YALE **SCHOOL OF MANAGEMENT**

Sepracor (SEPR)

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Company report

November 4, 2007

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Current Price:	**$25.91**
12-Month Target:	**$19.30**
	↓ 25.5%

SEPR 36 month stock

Source: Yahoo Finance as of closing 2 Nov 2007

Recommendation: Sell

Summary

Our recommendation is to **sell** Sepracor stocks. SEPR market value according to our valuation is $2,043mm, or **26.5% below** the current valuation.

cutthroat competition and poor positioning threatens fragile revenues

Lunesta, Sepracor's most important product, is facing competition from a more established brand. Despite significant investment in advertising, Sepracor has not been able to increase its market share, in part due to the fact that Ambien is now off the patent and cheaper generic versions are available.

Marketing restructuring brings more woes than gains

In contrast to the management's belief that their sales and marketing department restructuring will improve sales, we expect sales to remain relatively flat. This is in part due to the fact that cutting costs is unlikely to improve brand recognition. Moreover, we expect training expenses for marketing team to be a longer term burden. Given current circumstances, gains in sales, if any, will unlikely be realized until at least 2H08.

Weak pipeline and slow market expansion

Research pipeline is limited at best, with only one early Phase II product and several research projects focusing on products in which the company has no expertise. The recent partnership with GSK to explore European insomnia market is not seen as a lucrative deal. Japanese market development is only in Phase I and will not come to fruition in one year.

Xopenex UDV profits suffocated by CMS reimbursement termination

We expect that sales of Xopenex, SEPR's second most important product, will continue to be negatively impacted by the Medicare reimbursement termination, contrary to company justification. Recent developments in generic albuterol solutions and SEPR's lack of market diversification strategies.

Company description

Sepracor is a mid-cap specialty pharmaceutical company that focuses on developing drugs for respiratory and central nervous system disorders. Its 4 products are

1. Lunesta (Insonmia),
2. Xopenex HFA (Chronic Obstructive Pulmonary Disease (COPD),
3. Xopenex UDV (COPD), and
4. Brovana (COPD)

SEPR has 6 products in the pipeline that focuses on depression and anxiety disorders with SEP-225289 just reaching phase II this year and others in early Phase I stages. Founded in 1984 and gone public in 1991, SEPR has been active in engaging partnerships and has spun off 4 publicly-traded companies. Its most significant developments in Q307 is its announcement to restructure its marketing and sales team to promote Lunesta, expansion of corporate headquarters in MA, and a push for expansion to international markets through an alliance with GlaxoSmithKline (GSK).

Conclusions

Current prices are overvalued by 19-32%. The median model presented here demonstrates that a set of reasonable optimistic assumptions values SEPR 25.5% below the market.

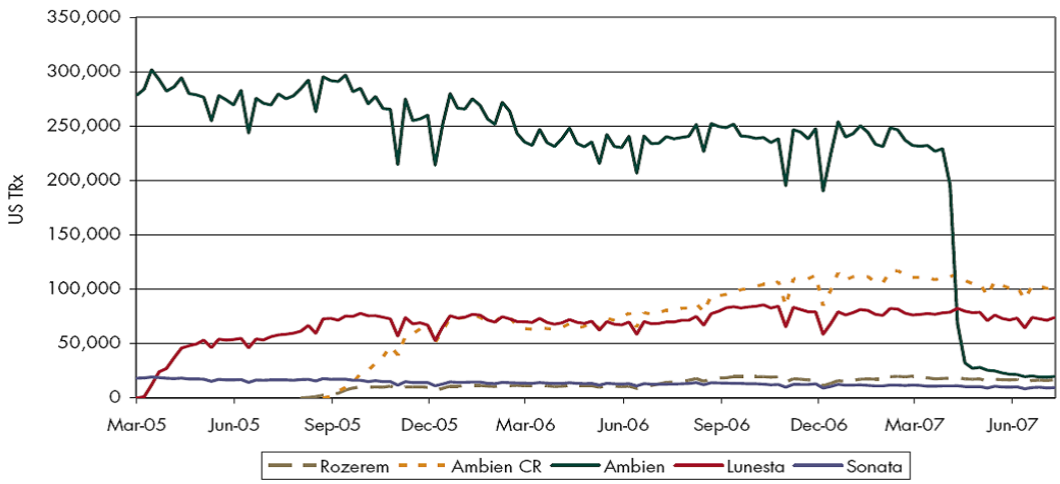
What makes our analysis pertinent is the fact that although other analysts use the same or similar numbers, their judgment calls are different by:

1. Believing that SEPR marketing and sales efforts will be more effective in the future, despite the lack of evidence of this conclusion, excepting a cost-cutting measure currently underway
2. Technical analysis supports a stock rebound, since it has dropped significantly this year and the price seems to have found a bottom
3. 3Q07 results were better than expected, prompting a rush to buy. However, those results were far from positive and should not be viewed as a catalyst
4. Ignoring overhead costs associated with construction of new headquarters and corresponding administrative expenses
5. Investors seem to price-in significant international growth opportunities. We doubt that such opportunities can be exploited by SEPR

Lunesta: Cutthroat competition threatens fragile revenues

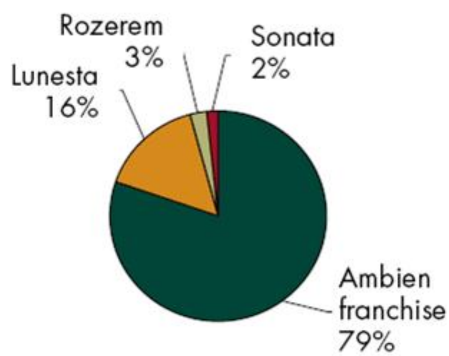
Lunesta is estimated to contribute 50% of SEPR revenue in 2007. Lunesta came out in Jan 2005 and prescription volume has already tapered off within 8 months to approximately 80,000 (see Figure 1). Fierce competition with Ambien (SNY), especially now that Ambien CR is now off the patent, leaves little room for Lunesta to grow in market share. Ambien was an early entrant into the space and has successfully maintained its leadership position (see Figure 2).

Figure 1. US prescription volume of branded Insomnia drugs since Jan 05



Source: IMS Health, Lehman Brothers research Aug 2007

Figure 2. Worldwide insomnia market by sales



Source: Lehman Brothers – Biotechnology Aug 2007

The insomnia market is large but opportunities are sparse. The US insomnia prescription market peaked at \$3.6BN in 2006 with Ambien franchise (SNY) taking 79% share and Lunesta taking 16%.[1] Increase in sales due to expansion to international markets is likely to compensate for slowing growth in domestic insomnia patient population. Ambien seems to be better positioned to capitalize on international market penetration than Lunesta due to the higher resources and international expertise of SNY, whereas SEPR relies on strategic partnerships for its international sales. As a result, SEPR will have a claim only on a limited portion of Lunesta's revenues abroad.

In addition to pricing pressures, Lunesta margins are hurt by expensive, yet ineffective marketing. Bank of America estimates that \$333mm is spent just on Lunesta.[2] Since Lunesta is promotion-sensitive, maximizing marketing efficiency is necessary for Lunesta to grow or even maintain market share against the dominant Ambien franchise. Given past trends and a possible decrease in marketing spending, we see such an improvement unlikely.

[1] Welford, Peter et al. Lehman Brothers. 9 Aug 2007 Biotechnology- Trends in insomnia, awaiting the dream.
[2] Comeaux, Ross. Bank of America. 23 Oct, 2007. Defining Current Expectations; Investigation of an Oversold Stock

Marketing restructuring brings more woes than gains

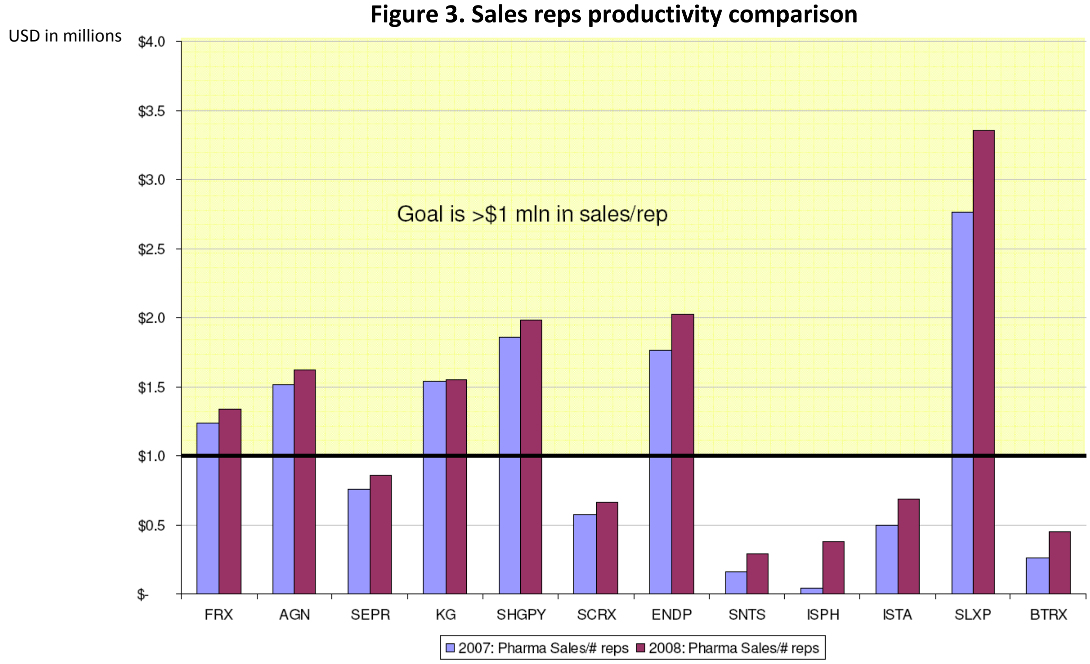
Sales and marketing expenses are forecasted to constitute 59.7% of SEPR's revenues in 2007. SEPR spent $329mm on Lunesta's Direct-To-Consumer (DTC) marketing in 2006, the most in its class, according to a recent MedAdNews survey.[3] By comparison, Lunesta's archrival Ambien CR, spent $208mm on DTC marketing in the same period.

SEPR has 1,750 sales reps and they are delivering sub-standard sales. Each rep brought $664,000 sales in 2006, whereas the industry benchmark is $1million (Figure 3).[4] Sepracor hopes to achieve a better ratio through a series of initiatives as early as 2008. Those include:

1. $90-100mm decrease in salary expenses due to employee reduction by 300 positions
2. Changes in top management strategies
3. Training program revamp

No indication of any potential positive effect of this restructuring, beyond an initial cost decrease, is apparent. Moreover, we expect training expenses for marketing team to be a longer term burden. The fact that SEPR Q307 reports and conference calls demonstrated no metrics in measuring sales boost from marketing restructuring is an indication of slow progress. Given current circumstances, gains in sales, if any, will unlikely be realized until at least 2H08.

Figure 3. Sales reps productivity comparison



Source: SFG research in Susquehann – Sepracor Jul 2007

[3] Welford, Peter et al. Lehman Brothers. 9 Aug 2007 Biotechnology- Trends in insomnia, awaiting the dream

[4] Larson, Angela, Belanger, Serge. Susquehanna Financial Group. 31 Jul 2007. Sepracor Inc, a CEO's Dilemma

Poor positioning

Although Sepracor's R&D is 15% of its revenues, in line with the industry average, their resources are not deployed optimally. As Figure 4 demonstrates, Lunesta is overall a less attractive option than Ambien. However, instead of focusing on core competencies, SEPR is spending its R&D budget on research that is too risky, too distant, and too different from SEPR's expertise to make any positive impact on the firm in the foreseeable future. Sepracor's core competency is in insomnia and asthma medication. Nevertheless, the few research projects the firm has taken-up focus on depression and anxiety (Figure 5).

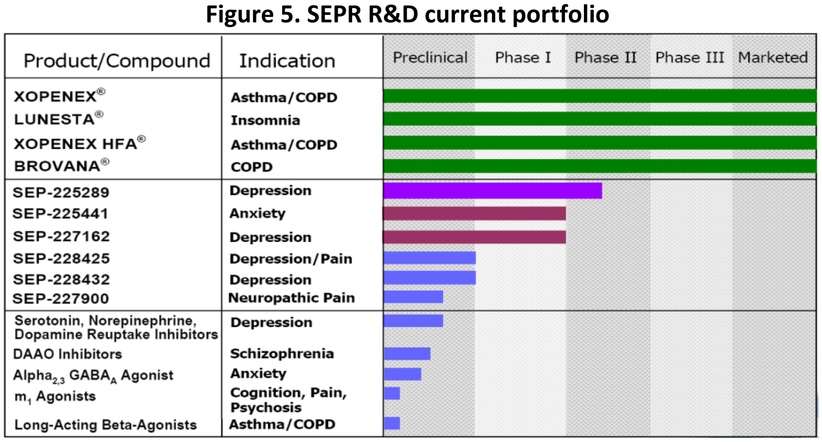
Additionally, more of the company's resources are now dedicated to competition with larger firms. Ambien vs. Lunesta is a case in point. While Lunesta is sucking up over half of its revenue on targeted marketing, Ambien CR is being marketed as one of many products Sanofi-Aventis has and is delivering more sales than Lunesta.

Figure 4. Lunesta vs. Ambien CR[5]

	Lunesta (SEPR)	Ambien CR (SNY)
Total trial sample size	1091	1223
Next-day residual effects	1 study showing ambiguous DSST[6] results. No research on next day residual effects	5 studies showed no next-day residual effects
Rebound	More frequent	Less frequent
Tolerance	No tolerance developed	Should be used no longer than 1-2 wks
Side effects if used LT	Unpleasant taste, dry mouth	Headache, somnolence
Usage restriction	None	Limited to 7-10 days
Price per month (as of 2 Nov 07)	$139.09	$109.17

Source: National Library of Medicine (MedLinePlus) Nov 2007

Figure 5. SEPR R&D current portfolio



Source: SEPR Q307 earnings webcast 30 Oct 07

5 Source: National Library of Medicine (MedLinePlus) *http://www.nlm.nih.gov/medlineplus/druginfo/medmaster/a605009.html*

6 Digit Symbol Substitution Test: This is a measure of attention, perceptual speed, motor speed, visual scanning and memory. Information from Van Uffelen, et. al. Dec 2005. Protocol for Project FACT: a randomized controlled trial on the effect of a walking program and vitamin B supplementation on the rate of cognitive decline and psychosocial wellbeing in older adults with mild cognitive impairment [ISRCTN19227688] *BMC Geriatrics* 2005, **5**:18doi:10.1186/1471-2318-5-18

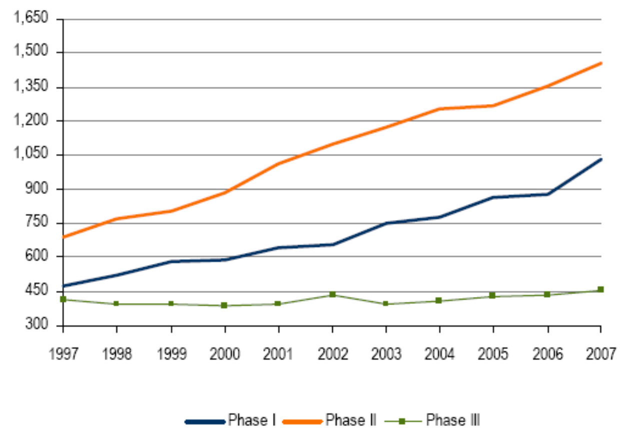
Weak pipeline and slow market expansion

Pipeline drugs will not contribute to revenue growth in 2008, and are unlikely to generate strong value in the near term. Three factors contribute to this:

1. Lack of Phase III drugs in pipeline compared to competitors
2. New management team sales-, rather than R&D-oriented
3. Over-reliance on global partnerships dilutes core strengths

SEPR latest pipeline development, SEP-225289 just reached phase II recently, and considering high failure rates between phase II and phase III, the three drugs currently in phase II are unlikely to reach maturity (see Figure 6). SEP-226330 recently failed in a Phase II trial for Restless Legs Syndrome.[7] On the insomnia front, SEPR is not coming out with a new generation of insomnia drugs to fight competition. Figure 7 indicates upcoming competition against SEPR.

Figure 6: Worldwide Active R&D Projects by Stage, 1997-2007



Source: Merrill Lynch Research, August 2007

In the new management team, all 4 recent hires were on the commercial and sales team; none of the recent hires focus on R&D.[8] SEPR has appointed four new people to senior management positions in hopes of spurring sales growth, especially for Lunesta and Brovana.[9]

Figure 7 insomnia drugs in Phase II-III trials across different companies

Drug	Company	Mechanism of Action	Status
eplivanserin	Sanofi Aventis	Selective $5HT_{2A}$ receptor antagonist	Phase III (results late 2007-2008E)
Silenor (doxepin)	Somaxon	Histamine H1 receptor antagonist	Phase III
Org 50081	Schering Plough	Serotonin-2 blocker	Phase III

Source: Lehman Brothers research in Biotechnology Aug 2007

[7] Neibor, Lawrence and Krecak, Robert. Baird. 15 Oct 2007. Sepracor: New management appointed to revive sales
[8] SEPR Q307 earnings webcast 30 Oct 07
[9] Sepracor corporate website

In the short run, momentum of international expansion is too weak to generate significant growth. EU marketing application for Lunesta just began. [10] Sepracor and GlaxoSmithKline (GSK) announced an agreement for the marketing of Lunesta for all worldwide markets (called Lunivia). Under the agreement: [11]

1. SEPR will receive an initial payment of $20 million,
2. can earn up to a total of $155 million in milestone and license payments
3. plus double-digit royalty on sales

According to industry analysts, this constitutes a substandard deal for SEPR. Although the company will not be responsible for the resources used in marketing and manufacturing of Lunesta in Europe, its upside potential will also be severely limited. While we agree that GSK would represent an ideal partner due to their reach, [12] we think that this partnership initiative came too late. Pipeline insomnia drugs in other firms (Figure 7) and generics development will quickly and significantly erode margins of Lunesta.

Additional international developments include a Phase I drug development for the Japanese market. The risk-adjusted potential of that drug is severely limited due to the low probability of final approval and long progression of research. Also, considering the low terms received in the European deal, a reasonable expectation is that SEPR will receive similar terms in Japan.

Xopenex Inhalation Solution profits suffocated by CMS reimbursement termination

We expect Xopenex Inhalation Solution (Xopenex UDV) sales to continue to be impacted despite company justifications. Xopenex UDV, being the second largest revenue generator for SEPR (39% projected in 2007), relies on Medicare reimbursements for growth. Figure 8 shows reliance of Xopenex UDV on hospital sales (linked to Medicare reimbursement), as compared to sales in retail units. The drop between 3Q06 and 3Q07 is a direct impact of Center for Medicare and Medicaid Services (CMS) reimbursement termination. CMS announced on 18th May, 2007 a termination of a portion of the reimbursement arrangement for Xopenex UDV from the Medicare program. [13] CMS has replaced a part of the Xopenex UDV with generic albuterol inhalation solution. The new prices went into effect on July 1, 2007, and have since:

1. caused a direct sales slash to Xopenex UDV (inventory draw-down occurred immediately following the announcement in the amount of $23mm) [14]
2. indirectly induced competition between Xopoenex UDV and its generic counterpart in what used to be a pristine space for Xopenex UDV

While SEPR stated in their Q307 conference call that all negative impact is factored into their sales calculation, we expect intensified competition with generic albuterol to remain a material threat to Xopenex UDV sales.

[10] Sepracor 2006 10K report

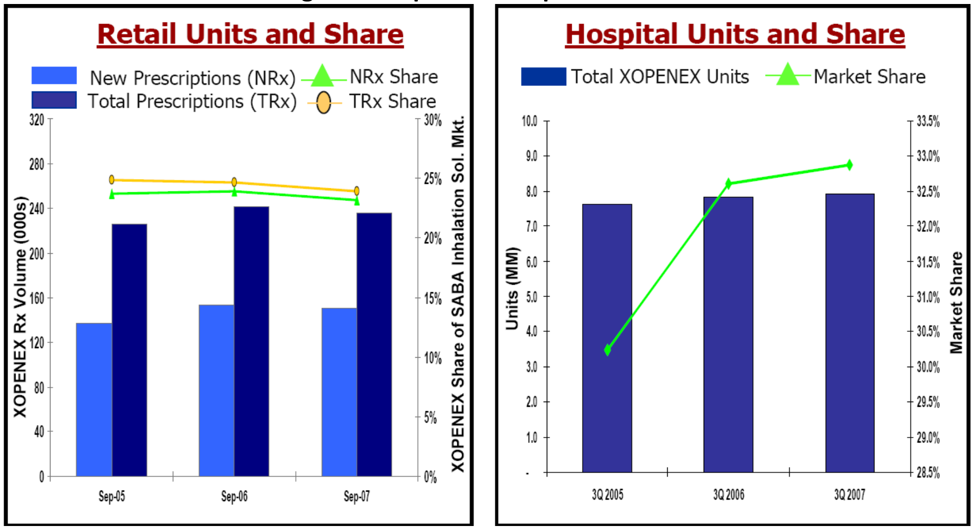
[11] Neibor, Lawrence and Krecak, Robert. Baird. 15 Oct 2007. Sepracor: New management appointed to revive sales

[12] Larson, Angela, Belanger, Serge. Susquehanna Financial Group. 31 Jul 2007. Sepracor Inc, a CEO's Dilemma

[13] Sepracore 10Q, 2Q07. Accessed: http://www.marketwatch.com/news/story/10-q-sepracor-inc-de/story.aspx?guid=%7B69E81371-EF6F-4F17-B149-8AD6456D831C%7D

[14] Larson, Angela, Belanger, Serge. Susquehanna Financial Group. 31 Jul 2007. Sepracor Inc, a CEO's Dilemma

Figure 8. Xopenex UDV performance



Source: IMS Health NPA and Sepracor Q3 earnings report Oct 07

Xopenex HFA growth limited, despite regulatory blue skies

We expect Xopenex hydro-fluoroalkane metered dose inhalers (HFA MDIs) to benefit from recent policy enforcement. According to a Datamonitor report, from 2008, the Montreal Protocol requires all (usually generic and cheap) chlorofluorocarbons-based metered dose inhalers (CFC MDIs) to be replaced with (more expensive branded) HFA MDIs.[15] This enforcement is expected to increase the albuterol market by 50% between 2005 and 2009. Since there are only a few HFA MDIs in the US, Xopenex HFA can capture a large per cent of this market. However, Xopenex constitutes a small part of SEPR's revenue—starting from a low base, the success of Xopenex HFA will depend on whether near term sales can pay off patent infringement litigation expenses and still profit.

There is a high likelihood of generics entering inhaler market at around 2010, and Sepracor is already feeling the blow from current patent litigations. USFDA approved the application of Xopenex in March 2005. Already in October the same year, SEPR is filing charges against Breath Limited in the District Court of Illinois. Four months after the first lawsuit, SEPR filed another one against Dey's ANDA applications for different dose formulations of generic Xopenex HFA. Currently, five of the six patents for Xopenex are under litigation, under the premise of infringement.[16] If generics are successful, the legal team of Credit Suisse reckoned Xopenex patents will be protected until only January of 2010.

Brovana: growth potentials exist, but sluggish over short term

Despite a slow start for SEPR's final product in 2Q07, Brovana has shown growth potential. We expect this product to be the fastest growing line of business in the foreseeable future. However, starting from a low base, Brovana is not expected to reap significant shares of the market in the near term. Brovana is also less than 10 years away from patent expiration, giving SEPR little time to boost sales. Please refer to valuation assumptions and model for our projections.

[15] Datamonitor. 10 Sept 2007. Sepracor Inc. Company Profile
[16] Goodman, Marc, and Hirsch, Scott. Credit Suisse. 22 Oct 2007. A little more bearish after Xopenex Patent Review.

Upside Potential

Although a faster-than-expected growth of Xopenex and Lunesta franchises is possible, given past trends and current competition, we see this scenario as highly unlikely, save a miniscule possibility that Ambien will be discovered to have significant side effects.

Similarly, if SEPR comes up with a blockbuster drug soon, our model will be invalidated. Statistically, given the current pipeline, that is unlikely as well. International expansion, as we have demonstrated, will be capped by SEPR's partners abroad.

The only real upside potential comes from potential M&A and spin-off activity. SEPR has a history of delivering equity value through spin-offs or acquisitions.

Valuation Model Assumptions

Assumptions used in the model presented below trend towards optimistic. Nevertheless, SEPR is shown to still be overvalued by 25.5%. Some sensitivity analysis on the assumptions has been done. If WACC assumptions are the only ones altered, the range of the amount by which equity is overvalued is between 19% and 32%. If growth and margin assumptions are changed beyond reason, the range changes to 13% to 47%. In no case have we been able to show that the current price is roughly correct.

Growth is forecasted individually for each product. For Lunesta, Xopenex, and Xopenex HFA we forecasted 4Q07 to be the average of 1Q-3Q07. Absent seasonality, our forecast is in line with many of the other analyst forecasts for these drugs. Given the lack of public information on Brovana (due to its novelty) and Royalty Revenues, we relied primarily on analyst forecasts, a mix of Bank of America and Merrill Lynch, to project 2007 figures. We assume that the year just prior to generics' entry into each drug's market growth will be close to 0%, due to the expiration of the patent and the necessity to reduce prices. The following year we assume a drop of 30% and the year after of 20%, an optimistic assumption, given our industry research, which has shown that although decreases in sales differ case-by-case, the drop happens within 12 months and is can be as high as 90%.

Xopenex sales are set to decline in 2007 over 2006. Assuming a turn-around in 2008, modest growth (not to exceed 5.4%, the industry-wide growth rate) can be expected until 2013, when, according to Bank of America, several of the patents protecting Xopenex will expire, placing some pressure on the price. Still, we assumed that no sizable declines would occur until 2016, when Xopenex will face competition from generics.

Xopenex HFA is a new drug, still growing significantly. However, growth is slowing. Our assumption was a smoothing of growth rate of -50% annually until the industry average rate is achieved.

Lunesta is a mature drug. Over the past three years its growth has been stable, despite aggressive advertising. We doubt that given cost-cutting measures sales of this drug can grow any more than they recently have. We therefore picked a stable growth rate to be equal to the 2006-07 growth until patent expiration.

Brovana is forecasted to grow at a rate higher than Xopenex HFA to reflect management's high expectations from the drug. Its growth is smoothed to 5.4% over several years, since our industry research forecasts 5.4% as the average pharmaceutical growth rate in the next 10 years.

Other products include the new products in the company's pipeline. The expectation is that in the best-case scenario the first product to make it to the market will be on sale in 2009. We assume first year sales to equal those of Brovana's first year and growth to be slightly lower, in part due to incredible uncertainty of these sales. We use this forecast to account for the possibility of new product releases in the next 10 years, while conceding that no analyst can forecast those sales with any degree of certainty.

Royalties include domestic and international manufacturing and partnership revenues. Growth in 2008 reflects the lump-sum gains from the European expansion. However, even if similar deals are struck almost every year thereafter, growth past 2008 will not exceed industry-wide growth.

Cost of Goods Sold wobbled around 9% in the past three years. We assume all products to have 9% COGS and royalties 4.5% COGS to reflect the fact that a large portion of partnerships (but not all) will not have direct costs associated with them.

Operating Expenses assumptions for 2007 are from Bank of America and Merrill Lynch analysts. We assume R&D to grow at 5%, below its current rate, primarily as an attempt to showcase the company's potential to cut costs. G&A costs are set to grow in the next two years due to a move to new headquarters and a potential staff expansion. Beyond that we expect a series of cost cutting measures to trim long-term G&A growth. Sales and marketing is expected to decrease in the next two years to reflect cost cutting measures, with modest growth resuming thereafter. Unusual losses and subsidiary losses have historically been immaterial.

Balance Sheet 2006 figures reflect 10-K. The rest is calculated by the model. Major short-term accounts are assumed to remain constant as per cent of revenue, to reflect historical trends and lack of any operational changes that would shift these accounts. We assume that the company holds $100mm in cash minimum and reserves, if any, are invested. This assumption does not impact valuation in this case, as cash balance never falls below this minimum. Neither 10-K, nor analysts itemize amortization. No recent acquisitions are known to us. Therefore we assume amortization to be 0. Capital expenditures will be higher for 2007, reflecting facility expansion. For the model we assumed Cap Ex to replace depreciation after 2007.

Debt, interest, and repayment were taken from the latest 10-K and 10-Q. Interest rate is 5% and will not change in the period analyzed, since debt maturity occurs after 2017. **Interest income** reflects 2006 interest income rate.

APV valuation assumes the following: risk-free rate at 4.4% - current yield on a 10-year T-Bond; 7% market premium, in accordance with Ibbotson; current market value from Yahoo Finance as of November 2, 2007. As a result, CAPM is 16.0. Cost of debt is the interest on current debt. Tax rate is assumed at 39%. **Beta** used is 1.65, 5 year weekly data compared with MSCI US Total Return Index. Beta reported by Google Finance is 1.19, which is possibly a smoothed beta. However, even at 1.19, the recommendation is sell with overvaluation of 13.5%. In fact, the current market price is achieved only if beta used is below 1.04.

Valuation Model

Revenue Forecasts

(US dollars in millions)

Xopenex	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	$ 555.1	$ 469.1	$ 469.1	$ 494.4	$ 521.1	$ 549.2	$ 578.9	$ 578.9	$ 578.9	$ 578.9	$ 405.2	$ 324.2
Growth	NM	-15.5%	0.0%	5.4%	5.4%	5.4%	5.4%	0.0%	0.0%	0.0%	-30.0%	-20.0%
COGS	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%

Xopenex HFA	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	$ 40.9	$ 66.8	$ 88.0	$ 101.9	$ 109.9	$ 115.9	$ 122.1	$ 128.7	$ 135.7	$ 143.0	$ 143.0	$ 100.1
Growth	NM	63.3%	31.7%	15.8%	7.9%	5.4%	5.4%	5.4%	5.4%	5.4%	0.0%	-30.0%
COGS	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%

Lunesta	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	$ 566.8	$ 602.9	$ 641.4	$ 682.3	$ 725.8	$ 772.0	$ 821.2	$ 873.6	$ 873.6	$ 611.5	$ 489.2	$ 489.2
Growth	NM	6.4%	6.4%	6.4%	6.4%	6.4%	6.4%	6.4%	0.0%	-30.0%	-20.0%	0.0%
COGS	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%

Brovana	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	$ -	$ 24.9	$ 62.3	$ 124.5	$ 186.8	$ 233.4	$ 262.6	$ 276.8	$ 291.7	$ 307.5	$ 307.5	$ 215.2
Growth	NM	NM	150.0%	100.0%	50.0%	25.0%	12.5%	5.4%	5.4%	5.4%	0.0%	-30.0%
COGS	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%

Other products	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	$ -	$ -	$ -	$ 24.9	$ 43.6	$ 65.4	$ 81.7	$ 91.9	$ 96.9	$ 102.1	$ 107.6	$ 113.4
Growth	NM	NM	NM	NM	75.0%	50.0%	25.0%	12.5%	5.4%	5.4%	5.4%	5.4%
COGS	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%

Royalties	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	$ 33.8	$ 40.5	$ 81.0	$ 85.4	$ 90.0	$ 94.8	$ 100.0	$ 105.4	$ 111.1	$ 117.0	$ 123.4	$ 130.0
Growth	NM	19.8%	100.0%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%
COGS	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%

Note: numbers in blue reflect our model assumptions

Income Statement

(US dollars in millions)

	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Net Revenues	$ 1,196.6	$ 1,204.2	$ 1,341.6	$ 1,513.3	$ 1,677.1	$ 1,830.8	$ 1,966.5	$ 2,055.3	$ 2,087.8	$ 1,860.1	$ 1,575.9	$ 1,372.2
COGS	$ 106.2	$ 106.6	$ 117.1	$ 132.4	$ 146.9	$ 160.5	$ 172.5	$ 180.2	$ 182.9	$ 162.1	$ 136.3	$ 117.6
Gross Profit	$ 1,090.4	$ 1,097.6	$ 1,224.5	$ 1,380.9	$ 1,530.2	$ 1,670.3	$ 1,794.1	$ 1,875.0	$ 1,904.9	$ 1,697.9	$ 1,439.7	$ 1,254.6
R&D	$ 163.5	$ 181.6	$ 190.7	$ 200.2	$ 210.2	$ 220.7	$ 231.8	$ 243.4	$ 255.5	$ 268.3	$ 281.7	$ 295.8
Selling and Marketing	$ 691.8	$ 718.6	$ 646.7	$ 582.1	$ 611.2	$ 641.7	$ 673.8	$ 707.5	$ 742.9	$ 780.0	$ 819.0	$ 860.0
General Administrative	$ 72.0	$ 79.2	$ 95.0	$ 109.3	$ 109.3	$ 112.0	$ 117.6	$ 123.5	$ 129.7	$ 136.2	$ 143.0	$ 150.1
Unusual Items	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Subsidiary Loss (Income)	$ 0.5	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Amortization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
EBIT	$ 162.6	$ 118.2	$ 292.1	$ 489.4	$ 599.5	$ 695.8	$ 770.8	$ 800.7	$ 776.8	$ 513.4	$ 195.9	$ (51.3)
Interest Expense (Net)	$ 11.4	$ 3.8	$ 2.7	$ (7.0)	$ (23.8)	$ (44.8)	$ (69.7)	$ (98.0)	$ (128.2)	$ (158.7)	$ (181.3)	$ (194.0)
Income Before Taxes	$ 151.2	$ 114.5	$ 289.4	$ 496.4	$ 623.3	$ 740.5	$ 840.5	$ 898.7	$ 905.1	$ 672.1	$ 377.2	$ 142.6
Income Tax	$ 59.0	$ 44.6	$ 112.9	$ 193.6	$ 243.1	$ 288.8	$ 327.8	$ 350.5	$ 353.0	$ 262.1	$ 147.1	$ 55.6
Net Income	**$ 92.2**	**$ 69.8**	**$ 176.5**	**$ 302.8**	**$ 380.2**	**$ 451.7**	**$ 512.7**	**$ 548.2**	**$ 552.1**	**$ 410.0**	**$ 230.1**	**$ 87.0**

As % ofNet Revenues	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Net Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
COGS	8.9%	8.8%	8.7%	8.7%	8.8%	8.8%	8.8%	8.8%	8.8%	8.7%	8.6%	8.6%
Gross Profit	91.1%	91.2%	91.3%	91.3%	91.2%	91.2%	91.2%	91.2%	91.2%	91.3%	91.4%	91.4%
R&D	13.7%	15.1%	14.2%	13.2%	12.5%	12.1%	11.8%	11.8%	12.2%	14.4%	17.9%	21.6%
Selling and Marketing	57.8%	59.7%	48.2%	38.5%	36.4%	35.1%	34.3%	34.4%	35.6%	41.9%	52.0%	62.7%
General Administrative	6.0%	6.6%	7.1%	7.2%	6.5%	6.1%	6.0%	6.0%	6.2%	7.3%	9.1%	10.9%
Unusual Items	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Subsidiary Loss (Income)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBIT	13.6%	9.8%	21.8%	32.3%	35.7%	38.0%	39.2%	39.0%	37.2%	27.6%	12.4%	-3.7%
Interest Expense (Net)	1.0%	0.3%	0.2%	-0.5%	-1.4%	-2.4%	-3.5%	-4.8%	-6.1%	-8.5%	-11.5%	-14.1%
Amortization	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Income Before Taxes	12.6%	9.5%	21.6%	32.8%	37.2%	40.4%	42.7%	43.7%	43.3%	36.1%	23.9%	10.4%
Income Tax	4.9%	3.7%	8.4%	12.8%	14.5%	15.8%	16.7%	17.1%	16.9%	14.1%	9.3%	4.1%
Net Income	**7.7%**	**5.8%**	**13.2%**	**20.0%**	**22.7%**	**24.7%**	**26.1%**	**26.7%**	**26.4%**	**22.0%**	**14.6%**	**6.3%**

Note: numbers in blue reflect our model assumptions

Balance Sheet

(US dollars in millions)

	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
ASSETS												
Current Assets:												
Cash & Equivalents	$ 415.4	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0
Short-Term Investments	$ 568.0	$ 504.1	$ 680.8	$ 984.0	$ 1,364.5	$ 1,816.5	$ 2,329.5	$ 2,877.9	$ 3,430.0	$ 3,839.6	$ 4,069.1	$ 4,155.7
Accounts Receivable	$ 175.0	$ 176.1	$ 196.2	$ 221.3	$ 245.3	$ 267.7	$ 287.6	$ 300.6	$ 305.3	$ 272.0	$ 230.5	$ 200.7
Inventories	$ 37.0	$ 37.2	$ 41.5	$ 46.8	$ 51.9	$ 56.6	$ 60.8	$ 63.6	$ 64.6	$ 57.5	$ 48.7	$ 42.4
Other Current Assets	$ 25.4	$ 25.6	$ 28.5	$ 32.1	$ 35.6	$ 38.9	$ 41.7	$ 43.6	$ 44.3	$ 39.5	$ 33.5	$ 29.1
Total Current Assets	$ 1,220.8	$ 843.0	$ 1,047.0	$ 1,384.2	$ 1,797.2	$ 2,279.7	$ 2,819.7	$ 3,385.6	$ 3,944.2	$ 4,308.6	$ 4,481.8	$ 4,528.0
Long-Term Investments	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9	$ 182.9
PP&E, Net	$ 72.9	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1	$ 82.1
Investment in Affiliate	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1	$ 5.1
Deferred Costs	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9	$ 11.9
Other Assets	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1
Total Assets	**$ 1,493.7**	**$ 1,125.0**	**$ 1,329.1**	**$ 1,666.3**	**$ 2,079.3**	**$ 2,561.8**	**$ 3,101.7**	**$ 3,667.7**	**$ 4,226.3**	**$ 4,590.7**	**$ 4,763.8**	**$ 4,810.0**
LIABILITIES AND EQUITY												
Current Liabilities:												
Accounts Payable	$ 10.8	$ 10.8	$ 12.1	$ 13.6	$ 15.1	$ 16.4	$ 17.7	$ 18.5	$ 18.8	$ 16.7	$ 14.2	$ 12.3
Accrued Expenses	$ 113.1	$ 113.8	$ 126.8	$ 143.0	$ 158.5	$ 173.0	$ 185.9	$ 194.3	$ 197.3	$ 175.8	$ 149.0	$ 129.7
Other Current Liabilities	$ 115.9	$ 116.6	$ 129.9	$ 146.6	$ 162.4	$ 177.3	$ 190.5	$ 199.1	$ 202.2	$ 180.2	$ 152.6	$ 132.9
Total Current Liabilities	$ 239.8	$ 241.3	$ 268.8	$ 303.2	$ 336.0	$ 366.8	$ 394.0	$ 411.8	$ 418.3	$ 372.7	$ 315.8	$ 274.9
Notes Payable & cap lease	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7	$ 0.7
Debt	$ 1,160.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8	$ 720.8
Total Liabilities	**$ 1,401.3**	**$ 962.7**	**$ 990.3**	**$ 1,024.7**	**$ 1,057.5**	**$ 1,088.3**	**$ 1,115.5**	**$ 1,133.3**	**$ 1,139.8**	**$ 1,094.2**	**$ 1,037.2**	**$ 996.4**
Stockholders' Equity	$ 92.5	$ 162.3	$ 338.8	$ 641.6	$ 1,021.8	$ 1,473.5	$ 1,986.2	$ 2,534.4	$ 3,086.5	$ 3,496.5	$ 3,726.6	$ 3,813.6
Total Liabilities and Equity	**$ 1,493.7**	**$ 1,125.0**	**$ 1,329.1**	**$ 1,666.3**	**$ 2,079.3**	**$ 2,561.8**	**$ 3,101.7**	**$ 3,667.7**	**$ 4,226.3**	**$ 4,590.7**	**$ 4,763.8**	**$ 4,810.0**

	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
OPERATING ACTIVITIES												
Net Income	$ 92.2	$ 69.8	$ 176.5	$ 302.8	$ 380.2	$ 451.7	$ 512.7	$ 548.2	$ 552.1	$ 410.0	$ 230.1	$ 87.0
Depreciation and Amortization	$ 20.7	$ 20.9	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4
Accounts Receivable	$ (34.6)	$ (1.1)	$ (20.1)	$ (25.1)	$ (24.0)	$ (22.5)	$ (19.9)	$ (13.0)	$ (4.8)	$ 33.3	$ 41.6	$ 29.8
Inventories	$ 1.9	$ (0.2)	$ (4.2)	$ (5.3)	$ (5.1)	$ (4.8)	$ (4.2)	$ (2.7)	$ (1.0)	$ 7.0	$ 8.8	$ 6.3
Other Current Assets	$ (3.3)	$ (0.2)	$ (2.9)	$ (3.6)	$ (3.5)	$ (3.3)	$ (2.9)	$ (1.9)	$ (0.7)	$ 4.8	$ 6.0	$ 4.3
Accounts Payable	$ (0.9)	$ 0.1	$ 1.2	$ 1.5	$ 1.5	$ 1.4	$ 1.2	$ 0.8	$ 0.3	$ (2.0)	$ (2.6)	$ (1.8)
Accrued Expenses	$ (74.3)	$ 0.7	$ 13.0	$ 16.2	$ 15.5	$ 14.5	$ 12.8	$ 8.4	$ 3.1	$ (21.5)	$ (26.9)	$ (19.3)
Other Current Liabilities	$ 38.9	$ 0.7	$ 13.3	$ 16.6	$ 15.9	$ 14.9	$ 13.2	$ 8.6	$ 3.2	$ (22.1)	$ (27.5)	$ (19.7)
Other Adjustments	$ 119.1	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Net Cash from Operating Activities	$ 159.8	$ 90.7	$ 200.2	$ 326.6	$ 404.0	$ 475.5	$ 536.4	$ 571.8	$ 575.6	$ 433.0	$ 253.0	$ 110.0
INVESTING ACTIVITIES												
Investments in Affiliate	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Capital Expenditures	$ (21.1)	$ (30.0)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)
Net Cash from Investing Activities	$ (21.1)	$ (30.0)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)
FINANCING ACTIVITIES												
Stock Issuance or Repurchase	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Debt Issuance or Repayment	$ -	$ (440.0)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Net Cash from Financing Activities	$ -	$ (440.0)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Net Cash Flow	**$ 138.67**	**$ (379.32)**	**$ 176.78**	**$ 303.15**	**$ 380.52**	**$ 452.02**	**$ 512.99**	**$ 548.36**	**$ 552.16**	**$ 409.55**	**$ 229.55**	**$ 86.59**
Beginning Cash	$ 844.7	$ 983.4	$ 604.1	$ 780.8	$ 1,084.0	$ 1,464.5	$ 1,916.5	$ 2,429.5	$ 2,977.9	$ 3,530.0	$ 3,939.6	$ 4,169.1
Ending Cash	$ 983.4	$ 604.1	$ 780.8	$ 1,084.0	$ 1,464.5	$ 1,916.5	$ 2,429.5	$ 2,977.9	$ 3,530.0	$ 3,939.6	$ 4,169.1	$ 4,255.7

Note: numbers in blue reflect our model assumptions

Free Cash Flows

(US dollars in millions)

	2006A	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Net Income	$ 92.2	$ 69.8	$ 176.5	$ 302.8	$ 380.2	$ 451.7	$ 512.7	$ 548.2	$ 552.1	$ 410.0	$ 230.1	$ 87.0
Add depreciation	$ 20.7	$ 20.9	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4	$ 23.4
Less Capital Expenses	$ (21.1)	$ (30.0)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)	$ (23.4)
Add Interest (after-tax)	$ 35.4	$ 35.4	$ 22.0	$ 22.0	$ 22.0	$ 22.0	$ 22.0	$ 22.0	$ 22.0	$ 22.0	$ 22.0	$ 22.0
Free Cash Flows	**$ 127.2**	**$ 96.1**	**$ 198.5**	**$ 324.8**	**$ 402.2**	**$ 473.7**	**$ 534.7**	**$ 570.2**	**$ 574.1**	**$ 432.0**	**$ 252.1**	**$ 109.0**

Discounted Cash Flow Analysis - APV Methodology

(US dollars in millions)

		2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	Terminal
Nominal Value		$ 96.1	$ 198.5	$ 324.8	$ 402.2	$ 473.7	$ 534.7	$ 570.2	$ 574.1	$ 432.0	$ 252.1	$ 109.0	$ 1,219.5
Discount		1.00	1.13	1.28	1.45	1.65	1.87	2.11	2.40	2.71	3.08	3.48	3.48
Present Value		$ 96.1	$ 175.2	$ 253.0	$ 276.6	$ 287.5	$ 286.5	$ 269.6	$ 239.6	$ 159.2	$ 82.0	$ 31.3	$ 350.0
Interest Expense		$ 58.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 36.0	$ 226.0
Nominal Tax Shield		$ 22.6	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 14.1	$ 88.1
Discount		1.00	1.05	1.10	1.16	1.22	1.28	1.34	1.41	1.48	1.55	1.63	1.63
Present Value of Tax Shield		$ 22.6	$ 13.4	$ 12.7	$ 12.1	$ 11.6	$ 11.0	$ 10.5	$ 10.0	$ 9.5	$ 9.1	$ 8.6	$ 54.1
NPV	**$ 2,691.8**												

Projected Equity Value	$ 2,071.0
Different from the market by	$ (709.0)
Difference in %	-25.5%

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