Brandes analyzes:

THE BRANDES PERSPECTIVE
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Pharmaceutical Industry

Select pharmaceutical firms have been trading at historically low price-to-earnings (P/E) multiples, in part due to anxiety over healthcare reforms and concerns regarding drug patent expirations. With dividend yields near 3.5% and free cash flow (FCF) yields around 10%, we believe the market may be too pessimistic on the industry. Below, we review the challenges facing pharmaceutical companies, and the strengths of select pharmaceutical firms that we believe are not reflected in current prices.

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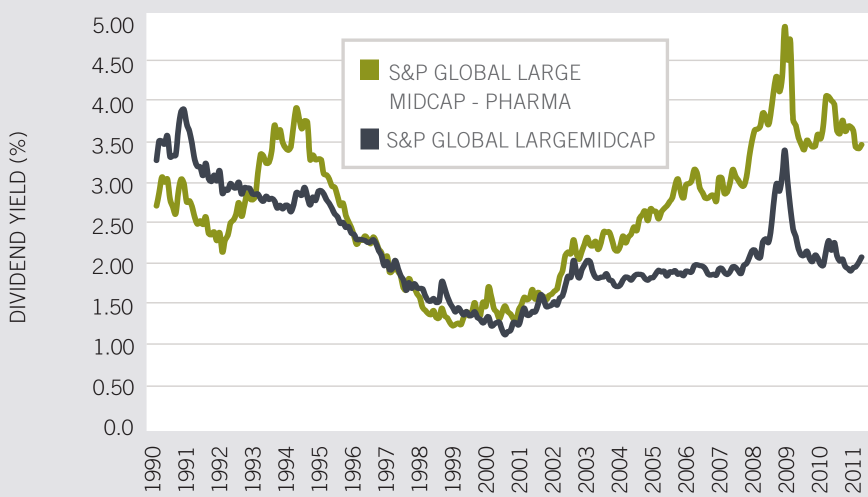
Exhibit 1: Dividend Yield for S&P Global LargeMidCap Index and Pharmaceutical Companies

January 1, 1990 - June 30, 2011



Source: FactSet, the Brandes Institute, as of 6/30/11. Past performance is not a guarantee of future results.

Current Concerns

- Looming patent expirations for certain drugs.
- Declining research & development (R&D) productivity due to longer and more expensive clinical trials and greater U.S. Food and Drug Administration scrutiny with lower approval rates for new drugs.
- Forthcoming changes for companies and consumers stemming from global healthcare reform and austerity measures.
- Safety and litigation issues, including product recalls, manufacturing deficiencies, and increased scrutiny on side effects.

The Brandes Perspective

While there are variables that raise concerns about pharmaceutical companies, current stock prices for several pharmaceuticals firms held in Brandes portfolios appear unduly punitive to us in light of the many positive traits exhibited by the companies. Despite fundamental strengths for pharmaceutical companies, investor expectations generally remain low, reflected in low valuations and recent underperformance relative to major indices. The annualized 3-year performance of the pharmaceutical industry relative to the S&P Global LargeMidCap Index is -2.98%, as of December 31, 2010. Note that past performance is not a guarantee of future results.

As of June 2011, the FDA has approved 20 drugs, just one short of the total number approved in 2010.

The Concern: Patent Expirations and R&D

Over the next four years, patents for 18 of the current 20 top branded drugs will expire. Where there are generic alternatives, the estimated sales going off patent is around 10-15% of worldwide pharma sales. Generics typically have been priced at a small fraction of branded drugs.

The broader market appears to be focusing largely on declining revenues for firms losing patents and showing little to no regard for future products currently in various R&D phases. Concerns about R&D have some merit; since 1996, R&D has grown faster than sales, while annual new product approvals dropped from 56 in 1996 to 21 in 2010. However, we believe market participants are generally being pessimistic and too focused on short-term results when it comes to R&D.

Our Perspective: Patent Expirations and R&D

Based on our company-specific analysis, we believe that innovations currently being introduced in the R&D process will yield rewards. New technologies are allowing companies to identify R&D failures earlier in the process. Also, companies have been aggressive in reducing R&D spending or decentralizing their R&D efforts by acquiring licenses and other companies to augment the R&D pipeline. Finally, more R&D work is being outsourced to reduce upfront costs and risks. Overall, firms are focused on increasing R&D productivity through more disciplined spending. As of June 2011, the FDA has approved 20 drugs, just one short of the total number in 2010.[i] The approval rate is on pace to potentially exceed the previous few years.

When valuing a pharmaceutical company, we generally evaluate existing products, products in development, and other company-specific factors such as pension liabilities and, if applicable, liabilities related to product litigation. The value of existing products

[i] http://online.wsj.com/article/SB10001424052702303365804576432170845403108.html?mod=WSJ_markets_stocks#printMode

is most quantifiable; the value of products yet to be discovered is difficult to estimate. For existing holdings, the current market prices of most pharmaceutical companies do not give much value to future R&D developments. Thus, an investor will own these companies' existing products and get a potential upside from new products at a very low price.

The Concern: Healthcare Reform and Austerity Measures

A change from the traditional in-house R&D development strategy to a licensing and acquisition model has reduced the risks and initial costs of drug development for global pharmaceutical firms.

Around the world, healthcare reform pressures are raising concerns for the pharmaceutical industry. Passage of reform legislation in the United States is one example of growing global attention on healthcare-related issues and the potential for diminished revenues industry wide. With the U.S. Congress approving healthcare legislation in March 2010, a variety of changes are coming for U.S. companies and consumers. Major reform items will roll out progressively until 2018. Some of the principal goals are extending coverage to 32 million Americans who currently lack it, expanding Medicare and Medicaid coverage, and new industry taxes to cover certain costs.

Our Perspective: Healthcare Reform

Overall, we view the effects of U.S. reforms on pharmaceutical firms as slightly negative in the short term due to the potential for lower earnings, as most of the additional cost burden (taxes and required discounts), are front-loaded. However, we retain our conviction in the long-term potential of our current pharmaceutical holdings. At this point, we believe the new measures will put near-term pressure on pharmaceutical firms' operating profit margins – but that pressure could be offset by increased volumes resulting from broader coverage.

Other Positives for Pharmaceuticals

Restructuring: Industry operating margins tend to average more than 20%, and many companies are pursuing cost-cutting measures to further boost margins and improve R&D productivity.

Diversification of Business Risk: Pharmaceutical companies are expanding investment in more specialized medicines such as vaccines, biologics, and other unmet medical needs. More defensible patents and difficult production processes associated with biologics provide higher barriers to entry for generic drug makers. Some companies also are seeking to gain greater market share in the growing areas of diagnostic tools as well as animal health care products.

Expanding into Emerging Markets: To complement existing revenue streams, certain firms are targeting emerging countries, given their expanding populations and developing healthcare infrastructure. Very little incremental R&D is needed, per capita GDP growth is significant, and returns are commensurate. Currently, roughly 10-20% of total drug sales are generated from emerging markets; expectations for continued double-digit growth in these regions appear reasonable.

R&D: A change from the traditional in-house R&D development strategy to a licensing and acquisition model has reduced the risks and initial costs of drug development for global pharmaceutical firms. Also, business and geographical diversification are significant mitigation strategies for R&D risk.

Conclusion

Even with our very conservative estimates, we believe select pharmaceutical companies are trading at steep discounts to our assessments of underlying business values. We continue to focus on companies with diverse product portfolios, potential for R&D success, and strong fundamentals such as strong free cash flow generation, robust balance sheets, high dividend yields (including share buybacks) continued high returns on capital, and low valuations. We should also note that investors may fall back on current dividends as they wait for the ongoing R&D pipeline to mature. We have incorporated various risks into our valuation assessments and believe patient investors may be well rewarded.

Price-to-earnings (P/E) - Price per share divided by earnings per share.

Dividend Yield - Total annual dividend divided by the market price of the investment.

Free Cash Flow (FCF) - Cash generated by a company minus capital expenditures.

Free Cash Flow Yield - Free cash flow per share divided by price per share.

The S&P Global LargeMidCap Index with net dividends is an unmanaged, float-adjusted market capitalization weighted index that measures the equity performance of mid to large capitalization companies from markets around the world. This index is derived using the S&P Global BMI Index, filtered to include companies with mid to large capitalization. This index includes dividends and distributions net of withholding taxes, but does not reflect fees, brokerage commissions, or other expenses of investing.

The S&P Global BMI (Broad Market Index), comprised of the S&P Developed BMI and S&P Emerging BMI, is a comprehensive, rules-based index measuring global stock market performance. The S&P Global BMI represents the only global index suite with a transparent, modular structure that has been fully float adjusted since its inception in 1989.

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