

UBS Investment Research
Life Sciences

Americas

Biotechnology

Quarterly Results Review



Recent Events and Sector Outlook

■ Life sciences sector has outperformed the broader market

The UBS Life Sciences Index is up 18% year-to-date, outperforming both the BTK (+13%) and S&P 500 (+12%). We remain long-term bulls on the life sciences sector, but because we believe 1Q07 could prove challenging, we are a little more cautious entering 2007.

■ Limited visibility into pharma and academic spending

U.S. Big Pharma spending modestly improved in 3Q06, and 4Q06 looks solid. However, following the trend of the past two years, we expect conservative Big Pharma spending in 1H07. We believe the Democrats' control of Congress is positive, but the release of new NIH funds could be delayed since FY07 appropriations bills were not finalized before the lame duck Congress adjourned.

■ Biotech, industrial, and applied markets remain healthy

Biotech financing slowed in 3Q, but most small- to mid-cap companies are still well funded and, we believe, should continue to spend at a healthy pace. Though year-over-year comparisons become more difficult, we expect ex-U.S. industrial markets to remain strong in 2007, helped in part by the weaker U.S. dollar. We believe growth from applied markets, such as forensics, food safety, and biosecurity, will remain robust.

■ UBS recommendations: Top picks are TMO, MIL, and MTD

We maintain our Buy 1 rating on TMO; Buy 2 on CRA, MIL, and MTD; Neutral 1 on ABI, PKI, SIAL, and WAT; Neutral 2 on AFFX, BRKR, CPHD, CRL, IVGN, and VARI.

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Summary

Year-to-Date the Life Sciences Sector Continues to Outperform

For the quarter ended September 30, 2006, the UBS Life Sciences Index was up 0.5%, below the 0.9% gain in the Amex Biotechnology Index (BTK) and the 5.2% gain in the S&P 500. Overall in 2006 the performance of the UBS Life Sciences index has been strong—up 17.5% through November 30, 2006), ahead of the S&P 500’s 12.2% gain and BTK’s 13.1% gain (see Table 1 and Chart 1).

The UBS Life Sciences Index is up 17.5% in 2006

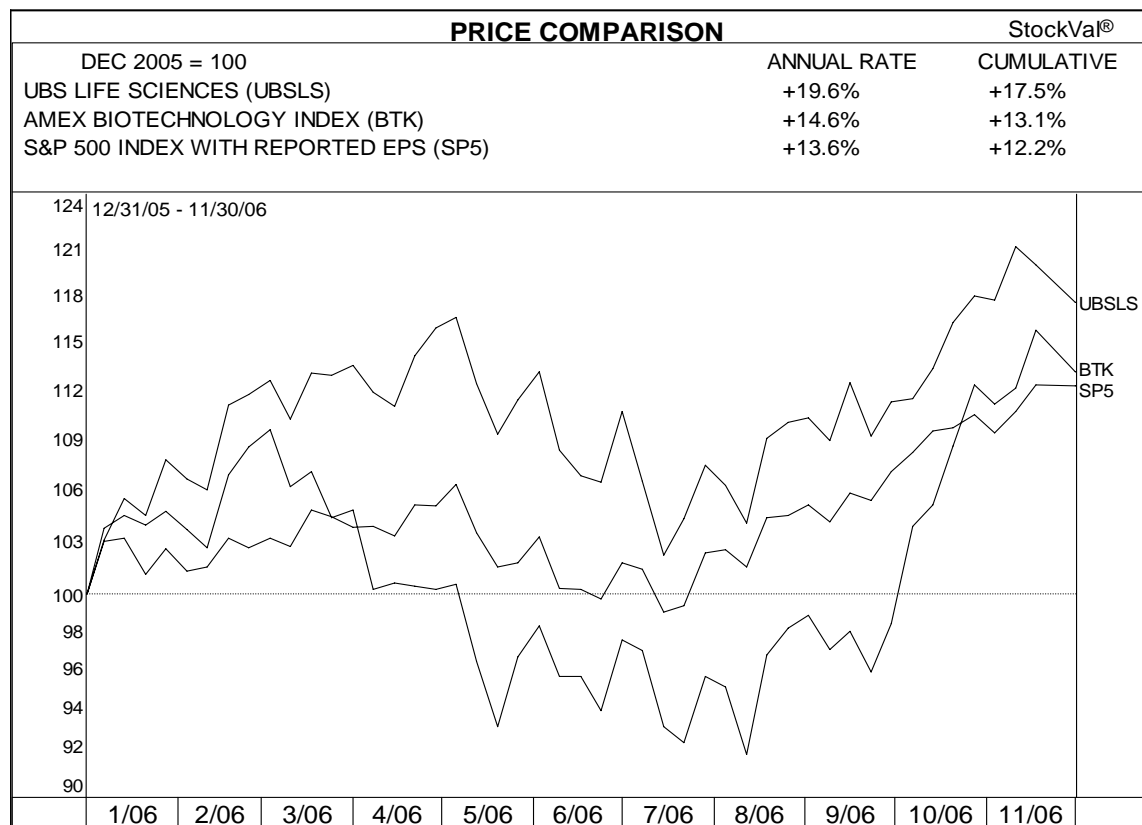
Table 1: The UBS Life Sciences Tools Index, 2004-06 Performance

	2004	2005	1Q06	2Q06	3Q06	2006 YTD (11/30/06)
UBS LS Tools Index	5.9%	10.5%	13.5%	-2.5%	0.5%	17.5%
BTK	11.0%	25.1%	4.7%	-6.9%	0.9%	13.1%
S&P 500	9.0%	3.0%	3.7%	-1.9%	5.2%	12.2%

Note: Companies selected for the UBS Life Sciences index calculation are: ABI, AFFX, BRKR, CALP, CPHD, CRL, DNEX, ILMN, IVGN, LMNX, MIL, MTD, PKI, QGEN, SIAL, TECH, TMO, VARI, and WAT. The index has been rebalanced to reflect the acquisitions of SERO and FSH.

Source: FactSet

Chart 1: UBS Life Sciences Index (UBSLS) vs. BTK and S&P 500 (SP5), Year-to-Date (11/30/06) Performance



Source: StockVal

For 3Q06, with the notable exception of Invitrogen, most of our covered companies beat UBS and Street forecasts (see Table 2). In general, companies with significant exposure to industrial (e.g., Thermo Electron, Mettler-Toledo, and Varian) and applied markets (e.g., Applied Biosystems, Waters, and PerkinElmer) reported better than expected top-line organic growth. Sales to biotechnology companies remained healthy, while some companies (e.g., Invitrogen, Sigma-Aldrich) noted soft spending at U.S. academic labs.

In 3Q06, spending at U.S. Big Pharma modestly improved; Biotech, Industrial and Applied markets remained healthy; but academic sales showed some softness

Spending on capital equipment at certain U.S. Big Pharma accounts improved from 1H07. However, despite generally positive quarterly results, some U.S. Big Pharma companies (e.g., Pfizer) have made cautious remarks regarding future R&D commitments. Spending by European pharmaceutical, CRO, and specialty pharmaceutical companies continues to show strength.

Outsourcing trends remain strong, as CROs and companies such as Fisher Scientific (now Thermo Fisher Scientific) saw drug development companies continue to increase their focus on their core R&D competencies and seek to outsource certain peripheral development activities (e.g., clinical trial packaging, sample management, and clinical trial logistics management). Demand for biomanufacturing experienced another strong quarter thanks to growing sales of existing biologics and new product approvals.

Table 2: 3Q06 Earnings Results vs. Expectations

	Actual	UBS Est.	First Call Est.
AFFX	\$(0.06)	\$0.01	\$(0.08)
ABI	0.29	0.25	0.25
BRKR	0.04	0.03	0.04
CRA	(0.09)	(0.10)	(0.11)
CPHD	(0.07)	(0.13)	(0.11)
CRL	0.56	0.54	0.54
FSH	1.09	0.98	1.02
IVGN	0.72	0.75	0.78
MIL	0.65	0.66	0.66
MTD	0.91	0.80	0.81
PKI	0.30	0.26	0.26
SIAL	1.02	0.97	0.96
TMO	0.44	0.43	0.43
VARI	0.54	0.52	0.52
WAT	0.49	0.47	0.46

Source: Company reports, First Call, and UBS estimates

On the bottom line, operational improvements and share buybacks contributed to EPS upside. Many companies continue to benefit from significantly lower than forecast tax rates, due in part to SEC-mandated reductions in tax reserves and improved tax planning. For example, Mettler-Toledo implemented a tax optimization strategy, allowing the company to reduce its effective tax rate from 30% to 27% going forward.

In 3Q06 we made a number of rating changes. Despite possible near-term challenges from the Serologicals integration, we upgraded Millipore to Buy 2 from Neutral 2, based on our positive long-term outlook for the company, which is driven by growing markets for monoclonal antibodies and recombinant vaccines; expanding gross margins thanks to favorable product mix and improving sales growth; and improving cash flow.

We upgraded MIL to Buy 2 from Neutral 2, ABI to Neutral 1 from Reduce 1, and AFFX to Neutral 2 from Reduce 2; we downgraded CPHD and IVGN to Neutral 2 from Buy 2

We also upgraded Applied Biosystems to Neutral 1 from Reduce 1. It is difficult to argue against the fact that by almost any measure we use, Applied Biosystems' overall business has improved: The core business has stabilized, margins have improved, R&D investments are paying off, the corporate structure has been simplified, and management has effectively deployed its cash for both acquisitions and share buybacks. Furthermore, when we look at the key growth areas across the life sciences landscape—molecular diagnostics, genotyping, pharmacogenomics, quality control and assurance, functional genomics, proteomics, forensics, and biosecurity—we see that ABI has a strong position in each of these end markets. Although the recent departure of President Cathy Burzik and the company's premium valuation still keep us cautious, we believe ABI has a good chance of successfully implementing its strategic vision of evolving from a tool company chiefly tied to basic research into a broad range supplier of validation and commercialization technologies.

We also upgraded Affymetrix to Neutral 2 from Reduce 2. Recent genotyping contract wins and feedback on the new 1-chip 500K product suggest that, though still under pressure, Affymetrix's business has incrementally improved. Customer discussions and results from competitors give us greater conviction that price cuts can drive volume and expand the total genotyping market. We are also more positive on the use of microarrays as diagnostic tools. However, we remain concerned about near-term erosion of the company's core gene expression franchise; management's execution record to date has been lackluster.

After cutting guidance in 2Q06, Invitrogen reported its third consecutive quarter of disappointing results and again lowered guidance, as both margins and cash flow deteriorated further. Although we are still believers of the intrinsic value of the Invitrogen franchise and believe its string of acquisitions make long-term strategic sense, we think 3Q left too many questions unanswered, and we are skeptical that current management can engineer a quick fix. Based on our increasing caution, we downgraded Invitrogen to Neutral 2 from Buy 2.

Finally, further delays in the company's key MRSA molecular diagnostic program led us to downgrade Cepheid to Neutral 2 from Buy 2 in mid-September. However, 3Q06 results were better than expected, and we are encouraged that management's visibility and execution may be improving.

Sector Overview

Organic Revenue Growth Trends

Given the significant M&A activity in the life sciences sector, we monitor organic revenue growth trends, which we view as a key measure of a company's underlying business strength. We define organic revenue growth as y/y growth excluding the impact of foreign exchange and acquisitions (or divestitures) not yet annualized. However, because the level of disclosure varies greatly from company to company, it is difficult to estimate organic growth. With that in mind, as Table 3 shows, 3Q06 organic growth averaged approximately 8% for the overall group—9% for instrument-focused companies and 6% for consumables-focused companies. Estimated revenue mix by product is shown in Chart 2.

Organic growth averaged 7% for 3Q06

Table 3: Estimated Revenue Organic Growth Trends for Selected Life Sciences Companies Under UBS Coverage

Company	1Q03	2Q03	3Q03	4Q03	FYA	1Q04	2Q04	3Q04	4Q04	FYA	1Q05	2Q05	3Q05	4Q05	FYA	1Q06	2Q06	3Q06
Consumables greater than 50% of sales																		
IVGN	4%	7%	9%	7%	7%	5%	3%	6%	7%	5%	4%	7%	1%	11%	6%	2%	-1%	3%
CRL	2%	5%	2%	5%	3%	7%	13%	11%	14%	11%	10%	9%	4%	11%	9%	7%	7%	8%
SIAL	3%	-1%	-2%	1%	0%	2%	2%	2%	2%	2%	2%	12%	7%	7%	2%	8%	1%	5%
FSH	5%	4%	6%	7%	5%	8%	7%	10%	4%	7%	3%	5%	4%	6%	5%	6%	4%	6%
QGEN	7%	9%	12%	12%	10%	12%	10%	12%	8%	11%	8%	10%	4%	15%	9%	13%	11%	11%
MIL	3%	3%	9%	7%	6%	11%	11%	1%	1%	6%	9%	6%	11%	15%	6%	9%	8%	9%
AFFX	-2%	-3%	5%	14%	4%	17%	15%	4%	20%	14%	12%	4%	4%	4%	4%	-2%	-4%	1%
Average	3%	3%	6%	7%	5%	9%	9%	7%	8%	8%	7%	8%	5%	10%	6%	6%	4%	6%
Capital Equipments greater than 50% of sales																		
ABI	-3%	1%	-5%	0%	-2%	4%	5%	0%	-1%	2%	1%	3%	7%	6%	4%	6%	6%	10%
BRKR	13%	1%	2%	3%	5%	-3%	1%	-1%	11%	3%	10%	11%	6%	-6%	5%	4%	9%	17%
WAT	2%	0%	0%	-3%	-2%	8%	7%	9%	12%	10%	3%	8%	3%	6%	5%	12%	5%	10%
VARI**	6%	2%	9%	3%	5%	8%	7%	-5%	10%	5%	1%	-2%	6%	3%	4%	5%	6%	9%
MTD	2%	0%	0%	2%	1%	2%	4%	3%	3%	3%	3%	5%	7%	7%	6%	7%	6%	7%
TMO*	-7%	-5%	-2%	-1%	-4%	4%	3%	9%	3%	4%	0%	7%	5%	6%	5%	10%	6%	6%
PKI	1%	-6%	-4%	-6%	-5%	5%	8%	8%	8%	7%	4%	1%	5%	5%	5%	2%	2%	4%
Average	2%	-1%	0%	0%	0%	4%	5%	3%	7%	5%	3%	5%	6%	4%	5%	7%	6%	9%
Overall Average	3%	1%	3%	4%	2%	6%	7%	5%	7%	6%	5%	6%	5%	7%	5%	6%	5%	8%

Note: Calendar year estimates are shown. Following the close of the TMO-FSH merger on 11/09/06 this will be the last quarter we report FSH organic growth.

1. ABI fiscal year ends June 30

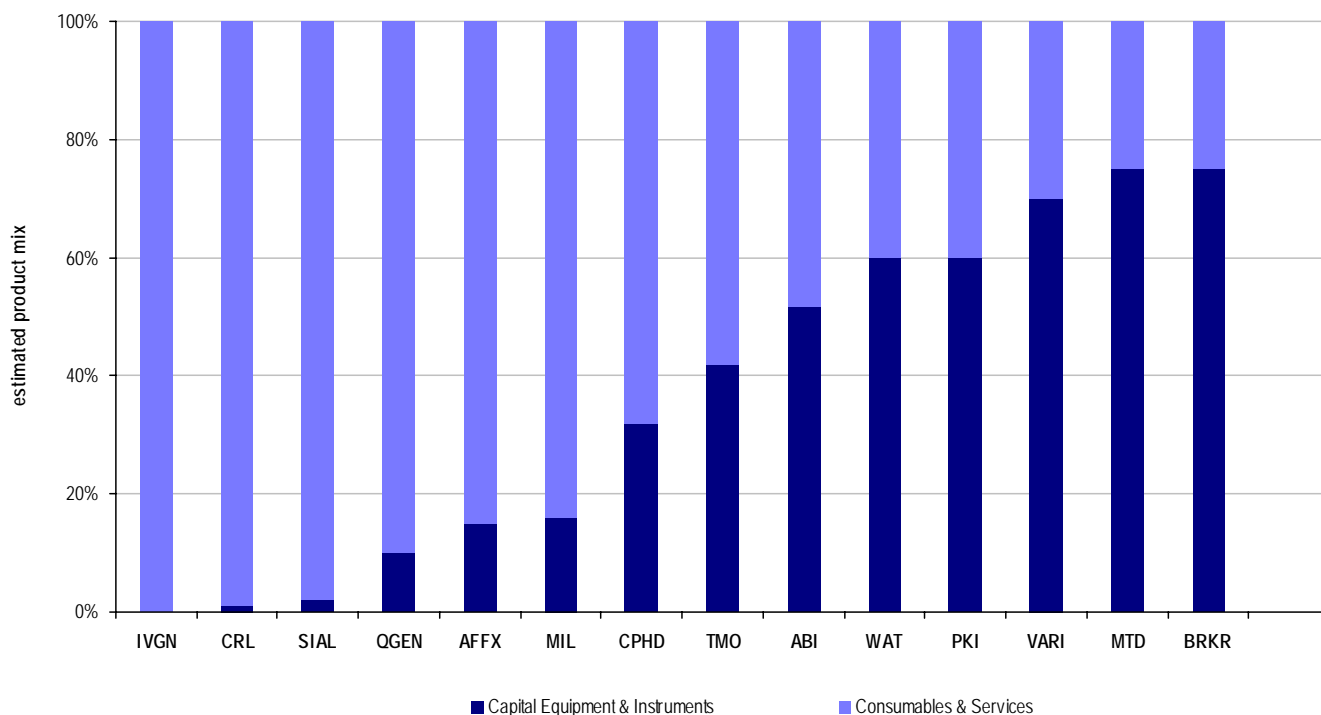
2. VARI fiscal year ends September 30.

Source: Company reports and UBS estimates

When looking at organic growth trends, it is important to note that because of fluctuations in the timing of shipment and acceptance of capital equipment orders, quarterly instrument sales are frequently lumpy. There is limited visibility since most instruments are shipped in the last two weeks of the quarter. Likewise, sales of products used for biomanufacturing are notoriously lumpy, as customers often change their production campaigns based on capacity supply and product demand. Thus, we believe it is important to focus on annual organic growth and take a long-term view when investing in the life sciences sector.

Quarter-to-quarter organic growth tends to be lumpy

Chart 2: Estimated Revenue Mix, by Product, for Life Sciences Companies Under UBS Coverage



Source: Company reports and UBS estimates

Geographic Trends

North America continued to perform well across all customer segments during 3Q. However, some companies see a cooling of the U.S. economy in 2007. Asia (excluding Japan) remains the fastest-growing region and one of increasing importance for the life sciences sector, both as a low-cost manufacturing site and as an emerging market. Japan remains challenging, but the market appears to have stabilized somewhat in the past two quarters. Mixed economic conditions and uncertain academic and government research environments in some Western European countries continue to weigh on sales. That said, most companies reported further improvements in the region and are cautiously optimistic going into 2007. Emerging markets in Eastern Europe and Latin America, although still a relatively small percentage of total sales for most companies, continue to grow.

China and India remain the fastest growing; Europe is steady; Japan remains challenging but is stabilizing; North America could slow in 2007

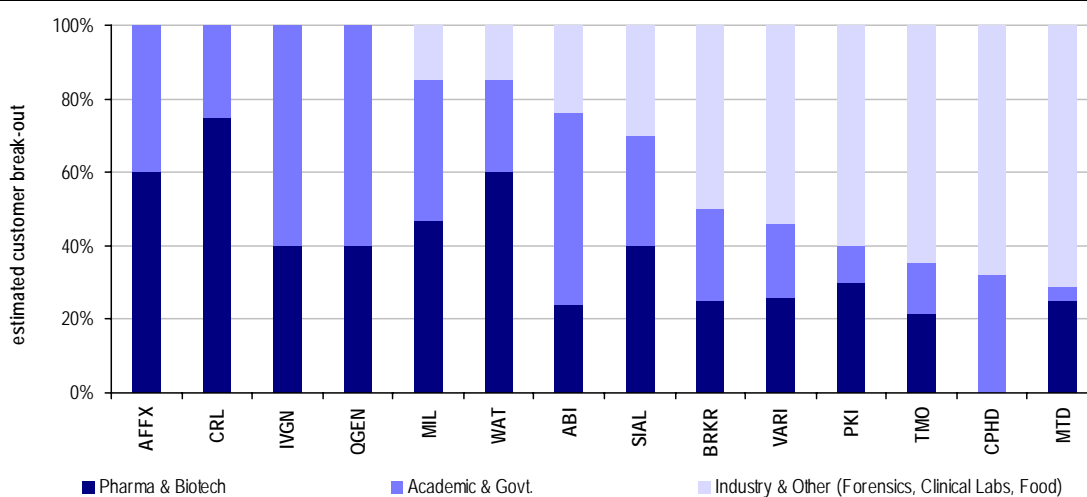
Looking Ahead: 4Q06 Looks Solid, But We Are More Cautious Going Into 2007

We believe the 4Q06 outlook remains positive. Note that 4Q is typically the seasonally strongest quarter owing to the year-end “R&D budget flush” at many labs. Pharma spending improved in 3Q06, and anecdotal evidence from management meetings, conference calls, guidance commentaries, and end-user channel checks continue to suggest that both R&D and capital equipment budgets are intact among pharma and biotech accounts.

Despite a slowdown in the U.S., industrial spending on capital equipment still appears to be growing as customers invest in new capacity, infrastructure, and facility upgrades. Given order trends and the global economic outlook, several late-cycle companies (e.g., Thermo Electron and Mettler-Toledo) appear confident that these trends will continue through into 2007. We expect the significantly weaker U.S. dollar should also help industrial sales.

Although we do not expect a dramatic decline in year-end academic spending, our university and government contacts are feeling the pinch of lower NIH funding levels, which could weigh on consumable suppliers. As a reference, we present a breakdown of life sciences company revenues by customer (pharma/biotech, academic/government, and industrial/other) in Chart 3.

Chart 3: Revenue Mix, by Customer, for Life Sciences Companies Under UBS Coverage



Source: Company reports and UBS estimates

With the Democrats in control of Congress, we foresee a better environment for biomedical research funding. It remains to be seen if good intentions actually turn into R&D dollars, but we believe NIH and NSF are now much less at risk of budget cuts. Most domestic appropriations bills for the FY07 budget were incomplete at the end of the lame duck congressional session. If the Democrats decide to reopen the appropriations process, approval of the FY07 budget could be delayed well into 1Q07, hampering the release of new grant money and potentially leading to weaker academic spending. However, one likely scenario, according to our Washington consultant, calls for the Democrats to pass the remaining appropriations as they stand and then, come March, tack on new spending programs to the president’s \$150 billion request for Iraq.

Politics could also affect pharmaceutical company spending. In the past two years, we have seen conservative R&D spending from U.S. Big Pharma in the first half of the year. We expect this trend to continue in 2007, and think it could be exacerbated by the congressional changeover. In addition, during 3Q06 conference calls, some U.S. Big Pharma companies made cautious remarks regarding their future R&D spending.

We believe the recent biopharma M&A wave could also cause near-term disruptions in spending as R&D organizations are rationalized. Biotech company financing slowed in 3Q, and if this trend continues in 4Q, we believe this perceived narrowing of the window could lead to conservative spending by small- to mid-cap biotech companies and spur additional M&A. Finally, given the strong performance of the tools sector during 2006, we foresee some profit-taking, as valuations appear healthy. All told, although we remain long-term bulls on the life sciences sector, we are more cautious about 1Q07.

Pharmaceutical Companies: U.S. Big Pharma Spending Improves in 3Q06

Research and development spending at the six U.S. large-cap pharmaceutical companies increased an average of 7% in 3Q06 (Table 4). In contrast to most of 2005 and 1H06, spending for high-end research tools improved modestly y/y. Waters, for example, saw a low-teens pickup in sales to U.S. Big Pharma accounts in 3Q, versus double-digit declines in 2Q. Fisher Scientific also noted an increase in spending from its U.S. Big Pharma accounts, particularly for clinical trial support services. Similarly, Charles River saw continued robust demand for outsourced preclinical services, although demand for its research animal models by some Big Pharma accounts remained soft.

For 4Q06, conversations with vendors and customers at the Eastern Analytical Symposium suggested that sales to Big Pharma accounts will remain healthy. However, these same sources were noncommittal when discussing the outlook for 2007, in part because of the uncertain political environment. Incoming Democratic Speaker of the House Nancy Pelosi has publicly commented that changing Medicare law to give the government more power to negotiate drug prices is a top priority. In the past two years, we have seen conservative R&D spending from U.S. Big Pharma in the first half of the year. We expect this trend to continue in 2007, and think it could even be exacerbated by the congressional changeover.

The UBS U.S. pharmaceuticals research team estimates that R&D will increase 9% y/y in 2006 and 4% in 2007 (see Table 4). European pharmaceutical companies' overall R&D spending is expected to increase 11% in 2006 and 6% in 2007 (see Table 5).

Global Big Pharma R&D spending increased an average of 10% in 3Q06

Table 4: R&D Spending Growth by U.S. Large-Cap Pharmaceutical Companies

Company	1Q05A	2Q05A	3Q05A	4Q05A	1Q06A	2Q06A	3Q06A	2005A	2006E	2007E
BMJ	6%	8%	11%	12%	19%	14%	13%	10%	12%	8%
LLY	4%	7%	10%	11%	5%	2%	1%	8%	4%	5%
MRK	-15%	-4%	3%	-1%	5%	24%	0%	-4%	8%	2%
PFE	9%	5%	-6%	-15%	-5%	-6%	9%	-2%	2%	-2%
SGP	3%	19%	17%	17%	25%	22%	-5%	14%	23%	14%
WYE	9%	7%	21%	35%	12%	19%	19%	28%	10%	7%
<i>Average</i>	<i>2.7%</i>	<i>7.0%</i>	<i>9.4%</i>	<i>9.8%</i>	<i>10%</i>	<i>12%</i>	<i>7%</i>	<i>9.0%</i>	<i>9%</i>	<i>4%</i>

Source: Company reports and UBS pharmaceuticals research estimates

Table 5: R&D Spending Growth by European Large-Cap Pharmaceutical Companies

Company	1Q05A	2Q05A	3Q05A	4Q05A	1Q06A	2Q06A	3Q06A	2005A	2006E	2007E
AZN	1%	-3%	-15%	-3%	0%	11%	23%	-3%	11%	2%
GSK	1%	1%	15%	13%	14%	22%	9%	8%	11%	7%
NVS	16%	15%	14%	29%	4%	15%	19%	19%	10%	8%
Roche*	-	8%	-	13%	-	20%	-	11%	14%	17%
SNY	0%	-1%	2%	7%	13%	12%	8%	2%	9%	3%
<i>Average</i>	<i>5%</i>	<i>4%</i>	<i>4%</i>	<i>7%</i>	<i>8%</i>	<i>15%</i>	<i>15%</i>	<i>7%</i>	<i>11%</i>	<i>7%</i>

*1H05, 2H05, and 2H06 figures.

Source: Company reports and UBS pharmaceuticals research estimates

Biotechnology Companies: Financing Slows in 3Q

With open capital markets and positive sales growth, U.S. biotechnology companies remain well funded, as commercial stage companies continue to launch products and development stage companies continue to have access to funds. Biotech financing had a good start in 1H06 but slowed significantly in 3Q06, due in part to seasonal summer slowness in the market.

We expect Biotech R&D spending to remain robust

In 3Q06, the biotech industry raised approximately \$3 billion from both private and public sources (\$159 million from the IPO market, \$1.4 billion from debt and follow-on deals, and \$1.5 billion in VC funds)—significantly below the \$6.9 billion raised in 2Q05. A total of \$19.5 billion was raised in the first nine months of 2006, compared with \$20.2 billion raised in all of 2005. However, excluding the \$5 billion raised by Amgen in February 2006, the \$1.3 billion convertible raised by Gilead in April 2006, and the \$1.15 billion convertible raised by MedImmune in June 2006, adjusted year-to-date 2006 financing totaled \$12 billion versus \$14.9 billion in the same period last year.

Among the six largest profitable U.S. biotechnology companies, R&D grew 14.8% q/q and 20% y/y. We expect spending to remain strong for the remainder of 2006 and into 2007 as these companies move their early-stage pipelines forward while maintaining or accelerating their late-stage clinical activities (Table 6).

Table 6: R&D Spending by Six Largest Biotech Companies, as % of Revenue

Company	2005A	1Q06A	2Q06A	3Q06A
AMGN	18.6%	20.4%	21.9%	24.1%
BIIB	30.9%	23.9%	24.5%	30.0%
DNA	19%	18.8%	17.7%	19.0%
GENZ	19.4%	20.8%	21.3%	20.2%
GILD	13.7%	12.8%	13.2%	12.5%
MEDI	30.9%	17.7%	128.5%	91.4%
<i>Average</i>	<i>20%</i>	<i>19.1%</i>	<i>*19.8%</i>	<i>*21.2%</i>

*Excludes outlier (MEDI).

Source: Company reports and UBS estimates

Academic and Government: Democrats Are Likely a Positive, But NIH Budget Could See Delays

In part because of the tighter funding environment, demand from academic customers for consumable research kits, chemical reagents, and cell culture products fell short of expectations. The notable exception was Fisher, which reported solid academic sales.

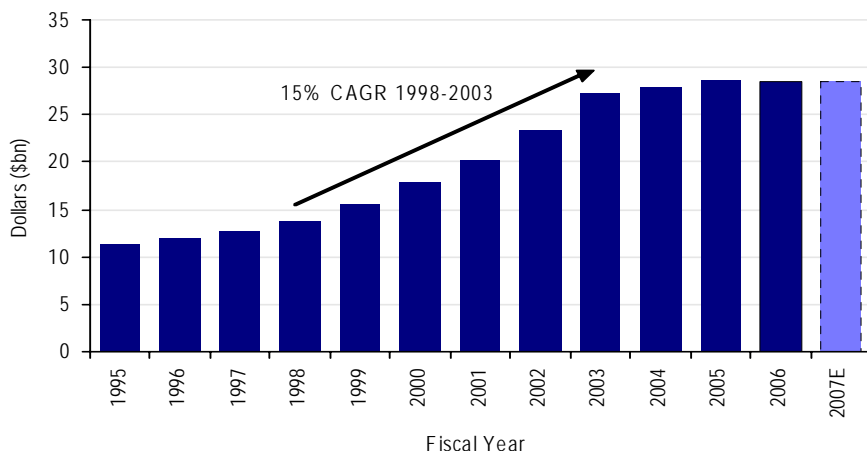
The U.S. NIH (National Institutes of Health) is the second-largest funding source for biomedical research behind Big Pharma, and the NIH has enjoyed steady budget growth of just over 6% (CAGR) for several decades. Between 1998 and 2003, growth accelerated sharply (at about 15% per year) as a result of a five-year campaign to double the NIH budget. However, NIH budget growth has slowed to 3.2% in FY04 and just 2% to \$28.6 billion in FY05, and the budget was down 0.1% in FY06 (Chart 3).

Of the allocations in the 2006 budget, research funding was cut in areas such as child development, alcohol and drug abuse, mental health and general medicine, but these areas are not particularly heavy users of life sciences tools. On the other hand, funding was solid in areas such as cancer research and NIH Road Map projects, the key drivers of academic spending on life science tools.

In early February 2006, the White House released its proposed FY07 federal budget, wherein \$28.6 billion was allocated to the NIH. The FY07 budget request was essentially flat with the FY06 appropriation level, in line with our expectations. At the current proposed level, 2007 would be the third straight year in which NIH funding will lag inflation. According to the American Association for the Advancement of Science (AAAS), after adjusting for inflation, the 2007 NIH budget would be 6% below the 2004 peak.

Academic labs that receive grants from the NIH are a key component of the life sciences market

Chart 4: Trends in NIH Funding, FY95-07E



Source: The American Association for the Advancement of Science (AAAS) and UBS estimates

A number of key NIH Road Map projects, as well as research in areas such as genetic disease, biodefense, and influenza, will see modest budget gains. In addition, private funding sources (e.g., university endowments, state funds, and corporate grants) are helping academic institutions offset the flat NIH budget.

The proposed FY07 budget is still working its way through Congress. Although the government's fiscal year began on October 1, to date only the appropriations for the Departments of Defense and Homeland Security have been finalized. Before the midterm election, the House essentially endorsed the Bush Administration's NIH plan, with a \$28.5 billion appropriation, while the Senate indicated that it would give NIH \$28.8 billion, an increase of 0.7%.

Although the NIH has strong supporters in both political parties, the Democrats are generally seen as more generous with respect to R&D funding in general and to biomedical research funding in particular. As such, we believe the Democrats' control of Congress could be perceived as an incremental positive for the sector. While it remains to be seen if good intentions actually turn into R&D dollars, we believe that NIH and NSF (National Science Foundation) are now less at risk of budget cuts and that "unpopular" programs, such as stem cell research, will get a boost.

We believe the Democrats' control of Congress is likely to be positive for biomedical research

However, there could be near-term problems with NIH funding, as discretionary appropriations bills—including the bill for the Department of Health and Human Services (DHHS), which is the largest domestic R&D funding agency and houses the NIH—were not finished before the lame duck Congress adjourned. If the appropriations process is reopened by the new Congress, the FY07 federal budget may not be signed into law until late 1Q07 (versus the end of January in a "normal" year). Under this scenario, the government would continue to function under various continuing resolutions.

We believe the likelihood of a delay in the NIH budget is high

Under a continuing resolution, ongoing programs and research grants whose term has not yet expired continue to be funded, but new NIH programs and initiatives are not permitted, and new grants may be approved only as long as funds are available under FY06 levels and the grant falls under a current NIH program or initiative. Thus, a significant federal budget delay (beyond mid-March) may translate into a temporary hit to some life sciences companies during 1Q07, but we believe this primarily represents a shift in revenues to later quarters. We do not believe the total amount proposed for the NIH budget is at risk. Indeed, if the appropriations process is reopened, funding could even increase under the Democrats. Therefore, we believe NIH-related academic spending on life sciences tools will have an opportunity to recover in 2H07, as grant funds must be fully spent during the specific calendar year of the funding cycle.

Spending by NIH-funded labs could be constrained in 1Q07

That said, based on our recent interviews, the mood among U.S. academic scientists seems increasingly anxious, as the hurdle rate has dramatically risen for new grants, and some well-established labs have lost renewals. In addition, a flat NIH budget means that the number of funded grants will fall from an

The mood among U.S. academic scientists seems increasingly anxious

average of one out of every three grant applications in FY01 to fewer than one in five in FY07. For new grant applications, the success rate is expected to drop from 32% in FY01 to approximately 19% in FY06-07. This gloomy outlook could lead to constrained U.S. academic spending. Indeed, recent comments from Invitrogen and Sigma-Aldrich on their 3Q06 conference calls suggest that academic markets are beginning to tighten.

The FY07 budget includes projections for federal revenues and spending out to FY11. According to the AAAS (<http://www.aaas.org/spp/rd/07pch4.htm>), the Bush Administration calls for the NIH budget to decline to \$27.5 billion by 2010 before a slight 0.4% increase to \$27.9 billion in 2011. This translates into a 12.1% decline in the NIH budget in real terms over five years, erasing most of the gains of 1998-2003.

In our view, the Democrats are likely to alter this scenario in favor of the biomedical research community (or at least maintain the status quo)—if for no other reason than that, as Tip O’Neill said, “all politics is local,” and eight out of the top 10 states that receive NIH dollars are “blue states.”

Given the uncertain future for NIH funding, it is prudent for life sciences companies to diversify their businesses into such areas as molecular diagnostics, applied markets (e.g., forensics, food safety), and biomanufacturing and to increase their non-U.S. exposure. Since there is currently limited life sciences R&D infrastructure in Asia (ex-Japan), these markets have yet to be tapped and could prove quite lucrative. However, the size and timing of the opportunity are difficult to pin down. That said, according to a *New York Times* article citing a report by Booz Allen Hamilton & Insead, China and India will account for about 31% of the world’s total R&D personnel by 2008, up from 19% in 2004.

Although all life sciences companies have some exposure to academic and government funding, those companies that derive a higher percentage of total revenues from the sale of reagents and laboratory consumables are more likely to be affected by changes to the NIH budget. This is partly because big-ticket capital equipment purchases by academic labs are often covered by special instrumentation grants, and labs frequently pool resources to equip centralized core facilities.

Companies that sell reagents and laboratory consumables are more likely to be affected by changes in the NIH budget

However, because a significant portion of the requested funds in any NIH grant request is for salary support, more NIH dollars means more scientists at the lab bench doing experiments and consuming reagents. Simply put, it is sometimes easier to buy the razor than to get grant support to either buy razor blades or hire someone who knows how to shave.

As shown in Chart 3 on page 8, exposure to academic and government customers varies greatly between life sciences companies. Note that the chart reflects sales to all global academic and government labs, not just those funded by the U.S. NIH.

Direct exposure to NIH is difficult to estimate, but at the low end are the more diversified tool companies—Mettler-Toledo, PerkinElmer, Fisher (now Thermo Fisher Scientific), Waters, Varian, Bruker Biosciences, and Thermo Electron (now Thermo Fisher Scientific)—which we estimate derive less than 10% of their sales from NIH-funded sources. As a leading supplier of laboratory animals and contract research services for biopharma customers, Charles River Labs also has less than 10% direct exposure to NIH. Similarly, Cepheid is more vulnerable to funding changes at the U.S. Postal Service than at the NIH.

At the higher end are Invitrogen, QIAGEN, Affymetrix, and Applied Biosystems, which we estimate have more than 10% direct exposure to NIH funding; to a lesser extent, Millipore and Sigma-Aldrich also rely on sales of consumables to these labs. Although one company's exposure to NIH may be higher than another's, a company can have a variety of characteristics (including possession of transforming technology, ability to collaborate or consolidate and leverage) that may help mitigate the risk implied by a change in NIH funding.

Academic markets remain constrained in some Western European countries (Germany and France, in particular), and there is modest improvement in Japan.

Industrial Market: Positive in '06; Looking Strong in '07

Companies within our coverage universe with sizable exposure to industrial markets (such as Thermo Electron, Agilent, Waters, Mettler-Toledo, Varian, and Sigma-Aldrich) continued to see positive sales growth from non-life sciences end markets (sales outside of traditional pharmaceutical, biotechnology, and academic R&D labs), particularly those in Asia. In addition, European industrial sales rebounded in 3Q.

In the industrial segment, growth is being driven by robust demand for process control instruments (a result of the global industrial capacity expansion); analytical instruments used in petrochemical, mining, chemical, and metals analysis; and sales of environmental monitoring products (a result of expansion in the power generation industry and new air quality regulations). Likewise, Sigma-Aldrich has seen a general rebound in its industrial chemical, high-tech, and materials science research markets since the end of 1Q05, and Fisher is also seeing an uptick in industrial R&D, particularly among companies focusing on alternative energy and chemicals. Notable industrial growth in 3Q included strong demand for Mettler-Toledo's product inspection equipment and Varian's mass spectrometry lines to energy, mining and environmental analysis users.

Looking at the overall economy, worldwide GDP grew 4.5% in 2005, and UBS economists forecast growth of 4.5% for 2006, 3.4% for 2007, and 3.7% for 2008. Although these rates are modestly slower than the 2005 rate, we believe tool companies will continue to benefit from an ongoing wave of global infrastructure investment. In particular, we expect sales of analytical tools and process control equipment to industrial customers to remain strong through 2007.

Companies with industrial exposure continue to benefit from strong global economic growth

Global GDP is forecast to grow at 4.5% in 2006, 3.4% in 2007, and 3.7% in 2008

Table 7: Global GDP Growth Trends

GDP (Y/Y %)	2001	2002	2003	2004	2005	2006E	2007E
U.S.	0.8%	1.6%	2.5%	3.9%	3.2%	3.2%	2.0%
Canada	1.8%	2.9%	1.8%	3.3%	2.9%	2.8%	2.3%
China	9.5%	10.5%	22.8%	11.7%	10.9%	10.2%	9.1%
Japan	0.4%	0.1%	1.8%	2.3%	2.7%	2.7%	1.9%
EU12	1.8%	1.0%	0.7%	1.8%	1.4%	2.7%	1.8%
EU15	1.8%	1.1%	0.9%	2.1%	1.5%	2.7%	2.0%
India	5.8%	4.0%	8.5%	6.9%	8.4%	7.9%	6.9%
<i>World</i>	<i>1.8%</i>	<i>2.3%</i>	<i>3.2%</i>	<i>5.0%</i>	<i>4.2%</i>	<i>4.5%</i>	<i>3.4%</i>

Source: UBS economics research

By region, North America continued to perform well across all segments during 3Q. Most companies see a cooling of the U.S. economy in 2007. UBS economists forecast U.S. GDP growth at 3.2% in 2006, 2.0% in 2007, and 2.8% in 2008. Asia (excluding Japan) remains the fastest-growing region and one of increasing importance for the life sciences sector, both as a low-cost manufacturing site and as an emerging market with growth forecast at 7.9% in 2006, 7.1% in 2007, and 7.0% in 2008. UBS economists project China's GDP growth at 10.2% for 2006 and 9.1% for 2007, down from 10.9% in 2005. Similarly, India's GDP grew 8.4% in 2005, and UBS forecasts growth of 7.9% for 2006 and 6.9% for 2007. Japan remains a challenging market, but the market appears to have somewhat stabilized in the past two quarters. UBS economists forecast Japan's GDP growth at 2.7% for 2006, 2.0% for 2007, and 2.7% in 2008, versus 2.6% in 2005.

Mixed economic conditions and uncertain academic and government research environments in some Western European countries continue to weigh on the sector. Most companies reported further "modest" improvement in the region and remain cautiously optimistic going into 2007. UBS economists forecast Euro area GDP growth at 2.7% for 2006 and 1.8% for 2007, both up from 1.5% in 2005. For the United Kingdom, the largest life sciences market in Europe, UBS sees GDP growth of 2.6% for 2006 and 2.5% for 2007, up from 1.9% in 2005.

Bullish on Biomanufacturing

Biological manufacturing—or biomanufacturing—refers to the production of recombinant protein drugs for commercial or clinical trial use. Growth continues to be driven by the success of older therapeutic monoclonal antibodies and fusion proteins such as Rituxan and Enbrel, as well as by broader indication approvals and compelling clinical data from such drugs as Avastin, Herceptin, and Erbitux.

With over 550 therapeutic monoclonal antibody drugs either on the market or in development, plus 2,000 other biologics in various stages of development, the global biotech drug pipeline is full (see the near-term monoclonal antibody

China and India remain the fastest growing; Europe steady; Japan remains challenging but is stabilizing; North America could slow in 2007

We believe improving conditions in Western Europe could continue into 2007

We remain bullish on long-term prospects for biomanufacturing suppliers

pipeline in Table 8). Separately, *Datamonitor* projects that sales of monoclonal antibody drugs could triple by 2010, to \$30 billion. Thus, we believe the long-term outlook for biomanufacturing suppliers is good. Within our coverage universe, Millipore, the leading supplier of filtration products used in therapeutic monoclonal antibody production, has the most exposure to biomanufacturing.

Biological pipeline remains full

Table 8: Monoclonal Antibodies (MAbs) in Development, 2006-10E

Launch Year	Total Mab Launches Expected	Mabs That Could Be Launched
2006(A)		Lucentis, Tysabri (re-launch), Panitumumab, Orenica
2007(E)	10	CDP 870, MRA, pexelizumab, ovarex, eculizumab, HuMax CD4, IGN-101, MDX-010, MDX-010, MDX-1379
2008(E)	3	Numax, Nuvion, removab
2009(E)	7	HepeX-B, HuMax-Inflam, LymphoStat B, MDX-060, MDX-018, Rencarex, TNX-355
2010(E)	4	AMG 612, HuMax CD20, IMMU 103, MT201

Source: *Datamonitor* and UBS

Notwithstanding the global acceleration in biomanufacturing, we remind investors that the business tends to be lumpy because of the often-large order sizes involved. Thus, companies with significant exposure to the biomanufacturing market, such as Invitrogen, Sigma-Aldrich, and Millipore, generally have above-average quarterly volatility.

M&A: Deal Flow Remained Strong in 3Q

In the first 10 months of 2006, the pace of M&A accelerated as both “traditional” tool companies and outside players did deals. Notable deals included Thermo Electron’s acquisition of Fisher Scientific, Millipore’s acquisition of Serologicals, GE Healthcare’s acquisition of Biacore, Bruker BioSciences’ acquisition of Bruker Optics, Applied Biosystems’ acquisition of Agencourt Personal Genomics, and Illumina’s acquisition of Solexa. Table 9 summarizes 2006 acquisitions by life sciences companies under our coverage.

M&A pace accelerated in 2006

We believe many of the smaller public and private tool companies have found or will find it increasingly difficult to compete with established players, particularly as Big Pharma begins to consolidate its preferred suppliers list and international markets become increasingly important growth drivers. In addition, customers are focused on improving the overall efficacy of their research spending, reducing the complexity of their supply chains, limiting overhead, and outsourcing non-essential activities—trends that benefit larger, broad-based life sciences suppliers. Furthermore, we expect players outside the sector (e.g., GE, Danaher, Siemens, Phillips) to increasingly look for acquisitions and alliances with life sciences companies as a way to increase their exposure to health care in general and to biotechnology in particular. On the other hand, a more and more frequently discussed topic is whether companies can successfully integrate, especially those that have acquired service businesses rather than products.

Smaller tool companies are finding it increasingly difficult to compete

We expect Varian, PerkinElmer, Millipore, Thermo Fisher Scientific, and Sigma-Aldrich to continue to make bolt-on acquisitions of products and technologies that can be easily moved through their global distribution networks, while we think Invitrogen and QIAGEN will continue to seek both products and less established technologies to add to their portfolios. Companies that have typically relied solely on internal R&D, such as Applied Biosystems, have implemented acquisition strategies.

Recently, in a bold move, Illumina (ILMN, not rated) announced the acquisition of Solexa (SLXA, not rated), an emerging next-generation DNA sequencing technology company, in a deal worth about \$650 million. Other players in the race to develop and commercialize next-generation DNA sequencing include Agencourt Personal Genomics (acquired by Applied Biosystems [Neutral 1] earlier this year), 454 Life Sciences (part of Curagen, CRGN, not rated), privately held Helicos Biosciences, VisiGen, and Pacific Biosciences, and a host of academic labs. The goal of these next-generation technologies is to dramatically lower the cost of whole human genome sequencing from \$10-20 million today to less than \$100,000. Although it is still too early to tell which will emerge as the winner, we believe these new technologies will have game-changing implications for the way genetic analysis will be performed in the future.

Although M&A can expand a portfolio, poor integration can prove detrimental if the integration is mismanaged. Invitrogen, for example, has run into numerous problems as the company tries to digest over 10 deals. Similarly, Millipore inherited a number of poorly integrated prior deals from Serologicals, while Charles River recently divested the underperforming Phase II-IV Clinical Services segment it acquired from Inveresk. With these examples in mind, many investors are cautious on the Thermo Electron-Fisher Scientific “mega merger.”

Thanks to mostly strong performances in both 2005 and so far in 2006, the major tools providers generally have solid balance sheets and ready access to capital. In addition, we understand that a number of private equity firms are seeking deals in the tools sector. As a result, valuations of companies appear to be increasing. Indeed, Applied Biosystems and Millipore paid over 5 times TTM sales for Ambion and Serologicals, respectively (versus the sector average of 2.7 times), and Invitrogen has noted that the deal environment is competitive and that deal values are near historical highs.

Deal environment remains competitive

Table 9: 2006 Mergers and Acquisitions by UBS-Covered Life Sciences Companies

Date	Acquirer/Target	Target Company Products/Technology	Deal Size	2006E Revs (\$M)	TTM Sales Multiple
11/30/06	PKI/Evotec Technologies GmbH	Majority-owned subsidiary of Evotec, focusing on high-content screening technologies	\$30M	\$24M	1.3x
11/21/06	WAT/Environmental Resource Associates	Privately held provider of environmental laboratory proficiency testing	-	\$17M	-
10/30/06	CRL/Northwest Kinetics	Privately held Phase 1 clinical service provider	\$29.5M	\$10-15	2-3x
10/27/06	QGEN/Genaco	Molecular diagnostics company with proprietary PCR-based technology	\$22M	-	-

Date	Acquirer/Target	Target Company Products/Technology	Deal Size	2006E Revs (\$M)	TTM Sales Multiple
		Biomedical Products			
10/09/06	SIAL/Advanced Separation Tech.	Privately held company that develops and manufactures chromatography media and columns for separating chiral compounds	-	\$2	-
09/08/06	BRKR/Quantron GmbH	Privately held company providing advanced optical emission spectroscopy systems for numerous metal analysis applications.	-	\$6	-
09/07/06	IVGN/TEF Labs	Asset purchase of Fluo 3 and Fluo 4 product lines and all related IP	-	-	-
09/05/06	PKI/Avalon Instruments	Manufacturer of bench-top dispersive Raman spectrometers for both bulk analysis and microscopic imaging	-	-	-
09/01/06	IVGN/Sentigen	Cell biology reagent company providing contract research and bioassay systems to measure protein-protein interaction	\$26M	\$5	5x
08/09/06	SIAL/Pharmorphix	UK based, privately held firm offering solid-form research services to the global pharmaceutical and biotech markets.	-	\$5	-
07/18/06	BRKR/KeyMaster Technologies	Privately held vendor of hand-held X-ray fluorescence systems (XRF)	-	-	-
07/20/06	TMO/GV Instruments Limited	UK-based manufacturer of isotope ratio mass spectrometers (IRMS)	\$21M	-	-
06/30/06	TMO/EGS Gauging	Manufacturer of instruments for industrial web process applications in the plastics processing and converting industries	-	-	-
06/05/06	PKI/Clinical & Analytical Service Solutions	UK-based scientific equipment asset and managed maintenance company	-	\$8	-
05/30/06	ABI/Agencourt Personal Genomics	Developer of next generation DNA sequencing tools	\$120M	-	-
05/08/06	TMO/Fisher Scientific	One of the largest M&A deals ever in the sector; all stock transaction; helps diversify TMO's capital equipment heavy portfolio with consumables	\$9-10 B	\$5,900	All stock deal
05/04/06	QGEN/Gentra Systems	Privately held developer of non-solid phase nucleic acid purification products, (consumables and automated platforms)	\$38M	\$10	3.8x
05/03/06	SIAL/Iropharm	Business unit of Honeywell providing custom chemical synthesis	-	\$16	-
05/01/06	PKI/Spectral Genomics	Privately held vendor of molecular karyotyping technology used to evaluate chromosomal abnormalities	-	-	-
04/25/06	MIL/Serological	Life science and drug discovery reagents and cell culture products	\$1.1 B	\$300	5x
04/17/06	BRKR/Bruker Optics	Privately held provider of molecular spectroscopy tools (IR and Raman)	\$135M	\$80	1.7x
04/11/06	FSH/Clintrak Pharmaceutical Services	Provides clinical trial labeling services incorporating RFID technology for drug verification and tracking	\$125M	\$35	3.6x
04/11/06	FSH/TC Tech	Develops disposable systems for biopharmaceutical production	-	-	-
04/05/06	MIL/Newport Bio Systems	Develops disposable systems for biopharmaceutical production	-	-	-
03/16/06	FSH/Athena Diagnostics	Private developer and service provider of molecular diagnostic tests	\$283M	\$60	4.7x
03/09/06	PKI/Agilix	Private developer of protein labeling technology	-	-	-
03/01/06	WAT/VICAM	Private company selling test kits and columns for microtoxin analysis	-	\$8	-
02/27/06	VARI/IonSpec	Privately held vendor of high performance FTMS systems	\$16M	-	-
01/06/06	QGEN/Eppendorf reagent business	Includes Eppendorf "5-Prime" nucleic acid sample preparation and PCR reagent product lines and related intellectual property	-	\$6	-

Source: Company reports and UBS estimates

Favorable Currency Tailwinds

At the beginning of 2006, most tool companies forecast a 1-2% negative impact on revenue growth from currency headwinds. However, foreign currencies have significantly strengthened against the U.S. dollar, so companies are now benefiting from a modest tailwind. During 3Q, the euro appreciated 4% relative to the U.S. dollar, and the yen depreciated 4% (Table 10). Accordingly, most companies we cover reported 0-1% positive currency effects on revenues for 3Q.

Table 10: Estimated Impact of Currencies on Life Sciences Revenues

	YY Change in Euro vs. US\$	YY Change in Yen vs. US\$	Total Estimated Top-Line Impact From Currencies
1Q04	17%	11%	3-11%
2Q04	8.1%	6.1%	2-5%
3Q04	8.6%	6.7%	2-5%
4Q04	8.9%	2.9%	3-6%
1Q05	4.8%	2.5%	2-3%
2Q05	4.5%	1.9%	1-2%
3Q05	0%	-1%	0%
4Q05	-8%	-10%	(-2)-(-5)%
1Q06	-8%	-10%	(-2)-(-5)%
2Q06	0%	-6%	0-1%
3Q06	4%	-4%	0-1%

Source: Company reports and UBS estimates

The euro appreciated by about 7% from the end of 2005 to 30 September 2006 (EUR/US\$: \$1.27 as of 30 September 2006 versus \$1.18 at year-end 2005) and appreciated by 5% (\$1.20 as of 30 September 2005) from the year earlier, while the yen is essentially flat (US\$/YEN: 118.1 as of 30 September 2006 versus 117.9 at year-end 2005) and depreciated 4% (113.5 as of 30 September 2005).

Between the end of 3Q and November 30, 2006, the euro had appreciated another 4% (EUR/US\$: \$1.32 as of 30 November 2006 versus \$1.27 as of 30 September 2006), while the yen appreciated 2% (US\$/YEN: 115.7 as 30 November 2006 versus 118.1 as 30 September 2006).

UBS economists remain bearish on the U.S. dollar: Their forecasts for 2006 and outlook for 2007 include the view that the dollar's structural fundamentals remain significantly negative. The combination of peaking (then narrowing) interest rate differentials and a still-large U.S. current account deficit, as well as narrow growth differentials between the U.S. and the rest of the world, could push the dollar still lower in 2006 and 2007. All told, UBS economists forecast the euro at 1.32 as of year-end 2006 and the yen at 114. The UBS year-end 2007 forecasts for the euro and yen are 1.35 and 95, respectively.

Based on recent foreign exchange trends, our current 2006 revenue forecasts now assume a 1-2% positive effect on U.S.-based companies; we expect a smaller impact on the bottom line as most companies are either strategically or naturally hedged because of overseas manufacturing operations.

UBS economists remain bearish on the U.S. dollar

More Cautious on 1Q07, But Maintaining Our Positive Long-Term Bias on Tools

We continue to be bullish on the long-term outlook for the life sciences sector. In our view, the sector represents a relatively lower-risk approach to investing in drug development—especially given the ever-present risk of developmental setbacks experienced by pharmaceutical and biotechnology companies. In addition, the high percentage of non-healthcare sales offers investors a way to offset biotech volatility through the industrial and applied markets.

However, we are more cautious entering 2007, as valuations appear healthy and the market environment in 1Q07 could prove more challenging. As noted above, U.S. Big Pharma spending modestly improved in 3Q06, and 4Q06 looks solid. However, we expect Big Pharma spending in 1H07 to be conservative, following the trend seen during the past two years. We believe the Democrats' control of Congress is positive, but the release of new NIH funds could be delayed if the new Congress decides to reopen the FY07 budget appropriations process. Finally, in 2007, although we still expect strong demand from industrial customers, y/y comparisons become more difficult.

We suggest that investors keep in mind these points about the life sciences sector:

- It is still early days for the genomics, biotechnology, and personalized medicine revolution. Thus, our long-term forecast for the life sciences sector is very positive.
- For most life sciences companies, and capital equipment suppliers in particular, there is a general lack of visibility between quarters, and given the products' high price and complexity, quarterly sales are often lumpy. Thus, we believe it is important to take a long-term view when investing in the tools sector.
- No two life sciences companies are directly comparable, and there is often insufficient differentiation between names. As a result, a problem at one company may often trigger a share pullback in another, often unrelated company. These pullbacks often create buying opportunities.

Top Picks: TMO, MTD, and MIL

Our current top picks are Thermo Fisher Scientific and Mettler-Toledo in instruments and Millipore in consumables.

On November 9, Thermo Electron completed its merger with Fisher Scientific. We believe the merger makes strategic sense. It not only transforms the sector but also creates a highly diversified life sciences juggernaut. The product mix shift toward more laboratory consumables and higher-margin reagents should help smooth quarterly capital equipment volatility and reduce Thermo's cyclicality. The deal expands both companies' market access and geographic reach. The long-term financial goals are compelling: improved organic sales growth (to 6-8% from 4-5%), accelerated EPS growth (adjusted three-year EPS CAGR of 20%), and robust operating cash flow of over \$1 billion in 2007. Based on our analysis and Thermo management's excellent record, we are optimistic that the deal will deliver the promised synergies (about \$200 million over three years). Thermo will host an analyst day on December 14 and update 2007 guidance for the combined company.

Thermo Fisher Scientific (TMO, Buy 1)

Benefiting from its solid end markets and a record number of new product launches, as well as continuing operational efficiencies and lower taxes, MTD delivered repeated strong results in 3Q06, surpassing UBS and Street top- and bottom-line estimates.

Mettler-Toledo (MTD, Buy 2)

In the life sciences sector, Mettler-Toledo has the most exposure to global industrial markets. We see faster organic revenue growth (to 4-6% from 2-4%) and improving profitability, as the company is benefiting from a record number of new products. Targeted marketing initiatives are helping Mettler gain share. We expect further margin expansion, key drivers being an improving sales mix, volume leverage, and cost savings from manufacturing transfer to China. For the next several years we see the adjusted operating margin improving to over 16% from 12.8% in 2004. Starting in 3Q06, tax restructuring enables Mettler to lower its tax rate to 27% from 30%. MTD continues to use its cash for an aggressive share buyback program, and we expect this to translate to 12-15% EPS growth and improving cash flow.

As the leading provider of products used in the manufacture of biologic drugs and recombinant vaccines, Millipore is among the best derivative plays on these growing segments of the biopharma sector. Following the Serologicals acquisition, we see 2007 as a transition year for Millipore with possible growing pains. We believe management understands the near-term challenges and will execute and deliver as promised. We see organic sales growth rising to 8-10%, gross margins expanding beyond the 58% 2009 target; and cash flow improving.

Millipore (MIL, Buy 2)

Table 11: UBS Life Sciences Tools Coverage

Company	Ticker	Investment Rating	Price 12/7/06	Price Target	Market Cap.	Shares Out (M)	EPS (net of Options)			P/E			EV/EBITDA		EV/Sales	
							CY05A	CY06E	CY07E	CY05A	CY06E	CY07E	CY06E	CY07E	CY06E	CY07E
Consumables (consumable and reagent sales > 50% of total sales)																
Affymetrix	AFFX	Neutral 2	\$25.01	\$26.00	\$1,683	69.4	\$0.68	(\$0.20)	\$0.27	37.0	NM	92.4	148.6	35.4	4.3	3.8
Celera Genomics	CRA	Buy 2	\$14.21	\$17.00	\$1,078	74.3	(\$1.12)	(\$0.63)	(\$0.42)	NM	NM	NM	NM	NM	10.9	8.8
Cepheid	CPHD	Neutral 2 (CBE)	\$9.13	\$10.00	\$498	42.3	(\$0.52)	(\$0.42)	(\$0.33)	NM	NM	NM	NM	NM	4.9	4.3
Charles River Labs	CRL	Neutral 2	\$42.93	\$49.00	\$3,129	71.5	\$1.80	\$2.17	\$2.53	23.8	19.8	16.9	10.9	12.3	3.7	3.4
Invitrogen	IVGN	Neutral 2	\$57.25	\$66.00	\$3,139	60.2	\$3.17	\$2.97	\$3.40	18.0	19.2	16.8	12.5	11.4	3.0	2.9
Millipore	MIL	Buy 2	\$69.43	\$80.00	\$3,764	51.0	\$2.40	\$2.82	\$3.30	29.0	24.7	21.1	13.8	11.6	3.6	3.0
QIAGEN	QGEN	Neutral 2	€ 10.79	€ 12.50	\$1,643	148.6	\$0.40	\$0.54	\$0.60	27.2	25.0	24.0	14.8	13.2	4.7	4.2
Sigma-Aldrich	SIAL	Neutral 1	\$77.08	\$80.00	\$5,241	69.1	\$3.71	\$4.00	\$4.27	20.8	19.3	18.0	11.0	10.0	3.1	2.9
Consumable Average										26.0	21.6	31.6	35.3	15.7	4.8	4.1
Consumable Average (ex AFFX)										23.8	21.6	19.4	12.6	11.7		
Instrument companies (capital equipment sales > 50% of total sales)																
Applied Biosystems	ABI	Neutral 1	\$37.25	\$39.00	\$7,098	194.6	\$1.11	\$1.28	\$1.40	33.6	29.1	26.6	12.0	15.3	3.1	2.9
Bruker BioSciences	BRKR	Neutral 2 (CBE)	\$7.99	\$8.50	\$821	89.6	\$0.03	\$0.17	\$0.20	NM	48.3	39.8	17.2	13.2	1.7	1.5
Mettler Toledo	MTD	Buy 2	\$80.28	\$90.00	\$3,311	43.9	\$2.49	\$3.50	\$4.05	32.2	22.9	19.8	14.1	13.1	2.2	2.2
PerkinElmer	PKI	Neutral 1	\$21.71	\$23.00	\$2,814	129.5	\$0.88	\$1.12	\$1.26	24.6	19.5	17.2	12.2	10.9	1.8	1.6
Thermo Electron	TMO	Buy 1	\$45.18	\$52.00	\$18,492	164.9	\$1.54	\$1.81	\$2.35	29.2	25.0	19.2	30.5	10.7	5.5	2.2
Varian	VARI	Neutral 2	\$45.39	\$50.00	\$1,439	31.8	\$1.55	\$1.93	\$2.42	29.3	23.5	18.8	10.6	10.4	1.5	1.6
Waters Corporation	WAT	Neutral 1	\$50.55	\$52.00	\$5,210	119.1	\$1.80	\$2.21	\$2.54	28.1	22.9	19.9	16.5	15.3	4.6	4.3
Notes: Fiscal year end: ABI and CRA June, VARI September, CY estimate										29.5	27.3	23.0	16.2	12.7	2.9	2.3
CBE = Core Band Exception; UR=Under Review										29.5	23.8	20.2	16.0	12.6		
Instrument Average										29.5	23.8	20.2	16.0	12.6		
Instrument Average (ex BRKR)										29.5	23.8	20.2	16.0	12.6		
Overall Average										26.9	22.8	19.8	14.4	12.2	3.9	3.3
Overall Average (ex AFFX, BRKR)										26.9	22.8	19.8	14.4	12.2		

Source: Company reports and UBS estimates

Companies

Affymetrix

Company Description

Affymetrix is a leader in the development, application, and commercialization of DNA microarrays. The company manufactures instrument systems and a wide range of disposable microarray products, as well as related reagents and software. Affymetrix's microarrays, marketed under the GeneChip brand name, are manufactured using a patented photolithographic process, which improves reproducibility and allows for the production of uniform, high-content DNA microarrays.

Affymetrix has made several strategic investments and entered into a number of collaborations to expand microarrays beyond the gene expression market and into areas such as genotyping and molecular diagnostics. For example, in 2000, Affymetrix funded a spinout called Perlegen, which used Affymetrix's microarray technology to resequence and scan the human genome for genetic variations (e.g., single nucleotide polymorphisms, or SNPs). Affymetrix used the information derived from Perlegen as the basis of its SNP genotyping product line, launching the high-density 500K SNP Chip in 2005. In 2005, Affymetrix acquired ParAllele BioSciences, a developer of genetic analysis reagents and software. ParAllele's technology enables flexible and scalable SNP genotyping, so it both complements Affymetrix's high-density products and fills a seeming gap in Affymetrix's portfolio. In addition, Affymetrix is collaborating with Roche, JNJ, and medical/academic/nonprofit research institutions such as Partners Healthcare to develop microarray-based diagnostic products for the clinical laboratory setting. The first product from the Roche collaboration, the AmpliChip CYP450, received FDA approval in 2005.

In 2005, Affymetrix had total revenues (including Perlegen) of \$368 million, \$350 million of which was from products—69% from microarrays and reagents, 18% from instruments, and 13% from "Other" (e.g., subscription fees, grants, license fees and royalties). Product revenues by region were about 52% from the United States, 30% from Europe, and 18% from the rest of the world, including Japan. We estimate that 50% of Affymetrix's customers are pharmaceutical and biotech companies, with the other 50% academic and government labs.

Investment Summary

Affymetrix (AFFX, Neutral 2)

Affymetrix is a first mover and market leader in the development and commercialization of DNA microarrays. We believe DNA microarrays are a transforming technology, and we are positive about their long-term commercial potential for the genotyping and, to a lesser extent, the diagnostics markets. Although we continue to believe the company's large installed base of over 1,400 systems and intellectual property position represent a high barrier to entry, we are also cautious about the total microarray market size and growth rate for both gene expression and genotyping applications.

Affymetrix is the undisputed leader in DNA microarrays

We rate AFFX shares Neutral 2

Throughout most of 2005 and year-to-date in 2006, Affymetrix was plagued by execution problems. As a result, the company repeatedly missed expectations, and in 1Q06 Affymetrix withdrew guidance. In 2Q06, Affymetrix announced a significant restructuring to bring costs more into line with dramatically reduced revenue expectations.

Affymetrix was plagued by execution problems for most of 2006

Affymetrix's missteps have helped its chief competitor, Illumina (ILMN, not rated), establish a strong foothold in the microarray market and take share in the rapidly growing, albeit difficult to define, genotyping market. Competition between the two companies is fierce: They are currently engaged in a price war, the full impact of which has yet to be seen. Compounding the uncertainty in the marketplace is the patent infringement lawsuit filed against Illumina by Affymetrix; the trial is expected to be in March 2007.

Although the business will continue to face pressure at a number of points, and to date management's track record on execution has been less than stellar, we believe the business may be nearing a bottom. This view is based a combination of greater confidence in the growth potential of the overall microarray market, regained momentum via deals in the wake of product price cuts, revised positive expectations for the new 1-chip 500K SNP genotyping array, improving cost structure, and the potential for significant revenue generation from royalty payments.

Is Affymetrix nearing a bottom?

Valuation

Given the volatility of the company's revenues and cash flows, as well as the dynamic nature of the emerging genotyping market, valuing AFFX shares has proved to be a challenge. Affymetrix is an acknowledged leader and first mover in the development, application, and commercialization of DNA microarray technology. Due in part to the company's dominant market position and high growth potential, investors have awarded Affymetrix a premium multiple of 30-40 times versus the life sciences group average of 20-25 times. Although the company continues to hold its leading (about 45%) share of the microarray-based gene expression market, execution problems and viable competition have hampered Affymetrix's genotyping business. Uncertainty about the genotyping market's size and growth rate further undermine investors' confidence, calling into question the company's execution capability and competitive edge and the market outlook. The 48% decline in the company's share price in the past 11 months is reflective of these concerns.

Our 12-month price target on AFFX shares is \$26

We have re-examined our estimates for the overall microarray market and are now more bullish on market's prospects. In our view, the overall microarray market today (gene expression, genotyping, and diagnostics) totals \$0.9-1.1 billion and should grow to \$1.6-1.9 billion by 2010 (a 13-17% CAGR). Our base case scenario assumes a 6% CAGR (2005-10) for the gene expression market, a 29% CAGR in the microarray-based DNA analysis/genotyping market, and a 37% CAGR for microarray-based molecular diagnostics.

In the absence of a disruptive technology, Affymetrix retains its dominant (about 40%) share of the gene expression market and shares the large-scale genotyping market with Illumina (we estimate a 60:40 split in 2006, but in the absence of a disruptive technology, the market could eventually become 50:50). Based on this scenario, by 2010 we now forecast Affymetrix revenues of approximately \$550-650 million (a 9-12% CAGR for 2005-10, above the 6-8% levels seen for most life sciences consumable companies but well below the high-double-digit expectations of some investors).

To value AFFX shares, we conducted a DCF analysis, using our base case scenarios for the microarray market and Affymetrix, a 10% WACC, and a 5% terminal growth rate (in line with the tools sector's historical long-term growth rate). Under these assumptions, our DCF model implies a price of \$22-25 per share for the core Affymetrix business. That said, we admit that both the revenue and margin assumptions implied in our DCF analysis could be conservative, particularly with respect to market size.

To check our DCF analysis, we asked the question "What would another company pay to acquire Affymetrix?" Given its technology leadership and market position, as well as the emerging, albeit unpredictable, nature of the genotyping market, we believe an acquirer might pay 3-5 times sales for Affymetrix. This multiple is in line with similar "high tech" acquisitions in the life sciences sector. Applying these multiples to our lower 2007 revenue assumption of \$375 million, we reach a value of \$17-28 per share.

Based on these analyses, our \$26 sum-of-the-parts price target assumes about \$24 for the base business, with \$2 coming from potential royalty payments. Given the numerous overhanging questions, we believe AFFX shares will remain in the \$22-26 range until the company provides 2007 guidance. A more positive outlook would require improving cash flows, successful product launches, and further evidence that AFFX can protect and grow its market share.

3Q Review and Recent Events

Recall that in 1Q06 Affymetrix withdrew formal 2006 guidance. For 3Q06, the company reported an adjusted loss per share of \$0.06 (net of \$0.05 in stock option expense), below the UBS estimate of a \$0.01 profit but above the Street consensus estimate for an \$0.08 loss.

Product and product-related revenues of \$56.1 million were below UBS estimates of \$62.5 million, but total revenues of \$84.7 million (+1.1% y/y) beat the UBS estimate of \$82 million and Street consensus of \$81 million, chiefly due to higher royalty payments and Perlegen sales. The company placed 33 GeneChip systems in 3Q, bringing the total number of systems shipped to about 1,480. Product sales are detailed in Table 12.

Table 12: Affymetrix Product Sales, Excluding Sales to Perlegen (\$ millions)

Product	3Q05A	4Q05A	1Q06A	2Q06A	3Q06A	3Q06/3Q05	3Q06 UBSe
Arrays	\$44.6	\$59.7	\$43.2	\$40.2	\$37.4	-16%	\$41.0
Reagents	\$10.6	\$12.1	\$10.5	\$9.6	\$10.1	-5%	\$10.0
Instrument	\$13.8	\$19.4	\$12.3	\$11.2	\$8.6	-38%	\$11.5
Total	\$69.0	\$91.2	\$65.9	\$61.0	\$56.1	-19%	\$61.5

Source: Company reports and UBS estimates

About 40% of total revenues were derived from genotyping applications and 60% from gene expression. Sales from genotyping increased over 30% q/q in 3Q06, while sales of core gene expression products remained sluggish, growing at a low- to mid-single-digit rate. Reduced growth for gene expression products is due to soft spending by academia and slow adoption of new exon and tiling array products, as customers await new funding and the introduction of improved array analysis software.

Surprisingly, the 50% price reductions (Affymetrix cut prices to \$250 in early July) for the 2-chip 500K SNP set seem to have boosted genotyping consumable sales (including those from Perlegen), as genotyping revenues increased by \$6 million and volume demand nearly doubled (+90% q/q). Both Illumina (which also cut prices) and Applied Biosystems also reported strong growth for their genotyping products during the September quarter, suggesting robust demand and limited impact from the price war. With the FDA's increasing emphasis on biomarkers, the biopharmaceutical industry's willingness to sponsor and collaborate with academic research institutes on disease-association and pharmacogenomics studies, and increasing private funding for genotyping programs, we believe the genotyping market may be larger than our prior expectations.

Affymetrix recorded an options-adjusted 3Q gross margin of 56.7%, which fell short of the UBS estimate of 67% and represented a y/y decrease of 1,390 bps. This contraction resulted from price cuts and expenses related to the new Singapore manufacturing facility build-out. According to management, price reductions affected the gross margin by approximately \$8 million and manufacturing expenses in Singapore reduced the gross margin by \$2.5 million.

The company burned about \$23.7 million in cash mainly for the Singapore facility buildup, and ended the quarter with \$2145.5 million in cash and \$120 million in long-term debt.

Table 13: Affymetrix 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Change	3Q06 UBSe	Comments
Product Revenues	\$56.1M	-19%	\$62.5M	Performance:
- Arrays	\$37.4M	-16%	\$40.2M	(1) Competition and price; 60%RNA, 40% DNA
- Reagents	\$10.1M	-5%	\$9.6M	(2) Soft academic sales; slower-than-expected adoptions of exon and tiling arrays
- Instruments	\$8.6M	-38%	\$11.2M	(3) Second quarter product sales were 70% RNA, 30% DNA
Product-related Revenues	\$17.9M	+72%	\$14.4M	Near-term Product Introductions:
				(1) Introduction of 500K SNP chip in one-chip format vs. current two-chip set in Dec (full launch in 1Q07)
				(2) Introduction of 1 M SNP chip expected by early 1H07
				(3) Introduction of 96-well reader for automated high-throughput expression analysis
				(4) Introduction of second-generation software for exon- and tiling-gene expression analysis
Product and Product-Related Revenues	\$74.1M	-6.8%	\$75.5M	Near-term Issue(s):
				(1) Array volume expansion vs. price cut
				(2) Genotyping market size
				(3) Timeline for introduction of new products
License Fees & Royalties	\$6.0M	+246%	\$2M	In-line
Perlegen Revenues	\$4.6M	n/a	\$3.0M	Higher-than-expected, due to more genotyping service
Total Revenues	\$84.7M	1.1%	\$80.1M	Higher-than-expected, due to higher royalty payments and Perlegen sales Lower y/y chiefly due to price cuts and charges related to capacity expansion in Singapore
Gross Margin	56.7%	-1390bp	67%	Expectations: The Singapore facility is expected to functional in 2H06; margins likely to improve
SG&A (% Rev)	24.9%	+70bps	26%	
R&D (% Rev)	40.4%	+320bps	42%	
Operating Margin	NM	-	0.6M	
Taxes	\$0.3M (NA)	-	\$1.5M	
Net Interest Income	\$2.6M	+\$2.7M	\$3.5M	
Adj. EPS (net of options)	(\$0.06)	NA	\$0.01	

Source: Company reports and UBS estimates

Company Guidance

As expected, the company did not reinstate 2006 guidance. Because of its announced restructuring plan and facility transition, the company expects to record about \$2-3 million of restructuring charges per quarter for the next three quarters.

UBS Estimates

We now project 2006 product revenues of \$248 million (-18% y/y) and total revenues of \$341 million (-7.5% y/y). Our 2007 projections are \$283 million (+14%) and \$375 million (+10%). Our gross margin expectations have been decreased to 61.7% (from prior 67.0%) in 2006 and to 63% (from prior 69%) in 2007, primarily due to lower chip set prices and underutilized capacity, offset by new product introductions, manufacturing improvement, and volume leverage. Our newly revised 2007 tax rate estimate is at 20% (versus prior 38%), but the tax rate is likely to be a moving target as the Singapore facility ramps up and U.S. business remains under pressure. As a consequence, we now project a \$0.20 per-share loss for 2006 and EPS of \$0.27 for 2007 (both net of options).

Table 14: Affymetrix 2006 Estimates (revenues in \$ millions)

	4Q 2006			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Product Revenues	-	\$64.5M (-29.3%)	-	-	\$248 (-9.7%)	-
Total Revenues	-	\$89M (-20.6%)	\$100	-	\$341 (-4.0%)	\$351
EPS (net of options)	-	(\$0.02)	(\$0.04)	-	(\$0.20)	(\$0.18)

Source: Company reports, First Call, and UBS estimates

Table 15: Affymetrix Earnings Model, 2004-07E

Fiscal year ended December 31

	2004A					2005A					2006E	2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
Revenues												
Product - Arrays	168,243	47,727	45,941	44,577	59,700	197,945	43,204	40,200	37,422	42,000	162,826	190,000
Product - Reagents	31,744	9,916	9,746	10,692	12,100	42,454	10,440	9,600	10,166	12,500	42,706	48,000
Product - Instruments	77,269	15,908	13,526	13,775	19,400	62,609	12,328	11,200	8,551	10,000	42,079	45,000
Product Revenue	277,256	73,551	69,213	69,044	91,205	303,013	65,972	61,043	56,139	64,500	247,611	283,000
Product Related - Subscription Fees	20,669	3,317	3,153	3,066	2,997	12,533	1,993	1,716	1,700	2,000	7,409	7,000
Product Related - Services and Other	15,526	4,229	4,199	3,789	7,300	19,517	7,712	9,112	13,200	13,500	43,524	48,000
Product Related - License Fees/Milestones	17,434	3,771	3,582	3,604	3,700	14,657	3,538	3,579	3,071	3,000	13,188	12,000
Product Related Revenue	53,629	11,317	10,934	10,456	14,470	47,177	13,243	14,407	17,971	18,500	64,121	67,000
Total Product and Product Related	330,885	84,868	80,147	79,500	105,675	350,190	79,215	75,450	74,110	83,000	311,732	350,000
Total Product and Product Related	330,885	84,868	80,147	79,500	105,675	350,190	79,215	75,450	74,110	83,000	311,732	350,000
Contract (Research)/Grant	-	-	-	-	-	-	-	-	-	-	-	-
License fees/royalties	9,832	1,560	1,993	1,727	3,059	8,339	1,876	2,419	5,969	3,000	13,264	10,000
Total revenues ex-Perlegen	340,717	86,428	82,140	81,227	108,734	358,529	81,091	77,869	80,079	86,000	324,996	360,000
Total Perlegen revenues	5,245	2,187	1,911	2,220	2,755	9,073	5,300	2,197	4,593	3,000	15,090	15,000
Cost of Perlegen revenues	3,611	1,242	1,750	1,359	803	5,154	1,584	1,074	1,646	1,080	5,384	5,250
Total Revenues Including Perlegen	345,962	88,615	84,051	83,447	111,489	367,602	86,391	80,066	84,672	89,000	340,086	375,000
Recorded Perlegen Revenues	1,634	945	161	861	1,952	3,919	3,716	1,123	2,947	1,920	9,706	9,750
Total Revenues for EPS	342,351	87,373	82,301	82,088	110,686	362,448	84,807	78,992	83,026	87,920	334,702	369,750
Expenses												
Cost of product	91,334	21,784	20,411	23,410	30,653	96,258	25,174	26,681	32,069	34,860	118,784	129,500
Research & Development	73,405	17,090	20,799	19,835	19,680	77,404	22,439	20,555	20,705	20,500	84,199	86,000
Selling, general & administrative	116,973	29,597	32,540	30,503	29,453	122,093	36,406	35,776	33,575	33,500	139,257	135,000
Amortization of Purchased Intangibles	-	-	-	-	-	-	-	-	-	-	-	-
Amortization of Deferred Stock Comp	920	83	33	0	849	965	-	-	-	-	-	-
Charge for in-process R&D, Restructuring	0	0	0	0	8,315	8,315	-	-	10,008	3,000	13,008	6,000
Operating Expenses	282,631	68,554	73,783	73,748	88,950	305,035	84,019	83,012	96,357	91,860	355,248	356,500
Operating Income (Inc. amort)	59,721	18,819	8,518	8,340	21,736	57,413	788	(4,020)	(13,331)	(3,940)	(20,546)	13,250
Net Interest Income (expense)	1,049	287	664	1,881	2,363	5,195	3,863	3,320	2,592	2,600	12,375	15,000
Debt Conversion Expense (Special Charge)	(9,834)	0	0	0	0	0	-	-	-	-	0	0
Pre-Tax Income	50,936	19,106	9,182	10,221	24,099	62,608	4,651	(700)	(10,739)	(1,340)	(8,171)	28,250
Taxes	3,326	2,888	1,371	824	(675)	4,408	421	5,033	(293)	(268)	4,893	5,650
Add Back Debt Tax Credit	414	150	350	413	-	913	-	-	-	-	-	-
Net Income	48,024	16,368	8,161	9,810	24,774	59,113	4,230	(5,733)	(10,446)	(1,072)	(13,064)	22,600
Add back Acquisition-related, Restructure expenses	-	-	-	-	8,315	8,315	0	0	10,008	3,000	13,008	6,000
Net Income (pro forma)	57,597	16,451	8,194	9,810	33,089	68,393	4,230	(5,733)	(438)	1,928	(56)	28,600
Pro Forma EPS (ex-option expenses)	\$0.74	\$0.24	\$0.12	\$0.14	\$0.35	\$0.84	\$0.06	(\$0.09)	(\$0.16)	(\$0.02)	(\$0.19)	\$0.33
Pro Forma EPS (ex-one time charges)	\$0.91	\$0.24	\$0.12	\$0.14	\$0.46	\$0.95	\$0.06	(\$0.09)	(\$0.01)	\$0.03	(\$0.00)	\$0.42
Option expenses per share	-	-	-	-	-	(\$0.02)	(\$0.03)	(\$0.06)	(\$0.05)	(\$0.05)	(\$0.19)	(\$0.15)
Pro Forma EPS (net of option expenses)	\$0.74	\$0.24	\$0.12	\$0.14	\$0.46	\$0.93	\$0.03	(\$0.15)	(\$0.06)	(\$0.02)	(\$0.20)	\$0.27
Shares Outstanding (000s)	63,243	69,081	70,227	70,463	72,250	70,505	68,680	67,313	67,248	67,600	67,710	68,000
YEAR-OVER-YEAR GROWTH												
Product Revs - Arrays	20.5%	25.7%	29.9%	18.8%	4.0%	17.7%	-9.5%	-12.5%	-16.1%	-29.6%	-17.7%	16.7%
Product Revs - Reagents	55.5%	31.4%	56.5%	27.3%	26.5%	33.7%	5.3%	-1.5%	-4.9%	3.3%	0.6%	12.4%
Product Revs - Instruments	23.16%	2.2%	-32.6%	-16.0%	-23.1%	-19.0%	-22.5%	-17.2%	-37.9%	-48.5%	-32.8%	3.0%
Total Product	24.5%	20.4%	12.2%	10.8%	-1.1%	9.3%	-10.3%	-11.8%	-18.7%	-29.3%	-18.3%	14.3%
Total Product Related	-7.6%	-16.3%	-19.1%	-24.9%	14.2%	-12.0%	17.0%	31.8%	71.9%	27.9%	35.9%	12.5%
Product and Product Related Revenues	27.1%	13.7%	6.6%	4.3%	0.8%	5.8%	-6.7%	-5.9%	-6.8%	-21.5%	-11.0%	12.3%
License fees/royalties	-6.8%	-34.2%	-37.5%	-37.0%	99.7%	-15.2%	20.3%	21.4%	245.6%	-1.9%	59.1%	-24.6%
Perlegen	na	na	na	na	na	73.0%	na	na	na	na	66.3%	-0.6%
Total Revenues	17.5%	12.7%	5.4%	4.5%	3.5%	6.3%	-2.9%	-4.0%	1.1%	-20.6%	-7.5%	10.3%
Cost of product	1.7%	-7.6%	-4.9%	20.2%	14.3%	5.4%	15.6%	30.7%	37.0%	13.7%	23.4%	9.0%
Research & Development	11.4%	-1.2%	16.8%	11.5%	-4.1%	5.4%	31.3%	-1.2%	4.4%	4.2%	8.8%	2.1%
Selling, General & Administrative	11.6%	4.7%	8.6%	13.0%	-7.3%	4.4%	23.0%	9.9%	10.1%	13.7%	14.1%	-3.1%
Operating Expenses	3.2%	-1.3%	6.1%	14.3%	12.5%	7.9%	22.6%	12.5%	30.7%	3.3%	15.5%	2.3%
Operating Income	240.4%	141.7%	-6.5%	-43.6%	-22.5%	-3.9%	-95.8%	-147.2%	-259.8%	-118.1%	-135.8%	-164.5%
Pre-Tax Income	202.3%	-2061.6%	18.3%	-36.0%	-14.4%	22.9%	-75.7%	-107.6%	-205.1%	-105.6%	-113.1%	-445.7%
Net Income	236.2%	-993.0%	16.4%	-36.2%	-9.8%	23.1%	-74.2%	-170.2%	-206.5%	-104.3%	-122.1%	-273.0%
EPS (ex-acquisition costs)	98.4%	98.7%	-0.2%	-44.2%	12.4%	4.4%	-74.0%	-173.3%	-104.7%	-93.8%	-100.1%	-50953.8%
EPS (ex-options)	209.1%	-874.3%	4.4%	-43.3%	-14.1%	14.5%	-74.0%	-173.3%	-211.6%	-104.5%	-100.1%	-50953.8%
AS A PERCENTAGE OF REVENUES												
COGS	26.7%	24.9%	24.8%	28.5%	27.7%	26.6%	29.7%	33.8%	38.6%	39.6%	35.5%	35.0%
Gross Profit	72.2%	74.3%	74.5%	70.6%	71.0%	72.6%	67.8%	64.1%	56.7%	58.0%	61.7%	63.0%
Research & Development	21.4%	19.6%	25.3%	24.2%	17.8%	21.4%	26.5%	26.0%	24.9%	23.3%	25.9%	23.9%
Selling, General & Administrative	34.2%	33.9%	39.5%	37.2%	26.6%	33.7%	42.9%	45.3%	40.4%	38.1%	42.8%	37.5%
Operating Expenses	82.6%	78.5%	89.7%	89.8%	80.4%	84.2%	99.1%	105.1%	116.1%	104.5%	109.3%	99.0%
Operating Income	17.5%	21.8%	10.4%	10.3%	28.4%	18.6%	1.0%	-5.2%	-4.1%	-1.1%	-6.3%	3.7%
Pre-Tax Income	14.9%	21.9%	11.2%	12.5%	21.8%	17.3%	5.5%	-0.9%	-12.9%	-1.5%	-2.5%	7.8%
tax rate	6.5%	15.1%	14.9%	8.1%	-2.8%	7.0%	9.1%	-719.0%	2.7%	20.0%	-59.9%	20.0%
Net Income	14.0%	18.7%	9.9%	12.0%	22.4%	16.3%	5.0%	-7.3%	-12.6%	-1.2%	-3.9%	6.1%

Source: Company reports and UBS estimates

Applied Biosystems

Company Description

Headquartered in Foster City, California, Applied Biosystems manufactures instrumentation, reagents, and software used in the life sciences and applied research markets. Applied Biosystems' parent holding company, Applied Biosystems Corp., also holds Celera Genomics. Although Applied Biosystems is not publicly traded, both Applied Biosystems and Celera trade on the NYSE as separate tracking stocks under the tickers ABI and CRA. Applied Biosystems has one of the largest installed bases of genomics and proteomics instruments, with market-leading positions in a number of key segments in the life sciences market, including DNA sequencing, mass spectrometry (MS), and real-time (quantitative) PCR (polymerase chain reaction).

Applied Biosystems is the leading supplier of products for DNA sequencing, mass spectrometry, and real-time PCR

In December 2005, Applied Biosystems acquired the Research Products division of Ambion, a leading provider of consumables for RNA sample prep and analysis. In January 2006, the company sold its 50% share of the Celera Diagnostics joint venture to Celera Genomics in exchange for the rights to develop and sell instruments for the diagnostics market, among other considerations. In May 2006, the company acquired Agencourt Personal Genomics, a developer of next generation DNA sequencing tools.

Applied Biosystems has been in the process of reorganizing its business for three years, during which margins have steadily improved. Applied Biosystems finished FY06 (ended June 30) with revenues of \$1.91 billion, up 7.0% y/y. About 48% of FY05 revenues were from instruments, with about 35% from consumables, and 17% from other sources (service contracts, royalties, licenses).

Applied Biosystems' customer base is composed of about 52% basic research (academic, nonprofit, and government labs), 24% commercial research (pharmaceutical and biotechnology companies), and 24% standardized testing (e.g., forensic identification and food testing). Its distribution network sells products in about 100 different countries—about 46% from North America, 31% from Europe, 19% from Asia/Pacific, and 4% from the rest of the world.

Investment Summary

Applied Biosystems (ABI, Neutral 1)

Applied Biosystems has one of the largest installed bases of genomics and proteomics instruments and is a market leader in a number of key life sciences segments, including DNA sequencing, MS, and real-time (quantitative) PCR.

We rate Applied Biosystems Neutral 1

In the last three years, Applied Biosystems has enhanced its management team, undergone a major reorganization, refocused its R&D, realigned its cost structure, and engaged in selective M&A to better position itself for top- and bottom-line growth. To simplify its corporate structure and focus on its core competencies, in January 2006, Applied Biosystems sold its 50% share of the Celera Diagnostics joint venture to Celera Genomics.

It is difficult to argue against the fact that by almost any measure we use Applied Biosystems' business has improved: The core business has stabilized, margins have improved, R&D investments are paying off, the corporate structure has been simplified, and management has effectively deployed its cash for both acquisitions and share buybacks. Furthermore, when we look at the key growth areas across the life sciences landscape—molecular diagnostics, genotyping, pharmacogenomics, quality control and assurance, functional genomics, proteomics, forensics, and bio-security—we see that ABI has a strong position in each of these end markets. Ultimately, we believe ABI has a good chance of successfully implementing its strategic vision of evolving from a tool company chiefly tied to basic research into a broad-range supplier of validation and commercialization technologies. We believe ABI's business has stabilized, and we have increased confidence in the company's prospects.

Valuation

Considering that ABI shares are currently trading at 26x our CY07 EPS estimate of \$1.42, a 35% premium to the tools group average of about 19.5x, we think the Street appears to agree with ABI's vision of the genomics future. With the company's organic top-line growth currently in line with that of other life sciences companies (at 6-8%), and an estimated EPS growth rate of 12% (FY06-09 CAGR) versus 10-15% for most of its peers, ABI shares appear to be fully valued, in our view.

Our 12-month price target for ABI shares is \$39

Assuming that ABI continues to execute and that its long-term investments bear fruit and ultimately lead to further acceleration of top-line growth and to margin expansion, then applying a DCF analysis (the UBS VCAM model with a WACC of 8.5% and a terminal growth rate of 5%), we arrive at a 12-month price target of \$39 per share, or about 24x our CY08 EPS estimate of \$1.62.

Fiscal 1Q Review and Recent Events

Applied Biosystems' F1Q07 revenues totaled \$476 million (+15%—10% organic, 4% from the Ambion acquisition, and 1% F/X) versus our estimate of \$451 million and the Street's \$450 million. Excluding \$15 million from the Ambion acquisition, total revenues grew about 10% organically. Adjusted EPS of \$0.29 were above the UBS estimate and Street consensus of \$0.25 thanks to strong sales and lower SG&A (28.4% versus UBS estimate of 29.9%), offset by lower than expected gross margins (53.7% versus UBS estimate of 54.3%). Adjusted operating margins of 15.8% were above the UBS estimate of 14.4%.

Table 16: Applied Biosystems Fiscal 1Q07 Income Statement Highlights

	F1Q07 Actual	Y/Y Growth	F1Q07 UBSe	Comments
DNA Sequencing	\$131.5M	+5%	\$122.4M	Above our -0.3% estimate. ABI believes that 2007 could be an inflection year for DNA sequencing, with stabilization of the core business and a planned CY07 launch of next generation technology from Agencourt
RT-PCR/Applied Genomics	\$158.1	+30%	\$152.3M	Includes \$15M from Ambion; excluding Ambion, organic growth was 17.5%, above our ~15% estimate
Mass Spectrometry	\$116M	+19%	\$104.6M	Sales into the applied and proteomics markets were particularly strong.
Core PCR & DNA Synthesis	\$46.2M	-3%	\$47.8M	Higher due to license fees and royalties
Other Product Lines	\$24.5M	1%	\$24M	
Total Revenues	\$476.3M\$	+15%	\$451.0M	Ambion (4%), FX (1%); organic growth 6%; Instruments \$235M (+5%), Consumables \$200M (+11%), and Service/Licenses/Royalties \$88.7M (+19%)
Gross Margin	53.7%	+20bp	54.3%	
SG&A (% Rev)	28.4%	-90bp	30%	Above UBSe due to integration costs for Ambion, China investments
R&D (% Rev)	9.5%	-30bp	10%	Y/Y decline due to transfer of MALDI lines to MDS Sciex
Adj. Operating Margin	13.4%	-260bps	14.4%	
Net Interest Inc.	\$2.6	-	\$3.5M	In line
Tax Rate	31.0%	-	29.0%	In line
Share Count	183.1M	-15.8M	188.5M	
EPS	\$0.29	+26%	\$0.25	EPS does not reflect cost of acquired R&D as a result of Agencourt purchase

Source: Company reports and UBS estimates

Overall, it was a stronger than expected quarter. Notably, ABI's DNA sequencing segment (\$131.5 million sales in F1Q07) experienced sales growth of 5.3% (versus the UBS estimate of a 0.3% decline), as the company saw a pickup in both sequencing consumables (+4% y/y) and sequencing instruments (+6% y/y), primarily because of an increase in applications for DNA forensics, quality assurance applications in pharma, and CRO environment, medical sequencing, and genotyping studies.

With an estimated 85%-plus market share and 14,000 worldwide installations, ABI is the leading supplier of DNA sequencing instruments, reagents, and software. DNA sequencing accounted for about 30% of the company's \$1.91 billion in FY06 revenues. Despite this enviable market position and the fact that the amount of DNA being sequenced continues to increase annually, ABI's DNA sequencing business has been the company's weakest link with respect to overall growth. Indeed, during the past five years the business has been in decline, falling from \$725 million in FY01 to \$540 million in FY06, chiefly because of a shift in research priorities by government-funded genome labs and a dramatic decrease in DNA sequencing costs.

However, 2007 looks to be a transition year for DNA sequencing. ABI management sees FY07 as an inflection year for its DNA sequencing business, with the stabilization of the core capillary electrophoresis (CE) business and the introduction of next-generation technology from Agencourt. These assumptions seem to be supported by third-party research, as a recent Frost & Sullivan report on the DNA sequencing market suggests that the core CE market will rebound to about 2% growth next year, while next-generation technologies could drive the total sequencing market to about 10% growth by 2012.

In the near term we expect CE-based DNA sequencing to benefit a number of high-profile projects, including the three-year \$100 million pilot study of the Cancer Genome Atlas project, adoption of legislation requiring DNA profiling of felons, and DNA re-sequencing tied to genotyping, pharmacogenomics, and molecular diagnostics.

Over the long term, next-generation technologies will likely become growth drivers. ABI expects to place initial Agencourt systems with early-access customers in FY07. As such, we do not expect Agencourt's high-speed genetic analysis technology to contribute meaningfully to ABI's revenues in FY07-08, but we believe this could ultimately double this segment's growth rate from 2% to 4% in later years. We expect the adoption of next-generation technology to be gradual, and once commercialized, these technologies are likely to complement CE-based methods.

ABI management believes Agencourt offers the combination of data quality, high-throughput capability and other technological characteristics that are advantageous over other next-generation genetic analysis technologies currently being marketed or known to be in development (e.g., 454 Life Sciences, Helicos, and the recently acquired Solexa [Illumina]). However, we believe it is too early to tell which of these next-generation technologies will come to dominate the market. Indeed, Frost & Sullivan believes that none of these next-generation systems is likely to reach the goal of the "\$1,000 Genome" by 2012.

Mass spectrometry sales remained strong, with F1Q07 sales of \$116 million, +19.2% y/y (versus UBS estimate of 7.5%), as the company's family of products, including 4800 and QTRAP systems, continued to book record sales in the biotech/pharmaceutical target discovery (e.g., small molecule and proteomics, biomarker discovery), validation (e.g., biomarkers, proteomics), and applied markets (e.g., environmental and food testing).

ABI's RT-PCR and applied genomics products (\$158.1 million sales in F1Q07) grew at 30% y/y versus the UBS estimate of 25%. Excluding Ambion, this segment was growing at 18%, above our estimate of 15%. The company saw continued strong growth for its RT-PCR instrumentation and consumables (e.g., TaqMan assays) for both genotyping and gene expression studies across a broad spectrum of applications (e.g., disease-association studies and validation).

As expected, the company's core PCR and DNA synthesis products declined 3% y/y as demand continued to soften.

ABI ended the September 2006 quarter with cash and short-term investments of \$284 million. Cash flow from operations was \$23 million with capex of \$14.5 million.

Despite falling prices for its DNA sequencing reagents and expiration of certain core PCR patents, ABI's gross margin has improved from 52.2% in FY01 to

54.6% in FY06, and we believe further expansion is possible. A key driver of margin expansion during 2001-06 was growth in ABI's real-time PCR reagents business, particularly its "Assays on Demand" portfolio for both gene expression and genotyping. We believe demand for these high-value consumable TaqMan products will steadily increase in the mid- to high-single-digit range for several years.

In March 2006, ABI completed the acquisition of the Research Products division of Ambion. ABI's acquisition of Ambion makes strategic sense, as it complements ABI's consumables portfolio by augmenting RNA-based research tools, including the fast-growing and now well-recognized RNA interference (RNAi) technology and microRNA (miRNA) in the study of gene expression process, disease development, and disease progression. Although still a small part of ABI's overall consumables business, the Ambion products should contribute meaningfully to ABI's total gross margin (about 70-80% for proprietary consumables versus 40-50% for instruments) as the business grows.

During ABI's analyst day, the company briefly noted that as part of its plan to improve operational excellence, it will increase its efforts to develop and manufacture its own enzymes. We believe this move toward self-manufacture, as well as the restructuring of certain patent agreements between ABI and Roche, could help increase ABI's gross margins another 50-100 bps by FY09.

Guidance Update

ABI did not change guidance. Management still sees high-single-digit FY07 revenue growth (including Ambion and F/X). We expect Ambion to contribute about \$60 million to FY07 sales, and expect contributions from APG. With an expected effective tax rate of 31%, management projects FY07 pro forma EPS (net of \$0.05 in options) to increase at a rate slightly below revenue growth.

UBS Estimates

Based on our positive outlook for ABI and the current markets, we raised our sales forecasts to \$2.092 billion for FY07 and \$2.254 billion for FY08 from respective prior estimates of \$2.061 billion and \$2.217 billion. We expect adjusted operating margins of 16.8% for FY07 and 17.2% for FY08, and respective tax rates of 31% and 30.5%. We now project pro forma EPS of \$1.35 for FY07 and \$1.53 for FY08, up from \$1.31 and \$1.50. Our calendar year EPS estimates are \$1.42 for 2007 and \$1.62 for 2008.

Table 17: ABI 2007 Estimates (revenues in \$ millions)

	2Q 2007			2007		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	\$532(+10.4%)	\$526	-	\$2092 (+9.5%)	\$2079
EPS (net of options)	-	\$0.35	\$0.35	-	\$1.35	\$1.36

Source: Company reports, First Call, and UBS estimates

Recent Events

ABI President Resigns

On October 20, ABI announced that effective immediately, President Catherine Burzik would resign from the company to become CEO of Kinetic Concepts (KCI, not rated), a wound-healing medical device company. Ms. Burzik had been president of ABI since 2004, prior to which she was ABI's COO. Ms. Burzik's departure was unexpected. While ABI searches for a replacement, Tony White, president/CEO/chairman of Applera Corp. (parent company of ABI and Celera Genomics), will be interim president.

Table 18: Applied Biosystems Earnings Model, FY05-08E

Dollars in millions except per share data

Fiscal year ended June 30

	2005A					2006E					2007E		2008E	
	FY	1QA-Sep	2QA-Dec	3QA-Mar	4QA-Jun	FY	1QA-Sep	2QE-Dec	3QE-Mar	4QE-Jun	FY	FY	FY	FY
DNA Sequencing	541.4	124.9	140.7	136.5	137.8	539.9	131.5	142.1	139.2	140.6	553.4	553.4	569.4	569.4
RT-PCR/Applied Genomics	519.7	121.8	146.6	162.2	169.7	600.3	158.1	186.2	191.4	195.2	730.8	730.8	840.5	840.5
Mass Spectrometry	426.7	97.3	119.5	113.9	134.7	465.4	116.0	130.3	123.0	145.3	514.6	514.6	554.0	554.0
Core PCR & DNA Synthesis	190.7	47.3	47.7	51.7	51.7	198.4	46.2	46.7	46.5	49.1	188.6	188.6	186.7	186.7
Other Product Lines	108.5	24.2	27.4	26.4	29.2	107.2	24.5	26.6	25.6	28.3	105.0	105.0	104.0	104.0
Total Product Revenues	1,787.0	415.5	481.9	490.7	523.1	1,911.2	476.3	531.9	525.8	558.5	2,092.4	2,092.4	2,254.5	2,254.5
Expenses														
COGS	835.4	192.7	219.7	215.7	238.8	866.9	220.7	241.7	240.3	250.8	953.4	953.4	1,008.3	1,008.3
Selling, General, & Administrative	473.9	122.0	135.8	141.1	149.9	548.8	135.1	147.9	148.3	157.5	588.7	588.7	634.8	634.8
Research & Development	203.9	40.8	45.2	48.0	46.3	180.3	45.1	50.5	50.5	52.5	198.6	198.6	214.6	214.6
Special charges	(6.3)	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating Expenses	1,506.9	355.5	400.7	404.8	435.0	1,596.0	400.9	440.1	439.0	460.8	1,740.7	1,740.7	1,865.7	1,865.7
Operating Income	280.1	60.0	81.2	85.9	88.1	315.2	75.4	91.8	86.8	97.7	351.7	351.7	388.8	388.8
Interest Expense	0.0	-	-	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest Income	12.1	4.4	3.3	4.1	2.9	14.7	2.6	3.8	4.5	6.0	16.9	16.9	30.2	30.2
Other income (expense)	1.1	1.7	1.2	0.8	1.8	5.5	1.5	-	-	-	1.5	1.5	0.0	0.0
Loss on Investments, net	3.9	0.0	0.0	-	-	0.0	-	-	-	-	0.0	0.0	0.0	0.0
Total other income/(expense), net	17.1	6.1	4.5	4.9	4.7	20.2	4.1	3.8	4.5	6.0	18.4	18.4	30.2	30.2
Pre-Tax Income	297.2	66.1	85.7	90.8	92.8	335.4	79.5	95.6	91.3	103.7	370.1	370.1	419.0	419.0
Taxes	84.8	19.2	24.9	26.7	26.9	97.7	24.7	29.6	28.3	32.2	114.8	114.8	127.8	127.8
Loss from discontinued operations	1.6	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income from cont'd ops	214.0	46.9	60.8	64.1	65.9	237.7	54.8	66.0	63.0	71.6	255.3	255.3	291.2	291.2
EPS	\$1.08	\$0.24	\$0.32	\$0.34	\$0.35	\$1.24	\$0.29	\$0.35	\$0.33	\$0.38	\$1.35	\$1.35	\$1.53	\$1.53
EPS (net of options, ex-1x items)	\$1.06	\$0.24	\$0.32	\$0.34	\$0.35	\$1.24	\$0.29	\$0.35	\$0.33	\$0.38	\$1.35	\$1.35	\$1.53	\$1.53
EPS (net of options, ex-1x items)	\$1.06	\$0.24	\$0.32	\$0.34	\$0.35	\$1.24	\$0.29	\$0.35	\$0.33	\$0.38	\$1.35	\$1.35	\$1.53	\$1.53
Shares Outstanding (000s)	199.0	197.9	190.2	190.5	188.7	191.8	189.2	189.5	189.7	189.9	189.6	189.6	190.4	190.4
YEAR-OVER YEAR GROWTH														
DNA Sequencing	-5.4%	7.6%	-0.4%	-3.3%	-3.6%	-0.3%	5.3%	1.0%	2.0%	2.0%	2.5%	2.5%	2.9%	2.9%
RT-PCR/Applied Genomics	20.6%	8.9%	8.8%	21.5%	21.6%	15.5%	29.8%	27.0%	18.0%	15.0%	21.7%	21.7%	15.0%	15.0%
Mass Spectrometry	2.9%	9.2%	5.0%	8.6%	13.3%	9.1%	19.2%	9.0%	8.0%	7.9%	10.6%	10.6%	7.7%	7.7%
Core PCR & DNA Synthesis	-5.9%	-0.2%	1.1%	3.8%	11.7%	4.0%	-2.3%	-2.0%	-10.0%	-5.0%	-4.9%	-4.9%	-1.0%	-1.0%
Other Product Lines	-9.9%	-6.6%	3.8%	3.5%	-4.9%	-1.2%	1.2%	-3.0%	-3.0%	-3.0%	-2.0%	-2.0%	-1.0%	-1.0%
Revenues	2.6%	6.5%	4.0%	7.9%	9.3%	7.0%	14.6%	10.4%	7.1%	6.8%	9.5%	9.5%	7.7%	7.7%
COGS	0.0%	5.5%	-0.3%	3.9%	6.3%	3.8%	14.5%	10.0%	11.4%	5.0%	10.0%	10.0%	5.8%	5.8%
Selling, General & Administrative	8.0%	11.9%	16.4%	14.3%	20.1%	15.8%	10.7%	8.9%	5.1%	5.1%	7.3%	7.3%	7.8%	7.8%
Research & Development	-12.8%	-20.2%	-15.7%	-5.7%	-4.1%	-11.6%	10.5%	11.8%	5.2%	13.4%	10.1%	10.1%	8.1%	8.1%
Operating Expenses	-1.6%	4.0%	9.5%	6.2%	4.1%	5.9%	12.8%	9.8%	8.5%	5.9%	9.1%	9.1%	7.2%	7.2%
Operating Income	33.8%	23.5%	-16.5%	16.6%	45.6%	12.5%	25.7%	13.1%	1.0%	10.9%	11.6%	11.6%	10.5%	10.5%
Pre-Tax Income	23.9%	28.1%	-16.2%	16.6%	41.9%	12.9%	20.3%	11.6%	0.5%	11.8%	10.3%	10.3%	13.2%	13.2%
Net Income	0.8%	63.3%	-5.7%	17.1%	-35.6%	21.5%	-40.9%	15.2%	9.8%	106.9%	15.0%	15.0%	78.7%	78.7%
EPS	23.6%	29.4%	13.2%	20.7%	10.9%	17.0%	22.2%	8.9%	-1.3%	7.9%	8.7%	8.7%	13.6%	13.6%
AS A PERCENTAGE OF REVENUES														
DNA Sequencing	30%	32%	36%	35%	29%	28%	34%	31%	31%	29%	29%	29%	30%	30%
RT-PCR/Applied Genomics	29%	31%	38%	42%	35%	31%	41%	40%	42%	41%	38%	38%	44%	44%
Mass Spectrometry	24%	25%	31%	29%	28%	24%	30%	28%	27%	30%	27%	27%	29%	29%
Core PCR & DNA Synthesis	11%	12%	12%	13%	11%	10%	12%	10%	10%	10%	10%	10%	10%	10%
Other Product Lines	6%	6%	7%	7%	6%	6%	6%	6%	6%	6%	5%	5%	5%	5%
Gross Profit	53.3%	53.6%	54.4%	56.0%	54.3%	54.6%	53.7%	54.6%	54.3%	55.1%	54.4%	54.4%	55.3%	55.3%
Research & Development	11.5%	9.8%	9.4%	9.8%	8.9%	9.4%	9.5%	9.5%	9.6%	9.4%	9.5%	9.5%	9.5%	9.5%
Selling, General & Administrative	26.5%	29.4%	28.2%	28.8%	28.7%	28.7%	28.4%	27.8%	28.2%	28.2%	28.1%	28.1%	28.2%	28.2%
Adj Operating Expenses	84.7%	85.6%	83.2%	82.5%	83.2%	83.5%	84.2%	82.7%	83.5%	82.5%	83.2%	83.2%	82.8%	82.8%
Adj Operating Margin	15.3%	14.4%	16.8%	17.5%	16.8%	16.5%	15.8%	17.3%	16.5%	17.5%	16.8%	16.8%	17.2%	17.2%
Pre-Tax Income	16.6%	15.9%	17.8%	18.5%	17.7%	17.5%	16.7%	18.0%	17.4%	18.6%	17.7%	17.7%	18.6%	18.6%
Tax Rate	28.5%	29.0%	29.1%	29.4%	29.0%	29.1%	31.1%	31.0%	31.0%	31.0%	31.0%	31.0%	30.5%	30.5%
Net Income	12.0%	11.3%	12.6%	13.1%	12.6%	12.4%	11.5%	12.4%	12.0%	12.8%	12.2%	12.2%	12.9%	12.9%

Source: Company reports and UBS estimates

Bruker Biosciences

Company Description

Bruker BioSciences is the result of the combination of three Bruker family companies: 1) Bruker Daltonics, a developer of mass spectrometry instruments (with particular strength in proteomics) and homeland security products used for nuclear, chemical, and biological detection; 2) Bruker AXS, a leading provider of advanced X-ray diffraction and X-ray fluorescence systems used to characterize chemical and biological samples and their component elements; and 3) Bruker Optics, a supplier of molecular spectroscopy tools—in particular Fourier Transform Infrared, Near Infrared, and Raman spectrometers.

Bruker BioSciences was formed with the merger of Bruker Daltonics and Bruker AXS

Bruker BioSciences markets around the world to pharmaceutical, biotechnology, and chemical markets (about 40% revenues), university and medical schools (about 50%), and military and government organizations (about 10%).

Investment Summary

Bruker BioSciences (BRKR, Neutral 2)

We see the Bruker Optics acquisition as a long-term positive for the company, as it increases critical mass and helps diversify the business. In addition, the deal should help Bruker Biosciences accelerate margin expansion and help reduce the company's unusually high tax rate (a result of the Bruker Daltonic unit not being profitable in the United States). Although we expect the company's Bruker Optics (molecular spectroscopy) and Bruker AXS (X-Ray) divisions to continue to benefit from strong industrial and ex-U.S. growth, we believe Bruker Daltonics could lag due to increased competition from much larger mass spectrometry vendors, potentially limiting upside.

We rate BRKR shares Neutral 2

Valuation

Our \$8.50 target is based on a DCF analysis (9.5% WACC, 3.5% terminal growth rate) that implies a share price of \$8-9. Our target implies an enterprise value (EV) of about \$800 million or roughly 2 times estimated 2006 sales. Comparable life sciences companies currently trade at an average EV/sales multiple of 2.5 times. Given Bruker Biosciences' lower margins and profitability relative to comparable companies, we believe the lower multiple is justified.

Our 12-month price target for BRKR shares is \$8.50

3Q Review and Recent Events

Having completed the acquisition of Bruker Optics, Bruker Biosciences has begun reporting financial results of the combined company under the pooling-of-interests principles and has been retrospectively restating historical numbers in comparable quarters.

For 3Q06, the combined Bruker Biosciences reported total revenues of \$105 million (+22.1% y/y, about 17% organic growth), ahead of our estimate of \$97 million and Street consensus of \$94 million.

Although the company did not break out segment sales, we estimate that sales consisted of \$40.5 million (+15.7% y/y) from Bruker Daltonics (versus UBS estimate of \$38 million), \$39.5 million (+19.7% y/y) from Bruker AXS (versus UBS estimate of \$37 million), and \$25 million (+19.7% y/y) from Bruker Optics (versus UBS estimate of \$22 million). Adjusted EPS (net of options) totaled \$0.03, meeting UBS estimates but falling short of the \$0.04 Street consensus.

Third quarter gross margins missed the UBS estimate of 45%, as a less favorable product mix led to a decline of 110 bps y/y to 44%. Decreases in SG&A (25.1% versus 26.2% in 3Q05) and R&D (11.4% versus 13.6%) resulted in an operating margin (excluding FAS 123 and acquisition-related charges) of 6.7%, which exceeded our UBS estimate of 4.8% and represented a 100-bp y/y increase.

Table 19: Bruker Biosciences 3Q06 Income Statement Highlights

	3Q06A	Y/Y Change	3Q06 UBSe	FC Consensus	Comments
Bruker Daltonics	~\$40.5M	~15.7%	\$38M	-	Actual segment breakdowns not given; strong sales to European customers
Bruker AXS	~\$39.5M	~19.7%	\$38M	-	"Double-digit growth" in-line with our estimate. Strong sales to industrial customers
Bruker Optics	~\$25M	~19.7%	\$20.5M	-	Fastest growing segment; "Double-digit growth"; ~2% from acquisitions
Total Revenues	\$105.5M	22.1%	\$97M	\$94M	~17% organic growth for the combined company. Recall that Bruker Optics merger is a pooling-of-interests and results are included for the FY06
Gross Margin	44%	+110bps	45%	-	Growth due to increased sales to industrial users and healthy spending by pharma/biotech
R%D (% Rev)	11.4%	-200bps	13.6%	-	
SG&A (% Rev)	25.1%	-80bps	26.0%	-	
Operating Margin	6.7%	+100bps	4.8%	-	
Net Interest/other Income (Combined)	-\$0.9M	-	\$0M	-	Higher net interest /other income, partially due to gain of \$0.9M related to F/X contact marked-to-market; Bruker Optics acquisition will decrease net interest income/(expense) going forward by ~(\$1.3M) from 2Q06 level
Tax Rate (Combined)	47.4%	-	54%	-	High tax rates due to marginal profitability in the U.S. mass spectrometry. Excludes acquisition charges
Adj. EPS (net of options) (Combined)	\$0.03	-	\$0.03	\$0.04	

Source: Company reports, First Call, and UBS estimates

The double-digit growth for Bruker Optics and Bruker AXS, and high-single-digit growth for Bruker Daltonics was partially due to solid sales to European customers, as well as improved spending by biopharmaceutical companies—trends that were seen throughout the sector during 3Q. Solid bookings in mass spectrometry led to strong industrial end-market sales, while purchasing from the academic environment was somewhat constrained.

We look for AXS performance to be augmented by 3Q acquisitions of a handheld XRF product line for metals and environmental analysis and of a Spark OES company (Quantron) that offers metal analysis technology and complements Bruker's growing strength in X-ray fluorescence. These additions broaden the product portfolio offered to industrial end users and we expect should be accretive in the near term. Third quarter revenues from these acquisitions approximated \$1.9 million, or about 2%.

In 3Q06, the tax rate for the combined company was 54.4% (excluding Optic-acquisition related charges) versus the UBS estimate of 47%. The U.S. business was modestly profitable during 3Q, and as profitability increases, management believes it can further reduce the rate toward nominal levels.

Bruker ended 3Q with cash and equivalents of \$44 million, reflecting the \$74 million expenditure for the Bruker Optics acquisition in July. Bruker's net debt position at the end of 3Q was \$12 million. With all acquisitions completed and no 4Q charges foreseen, we expect cash flows to increase steadily in 2007.

Company Guidance

Bruker has not provided 2006 guidance.

UBS Estimates

Based on 3Q results and recent acquisitions, we raised our 2006 revenue projection from \$401 million to \$417 million (+12.1% y/y) and our estimate of adjusted EPS (net of \$0.01 in options) from \$0.16 to \$0.17. We now project 2007 revenues of \$431 million (+7.4% y/y) and adjusted EPS of \$0.20.

Table 20: Bruker 2006 Estimates (revenues in \$ millions)

	4Q 2006			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	\$118M (+10.6%)	\$113	-	\$417 (+12.1%)	\$402
EPS (net of options)	-	\$0.05	\$0.06	-	\$0.17	\$0.15

Source: Company reports, First Call, and UBS estimates

Table 21: Bruker BioSciences Earnings Model, 2004-07E

Dollars in millions, except per share data

Fiscal year ended December 31

	2004A					2005A					2006E	2007E
	FY	10A	20A	30A	40A	FY	10A	20A	30A	40E	FY	FY
Revenues												
Estimated Mass Spectrometry Revenues (Bruker Daltonics)	152.7	57.9	37.4	35.0	39.8	160.2	36.6	39.8	40.5	45.0	161.8	169.9
Estimated X-Ray Revenues (Bruker AXS)	131.7	32.5	34.0	33.0	37.9	137.4	37.9	38.8	39.5	43.0	159.1	172.6
Estimated Bruker Optics	74.2	16.2	19.0	20.9	24.0	78.7	21.3	23.0	25.0	30.0	99.3	108.7
Eliminations	(1.6)	(0.7)	(1.0)	(3.0)	5.0	(4.0)	(0.9)	(1.0)	(0.1)	(1.0)	(3.0)	(4.0)
Total Revenues	357.0	90.4	89.3	85.9	106.7	372.3	94.9	100.5	104.9	118.0	417.2	447.2
Cost of product revenues	206.1	50.8	49.1	47.2	59.2	206.3	51.1	54.3	58.7	64.4	228.4	240.9
Gross Margin	150.9	39.5	40.2	38.7	47.5	166.0	43.8	46.2	46.2	53.6	188.8	206.37
Operating Expenses												
Sales, general and administrative	96.6	23.1	24.0	22.2	27.3	96.6	25.4	27.4	26.3	30.1	109.2	114.0
Research and development	48.4	12.5	12.5	11.5	10.9	47.5	12.3	12.3	11.9	12.5	49.0	52.8
Restructuring charge/Merger costs	-	-	-	-	-	-	1.2	3.7	1.0	0.5	6.3	-
Total Operating Expenses	144.9	35.7	36.4	33.8	38.2	144.1	38.9	43.4	39.2	43.1	164.5	166.8
Operating Income	5.9	3.9	3.8	4.9	9.3	21.9	4.9	2.9	7.0	10.5	24.2	39.6
Other income (expense), net	(4.5)	(1.0)	(0.0)	-	1.0	-	0.2	0.9	0.4	0.5	2.0	2.0
Interest income (expense), net	(3.8)	(0.0)	0.6	0.2	(5.0)	(4.2)	1.5	1.4	(0.9)	(1.0)	1.1	(4.0)
Income from cont ops before taxes	(2.4)	2.9	4.3	5.1	5.3	17.6	6.5	5.2	6.5	10.0	27.3	37.6
Provision for taxes	5.5	2.5	1.8	3.0	4.4	11.9	3.2	2.6	3.5	5.2	14.6	16.0
Minority Interests	0.1	0.1	0.0	0.0	(0.1)	0.0	0.05	0.05	(0.02)	(0.02)	0.1	0.1
Income from continuing ops	(8.0)	0.3	2.4	2.1	1.0	5.8	3.3	2.5	3.0	4.8	12.6	21.5
Adjustments												
Net Income - Reported	(8.0)	0.3	2.4	2.1	1.0	5.8	3.3	2.5	3.0	4.8	12.6	21.5
Net Income - Adjusted (ex- option expenses)	(8.0)	0.3	2.4	2.1	1.0	5.8	4.5	5.3	3.9	5.3	19.1	21.5
EPS - GAAP	(0.08)	\$0.00	\$0.02	\$0.02	\$0.01	\$0.06	\$0.03	\$0.02	\$0.03	\$0.05	\$0.12	\$0.21
EPS - Adjusted (ex. Option expenses)	(0.08)	\$0.00	\$0.02	\$0.02	\$0.01	\$0.06	\$0.04	\$0.05	\$0.04	\$0.05	\$0.19	\$0.21
Option expenses per share							\$0.00	0.00	0.00	0.00	0.01	0.01
EPS Diluted (net of option expenses)							\$0.04	\$0.05	\$0.03	\$0.05	0.17	0.20
Avg. shares outstanding - Diluted	99.653	100.74	100.76	101.04	102.27	101.20	101.48	101.87	102.70	103.20	102.31	103.90
AS A PERCENTAGE OF REVENUES												
BDAL Revenues (% Total Revenues)	42.8%	64.0%	41.8%	40.8%	37.3%	43.0%	38.5%	39.6%	38.6%	38.1%	38.8%	38.0%
BAXS Revenues (% Total Revenues)	36.9%	36.0%	38.1%	38.4%	35.5%	36.9%	39.9%	38.6%	37.7%	36.4%	38.1%	38.6%
Bruker Optics								22.9%	23.8%	25.4%	23.8%	24.3%
Gross Margin	42.3%	43.8%	45.0%	45.1%	44.5%	44.6%	46.1%	46.0%	44.0%	45.5%	45.2%	46.1%
Sales, general and administrative	27.1%	25.6%	26.8%	25.9%	25.6%	26.0%	26.8%	27.2%	25.1%	25.5%	26.2%	25.5%
Research and development	13.5%	13.9%	14.0%	13.4%	10.3%	12.8%	12.9%	12.2%	11.4%	10.6%	11.7%	11.8%
Operating Expenses	40.6%	39.5%	40.8%	39.3%	35.8%	38.7%	41.0%	43.1%	37.4%	36.5%	37.9%	37.3%
Operating Margin	1.7%	4.3%	4.2%	5.7%	8.7%	5.9%	5.1%	2.8%	6.7%	8.9%	7.3%	8.8%
Provision for taxes (% of Income)	-234.0%	87.8%	43.2%	59.0%	83.2%	67.2%	49.5%	50.4%	54.4%	52.0%	53.6%	42.5%
Net Income	-2.2%	0.3%	2.7%	2.4%	0.9%	1.5%	4.7%	5.3%	3.8%	4.5%	3.0%	4.8%
YEAR-OVER-YEAR GROWTH												
MS Revenues	4.1%	49.0%	7.1%	2.3%	-11.1%	4.9%	-36.8%	6.4%	15.7%	13.0%	1.0%	5.0%
X-ray Revenues	15.6%	10.8%	16.2%	2.3%	-7.3%	4.3%	16.5%	14.0%	19.7%	13.6%	15.8%	8.5%
Bruker Optics	23.5%					6.1%	31.6%	21.7%	19.7%	25.0%	26.1%	9.5%
Total Revenues	36.9%	32.6%	39.2%	29.2%	24.6%	4.3%	5.0%	12.5%	22.1%	10.6%	12.1%	7.2%
Cost of Product Sales	43.2%	24.4%	21.3%	25.7%	23.5%	0.1%	0.6%	10.5%	24.4%	8.8%	10.7%	5.4%
Sales, General and Administrative	24.4%	44.8%	30.8%	22.2%	18.4%	0.0%	10.0%	14.3%	18.2%	10.2%	13.0%	4.4%
Research and Development	27.2%	26.2%	20.9%	6.5%	-9.8%	-1.8%	-2.1%	-1.6%	3.5%	14.2%	3.2%	7.7%
Operating Expenses	20.8%	37.7%	27.2%	16.3%	8.7%	-0.6%	9.0%	19.0%	16.1%	12.7%	14.2%	1.4%
Operating Income	-282.8%	175.3%	-175.6%	-5905.9%	264.8%	269.5%	25.6%	-24.4%	41.5%	13.6%	10.9%	63.2%
Net Income	-54.2%	-40.5%	-154.9%	-168.0%	-215.2%	-172.2%	1051.9%	5.5%	42.8%	388.2%	119.1%	71.0%
EPS	-389.1%	-48.8%	-159.0%	-273.2%	-200.8%	-171.1%	1464.5%	120.2%	85.9%	433.7%	227.9%	11.3%

Source: Company reports and UBS estimates

Celera Genomics

Company Description

Celera Genomics was founded in 1998 as a human genome sequencing and bioinformatics company. In 1999, Celera became a tracking stock under Applera Corp., which also owns Applied Biosystems (ABI).

Applera is the parent company of Celera Genomics and Applied Biosystems

Since completing its pioneering work on sequencing the human genome, Celera has undergone two significant transformations. In 2000-01, the company shifted its primary focus from DNA sequencing and commercial development of its genomics database to molecular diagnostics and proteomics-based drug discovery. During this phase, the company acquired small molecule drug developer Axys Pharmaceuticals and formed Celera Diagnostics, a 50/50 joint venture with ABI to develop products for the in vitro diagnostics (IVD) and pharmacogenomics markets. Celera Diagnostics then formed a discovery and marketing alliance with Abbott Labs (ABT). To better align its operational and technological focus, in January 2006, Celera announced the discontinuation of its drug development to focus exclusively on molecular diagnostics. Toward this goal, the company acquired from ABI the 50% of Celera Diagnostics it did not already own. In our view, these moves 1) helped simplify the complex Applera corporate structure, partly removing an overhang from the company, and 2) resulted in Celera having a tighter focus.

As a result of the recent restructuring, Celera Genomics now fully controls Celera Diagnostics. In our view, this integration of Celera Diagnostics' business into Celera Genomics, along with the company's recent move to partner out its small molecule drug discovery and development programs, makes strategic and operational sense. The "newer" Celera is now better positioned to focus its operational and financial resources.

In addition to the changes in the ABI relationship, in January 2006 Celera announced a restructuring of its strategic alliance with Abbott. Through a profit-sharing arrangement, Celera will continue to work with Abbott in most areas of in vitro diagnostics, including the new m2000 automated Real-Time PCR-based diagnostic system used in the diagnosis of infectious diseases. Independent of Abbott, Celera is capitalizing on the company's genomics and proteomics capabilities by developing novel molecular diagnostic tests, such as a Cirrhosis Risk Score test and several pharmacogenomics assays for the better prognosis and treatment of cardiovascular, autoimmune, and neurodegenerative diseases. Finally, the company has multiple genomics- and proteomics-based product development partnerships in the areas of oncology and neuroscience, including a novel in vivo imaging development pact with General Electric.

Investment Summary

Celera Genomics (CRA, Buy 2)

We view as positive the company's restructuring and exit from drug discovery, as it provides Celera with a faster and potentially less risky path to profitability. With these changes, the company is targeting profitability by year-end FY08, well ahead of our expectation of late FY09 or early 2010.

We rate Celera Buy 2

By taking full ownership of Celera Diagnostics, Celera becomes a focused player in the growing \$2 billion molecular diagnostics market. Overall, we believe Celera, through its alliance with Abbott, has an infectious disease testing portfolio that appears competitive with, and in some cases is superior to, other molecular diagnostic platforms for more established players.

In addition, Celera has a rich pipeline of partnered and unpartnered pharmacogenomics tests that could be among the first targeted medicine products to enter the market. Established commercialization partnerships with Abbott, Quest, LabCorp, and Specialty Labs will enable Celera to bring these "new genetics" products to market. Note that pharmacogenomics is a new market. As such, it is difficult to judge how quickly it will develop given the need to educate physicians about their use and clinical utility. In addition, it remains to be seen what, if any, additional work will be required for regulatory approval or to secure reimbursement. That said, we believe it is best to keep modest expectations regarding such products.

Finally, Celera has a number of therapeutic and molecular imaging licensing agreements in place with companies such as GE and Abbott, which we believe could drive additional upside if these companies successfully commercialize products based on Celera's proteomics targets. In total, we believe that over the next five years Celera has ample fuel for top-line growth.

Valuation

Our \$17 price target is based on a sum-of-the-parts analysis: \$565 million in cash or \$7/share plus 7x our FY11 peak sales estimate of \$187 million, discounted at 15% or about \$10/share.

Our 12-month target for CRA is \$17

Fiscal 1Q07 Review and Recent Events

CRA reported F1Q07 revenues of \$10.2 million, slightly above the Street's \$10 million, while end-user sales of \$25.8 million were slightly ahead of our \$23.1 million estimate. End-user revenues were bolstered by increased sales of the m2000 system, as well as growth in demand for analyte-specific reagents and the Viroseq HIV genotyping system.

Management remarked on its satisfaction with the penetration of the m2000 in international markets and called for approval within the U.S. in the near future. At present, the m2000 is pending 510(k) clearance with the FDA, with a PMA

submitted by ABT for a HIV-1 viral load assay on the m2000 system. We expect FDA action by the end of CY06. In addition, we expect FDA approvals for the use of the m2000 for testing HCV viral load, CT/NG, and HBV in CY07, shortly after that. Following U.S. approval, we expect ABT/CRA to obtain Japanese regulatory approval in FY08. In our view, the timely approval and subsequent launch in both the U.S. and Japan are critical for m2000's success.

Table 22: Celera Genomics Fiscal 1Q07 Income Statement Highlights

	F1Q07 Actual	Y/Y Growth	F1Q07 UBSe	Comments
End User Sales	\$25.8M	+45%	\$23.1M	Above estimate, due to strategic alliance with Abbott and revenues from genetic tests; FY07 total end user sales guided at \$105-115M
CDx Revenues	~\$8.2 M	-	\$8.8M	-
Other Revenues	\$2.0M	-	\$2.3M	-
Total CRA Revenues	\$10.2M	+9.8%	\$11.0M	FY07 total revenue guidance is \$40-45M
Gross Margin (% of End User Sales)	85.3%	+100bp	81%	Above estimate, due to higher consumable sales and favorable product mix
SG&A	\$7.2M	37.5%	\$7.7M	Below estimates, due to decreased costs from FY06 restructuring
R&D	\$13.2M	-123%	\$15.0M	Below estimate, due to exit from small molecule drug discovery and development, as well as discontinuation of online information business
Employee-related charges	\$3.5M	-	\$0M	One-time charge related to litigation with Innogenetics
Operating Margin	NM	NM	NM	-
Net Interest Inc.	\$6.5M	+18.4%	\$5.3M	-
Tax Credit	\$3.8M	-	\$4.2M	-
EPS	(\$0.09)	-	(\$0.10)	-

Source: Company reports and UBS estimates

Toward the end of the quarter CRA announced the successful launch of its Hepatitis C Virus (HCV) Liver Fibrosis GenotypR by Specialty Laboratories. Based on biomarker discoveries made in the Celera lab, the test allows for the prediction of liver fibrosis and cirrhosis risk in HCV-infected patients. Celera has licensed the marker technology to Specialty and has entered into an arrangement that calls for both upfront royalty payment and subsequent payments of about 35-45% of end-user sales.

Celera noted that during the quarter, a legal decision in Wisconsin, which found Abbott to be in violation of a U.S. patent held by Innogenetics and related to the sale of HCV genotyping ASR products. As a result of the sale of these products, which are manufactured by Celera, a U.S. District Court found Abbott liable for \$7 million in damages. Innogenetics is currently awaiting scheduling by the court to address its request for both an injunction and enhanced payment of damages, while Abbott has stated its intention to appeal the judgment. Celera is not named as a party in the lawsuit, but the alliance agreement between Abbott and Celera calls for CRA to share equally in the costs and implications of litigation, which has resulted in a pretax charge of \$3.5 million.

Company Guidance

For FY07, CRA expects end-user sales to be up 35-40% y/y, to \$105-115 million, with revenues of \$40-45 million and a net loss of \$28-35 million. Because of its restructuring, the company now expects a lower cash burn of \$35-45 million (versus prior \$45-55 million).

CRA ended 1Q with \$566.4 million of cash and no debt.

Table 23: Financial Targets for the "New" Celera

Item	FY07E	By FY11E
End Market Sales	\$105-115M	\$400-500M
Celera Revenues	\$40-45M	\$160-200M
Net Loss	\$28-35M	15-20% profit

Source: Company presentation

UBS Estimates

We maintain our end-user sales estimates of \$110.8 million for FY07 and \$155.1 million for FY08, with total revenues estimated at \$44 million and \$72.4 million. We also maintain our estimate for a per-share loss of \$0.42 for FY07, but adjusted our FY08 forecast to a loss of \$0.24 from a loss of \$0.25.

Table 24: CRA 2007 Estimates (revenues in \$ millions)

	2Q 2007			2007		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	10.7(+3.7%)	\$11	-	\$44 (-4.8%)	\$45
EPS (net of options)	-	(\$0.11)	(\$0.10)	-	(\$0.42)	(\$0.39)

Source: Company reports, First Call, and UBS estimates

Anticipated Upcoming Milestones for Celera

- FDA approval of m2000 in the U.S. (510[k]) pending: CY06.
- Launch of Cirrhosis Risk Score Test : CY2006.
- FDA approval (PMA) of HIV-1 viral load assay on m2000: 1Q CY07.
- Approvals for HCV viral load, CT/NG, and HBV on m2000: FY07.
- Japanese regulatory approval of m2000: FY08.
- Approval of HCV genotyping and GBS (FY08) and two undisclosed assays on m2000 (FY09-10).
- Coronary Heart Disease Genetic Risk Score (GRS) (FY08); GRS for Stroke (FY09); Statin Benefit Test (FY08).
- Advance therapeutic antibody targets with partners ABT, DNA, MEDX, and SGEN: FY07-11.
- Advance diagnostic imaging targets with partner GE: FY07-11.

Table 25: Celera Genomics Earnings Model, FY05-08E

Dollars in millions except per share data

Fiscal year ended June 30

	2005A					2006A					2007E		2008E
	FY	1QA-Sep	2QA-Dec	3QA-Mar	4QA-Jun	FY	1QA-Sep	2QE-Dec	3QE-Mar	4QE-Jun	FY	FY	
End User Sales	61.2	17.8	19.1	20.1	22.5	79.5	25.8	26.5	28.5	30.0	110.8	155.1	
CDx Revenues	35.5	7.7	8.2	8.9	9.2	33.4	8.2	8.5	9.0	9.3	35.0	54.4	
Other Revenues		2.1	2.1	0.0	8.6	12.8	2.0	2.2	2.4	2.4	9.0	18.0	
Total CRA Revenues	31.0	9.2	10.3	8.9	17.8	46.2	10.2	10.7	11.4	11.7	44.0	72.4	
<i>Cost of Sales (%)</i>	<i>9.8%</i>	<i>3.9%</i>	<i>8.9%</i>	<i>24.4%</i>	<i>23.1%</i>	<i>15.7%</i>	<i>14.7%</i>	<i>19.0%</i>	<i>19.0%</i>	<i>19.0%</i>	<i>17.9%</i>	<i>16.5%</i>	
Expenses:													
Manufacturing Cost by CRA	6.0	0.7	1.7	4.9	5.2	12.5	3.8	5.0	5.4	5.7	20.0	25.6	
Research & Development	105.1	21.8	20.9	20.4	15.7	78.8	13.2	14.5	14.6	14.7	57.0	55.0	
SG&A	24.7	6.6	6.8	8.3	9.1	30.8	7.2	8.0	8.5	8.3	32.0	33.9	
Other	2.6	0.5	0.0	20.9	5.3	26.7	3.5	0.0	0.0	0.0	3.5	0.0	
Amortization of Goodwill and Other	2.8	0.7	0.4		0.0	1.1	0.0	0.6	0.6	1.3	2.5	2.5	
Operating Expenses	141.2	30.3	29.8	54.5	35.3	149.9	27.7	28.1	29.1	30.0	115.0	116.9	
Operating Income	(110.2)	(21.1)	(19.5)	(45.6)	(17.5)	(103.7)	(17.5)	(17.5)	(17.7)	(18.3)	(71.0)	(44.5)	
Interest Income/(Expense), net	15.0	5.3	5.9	5.2	6.0	22.4	6.5	4.9	4.7	4.5	20.6	16.0	
Loss from the JV	(29.9)	(7.8)	(5.1)	0.0	0.0	(12.9)	0.0	0.0	0.0	0.0	0.0	0.0	
Other Expenses, Net	1.1	0.0	(0.2)	0.0	0.0	(0.2)	0.0	0.0	0.0	0.0	0.0	0.0	
Gain (loss) on Investments	0.0	4.5	0.0	3.1	0.0	7.6	0.1	0.0	0.0	0.0	0.0	0.0	
Pre-Tax Income	(124.0)	(19.1)	(18.9)	(37.3)	(11.5)	(86.8)	(10.9)	(12.6)	(13.0)	(13.8)	(50.4)	(28.5)	
Taxes	46.8	9.5	9.8	14.0	6.2	39.5	3.8	4.4	4.6	4.8	17.6	10.0	
Net Income	(77.2)	(9.6)	(9.1)	(23.3)	(5.3)	(47.3)	(7.1)	(8.2)	(8.5)	(8.9)	(32.8)	(18.5)	
EPS Less One Time Charges	(1.05)	(0.13)	(0.12)	(0.31)	(0.07)	(0.63)	(0.09)	(0.11)	(0.11)	(0.11)	(0.42)	(0.24)	
Shares Outstanding (000s)	73.3	72.6	74.8	75.8	77.0	75.5	77.8	77.6	78.0	78.2	77.9	78.3	
YEAR-OVER-YEAR GROWTH													
End User Sales	33.3%	38.0%	28.2%	38.2%	21.4%	30.7%	44.9%	30.0%	50.0%	33.3%	39.4%	40.0%	
CRA Revenues	-48.4%	-4.2%	25.6%	-2.4%	60.0%	14.5%	10.9%	3.7%	27.8%	-34.0%	-4.8%	64.7%	
Research & Development	0.4%	-10.7%	-18.7%	-45.8%	-63.4%	-35.6%	-39.4%	-30.6%	-28.4%	-6.4%	-27.7%	-3.5%	
Cost of Sales	-45.0%	-73.1%	41.7%	336.4%	263.6%	86.7%	442.9%	196.2%	10.5%	9.6%	59.6%	28.3%	
Selling, General & Administrative	-15.1%	20.0%	30.8%	-8.5%	-49.3%	-5.3%	9.1%	17.6%	2.4%	-8.8%	3.9%	5.8%	
Operating Expenses	-45.0%	-15.8%	-9.1%	14.8%	-7.3%	6.2%	-8.6%	-5.6%	-46.6%	-15.0%	-23.3%	1.7%	
AS A PERCENTAGE OF REVENUES													
Cost of Sales	19%	8%	17%	24%	23%	16%	15%	19%	19%	19%	18.01%	17%	
R&D	339%	237%	203%	229%	88%	171%	129%	136%	128%	125%	130%	76%	
SG&A	80%	72%	66%	93%	51%	67%	71%	75%	75%	71%	73%	47%	
Operating Expenses	455%	329%	289%	612%	198%	324%	272%	263%	256%	255%	261%	161%	
Operating Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	
Tax	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	
Net Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	

Source: Company reports and UBS estimates

Cepheid

Company Description

Cepheid is an emerging player in the field of genetic analysis and nucleic acid detection in the life sciences, molecular diagnostic, and biodefense markets. The company develops, manufactures, and sells integrated instruments and related consumables used for the rapid detection of nucleic acids (DNA and RNA) using real-time or quantitative PCR-based technologies. Because of their speed, flexibility, and ease of use, Cepheid's products may have certain advantages over other real-time PCR instruments currently on the market.

Cepheid manufactures and sells real-time PCR instruments and related consumables for the research, molecular diagnostic, and bioterror markets

Cepheid was founded in 1996 on key technologies first licensed from the University of California/Lawrence Livermore National Laboratory, and it had its IPO in 2000. Cepheid commercially launched its first real-time PCR instrument, the SmartCycler, in 2000 and to date has placed over 1,700 units, mostly in life sciences labs. In October 2005, the company launched its second system, the GeneXpert, a rapid real-time PCR instrument that integrates automatic sample preparation, amplification, and detection in a novel, easy-to-use system. Key to both the SmartCycler and the GeneXpert are proprietary disposable cartridges and reagents that are specific to the detection of DNA from either pathogens or human-disease-associated genes. With a growing menu of medically relevant tests for both the SmartCycler and the GeneXpert, Cepheid hopes to expand into the growing molecular diagnostic market by reducing both the complexity and the time required for genetic analysis.

Part of a consortium led by Northrop Grumman, Cepheid's GeneXpert module and sample cartridges are at the heart of the Biohazard Detection System (BDS) designed for the U.S. Postal Service (USPS) for the real-time detection of anthrax. Initial installation is completed, and ongoing cartridge usage will provide Cepheid with significant near-term revenues; however, the profit-sharing agreement with Applied Biosystems restricts profitability.

We believe molecular diagnostics represents the more attractive long-term opportunity for Cepheid. In addition to a pipeline of internal clinical trials for new tests, Cepheid recently raised cash through a stock offering to fund future acquisitions in molecular markers. Overall, with a growing menu of infectious disease and cancer-related DNA-based diagnostic tests, we believe Cepheid's GeneXpert could become a key diagnostic platform. However, it remains to be seen how quickly this could occur, especially since in several cases Cepheid will compete directly with other marketed molecular-based tests.

Investment Summary

Cepheid (CPHD, Neutral 2)

Real-time PCR is the gold standard for molecular diagnostics, and Cepheid is an emerging player in this rapidly growing market. Cepheid competes against a number of well-established companies, including Roche, Applied Biosystems, and Bio-Rad. We believe Cepheid's platform may offer certain advantages over other systems. Its GeneXpert platform incorporates the three key steps of the real-time PCR process in one stand-alone system. Thanks to their simplicity and sensitivity, we believe integrated real-time PCR systems may be particularly appealing to customers in the biothreat and molecular diagnostic markets.

We rate Cepheid Neutral 2

With the launch of the GeneXpert, FDA approval of the Xpert GBS test, release a CE-marked Xpert MRSA test in Europe, and what we believe is an increasing need for real time/point-of-care infectious disease detection products, we are optimistic about Cepheid's long-term potential. However, management's near-term visibility appears limited and timeline have repeated slipped. For example, during the 2Q06 conference call, Cepheid lowered guidance and pushed out its profitability target into 2007. Also, clinical trials for the MRSA/MSSA combination test are now delayed until 2007, with a possible launch in 2008. Although the delay in the combination test is disappointing, we note that Cepheid has a stand-alone MRSA test is under development, and expects clinical trials to be completed by year-end 2006 with FDA approval and product launch in 2007. We are hopeful that these products will help drive top-line sales to close to \$100 million in 2007.

We remind investors that since the company is still unprofitable, CPHD shares could face significant stock price volatility if the company continues to miss timelines. We therefore believe CPHD shares are most appropriate for investors with a high tolerance for risk as part of a fully diversified portfolio.

Valuation

Cepheid has a novel, fully automated real-time PCR instrument (the GeneXpert), a recurring revenue stream from the USPS Biothreat contract, and, in our view, an interesting, albeit early stage, molecular diagnostic product pipeline. Moreover, we believe that MRSA test on the GeneXpert serves an unmet medical need and that once FDA approved and launched, the product has the potential to do well in the market. However, the numerous delays in clinical trials and missed milestones for MRSA and other products, are concerning, and in our view the stock is fairly valued given the lack of visibility and above average risk. We therefore await additional evidence that management will deliver on its promised clinical time lines and milestones before we become more positive. That said, we are encouraged by 3Q06 results, as they suggest that visibility may be improving. Our \$10 price target is based on an EV/sales multiple of 5.5x our 2007 revenue estimate of \$102.5 million. This multiple is based the average for a comparable universe of small-cap diagnostics and life sciences companies.

Our 12-month price target is \$10

3Q Review and Recent Events

Cepheid's 3Q06 total revenues of \$23.8 million (+16% y/y) were above the UBS estimate of \$20 million and the consensus estimate of \$21 million, primarily because of increased clinical sales and a pickup in industrial sales.

Net of about \$0.03 in stock option expenses, Cepheid reported an adjusted per-share loss of \$0.07, above the UBS estimate for a loss of \$0.13 and the consensus estimate for a loss of \$0.11. The smaller loss was due higher sales, much improved gross margins (42.7% versus the UBS estimate of 41%), and lower operating expenses (22% of SG&A versus the UBS estimate of 30% and 21% of R&D versus the UBS estimate of 27%).

Table 26: Cepheid 3Q06 Income Statement Highlights

	3Q06 Actual	YY Change	3Q06 UBSe	FC Consensus	Comments
Instruments	\$7.3M	-12%	\$4M		Down y/y as instrument module sales to the USPS have been completed (as expected); Instrument sales beat our estimate due to (1) strong clinical placement and (2) pickup in industrial placement
Reagents & Disposables	\$15.4M	40%	\$15M		Driven by (1) increased clinical tests due to new product introduction and increased adoption; (2) pickup in industrial use, and (3) in-line Biothreat cartridge sales
Total Product Sales	\$22.7M	18%	\$19M		
Total Revenues	\$23.8M	16%	\$19.9M	\$21M	
Collaboration Profit Sharing	\$4.0M		\$3.8M		In line (CPHD shares the gross margin on Biothreat sales with Applied Biosystems)
Gross Margin	42.7%	+300bp	41%		Driven by (1) favorable product mix (more clinical and industrial uses vs. biothreat); and (2) higher volume-driven margin expansion
SG&A (% of Rev)	22%	-10bp	30%		Expect SG&A to increase as CPHD starts to push clinical tests in U.S. and ROW
R&D (% of Rev)	21%	-230bp	27%		Expect R&D to increase due to ongoing and increased clinical trials
EPS (ex-option expenses)	(\$0.04)	-	(\$0.09)		-
EPS (net of option expenses)	(\$0.07)		(\$0.13)	(\$0.11)	Net of \$0.03 option expenses

Source: Company reports, First Call, and UBS estimates

Product sales totaled \$22.7 million (+18% y/y), comprising \$7.3 million in instrument sales (32% of total) and \$15.4 million in reagent/disposable sales (68%); see Table 27. Based on the market segment, Cepheid recorded \$5.8 million clinical product sales (+132% y/y) primarily thanks to multiple product launches in the EU (e.g., GBS/EV/MRSA tests on Xpert system, and EBV, CMV and GBS on SmartCycler system), as well as greater adoption and market penetration in hospital settings. Industrial product sales of \$4.8 million were up 30% y/y owing to a pickup from industrial customers from 2Q06. As expected, BioThreat product sales of \$12.1 million were down 7% y/y, primarily due to the completion of the installation of BDS units for the USPS.

Table 27: Cepheid Product Sales From Various End Markets (\$ millions)

	3Q05	4Q05	Full Year			3Q06
			2005	1Q06	2Q06	
Clinical Market	\$2.5	\$3.4	\$9.2	\$3.7	\$4.0M	\$5.8M
Industrial Market	\$3.7	\$3.6	\$13.4	\$3.5	\$2.8M	\$4.8M
USPS/Biothreat	\$13	\$15.2	\$57.8	\$12.1	\$12.1	\$12.1
Total	\$19.2	\$22.2	\$80.4	\$19.3	\$19.3	\$22.7

Source: Company reports

On the product strategy front, Cepheid has three GeneXpert-based tests being commercialized in Europe—EV, GBS, and MRSA (launched in October). In U.S., it has received FDA clearance for its 510(k) for the GeneXpert-based GBS test, with moderate complexity designation under Clinical Laboratory Improvement Amendments. During the 3Q06 conference call, management indicated that this GBS test is currently going through an evaluation phase through several reference labs, and sales should follow in early to mid 2007.

The EV Xpert test is still pending FDA approval. With a 510(k) filed in April, management expects to learn of an FDA decision by no later than year-end.

Cepheid expects to complete U.S. clinical trials for the GeneXpert-based MRSA test by year-end, with a goal of submitting a 510(k) application in 1Q07. This timeline puts the automated POC MRSA test in the U.S. market potentially by 2H07, given the typical four to six months needed for lead and validation time, as well as imbursement clearance, for a typical system placement or test orders.

Likewise, because of the priority of getting the MRSA test into the U.S. market, Cepheid management indicated that development of an MRSA/MSSA combination test is likely to be a secondary priority. Thus, trials will probably be delayed until 2007, and we don't expect this test to be launched until well into late 2008 or 2009. In our view, potential further delays for these important tests could further push back Cepheid's operational profitability (now guided for 2007).

The company has recently shipped an interim bridging order to the USPS as part of the plan to secure FY07 a new cartridge re-order. Management indicated that we should hear the re-order announcement at any time. Given the current federal budget pressures and the USPS's effort to economize, management also expects the 2007 order size to be similar to the 2006 level (\$45-50 million).

As promised, CPHD launched a stand-alone CE-marked MRSA test based on the GeneXpert system in Europe. CPHD's MRSA test enables the detection of MRSA strains from a nasal swab specimen in about 75 minutes versus the standard culture-based method's 48-72 hours. According to several recently published medical surveys, MRSA is increasingly becoming a major cause of hospital-acquired and community-acquired infection in developed countries. CDC and CMS recently updated their guidelines regarding the need for prompt

and accurate diagnostics for infectious diseases (e.g., the resistant strains), and potential reduction of hospital-related costs through timely treatment of hospital-related (nosocomial) infections via cost-effective POC diagnostics (e.g., home-brew versus FDA approved). In our view, a rapid and accurate molecular MRSA detection assay could permit improved treatment for critically ill patients in intensive care units and could also permit pre-emptive actions to avoid cross-infection. Thus, we believe Cepheid's POC MRSA test could prove to be attractive in the hospital and community clinic settings.

The 3Q gross margin was 42.7% (net of option expenses), a 300-bp y/y improvement primarily attributable to higher-volume-leveraged margin expansion and favorable product mix, as a higher percentage of clinical and industrial tests were shipped during the quarter relative to lower-margin Biothreat tests. We expect the gross margin to incrementally improve as the company introduces new higher-margin diagnostic tests, achieves greater market penetration, and improves mix and volume.

The company ended 3Q06 with cash and marketable securities totaling \$98.4 million.

Company Guidance

Cepheid maintained its already-lowered 2006 guidance for total product sales of \$83-86 million and a net loss of \$12-14 million or \$0.23-0.27 per share excluding stock option expenses.

UBS Estimates

Given the early but positive signs of product adoption in the clinical setting and a pickup in industrial customers, offset by flattish growth from USPS orders, we have slightly raised our product sales estimates to \$89 million for 2006 and \$102 million for 2007 from our prior estimates of \$81 million and \$97 million, respectively. Excluding option expenses, we now project per-share net losses of \$0.28 for 2006 and \$0.19 for 2007, up from our prior loss estimates of \$0.36 and \$0.23. Including stock option expenses of \$0.14, our respective per-share loss estimates are \$0.42 and \$0.33, up from our prior estimates of \$0.54 and \$0.46.

Table 28: CPHD 2006 Estimates (revenues in \$ millions)

	4Q06			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	\$22	\$25	-	\$89	\$88
EPS (net of options)	-	(\$0.08)	(\$0.07)	-	(\$0.42)	(\$0.42)

Source: Company reports, First Call, and UBS estimates

Product/Milestone Update

To date, Cepheid has launched in the EU assays for CMV, VZV, EBV, and GBS on SmartCycler system, as well as GBS, EV, and MRSA on the GeneXpert system. In addition, the company launched its high-throughput, fully integrated, close and on-demand 16-module GeneXpert during the annual meeting of the American Society for Microbiology, with a total of five systems having been installed in hospital accounts to date.

Table 29: Cepheid Clinical Milestones

Product	Status
GeneXpert	
GBS	FDA cleared, EU launched
Enterovirus (EV)	Filed FDA in April
BCR/ABL	Launched in EU in February
MRSA	Launched in EU in October
MRSA	Accrual to complete by 2006 year-end Potential FDA approval and launch in 2007
SmartCycler	
Epstein-Barr (EBV)	EU launched
Cytomegalovirus (CMV)	EU launched
2 nd -generation GBS	EU 2H06
B. Parapertussis	EU 2H06
B. Pertussis	EU 2H06
HSV (1,2)	EU 2H06
Noravirus	EU 2H06
HBV	EU 2H06

Source: Company reports and UBS estimates

Table 30: Cepheid Income Statement, 2004-07E

Calendar year ended December 31												
	2004A					2005A					2006E	2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
Instruments	27,928	6,360	7,262	8,300	6,342	28,264	4,538	4,030	7,287	8,000	23,855	28,000
Reagents & Disposables	22,037	12,392	12,942	10,938	15,905	52,177	14,734	14,852	15,360	16,500	61,446	70,500
Product Sales	49,965	18,752	20,204	19,238	22,247	80,441	19,272	18,882	22,647	24,500	85,301	98,500
Grants & Govt. Research Revenues	33	168	437	352	552	1,509	278	288	987	250	1,803	1,000
Contract, License and Royalty Revenues	2,970	646	743	822	850	3,061	611	677	128	650	2,066	2,500
Total Revenues	52,968	19,566	21,384	20,412	23,649	85,011	20,161	19,847	23,762	25,400	89,170	102,000
Cost of Product Sales	27,541	10,274	11,743	11,601	12,614	46,232	11,193	11,483	12,981	13,965	49,622	53,683
R&D Expense	15,903	4,506	4,538	4,754	5,164	18,962	5,329	5,107	5,068	5,200	20,704	22,000
SG&A Expense	16,134	4,555	5,036	4,518	4,791	18,900	5,146	5,821	5,346	5,800	22,113	23,500
Collaboration Profit Sharing	6,096	3,606	3,602	2,904	4,371	14,483	3,811	3,843	3,952	3,872	15,478	15,840
Expense for patent-related matter	1,264	0	0	0	0	0	0	0	0	0	0	0
Operating Expenses	66,938	22,941	24,919	23,777	26,940	98,577	25,479	26,254	27,347	28,837	107,917	115,023
Operating income	(13,970)	(3,375)	(3,535)	(3,365)	(3,291)	(13,566)	(5,318)	(6,407)	(3,585)	(3,437)	(18,747)	(13,023)
Other Income, Net	188	(111)	(189)	(13)	53	(260)	0	0	0	0	0	0
Net Interest income (expense)	(18)	28	89	116	233	346	1,365	1,215	1,000	3,926	2,300	2,300
Income before taxes	(13,800)	(3,458)	(3,635)	(3,262)	(3,238)	(13,593)	(4,972)	(5,042)	(2,370)	(2,437)	(14,821)	(10,723)
Income taxes	0	0	0	0	0	0	0	0	0	0	0	0
Net income to common	(13,800)	(3,458)	(3,635)	(3,262)	(3,238)	(13,593)	(4,972)	(5,042)	(2,370)	(2,437)	(14,821)	(10,723)
EPS Diluted (ex-option expenses)	(0.34)	(0.08)	(0.09)	(0.08)	(0.08)	(0.32)	(0.11)	(0.09)	(0.04)	(0.04)	(0.28)	(0.19)
Option expenses per share							(0.04)	(0.04)	(0.03)	(0.03)	(0.14)	(0.14)
EPS Diluted (with option expenses)	(0.34)	(0.08)	(0.09)	(0.08)	(0.08)	(0.32)	(0.15)	(0.13)	(0.07)	(0.08)	(0.42)	(0.33)
Diluted shares outstanding	41,083	42,245	42,465	42,581	42,684	42,494	44,946	54,518	54,771	54,971	52,302	56,070
YEAR-OVER-YEAR GROWTH												
Instruments	115%	31%	-6%	3%	-13%	1%	-29%	-45%	-12%	26%	-16%	17%
Reagents & Disposables	685%	597%	371%	103%	31%	137%	19%	15%	40%	4%	18%	15%
All Products	216%	182%	93%	43%	15%	61%	3%	-7%	18%	10%	6%	15%
Grants & Govt. Research Revenues	-98%	N/A	N/A	N/A	2660%	4473%	N/A	-34%	180%	-55%	19%	-45%
Contract, License and Royalty Revenues	366%	5%	-8%	32%	-8%	3%	-5%	-9%	-84%	-24%	-33%	21%
Revenues	186%	169%	89%	45%	16%	60%	3%	-7%	16%	7%	5%	14%
Cost of Product Sales	219.2%	240.4%	92.1%	54.8%	15.6%	67.9%	8.9%	-2.2%	11.9%	10.7%	7.3%	8.2%
R&D	3.7%	24.1%	17.4%	17.8%	18.1%	19.2%	18.3%	12.5%	6.6%	0.7%	9.2%	6.3%
SG&A	35.9%	48.5%	13.6%	13.4%	3.1%	17.1%	13.0%	15.6%	18.3%	21.1%	17.0%	6.3%
Operating Expenses	85.5%	101.2%	65.9%	40.0%	14.5%	47.3%	11.1%	5.4%	15.0%	7.0%	9.5%	6.6%
Net income	-21.3%	-16.6%	-2.0%	11.9%	7.0%	-1.5%	43.8%	38.7%	-27.3%	-24.7%	9.0%	-27.7%
EPS	-36.1%	-23.6%	-3.8%	10.1%	5.3%	-4.8%	35.1%	8.0%	-43.5%	-41.6%	-11.4%	-32.5%
AS A PERCENT OF REVENUES												
Instruments (as % of product sales)	55.9%	33.9%	35.9%	43.1%	28.5%	35.1%	23.5%	21.3%	32.2%	32.7%	28.0%	28.4%
Reagents & Disposables (as % of product sales)	44.1%	66.1%	64.1%	56.9%	71.5%	64.9%	76.5%	78.7%	67.8%	67.3%	72.0%	71.6%
Product sales as % of total revenues	94.3%	95.8%	94.5%	94.2%	94.1%	94.6%	95.6%	95.1%	95.3%	96.5%	95.7%	96.6%
Grants & Govt. Research Revenues	0.1%	0.9%	2.0%	1.7%	2.3%	1.8%	1.4%	1.5%	4.2%	1.0%	2.0%	1.0%
Contract, License and Royalty Revenues	5.6%	3.3%	3.5%	4.0%	3.6%	3.6%	3.0%	3.4%	0.5%	2.6%	2.3%	2.5%
Gross Profit	44.9%	45.2%	41.9%	39.7%	43.3%	42.5%	41.9%	39.2%	42.7%	43.0%	41.8%	45.5%
R&D	30.0%	23.0%	21.2%	23.3%	21.8%	22.3%	26.4%	26%	21%	20%	23%	22%
SG&A	30.5%	23.3%	23.6%	22.1%	20.3%	22.2%	25.5%	29%	22%	23%	24.8%	23.0%
Operating Expenses	126.4%	117.2%	116.5%	116.5%	113.9%	116.0%	126.4%	132%	115%	114%	121.0%	112.8%
Operating Income	-26.4%	-17.2%	-16.5%	-16.5%	-13.9%	-16.0%	-26.4%	-32%	-15%	-14%	-21.0%	-12.8%
Net Income	-26.1%	-17.7%	-17.0%	-16.0%	-13.7%	-16.0%	-24.7%	-25%	-10%	-10%	-16.6%	-10.5%

Source: Company reports and UBS estimates

Charles River Laboratories

Company Description

Charles River Laboratories is a leading supplier of research animal models (chiefly rats and mice) and outsourced pre-clinical and clinical contract research services to drug development and medical device companies.

Charles River Labs is a leading supplier of research animal models and the #2 pre-clinical CRO

In 2004, Charles River acquired Inveresk Research Group, a major contract research organization providing drug development services to the pharmaceutical and biotechnology industries. The merger created a new global business in the areas of research animal models, general and specialty toxicology testing and niche clinical development services.

In May 2006, Charles River announced a major restructuring and sold its non-core Phase II-IV clinical business. Concurrent to the sale, the company closed its underperforming Interventional Surgical Services division. As a result of these actions, the company now operate in two segments: 1) Research Models and Services (about 48% of estimated 2007 revenues) provides research animal models (chiefly laboratory mice and rats) and related services (e.g., transgenic services, laboratory staffing, endotoxin testing, pathogen-free egg production) for drug discovery and target validation; and 2) Preclinical Services (about 52% of estimated 2007 sales) provides contract research focused chiefly on general and specialty toxicology and Phase I clinical trial services.

Approximately 75% of the company's sales are to global pharmaceutical and biotechnology customers.

Investment Summary

Charles River Labs (CRL, Neutral 2)

In our view, the 2004 combination with Inveresk has improved Charles River's global CRO footprint and transformed the company into a leading provider of contract preclinical general and specialty toxicology services. We continue to believe the market for outsourced services will remain strong during the next 12 months. Charles River's Research Models and Services (RMS) business dominates the industry, with over 50% of the lab animal market, and has an unsurpassed reputation for quality.

We rate Charles River Labs Neutral 2

Despite the continued strength in Preclinical Services, we are concerned that these gains may not be sustainable. In addition, we believe the company could have problems bringing new preclinical capacity on line this year and in early 2007. Specifically, competition for talent is increasing, and in our view, the company's ongoing internal realignments and tightly controlled SG&A spending could lead to staffing delays. We also remain concerned about the weakness in Charles River's core research animal model business, as we do not see sales to certain large pharmaceutical rebounding in the near term. That said, we are intrigued by the new PTS endotoxin test, which could be a catalyst to help drive organic growth above our estimates.

Valuation

Our \$49 price target is about 20x our pro forma 2007 EPS estimate of \$2.53 (net of options). Our target PE is based on a blended average of about 19x for the life sciences group (for RMS) and 21x for the CROs (for Preclinical Services).

Our 12-month price target for CRL is \$49

3Q Review and Recent Events

Overall it was a second consecutive solid quarter for CRL. With results from Phase II-IV clinical and ISS businesses classified as discontinued operations, CRL reported 3Q06 sales of \$265 million (+9.0% y/y), generally in line with the UBS estimate of \$266 million and Street consensus estimate of \$264 million. Net of a positive 1.2% F/X impact, organic sales growth approximated 7.8%, in line with the UBS estimate of 8%. Adjusted EPS (net of \$0.02 option expenses) totaled \$0.56, above the UBS and Street estimates of \$0.54, as lower SG&A (13.6% versus the UBS estimate of 14.6%) and share count was partly offset by lower gross margins (38.6% versus the UBS estimate of 39.2%), and higher taxes (32.2% versus UBS estimate of 30%).

Table 31: Charles River 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Growth	3Q06 UBSe	First Call	Comments
RMS	\$128M	7.3%	\$127M		Continued weakness in transgenics and soft demand from certain large pharmaceutical accounts, were offset by a broad pickup from biotech/pharma customers and strength in in vitro products. Improved sales in N. America, Europe, and Japan
Preclinical	\$137M	10.6%	\$138.6M		Continued robust biotech and pharmaceutical outsourcing demand, stable pricing, benefits from new capacity that came on line in 2Q
Total Revenues (Continuing Ops)	\$265M	9.0%	\$266M	\$264M	7.8% organic growth. 1.2% F/X
Adj. Gross Margin	38.6%	-100bps	39.2%		Lower due to a sub-optimal Pre-clinical product mix, capacity constraints, costs associated with capacity expansion
RMS Gross Margin	41.1%	-90ps	41.0%		Lagging sales in transgenic services and large research models
Preclinical GM	36.4%	-80bps	37.5%		GM affected by unfavorable product mix
Adj. SG&A (% Rev)	15.6%	+20bps	16.8%		Lower due to expense reductions and a reversal from early adoption of accounting bulletin 108
Adj. Op. Margin	24.7%	-50bps	23.7%		Lower GMs were offset by lower SG&A expenses
Net Interest Exp.	(\$3.6M)	-	(\$4.1)		
Share count	68.05M	-5.3M	68M		Accelerated buy back, with 1.8M repurchased in 3Q for \$75M, and \$38.6M left
EPS Pro Forma	\$0.56	-	\$0.54	\$0.54	Net of \$0.02 option expenses

Source: Company reports, First Call, and UBS estimates

RMS net 3Q06 sales were \$127.6 million (+7.3% y/y), in line with our estimate of \$127.2 million. Research model sales continued to be affected by cost-cutting kept in place by several key large pharmaceutical accounts, although the decline in spending was reported to be less in 3Q than in 2Q. This weakness was also offset by a pickup in sales to other pharmaceutical and biotech clients, resulting in sales growth in Europe, Japan, and North America—with notable improvement in California biotech—and market share gains.

Sales of CRL's large research models (primates) increased y/y, but expectations of higher 2H06 sales were scaled back owing to the extension of a CDC-mandated quarantine period. Shipment delays will continue through December.

Transgenic Services sales also saw a y/y decline but q/q stability, while vaccines also improved on increased sales of laboratory products.

The in vitro unit reported double-digit sales growth, driven by strong demand for existing test kits and the new portable PTS system. CRL management conveyed its enthusiasm for the market reaction to the first-ever FDA-approved hand-held endotoxin detection device. The device appears to be well positioned to expand its use into multiple critical applications, including environmental, bio-manufacturing, and process analytics, with a potential market size estimated at \$200 million (from \$60-70 million today). We view EndoSafe-PTS as a potential upside driver of organic growth and RMS margins.

As expected, CRL saw a decline in the RMS gross margin (to 41.1% from 42% in the prior year; we had estimated 41.0%) as a result of slow Transgenic Services business, a delivery cost increase, and unfavorable changes in sales mix. For 2H06, CRL expects low-single-digit growth based on 4Q seasonality, tough comparisons with 4Q05, and a lag in Transgenic and large research model sales, but management maintains a positive long-term outlook.

In 3Q, Preclinical Services sales grew 10.6% y/y to \$137 million, just below the UBS estimate of \$138.6 million. Performance was driven by factors similar to those seen in 2Q06, as demand for outsourced services remained strong while capacity was added and prices remained stable. The Preclinical gross margin was 36.4%, down from 37.2% in the prior year and 37.7% the prior quarter and below our estimate of 37%. The lower than expected gross margin was chiefly due to a sub-optimal sales mix relative to 2Q06's mix, which had a greater percentage of specialty toxicology projects. In 2007, CRL hopes to maintain flat Preclinical margins in the face of new capacity coming on line during the year.

Plans to expand Preclinical capacity appear to be on target, as CRL's new facilities in Shrewsbury, Massachusetts, and Reno, Nevada, are currently set to open as scheduled. As the Shrewsbury location comes on line for validation in 4Q06, CRL will operate its toxicology business in Worcester, Massachusetts, and in the new facility for two or three years to minimize disruption and comply with FDA guidelines regarding the movement of in-progress studies. The Reno site is scheduled to open in mid-2007. While multiple locations may put some pressure on margins, management remains confident that this will be short-lived and will be offset by gains in efficiency and capacity utilization.

Higher tax payments were recorded during 3Q, as the GAAP tax rate increased to 32.3% (versus the UBS estimate of 29.5%) from 28.9% a year earlier, while the non-GAAP rate increased to 32.1% from 29.3% the year before. This change resulted from the recording of a German tax reserve, a tax expense related to out-of-period adjustments during 3Q, and a reduction of tax expense related to the completion of a statutory tax audit. In light of these discrete items, the full-year tax rate is now estimated at 28-28.5% for GAAP (down from 28.5%) and 29-29.5% for non-GAAP (down from 29.5%).

CRL ended 3Q06 with \$253.5 million cash and marketable securities, and total long-term debt of \$576 million. Year-to-date, CRL generated free cash flow at approximately \$3 million, compared with \$75.2 million for the first nine months in 2005, due to 1) a higher tax payment in 1Q06 for repatriated profits generated in 2005; 2) a reduction in deferred revenue; 3) an increase in pre-paid expenses; and 4) an increase in capital expenditures (\$99.8 million YTD versus \$69.2 million for 9M05) as the company ramped up its RMS and Preclinical Services facility expansion. With total capex guidance of about \$175 million for the year, CRL expects to generate total FCF of about \$25-50 million by year-end.

CRL continued its accelerated stock repurchase, as it bought back 1.8 million shares in 3Q for \$70 million as part of a plan implemented in late 2Q06. Under the current \$300 million authorization, about 6.4 million shares have been repurchased at a cost of \$261 million. At the end of 3Q06, CRL had around 66.9 million shares outstanding. The company currently has approximately \$38.6 million available under the repurchase authorization program and we expect it to complete the share buyback by the end of 2006.

Company Guidance

Management reiterated its full-year 2006 guidance for net revenue growth of 6-8% to \$1.05-1.075 billion and non-GAAP EPS (net of option expenses) of \$2.12-2.18. CRL now expects a full-year non-GAAP tax rate of 29-29.5% (versus prior 28.5-29.5% guidance), as a result of higher than expected tax expenses in 3Q related to a tax gain from sales of its clinical business. Net interest expenses are now expected to approximate \$12-13 million, below prior guidance of \$15 million due to higher interest income on a projected increase in cash balances.

For 4Q06, CRL expects total revenue growth to be negatively affected by the extra week recorded in 4Q05 (52 weeks in 4Q06 versus 53 weeks in 4Q05). As a result, the company expects 4Q06 revenue growth to be reduced 3-5% y/y.

CRL will host a conference call on December 14, when it is expected to provide 2007 financial guidance for the first time.

UBS Estimates

For 4Q06, we slightly raised our RMS sales forecast to \$130.6 million (+4% y/y) from our prior estimate of \$128.1 million, with gross margins of 40.0%. For Preclinical Services, we now expect 4Q06 sales of \$143.2 million (versus our prior estimate of \$146.0 million), which accounts for the extra-week difference between 4Q06 and 4Q05. We estimate the 4Q06 Preclinical gross margin at 36.4%, and we estimate 4Q EPS of \$0.58, up from our prior estimate of \$0.55, reflecting a lower share count, tax rate, and stock option expense. For CY06, we now forecast total revenues of \$1.060 billion versus our prior estimate of \$1.062 billion and adjusted EPS of \$2.17 (net of \$0.10 options) versus our prior estimate of \$2.14 (net of \$0.13 options).

For 2007, we expect RMS business to grow 5% y/y, due to: 1) stabilization of the large pharmaceutical accounts (particularly in 2H07); 2) continuing strength of in vitro products; and 3) still-solid demand from biotech. For Preclinical Services, we expect outsourcing trends to remain robust, the fully operational Shrewsbury facility to be fully on line by early 2007, and newly acquired Northwest Kinetics (\$10-15 million in 2007) to be the growth drivers. As such, we expect Preclinical sales to grow 13% y/y in 2007. In total, we now project 2007 revenues at \$1.157 billion (+9.1% y/y) versus our prior estimate of \$1.145 billion (+7.9% y/y).

We expect 2007 gross margins to be flat with 2006, at 38.6%, as RMS may continue to experience further softness. Preclinical should see a modest improvement thanks to volume and capacity expansion and product mix. We now project an adjusted operating margin of 22.3% versus our prior estimate of 22.9%, partially owing to prospects for higher adjusted SG&A (15.3% versus our prior estimate of 14.9%) as CRL maintains the temporary operation of two facilities in Massachusetts as the transition from the Worcester facility to the Shrewsbury facility might take two or three years. Assuming a lower estimated tax rate of about 28.5% versus our prior estimate of 30%, our new pro forma 2007 EPS estimate (net of \$0.12 of options versus our prior estimate of \$0.14) is \$2.53 versus our prior estimate of \$2.42.

Table 32: CRL 2006 Estimates (revenues in \$ millions)

	4Q 2006			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	\$274 (+6.1%)	\$270	-	\$1060 (+6.8%)	\$1064
EPS (net of options)	-	\$0.58	\$0.57	-	\$2.17	\$2.18

Source: Company reports, First Call, and UBS estimates

Recent Events

On October 30, CRL announced the acquisition of Northwest Kinetics (NK), a private Phase I clinical services provider. Based in Tacoma, NK adds 150 beds (and is in the process of adding 100 more), and complements CRL's Edinburgh facility. By year-end CRL will have more than 300 beds. This deal is not surprising given management's prior comments on its intention to expand the Phase I business. CRL paid \$29.5 million for NK; no other financial details were given. CRL expects the deal to be neutral to 2006 GAAP EPS and slightly accretive to 2007 pro forma EPS.

Table 33: Charles River Earnings Model, 2004-07E

Fiscal year ended December 31

In millions except for per share data

	2004A				2005A				2006E		2007E	
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QE	4QE	FY	FY
Revenues												
Research Models and Services (RMS)	476.67	127.91	130.77	118.88	125.60	503.17	128.97	130.82	127.20	128.11	515.11	535.71
Pre-Clinical	265.97	113.50	120.12	123.95	132.60	490.16	125.17	137.04	140.06	145.86	548.13	611.16
Clinical	24.27					0.00						
Total Net Sales	766.91	241.41	250.89	242.83	258.20	993.33	254.14	267.86	267.26	273.97	1,063.23	1,146.87
Cost of Goods Sold												
Research Models and Services (RMS)	269.87	71.35	73.04	68.90	74.35	287.63	73.11	75.34	75.05	76.87	300.36	318.21
Pre-Clinical	179.74	74.00	76.24	77.85	87.90	315.99	85.53	85.41	87.54	91.89	350.37	383.20
Clinical	18.73					0.00						
Total Cost of Goods Sold	468.35	145.34	149.29	146.75	162.24	603.62	158.64	160.75	162.59	168.76	650.73	701.41
SG&A	121.45	39.04	41.07	37.41	40.49	158.00	39.73	41.83	41.90	41.66	165.12	182.97
Amortization of Purch. Intangibles	12.10	11.60	11.48	11.50	12.43	47.01	9.08	9.38	10.25	10.25	38.95	32.50
Amortization of Other Intangibles	4.69					0.00					0.00	
One-time charges (Repairment, Restructuring, etc)								5.30			5.30	
Stock Option expense							3.00	2.90	3.00	3.00	11.90	12.00
Operating Expenses	606.59	195.98	201.83	195.66	215.16	808.63	210.45	220.16	217.74	223.67	872.01	928.88
Operating Income	160.32	45.43	49.06	47.17	43.04	184.69	43.70	47.70	49.53	50.31	191.23	217.99
Net Interest (Expense)	(9.22)	(6.29)	(4.81)	(3.87)	(5.67)	(20.63)	(3.02)	(3.66)	(4.10)	(4.35)	(15.13)	(17.00)
Other Income (expense)	0.72	0.35	(0.60)	(0.52)	0.60	(0.18)	0.05	(0.74)	0.00	0.00	(0.69)	(0.50)
Pre-tax Income	152.52	39.48	43.65	42.78	37.97	163.89	40.73	43.31	45.43	45.96	175.41	200.49
Tax	(61.16)	(10.65)	(12.22)	(12.35)	18.97	(16.26)	(11.81)	(9.87)	(13.40)	(13.56)	(48.64)	(60.15)
Minority interest and equity investment	(1.58)	(0.49)	(0.42)	(0.54)	(0.39)	(1.84)	(0.40)	(0.65)	(0.50)	(0.50)	(2.06)	(2.00)
Income (loss) from discontinued business		(0.70)	0.85	2.18	(6.13)	(3.79)	(128.63)	(7.03)			(135.66)	
Net income (GAAP)	89.79	27.65	31.86	32.07	50.42	142.00	(100.12)	25.749	31.525	31.899	(10.94)	138.35
Add back:												
Amortization of Purch. Intangibles	8.31	10.78	10.61	10.67	11.60	43.67	8.26	8.53	7.23	7.23	31.24	22.75
Converts interest expense	4.13	1.17		0.00	0.00	1.17						
One-time charges, Discontinued ops & Option expenses	8.60	3.37	1.82	(0.32)	(17.68)	(12.81)	128.30	8.81			137.11	9.31
Net income (Continuing operations, pro forma)	110.79	42.96	44.29	42.43	44.34	174.02	36.44	43.09	38.75	39.12	157.41	170.41
EPS (GAAP)	1.68	0.38	0.44	0.44	0.69	1.96	0.39	0.46	0.46	0.48	1.78	2.08
EPS Continuing Operations (ex-options)	1.98	0.59	0.61	0.58	0.61	2.38	0.50	0.60	0.57	0.58	2.25	2.56
Stock Option expense		0.06	0.06	0.06	0.06	0.24	0.03	0.03	0.03	0.03	0.12	0.14
EPS (pro forma), net of option expenses		0.53	0.55	0.52	0.55	2.14	0.47	0.57	0.54	0.55	2.13	2.42
Diluted weighted average shares outstanding	56.05	72.53	72.92	73.37	73.16	72.99	72.89	71.84	68.00	67.00	69.93	66.50

As a percentage of revenues:

Research Models and Services (RMS)	62.2%	53.0%	52.1%	49.0%	48.6%	50.7%	50.7%	48.8%	47.6%	46.8%	48.4%	46.7%
Pre-Clinical	34.7%	47.0%	47.9%	51.0%	51.4%	49.3%	49.3%	51.2%	52.4%	53.2%	51.6%	53.3%
Clinical	3.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Overall Gross Profit	38.9%	39.8%	40.5%	39.6%	37.2%	39.2%	37.6%	40.0%	39.2%	38.4%	38.8%	38.8%
Segment gross margin:												
Research Models and Services (RMS)	44.3%	44.2%	44.1%	42.0%	40.8%	42.8%	43.3%	42.4%	41.0%	40.0%	41.7%	40.6%
Pre-Clinical	32.4%	34.8%	36.5%	37.2%	33.7%	35.5%	31.7%	37.7%	37.5%	37.0%	36.1%	37.3%
Clinical	22.8%											
SG&A, Reported	15.8%	16.2%	16.4%	15.4%	15.7%	15.9%	16.8%	18.7%	16.8%	16.3%	17.1%	17.0%
SG&A, Adjusted	14.3%	14.9%	15.3%	14.9%	10.4%	13.8%	14.5%	16.5%	14.6%	14.1%	14.9%	14.9%
Operating Expenses	79.1%	81.2%	80.4%	80.6%	83.3%	81.4%	82.8%	82.2%	81.5%	81.6%	82.0%	81.0%
Operating Income, GAAP	20.9%	18.8%	19.6%	19.4%	16.7%	18.6%	17.2%	17.8%	18.5%	18.4%	21.6%	21.8%
Operating Income, Adjusted	24.1%	24.3%	24.1%	24.7%	26.8%	25.0%	21.7%	24.1%	23.5%	23.2%	23.1%	22.9%
Pre-Tax Income	19.9%	16.4%	17.4%	17.6%	14.7%	16.5%	17.2%	19.2%	18.1%	17.9%	18.1%	18.5%
GAAP tax rate	40.1%	27.0%	28.0%	28.9%	-49.9%	9.9%	29.0%	22.8%	29.5%	29.5%	27.7%	30.0%
Net Income Reported	11.7%	11.5%	12.7%	13.2%	19.5%	14.3%	-39.4%	9.6%	11.8%	11.6%	-1.0%	12.1%
Net Income Adjusted	14.4%	17.8%	17.7%	17.5%	17.2%	17.5%	14.3%	16.1%	14.5%	14.3%	14.8%	14.9%

Year-over-year change

Research Models and Services (RMS)	11.3%	7.1%	8.9%	0.7%	5.5%	5.6%	0.8%	0.03%	7.0%	2.0%	2.4%	4.0%
Pre-Clinical	43.3%	113.5%	99.8%	114.0%	39.9%	84.3%	10.3%	14.1%	13.0%	10.0%	11.8%	11.5%
Clinical	NA					-100.0%						
Total Net Sales	25.0%	39.8%	39.2%	38.0%	8.5%	29.5%	5.3%	6.8%	10.1%	6.1%	7.0%	7.9%
Cost of sales	23.2%	40.0%	41.4%	37.6%	6.5%	28.9%	9.1%	7.7%	10.8%	4.0%	7.8%	7.8%
Selling, general, & administrative	35.7%	38.8%	40.6%	50.7%	3.0%	30.1%	1.8%	1.9%	12.0%	2.9%	4.5%	10.8%
Operating Expenses	27.9%	47.2%	48.4%	47.5%	5.0%	33.3%	7.4%	9.1%	11.3%	4.0%	7.8%	6.5%
Operating Income	15.1%	15.0%	11.0%	8.8%	29.5%	15.2%	-3.8%	-2.8%	5.0%	16.9%	3.5%	14.0%
Pretax Income	15.0%	3.1%	1.9%	1.7%	29.4%	7.5%	3.2%	-0.8%	6.2%	21.0%	7.0%	14.3%
Provision for income taxes	19.8%	-47.1%	-23.9%	-21.7%	-306.8%	-73.4%	10.9%	-19.3%	8.5%	-171.5%	199.1%	23.7%
Net income Adjusted	30.2%	76.2%	62.3%	58.2%	37.3%	57.1%	-15.2%	-2.7%	-8.7%	-11.8%	-9.5%	8.3%
EPS adjusted for extraordinary items	19.3%	26.7%	17.0%	13.3%	25.8%	20.6%	-15.6%	-1.2%	-1.4%	-3.7%	-5.6%	13.8%

Source: Company reports and UBS estimates

Invitrogen

Company Description

Invitrogen is the leading supplier of molecular biology and cell culture products. The company develops, manufactures, and markets more than 20,000 products to academic research, biotechnology, and pharmaceutical customers. Most of Invitrogen's molecular biology products are consumables sold as premium-priced research kits. By packaging the necessary reagents together into a single quality-controlled kit, Invitrogen's products help accelerate the discovery process by reducing experimental uncertainty.

Invitrogen is the leading supplier of molecular biology and cell culture products

Invitrogen has significantly broadened its product offerings through a number of key acquisitions, including Molecular Probes (cell biology and proteomics tools), PanVera (drug screening tools), Sequitor (RNAi), BioReliance (preclinical and bioproduction services), Protometrix (protein array technology), and the 2006 acquisitions of Zymed and Caltag Labs (both for antibody technologies), Dynal (magnetic particle technology), BioSource (signal transduction assays and cytokines), and Quantum Dots (nanoparticles for biomolecular and cellular imaging).

A number of key acquisitions positions Invitrogen for long-term growth

Broken out by product mix, about 62% of Invitrogen's total 2005 revenues were from BioDiscovery (molecular biology products), with 38% from BioProduction (cell culture products). In terms of customers, about 50% of BioDiscovery sales are to academic and government researchers, and about 50% are to commercial clients such as pharmaceutical and biotech companies. On the BioProduction side, about 60% of Invitrogen's cell culture sales are to academic and industrial researchers, whereas the other 40% are to industrial bioproduction. Invitrogen's geographic revenue breakdown in 2005 was approximately 55% from the Americas, 30% from Europe, and 15% from the Asia/Pacific region.

Investment Summary

Invitrogen (IVGN, Neutral 2)

After falling short in 1Q and lowering expectations, hosting a bullish analyst day in mid-June, and then missing 2Q and lowering 2006 guidance in July, Invitrogen had another miss in 3Q and cut its guidance again.

We rate Invitrogen Neutral 2

We had previously recommended Invitrogen on the strength of the brand and such factors as the company's status as a leading supplier of proprietary high-margin life sciences reagents, its record for product innovation, growing demand for biologic manufacturing (from which the company would benefit as the leading supplier of cell culture products), and strong cash flow. However, we reconsidered our position on IVGN in view of management's lack of visibility and poor execution, combined with deteriorating cash flows, eroding margins, sales force disarray, manufacturing problems, ERP changeover issues, concerns about share loss, increasing competition, poor integration of prior deals, and possible near-term delays in NIH funding.

In our view, 3Q leaves too many unanswered questions, and we are skeptical of current management's ability to identify, isolate, and fix the problems in a timely manner. Indeed, the manufacturing and other problems related to the 350-bp q/q decline in the 3Q gross margin will linger at least through 4Q, but 2007 may also be at risk. Prior concerns about the cell culture business and ERP implementation are now compounded by worries that the core molecular biology business is losing share. As such, we downgraded our rating on IVGN shares to Neutral 2 from Buy 2 until the situation shows signs of stabilizing.

We continue to believe there is much intrinsic value in the Invitrogen franchise. And, in our view, though Invitrogen may have acquired too much too fast, the deals made strategic sense and should enhance the business as synergies are finally realized.

Valuation

IVGN shares now trade at about 16.5x our 2007 pro forma EPS estimate of \$3.40 (including \$0.52 in option expense) versus the group average of about 19x. Our 12-month price target of \$66 is 19x our 2007 EPS estimate and is supported by a DCF analysis using the UBS VCAM models, a 4% terminal growth rate, and WACC of 8.5%, which implies a one-year price of \$66-70 per share.

Our 12-month price target for IVGN shares is \$66

3Q Review and Recent Events

IVGN's 2Q06 results were disappointing, as BioProduction delays, dramatic declines in serum pricing, and operational glitches in implementing the ERP system in Europe took their toll. This time around, 3Q uncovered additional concerns about the health of the business.

For 3Q06, IVGN reported total revenues of \$311 million (up 7% y/y—3% organic and 7% from acquisitions, divestitures, and FX), generally in line with UBS and Street estimates of \$311 million.

BioDiscovery revenues of \$201.1 million (+10% y/y) were generally in line with the UBS estimate of \$200 million. However, excluding the impact of F/X and acquisitions, BioDiscovery achieved only about 2% organic growth, below the UBS estimate of 5%. Management blamed lower than expected organic growth on weakness in Japan and less than anticipated growth from certain acquisitions. This less than optimal growth is possibly due to a mix of factors, including 1) misalignment of the sales force to optimize portfolio to customers; 2) lingering issues concerning integration of prior acquisitions; and 3) stiffer competition and possible share loss in both the U.S. and Japan.

Table 34: Invitrogen 3Q06 Income Statement Highlights

	3Q06A	Y/Y Change	3Q05 UBSe	FC Consensus	Comments
BioDiscovery	\$201.2M	9.5%	\$200M	--	+2% organic growth; growth in cellular and protein analysis partially offset by less than anticipated contributions from acquisitions and weakness in Japan
BioProduction	\$109.9M	2.0%	\$111M	--	4% organic growth of Cell Culture Systems partially offset by poor sera sales
Total Revenues	\$311M	6.9%	\$311M	\$311M	7% growth; 3% organic, 1% F/X related
Pro forma Gross Margin	58%	-400bp	61.1%	--	BioDiscovery margin and overall gross margin were below estimates, due to product mix issues and manufacturing costs
S&M (% Rev)	18.2%	+70bp	19.7%	--	Higher due to ERP implementation costs
R&D (% Rev)	10.8%	-80bp	8.1%	--	Realignment of cost structure will keep R&D flat
G&A (% of Rev)	9.2%	-170bp	10.5%	--	Expect G&A costs to decline in the wake of cost controls
Pro forma Operating Margin	22.0%	-160bp	22.8%	--	-
Net Interest Exp.	\$0.6M	--	\$0.5M	--	-
Adj. Tax Rate	30.5%	+50bp	32.0%	--	-
Pro Forma EPS	\$0.87	-	\$0.75	\$0.78	9% y/y increase mainly due to buyback of 4.7 million shares

Source: Company reports, First Call, and UBS estimates

Also of concern was that BioDiscovery gross margins, at 65%, came in well below our 70% estimate owing to higher manufacturing costs (production variance as facilities consolidation continues, at about 200 bps), a shift in mix toward lower-margin products (around 200 bps), lower pricing (50 bps), lower royalties (50 bps), and several one time items (roughly 100 bps).

BioProduction sales totaled \$110 million, in line with our estimate. Organic growth amounted to 4% despite declining sales of FBS; BioReliance recovered slightly. BioProduction gross margins of 47.7% rebounded to beat our estimate of 45.2%. This improvement was dampened, however, by significant erosion of overall margins (to 58.2% versus the UBS estimate of 61.1%).

As a result of significant gross margin erosion in 3Q, IVGN's adjusted operating margin of 22% was below the UBS estimate of 22.8%. Excluding the impact of stock options, pro forma EPS totaled \$0.87 versus our estimate of \$0.89. In 3Q06, IVGN booked \$0.15 per share related to option expenses versus the UBS estimate of \$.14/share. Net of option expenses, IVGN's pro forma EPS were \$0.72 versus the UBS estimate of \$0.75 and Street consensus estimate of \$0.78. In 3Q, IVGN aggressively bought back 4.7 million shares at a cost of \$287 million.

At the end of 2Q the company began a full review of its product portfolio, which is now largely complete. Some divestitures may occur, but management has not made a firm decision. The company will use the proceeds from any sales to repurchase shares so the event will be EPS neutral. That said, management noted that it is likely to hold onto the underperforming industrial Serum business but will reduce the amount of collection (and thus inventory) going forward.

Management also commented on several execution missteps that led to poor financials and raised questions about the company's future direction. The

expectation of higher (6-10%) growth rates had caused IVGN to scale up costs to meet demand that never materialized. In addition, integration of business units has been difficult to achieve on the heels of both multiple acquisitions in 2005 and transitions to new IT systems. For example, the company is consolidating its three antibody manufacturing facilities into one, moving to one ERP system from more than 10, and moving Biosource inventory to distribution centers on both the East and West Coasts.

Finally, increased pressure from IVGN's life sciences peers appears to have been compounded by aforementioned product mix issues stemming from sales force miscommunications regarding the products being sold in certain regions. Misguided sales force incentives and poor pricing discipline have added to the margin weakness responsible for bottom-line contraction. It is believed by management that compensation restructuring and territory realignment are needed to correct this issue. While working to address these issues, we believe the company's difficult circumstances may be compounded by the recent MIL-SERO and TMO-Fisher mergers, as well as better focus from SIAL.

Company Guidance

Invitrogen management lowered its guidance for the third time since the December 2005 analyst meeting. IVGN now expects flat q/q growth in 4Q revenues to \$310-315 million versus the UBS estimate of \$338 million. It is difficult for us to imagine a tool company not growing from the September to the December quarter given the typical year-end budget flush by most labs. Although we hope IVGN is simply being conservative, we are worried that this guidance implies deeper problems.

Management does not expect the gross margin to rebound soon. However, it still "believes" that the company could see 100 bps of operating margin improvement in 2007 due to facility closures and workforce reductions. We expect IVGN to announce plans in the near future.

With interest expenses of \$8 million, interest income of \$3.5 million, and a 31.5% tax rate, the company now forecasts 4Q06 pro forma EPS to be "consistent" with 3Q06 EPS, at \$0.70-0.75 (net of \$0.15 options).

By the end of 3Q, IVGN had \$513 million cash and cash equivalents and \$1.33 billion in convertible debt, as well as approximately \$200 million remaining on its share repurchase program, effectively for about three years. Having aggressively bought back shares in 3Q, Invitrogen's repurchase rate will probably slow down in 4Q. In 9M06, IVGN achieved total cash flow from operations of \$129 million. With capex of \$44 million, free cash flow totaled \$84 million.

UBS Estimates

We have lowered our revenue estimates to \$1.246 billion for 2006 and \$1.310 billion for 2007 from prior respective estimates of \$1.272 billion and \$1.340 billion. For BioDiscovery, we project gross margins of 66.8% for 2006 and 66.5% for 2007, versus our prior estimates of 69.7% and 70%. For BioProduction, we have slightly raised our gross margin forecasts to 47.4% for 2006 and 47% for 2007 from prior estimates of 46.4% and 46.5%. As a result, we now project adjusted operating margins of 22.6% and 23.2%, down from prior estimates of 23.9% and 25%. We now forecast adjusted EPS at \$2.97 for 2006 (net of \$0.58 options) and \$3.40 for 2007 (net of \$0.52 options), down from our prior estimates of \$3.27 and \$3.85, respectively.

Table 35: IVGN 2006 Estimates (revenues in \$ millions)

	4Q 2006			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	\$313(-3.9%)	\$314	-	\$1246 (4%)	\$1247
EPS (net of options)	-	\$0.73	\$0.72	-	\$2.97	\$2.96

Source: Company reports, First Call, and UBS estimates

Table 36: Invitrogen Earnings Model, 2004-07E

Dollars in thousands, except per share data												
Fiscal year ended December 31												
	2004A					2005A					2006E	2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
Revenues												
BioDiscovery	591,417	162,351	185,422	181,985	206,841	736,599	203,459	204,763	201,161	202,500	811,883	855,000
BioProduction	432,434	114,730	121,034	107,654	118,435	461,853	105,545	108,874	109,882	110,000	434,301	455,000
Total Revenues	1,023,851	277,081	306,456	289,639	325,276	1,198,452	309,004	313,637	311,043	312,500	1,246,184	1,310,000
Cost of BioDiscovery Revs	175,664	46,196	54,466	54,763	65,324	220,749	62,375	61,207	72,548	73,710	269,840	286,425
Cost of BioProduction Revs	222,441	59,532	62,826	56,530	65,440	244,328	54,015	59,247	57,426	57,750	228,438	241,150
Unallocated Costs	17,897	694	11,254	5,222	13,119	30,289	2,957	2,609	1,032	-	6,598	-
Total Cost of Sales	416,002	106,422	128,546	116,515	143,883	495,366	119,347	123,063	131,006	131,460	504,876	527,575
Overall Gross Margin	607,849	170,659	177,910	173,124	181,393	703,086	189,657	190,574	180,037	181,040	741,308	782,425
Operating Expenses												
Sales and marketing	180,663	48,480	56,294	52,644	56,156	213,574	58,980	62,359	58,693	58,438	238,470	245,625
General and administrative	110,656	30,004	31,999	31,142	36,683	129,828	32,109	34,156	28,317	28,438	123,020	128,380
Research and development	73,116	21,241	24,263	26,400	27,395	99,299	27,852	25,542	25,772	25,313	104,479	104,800
Amortization of purch intangibles	106,821	25,901	29,866	29,509	30,043	115,319	29,952	29,476	179,310	30,750	269,488	125,000
Purchased in-process R&D	728	1,200	12,686	-	3,160	17,046	-	-	-	-	-	-
Business integration costs	-	-	-	-	960	-	2,131	3,268	2,644	-	8,043	-
Total Operating Expenses	471,984	126,826	155,108	139,695	154,397	575,066	151,024	154,801	294,736	142,938	743,499	603,805
Operating Income	135,865	43,833	22,802	33,429	26,996	128,020	38,633	35,773	(114,699)	38,103	(2,191)	178,620
Add: Amort of purchased intangibles	106,821	25,901	29,866	29,509	30,043	115,319	29,952	29,476	179,310	30,750	269,488	125,000
Add: Business integration costs	-	-	-	-	960	-	2,131	3,268	2,644	-	8,043	-
Add: Amort of inv revaluation/other unallocated	17,897	694	11,254	5,222	13,119	30,289	2,957	2,609	1,032	-	6,598	-
Add: In-process R&D	728	1,200	12,686	-	3,160	17,046	-	-	-	-	-	-
Add: Deferred comp option related expenses	1,150	288	287	289	284	1,148	-	-	-	-	-	-
Add: Goodwill	-	-	-	-	-	-	-	-	-	-	-	-
Operating Income - Adjusted	262,461	71,916	76,895	68,449	74,562	291,822	73,673	71,126	68,287	68,853	281,939	303,620
Add: Other one-time gains	-	(20,123)	-	-	(25,485)	(45,608)	-	-	-	-	-	-
Interest income	25,271	5,876	5,000	7,593	6,000	24,469	6,400	7,925	7,471	3,500	25,296	16,000
Interest expense	(32,203)	(7,258)	(9,000)	(9,129)	(9,000)	(34,387)	(8,300)	(8,108)	(8,089)	(8,000)	(32,497)	(33,500)
Add: Int. exp. related to \$500M debt due 2006	9,461	2,382	2,018	1,825	1,670	7,895	189	176	120	125	610	-
Interest expense (net of convertible debt interest)	(22,742)	(4,876)	(6,982)	(7,304)	(7,330)	(26,492)	(8,111)	(7,932)	(7,969)	(7,875)	(31,887)	(33,500)
Other income	(7,557)	25,673	1,607	1,553	27,719	56,552	454	658	(1,821)	-	(709)	-
Total other income - Adjusted	(5,028)	26,673	(375)	1,842	26,389	54,529	(1,257)	651	(2,319)	(4,375)	(7,300)	(17,500)
Income before taxes	130,837	70,506	22,427	35,271	53,385	181,589	37,376	36,424	(117,018)	33,728	(9,491)	161,120
Income before taxes - Adjusted	257,433	78,466	76,520	70,291	75,466	300,743	72,416	71,777	65,968	64,478	274,639	286,120
Provision for income taxes - GAAP	32,551	21,050	5,639	9,579	2,121	38,389	8,394	7,961	3,292	7,420	(1,507)	35,446
Provision for income taxes - Adjusted	81,881	25,183	23,801	21,813	22,957	93,754	23,112	22,625	20,101	20,310	86,104	90,128
Minority interest	-	-	-	-	-	-	-	-	-	-	-	-
Net Income - GAAP	98,286	49,456	16,788	25,692	51,264	143,200	28,982	28,463	(120,310)	26,307	(7,984)	125,674
Net Income - Adjusted	175,552	53,283	52,719	48,478	52,509	206,989	49,304	49,152	45,867	44,167	188,534	195,992
EPS - GAAP	1.52	0.82	0.28	0.42	0.87	2.39	0.53	0.52	(2.29)	0.52	(0.15)	2.51
EPS adjusted	2.91	0.88	0.87	0.80	0.90	3.45	0.90	0.90	0.87	0.88	3.55	3.92
Stock Option Expense							0.13	0.15	0.15	0.15	0.58	0.52
EPS adjusted, including option expense							0.77	0.75	0.72	0.73	2.97	3.40
Shares out. (000s), diluted pro forma	60,396	60,229	60,461	60,704	58,661	60,014	54,822	54,824	52,585	50,200	53,108	50,000
YEAR-OVER-YEAR GROWTH												
BioDiscovery Segment	18.2%	6.3%	29.7%	24.0%	38.8%	24.5%	25.3%	10.4%	10.5%	-2.1%	10.2%	5.3%
BioProduction Segment	56.0%	16.3%	9.1%	-1.8%	4.6%	6.8%	-8.0%	-10.0%	2.1%	-7.1%	-6.0%	4.8%
Total Revenues	31.6%	10.2%	20.7%	13.0%	24.0%	17.1%	11.5%	2.3%	7.4%	-3.9%	4.0%	5.1%
Cost of total revenues	34.9%	-2.7%	19.1%	17.5%	44.4%	19.1%	12.1%	-4.3%	12.4%	-8.6%	1.9%	4.5%
Gross Profit	29.5%	20.2%	21.8%	10.1%	11.5%	15.7%	11.1%	7.1%	4.0%	-0.2%	5.4%	5.5%
Sales and marketing	16.9%	6.7%	30.1%	15.4%	21.2%	18.2%	21.7%	10.8%	11.5%	4.1%	11.7%	3.0%
General and administrative	24.7%	11.0%	22.1%	12.8%	23.0%	17.3%	7.0%	6.7%	-9.1%	-22.5%	-5.2%	4.4%
Research and development	33.9%	34.9%	33.7%	37.4%	37.0%	35.8%	31.1%	5.3%	-2.4%	-7.6%	5.2%	0.3%
Total operating expenses	24.2%	8.9%	33.0%	19.0%	27.1%	21.8%	19.1%	-0.2%	111.0%	-7.4%	29.3%	-18.8%
Operating Income	51.9%	71.7%	-22.4%	-16.0%	-34.4%	-5.8%	-11.9%	56.9%	-443.1%	41.1%	-101.7%	-8254.3%
Net Income	37.5%	41.1%	19.1%	7.4%	10.3%	17.9%	-7.5%	-6.8%	-5.4%	-15.9%	-8.9%	4.0%
EPS adjusted	30.2%	39.8%	17.9%	3.8%	11.8%	18.7%	1.7%	2.8%	9.2%	-1.7%	2.9%	10.4%
AS A PERCENTAGE OF REVENUES												
BioDiscovery Segment	57.8%	58.6%	60.5%	62.8%	63.6%	61.5%	65.8%	65.3%	64.7%	64.8%	65.1%	65.3%
BioProduction Segment	42.2%	41.4%	39.5%	37.2%	36.4%	38.5%	34.2%	34.7%	35.3%	35.2%	34.9%	34.7%
BioDiscovery Gross Margin	70.3%	71.5%	70.6%	69.9%	68.4%	70.1%	69.3%	70.1%	63.9%	63.6%	66.8%	66.5%
BioProduction Gross Margin	48.6%	48.1%	48.1%	47.5%	44.7%	47.1%	48.8%	45.6%	47.7%	47.5%	47.4%	47.0%
Overall Gross Margin - Adjusted	61.1%	61.8%	61.7%	61.6%	59.8%	61.2%	62.3%	61.6%	58.2%	57.9%	59.5%	59.7%
Sales and Marketing	17.6%	17.5%	18.4%	18.2%	17.3%	17.8%	19.1%	19.9%	18.9%	18.7%	19.1%	18.8%
General and Administrative	10.8%	10.8%	10.4%	10.8%	11.3%	10.8%	10.4%	10.9%	9.1%	9.1%	9.9%	9.8%
Research and Development	7.1%	7.7%	7.9%	9.1%	8.4%	8.3%	9.0%	8.1%	8.3%	8.1%	8.4%	8.0%
Operating Expenses	46.1%	45.8%	50.6%	48.2%	47.5%	48.0%	48.9%	49.4%	94.8%	45.7%	59.7%	46.1%
Adjusted Operating Margin	25.6%	26.0%	25.1%	23.6%	22.9%	24.3%	23.8%	22.7%	22.0%	22.0%	22.6%	23.2%
Tax Rate - GAAP	24.9%	29.9%	25.1%	27.2%	4.0%	21.5%	22.5%	21.9%	-2.8%	22.0%	15.9%	22.0%
Tax Rate - adjusted	31.8%	32.1%	31.1%	31.0%	30.4%	31.2%	31.9%	31.5%	30.5%	31.5%	31.4%	31.5%
Net Income	17.1%	19.2%	17.2%	16.7%	16.1%	17.3%	16.0%	15.7%	14.7%	14.1%	15.1%	15.0%

Source: Company reports and UBS estimates

Mettler-Toledo International

Company Description

Mettler-Toledo is the world's largest manufacturer of precision weighing instruments for use in laboratory, industrial, and retail applications. With headquarters on the outskirts of Zurich, Switzerland, it is the leader in the \$3-4 billion global weighing instruments market, with an estimated share more than twice that of its nearest competitor. Mettler-Toledo has also expanded into higher-growth complementary product areas such as laboratory analytical instruments, process analytics, pipettes, and automated chemistry systems. In addition, the company's industrial and retail products focus on high-value-added market segments, such as logistics/shipping, packaging, inventory and process control, and product safety. Mettler-Toledo's products address a wide customer base, which includes pharmaceuticals, food and beverage production, food retailing, transportation, and industrial manufacturing.

Mettler-Toledo is the world's largest manufacturer of precision weighing instruments for use in laboratory, industrial, and retail applications

Mettler-Toledo posted 2005 revenues of \$1.53 billion, about 65% incorporating products and services directly related to weighing. The company divides its business into laboratory sciences (about 45% of net sales), industrial instruments (about 40%), and food retail (about 15%) segments. In each area, we believe Mettler-Toledo has one of the top-three market positions. Moreover, about 80% of the company's revenues come from products where the company is No. 1 in the market.

Investment Summary

Mettler-Toledo (MTD, Buy 2)

Mettler-Toledo has one of the strongest brand names and largest installed product bases in the life sciences industry. The company's products, used in virtually every laboratory around the world, are supported by an innovative R&D infrastructure and a comprehensive sales and service organization. Given Mettler's 70% industrial exposure and late-cycle product mix, we believe the company is well positioned to benefit from the strong global economy and the heightened demand for capital goods and infrastructure investment.

We rate Mettler-Toledo Buy 2

In addition to robust end markets, we see accelerating organic revenue growth and improving profitability, as Mettler is benefiting from a record number of new product launches. In addition, targeted marketing initiatives (e.g., Project Spinnaker) are helping Mettler gain share. Overall we believe organic revenue growth has improved to a sustainable rate of 4-6%. We also expect further margin expansion, the key drivers being an improving sales mix, volume leverage, and cost savings from manufacturing transfer to China. For the next several years we see the adjusted operating margin improving to 15-16% from 12.8% in 2004. Recent tax restructuring moves have enabled Mettler to lower its tax rate to 27% from 30%. We expect this to translate to 12-15% EPS growth.

Valuation

For the past five years, MTD shares have typically traded at 15-18x estimated next fiscal year EPS compared with the overall life sciences group average of 18-22x. Our \$90 price target is 20x our new 2008 pro forma EPS estimate of \$4.05 (net of stock option expenses). This multiple is in line with those accorded other Buy-rated life sciences capital equipment stocks. We believe that robust end markets, combined with the company's improving organic growth rate, expanding margins, and aggressive share buyback program will sustain a higher PE.

Our 12-month price target for MTD is \$90

3Q Review and Recent Events

Mettler delivered strong 3Q results, with total revenues of \$397.3 million (+9% y/y including 2% from currency), exceeding both UBS and Street consensus of \$384 million. Adjusted EPS (net of a \$0.19 nonrecurring discrete tax benefit, \$0.06 tax rate adjustment, and \$0.03 option expense) also surpassed our estimate of \$0.80 and the Street's \$0.81, representing a 31% increase from a strong 3Q05.

Table 37: Mettler-Toledo 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Change	3Q06 UBSe	FC Consensus	Comments
Total Revenues	\$97.3	9%	\$384M	\$384	+7% organic, 2% F/X tailwind
Gross Margin	48.8%	-20bp	49.6%	-	Price, volume, cost control, and favorable product mix
SG&A (% of Rev)	29.1%	-70bp	29.8%	-	Increase in local currency due to China investment, small restructuring
R&D (% of Rev)	5.2%	-10bp	5.5%	-	
Adj. Operating Margin	14.6%	+70bp	14.3%	-	
Interest Exp (net)	(\$4.4)	-	(\$4.1M)	-	
Tax Rate	27.0%	-	30.0%	-	Tax reorganization allowed for cost-efficient repatriation of earnings; rate is sustainable
Share count	40.4	2.2	41.1		Repurchased 1.1M shares
EPS	\$0.84	-	\$0.81	\$0.81	Net of \$0.04 option expenses

Source: Company reports, First Call, and UBS estimates

Mettler continues to deliver improving margins, as gross margins remained around 50%, while adjusted operating margins increased 70 bps to 14.6%. Revenue generation was robust across multiple business segments and regions, as sales grew 5% y/y in the EU, 6% in the Americas, 11% in ROW, and 8% in China. Lab Products (about 43% of sales) grew 5% on moderate to good growth from all product lines with the exception of automated chemistry. Soft Lab sales to large pharma, particularly in the Americas, were offset by growth in Europe.

Industrial sales (about 43% of revenues) increased 6% during the quarter, driven by solid growth from core industrial and product inspection, especially in the Americas and China, where significant order backlogs have been booked. Transport and logistics businesses were down slightly on a tough y/y comparison.

Sales from food retailing (14% of revenue) grew 13% during 3Q as expected large orders were supplemented by unexpectedly strong sales from the core retail business. Weak sales relative to the prior year are expected in 4Q owing to a particularly strong 4Q05.

Implementation of a tax optimization strategy allowed Mettler to reduce its effective tax rate from 30% to 27%. Barring unforeseen changes in rate structure, management believes taxes will be configured using the lower rate in 2007, resulting in significant improvements in the cash position.

Mettler ended 3Q with \$195 million in cash and \$380 million in total debt. Cash from operations totaled \$67.5 million, and free cash flow amounted to \$59.5 million. In 3Q, Mettler repurchased 1.1 million shares for \$65 million, and it ended the quarter with 40.5 million shares outstanding.

Company Guidance

Due chiefly to the lower 27% tax rate going forward and 3Q upside, management raised its 2006 EPS guidance. For 4Q, Mettler sees local currency revenue growth of 3-5%, as the company faces tough comps for food retail and lab, which were up 22% and 9%, respectively, in 4Q05. Fourth quarter EPS, net of stock option expense, are estimated at \$1.16-1.21, ahead of the \$1.09 consensus estimate.

The company also introduced its 2007 guidance. Assuming an economic environment similar to today's, management continues to see local currency sales growth of 4-6% for 2007 with a 1% favorable impact from currencies. Mettler believes the company can continue to deliver about 50 bps of operating margin expansion per year and sees a 27% tax rate with stock option expenses of \$0.15-0.16. All told, Mettler expects 2007 EPS of \$4.00-4.10. This guidance is well above the full-year 2007 consensus estimate of \$3.65 and UBS estimate of \$3.71. For 1Q07, Mettler expects EPS of \$0.65-0.67 versus the consensus estimate of \$0.63.

UBS Estimates

We project 4Q06 sales of \$430 million (+4.5% y/y—3.5% organic, 1% F/X) and EPS of \$1.18. Including the 3Q upside, our 2006 estimates increased to \$1.562 billion in sales and \$3.50 in EPS, up from the prior \$1.555 billion and \$3.30. We increased our 2007 estimates to \$1.653 billion (+5.8%—about 5% organic) from \$1.625 billion in sales and to \$4.05 from \$3.71 in EPS. For 2008, as the economic cycle wanes, we now forecast 4.6% sales growth (about 3.5% organic) to \$1.73 billion with EPS of \$4.55 (net of options). Larger than expected share buybacks could add upside to our EPS estimates.

Table 38: MTD 2006 Estimates (revenues in \$ millions)

	4Q06			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Revenues	-	\$430M (4.5%)	\$435M	4-6% growth	\$1,562 (5.4%)	\$1,567M
EPS (net of options)	\$1.16-1.21	\$1.20	\$1.20	-	\$3.50	\$3.50

Source: Company reports, First Call, and UBS estimates

Table 39: Mettler-Toledo Earnings Model, 2004-07E

Dollars in thousands, except per share data

	2004A				2005A				2006E				2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY	
Total Revenues	1,404,454	337,160	368,637	365,428	411,247	1,482,472	346,160	389,157	397,318	429,753	1,562,388	1,653,475	
Cost of Revenues	722,047	174,365	188,212	186,422	203,154	752,153	175,820	196,722	203,261	213,072	788,875	825,635	
Gross Profit	682,407	162,795	180,425	179,006	208,093	730,319	170,340	192,435	194,057	216,682	773,514	827,840	
Operating Expenses													
Selling, General & Admin.	419,780	106,317	108,115	108,777	118,493	441,702	109,931	115,467	115,751	121,190	462,339	489,429	
Research and Development	83,217	20,802	20,936	19,315	20,840	81,893	19,939	20,562	20,478	22,347	83,326	89,288	
Amortization	12,256	2,808	2,991	2,816	2,821	11,436	2,855	2,850	2,793	2,850	11,348	11,500	
Total Operating Expenses	515,253	129,927	132,042	130,908	142,154	535,031	132,725	138,879	139,022	146,388	557,014	590,216	
Operating Income	167,154	32,868	48,383	48,098	65,939	195,288	37,615	53,556	55,035	70,294	216,500	237,624	
Interest Income (Expense)	(12,888)	(3,516)	(3,764)	(4,006)	(3,594)	(14,880)	(4,076)	(4,350)	(4,409)	(4,500)	(17,335)	(19,500)	
Other Income/(Charges)	-	336	(21,581)	(249)	772	(20,722)	2,538	2,557	1,441	1,350	7,886	5,500	
Income before taxes	154,266	29,688	23,038	43,843	63,117	159,686	36,077	51,763	52,067	67,144	207,051	223,624	
Income Tax Provision	(46,280)	(8,907)	(4,727)	(18,723)	(18,925)	(51,282)	(10,822)	(15,530)	(14,059)	(18,129)	(58,540)	(60,378)	
Minority Interest Income	-	-	-	-	-	-	-	-	-	-	-	-	
Net Income from Cont. Ops	107,986	20,781	18,311	25,120	44,192	108,404	25,255	36,233	38,008	49,015	148,511	163,245	
Add back: Restructuring Charge	-	-	-	-	-	-	-	-	-	-	-	-	
Add back: Non-Recurring Items	-	-	13,100	5,600	-	18,700	(1,500)	(1,800)	9,100	(1,000)	4,800	-	
Add back: Goodwill amortization	-	-	-	-	-	-	-	-	-	-	-	-	
Net Income X-Items	107,986	20,781	31,411	30,720	44,192	127,104	23,755	34,433	47,108	48,015	153,311	163,245	
GAAP EPS	\$2.37	\$0.47	\$0.42	\$0.59	\$1.04	\$2.50	\$0.57	\$0.84	\$1.16	\$1.21	\$3.76	\$4.21	
Cash EPS - Pro Forma	\$2.37	\$0.47	\$0.72	\$0.72	\$1.04	\$2.94	\$0.60	\$0.88	\$0.94	\$1.23	\$3.64	\$4.21	
Option Expense per share	-	\$0.00	\$0.00	\$0.00	\$0.00	\$0.16	\$0.03	\$0.04	\$0.03	\$0.04	\$0.14	\$0.16	
Adjusted EPS (includes FAS123)	\$2.37	\$0.47	\$0.72	\$0.72	\$1.04	\$2.78	\$0.57	\$0.84	\$0.91	\$1.20	\$3.50	\$4.05	
Avg Shares Outstanding - Diluted	45,484	44,389	43,439	42,894	42,419	43,285	41,774	41,237	40,456	39,800	40,817	38,800	
YEAR-OVER-YEAR CHANGE													
Total Revenues	7.7%	5.8%	7.0%	6.8%	3.0%	5.6%	2.67%	5.57%	8.73%	4.50%	5.4%	5.8%	
Cost of Revenues	5.2%	3.5%	6.6%	5.7%	1.2%	4.2%	0.8%	4.5%	9.0%	4.9%	4.9%	4.7%	
Selling, General & Admin.	12.6%	9.8%	7.0%	3.9%	1.0%	5.2%	3.4%	6.8%	6.4%	2.3%	4.7%	5.9%	
Research and Development	6.7%	0.7%	3.8%	-4.3%	-6.2%	-1.6%	-4.1%	-1.8%	6.0%	7.2%	1.8%	7.2%	
Total Operating Expenses	11.4%	8.0%	6.4%	2.4%	-0.7%	3.8%	2.2%	5.2%	6.2%	3.0%	4.1%	6.0%	
Operating Income	7.4%	9.5%	10.4%	26.7%	19.1%	16.8%	14.4%	10.7%	14.4%	6.6%	10.9%	9.8%	
Income before taxes	12.7%	11.6%	-43.3%	24.6%	21.8%	3.5%	21.5%	124.7%	18.8%	6.4%	29.7%	8.0%	
Net Income from Continuing Ops	12.7%	11.6%	-35.6%	2.0%	21.8%	0.4%	21.5%	97.9%	51.3%	10.9%	37.0%	9.9%	
Net Income Ex-Items	8.3%	11.6%	10.5%	24.7%	21.8%	17.7%	14.3%	9.6%	53.3%	8.7%	20.6%	6.5%	
GAAP EPS	12.7%	15.2%	-32.1%	8.2%	28.7%	5.5%	21.5%	98.1%	98.8%	15.8%	50.0%	12.0%	
Cash EPS - Pro Forma	8.4%	15.2%	16.4%	32.4%	28.7%	23.7%	29.1%	21.5%	31.2%	18.2%	23.9%	15.6%	
AS A PERCENTAGE OF REVENUES													
Cost of Revenues	51.4%	51.7%	51.1%	51.0%	49.4%	50.7%	50.8%	50.6%	51.2%	49.6%	50.5%	49.9%	
Gross Margins	48.6%	48.3%	48.9%	49.0%	50.6%	49.3%	49.2%	49.4%	48.8%	50.4%	49.5%	50.1%	
Selling, General & Admin.	29.9%	31.5%	29.3%	29.8%	28.8%	29.8%	31.8%	29.7%	29.1%	28.2%	29.6%	29.6%	
Research and Development	5.9%	6.2%	5.7%	5.3%	5.1%	5.5%	5.8%	5.3%	5.2%	5.2%	5.3%	5.4%	
Total Operating Expenses	36.7%	38.5%	35.8%	35.8%	34.6%	36.1%	38.3%	35.7%	35.0%	34.1%	35.7%	35.7%	
Operating Income	11.9%	9.7%	13.1%	13.2%	16.0%	13.2%	10.9%	13.8%	13.9%	16.4%	13.9%	14.4%	
Adjusted Operating Income	12.8%	10.6%	13.9%	13.9%	16.7%	13.9%	11.7%	14.5%	14.6%	17.0%	14.6%	15.1%	
Tax Rate	30.0%	30.0%	20.5%	30.4%	30.0%	30.0%	30.0%	30.0%	27.0%	27.0%	28.3%	27.0%	
Income from Cont. Ops	7.7%	6.2%	5.0%	6.9%	10.7%	7.3%	7.3%	9.3%	9.6%	11.4%	9.5%	9.9%	
Income less X-Items	7.7%	6.2%	8.5%	8.4%	10.7%	8.6%	6.9%	8.8%	11.9%	11.2%	9.8%	9.9%	

Source: Company reports and UBS estimates

Millipore

Company Description

Millipore is a leading supplier of consumables, reagents, technology, hardware, and services for life sciences research and biologic drug manufacturing. Millipore is the No. 1 provider of purification and filtration products used for biopharmaceutical manufacturing, particularly therapeutic monoclonal antibodies. With the recent acquisition of Serologicals, Millipore expanded its business beyond filtration into drug discovery reagents and upstream bioprocessing.

Millipore is a leading supplier of technology and services for life sciences research and biomanufacturing

The company is organized around two business units: Bioprocess (about 60% of sales) and Bioscience (40%). Millipore's core Bioprocess unit focuses on downstream purification, filtration, and quality assurance products and services for the clinical and commercial scale manufacture of therapeutics, including monoclonal antibodies, vaccines, and other biologics. To this portfolio, Serologicals adds various cell culture supplements, which are used upstream in biologic production as nutrient additives in culture media, as well as services in the areas of cell-line development and protein expression.

Millipore's core Bioscience division provides filtration-related products and services for customers in the life science, analytical, and clinical laboratory markets. To this division, Serologicals adds molecular and cell biology kits, antibodies, and other life sciences reagents to research customers working in drug development, cell signaling, neuroscience, immunology, oncology, and stem cell research.

The Serologicals acquisition gives Millipore critical mass for an entry to the \$5-6 billion life sciences reagent and \$1 billion upstream bioprocess markets. In return, Millipore's well-established sales and distribution infrastructure, as well as its strong brand name and customer relationships, may help expand the market for Serologicals' products and services, especially in international markets where Serologicals derived about 35% of sales, versus Millipore's 75%.

Investment Summary

Millipore (MIL, Buy 2)

Since Millipore is the leading supplier of technologies for the production of high-volume monoclonal antibodies, and we expect its key growth driver to be its biotechnology business, as there are over 260 monoclonal antibodies on the market or in clinical trials and another 300-plus in pre-clinical development. *Datamonitor* projects that sales of therapeutic antibody drugs could triple by 2010, to \$30 billion. Moreover, 2,000 other biologics are in various stages of development, and increasing demand for recombinant vaccines should also help drive growth. Thus, we believe the long-term outlook for biomanufacturing suppliers is good, particularly for Millipore.

We rate MIL shares Buy 2

Because of the broad base of customers served by Millipore, the company does not depend on the success of any single company or clinical trial. For this reason, we believe Millipore represents a relatively conservative way to invest in biotechnology. However, because of the uncertain timing of biomanufacturing facility building and ongoing drug production campaigns, Millipore's quarterly Bioprocess revenues tend to be lumpy and, as a result, the business is difficult to model. That said, we are bullish on Millipore's long-term potential and believe it is among the best-positioned tool companies to benefit from accelerating biomanufacturing demand. Normalizing for the lumps, we estimate the biomanufacturing market's annual organic growth at 8-12%.

Millipore's core Bioscience division provides filtration-related products and services for customers in the life science, analytical, and clinical laboratory markets. Since new management took control in early 2005, the Bioscience division has been reorganized and many new products launched. As a result, organic growth has accelerated from 3-4% to about 10% in the last four quarters, above the market average of 5-8%.

On April 25, 2006, Millipore announced the acquisition of Serologicals. The all-cash transaction was valued at \$1.4 billion, or about 5x Serologicals' 2005 sales. To finance this deal, Millipore took on a total of \$1.4 billion in debt (around 60% debt-to-total capital), putting the company at the high end for financial leverage among the companies in the sector. The deal closed on July 17, 2006.

With the acquisition of Serologicals, Millipore significantly expanded its business beyond laboratory and biopharmaceutical drug filtration into drug discovery reagents and upstream bioprocessing. Indeed, other than selling into similar end markets, there is little product overlap between the two companies. This deal provides Millipore with critical mass in the \$5-6 billion life sciences reagent and roughly \$1 billion upstream bioprocess markets. In return, we believe Millipore's well-established sales and distribution infrastructure, as well as its strong brand name and customer relationships, may help expand the market for Serologicals' products and services, particularly outside North America, where Serologicals derived about 35% of sales versus Millipore's 75%.

With a broad range of specialty life science reagents, including antibodies, molecular and cell biology research kits, and drug discovery assays, Serologicals has established market positions in fast-growing areas of research such as neuroscience, stem cells, oncology, and signal transduction. With the combination of Biosciences' technical strength in filtration and sample preparation and Serologicals' strength in enzyme/antibody-based assays, we see expanded market opportunities from the company's plan to offer high-value, high-margin assay and reagent kits, with integrated workflows, for multiple applications (e.g., drug target validation screening, molecular diagnostics).

Though it is still a relatively small player in the cell culture market, we also see upside potential for Millipore's core Bioprocess business from the Serologicals merger, as certain biopharmaceutical customers may value an integrated and optimized total solution.

In terms of financial metrics, the core Millipore business is performing well (+9% organically in 3Q), and looks on track to hit its 2006 target of 10-12% growth. In addition, the company's manufacturing facility consolidation and global supply chain initiatives are on or ahead of schedule, and we believe the company can hit its target for approximately 58% gross margins by 2009 (up 400 bps from 2005).

Despite the strength of Millipore's core, as noted during the company's September 21 analyst day, unforeseen complications with the newly acquired Serologicals business have raised the possibility of some short-term business disruptions. Serologicals was in the process of incorporating a number of businesses (Chemicon, Upstate, LINCO) prior to the Millipore deal, and the integration was not as far along as Millipore management had thought. In addition, Serologicals' 2Q06 and 3Q06 sales were below Street expectations, chiefly owing to competitive pressures facing the Upstate drug discovery business, as well as integration-related order delays.

Acknowledging these challenges, Millipore management appears to have a sound roadmap for Serologicals' integration and looks on track to launch a unified sales force and marketing program, transition Serologicals' IT system (SAP) to Millipore's (Oracle), and close Serologicals' Toronto facility by mid-2007. Management expects cost savings and synergies of \$9-10 million in 2007 and \$15-17 million in 2008 as a result of the deal. In addition, given that Serologicals' consumables portfolio had a gross margin of about 57% in 2005, well ahead of Millipore's 54%, we see upside to the combined company's gross margin beyond Millipore's 2009 target of 58%.

In addition to the known issues, we believe see other risks, including the fact that this is the largest (and most expensive acquisition) ever undertaken by the company and the fact that although the two firms sold into similar end markets, their customers and sales process were inherently different, raising a question as to how easily and effectively the sales force can be combined.

That said, we believe Millipore management understands the problems and can deliver on the promised synergies that should eventually lead to an acceleration in organic sales growth and margin expansion. Thus, although 2007 is a key transition year for the company and there could be growing pains, we are increasingly positive about the long-term outlook for the "new" Millipore, so we raised our rating on MIL shares to Buy 2 from Neutral 2. On the 3Q call management reiterated its 2006 guidance but did not back earlier 2007 EPS guidance as it evaluates the Serologicals forecast "from the bottom up." We believe the stock could see above-average volatility until investors gain confidence that Serologicals' issues are limited.

Valuation

Our \$78 target is 20x our 2008 pro forma EPS estimate (net of stock options) of \$3.95. Our price target is supported by a DCF analysis using the UBS VCAM model, a WACC of 8.5%, and a 5% terminal growth rate, which implies a share price of about \$80.

Our 12-month price target for MIL is \$78

3Q Review and Recent Events

Millipore reported 3Q06 revenues of \$330 million, \$2 million above the UBS estimate of \$328 million and \$10 million below the Street consensus estimate of \$338 million. Both of Millipore's core businesses—Bioprocess and Bioscience—recorded solid quarters, organically growing 9% y/y (excluding +2% F/X and acquisition impact).

Millipore experienced solid growth in both North America (11% y/y) and Asia-Pacific region (18% y/y), while Europe grew at 6%. 3Q06 adjusted EPS (net of \$0.04 option expenses) were \$0.65 versus UBS and Street estimates of \$0.66 due to higher SG&A costs (28.7% versus the UBS estimate of 27.7%) and taxes.

In the Bioscience segment, MIL reported 3Q06 revenues of \$135 million (+44% y/y—6% organically, excluding the F/X and Serologicals impact), below the UBS estimate of \$139 million, partly reflecting 11 weeks versus 13 weeks of Serologicals 3Q sales. MIL's core Bioscience business performed well thanks to increased demand across a broad range of research customers. Lingering integration issues and increasing competition for Serologicals' kinase assays put pressure on top-line growth.

During the recent MIL analyst day and during the 3Q06 conference call, Millipore management reiterated its understanding of the challenges and issues facing the company in integrating Serologicals' business into Millipore's core franchise. In our view, 2007 is a key transition year for the company, and there could be growing pains. However, given Millipore's recent success in revitalizing its own core business and implementing operational efficiency plans (e.g., the global supply chain initiative), we are increasingly positive about the potential synergies and long-term outlook.

In Bioprocess, MIL reported 3Q06 revenues of \$195 million (+34% y/y—13% organic, excluding the F/X and Serologicals' impact), above the UBS estimate of \$189 million. Not surprisingly, strong sales of core downstream bioprocess products (e.g., filtration, purification, and QA/QC), owing to growing demand for biological manufacturing, drove the top-line growth.

Table 40: Millipore 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Growth	3Q06 UBSe	Comments
Bioscience	\$135.2M		\$139M	Core Bioscience grew 6% organically, while SERO segment was soft due to continued integration issues and competition
Bioprocess	\$194.9M	12.8%	\$189M	Core Bioprocess grew 13% organically, driven by strong bio-manufacturing
Total Revenues	\$330	11.8%	\$328M	Core business grew 9% organically, due to both strong bioprocess and bioscience, offset by softness in SERO Bioscience; SERO contributed \$63M vs. UBSe \$63M
Adj. Gross Margin	55%	+120bps	55%	In-line, as MIL's core business manufacturing consolidation and global supply chain initiative on track, offset by SERO bioscience
SG&A (% Rev)	28.7%	-130bps	27.7%	Higher than expected due to combining of MIL and SERO; expect decrease due to facility closedown and more streamlined SG&A structure
R&D (% Rev)	6.7%	+10bps	6.7%	In-line
Adj. Operating Margin	19.6%	+280bps	20.9%	Lower than expected due to higher SG&A
Tax Rate	-28%	-	28.0%	In-line
Adj. EPS (ex-options)	\$0.69	-	\$0.72	
Adj. EPS (net of options)	\$0.65		\$0.66	Net of ~\$0.04 per share option expenses; Consensus was \$0.66

Source: Company reports and UBS estimates

Company Guidance

During the 3Q06 conference call, management reiterated its full-year 2006 y/y sales growth target of 10-12% and adjusted EPS guidance of \$3.00-3.10 (ex-options), but it did not back its earlier (April 2006) 2007 adjusted EPS guidance of \$3.60-3.75 (ex-options), as the company took a conservative approach in assessing the Serologicals impact on the combined company from the bottom up. Management expects it will take two or three quarters to fully integrate SERO. In terms of Millipore's core operations, the company has, to date, reached the midpoint of the five-year global supply chain initiative and is on track to deliver its goal of delivering \$40 million of cost savings by 2009.

UBS Estimates

Given management's lack of color on 2007, we are taking a more conservative near-term approach and revised our revenue forecasts to \$1,237.5 million for 2006 and \$1,476.4 million for 2007 from our prior estimates of \$1,243 million and \$1,510 million, respectively. Because of a greater contribution from SERO's consumables and MIL's own operational efficiency programs, we expect the gross margin to improve from 55% in 2006 to 56% in 2007. With the company on plan to streamline its sales and marketing organization, we project that overall operating margins will improve as a result of a further reduction in SG&A to 19.6% in 2006 and 22.4% in 2007.

On the bottom line, we expect 2006 pro forma EPS net of options of \$2.82 (\$3.00 excluding options) versus the prior \$2.85 (\$3.04 excluding options). For 2007, we now expect pro forma EPS net of options of \$3.30 (\$3.52 excluding options) versus the prior \$3.45 (\$3.66 excluding options).

Table 41: MIL 2006 Estimates (revenues in \$ millions)

	4Q06			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Revenues	-	\$365M (+42.4%)	\$368M	-	\$1,238M (+24.9%)	\$1,242M
EPS (net of options)	-	\$0.78	\$0.81	-	\$2.82	\$2.84

Source: Company reports, First Call, and UBS estimates

Table 42: Millipore Earnings Model, 2004-07E

Dollars in thousands except per share data
Fiscal year ended December 31

	2004A				2005A				2006E		2007E	
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
Revenues - Reported Currency												
Bioscience	330,900	100,000	97,000	93,892	97,527	388,419	104,800	106,900	135,217	147,854	494,771	609,353
Bioprocess	478,100	150,178	147,964	145,165	158,805	602,112	163,615	166,875	194,900	217,362	742,752	867,027
Total Net Sales - Local Currency	809,000	250,178	244,964	239,057	256,332	990,531	268,415	273,775	330,117	365,215	1,237,522	1,476,379
Fix Correction	75,036											
Total Net Sales - Reported Currency	883,563	250,178	244,964	239,057	256,332	990,531	268,415	273,775	330,117	365,215	1,237,522	1,476,379
Expenses												
Cost of sales	412,129	114,103	113,525	110,545	119,137	457,310	121,183	123,358	148,482	163,434	556,457	649,607
Selling, general, & administrative	263,596	69,133	74,000	72,600	75,813	291,546	78,957	81,850	94,785	99,049	354,641	395,266
Research & development	62,485	16,073	16,891	15,859	16,929	65,752	18,095	19,317	22,147	24,360	83,919	100,394
Restructuring and other costs	0	0	0	0	0	0	0	0	0	0	0	0
CEO Transition Costs and Others	4,200	8,300	9,600	0	0	17,900	0	0	0	0	0	0
Operating Expenses	742,410	207,609	214,016	199,004	211,879	832,508	218,235	224,525	116,932	286,843	995,017	1,145,267
Operating Income	141,153	42,569	30,948	40,053	44,453	158,023	50,180	49,250	64,703	78,372	242,505	331,113
Gain on sale of equity securities	0	0	0	0	0	0	0	0	0	0	0	0
Loss on investments												
Interest Income	2,073	675	633	894	1,264	3,466	6,892	9,268	4,713	1,250	22,123	4,000
Interest Expense	(9,447)	(1,834)	(1,755)	(1,432)	(1,690)	(6,711)	(4,193)	(6,682)	(16,548)	(17,000)	(44,423)	(66,030)
Income from cont. ops before taxes	133,779	41,410	29,826	39,515	44,027	154,778	52,879	51,836	52,868	62,622	220,205	269,083
Provision for income taxes	29,299	9,110	5,849	9,674	11,339	35,972	12,951	12,441	14,803	16,908	57,103	73,998
Other items	0	0	0	7,424	0	7,424	(97)	424	439	0	766	0
Net Income	104,480	32,300	23,977	22,417	32,688	111,382	40,025	38,971	37,626	45,714	162,337	195,085
Unusual Items	4,200	6,474	5,760	7,424	0	19,658	0	0	0	0	0	0
Pro forma Net Income	108,680	38,774	29,737	29,841	32,688	131,040	40,025	38,971	37,626	45,714	162,337	195,085
Pro forma EPS (ex-options)	\$2.14	\$0.77	\$0.59	\$0.57	\$0.62	\$2.54	\$0.74	\$0.72	\$0.69	\$0.84	\$3.00	\$3.52
Option expenses per share	-	-	-	-	-	-	(\$0.04)	(\$0.04)	(\$0.04)	(\$0.06)	(\$0.18)	(\$0.22)
Pro forma EPS (net of options)	\$2.14	\$0.77	\$0.59	\$0.57	\$0.62	\$2.54	\$0.70	\$0.68	\$0.65	\$0.78	\$2.82	\$3.30
Diluted weighted avg shares outstanding	50,240	50,327	50,707	52,579	52,964	51,644	53,883	54,207	54,172	54,500	54,191	55,500
YEAR-OVER-YEAR CHANGE												
Revenues												
Bioscience	5.0%	-	-	-	-	-	4.8%	10.2%	44.0%	51.6%	27.4%	23.2%
Bioprocess	6.2%	-	-	-	-	-	8.9%	12.8%	34.3%	36.9%	23.4%	16.7%
Total Net Sales - Reported Currency	10.5%	12.5%	8.9%	13.4%	13.7%	12.1%	7.3%	11.8%	38.1%	42.5%	24.9%	19.3%
Expenses												
Cost of sales	11.6%	13.1%	10.0%	13.5%	7.7%	11.0%	6.2%	8.7%	34.3%	37.2%	21.7%	16.7%
Selling, general, & administrative	6.8%	2.0%	13.4%	15.6%	12.0%	10.6%	14.2%	10.6%	30.6%	30.6%	21.6%	11.5%
Research & development	7.0%	0.5%	5.3%	4.7%	10.6%	5.2%	12.6%	14.4%	39.6%	43.9%	27.6%	19.6%
Operating Expenses	10.3%	12.4%	14.9%	12.7%	8.7%	12.1%	5.1%	4.9%	-41.2%	35.4%	19.5%	15.1%
Operating Income	11.5%	12.7%	-19.9%	17.3%	45.2%	12.0%	17.9%	59.1%	61.5%	76.3%	53.5%	36.5%
Net income adjusted	16.5%	42.6%	-2.2%	13.8%	31.5%	20.6%	3.2%	31.1%	26.1%	39.9%	23.9%	20.2%
EPS adjusted	12.6%	41.3%	-2.9%	9.0%	25.0%	18.4%	-3.6%	22.6%	22.4%	35.9%	18.1%	16.8%
AS A PERCENTAGE OF REVENUES												
Bioscience	37.5%	40.0%	39.6%	39.3%	38.0%	39.2%	39.0%	39.0%	41.0%	40.5%	40.0%	41.3%
Bioprocess	54.1%	60.0%	60.4%	60.7%	62.0%	60.8%	61.0%	61.0%	59.0%	59.5%	60.0%	58.7%
Adjusted Gross Profit	53.4%	54.4%	53.7%	53.8%	53.5%	53.8%	54.9%	54.9%	55.0%	55.3%	55.0%	56.0%
Selling, General & Administrative	29.8%	27.6%	30.2%	30.4%	29.6%	29.4%	29.4%	29.9%	28.7%	27.6%	28.7%	27.5%
Research & Development	7.1%	6.4%	6.9%	6.6%	6.6%	6.6%	6.7%	7.1%	6.7%	6.7%	6.8%	6.8%
Pro Forma Operating Expenses	83.5%	79.7%	83.4%	83.2%	82.7%	82.2%	81.3%	82.0%	35.4%	78.5%	80.4%	77.6%
Adj. Operating Income	16.6%	20.3%	16.4%	16.8%	17.3%	18.5%	18.7%	18.0%	19.6%	21.5%	19.6%	22.4%
Pre-Tax Income	15.1%	16.6%	12.2%	16.5%	17.2%	15.6%	19.7%	18.9%	16.0%	17.1%	17.8%	18.2%
Taxes, as percentage of pre-tax income	21.9%	22.0%	19.6%	24.5%	25.8%	23.2%	24.5%	24.0%	28.0%	27.0%	25.9%	27.5%
Net Income Reported	11.8%	12.9%	9.8%	9.4%	12.8%	11.2%	14.9%	14.2%	11.4%	12.5%	13.1%	13.2%
Net Income Adjusted	11.8%	12.9%	9.8%	9.4%	12.8%	11.2%	14.9%	14.2%	11.4%	12.5%	13.1%	13.2%

Source: Company reports and UBS estimates

PerkinElmer

Company Description

PerkinElmer is a diversified, global provider of scientific instruments, consumables, and related services to the broad life sciences and general industrial markets. PerkinElmer holds leading market positions in molecular and atomic spectroscopy, high-throughput screening, automated liquid handling, and immunoassay-based genetic screening assays for newborn and maternal health testing, and it has well-regarded specialized lighting, digital imaging, and optical technology products. With operations in 40 countries and 10,000 employees globally, the company's products are marketed in over 125 countries.

PerkinElmer is a diversified global tools provider

In 1999, PerkinElmer embarked on a series of acquisitions and divestitures, which have transformed it into a more focused player in the life sciences and health-care-related markets. In 2005, the company generated sales of \$1.47 billion from two business units, Life and Analytical Sciences (LAS; 73% of 2005 sales) and Optoelectronics (OE; 27%). The two divisions derive 30% revenues from pharmaceutical and biotech companies, 10% from academic labs, 20% from clinics and hospitals, and 40% from general industrial markets.

With the 2005 sale of the Fluid Science division, PerkinElmer's strategic refocus neared completion, and the company significantly reduced its debt burden. As such, management is now better positioned to concentrate on top-line growth. In 2006, through a combination of small acquisitions, an increase in internal R&D, and new collaborations and technology licensing deals, PerkinElmer has attempted to facilitate product innovation, particularly in biopharma. The company expects to expand its presence in its niche markets such as genetic screening and molecular imaging through bolt-on acquisitions, and it continues to target geographic expansion into the faster-growing Asian markets.

Investment Summary

PerkinElmer (PKI, Neutral 1)

Thanks to a number of restructuring programs and divestitures, PerkinElmer's operating efficiency has improved, with adjusted operating margins (for continuing businesses) expanding from around 3.0% in 2002 to 13.0% in 2005. Importantly, the company significantly reduced its debt at the end of 2005. In our view, management has done a solid job of transforming PerkinElmer, and the company has never been better positioned to focus on top-line growth.

We rate PerkinElmer Neutral 1

Although niche products (genetic screening, medical imaging), combined with the company's broad exposure to industrial markets and expansion into Asia, could help drive PerkinElmer's top-line organic growth to 4-6%, the company's core biopharma business continues to lag. In our view, a turnaround in the biopharma business may take longer than expected given the increasingly competitive nature of the end markets, the struggle for accretive deals, continued constraints on drug discovery spending, and management's mixed track record for M&A. Overall,

given the company's current product portfolio, which we believe lacks sufficient differentiation and cohesion, we think accelerating top-line growth through internal R&D and acquisitions could prove to be more challenging than improving operations. We rate PKI shares Neutral 1 until we gain confidence in the sustainability of the company's long-term top-line growth.

Valuation

Our \$23 price target is 18x our 2007 pro forma EPS estimate of \$1.26 (net of options), in line with the life sciences group average. Although we believe PerkinElmer has the potential for above-average EPS growth and it has never been better positioned to focus on top-line growth, the continued lackluster performance of biopharma and non-core segments in Optoelectronics (specialty lighting and sensors) keeps us cautious. Our price target is supported by the UBS VCAM DCF model, which implies a price of \$25.60 per share (assuming an 8.5% WACC and 3.5% terminal growth rate).

Our 12-month price target is \$23

3Q Review and Recent Events

PerkinElmer's adjusted 3Q06 EPS (net of \$0.02 options) totaled \$0.30, above the UBS and Street estimates of \$0.26, in part because of higher sales, lower SG&A (23.7% versus the UBS estimate of 24.5%), and a lower tax rate (16.3% versus 24.5%). The tax rate was lower than expected due to a \$1.2 million net benefit related to the difference between the prior-year tax provision and the actual tax liability.

Genetic screening growth was strong, driven mainly by increased adoption of neonatal screening (about 80% of the total genetic screening business, growing at a double-digit rate) in the U.S. and internationally. Although only a small base, prenatal screening, which is growing at a double-digit rate, also contributed to overall growth. The company believes that increased awareness and adoption of these tests in and outside the U.S. and the introduction of new products (e.g., NTD Labs' trimester prenatal risk assessment test) will continue to drive growth.

In environmental and chemical products, 3Q growth was at a mid-single-digit rate, a slight improvement from the low-single-digit rate experienced in 2Q06, driven by continued strength in emerging markets (e.g., China and India) and growing demand for air, food, and water quality instruments. In 3Q, PKI introduced the Clarus 600 series Gas Chromatograph (GC) and GC/MS, which offer a fast GC solution for commercial users looking for efficient and productive ways of conducting GC and GC/MS-based analysis in a wide variety of environmental and industrial applications. Also in 3Q, PKI bought Avalon Instrument, a provider of bench-top Raman Spectroscopy instruments, which complements PKI's existing NIR and IR instruments in industrial and pharmaceutical areas. In 3Q, PKI experienced mid-single-digit growth in service, driven by one-source offering.

Table 43: PerkinElmer 3Q06 Earnings Overview

	3Q06 Actual	Y/Y Growth	3Q06 UBSe	Comments
				<u>Overall Performance:</u> 9% growth y/y (-5% organic growth + 4% F/X and acquisitions) <u>Sub-segment Performance:</u>
Life and Analytical Sciences	\$278.5M	3%	\$274.8M	Genetic Screening (15% of LAS total): Double-Digit organic growth, driven by neonatal screening (double-digit growth) and expansion in both U.S. and International markets, as well as new product introductions (e.g. NTD Labs acquisition brings trimester risk assessment, Spectral Genomics) Service (24% of LAS total): High—digit organic growth vs. mid single-digit growth in 2Q06 Environmental and Chemical Products (26% of LAS total): Mid-SD organic growth vs. Low-SD organic growth in 2Q06, driven by new product introductions (e.g. Clarus 6000 and GC/MS), expansion in int'l markets for air, food, water quality Bio-pharmaceutical (35% of LAS total): a Low-Single-Digit decline organically, related to weakness in radioisotope business, while certain product lines (e.g. cell imagin) grew strongly. Regarding the end markets, Biotechs were strong, academic flat-to-down and Pharma spend picking up <u>Guidance:</u> 7% organic growth in 4Q06
Optoelectronics	\$98.5M	1%	\$99.2M	<u>Overall Performance:</u> 2.6% growth y/y (-1% organic growth + 2% F/X impact) <u>Previous Guidance :</u> 2-4% organic growth in 3Q06 <u>Sub-segment Performance:</u> Imaging: Double-digit organic growth, driven by strong demand for digital/X-ray panels; Expect flat panel fabrication capacity expansion will add additional growth driver to imaging Specialty Lighting: continues to decline due to reduced demand for single-use flash, partially offset by strong growth in the digital camera flash (3Q05 was a difficult comparison) Overall Performance: 7.5% growth y/y (4% organic growth, -1% Acquisition + 2% F/X impact)
Total Revenues	\$377M	2%	\$374M	Geographical Performance: (1) N America (46% of total) grew at mid-SD vs. 0% organic growth in 2Q06; (2) Europe (36% of total) grew at mid-SD -2-3% organic growth; (3) Asia (18% of total): grew at low-SD% vs. -5-6% organic growth. (ex-Japan, China, and India grew at double-digit rate)
Gross Margin	42.3%	-80bps	43%	Gross margin decline y/y was due to (1) high commodity costs, and (2) difficult 3Q06 comps, offset by high volume and favorable mix
SG&A (% Rev)	24.1%	-20bps	25%	Decrease of SG&A was due to (1) productivity initiatives; and (2) geographic mix, offset by the impact of acquisitions
R&D (% Rev)	6.6%	+50bps	6.6%	
Adj. Operating Margin	11.8%	-140bps	11.4%	
Tax Rate	18%	-70bps	24.5%	Mainly due to the benefit of a \$1.2M tax credit related to acquisition and others
Share Count	127.4M	-3.3M	127M	Bought back 3.9M shares; authorized new 10M repurchase
EPS (net of options)	\$0.25	-30%	\$0.25	\$1.15-1.20 (net of options) for full-yr 2006 vs. prior \$1.11-\$1.16

Source: Company reports and UBS estimates

In BioPharma, radioisotope continued to drag down total growth; the company indicated that the non-radioisotope reagent portfolio was actually growing at a double-digit rate in 3Q. Although management saw the overall R&D budget increase from its Big Pharma customers, because of its R&D focus, the commitment has been slow in the high-throughput screening business in which PKI has a considerable stake. The company hopes product introductions (e.g., cellular imaging and high-content screening) could help it win Big Pharma accounts in the future.

Optoelectronics had total revenues of \$103.4 million (+2.6%, about 1%), slightly below our estimate of \$104.3 million, as strong imaging was offset by weak specialty lighting. The company faced a difficult comparison against 3Q05

for the single-use flash product line. The company believes that 1) expansion of flat panel fabrication capacity, expected by the end of 2007 and 2) continuing growth in demand for its digital flash business should have a further positive impact on overall Optoelectronics growth in 4Q06 and full-year 2007.

In 3Q, the company repurchased the remaining 3.9 million shares from its share repurchase program approved in 2005. A new authorization—to buy back 10 million shares over four years—was recently approved by the board. The company ended the quarter with approximately \$207 million in cash and \$201 million in long-term debt.

Company Guidance

For 4Q06, management guided for adjusted EPS (net of options) of \$0.38-0.40, with full-year adjusted cash EPS of \$1.15-1.20. The company expects an acceleration in growth rates, including strong performance from the BioPharma segment (with the exception of the lagging Radioisotope unit) and Genetic Screening (via continued gains from the NTD Labs acquisition) within LAS, as well as improvement from the Lighting and Sensors business within Optoelectronics. Fourth quarter gross margins are expected to be flat due to commodity cost changes, pricing pressure, and product introductions, while operating margins should expand 50-75 bps. Total 4Q revenue growth is expected to be in the range of 6-8%. Heading into 2007, management looks to be on firmer ground than a year ago, as the organization focuses on optimization of R&D activities, as well as the devotion of resources to those activities.

UBS Estimates

We are increasingly optimistic that PerkinElmer's organic revenue growth will improve, so we raised our sales forecasts to \$1,540 million for 2006 and \$1,638 million for 2007 from our prior estimates of \$1,526 million and \$1,585 million. We now expect 2006 adjusted EPS of \$1.12, versus our prior estimate of \$1.11. For 2007, in the wake of a number of acquisitions, including the recent Evotec Technologies deal, we increased our out-year R&D forecasts and lowered our interest income estimates. As such, we reduced our 2007 adjusted EPS estimate to \$1.26 from \$1.32 (+14% y/y), below the current \$1.30 consensus estimate. The company's new share buyback plan could add upside to our EPS estimates.

Table 44: PerkinElmer 2006 Estimates (revenues in \$ millions)

	4Q06			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Revenues	-	\$420M (8.6%)	\$412M	-	\$1,540M (4.5%)	\$1,531M
EPS (net of options)	\$0.38-0.40	\$0.38	\$0.38	\$1.15-1.120	\$1.12	\$1.12

Source: Company reports, First Call, and UBS estimates

Recent Events

On December 1, PerkinElmer announced the acquisition of Evotec Technologies, a private manufacturer of cellular screening hardware and image analysis software for drug discovery research. PerkinElmer paid about \$30 million for the company, which recorded 2005 revenues of approximately \$17 million. The deal is expected to close in late 4Q06 or early 1Q07 and be neutral to EPS.

Evotec's portfolio includes automation platforms, plate readers, and cell handling systems (e.g., Image Activated Cell Selection) that complement PerkinElmer's products in these areas. In addition, the deal greatly expands PerkinElmer's portfolio of ultra-high-throughput cellular analysis and high-content screening products. High-content screening (HCS) relies on cell-based, rather than biochemical, assays to provide information about content and spatial regulation of multiple macromolecules in individual cells. The basic idea of HCS is to provide more biologically relevant data about a compound earlier in the drug discovery process. HCS has been developing rapidly, with marketed products from companies such as Beckman Coulter, Thermo Fisher Scientific (through Cellomics), GE Healthcare, and Molecular Devices. CellLux is PerkinElmer's main HCS product. The HCS market is estimated at \$80 million, growing at a rate of 15-20%.

Table 45: PerkinElmer Income Statement, 2004-07E

Dollars in millions, except per share data
Fiscal year ended December 31

	2004A					2005A					2006E	2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
Revenues												
Life and Analytical Sciences	1,062.8	264.8	270.8	259.1	286.5	1,081.1	261.9	278.5	283.5	315.1	1,139.0	1,218.8
Optoelectronics	366.3	93.4	97.2	100.8	101.2	392.6	93.5	98.5	103.4	105.7	401.2	419.3
Fluid Sciences	-	-	-	-	-	-	-	-	-	-	-	-
Total Revenues	1,429.1	358.2	368.0	359.9	387.7	1,473.7	355.5	377.0	386.9	420.9	1,540.2	1,638.0
Cost of products sold (ex- amortizations)	818.8	203.3	209.4	203.0	215.8	831.5	206.4	217.6	221.9	234.4	880.4	930.4
Gross Margin	612.9	154.8	158.6	156.9	171.8	642.2	149.1	159.4	165.0	186.4	659.9	707.6
Operating Expenses												
Sales, general and administrative	362.3	96.5	92.9	87.4	87.8	364.7	88.4	90.8	91.8	96.8	367.7	388.2
R&D Expense	82.3	22.7	22.2	21.8	21.0	87.7	22.6	24.8	24.6	27.1	99.2	106.5
Other operating expenses	0.4	(0.1)	-	-	(1.4)	(1.5)	-	-	-	-	-	-
Operating Expenses	445.0	119.1	115.1	109.2	107.4	450.8	111.0	115.6	116.3	123.9	466.9	494.7
Operating Income	167.9	35.7	43.6	47.7	64.4	191.4	38.1	43.8	48.7	62.5	193.0	212.9
Interest income	2.6	0.7	0.6	0.5	1.5	3.3	3.4	2.4	1.9	2.0	9.7	11.0
Interest expenses	36.8	8.3	8.1	6.9	4.8	28.1	2.3	2.2	2.2	1.5	8.2	8.0
Other income (expense), net	(4.9)	(0.5)	-	0.3	-	(0.2)	(1.2)	(2.6)	(3.0)	-	(6.8)	-
Income from continued ops before taxes	128.7	27.6	36.1	41.6	61.2	166.5	38.0	41.3	45.4	63.0	187.7	215.9
Provision for taxes (pro forma)	34.2	7.5	9.0	10.4	15.1	42.0	9.4	7.6	7.8	14.8	39.5	52.9
Net Income - pro forma	94.5	20.1	27.1	31.2	46.1	124.5	28.6	33.7	37.6	48.2	148.1	163.0
Unusual items												
Amortization of (Purchased) Intangible Assets	(19.3)	(5.2)	(5.3)	(5.4)	(3.9)	(19.7)	(5.2)	(6.4)	(8.4)	(4.3)	(24.3)	(12.4)
Restructuring	-	-	(11.8)	-	(5.2)	(17.0)	-	-	-	-	-	-
One-time tax benefit	-	-	19.6	-	(44.1)	(24.5)	-	-	-	-	-	-
Net Income - GAAP	75.3	14.9	29.7	25.8	(7.1)	63.3	23.5	27.3	29.2	43.9	123.9	150.6
GAAP EPS	\$0.58	\$0.11	\$0.23	\$0.20	(\$0.05)	\$0.48	\$0.18	\$0.21	\$0.23	\$0.35	\$0.98	1.21
Pro Forma EPS	\$0.73	\$0.15	\$0.21	\$0.24	\$0.36	\$0.95	\$0.22	\$0.26	\$0.30	\$0.39	\$1.17	1.31
Option Expenses per share	-	-	-	-	-	-	(\$0.01)	(\$0.01)	(\$0.02)	(\$0.01)	(\$0.05)	(0.05)
Pro Forma EPS ex-option expenses	\$0.73						\$0.21	\$0.25	\$0.28	\$0.38	\$1.12	\$1.26
Avg. shares outstanding - Diluted	129.4	131.1	130.7	131.3	129.7	130.7	129.6	127.4	125.2	124.0	126.5	124.0
YEAR-OVER-YEAR GROWTH												
Life and Analytical Sciences	5.9%	6.2%	5.0%	6.3%	-8.2%	1.7%	-1.1%	2.8%	9.4%	10.0%	5.4%	7.0%
Optoelectronics	5.1%	12.7%	8.2%	7.4%	1.6%	7.2%	0.1%	1.4%	2.6%	4.5%	2.2%	4.5%
Total Revenues	5.7%	7.0%	5.8%	6.6%	-5.8%	3.1%	-0.8%	2.4%	7.5%	8.6%	4.5%	6.3%
Cost of Product Sales	-9.2%	4.6%	5.0%	3.2%	-5.5%	1.6%	1.5%	4.0%	9.3%	8.6%	5.9%	5.7%
Sales, General and Administrative	-6.1%	7.9%	1.8%	5.2%	-10.8%	0.6%	-8.4%	-2.3%	5.0%	10.2%	0.8%	5.6%
Research and Development	0.0%	20.2%	6.5%	7.8%	-6.1%	6.5%	-0.3%	12.1%	12.6%	29.2%	13.1%	7.3%
Operating Expenses	-3.7%	10.2%	3.0%	5.9%	-11.9%	1.3%	-6.8%	0.4%	6.5%	15.4%	3.6%	6.0%
Operating Income	49.9%	53.5%	61.7%	60.8%	31.8%	48.6%	37.9%	21.2%	17.0%	2.2%	15.9%	13.5%
Net Income - pro forma	24.6%	18.0%	51.1%	37.7%	24.8%	31.6%	42.3%	24.4%	20.6%	4.6%	19.0%	10.1%
EPS - pro forma	23.0%	18.0%	49.5%	35.7%	25.2%	30.5%	43.9%	27.6%	26.5%	9.4%	22.8%	13.3%
AS A PERCENTAGE OF REVENUES												
Life and Analytical Sciences	74.4%	73.9%	73.6%	72.0%	73.9%	73.4%	73.7%	73.9%	73.3%	74.9%	74.0%	74.4%
Optoelectronics	25.6%	26.1%	26.4%	28.0%	26.1%	26.6%	26.3%	26.1%	26.7%	25.1%	26.0%	25.6%
Fluid Sciences	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Gross Margin	42.9%	43.2%	43.1%	43.6%	44.3%	43.6%	41.9%	42.3%	42.6%	44.3%	42.8%	43.2%
Sales, general and administrative	25.4%	26.9%	25.3%	24.3%	22.7%	24.7%	24.9%	24.1%	23.7%	23.0%	23.9%	23.7%
Research and Development	5.8%	6.3%	6.0%	6.1%	5.4%	5.9%	6.4%	6.6%	6.3%	6.5%	6.4%	6.5%
Adj. Operating Expenses	31.1%	33.3%	31.3%	30.4%	27.7%	30.6%	31.2%	30.7%	30.1%	29.5%	30.3%	30.2%
Adj. Operating Margin	11.7%	10.0%	11.8%	13.2%	16.6%	13.0%	10.7%	11.6%	12.6%	14.9%	12.5%	13.0%
Pro forma tax rate (% of Pre-tax Income)	26.6%	27.1%	24.9%	25.0%	24.7%	25.2%	24.6%	18.3%	17.2%	23.5%	21.1%	24.5%
Net Income - Pro Forma	6.6%	4.2%	8.1%	7.2%	-1.8%	8.4%	6.6%	7.3%	9.7%	11.5%	9.6%	10.0%

Source: Company reports and UBS estimates

Sigma-Aldrich

Company Description

Headquartered in St. Louis, Missouri, Sigma-Aldrich (Sigma) is a leading global provider of chemical and other products for the life science and high-technology industrial markets. With operations in 35 countries and over 6,100 employees, the company manufactures and distributes 90,000 chemical and some 30,000 consumable and equipment products. Through a variety of distribution channels, including its numerous print catalogs and comprehensive Internet site, Sigma products are sold to 60,000 accounts that represent over 1 million individual customers across 150 countries. Today, over 40,000 of Sigma's products are self-manufactured, with the balance coming from around 10,000 suppliers.

Sigma is an established leader in fine chemicals for R&D

To help grow its top line, in 2004, the company stepped up its acquisition activity, focusing on companies with strong pharmaceutical and biotechnology customer bases. Recent acquisitions include those of Ultrafine and Tetrionics in 2004, and JRH and Proligo in 2005. The JRH acquisition, in our view, was particularly important, as it gives Sigma a strong No. 2 position in the rapidly growing biomanufacturing segment of the cell culture market.

In addition to acquisitions, Sigma has stepped up R&D, adding scientists to its workforce and new laboratory facilities to its infrastructure. The bulk of the company's R&D is being directed toward development of differentiated life sciences products, particularly in cell signaling, neuroscience, and proteomics. Ultimately, Sigma hopes that its recent acquisitions and targeted R&D will help diversify its portfolio and, in turn, re-accelerate growth. In short, Sigma-Aldrich is evolving from a fine chemicals distributor into a broad range and differentiated supplier to the biotechnology, pharmaceutical, life sciences, and high-technology industries.

In 2005, Sigma reported sales of \$1.67 billion, +18% y/y (5% organic). Sigma derives 40% of its sales from the U.S., 40% from Europe, and 20% from the rest of the world. About 40% of Sigma's sales are to pharma and biotech, 30% to academia, and 30% to industrials and hospitals.

Investment Summary

Sigma-Aldrich (SIAL, Neutral 1)

Sigma-Aldrich is a well-established supplier of fine chemicals and other consumable products for research and development. After a prolonged period of flat to declining volume growth, Sigma's core business has shown significant improvement since 2Q05. We believe the core chemicals business offers a relatively solid platform from which to grow, and we are increasingly optimistic about the long-term outlook. In the past two years Sigma has repositioned its portfolio and expanded its footprint in the faster-growing biotechnology, molecular biology, and biopharmaceutical markets. Through a number of

We rate Sigma-Aldrich Neutral 1

acquisitions, a step-up in internal R&D, and increased collaborations and licensing deals, Sigma is working to make up for having previously under-invested in top-line growth. We view this as a positive long-term move by Sigma and believe management is making prudent choices in its effort to evolve the company into a broad range, differentiated life sciences supplier. That said, with mid- to high-single-digit EPS growth forecast for 2006-08, we maintain our Neutral 1 rating until we foresee organic EPS growth more in line with the 10-15% rate of Sigma's life sciences peers.

Valuation

Our \$80 price target is 19x our 2007 EPS estimate of \$4.27, in line with the life sciences group average, and is supported by a DCF analysis using the UBS VCAM model (7.5% WACC, 2.5% terminal growth rate), which implies a share price of \$80.

Our 12-month price target for
SIAL is \$80

3Q Review and Recent Events

Sigma's 3Q sales totaled \$441.4 million, +7.1% y/y (including a 1.9% benefit from favorable currency movements) but short of our revenue growth estimate of \$446 million (8.2% growth) and the \$444 million consensus estimate. Sigma's 3Q saw a rebound to about 5% organic growth, up from 0.5-1% in 2Q. However, 5% growth was below our expectation of roughly 6% and company guidance of 8-9%. Year-to-date organic revenue growth of 5-6% is tracking below expectations and led Sigma to reduce its 2006 organic growth guidance from 7% to 6%.

Adjusted EPS (net of options) totaled \$1.02 (+7.4% y/y), as SIAL beat the Street estimate of \$0.96 and UBS estimate of \$0.97. Driving almost all of the EPS upside was the recognition of a lower tax rate of 24.1%, versus our estimate of 29.7%. Tax rate improvement was due to a reduction in tax liabilities related to tax audits.

Improved sales from the Research Specialties (+6.4%) and SAFC units (+7.4%) were somewhat offset by soft sales of synthetic DNA products from Research Biotech and cell culture reagents from Research Essentials. Uptake of new Research Biotech products was also slower than expected. Sales to pharmaceutical and diagnostic manufacturers in both the U.S. and Europe improved, while Sigma began to recognize contributions from acquisitions made in both 2Q and 3Q. International sales (ex-Europe) continued to do well, up 12% in 3Q, but penetration of the Japanese markets has proved difficult.

Gross margin declined to 50.5% from 52.1% a year earlier, and was below our estimate of 51.5%. The decline was due primarily to sales of lower-margin SAFC products, as well as a slower than expected uptake of new higher-margin Research Biotech products. SG&A and R&D expenses totaling 28% of sales (excluding about \$2.5 million in option expense) were below our estimate of 28.5%, due in part to benefits from cost savings initiatives.

Table 46: Sigma-Aldrich 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Change	3Q06 UBSe	First Call	Comments
Research Essentials	\$87.4M	4.5%	\$89.5M		2.5% organic growth; modest growth in sales to academic accounts, as well as other commercial accounts. 2006 goal of 4% organic growth
Research Specialties	\$164.2M	8.4%	\$162.1M		6.4% organic growth; growth in both academic and commercial accounts; in-line with 2006 goal of 6% organic growth
Research Biotech	\$65.4M	3.3%	\$69.3M		1.9% organic growth; slower growth to academic accounts and soft sales of DNA products
SAFC	\$124.4M	9.3%	\$125.2M		4-5% organic growth; strong demand from pharma and diagnostic manufacturers, coupled with contributions from 2Q and 3Q acquisitions— Iropharm and Pharmorphix
Total Revenues	\$441.4M	7.1%	\$446M	\$444	Overall sales growth of 7.1% with ~5% organic growth; demand from commercial accounts and contributions from 2Q and 3Q acquisitions (Beijing Superior, Iropharm, and Pharmorphix) drove increased sales
Adj. Gross Margin	50.5%	-160bp	51.5%	-	Y/Y decrease due to stronger sales of lower-margin SAFC products, delayed impact of a strong dollar earlier in 2006, and modest inventory write-offs
SG&A (% of Rev)	25.0%	-60bp	25.8%	-	Wage increases offset by lower professional fees, advertising, and compliance costs; We exclude option expense from SG&A
R&D (% of Rev)	3.0%	-10bp	3.2%	-	
Adj. Oper. Margin	22.5%	-70bp	23.1%	-	We exclude ~2.5M in stock option expense; 21.9% with options
Interest Expense (net)	\$6.5M	-	\$6.7M	-	
Tax Rate	23.4%		29.7%	-	The tax rate improvement was due to a reduction in tax liabilities related to tax audits
Share count	67.1		67.4		Repurchased 0.5M shares @ average price of \$70.52/share
Adj. EPS (net of options)	\$1.02		\$0.97	\$0.96	Net of \$0.04/share option expense

Source: Company reports, First Call, and UBS estimates

Sigma ended 3Q with \$137 million in cash and \$547 million in total debt. During the quarter, the company used about \$35.3 million to repurchase 0.5 million shares, citing an additional 5.2 million shares that have been authorized and earmarked for buyback. Finally, for 9M06, Sigma generated \$226 million in cash flow from operations and \$179 million of free cash flow.

Company Guidance

Sigma now expects 6% organic sales growth for 2006, with a currency contribution that will be minimal in 4Q and a wash for the year. Due to the lower tax rate (30-31% in 4Q06, versus prior guidance of 31-32%), Sigma raised its 2006 pro forma EPS guidance by \$0.05 to \$3.95-4.05 (net of options), which represents 3-6% growth from 2005.

UBS Estimates

Due to the lower expectations for organic growth, we modestly lowered our 2006 revenue forecast to \$1.779 billion from \$1.783 billion. Based on the lower tax rate assumptions and the \$0.05 beat in 3Q06, we raised our 2006 EPS estimate to \$4.00 from \$3.97, net of \$0.16 in stock option expenses. The tax benefits enjoyed in 2006 may not be repeated 2007, so we maintain our 2007 EPS estimate of \$4.27.

Table 47: Sigma-Aldrich 2006 Estimates (revenues in \$ millions)

	4Q06			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Revenues	-	\$446M (8.6%)	\$445M	6% organic growth	\$1,779M (6.7%)	\$1,778M
EPS (net of options)	-	\$0.94	\$0.94	\$3.95-4.05	\$4.00	\$4.00

Source: Company reports, First Call, and UBS estimates

Recent Events

On November 14, Sigma announced that it will pay a 100% stock dividend on January 2, 2007, to shareholders of record on December 15, 2006. There were 65.9 million shares outstanding at September 30, 2006. Sigma has the capacity to buy back an additional 5.2 million shares under its current share repurchase authorization.

Table 48: Sigma-Aldrich Earnings Model, 2004-07E

Dollars in millions, except per share data
Fiscal year ended December 31

	2004A					2005A					2006E	2007E
	FY	1Q4	2Q4	3Q4	4Q4	FY	1Q5	2Q5	3Q5	4Q5	FY	FY
Revenues												
Research Essentials	833.7	87.5	88.6	83.6	81.3	341.0	91.8	88.1	87.4	85.4	352.7	373.8
Research Specialties	312.4	161.4	160.7	151.5	152.6	626.2	168.8	164.1	164.2	165.6	662.7	709.1
Research Biotech		65.6	68.3	63.3	64.8	262.0	71.8	69.0	65.4	68.4	274.6	296.5
SAFC	263.1	85.3	126.4	113.8	111.8	437.3	110.7	127.3	124.4	126.3	488.7	527.8
Total Revenues	1,409.2	399.8	444.0	412.2	410.5	1,666.5	443.1	448.5	441.4	445.6	1,778.6	1,907.2
Cost of products sold (adjusted for inventory build)	657.6	190.9	216.8	197.4	201.4	806.5	212.3	214.0	218.7	219.9	864.9	916.4
Gross Margin	751.6	208.9	227.2	214.8	209.1	860.0	230.8	234.5	222.7	225.7	913.8	990.8
Operating Expenses												
Sales, general and administrative	390.0	104.8	116.8	109.0	106.1	436.7	109.5	114.3	110.4	111.4	445.6	482.5
R&D Expense	42.6	11.7	13.1	12.8	12.2	49.8	13.0	13.4	13.2	13.5	53.1	57.2
Operating Expenses	432.6	116.5	129.9	121.8	118.3	486.5	122.5	127.7	123.6	125.0	498.8	539.8
Operating Income	319.0	92.4	97.3	93.0	90.8	373.5	108.3	106.8	99.1	100.8	415.0	451.1
Interest income (expense), net	(7.2)	(2.2)	(4.9)	(5.0)	(6.0)	(18.1)	(5.3)	(6.3)	(6.5)	(6.8)	(24.9)	(25.0)
Other income (expense), net	-	-	-	-	-	-	-	-	-	-	-	-
Income from continued ops before taxes	311.8	90.2	92.4	88.0	84.8	355.4	103.0	100.5	92.6	94.0	390.1	426.1
Provision for taxes	78.9	25.8	26.2	20.9	20.0	92.9	32.6	26.8	21.7	28.7	109.8	134.2
Net Income - Pro Forma	232.9	64.4	66.2	67.1	64.8	262.6	70.4	73.7	70.9	65.3	280.3	291.9
Discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-
Other one-time	-	10.2	(3.3)	(2.7)	(4.1)	0.1	(2.0)	(2.0)	(0.3)	-	(4.4)	-
Net Income - GAAP	232.9	74.6	62.9	64.4	60.7	262.6	68.4	71.7	70.6	65.3	275.9	291.9
GAAP EPS	\$3.34	\$1.07	\$0.91	\$0.94	\$0.89	\$3.82	\$1.01	\$1.06	\$1.05	\$0.98	\$4.09	\$4.42
Pro Forma EPS (ex-option expenses)	\$3.34	\$0.93	\$0.96	\$0.98	\$0.95	\$3.82	\$1.04	\$1.09	\$1.06	\$0.98	\$4.16	\$4.42
option expenses / share	-	-	-	-	-	-	(\$0.03)	(\$0.05)	(\$0.04)	(\$0.04)	(\$0.16)	(\$0.15)
GAAP EPS (net of options)	\$3.34	\$1.07	\$0.91	\$0.94	\$0.89	\$3.82	\$0.98	\$1.01	\$1.01	\$0.94	\$3.94	\$4.27
Pro Forma EPS (net of option expenses)	\$3.34	\$0.93	\$0.96	\$0.98	\$0.95	\$3.82	\$1.01	\$1.04	\$1.02	\$0.94	\$4.00	\$4.27
Avg. shares outstanding - Diluted	69.8	69.7	69.0	68.2	68.1	68.7	68.0	67.6	67.1	66.9	67.4	66.0
AS A PERCENTAGE OF REVENUES												
Research Essentials	59.2%	21.9%	20.0%	20.3%	19.8%	20.5%	20.7%	19.6%	19.8%	19.2%	19.8%	19.6%
Research Specialties	22.2%	40.4%	36.2%	36.8%	37.2%	37.6%	38.1%	36.6%	37.2%	37.2%	37.3%	37.2%
Research Biotech	18.7%	16.4%	15.4%	15.4%	15.8%	15.7%	16.2%	15.4%	14.8%	15.3%	15.4%	15.5%
SAFC		21.3%	28.5%	27.6%	27.2%	26.2%	25.0%	28.4%	28.2%	28.3%	27.5%	27.7%
Adjusted Gross Margin	53.3%	52.3%	51.2%	52.1%	50.9%	51.6%	51.6%	52.3%	50.5%	50.7%	51.4%	52.0%
Sales, general and administrative	27.7%	26.2%	26.3%	26.4%	25.8%	26.2%	24.7%	25.5%	25.0%	25.0%	25.1%	25.3%
Research and Development	3.0%	2.9%	3.0%	3.1%	3.0%	3.0%	2.9%	3.0%	3.0%	3.0%	3.0%	3.0%
Operating Expenses	30.7%	29.1%	29.3%	29.5%	28.8%	29.2%	27.6%	28.5%	28.0%	28.0%	28.0%	28.3%
Operating Margin	22.6%	23.1%	21.9%	22.6%	22.1%	22.4%	23.3%	23.1%	22.5%	22.6%	23.3%	23.7%
pre-tax margin	22.1%	22.6%	20.8%	21.3%	20.7%	21.3%	23.3%	22.4%	21.0%	21.1%	21.9%	22.3%
Tax rate (pro forma)	25.3%	28.6%	28.3%	23.8%	23.6%	26.1%	31.7%	26.7%	23.4%	30.50%	28.1%	31.5%
Net Income - Pro Forma	16.5%	16.1%	14.9%	16.3%	15.8%	15.8%	15.9%	16.4%	16.1%	14.7%	15.8%	15.3%
YEAR-OVER-YEAR GROWTH												
Research Essentials	8.5%						4.9%	-0.6%	4.5%	5.0%	3.4%	6.0%
Research Specialties	6.2%						4.6%	2.1%	8.4%	8.5%	5.8%	7.0%
Research Biotech	11.9%						9.5%	1.0%	3.3%	5.5%	11.8%	8.0%
SAFC		30.6%	94.5%	76.7%	63.5%	66.2%	29.8%	0.7%	9.3%	13.0%	6.7%	14.0%
Total Revenues	8.6%	8.6%	27.4%	21.0%	16.7%	18.3%	10.8%	1.0%	7.1%	8.6%	6.7%	7.2%
Cost of Product Sales	4.8%	11.3%	32.7%	24.7%	22.4%	22.6%	11.2%	-1.3%	10.8%	9.2%	7.2%	6.0%
Sales, General and Administrative	13.0%	5.2%	26.5%	15.6%	2.2%	12.0%	4.5%	-2.1%	1.3%	5.0%	2.0%	8.3%
Research and Development	0.1%	9.3%	28.4%	20.8%	9.9%	16.9%	11.1%	2.3%	3.1%	11.0%	6.7%	7.7%
Operating Expenses	11.6%	5.6%	26.7%	16.1%	3.0%	12.5%	5.2%	-1.7%	1.5%	5.6%	2.5%	8.2%
Operating Income	12.7%	9.9%	20.8%	22.2%	27.9%	17.1%	20.1%	15.5%	12.6%	18.8%	11.1%	8.7%
Net Income - pro forma	22.3%	3.4%	11.1%	19.2%	18.4%	12.7%	9.2%	11.2%	5.7%	0.8%	6.8%	4.1%
EPS - pro forma	24.7%	3.8%	12.4%	22.0%	21.1%	14.5%	11.9%	13.5%	7.4%	2.6%	8.9%	6.7%

Source: Company reports and UBS estimates

Thermo Fisher Scientific

Company Description

On November 9, 2006, Thermo Electron completed its merger with Fisher Scientific. The combined company, named Thermo Fisher Scientific, continues to trade under the symbol TMO.

Thermo Fisher Scientific is the largest, most diversified life sciences company

Before the merger, Thermo Electron was the largest provider of analytical instruments and equipment, serving markets ranging from drug discovery and basic life sciences research to mining and environmental monitoring. The company comprised two segments: Life and Laboratory Sciences, which serves pharmaceutical, biotechnology, and other research and industrial laboratory customers, and Measurement and Control, which provides analytical tools, online process instruments, and precision temperature-control systems used to increase quality, improve productivity, and meet environmental and other regulatory standards. With approximately 70% of revenues generated from capital equipment sales and 30% from consumables and services, Thermo Electron recorded total sales of \$2.6 billion in 2005.

Fisher Scientific was a leading global provider of laboratory consumables and equipment distribution for the life sciences sector. Fisher offers over 700,000 products from 6,000 suppliers to customers in a variety of industries across 145 countries. Tapping a variety of channels, including its famous “Fisher Catalog,” the company has maintained a nearly ubiquitous presence in scientific research and clinical laboratories. At the time of the merger, Fisher comprised two segments as continuing operations—Scientific Products and Services and Healthcare Products and Services—and one segment as a discontinued operation—Laboratory Workstations. The segments generated total combined sales of approximately \$5.6 billion in 2005.

The combined company, Thermo Fisher Scientific, expects to leverage the complementary portfolios, deep marketplace penetration, and expansive geographic coverage of both businesses to become a life sciences superstore. The company will have a highly diversified and more balanced portfolio mix, with approximately 56% of sales from consumables, 28% from instrumentation, and 16% from software and services. The markets within which Thermo Fisher will operate are expected to consist predominantly of life sciences customers (46%), followed by industrial/ environmental customers (34%), and healthcare customers (20%). The combined company will generate approximately 66% of sales from North America, 24% from Europe, and 9% from ROW.

Investment Summary

Thermo Fisher Scientific (TMO, Buy 1)

Since the 1999-2003 restructuring, Thermo Electron had consistently delivered solid EPS growth with improvements in operating margins, despite top-line pressures resulting from weak end markets. Solid customer spending, new products (both internally developed and acquired), and market share gains, along with ongoing productivity gains, have helped it achieve organic revenue growth of 4-5% and EPS growth of about 15%. We believe Thermo Fisher Scientific will continue to deliver on, and likely improve upon, this excellent track record.

We rate Thermo Fisher Buy 1

In our view, the Thermo Electron-Fisher Scientific merger made strategic sense for Thermo, as it helps diversify the company by shifting the product mix more toward consumables, which, in turn, should help smooth the quarterly capital equipment volatility and reduce cyclicality. In addition, the deal expands both companies' market access and geographic reach and diversifies the customer base. Indeed, the combined company is well positioned to capture increased demand for life sciences products in emerging markets such as China and India.

The long-term financial goals outlined for the combined company are compelling, with improved organic sales growth (to 6-8% from 4-5%), accelerated EPS growth (adjusted three-year EPS CAGR of 20%, well above the sector average), and operating cash flow of over \$1 billion in 2007. Based on our analysis, as well as management's excellent execution history, we are optimistic that the deal will deliver the promised synergies (about \$200 million over three years). We believe this is a sound strategic move and that Thermo Fisher is well on its way toward achieving management's goal of "owning the lab."

Valuation

Our \$52 price target is based on 18.5x our 2008 pro forma EPS estimate of \$2.79 (net of estimated \$0.13 option expenses). Prior to the deal, TMO shares traded at 20x while FSH shares traded at 16x. In our view, given that about two-thirds of the combined company now resembles FSH, in the near term TMO shares may trade at an intermediate multiple of about 18.5x until the Street becomes comfortable with the combined company. Ultimately, we believe TMO will execute well and deliver the promised deal synergies, and we foresee multiple expansion as a result. A DCF analysis using the UBS VCAM model (5% terminal growth rate and 8.9% WACC) implies a price target of about \$57.

Our 12-month price target for TMO is \$52

3Q Review and Recent Events

Since the Thermo-Fisher merger closed on November 9, we discuss 3Q results for both companies.

Thermo Electron 3Q Results

TMO reported total 3Q revenues of \$725 million (+6.7%; about 6% organic, -1% from Divestiture, 2% from F/X impact), above the \$701 million UBS estimate and \$712 million consensus. Steady demand for new products (TMO's vitality index—the percentage of revenues from products introduced in the last two years—was 27%) and solid global end markets helped drive sales growth above our expectations. TMO continues to experience solid demand from its Big Pharma customers, while biotech and industrials remain robust. Both WAT and FSH also reported a pickup from their pharma customers in 3Q06. We are still cautious on Big Pharma, but we believe TMO's strong market position should help it better weather the changes in this important end market.

Table 49: Thermo Fisher 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Change	3Q06 UBSe	First Call	Comments
Life and Lab Sciences	\$543.5M	5.3%	\$531M		~4-5% organic growth, driven by strong pharma/biotech/industrial demand and continued adoption of new mass spectrometry products
Measurement and Control	\$181.5M	11.1%	\$170M		9-10% organic growth; continues to benefit from late-cycle industrial capacity expansion, demand for process control, and geographical expansion (e.g., China)
Total Revenues	\$725M	6.7%	\$701M	\$712M	~6% organic growth, with -1% impact from divestitures, + 2% F/X impact; The company upped the full-yr guidance to \$2.88-2.90B (9-10% y/y) from prior \$2.81-2.86B (8-9%)
Adj. Gross Margin	46.7%	+140bp	45.6%		Higher GM due to distribution shift, new products, and manufacturing efficiency
SG&A (% of Rev)	25.7%	+90bps	24.3%		Higher SG&A due to one-time charge of \$2.5M relating to UK pension, higher new product selling costs and business location shift; will trend down again in 4Q
R&D (% of Rev)	5.3%	-40bps	5.6%		Generally in line
Adj. Operating Margin	15.7%	+100bp	15.8%		In line, due to higher sales, higher GM, but offset by higher SG&A; On track toward 2006 goal of "well above 100bp expansion"
Interest Expense (net)	\$4.4M	-\$1.3M	\$4.9M		Higher debt to fund share repurchase
Tax Rate	30.6%	+210bps	30.5%		In line
Share Count	162.2M	-3.4M	165.5M		During 2Q TMO ought back 6.3 M; seeing benefit now in 3Q
EPS Adjusted	\$0.44	+10%	\$0.43	\$0.43	Net of \$0.03 option expenses. TMO upped 2006 EPS guidance (net of \$0.10 in options) to \$1.74-1.77 (18-20% y/y) from prior \$1.68-1.73 Assuming 11/09 merger close, mgmt expects \$0.01-0.03 accretion in 4Q from incremental earnings from FSH; \$0.06-0.08 in FY06 due to share impact

Source: Company reports, First Call, and UBS estimates

Adjusted EPS of \$0.44 (net of \$0.03 option expenses) were above our estimate and the consensus of \$0.43, as higher sales (top-line improvement) and gross margins (46.7% versus the UBS estimate of 45.6%) were offset by higher SG&A (25.7% versus the UBS estimate of 24.3%). SG&A was higher than expected mainly because of a one-time charge of \$2.5 million for UK pension expenses and some shift-of-business location-related expenses. We expect SG&A to revert to a more normal rate of about 24.5% of sales.

Europe and Asia-Pacific both grew at in the high single digits, with China growing over 15%. North America was up slightly, while the rest of the world rebounded from last quarter, growing 30%.

Life and Laboratory Sciences revenues totaled \$543.5 million, +5.3% y/y, with about 4-5% organic (versus our 3-4% estimate). During the conference call, management indicated that the company's mass spectrometry products (Orbitrap, iCAP, and the new LTQ FT Ultra) remained strong and were increasingly being adopted for research (e.g., proteomics and small molecule research across the spectrum of customers) and industrial applications (e.g., commodity material productions).

Measurement and Control (M&C) sales totaled \$181.5 million (+11.1%—about 9-10% organic). Growth continues to be driven by robust demand for commodity materials (a result of the global industrial capacity expansion, wherein TMO sales are more related to late-cycle business activities) and sales of environmental testing, safety, and security products.

During 3Q, TMO acquired EGS Gauging, a manufacturer of measurement and control systems for web process applications in the plastics process and converting industries, and GV Instruments, a UK manufacturer of isotope ratio mass spectrometry systems.

Recently, TMO's Advanced Spectroscopic Portal (ASP) monitors were chosen as part of a \$1.2 billion Department of Homeland Security (DHS) contract. ASPs are used at ports and borders to detect nuclear/radiological materials. The DHS plans to equip more than 380 sites with radiation detection equipment. With the first release of \$14.6 million to TMO for development and testing and initial deployment of its ASP, we believe this contract could lead to over \$200 million in sales over five years to TMO's M&C.

TMO ended 3Q06 with cash and equivalents of \$173 million, and total debt declined to \$539 million from \$639 million. Operating cash flow during 3Q was strong, at \$101.1 million, and free cash flow amounted to \$93 million.

Fisher Scientific 3Q Results

Fisher's 3Q provided few surprises, and the company delivered another strong quarter of improving organic sales growth and expanding margins. The company reported EPS of \$1.09 (net of \$0.06 in stock option expense) versus the \$1.02 consensus estimate. A lower than expected tax rate (22.7% versus the UBS estimate of 25%) contributed about \$0.03 to the upside.

Total 3Q revenues of \$1.508 billion (+10.8% y/y—6.4% organic growth, 1.2% F/X, 3.2% acquisition) were slightly better than UBS and Street estimates of \$1.490-1.493 billion. Excluding F/X and safety products, the core scientific-health care business grew 8.6% organically, better than our 7% estimate.

Scientific products and services grew 9.9% (6.0% organic or 8.8% excluding safety-related products, which continue to be affected by slow domestic preparedness sales to government agencies). Notably, FSH saw mid-teens growth from its pharma customers, driven by strong demand for biopharmaceutical service (e.g., Lancaster Labs, FSH's CRO), clinical trial packaging, biological sample and specimen management, and clinical trial logistics management), compared to high-single-digit growth in 2Q06.

Demand from other customer segments was also strong, with more than 20% growth from biotech customers, mid-single-digit growth from academic (driven by orders from educational institutions at the start of the school year) and industrial customers, and mid-teens growth from government agencies and labs (ex-safety). Healthcare products and services grew 14% (8.6% organic, 0.2% F/X, 5.2% acquisitions), driven by strong demand for the company's proprietary diagnostic tests and outsourcing by life sciences and diagnostic companies.

During 9M06, FSH generated operating cash flow of \$423.7 million with capital expenditures totaling \$115.4 million, resulting in free cash flow of \$308.3 million. The company continued to guide for full-year operating cash flow of \$675-700 million and FCF of \$525-550 million, which include one-time charges related to both pre- and post-merger cost from the TMO/FSH deal and other acquisitions. We believe TMO/FSH will be able to achieve the combined operating cash flow guidance of "over \$1 billion" in 2007.

FSH maintained its full-year sales growth target of 10% (excluding the impact of currencies), in the middle of the prior 9-11% range, with an organic growth target of 6%, at the lower end of the prior 6-8% range due to the drag from safety-related products. Excluding these products, organic growth would be closer to 8%. FSH finished 3Q06 with improved operating margins of 15.0% versus 13.5% in 3Q05.

Company Guidance

During the company's 3Q06 conference call, TMO raised its 2006 revenue outlook to \$2.88-2.90 billion, +9-10%, versus prior guidance of \$2.81-2.86 billion (+7-9%), resulting in full-year EPS (net of \$0.10 option expense) of \$1.74-1.77 versus prior guidance of \$1.68-1.73.

Separately, FSH raised its 2006 EPS guidance to \$4.30-4.35 (excluding \$0.28 of equity-based stock option expenses) versus prior guidance of \$4.15-4.30, based on the improved operating margin outlook (to 14.4-14.5% versus prior guidance of 14.1-14.3%) and lower tax (24% versus prior 25%). The company maintained its full-year sales growth target of 10% (excluding the impact of currencies), which is in the middle of the prior 9-11% range, and cited an organic growth target of 6%, the lower end of the prior 6-8% range due to the drag from safety-related products.

With the completion of the merger, TMO management expects accretion of \$0.01-0.03 to 4Q06 earnings and \$0.06-0.08 to FY06 EPS due to the favorable effect of incremental earnings from FSH and the combined share count of TMO/FSH. This assumption is based on the remaining six weeks after the completion of the TMO/FSH deal, instead of the full 12 weeks in a typical 4Q and reflects minimal impact from integration synergies.

On the May 8 conference call announcing the deal, TMO management guided to 2007 total sales of \$9.2-9.3 billion, an adjusted operating margin of about 17%, and adjusted EPS (including option expenses) of \$2.27-2.37.

Table 50: Financial Goals for Thermo Fisher Scientific

	2007	Long-term
Revenue	\$9.2-9.3B	6-8% organic growth
Adjusted Operating Margin	17%	19-20%
Adjusted EPS (net of options)	\$2.27-2.37	18-20% growth
Operating Cash Flow	Over \$1B	-

Source: TMO conference call, 5/8/06

Thermo expects \$200 million of integration synergies during the next three years, with at least \$75 million to be realized in 2007. The \$200 million will include about \$150 million in cost savings (manufacturing rationalization, leverage of combined purchasing power, and administrative consolidation) and \$50 million in revenue synergies (cross-selling, geographic expansion, new markets, and new products). We admit that it is difficult to quantify this early in the process, but we think TMO's goal of delivering \$50 million in revenue synergies (to operating income) from the deal sounds reasonable.

TMO will formally update its 2007 expectations at a December 14 analyst meeting. Given the conservative nature of TMO's management, we do not expect dramatic changes to preliminary 2007 guidance at that time. In our view, management is likely to adjust EPS guidance to a range of \$2.30-2.40. TMO typically provides a three-year revenue and EPS outlook during its mid-May analyst meeting, and we expect further refinements to guidance at that time.

UBS Estimates

For 4Q06, we expect TMO/FSH to earn adjusted EPS of \$0.52 (net of \$0.02 option expenses) on total sales of \$1.513 billion (\$778 million for the full three months from TMO and \$735 million for the remaining days after the close of the merger from FSH). We raised our full-year 2006 estimates to \$3,636 million from \$2,893 million in sales, and to \$1.81 from \$1.76 in EPS.

For 2007, we expect TMO/FSH to generate sales of \$9,296 million versus our prior estimate of \$3,042 million for the stand-alone TMO. Our 2008 revenue estimate is \$9,833 million. We expect TMO/FSH to achieve adjusted operating margins of 17.5% in 2007 and 18.8% in 2008 (our adjusted margin excludes the impact of stock options), with enhanced gross margins (41.8% in 2007 and 42.8% in 2008), leaner SG&A (22.1% in 2007 and 21.8% in 2008) and reduced taxes (28.5% in 2007 and 27.3% in 2008). In total, we expect adjusted EPS (net of options) for the combined company of \$2.35 in 2007 and \$2.79 in 2008.

Table 51: TMO 2006 Estimates (revenues in \$ millions)

	4Q 2006			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Total Revenues	-	\$1513	\$1474	-	\$3636	\$3602
EPS (net of options)	-	\$0.52	\$0.53	-	\$1.81	\$1.80

Source: Company reports, First Call, and UBS estimates

Table 52: Thermo Electron Earnings Model, 2004-07E

Dollars in millions, except per share data
Fiscal year ended December 31

	2004A					2005A					2006E	2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
Revenues												
Life and Laboratory Sciences	1,573.0	393.3	487.5	516.0	563.3	1,960.2	512.4	539.3	543.5	594.3	2,189.4	2,296.7
Measurement and Control	634.1	165.9	166.2	163.4	177.4	672.9	171.9	174.2	181.5	184.5	712.2	736.4
Scientific Instruments and Services										560.0	560.0	4,798.4
SI & S (Pre-Merger)		983.8	1,030.4	1,060.1	1,066.9	4,141.2	1,076.9	1,126.0	1,165.3	1,180.0	4,548.2	
Healthcare Products and Services										183.0	183.0	1,529.9
HC & S (Pre-Merger)		336.7	326.2	317.5	324.0	1,304.4	353.5	356.4	362.1	385.0	1,457.0	
Elimination	(3.5)	-	-	-	-	-	-	-	-	(8.6)	(8.6)	(65.0)
Total Revenues	2,206.0	559.2	653.6	679.4	740.8	2,633.0	684.3	713.5	725.0	1,513.29	3,636.0	9,296.3
Cost of Revenues	1,188.2	300.0	354.7	372.0	398.1	1,424.7	371.7	387.7	386.1	877.0	2,022.4	5,415.1
Gross Margins	1,017.8	259.2	298.9	307.5	342.7	1,208.3	312.6	325.8	338.9	636.3	1,613.6	3,881.2
Operating Expenses												
Selling, General & Admin.	603.6	156.1	173.5	168.8	185.8	684.1	173.5	175.9	186.7	349.5	885.6	2,077.7
Research and Development	134.7	36.3	39.4	38.8	38.2	152.8	38.7	39.6	38.7	46.1	163.1	232.4
Amortization of Intangibles	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	738.3	192.4	212.9	207.5	224.1	836.9	212.3	215.5	225.3	395.6	1,048.7	2,310.1
Operating Income	279.5	66.8	86.0	99.9	118.7	371.4	100.3	110.3	113.5	240.7	564.9	1,571.1
Net Interest Income (expenses)		0.2	(4.7)	(5.8)	(4.5)	(14.8)	(4.3)	(4.5)	(6.5)	(22.9)	(38.1)	(141.0)
Other Income, net	14.1	3.1	2.6	3.4	0.9	10.0	0.5	1.2	0.7	(2.4)	0.0	2.0
Income before taxes	291.6	70.3	83.9	97.5	115.0	366.5	96.6	106.9	107.8	215.5	526.8	1,432.1
Income Tax Provision	(83.2)	(19.7)	(25.1)	(31.8)	(34.5)	(111.1)	(28.4)	(30.7)	(31.5)	(60.1)	(150.7)	(408.1)
Minority Interest Income	-	-	-	-	-	-	-	-	-	-	-	-
Restructuring and Other	(9.0)	-	-	-	-	-	(3.6)	(4.8)	(5.2)	-	(13.6)	-
Income from Continuing Ops	199.4	50.7	58.8	65.6	80.5	255.4	64.5	71.4	71.1	155.4	362.5	1,023.9
Add back: Restructuring Charge	9.0	-	-	-	-	-	3.6	4.8	5.2	-	13.6	-
Income X-Extraordinary Items	208.4	50.7	58.8	65.6	80.5	255.4	68.1	76.2	76.3	155.4	376.1	1,023.9
EPS - Pro Forma (ex-option expenses)	\$1.25	\$0.31	\$0.36	\$0.40	\$0.48	\$1.54	\$0.41	\$0.46	\$0.47	\$0.54	\$1.92	\$2.49
Option expenses							(\$0.02)	(\$0.04)	(\$0.03)	(\$0.02)	(\$0.11)	(\$0.14)
EPS - Pro Forma (with option expenses)	\$1.25	\$0.31	\$0.36	\$0.40	\$0.48	\$1.54	\$0.39	\$0.42	\$0.44	\$0.52	\$1.81	\$2.35
Average Shares Outstanding - Diluted	167.6	164.7	164.7	165.6	166.3	165.3	167.0	165.5	162.2	290.4	196.3	411.0
YEAR-OVER-YEAR CHANGE												
Life and Laboratory Sciences	21.8%	7.7%	31.8%	34.7%	23.8%	24.6%	30.3%	10.6%	5.3%	5.5%	11.7%	5%
Measurement and Control	4.8%	3.0%	6.9%	2.6%	12.1%	6.1%	3.6%	4.8%	11.1%	4.0%	5.8%	3%
Scientific Instruments and Services										NA	NA	757%
Healthcare Products and Services										NA	NA	736%
Total Revenues	16.1%	6.5%	24.4%	25.3%	20.8%	19.4%	22.4%	9.2%	6.7%	104.3%	38.1%	155.7%
Cost of Revenues	16.6%	6.5%	24.0%	27.8%	20.9%	19.9%	23.9%	9.3%	3.8%	120.3%	42.0%	167.8%
Gross Margins	15.7%	6.6%	25.0%	22.4%	20.7%	18.7%	20.6%	9.0%	10.2%	85.7%	33.5%	140.5%
Selling, General & Admin.	18.3%	6.4%	23.2%	14.5%	10.2%	13.3%	11.2%	1.4%	10.6%	88.1%	29.4%	134.6%
Research and Development	5.2%	6.0%	21.0%	18.0%	9.4%	13.4%	6.6%	0.5%	-0.3%	20.6%	6.8%	42.5%
Total Operating Expenses	15.7%	6.3%	22.7%	15.2%	10.0%	13.4%	10.3%	1.2%	8.6%	76.6%	25.3%	120.3%
Operating Income	15.7%	7.3%	30.8%	40.6%	47.5%	32.9%	50.2%	28.2%	13.6%	102.9%	52.1%	178.1%
Income from Continuing Ops	23.2%	20.6%	23.0%	38.6%	29.4%	28.1%	27.4%	21.4%	8.4%	93.1%	41.9%	182.5%
Cash EPS - Pro Forma	14.6%	14.7%	24.3%	25.2%	27.9%	23.5%	32.7%	28.9%	18.7%	10.6%	24.0%	30.0%
AS A PERCENTAGE OF REVENUES												
Life and Laboratory Sciences	71.3%	70.3%	74.6%	76.0%	76.0%	74.4%	74.9%	75.6%	75.0%	39.3%	60.2%	24.7%
Measurement and Control	28.7%	29.7%	25.4%	24.0%	24.0%	25.6%	25.1%	24.4%	25.0%	12.2%	19.6%	7.9%
Scientific Instruments and Services	0.1%	0.0%								37.0%	15.4%	51.6%
Healthcare Products and Services										12.1%	5.0%	16.5%
Cost of Revenues	53.9%	53.6%	54.3%	54.7%	53.7%	54.1%	54.3%	54.3%	53.3%	58.0%	55.6%	58.3%
Gross Margins	46.1%	46.4%	45.7%	45.3%	46.3%	45.9%	45.7%	45.7%	46.7%	42.1%	45.0%	41.8%
Selling, General & Admin.	27.4%	27.9%	26.5%	24.8%	25.1%	26.0%	25.4%	24.6%	25.7%	23.1%	24.4%	22.4%
Research and Development	6.1%	6.5%	6.0%	5.7%	5.2%	5.8%	5.7%	5.6%	5.3%	3.0%	4.5%	2.5%
Total Operating Expenses	33.5%	34.4%	32.6%	30.5%	30.2%	31.8%	31.0%	30.2%	31.1%	26.1%	28.8%	24.9%
Operating Income	12.7%	11.9%	13.2%	14.7%	16.0%	14.1%	14.7%	15.5%	15.7%	15.9%	15.5%	16.9%
Tax Rate	28.5%	28.0%	29.9%	32.7%	30.0%	30.3%	30.5%	30.6%	30.6%	28.7%	30.1%	28.5%
Income X-Extraordinary Items	9.4%	9.1%	9.0%	9.7%	10.9%	9.7%	10.0%	10.7%	10.5%	10.3%	10.3%	11.0%

Source: Company reports and UBS estimates

Varian, Inc.

Company Description

Headquartered in Palo Alto, California, Varian is a major supplier of instruments and consumables for life sciences and broader industrial sectors. In April 1999, Varian was spun off from Varian Associates Inc. as part of a major restructuring effort by the parent company. In July 2000, Varian announced a significant commitment to grow its life sciences exposure across all business segments to at least 50% to benefit from the fertile life sciences market. The investment in life sciences has also diversified Varian's customer base, which had been dominated by industrial markets, some of which are highly cyclical. In February 2005, the company divested its non-core electronics manufacturing services business, which left Varian with two business segments—scientific instruments and vacuum technologies.

Varian is a broad-based supplier of instruments, consumables, and services to life sciences and industrial customers

As a result of its internal R&D investment and acquisition strategy, Varian has significantly refreshed its product line over the past three years. The company's acquisition strategy has also greatly contributed to the life sciences expansion. By FY05, Varian's sales in the life sciences market had reached 45% of total sales, up from 25% in FY99. Over the long term, we expect Varian to maintain a balanced position among end users through continuing R&D investment and acquisitions using its strong free cash flow. We believe this strategy will allow the company to take advantage of long-term growth prospects for life sciences and to capture high-growth opportunities in the broader industrial categories.

Investment Summary

Varian (VARI, Neutral 2)

We consider Varian a solid supplier of general instruments in the research and industrial lab, with strong client relationships and a reputation for rapidly adapting to customer needs. In addition, Varian's management has successfully diversified its business lines with its investment in life sciences, resulting in one of the most balanced product portfolios in its peer group. We believe the company has built a solid base for revenue growth in life sciences and can benefit from a recovering global economy.

We rate Varian Neutral 2

Varian is a global leader in nuclear magnetic resonance (NMR) technology, a technique used to determine the 3D structure of biological and chemical molecules. We estimate that NMR products and services account for 20-25% of Varian's total sales and that the company has an installed base of about 3,000 instruments. NMR is one of the fastest-growing segments of the scientific instruments market. We estimate the NMR market at \$750 million in 2005, growing at 8-10%. Over the longer term, we believe this market can be significantly expanded as NMR technology moves out of the core lab as instruments become compact and easier to use; Varian should be at the forefront of this evolution.

Varian had previously set a “stretch” goal of about \$1 billion in sales (around 12% CAGR—half organic, half from acquisitions) and core operating margins of about 14% by the end of FY07 (versus 10.2% in FY05 and 11.2% in F3Q06). To get there, the company is focusing on a series of smaller, specialized acquisitions, a shift in the product mix toward higher-margin consumables and higher-value “information-rich detectors” (e.g., mass spectrometers, NMR, IR), lean manufacturing and productivity gains (particularly in vacuum technologies), and tight cost control. However, on the 4Q conference call, management was less supportive of this goal and gave 2007 EPS guidance below our expectations, suggesting limited near-term upside.

Valuation

Our \$50 price target is about 20x our FY08 EPS estimate of \$2.50. This target is supported by the UBS VCAM DCF model, which assumes a WACC of 9% and a terminal growth rate of 3.5% and yields a price target of about \$50.

Our 12-month price target for VARI is \$50

Fiscal 4Q06 Review and Recent Events

Overall, Varian had a solid F4Q06. Total revenues of \$220 million were in line with Street and UBS estimates, while adjusted EPS of \$0.54 beat UBS and consensus estimates by \$0.02.

We estimate that organic sales growth in 4Q approximated 8%, above the company’s historical level of about 6%. Vacuum technologies recorded revenues of \$36.6 million, up over 6% from 4Q05. Slow growth at some North American vacuum customers was offset by strong demand across Europe and the Pacific Rim.

Scientific Instruments grew by 12% (about 7% organic) during FY4Q. Sales growth was driven by strong order volume for imaging products and NMR systems, as well as the launch of new products. In addition, modestly improved spending by Big Pharma apparently stimulated purchase demand.

Industrial sales were strong in FY4Q. End-market use by customers with energy, mining, and environmental applications increased, resulting in higher demand for mass spectrometry products. International growth was particularly strong, as Germany and France overcame recent sluggish purchasing to help boost European sales by 7%. In addition, direct sales to countries such as Russia, India, and Brazil were brisk, reflecting the strong push into emerging markets. ROW sales accounted for 20% of quarterly revenue.

Table 53: Varian, Inc. Fiscal 4Q06 Income Statement Highlights

	F4Q06 Actual	Y/Y Growth	F4Q06 UBSe	Comments
Scientific Instruments	\$183M	11.8%	\$180.5M	F4Q06 saw strong mass spec sales and improving amaging/NMR to industrial and international customers
Vacuum Technologies	\$36.6M	6.4%	\$38.9M	Strong demand from both Industrial and Life Science markets; growth down from double digits
Total Revenues	\$219.4M	10.9%	219.4M	~ 10% ex-acquisition growth
Adj. Gross Margin	46.9%	+150bps	46.7%	In line; y/y improvement due to sales volume leverage and better product mix
SG&A (% Rev)	27.3%	+10bps	27.5%	In-line
R&D (% Rev)	7%	+50bps	7.2%	
Adj. Op Margin	12.5%	+80bps	12.0%	Improved for the 10 th consecutive quarter
Net Interest Inc.	\$0.62M		\$0.6M	-
Share count	31.3M	0.7M	31.2M	In line; in F4Q06, 0.32M shares were repurchased for \$13.9M; ~\$37M left for buyback
Adj. EPS (ex-options)	\$0.58	-	\$0.56	
Option expenses/share	\$0.04	-	\$0.04	
Adj. EPS (net of options)	\$0.54	-	\$0.52	Beat UBS, Street estimates by \$.02

Source: Company reports and UBS estimates

Management noted that F4Q06 finished with an increase in the order backlog, which spans multiple products lines and signals the potential for future growth.

F4Q06 gross margin rose 150 bps to 47%, in line with UBS estimates, while the adjusted operating margin slightly beat our estimate of 12.5% by 0.5%. SG&A of 27.3% was slightly below the UBS estimate of 27.5%. Similarly, R&D expense of 7% was slightly better than the UBS estimate of 7.2%.

Varian finished FY06 with an adjusted operating margin of 11.4%, in line with the UBS estimate and 140 bps greater than the prior year. Margin growth was attributed primarily to sales volume leverage and a shift toward greater revenue generation from higher-margin products. Management cites these results as a reflection of the firm's stated margin expansion strategy.

The company ended the quarter with \$154 million in cash and \$30 million in debt, while executing stock repurchases of 0.314 million shares. In total, \$63 million was spent on the buyback of 1.5 million shares during FY06. Plans remain in place for an additional repurchase of 37 million shares during FY07.

Varian finished the year by meeting its cash flow goal of "at least 100% of earnings," recording adjusted FCF of \$61.6 million or 123% of net earnings. For the quarter, the firm booked a record \$37 million in adjusted FCF, an increase of 27% from 4Q05.

Company Guidance

Varian gave FY07 guidance for the first time on the 4Q call. Its guidance is for organic top-line growth of 5.5-6.5%, an adjusted operating margin of 12.3-12.8%, and EPS of \$2.28-2.40 excluding \$0.20 in stock option expense. This compares with the current Street consensus of roughly 6% revenue growth and EPS of \$2.24 including option expense; thus, guidance was below current Street expectations. Although management did not back its prior “stretch” goal of exiting FY07 with an adjusted operating margin approaching 14%, guidance implies ongoing margin expansion throughout the year.

UBS Estimates

We modestly adjusted our 2007 revenue estimate to \$885 million from \$889 million (+6% y/y). We also lowered our adjusted operating margin estimate to 12.4% from 12.5%. The biggest changes to our model affecting EPS are that we now assume a higher share count, as the current buyback authorization is nearing the end and management would not commit to another round. We also increased our option expense estimate from \$0.17 to \$0.20. As a result of these changes, we lowered our FY07 EPS estimate to \$2.20 from \$2.33 (net of \$0.20 in options). For FY08 we see 5.5% revenue growth to \$933 million, a gross margin of 48%, an adjusted operating margin of 14.4%, and EPS of \$2.50, net of \$0.23 in stock option expense.

Table 54: Varian 2007 Estimates (revenues in \$ millions)

	F1Q07			F2007		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Revenues	-	\$219M (10.7%)	\$208M	5.5-6.5% organic growth	\$885M (8%)	\$883M
EPS (net of options)	-	\$0.52	\$0.47	\$2.08-2.20	\$2.20	\$2.17

Source: Company reports, First Call, and UBS estimates

Table 55: Varian Inc, Earnings Model, FY05-08E

Calendar Year Revenues												
Calendar Year EPS												
Fiscal year ended September 30. Dollars in millions, except per share data.												
	2005A		2006E			2006A			2007E		2007E	2008E
	FY	1QA-Dec	2QA-Mar	3QA-Jun	4QA-Sept	FY	1QE-Dec	2QE-Mar	3QE-Jun	4QE-Sept	FY	FY
Revenues												
Scientific Instruments	632.9	161.3	171.4	170.3	183.0	686.0	172.6	182.5	177.1	195.8	728.1	771.7
Vacuum Technologies	140.0	34.4	38.2	39.5	36.6	148.8	37.4	40.3	40.9	38.1	156.6	161.3
Electronics Manufacturing	-											
Total Revenues	772.9	195.7	209.6	209.8	219.6	834.8	210.0	222.9	218.0	233.9	884.7	933.1
Cost of Revenues	430.0	106.8	114.1	113.0	116.7	450.5	111.9	118.1	115.1	122.8	467.9	485.2
Gross Margins	342.9	89.0	95.5	96.8	102.9	384.2	98.0	104.7	102.9	111.1	416.8	447.9
Operating Expenses												
SG&A	209.3	54.1	58.2	57.6	60.0	229.8	57.9	62.0	60.2	63.8	243.9	256.6
Research and Development	54.1	13.8	14.5	15.4	15.5	59.2	14.9	15.8	16.1	16.4	63.2	66.6
Purchased In-process R&D/Restruct. Chg	0.7					-					-	-
Total Operating Expenses	264.1	67.9	72.7	73.0	75.4	289.0	72.9	77.8	76.3	80.2	307.2	323.2
Operating Income	78.8	21.1	22.8	23.9	27.4	95.2	25.2	27.0	26.6	30.9	109.6	124.7
Net Interest Income (Expense)	3.2	0.56	0.38	0.29	0.62	1.9	0.7	0.9	1.0	1.1	3.7	3.5
Income before taxes	82.0	21.6	23.2	24.2	28.1	97.1	25.9	27.9	27.6	32.0	113.3	128.2
Income Tax Provision	27.5	7.6	8.1	6.4	9.9	32.0	9.0	9.7	9.6	11.1	39.4	44.2
Other one-time	(0.1)											
Net Income (pro forma)	55.2	14.1	15.1	17.8	18.2	65.0	16.9	18.2	18.0	20.9	73.9	83.9
Net Income (GAAP)	54.3	14.1	15.1	17.8	18.2	65.0	16.9	18.2	18.0	20.9	73.9	83.9
EPS (GAAP)	\$1.47	\$0.44	\$0.48	\$0.57	\$0.58	\$2.07	\$0.55	\$0.59	\$0.58	\$0.68	\$2.40	\$2.73
EPS (pro forma)	\$1.61	\$0.44	\$0.48	\$0.57	\$0.58	\$2.07	\$0.55	\$0.59	\$0.58	\$0.68	\$2.40	\$2.73
Stock option expenses		1.3	1.6	1.3	1.6	5.7	1.6	1.5	1.5	1.5	6.2	7.1
EPS (pro forma) - ex option expenses	\$1.61	\$0.40	\$0.43	\$0.53	\$0.53	\$1.89	\$0.50	\$0.54	\$0.53	\$0.63	\$2.20	\$2.50
Average Shares Outstanding - Diluted	34.4	31.7	31.4	31.3	31.3	31.4	31.0	30.9	30.8	30.7	30.9	30.8
YEAR-OVER-YEAR CHANGE												
Scientific Instruments	8.2%	3.4%	6.3%	12.0%	11.8%	8.4%	7.0%	6.5%	4.0%	7.0%	6.1%	6.0%
Vacuum Technologies	0.3%	-1.6%	6.7%	13.5%	6.4%	6.3%	8.5%	5.5%	3.5%	4.0%	5.3%	3.0%
Total Revenues (ex-EMS starting F05)	6.7%	2.5%	6.4%	12.3%	10.9%	8.0%	7.3%	6.3%	3.9%	6.5%	6.0%	5.5%
Cost of Revenues	-24.4%	-2.8%	3.3%	11.3%	7.9%	4.8%	4.8%	3.5%	1.9%	5.2%	3.9%	3.7%
Gross Margins	-1.2%	9.6%	10.4%	13.6%	14.4%	12.0%	10.2%	9.7%	6.2%	8.0%	8.5%	7.5%
SG&A	3.5%	10.1%	9.3%	8.7%	11.2%	9.8%	7.2%	6.5%	4.5%	6.5%	6.1%	5.2%
Research and Development	11.0%	6.5%	2.1%	9.5%	20.4%	9.4%	7.8%	8.9%	5.1%	5.8%	6.8%	5.4%
Total Operating Expenses	3.9%	8.2%	7.7%	8.8%	13.0%	9.4%	7.3%	7.0%	4.6%	6.3%	6.3%	5.2%
Operating Income	-15.4%	14.6%	19.9%	30.9%	18.6%	20.8%	19.5%	18.4%	11.3%	12.5%	15.2%	13.7%
EPS	-13.4%	2.3%	73.8%	83.2%	27.5%	40.4%	22.9%	22.8%	3.0%	17.1%	15.8%	13.7%
EPS less Extraordinary Items	-9.1%	20.9%	31.0%	49.5%	15.6%	28.2%	22.7%	25.5%	1.4%	18.7%	16.3%	13.6%
AS A PERCENTAGE OF REVENUES												
Scientific Instruments	81.9%	82.4%	81.8%	81.2%	83.3%	82.2%	82.2%	81.9%	81.2%	83.7%	82.3%	82.7%
Vacuum Technologies	18.1%	17.6%	18.2%	18.8%	16.7%	17.8%	17.8%	18.1%	18.8%	16.3%	17.7%	17.3%
Electronics Manufacturing												
Cost of Revenues	55.6%	54.5%	54.4%	53.8%	53.1%	54.0%	53.3%	53.0%	52.8%	52.5%	52.9%	52.0%
Gross Margins	44.4%	45.5%	45.6%	46.2%	46.9%	46.0%	46.7%	47.0%	47.2%	47.5%	47.1%	48.0%
SG&A	27.1%	27.6%	27.8%	27.5%	27.3%	27.5%	27.6%	27.8%	27.6%	27.3%	27.6%	27.5%
Research and Development	7.0%	7.1%	6.9%	7.3%	7.0%	7.1%	7.1%	7.1%	7.4%	7.0%	7.1%	7.1%
Total Operating Expenses	34.2%	34.7%	34.7%	34.8%	34.4%	34.6%	34.7%	34.9%	35.0%	34.3%	34.7%	34.6%
Adjusted Operating Income	10.2%	10.8%	10.9%	11.4%	12.5%	11.4%	12.0%	12.1%	12.2%	13.2%	12.4%	13.4%
Tax Rate	33.6%	35.0%	35.0%	26.5%	35.3%	33.0%	35%	35%	35%	35%	34.8%	34.5%
Net Income	7.1%	7.2%	7.2%	8.5%	8.3%	7.8%	8.0%	8.2%	8.3%	8.9%	8.4%	9.0%

Source: Company reports and UBS estimates

Waters Corporation

Company Description

Waters is a leading supplier of analytical instrumentation and consumables for life sciences research and quality assurance applications. Waters has an established brand name and is a well-regarded developer of analytical instrumentation. The company derives revenues from four business segments: high-performance liquid chromatography (HPLC), mass spectrometry (MS), thermal analysis (TA), and NuGenesis, the LIMS/informatics business acquired in early 2004. Approximately 73% of the company's revenues are derived from instrument sales and 27% from services and consumables; about 40% of revenues are recurring. In 2005, Waters reported total sales of \$1.16 billion. We estimate that its HPLC, MA, TA, and NuGenesis businesses represented 66%, 20%, 12%, and 1% of total 2005 revenues, respectively.

Broken out by customers, we estimate that 60% of Waters's net sales are from the pharmaceutical and biotech industry, 25% from academic and government laboratories, and 15% from other industrial companies. About 36% of Waters's net revenues come from North America, while Europe, Asia-Pacific/Japan, and the rest of the world account for about 31%, 24%, and 9% of revenues, respectively.

Investment Summary

Waters (WAT, Neutral 1)

With an estimated market share of 25%, Waters is the leader in the lucrative roughly \$3 billion market for HPLC instrumentation and consumables. Because of about 40% recurring business in services and high-margin consumables, the company consistently generates strong cash flow (we estimate free cash flow of \$235-245 million for 2006), which Waters has typically deployed for share repurchases (20% of its outstanding shares since the beginning of 2003). This has enabled the company to grow EPS about 15% each year despite difficult end markets and increased competition, particularly in mass spectrometry.

We rate Waters Neutral 1

Waters is in the early phases of a new product cycle in both HPLC and MS. In 2004, Waters introduced ACQUITY UPLC, which contains a number of advancements designed to enhance speed and sensitivity over traditional HPLC methods. However, it remains to be seen how quickly ACQUITY will penetrate key Pharma QA/QC labs, especially in light of a price premium and regulatory barriers that deter switching. In addition, Waters's key competitor, Agilent, has unveiled its next generation HPLC system, the new 1200 series, which we believe could lead to further delays in the adoption of ACQUITY.

With this year's product launches at ASMS, during the past two and a half years, Waters has essentially replaced its entire MS portfolio. Although we remain cautious in light of increased competition, we consider this the strongest the company's MS business has been since 2002.

Despite these long-term positives, with two quarterly shortfalls in 2005 and a below-guidance 2Q06, we remain perplexed by management's lack of visibility into near-term sales trends at its Big Pharma clients. That said, U.S. Big Pharma spending was notably stronger in 3Q06 and appears solid for 4Q06. With an improving and refreshed MS portfolio and growing acceptance for ACQUITY, we are becoming more positive on the long-term outlook. However, as noted above, we believe 1H07 is likely to see conservative pharma spending, which keeps us neutral on WAT shares in the near term.

Valuation

Our price target of \$52 is based on 20x our 2007 pro forma EPS estimate of \$2.54 (net of options), in line with the company's historical average. The price target is supported by a UBS VCAM DCF model, which implies a price of about \$54 per share (assuming an 8.0% WACC and 3.5% terminal growth).

Our 12-month price target for WAT is \$52

3Q Review and Recent Events

Waters reported 3Q06 total sales of \$301.2 million (+10.3% y/y—about 9.5% organic, 0% FX, 0.7% from acquisitions), slightly above the UBS estimate of \$300 million and Street consensus estimate of \$296 million. Adjusted EPS of \$0.49 (net of \$0.05 in option expenses) beat the UBS estimate of \$0.47 and Street consensus estimate of \$0.46.

Table 56: Waters Corp. 3Q06 Income Statement Highlights

	3Q06 Actual	Y/Y Change	3Q06 UBSe	3Q06 FC Consensus	Comments
HPLC	\$210M	13%	\$201M	-	Saw a pickup in U.S. Big Pharma spending; other drivers included strong adoption of UPLC and robust demand from Asia and E. Europe
Mass Spectrometry	\$52M	3%	\$60M	-	Have not yet seen pull through from new products, new Triple Quad and Synapt should help 4Q sales
Thermal Analysis	\$33M	0%	\$35M	-	Compared to 7% org growth in 2Q06, 3Q was flat due to weak demand from developed countries, expect rebound in 4Q
NuGenesis (Informatics)	\$6M	59%	\$4.4M	-	-
Total Revenues	\$301M	10.3%	\$300M	\$296M	~9.5% organic, -0% F/X; -0.7% acquisition. Still expect 8% org growth in 2006
Gross Margin	58.1%	+40bp	58.7%	-	Below expectations due to Safety Stock/inventory buildup. Expect '07 GM to improve due to the completion of Singapore production facility
SG&A (% of Rev)	27.4%	+70bp	27.7%	-	Slightly lower than expected
R&D (% of Rev)	5.9%	+30bp	6.0%	-	In line
Adj. Operating Margin	24.3%	+140p	24.5%	-	Generally in line
Interest Inc (Exp) (net)	(\$6.7M)	-	(\$6.4M)	-	Generally in line, lower cash position due to share repurchases
Tax Rate	15.8%	-	18.5%	-	Guidance for 2006 is now 17% vs. prior 17.5-18%
Share count	103.1M	-14.7M	102.8M	-	WAT bought back 1.4M shares for \$58M; \$56M (out of \$500M) remaining in the repurchase program
Adj. EPS	\$0.49	-1.9M	\$0.47	\$0.46	Net of \$0.05/share option expenses

Source: Company reports, First Call, and UBS estimates

Notably in 3Q, Waters witnessed a low-teens pickup in spending from U.S. Big Pharma accounts. This is in contrast to most of 2005 and 1H06, when it saw double-digit declines. Although we are encouraged by the modest improvement

in Big Pharma spending, given the recent problems at Pfizer and still-tight capital equipment spending by other Big Pharma customers, we believe it is prudent to be cautious until there are signs that this turnaround is sustainable. That said, in the life sciences sector, with over 60% of sales from biopharmaceutical companies, Waters is the most leveraged company to the spending behavior of Big Pharma, and should this positive trend continue, we believe there is upside to our estimates.

Asia (particularly China) remains strong, growing 16% in 3Q; Europe (particularly East Europe) grew 8%; and the U.S. market finally rebounded, growing 9% (versus -2% in 2Q06).

HPLC sales, at an estimated \$210 million, grew 13% y/y (about 12% organic, 0.7% acquisition, 0% F/X) and were higher than the UBS estimate of \$201 million (+8%). Sales were driven by ACQUITY UPLC systems to CROs/generic drug manufacturers and improved Alliance consumable and service revenues to Big Pharma accounts. Although Waters no longer breaks out UPLC sales, the management noted that sales into Big Pharma customers were mainly for research purposes, whereas those to CROs and specialty pharma were to customers looking for productivity gains. It remains to be seen how quickly ACQUITY and other UPLC technologies will be adopted by the key QA/QC lab customer base. In addition, although ACQUITY enjoys a first-mover advantage, it is still too early to tell how Agilent's 1200 LC system (and UPLC-like products from other vendors such as TMO and DNEX) will change the HPLC competitive landscape. During the 3Q06 conference call, Agilent also reported strong HPLC sales, driven by solid demand for its 1200 LC systems.

Waters' mass spectrometry sales, at an estimated \$52 million, grew 3% y/y (about 3% organic, 0% F/X) and were below the UBS estimate of \$60 million (+20%) and guidance for "double-digit growth." Continued softness in "lower end" products (e.g., single quad) probably contributed to sales shortfall. With this year's product launches at ASMS and PITTCON, during the past two and a half years, WAT has replaced its entire MS portfolio. At PITTCON 2006, WAT launched an ACQUITY optimized single quadrupole detector (the ACQUITY SQD); at ASMS, WAT introduced the ACQUITY TQD (triple quadrupole detector) and the new Synapt High Definition MS system. The ACQUITY TQD and Synapt are expected to ship in late 4Q06 and should help 4Q and 2007 organic sales growth.

Thermal Analysis sales were flat y/y at \$33 million versus the UBS estimate of \$35 million (+7%), due chiefly to a delay of product shipments during the quarter and softness in developed markets. Management believes TA will rebound in 4Q06 on demand from industrial markets, particularly in Asia and East Europe. In late 3Q, WAT acquired Thermometric AB, a private company based in Sweden focused on high-performance microcalorimeters, with about \$4 million in 2005 sales. We expect Thermometric to contribute \$1 million or about 2% to 4Q06 TA sales and to be neutral to 2006 earnings.

Waters ended 3Q06 with \$512 million in cash, and net debt of \$374 million. In 3Q, Waters generated operating cash flow of \$62 million, spent \$14 million on capex, and reported free cash flow of \$48 million. FCF was lower than expected because of continued increase in inventories caused by a ramp-up in new MS products, the build of LC safety stock ahead of the Alliance move to Singapore, and deferred instrument shipments.

During 3Q, Waters repurchased 1.4 million shares for \$58 million, a little lower than our estimate of 1.6 million shares. Waters expects to continue repurchasing shares, as it has \$56 million remaining on its repurchase plan.

Company Guidance

For 4Q06, management now expects total sales growth of 8% (about 7% organic, 1% F/X), and pro forma EPS of \$0.78 (+/- \$0.01-0.02) net of \$0.05 in option expenses and restructuring charges. For full-year 2006, the company forecasts about 8% organic sales growth with 0% F/X impact, with pro forma EPS of \$2.14 (+/- \$0.01-0.02) net of \$0.20 in option expenses and \$0.06 in restructuring charges, up \$0.01.

UBS Estimates

In light of 3Q results and updated guidance, we now expect sales of \$1.256 billion (+8.4%) for 2006 and \$1.354 billion (+7.8%) for 2007 versus our prior estimates of \$1.248 billion (+7.8%) and \$1.339 billion (+7.3%), respectively. We modestly adjusted our interest expense, share count, and gross margin assumptions for 2006 and changed our tax rate assumptions to 17% for 2006 and 16.5% for 2007, from our prior numbers of 17.3% and 17.8%. This resulted in new pro forma EPS estimates of \$2.21 for 2006 and \$2.54 for 2007, up from our prior estimates of \$2.13 and \$2.41 (all net of options).

Table 57: Waters Corp. 2006 Estimates (revenues in \$ millions)

	4Q06			2006		
	Guidance	UBSe	First Call	Guidance	UBSe	First Call
Revenues	-	\$363M (9.1%)	\$361M	8%	\$1,256M (8.4%)	\$1,252M
EPS (net of options)	-	\$0.78	\$0.78	\$2.15+/- (\$0.01-0.02)	\$2.21	\$2.20

Source: Company reports, First Call, and UBS estimates

Recent Events

On November 21, Waters announced the acquisition of Environmental Resource Associates, a privately held company that performs laboratory proficiency testing (e.g., method standardization, quality and instrument calibration) for industrial and pharmaceutical companies. With the company's 2005 revenues at \$17 million, Waters expects the acquisition to be neutral to 2007 earnings. Financial terms of the deal were not disclosed.

Table 58: Waters Earnings Model, 2004-07E

Dollars in thousands except per share data
Fiscal year ended December 31

	2004A					2005A					2006E	2007E
	FY	1QA	2QA	3QA	4QA	FY	1QA	2QA	3QA	4QE	FY	FY
HPLC	730,721	178,649	187,457	186,007	217,880	769,994	200,087	199,455	211,006	239,668	850,216	918,234
Mass spectrometry	232,311	53,313	60,626	50,175	70,805	234,919	51,180	63,294	51,901	76,115	242,491	261,890
Thermal analysis	125,368	32,970	31,793	32,575	39,055	136,393	35,525	34,146	32,718	41,789	144,178	153,550
NuGenesis (Informatics)	16,136	3,373	4,753	4,250	4,530	16,906	3,425	5,005	5,556	4,983	18,969	19,918
Total Revenues	1,104,536	268,305	284,630	273,007	332,270	1,158,212	290,218	301,899	301,182	362,555	1,255,854	1,353,591
COGS	454,807	111,801	117,066	115,508	133,980	478,355	119,477	124,903	126,133	145,949	516,462	552,265
Selling, general and administrative expenses	300,150	80,595	82,861	76,645	81,593	321,694	80,555	84,155	82,611	87,738	335,059	362,762
R&D expense	65,241	16,747	16,485	16,982	16,691	66,905	17,663	18,467	17,833	18,128	72,091	77,155
Litigation provision	(9,277)	-	-	-	-	-	-	-	-	-	-	-
Goodwill and purchased technology amortization	4,814	1,282	1,266	1,241	1,216	5,005	1,194	1,383	1,403	1,250	5,230	5,000
Impairment of long-lived asset	3,997	-	-	-	-	-	-	-	-	-	-	-
Restructuring and other charges	(54)	-	-	-	3,122	-	-	-	-	-	-	-
Expensed in-process R&D	-	-	-	-	-	-	-	-	-	-	-	-
Operating expenses	819,678	210,425	217,678	210,376	236,602	871,959	218,889	228,908	227,980	253,065	928,842	997,182
Operating income	284,858	57,880	66,952	62,631	95,668	286,253	71,329	72,991	73,202	109,490	327,012	356,409
Other Income, Net	-	-	-	-	(3,421)	(3,103)	-	-	-	-	-	-
Interest income (expense), net	1,917	364	(463)	(1,969)	(3,421)	(5,489)	(6,136)	(6,272)	(6,688)	(7,000)	(26,096)	(29,000)
Income before taxes	285,761	58,244	66,489	60,662	89,144	277,661	65,193	66,719	66,514	102,490	300,916	327,409
Income taxes	61,618	11,649	12,424	11,169	13,546	48,788	11,865	11,351	10,516	17,423	51,155	54,022
Income before acctg change	224,143	46,595	54,065	49,493	75,598	228,873	53,328	55,368	55,998	85,067	249,761	273,386
Change in acctg/extrordinary items	(5,620)	-	-	-	5,123	5,123	-	-	-	-	-	-
Net income to common	218,523	46,595	54,065	49,493	80,721	233,996	53,328	55,368	55,998	85,067	249,761	273,386
Net income to common, X-OTC	218,523	46,595	54,065	49,493	80,721	233,996	53,328	55,368	55,998	85,067	249,761	273,386
EPS Diluted, GAAP	1.82	0.38	0.46	0.22	0.69	1.75	0.42	0.46	0.49	0.78	2.15	2.73
EPS diluted before extraordinary items	1.81	0.38	0.46	0.43	0.73	2.01	0.50	0.53	0.54	0.83	2.41	2.73
Option Expense per share	-	-	-	-	-	\$0.19	\$0.05	\$0.05	\$0.05	\$0.05	\$0.20	\$0.19
Adjusted EPS (includes FAS123)	1.82	0.48	0.52	0.43	0.73	2.20	0.55	0.58	0.59	0.88	2.61	2.92
Diluted shares outstanding	123,021	121,156	117,722	114,942	109,962	115,946	105,901	104,337	103,074	102,000	103,828	100,000
YEAR-OVER-YEAR GROWTH												
HPLC	13.2%	2%	11.5%	5.0%	4.0%	5%	12%	6%	13%	10%	10%	8%
Mass spectrometry	14.7%	5%	6.4%	-3.6%	-2.0%	1%	-4%	4%	3%	8%	3%	8%
Thermal Analysis	13.5%	18%	6.3%	5.4%	7.0%	9%	8%	7%	0%	7%	6%	7%
NuGenesis (Informatics)	NA	NA	-12.5%	-11.5%	-23.3%	5%	2%	5%	31%	10%	12%	5%
Revenues	15.3%	5.2%	9.3%	3.1%	2.5%	4.9%	8.2%	6.1%	10.3%	9.1%	8.4%	7.8%
COGS	14.3%	4.0%	10.3%	4.1%	2.9%	5.2%	6.9%	6.7%	9.2%	8.9%	8.0%	6.9%
SG&A	13.6%	12.8%	9.3%	6.5%	0.8%	7.2%	0.0%	1.6%	7.8%	7.5%	4.2%	8.3%
R&D	10.1%	4.2%	5.0%	-0.1%	1.3%	2.6%	5.5%	12.0%	5.0%	8.6%	7.8%	7.0%
Operating Expenses	10.9%	3.0%	19.9%	4.6%	1.6%	6.4%	4.0%	5.2%	8.4%	7.0%	6.5%	7.4%
Net income	23.8%	1.1%	10.4%	-4.7%	6.9%	7.1%	14.4%	2.4%	13.1%	5.4%	6.7%	9.5%
adj. EPS	26.1%	3.4%	15.2%	1.6%	19.3%	11.0%	30.9%	15.5%	26.2%	13.6%	19.8%	13.6%
AS A PERCENT OF TOTAL REVENUES												
HPLC	66.2%	66.6%	65.9%	68.1%	65.6%	66%	68.9%	66.1%	70.1%	66.1%	68%	68%
Mass spectrometry	21.0%	19.9%	21.3%	18.4%	21.3%	20%	17.6%	21.0%	17.2%	21.0%	19%	19%
Thermal Analysis	11.4%	12.3%	11.2%	11.9%	11.8%	12%	12.2%	11.3%	10.9%	11.5%	11%	11%
NuGenesis (Informatics)	3.5%	1.3%	1.7%	1.6%	1.4%	1%	1.2%	1.7%	1.8%	1.4%	2%	1%
Gross Profit	58.8%	58.3%	58.9%	57.7%	59.7%	58.7%	58.8%	58.6%	58.1%	59.7%	58.9%	59.2%
Sales, General & Administrative	27.2%	30.0%	29.1%	28.1%	24.6%	27.8%	27.8%	27.9%	27.4%	24.2%	26.7%	26.8%
Research & Development	5.9%	6.2%	5.8%	6.2%	5.0%	5.8%	6.1%	6.1%	5.9%	5.0%	5.7%	5.7%
Operating Expenses	74.2%	78.4%	76.5%	77.1%	71.2%	75.3%	75.4%	75.8%	75.7%	69.8%	74.0%	73.7%
Operating Income	25.8%	21.6%	23.5%	22.9%	29.7%	24.7%	24.6%	24.2%	24.3%	30.2%	26.0%	26.3%
Tax Rate	21.6%	20.0%	18.7%	18.4%	15.2%	17.0%	18.2%	17.0%	15.8%	17.0%	17.0%	16.5%
Net Income	19.8%	17.4%	19.0%	18.1%	24.3%	20.2%	18.4%	18.3%	18.6%	23.5%	19.9%	20.2%

Source: Company reports and UBS estimates

■ Statement of Risk

Slowdowns in R&D spending by pharmaceutical and biotechnology companies, as well as declines in government funding to academic laboratories, could negatively impact revenue and earnings growth in the life sciences tool sector. Many companies within the life sciences tool sector have significant international exposure, and so currency fluctuations can impact earnings. Consolidation within the pharmaceutical and biotechnology industries could be disruptive for life sciences tool providers if the consolidating companies reorganize, reduce, or even eliminate certain R&D programs. However, many of the synergies realized from such mergers typically result from consolidating manufacturing, sales, marketing, and administration functions rather than through wholesale reductions in R&D.

The genomics sector is volatile for a number of reasons, including: 1) product efficacy and safety risks inherent in clinical trials and drug development; 2) regulatory risk of potential products from FDA and EMEA decisions; 3) the early stage and unprofitability of a large number of biotech companies, which sometimes feature high cash burns in uncertain capital markets; and 4) dependence on partnerships for revenues, which can vary unpredictably depending on timing of payments and results, as well as the macroeconomic environment affecting expenditures by pharmaceutical and biotechnology companies. For these reasons, we generally recommend genomics stocks to sophisticated investors with a high tolerance for risk and broadly diversified investment portfolios.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage ¹	IB services ²
Buy 1	FSR is > 6% above the MRA, higher degree of predictability	Buy 2	FSR is > 6% above the MRA, lower degree of predictability	Buy	49%	34%
Neutral 1	FSR is between -6% and 6% of the MRA, higher degree of predictability	Neutral 2	FSR is between -6% and 6% of the MRA, lower degree of predictability	Hold/Neutral	38%	32%
Reduce 1	FSR is > 6% below the MRA, higher degree of predictability	Reduce 2	FSR is > 6% below the MRA, lower degree of predictability	Sell	12%	27%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Ratings allocations are as of 30 September 2006.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

EXCEPTIONS AND SPECIAL CASES

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Companies mentioned

Company Name	Reuters	Rating	Price	Price date/time
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Company Name	Reuters	Rating	Price	Price date/time
Affymetrix Inc. ^{2a,4b,18a}	AFFX.O	Neutral 2	US\$25.01	07 Dec 2006 19:38 EST
Agilent Tech. ^{18a}	A.N	Not Rated	US\$33.22	07 Dec 2006 19:38 EST
Applied Biosystems ^{4a,6a,18a}	ABI.N	Neutral 1	US\$37.25	07 Dec 2006 19:38 EST
Bruker BioSciences ^{2a,4b,18a,20}	BRKR.O	Neutral 2 (CBE)	US\$7.99	07 Dec 2006 19:38 EST
Celera Genomics ^{8,18a}	CRA.N	Buy 2	US\$14.21	07 Dec 2006 19:38 EST
Cepheid Inc. ^{2b,4a,6a,18a,20}	CPHD.O	Neutral 2 (CBE)	US\$9.13	07 Dec 2006 19:38 EST
Charles River Labs ^{18a}	CRL.N	Neutral 2	US\$42.93	07 Dec 2006 19:38 EST
Invitrogen Corp. ^{2a,4a,5,6a,6b,7,13,18a}	IVGN.O	Neutral 2	US\$57.25	07 Dec 2006 19:38 EST
Mettler-Toledo ^{2c,4a,6a,18a}	MTD.N	Buy 2	US\$80.28	07 Dec 2006 19:38 EST
Millipore Corp. ^{2b,4a,6a,6c,18a}	MIL.N	Buy 2	US\$69.43	07 Dec 2006 19:38 EST
PerkinElmer, Inc. ^{6b,7,18a}	PKI.N	Neutral 1	US\$21.71	07 Dec 2006 19:38 EST
Qiagen ^{2b,4a,13,18a}	QGEN.F	Neutral 2	€10.79	07 Dec 2006 23:40 GMT
Sigma-Aldrich Corp. ^{18a}	SIAL.O	Neutral 1	US\$77.08	07 Dec 2006 19:38 EST
Thermo Fisher ^{18a,18b}	TMO.N	Buy 1	US\$45.18	07 Dec 2006 19:38 EST
Varian Inc. ^{18a}	VARI.O	Neutral 2	US\$45.39	07 Dec 2006 19:38 EST
Waters Corp. ^{4a,6a,6b,7,18a}	WAT.N	Neutral 1	US\$50.55	07 Dec 2006 19:38 EST

Source: UBS. EST: Eastern standard time; GMT: Greenwich mean time.

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