.3%	10.1%	10.7%	14.3%	-72%	-72%	-53%	-62%	-66%	31%
Tax Rate	23.0%	20.0%	20.0%	20.0%	20.0%	20.0%	21.0%	-76%	-76%	-59%	-67%	-71%	38%
Net Income	633	173	182	208	170	734	951	-71%	-71%	-51%	-60%	-65%	30%
Diluted EPS	**$0.43**	**$0.12**	**$0.12**	**$0.14**	**$0.12**	**$0.50**	**$0.65**	**-71%**	**-71%**	**-51%**	**-60%**	**-65%**	**30%**

Source: Company reports and JPMorgan estimates.

Schering Late-Stage Product Pipeline

Drug/Compound	Phase	Filing	Comments
Asmanex DPI	Filed	4Q98	Inhaled steroid for asthma (recv'd apprvable ltr)
Clarinex line extensions	Filed	4Q00	Clarinex-D and other formulations
Noxafil (posaconazole)	III	2H03	Antifungal for opportunistic infections
Zetia+Zocor	III	Late '03	Fixed dose combo for cholesterol
Asmanex MDI	III	2004/05	Inhaled steroid for asthma
Sarasar (SCH 66336)	III	2005/06	Farnesyl protein transferase (FPT) inhibitor—solid tumors and leukemia
Anti-estrogen	II	2006/07	Menopause (put on hold owing to HRT concerns)

Source: Company reports and JPMorgan research.

Schering Upcoming Events Calendar

Timing	Event	Comments
July 23	2Q03 results and future outlook before market opens	Expect 71% decline to $0.12 (in-line with mge guidance); 9am conf. call at 706-634-5003
3Q03	Ribavirin patent trial - Ribapharm vs. generics	Summary judgment ruling in patent case
Nov 18	SGP Analyst Meeting	
2H03	Ribavirin patent trial - Ribapharm vs. generics	Expected timing of patent infringement trial
2H03	Asmanex DPI approval	Awaiting regulatory action in US.
2H03	Noxafil FDA filing	Antifungal for opportunistic infections
2H03	Claritin patent case appeal	Could hear from Federal Appeals Court regarding SGP's Claritin patent infringement case
Late '03	NDA filing-Zetia/Zocor	Fixed dose combo for cholesterol

Source: Company reports and JPMorgan estimates.

Table 28: Schering-Plough Annual Income Statement and Contribution to Growth

($ in millions)

									2002-2007E	
	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	Growth	Contrib. to Growth
Revenues										
Respiratory										
Claritin	$2,194	$2,238	$1,260	$315	$290	$285	$280	$275	-26%	(2)%
Claritin D	817	875	542	116	95	90	85	80	(32)	(1)
Clarinex	-	46	597	700	760	820	860	900	9	1
Clarinex-D	-	-	-	-	40	90	140	185	-	0
OTC Claritin*	-	-	105	400	390	380	370	360	28	0
Claritin Franchise (allergies)	3,012	3,158	2,504	1,531	1,575	1,665	1,735	1,800	(6)	(1)
Nasonex (allergies, inhaled steroid)	415	524	523	495	500	515	530	545	1	0
Vancenase (asthma)	175	2	10	8	4	2	1	1	(37)	(0)
Proventil (asthma)	197	230	128	60	30	15	10	5	(48)	(0)
Vanceril (asthma)	127	82	21	8	4	2	1	1	(46)	(0)
Asmanex (asthma)	-	-	-	50	225	315	400	460	-	1
Foradil (asthma)	-	-	2	60	110	175	140	100	-	0
Other respiratory	264	219	221	224	209	204	199	194	(3)	(0)
Anti-infective/Cancer										
Intron A (estimate)	503	345	241	150	95	60	44	33	(33)	(0)
Rebetron (estimate)	605	375	70	10	5	3	2	2	(51)	(0)
Rebetol (estimate)	209	425	1,410	875	400	330	300	285	(27)	(2)
PEG-Intron (estimate)	43	302	1,015	810	690	650	670	665	(8)	(1)
Hepatitis C Franchise	1,360	1,447	2,736	1,845	1,190	1,043	1,016	985	(18)	(3)
Eulexin (cancer, antiandrogen)	128	83	55	40	35	30	25	20	(18)	(0)
Caelyx (cancer, peg-doxorubicin)	25	40	60	95	120	140	160	180	25	0
Temodar (brain tumors)	121	181	278	355	435	500	570	635	18	1
Noxafil (antifungal, posaconazole)	-	-	-	-	30	60	95	130	-	0
Remicade (RA, Crohn's)	57	166	337	525	660	775	885	985	24	1
Marimastat (cancer)	-	-	-	-	-	-	60	120		
Other anti-infective/cancer	324	357	267	255	245	235	225	215	(4)	(0)
Dermatology										
Total dermatology	680	593	511	499	497	497	496	496	(1)	(0)
Cardiovascular										
Zetia (cholesterol)	-	-	25	400	835	1,400	1,810	2,100		
Zetia+Zocor (cholesterol)	-	-	-	-	25	460	1,170	1,775		
SGP Share of JV Profit (excl. R&D)	-	-	-	73	263	728	1,256	1,673	-	3
Imdur (angina)	120	52	10	6	2	1	1	1	(36)	(0)
Integrilin (anticoagulant)	172	231	304	363	415	460	505	545	12	0
Other cardiology	454	340	120	81	42	32	26	24	(28)	(0)
Other										
Astra Alliance Revs. (Prilosec)	120	120	120	120	-	-	-	-	(100)	(0)
New Pharmaceuticals	-	-	-	-	-	130	240	370	-	1
Other Pharmaceuticals	596	535	644	585	575	565	555	545	(3)	(0)
Total Pharmaceuticals	**8,346**	**8,362**	**8,745**	**6,878**	**6,776**	**7,709**	**8,761**	**9,670**	**2%**	**2%**
% Change	8%	0%	5%	-21%	-1%	14%	14%	10%		
Animal Health	720	694	677	640	630	620	610	600	(2)	(0)
OTC (incl. OTC Claritin)*	201	188	274	554	534	514	494	474	12	0
Footcare	347	310	290	285	280	275	270	265	(2)	(0)
Suncare/Other	201	208	195	195	195	195	195	195	0	0
Total Sales	**$9,815**	**$9,762**	**$10,180**	**$8,552**	**$8,415**	**$9,313**	**$10,330**	**$11,204**	**2%**	**2%**
% Change	8%	-1%	4%	-16%	-2%	11%	11%	8%		

Source: Company reports and JPMorgan estimates.

* SGP reports OTC Claritin sales as a part of its OTC division sales. For presentation purposes, we have included OTC Claritin sales as a part of the Claritin/Clarinex family sales detail, but have excluded the OTC Claritin sales from Total Pharma Sales and have included it in the OTC sales line.

Table 28: Schering-Plough Annual Income Statement and Contribution to Growth (cont'd)

($ in millions, except per share data)

	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	2002-2007E Growth	2002-2007E Contrib. to Growth
Total Sales	**$9,815**	**$9,762**	**$10,180**	**$8,552**	**$8,415**	**$9,313**	**$10,330**	**$11,204**	**2%**	**2%**
% Change	8%	-1%	4%	-16%	-2%	11%	11%	8%		
Cost of Goods	1,902	2,078	2,505	2,651	2,415	2,500	2,614	2,711	2	0
% of Sales	19.4%	21.3%	24.6%	31.0%	28.7%	26.9%	25.3%	24.2%		
SG&A	3,485	3,444	3,681	3,455	3,316	3,465	3,662	3,860	1	1
% of Sales	35.5%	35.3%	36.2%	40.4%	39.4%	37.2%	35.5%	34.5%		
R&D	1,333	1,312	1,425	1,527	1,460	1,541	1,643	1,748	4	(1)
% of Sales	13.6%	13.4%	14.0%	17.9%	17.4%	16.6%	15.9%	15.6%		
Operating Income	3,095	2,928	2,569	919	1,224	1,806	2,412	2,885	2%	2%
Operating Margin	31.5%	30.0%	25.2%	10.8%	14.6%	19.4%	23.4%	25.8%		
Net Interest Income/(Expense)	115	81	48	(12)	(30)	(32)	(31)	(23)		
FX Gains/Losses	(4)	(4)	2	-	-	-	-	-		
Other Income	(18)	18	95	10	10	10	10	10		
Total Other Income/Expenses	93	95	144	(2)	(20)	(22)	(21)	(13)		(1)
Pretax Income	3,188	3,023	2,713	917	1,204	1,784	2,391	2,872	1%	1%
Pretax Margin	32.5%	31.0%	26.7%	10.7%	14.3%	19.2%	23.1%	25.6%		
Taxes	765	697	624	183	253	392	550	660	1	(0)
Tax Rate	24.0%	23.1%	23.0%	20.0%	21.0%	22.0%	23.0%	23.0%		
Net Income	**$2,423**	**$2,326**	**$2,089**	**$734**	**$951**	**$1,391**	**$1,841**	**$2,211**	**1%**	**1%**
Net Margin	24.7%	23.8%	20.5%	8.6%	11.3%	14.9%	17.8%	19.7%		
Diluted EPS[#]	**$1.64**	**$1.58**	**$1.42**	**$0.50**	**$0.65**	**$0.95**	**$1.25**	**$1.50**	**1%**	**1%**
% Change	16%	(4)%	(10)%	(65)%	30%	46%	32%	20%		
Diluted Shares Outstanding (MM)	1,476	1,470	1,470	1,470	1,470	1,470	1,470	1,470		

Source: Company reports and JPMorgan estimates

* EPS impact due to FASB accounting rule change, which eliminates the amortization of goodwill from past and future acquisitions. The provisions for goodwill and other intangible assets are effective for years beginning on or after January 1, 2002.

Rating: Overweight

Wyeth (WYE)

Investment Thesis

Although valuation still implies some skepticism, we expect WYE's EPS growth to be robust and low risk and, from this point, the best growth acceleration story in the sector. The diversified and relatively new portfolio of in-line products–Effexor XR, Protonix, Prevnar, and Enbrel–should drive 80% of the top line, which should accelerate to 10-11% growth as the difficult Premarin-family comparisons annualize. Prevnar and Enbrel are poised for strong growth, helped by increased supplies, strong current demand, and upcoming international launches (especially in the case of Prevnar). Meanwhile, competitive threats for Protonix and Effexor XR have eased, as Protonix remains the lowest priced PPI despite generic omeprazole, and LLY's Cymbalta approval is delayed (expected in late '03) and will mainly target the SSRIs (which represent about 55% of the antidepressant market), rather than Effexor XR (which represents about 9%). Growth should be further supported by FluMist, Altace, rhBMP-2, and royalties from the JNJ drug-eluting stent Cypher. Diet drug litigation and incremental news from the WHI PremPro substudies are headline risks; however, neither seems likely to threaten earnings. Cost cutting is underway and we believe there is additional EPS cushion versus our projections (i.e., if SG&A and R&D are kept flat vs. +6%) if the top line unexpectedly disappoints. Although WYE's pipeline appears dry through 2004/05, the supply de-bottlenecking in '03 for Enbrel and Prevnar will be key in turbocharging top-line growth, in our view. We expect WYE's growth to accelerate from +12% in '03 to +14-15% in each of '04 and '05 (vs. industry average of +6% in '03, and +14% in '04 and '05).

Positives

- Attractive valuation, in our view, given projected growth of +12% in '03 and +14-15% in each of '04 and '05
- Outlook for key growth drivers (Effexor, Protonix, Enbrel, and Prevnar) strong and improving; sales growth should accelerate from 4% in '02 to 7% in '03 and 10-11% in '04/05; no significant exposure to generics
- Supply de-bottleneckings for Enbrel and Prevnar akin to new product launches, and backed by strong pending demand
- Impressive protein expertise makes WYE as much "Biotech" as "Pharma" (e.g., Enbrel, ReFacto, Mylotarg, and rhBMP-2), in our view
- Strong track record of in-licensing/partnering activities (e.g., Protonix, Enbrel, Altace, FluMist, InFuse, Cypher)

Risks

- A second shoe could fall on Premarin (e.g., organic generic Premarin, WHI Premarin-only arm early termination)
- More negative headlines on WHI PremPro substudies present sentiment risk
- Continued litigation fears over diet drugs are overhang
- Prevnar's second fill-n-finish line will be commissioned only towards the end of '03; any breakdown till then may affect supplies
- Pipeline relatively dry

Key Issues to Watch

- Premarin franchise issues: Rx trends, Barr/Natural Biologics' organic generic Premarin, WHI Premarin-only arm
- Enbrel Rx trends with Humira (ABT) entering the market
- Prevnar int'l launches (2H03)
- Growth trends for Effexor XR, Prevnar, Protonix, and Altace
- Filing for ReFacto AF (3Q03)
- Diet drug litigation updates

Summary of Earnings Estimates

	7/10/03 Price	1Q	2Q	3Q	4Q	FY	P/E	Prem./(Disc.) Drug
JPMorgan	$47.69							
2002		$0.65	$0.45	$0.47	$0.65	$2.22	21.5	3%
2003E		**$0.54**	**$0.52**	**$0.64**	**$0.78**	**$2.48**	**19.2**	**(3)%**
2004E						**$2.84**	**16.8**	**(2)%**
First Call								
2003E		**$0.54**	**$0.47**	**$0.66**	**$0.79**	**$2.46**	**19.4**	**(2)%**
2004E						**$2.77**	**17.2**	**1%**

Sales & Earnings Drivers

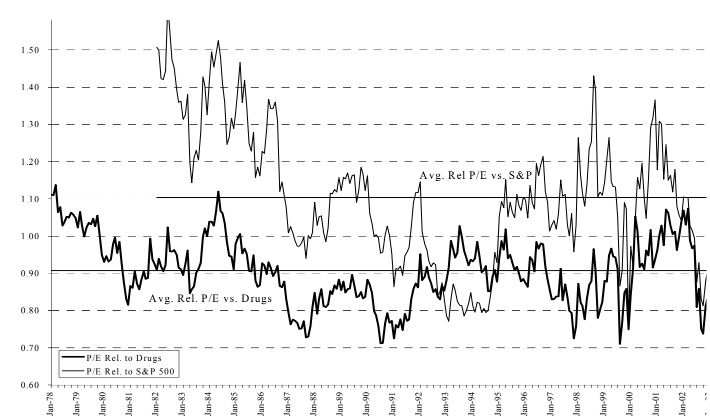
JPMorgan Est. Key Products	2002-2005E CAGR	Incremental Sales* 2002-2005E $ mill.	% Sls Growth	Cont. to Sls
Premarin Family	-15%	(745)	(17)%	(1.6)%
Effexor	18%	1,353	31%	2.8%
Protonix (anti-	14%	524	12%	1.1%
Enbrel (RA)	47%	844	19%	1.8%
Prevnar (vaccine)	34%	917	21%	1.9%
FluMist (vaccine)	-	325	7%	0.7%
ReFacto (hemophilia	34%	282	6%	0.6%
All Other Pharma	4%	794	18%	1.7%
Total Pharma	10%	4,013	91%	8.4%
Other Sales	4%	374	9%	0.8%
Total WYE Sales	9%	4,387	100%	9.2%

- Total sales growth of 4% in '02 expected to accelerate to 7% in '03 and 10-11% in '04-05, with pharma sales accelerating from 6% in '02 to 8% in '03 and 11-12% in '04-05
- Estimated operating margin improvement of 390 bps to 28.4% by 2005, driven by a combination of SG&A leverage (most of the sales force build was complete by 2000) and gross margin improvement (140 bps)
- Net interest expense should continue to improve in 2003 and beyond, driven by significant debt reduction from the sale of Amgen shares.

WYE Stock Performance

Source: FactSet. Note: All prices are indexed to 12/31/02.

WYE Valuation



Source: FactSet.

Second Quarter Outlook

For 2Q03, we project WYE's EPS at $0.52, up 17%, $0.05 above consensus and expected to be helped by gains from asset sales which should total an estimated $230MM pretax (or roughly $0.12 after tax, of which about $0.05-$0.07 was expected based on pro-rating management's previous guidance that full year asset sales would approximate the $330MM magnitude seen in '02—there is no resulting change in full year estimates, but 70% of the full year targeted asset sales were complete in 2Q). We expect 4% top line growth and 330 bps decline in gross margins, driven by lower Premarin and PremPro/PremPhase sales (which carry gross margins of 92% and 86%, respectively). SG&A is projected to grow 3%, and R&D 10%. For full-year 2003, we estimate EPS at $2.48, up 12% and $0.02 above consensus (company guidance was $2.40-2.50). For 2004, we estimate 15% growth to $2.84 ($0.07 above consensus).

Table 29: Wyeth Summary Quarterly P&L

($ in millions, except per share data)

								% Change Year Over Year					
	2Q02	1Q/03	2Q/03E	3Q/03E	4Q/03E	FY2003E	FY2004E	1Q/03	2Q/03E	3Q/03E	4Q/03E	FY2003E	FY2004E
Premarin Family	445	403	281	269	267	1,220	1,140	-40%	-37%	-36%	-21%	-35%	-7%
Effexor franchise	604	593	660	655	692	2,600	3,050	42%	9%	45%	16%	25%	17%
Protonix	192	360	285	405	335	1,385	1,490	46%	48%	18%	17%	29%	8%
Altace (alliance reven.)	31	8	68	87	96	259	359	-44%	119%	25%	50%	45%	38%
Enbrel (1)	93	122	150	180	195	647	928	27%	62%	88%	85%	66%	43%
ReFacto	52	52	60	65	73	250	320	36%	15%	23%	35%	27%	28%
Prevnar	149	229	245	272	304	1,050	1,465	55%	64%	135%	30%	62%	40%
Pharma. Prod.	2,816	2,975	2,930	3,292	3,393	12,590	14,128	0%	4%	14%	12%	7%	12%
Other Products	687	714	727	756	821	3,017	3,125	5%	6%	7%	265%	6%	4%
Total Sales	3,503	3,689	3,656	4,047	4,214	15,607	17,253	1%	4%	12%	10%	7%	11%
Gross Margin %	74.7%	74.8%	71.4%	74.8%	73.6%	73.7%	74.2%	-3%	0%	18%	17%	8%	11%
SG&A & other % Sales	37.4%	35.0%	36.8%	32.9%	31.0%	33.8%	32.5%	2%	3%	9%	8%	5%	6%
R&D % Sales	14.5%	13.9%	15.8%	14.4%	13.6%	14.4%	14.3%	7%	10%	12%	3%	8%	10%
Operating Margins	22.2%	25.9%	18.8%	27.5%	29.0%	25.5%	27.4%	(12)%	(12)%	34%	40%	11%	19%
Pretax Margins	22.0%	25.0%	24.5%	27.1%	31.5%	27.2%	28.2%	(18)%	16%	37%	25%	13%	14%
Tax Rate	22.3%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%	(19)%	15%	39%	48%	18%	14%
Net Income	600	719	698	856	1,037	3,311	3,791	(18)%	16%	37%	20%	12%	15%
Diluted EPS (JPM)	$0.45	$0.54	$0.52	$0.64	$0.78	$2.48	$2.84	(17)%	17%	36%	20%	12%	15%

Source: Company reports and JPMorgan estimates. (1) Enbrel revenues to WYE, which include international sales plus royalties on U.S. and Canada sales.

WYE Late-Stage Product Pipeline

Drug/Compound	Phase	Filing	Comments
ReFacto AF	III	3Q03	3rd generation hemophilia A product; totally albumin free throughout entire manufacturing process
tigecycline (GAR-936)	III	2004	Antibiotic resistant infections
CCI-779	II	2004	Cytostatic cancer agent (1st line) for renal cell carcinoma and breast cancer, multiple sclerosis
levonorgestrel/EE (ethanol estradiol)	III	YE'04	Oral contraception
9vPnC-MnCC	III	2005	Pneumococcal-meningitis vaccine; follow-up to Prevnar
bazedoxifene (TSE-424)	III	2005	SERM—for HRT & osteoporosis
bazedoxifene/CE	III	2006	Combination with Premarin
RhIL-11	II	2005/06	Crohn's disease, inflammatory bowel disease, multiple sclerosis (oral drug)
DVS-233	II	2005/06	Depression
MAC-321	II	2005/06	Taxane analog for non-small cell lung, colorectal, metastatic breast cancers
HTI-286	II	2005/06	Lung cancer

Source: Company reports and JPMorgan research.

Note: The filing dates are anticipated.

WYE Upcoming Events Calendar

Timing	Event	Comments
7/23/03	2Q03 earnings	Project EPS +17% to $0.52 ($0.05 above consensus). 8 a.m. conf. call (1-888 428 4479; int'l 1-612 326 1011).
Mid 03	Potential court ruling–Natural Biologics	Federal district court should return with ruling on trade secret misappropriation (Premarin manufacturing) lawsuit by WYE against Natural Biologics.
Mid 03	Approval–Enbrel once-weekly (50 mg [though still 2 injections])	New dosage (Enbrel is currently 2x 25mg weekly) could be launched in 2H03 against ABT's Humira (every other week or once weekly).
Aug-03	Launch—FluMist	Intranasal flu vaccine to be co-marketed with MedImmune.
3Q03	sNDA filing—Effexor XR	New indication for panic.
3Q03	BLA filing–ReFacto AF	WYE's 3rd-generation Factor VIII; to compete with Baxter's 3rd-generation product (filed at the end of 2Q02, expected approval 2Q/3Q03).
Nov-03	NIH WHI Study	Data and Safety Monitoring Board (DSMB) to look to Premarin-only arm data.
2H03	EU launch—Prevenar	Pneumococcal vaccine.
2H03	sBLA filing–Enbrel	New indications for psoriasis.
2003	NDA filing–trimegestone/Premarin	For HRT.
2004	E.U. filing–FluMist (liquid form)	Currently in Phase III.
2004	Enbrel mfg capacity expansion	Genentech facility comes on line.
2005	Enbrel mfg capacity expansion	Grange Castle, Ireland, plant and R.I. Phase B to be completed.

Source: Company reports and JPMorgan research. Note: The filing dates are anticipated.

Table 30: Wyeth Annual Income Statement and Sources of Growth

($ in millions)

									2002 - 2007E	
	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	Growth	Contrib. to Growth
Revenues										
Pharmaceuticals										
Premarin Family (ERT/HRT)	1,870	2,074	1,880	1,220	1,140	1,135	1,120	1,110	(10)%	(1)%
Effexor (depression)	1,159	1,542	2,072	2,600	3,050	3,425	3,825	4,175	15	2
Prevnar (pneumococcal vaccine)	461	798	648	1,050	1,465	1,565	1,515	1,365	16	1
Infant Nutritionals	691	813	835	850	885	915	945	975	3	0
Oral contraceptives	610	713	597	560	570	580	590	595	(0)	(0)
Protonix (ulcers)	145	561	1,071	1,385	1,490	1,595	1,710	1,790	11	1
Zosyn/Tazocin (anti-infective)	385	437	406	525	600	665	720	570	7	0
Zoton (ulcers)	234	284	309	320	320	320	320	320	1	0
Cordarone (cardiovascular)	203	270	283	40	35	30	25	20	(41)	(0)
Ativan (CNS)	246	233	217	188	165	160	155	150	(7)	(0)
Synvisc (pain & inflammation)	179	188	212	245	270	295	320	345	10	0
ReFacto (hemophilia A)*	91	147	198	250	320	480	605	735	30	1
Benefix (hemophilia B)*	180	213	219	243	264	285	300	315	8	0
Minocin (anti-infective)	147	122	117	118	115	115	115	115	(0)	(0)
Rapamune (immunosuppression)	26	70	130	187	225	250	275	300	18	0
Enbrel (rheumatoid arthritis)—Int'l*	38	94	159	265	400	550	700	875	41	1
rhBMP-2 (bone healing)*	-	-	18	75	125	180	215	245	69	0
Flumist (intranasal flu vaccine)	-	-	-	150	225	325	450	550		1
9vPnC (pneumococcal vaccine)	-	-	-	-	-	-	100	350		0
rhIL-11 (crohn's disease)	-	-	-	-	-	-	100	200		0
GAR-936 (antibiotic resistant infections)	-	-	-	-	-	-	30	125		0
TSE-424 (bazedoxifene; HRT/osteo.)	-	-	-	-	-	-	75	225		0
CCI-779 (cancer)	-	-	-	-	-	50	100	155		0
Other new pharma	-	-	-	-	-	190	390	585		1
Other pharma	2,932	2,028	1,943	1,585	1,470	1,390	1,340	1,285	(8)	(1)
Alliance Revenues										
Cypher (on worldwide sales)	-	-	80	1,752	2,147	2,175	1,977	1,797	86	
Enbrel (on U.S. sales)	652	762	798	1,316	1,820	2,360	2,625	2,825	29	
Altace (cardiovascular)	162	284	481	645	815	995	1,110	1,220	20	
Net Alliance Rev.'s	188	322	419	734	994	1,246	1,373	1,480	29	1
Total Wyeth-Ayerst	9,980	10,940	11,733	12,590	14,128	15,746	17,413	18,955	10	8
Animal Health	793	776	653	735	755	775	795	815	5	0
Total Pharmaceuticals	10,773	11,716	12,387	13,325	14,883	16,521	18,208	19,770	10	8
% Change	13%	9%	6%	8%	12%	11%	10%	9%	8	0
Consumer Health Care										
Centrum	517	503	516	530	555	580	600	620	4	0
Advil family	579	563	554	580	605	625	645	660	4	0
Caltrate	136	148	142	150	160	170	180	195	6	0
Solgar	112	99	100	102	105	110	115	120	4	0
Robitussin	269	247	206	195	205	210	215	220	1	0
Alavert	-	-	8	65	70	75	80	85	59	0
Other	827	707	670	660	670	680	685	690	1	0
Total Consumer Health Care	2,441	2,267	2,197	2,282	2,370	2,450	2,520	2,590	3	0
% Change	3%	(7)%	(3)%	4%	4%	3%	3%	3%		
Total Sales	**13,214**	**13,984**	**14,584**	**15,607**	**17,253**	**18,971**	**20,728**	**22,360**	**9%**	**9%**
% Change	11%	6%	4%	7%	11%	10%	9%	8%		

Source: Company reports and JPMorgan estimates.

* Protein products.

Table 30: Wyeth Annual Income Statement and Sources of Growth (cont'd)

($ in millions, except per share data)

	2000	2001	2002	2003E	2004E	2005E	2006E	2007E	2002 - 2007E Growth	Contrib. to Growth
Total Sales	**13,214**	**13,984**	**14,584**	**15,607**	**17,253**	**18,971**	**20,728**	**22,360**	**9%**	**9%**
% Change	11%	6%	4%	7%	11%	10%	9%	8%		
Cost of Goods Sold	3,269	3,389	3,918	4,105	4,451	4,838	5,224	5,590	7	2
% to Sales	24.7%	24.2%	26.9%	26.3%	25.8%	25.5%	25.2%	25.0%		
SG&A	4,983	5,035	5,011	5,275	5,607	6,071	6,592	7,043	7	2
% to Sales	37.7%	36.0%	34.4%	33.8%	32.5%	32.0%	31.8%	31.5%		
R&D	1,688	1,870	2,080	2,247	2,467	2,675	2,902	3,108	8	0
% to Sales	12.8%	13.4%	14.3%	14.4%	14.3%	14.1%	14.0%	13.9%		
Operating Income	3,273	3,691	3,575	3,980	4,727	5,388	6,011	6,619	13%	13%
Operating Margin	24.8%	26.4%	24.5%	25.5%	27.4%	28.4%	29.0%	29.6%		
Interest income	181	155	92	145	163	195	275	390		
Interest expense	(239)	(301)	(294)	(230)	(205)	(185)	(170)	(150)		
Interest, net	(58)	(146)	(202)	(85)	(42)	10	105	240		
IMNX equity income	77	70	27	-	-	-	-	-		
Other non-operating inc./exp.	84	205	356	350	175	150	125	100		
Other non-operating inc/exp	161	274	383	350	175	150	125	100		
Non-Operating Income	103	128	181	265	133	160	230	340		
Pretax Income	3,376	3,819	3,756	4,245	4,860	5,548	6,241	6,959	13%	13%
Pretax Margin	25.6%	27.3%	25.8%	27.2%	28.2%	29.2%	30.1%	31.1%		
Taxes	862	918	793	934	1,069	1,221	1,373	1,531	14	(0)
Tax Rate	25.5%	24.1%	21.1%	22.0%	22.0%	22.0%	22.0%	22.0%		
Net Income	2,514	2,900	2,963	3,311	3,791	4,327	4,868	5,428	13	13
Net Margin	19.0%	20.7%	20.3%	21.2%	22.0%	22.8%	23.5%	24.3%		
EPS—Diluted (cont'g ops, excl. extra.)	**$1.90**	**$2.18**	**$2.22**	**$2.48**	**$2.84**	**$3.24**	**$3.65**	**$4.07**	13%	13%
Percent Change	18%	15%	2%	12%	15%	14%	12%	11%		
Extraordinary Charges	(3,415)	(615)	1,485		-	-	-	-		
Discont'd Opns	(1,470)	-	-	-	-	-	-	-		
Net Income, Reported	(2,371)	2,285	4,447	3,311	3,791	4,327	4,868	5,428		
EPS (reported)	($1.81)	$1.72	$3.33	$2.48	$2.84	$3.24	$3.65	$4.07		
Percent Change	96%	-195%	94%	-26%	15%	14%	12%	11%		
Shares Outstanding—Diluted (MM)	1,323	1,331	1,334	1,334	1,334	1,334	1,334	1,334	0	0

Source: Company reports and JPMorgan estimates.

JPMorgan

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