

FAIRHOLME CAPITAL MANAGEMENT

Moderator: Bruce Berkowitz
March 30, 2009
2:00 p.m. CT

Operator: Good afternoon. My name is (Britney) and I will be your conference operator today. At this time, I would like to welcome everyone to the Fairholme Fund March 30th, conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question press the pound key.

Thank you. I would now like to turn the call over to Mr. Bruce Berkowitz, President of the Fairholme Fund, you may begin sir.

Bruce Berkowitz: Thank you, (Britney). Welcome everyone to the first conference call at Fairholme where we are focusing on one company, Pfizer, in the Fairholme fund. I'd also like to welcome Jeff Kindler the CEO of Pfizer and Frank D'Amelio, CFO of Pfizer.

Before we begin, I just want everyone to know that there's much information on Fairholme and it can be found on our Web sites www.fairholmefunds.com. Hopefully, this week we'll have a PDF of an extensive interview we had with *Outstanding Investor Digest*. In this interview we've discussed many of the positions in the Fairholme Fund including Pfizer.

Benjamin Franklin once said, "A great part of the miseries of mankind are brought upon them by the false estimates they have made of the value of things." Franklin in 1779 understood investing in what we now call

behavioral finance. Today, fear has replaced greed as the main contributor to false estimates of the value of our portfolio holdings. Today, we face, to paraphrase Dickens, the worst of times and the best of times. The worst of times in that investors face large losses and market values. The best of times in that such losses create opportunities.

On March 23rd, Barron's published "Sifting for Gold Among High-Profit Stocks." Barron's screened the large companies with high earnings yields, that is, low PEs and conservative balance sheets. The title for the screen was "better than bonds." Of interest is that Fairholme owns the top four companies of which Pfizer is one and our largest holding.

It amazes me how Pfizer traded at over 40 times earnings in the late 90s and today trades under 10 times. It is my hope that today's call with Jeff and with Frank will enable owners to weather the current storm. We've received dozens of questions from shareholders via e-mail. We have put together a list of the most common questions which I will address with Jeff after his update on the company and its merger with Wyeth. Time permitting; we'll then open the call to questions from our shareholders.

At this point, ladies and gentlemen, I would like to introduce Jeff Kindler, CEO of Pfizer.

Jeff Kindler: Thanks so much, Bruce and thank you for your support and good afternoon everybody. There's obviously quite a lot happening here at Pfizer and I'm looking forward to sharing all of that with you. The Wyeth transaction is something we're extremely excited about. I'm looking forward to reporting to you on our progress. And also our new business unit structure that we adopted last year and is all ready showing important results and that I really believe will better position us to deliver long-term value to shareholders.

First, regarding the business unit structure. As of January we're operating the company with accountable customer focused business units that have the entrepreneurial spirit of smaller companies but are backed by the power and the competitive advantages that the larger Pfizer enterprise brings to them. Each one is led by talented and experienced leaders responsible for products

from the late stages of clinical development all the way through the end of their lifecycle. That's a big change in the way we do business and one that I think is really well positioning us for the future.

Second, regarding the acquisition, we're more excited than ever. We've had the opportunity, Frank and I and others to really spend a lot of time with the leadership of Wyeth over the last several weeks since we announced the deal. And it's just confirmed for us that they are really a perfect fit with us for advancing the strategies that we detailed about a year ago. And just very quickly, to refresh those of you who may be familiar with this, more than a year ago we articulated that there were seven important strategies that we felt we needed to pursue as a company to position ourselves for success and to produce strong profitable growth especially in the years after Lipitor goes off patent. Those were to expand our investments in disease areas that we believed we could invest to win in, to become a leader in biologics, to enter the vaccines market, to strengthen our leadership in emerging markets, to create new opportunities for our established products, those are products that have lost exclusivity, to invest in complimentary businesses and to establish a lower and more flexible cost base. The Wyeth transaction helps accelerate each and every one of these strategies in a very meaningful way. It updates our portfolio mix by adding vaccines and biologics, consumer, nutritional businesses as well as a broad array of scientific programs and talented people.

So we're working now on finalizing the leadership structure of the new company which will have a strong management team that includes people from both companies, both on the science and the commercial side representing a broad range of expertise and experience. And we'll be talking about that in the weeks ahead.

In addition, we're making very good progress actually to some extent faster than anticipated on the mechanics of the merger. We filed the Hart Scott Rodino antitrust filing earlier this month and on this past Friday we filed our S-4 document with the SEC. Integration planning is well under way under Frank's leadership.

I think, however, it's important to emphasize and this is one of the learnings that we certainly had from other mergers is that while integration is underway and there's a number of people very focused on it as you would expect, the vast majority of people at Pfizer and Wyeth are not involved in the integration. We are keeping them from getting involved in it for the very good reason that we know how important it is to remain focused on running our day-to-day business and producing our financial results and to deliver on the commitments that we made to our shareholders.

We have, I hope you would agree, established over the last two years a track record of delivering on our commitments. Everybody at Pfizer understands there's nothing more important than making and keeping our commitments. And so the vast majority of employees at this company are focused on that.

With that said, we really believe that the new Pfizer with the benefit of the Wyeth assets and the structure that we've adopted is going to be very competitively positioned in this obviously fast changing healthcare environment. And that we'll be able to provide patients and prescribers and payers a broad and relevant mix of products related to prevention, wellness and treatment.

From a financial perspective, this deal and the other changes that we've made strengthens the platform for improved, consistent and stable earnings growth. We look forward to strong and consistent levels of operating cash flow that we've targeted by the end of 2012 and the options and opportunities that will provide for the business and for shareholders. And we can certainly elaborate on that as we get into the Q&A.

We feel we're at the forefront of change for the industry and we're relentlessly focused on delivering value for our shareholders. So with that Bruce, I'm happy to turn it back to you to start the Q&A.

Bruce Berkowitz: Thanks, Jeff. We'll get right to the questions. First question, most popular question asked, how does the weak global economy hurt Pfizer's profitability?

Jeff Kindler: Well, let me start by saying the obvious which is that we're certainly not immune to the global economic downturn. And to the extent that the

pharmaceutical industry may have in the past been highly recession resistant there have clearly been a lot of changes in recent years that have changed that to some extent, certainly higher copays on the part of individuals has an impact. As we sit here today we have not yet seen a really meaningful reduction in prescription volume but I want to emphasize it's early in the year. But as of this time we haven't seen that yet. And we were very careful to factor the economic slowdown into our 2009 financial guidance and took that into account in the guidance that we put out.

I also think that our business unit structure really enables us to respond more quickly to changing market conditions because it's different in every market both geographically and in terms of the therapeutics that we're in. So for example, we've seen some slowing in the emerging markets, but even there the long-term trend remains very strong and it continues to represent a very significant opportunity for our business. And where some parts of our business are effected negatively other parts of our business have opportunities. That's one of the reasons why we're very excited about our established products business which, as I mentioned, is off patent products that become a much more important component of pharmaceutical spending around the world in times like this and we think we have a competitive advantage there, particularly in the emerging markets.

Let me just ask if Frank wants to add anything to what I've said.

Frank D'Amelio: I think the only thing I'd add is just, Bruce, when we gave our guidance for '09 on January 26th, we also had a couple of items in there on lower interest income and higher pension expense, on a year-over-year basis, to the tune of about four cents, so about eight cents. And once again, that's clearly a result of everything that's going on in the global economy and just the macro capital markets these days. So that's all part of the guidance that we provided for 2009. We thought about it from a revenue perspective, put an adjustment into that, factor that in, and then we also factored in some of these items like increased pension expense and lower interest income.

Bruce Berkowitz: Great. Another question what keeps popping up is the various ways in which governments around the world can implement forms of price reductions to slow the skyrocketing costs. How big a threat is this?

Jeff Kindler: Well, let me distinguish, if I could between outside the United States and inside the United States. Outside the United States we've certainly for many, many years been dealing with pricing pressures on the part of governments, particularly in Western Europe where price pressures have been a part of the operating environment for a long time. And you know it's not something that we're thrilled about, but it's something we've learned how to operate and deal with. And to the extent that we can continue to demonstrate the value of our products, we've managed through that successfully and continue to experience healthy growth over the years in many of those markets.

I think the United States is a very different situation. Let me, if I could Bruce, take a few minutes to talk about that because that's obviously still the single largest and most profitable market in which we operate. And obviously as everybody on this call knows, there's a significant effort underway in Washington to adopt healthcare reform and we're very much a part of that discussion at this time and participating in it what I hope is a constructive way, and I see some actually encouraging signs in that regard.

For one thing, I think it's very notable that the President's budget did not include a number of potential provisions that could have been quite frankly much more of a concern to us such, as repeal of the Medicare Non-Interference clause for example. That doesn't mean that that idea won't come up again and garner some support, but I think it's very encouraging that in the first proposal out of the box it wasn't there.

I think there's a real understanding across all of the different groups that it speak to both inside and outside the government, whether it be on Capital Hill or in the administration or the stakeholders that are involved. I think there's two very important things going on that are encouraging. One is that there's a wide recognition that healthcare reform is not achievable except in a context in which all of the stakeholders participate in a constructive way. And there's a recognition that we are such a stakeholder and that we're important which is

the second encouraging sign. I think that for all of the criticisms of the industry there's a recognition that innovation would be stymied if innovators were precluded from receiving a fair return on these risky investments.

And that's why I believe that the – there's a recognition the government is unlikely to command meaningfully lower drug pricing compared to the competitive private sector programs because they don't have the authority to set formulary and restrict access to medicine and that's why I don't think you see those proposals gaining a lot of traction.

I think there's also a recognition, the numbers are very clear that a very relatively small portion of overall healthcare spending is related to prescription drugs, as compared to hospitalization costs, physician and medical equipment expenses. And as a result, even if you eliminated all of the sector's profits, it would pay for a very, very tiny portion of healthcare reform expenses. So people understand you can't achieve anything by that and indeed, you would create a lot of destruction in the way of innovation.

And then we have also the fact which is not something we're thrilled about by pharmaceutical spending growth is very low right now. It's at the lowest it's been in 50 years due to patent expirations and slow growth of new products. And there's, as you well know, a big wave of patent expirations coming on that are going to provide additional savings. And while those are not great things from a secular perspective, they certainly challenge any idea that pharmaceutical prices are a significant contributor to the problem when it comes to healthcare costs.

So for all of these reasons, I am very encouraged that while certainly in the end there will be aspects of any healthcare reform proposal that will entail compromises and contributions from everybody and we'll be no exception to that, I really do not see any sign that there's going to be a really serious effort to control or restrain our prices in a way that would be damaging to innovation and to our business model.

Bruce Berkowitz: OK. And beyond government, are there other ways in which Pfizer can get hurt in the quest to better control health costs?

Jeff Kindler: Well, I think that you know we experience every day the challenge in the private sector of insurance companies that are giving preferred formulary position to lower cost drugs, particularly generics. And that's an ongoing challenge in our business. And it puts a premium on our ability to put forward medicines who clearly can demonstrate significant value relative to generics. And you know so far we've done reasonably well but that's always going to be a challenge in our industry. And again, it comes back to the fundamentals of needing to develop through our research efforts and our external alliances products that have substantial value that payers are willing to pay for. And as long as we do that you know we'll be fine.

Bruce Berkowitz: OK. Jeff, I have a few questions for Frank regarding some of the math. One topic that comes up often is the use of adjusted EPS. And the question comes up is why use adjusted EPS when amongst the excluded non-recurring expenses appear to occur every year.

Frank D'Amelio: Yes, so a couple of comments to this. First, adjusted income is used to portray the results of our operations, prior to considering certain income statement elements and there are several elements. So purchase accounting for acquisitions, so for example, the pharmacy intangible, amortization, acquisition related costs like that, discontinued ops and certain significant items. And so last year, for example, the big certain significant items were some large legal settlements. So we try to exclude those and we do exclude those from adjusted even though they're in GAAP.

And what we also do is we present detailed reconciliation of adjusted to reported results in all of our external filings, our 10-Q and our 10-K, so that investors can adjust accordingly. So it's all there. We bridge all that proactively. And while some items may appear to be reoccurring like restructuring, they do relate to very specific and distinct programs. And what we believe is that this allows for a better comparison, period to period to reflect the underlying business performance. So the way I like to describe it is what we're trying to do with adjusted results is provide our investors with the momentum view of the business, the operational momentum view of the business. So that's the intent. But we do bridge gap to adjusted. We do that by line item. We've been doing that for the last year-and-a-half or so.

Jeff Kindler: And I would just add to that, that alternative – adjusted income is one of the means by which we judge our own performance internally and how we think about the business for the exact reason that Frank said. It reflects the actual ongoing momentum of the business and it's very relevant to us from a management perspective.

Bruce Berkowitz: All right. Next question, concerns tax rates. It's very confusing to a lot of investors as to what one could consider a normal tax rate for Pfizer given the various credits and offsets, so on and so forth. And when it is quite different, is it always quite different from the statutory rates and why?

Frank D'Amelio: Yes, so let me run the numbers first. And then I'll do a reconciliation on the different numbers. So our effective tax rate on an adjusted basis and we just went through adjusted with 22 percent last year and on a U.S. GAAP basis was about 17 percent. And we've also said, I've also said that for 2009, our effective tax rate on an adjusted income basis, the guidance we're estimating at about 30 percent. So just one point there on those numbers, Bruce, is the adjusted guidance number for '09, obviously gets much closer to the statutory federal rate, for example, of 35 percent versus the numbers in 2008.

Now, if you just say why the difference, why the big difference in the normal tax rate and the statutory rate there's a couple of big ticket items. First and foremost are earnings that are taxed at other than U.S. statutory rates, and this basically reflects the amount of operating – the amount of manufacturing and operations that we have in places like Puerto Rico, Ireland and Singapore, low tax jurisdictions where we leverage the tax rules and to transfer pricing strategies and where we locate our manufacturing operations strategies, we're able to basically reduce our effective tax rate which is a good thing for the company and for our shareholders. That, by far and away, is the biggest thing that we do. And if you look at the industry this isn't just the Pfizer item, the industry's effective tax rate is in the mid 20s. So the whole industry, basically leverages this and we do it through, I'll call it manufacturing abroad, and particularly in these low tax jurisdictions.

Another benefit last year was, I'll call it, the sale of the Esperion Therapeutics business and that resulted in a loss for tax purposes last year from an initial investment in 2004. We had taken a book loss but we actually sold that business last year and the result of the sale allowed us to actually take the tax benefit. So those two items significantly reduced the tax rate. And then we had those large legal settlements last year where we took a big charge and we assumed, quite frankly, on the bulk of the charge that it was not tax deductible. So that was from a tax rate perspective a bad guy which caused the rate to go up.

Now, there's some other odds and ends that move it around, other moving parts, but those are the three big chunks, two good ones and then the one bad one. And when you put those in that's how you net the number, the numbers that I quoted to you.

Well, obviously, the last two questions get at Pfizer's free cash flow and why it could be different from GAAP earnings. Are there other major elements that you haven't touched on?

Frank D'Amelio: Yes, so let me run the numbers and then there's one I didn't touch one. I did touch on one, I didn't touch on one.

So last year our operating cash flow is 18.2 billion. Our cap ex was 1.7 billion so our free cash flow, so I'm defining free cash flow here as operating cash flow, less cap ex was 16.5 billion. And then to your point, Bruce, just to punctuate your point, our GAAP earnings were 8.1 billion. So the question is, "Frank what's the difference between the 8.1 and the 16.5 which is about \$8-and-a-half billion." So one item is the legal settlement I alluded to before which is about \$3 billion and that was non-cash last year. That was a book charge. We'll have to lay out the cash this year, but in terms of '08 reconciliations that was a non-cash charge. And then the other big ticket item is depreciation and amortization which is in the GAAP EPS – in the GAAP earnings number but not in the cash flow number because it's a non-cash charge.

So that's – those are the to big ticket items. You add those two, those two items are eight billion give or take the \$8-and-a-half billion difference.

Bruce Berkowitz: All right, on to the – getting towards question about the Wyeth merger. You know I was – I publicly stated that I thought Pfizer could do quite well just going it alone, especially with the existing dividend and so on, so the question becomes – and we've heard much of it but any other points you may want to wish to mention regarding why the Wyeth deal just made so much more sense than just running a tight ship and shrewdly allocating capital.

Jeff Kindler: Sure. Well, let me start by really assuring you, very strongly, that we are running a tight ship and shrewdly allocating capital regardless of the Wyeth deal and that's something that is very important to both Frank and me and we've made a lot of changes in the last couple of years, year-and-a-half to really be very, very focused on financial discipline both in terms of operating expense and in terms of capital allocation improving the accountability of that. And I think this management team has been pretty disciplined about that and we intend to continue doing so.

Having said that, so why do the Wyeth deal? And I'd like to just sort of step back to answer that by saying, long before we contemplated doing the Wyeth deal or any deal in particular, we went through a process here with management and our board towards the end of '07 and the beginning of '08 and said to ourselves, we've got this Lipitor patent expiration at the end of 2011, what kind of company do we need to be to be successful after that event when we consider the changing operating environment and the challenges that the industry is facing?

And we concluded and I firmly believe that in many fundamental ways we had to change to and evolve our business model to become much more relevant to a broader array of patients and payers around the world with the right mix of healthcare product offerings. And that's how we developed the seven strategies that I listed very briefly at the beginning of this call. And those were strategies we identified completely independent of any transaction. These were places we felt we need to play and win to be successful and to

move away from sort of a blockbuster dependent model that had been fairly monolithic to be honest in the way it approached things.

Now, that's not to say we've got anything against blockbusters. We're all for blockbusters and we hope to find as many as we can. But to have the company overly dependent on its success in a relatively limited area, that is primary care, United States gigantic blockbusters was, in my judgment, at least, placing too much of a bet on the capabilities of research relative to what it could deliver. And we wanted to be in a variety of areas that we knew had great growth opportunities whether that was biologics, vaccines, oncology, the emerging markets, some of these complimentary businesses and so forth.

And after having determined that, we thought about OK, how do we get from here to there? Clearly, we could not do it all organically. And however tight the ship we ran and however good we were allocating capital, we weren't going to be able to establish meaningful beachheads in all of these areas other than through business development. And quite honestly, we had a choice. We could have either tried to make a series of smaller mid sized acquisitions to advance these strategies or we could have tried to find one deal that did it all for us. And just from the point of view of execution, disruption, availability of properties, prices and the rest, this is by far, by far the better way to do it. And as I said, Wyeth really hits on all cylinders. It changes the mix so that we're not as dependent on a single primary care blockbuster focus model, minimizes, or mitigates patent cliffs, provides more stable and persistent earnings growth. It gives us an opportunity to augment revenue opportunities.

For example you know our emerging market footprint and our capabilities in that very fast growing part of the world is second to none. And to take that distribution capability and bring some of Wyeth's great products like Enbrel and Prevnar, and even its consumer products and nutritional products, through that distribution gives us phenomenal opportunities. There's a tremendous amount of complementarity between their pipeline and ours and our expertise. They have tremendous strength in inflammation and we have a late stage oral product in that area that is one of our more exciting projects. They have similar complementarity with Alzheimer's.

So all of this, Bruce, creates an opportunity for us to really transform ourselves into a company that has just leadership you know you name it. Human health, animal health. Drugs, prescription drugs, consumer products. On patent, off patent, developed world, developing world. Biologics, vaccines, small molecules. And we'll have a range of products to go everywhere from pre natal vitamins to infant formula to vaccines to Alzheimer's drugs. So I think it just creates a powerhouse opportunity for us. And again, the ability to move away from a model that was dependent on a couple of huge drugs to one that is much – many more diversified sources of revenues and the benefit to shareholders will be much steadier and more consistent more reliable earnings growth.

Bruce Berkowitz: Jeff, switching to dividends, your shareholders loved that big dividend before the cut and they want to know when are they ever going to see that dividend?

Frank D'Amelio: So it's Frank, Bruce, and I'll – let me take a shot at this one. So first let me just run the numbers, which is again, today you know our dividend is 64 cents a share. You know, at our current stock price that's about a four percent yield. And to your point we cut that in half -what was 1.28 to 64 cents. We have 6.75 billion shares today outstanding. When we acquire Wyeth they've got about 1.3 billion shares and the fixed exchange ratio is 0.985 Pfizer shares for each share of Wyeth so call that 1.3 billion - no change to the number. You add those two numbers up, the new company will have about 8 billion shares at 64 cents a share, so we'll be paying about \$5 billion in dividends. So that's the current payment including the shares we have to issue for Wyeth.

Now, what we've said is we're targeting an operating cash flow number in 2012 that's \$20 billion plus which is a big number. And what that number does, is it provides us with lots of, I'll call it financial flexibility, to create value for our shareholders through various options. So let me just tell you what those options are without saying what we are or aren't going to do specifically but call it out that these will be areas each of which we'll be looking and always looking at them by the way from a total shareholder return perspective. And those areas include increasing the dividend, increasing stock buybacks you know deciding on how much cash we do or don't need to

repatriate. So for example, if we decided to repatriate less cash from overseas, that would take the tax rate down which would increase our earnings per share.

Obviously looking at reinvesting in the business in terms of where we can return you know what kind of returns on net capital we could get. And then, obviously, continuing to look at business development opportunities.

So those are all areas that we'll have lots of flexibility, lots of opportunity to basically deploy that capital. And once again, we'll deploy it always with total shareholder return in mind.

Bruce Berkowitz: Great. The next question has to deal with the past and a big of a history lesson. Pfizer appears to have spent over \$100 billion on mergers and acquisitions in the last 10 years not counting Wyeth. And today's Pfizer's market cap is under 100 billion. The question is, what went wrong and why will the Wyeth merger work? And I know you've touched on the merger and why it will work but more interesting is for shareholders to understand the mistakes of the past and how they will – if there have been mistakes and why they won't occur again.

Jeff Kindler: OK. Well, let me start by saying, I think I need to say, there were many aspects of those mergers that did work. And the Warner-Lambert acquisition brought us Lipitor which was no small thing. But I think there is something to be learned from that which is that those deals were driven by, primarily by, one or two products. So in Warner-Lambert's case it was Lipitor. In Pharmacia's case it was the Cox-2 franchise. And those are very valuable assets and I think we're very glad that we brought them into this company.

But in many ways, those deals did not fundamentally change the business model or transform the company. And I think that's a critical difference from those deals and this one and I won't repeat what I said a few minutes ago but this deal is not about any single product and this deal is not just sort of taking one big pharma company and glomming it on to another big pharma company which leads me to the next point I want to make, which is we have really

changed our operating model both on the research side and on the business unit side in some very fundamental and important ways.

And as we did that first and now as a result of that we can integrate the new company in a much more effective and efficient and I believe quicker way than we did in the past. I think one of the challenges particularly with regard to Pharmacia is I think we could have definitely improved our realization of synergies by moving more quickly in our decision making and implementation of the cost reduction programs. And we could have also done a lot to prevent some of the disruption and distraction to R&D that we experienced from both of these deals. We have changed the way we operate in research today. We have small focused research organizations with a single point of leadership and the ability to make decisions that are appropriate to that therapeutic area. And this is very different from the past when a lot of decisions were made sort of one size fits all approach across the enterprise.

Now with the commercial business units and the research units that we have we can tailor the way in which we bring those Wyeth assets in to make sure that we preserve the late stage pipeline of both companies which is critically important to make sure we bring in the scientists from both companies that need to be retained and motivated as well as the commercial leaders. And get the integration done much, much faster.

You know Martin Mackay who runs our R&D organization says that in some ways you could say that some of the integration associated with Pharmacia took two or three years and had a pretty profound impact on R&D productivity during that time. He intends to have a great deal of this done in the first 30 days. And that gives you some sense of the difference. Frank is running the integration. I'll let him comment but I think we are very confident and everything that's happened since the announcement only enhances my confidence that we are going to make decisions faster. We're going to make them more clearly. We're going to affect them faster. And we're going to do it in a way that ensures we really preserve the crucial assets from both companies that make this deal work. And again that is so important because this is not a deal about a single product. It's a deal about all of the

assets and capabilities that the two companies together provide. So Frank do you want to add a little bit to that?

Frank D'Amelio: Maybe just a minute or two. So let me just punctuate a few of the things that Jeff said on integration. I think we are moving along nicely is the word I'll use. We've been primarily, I'll call it blue printing. You know, drawing up the plans. We've done things. We have integration leads for both companies. We have project management offices for both companies. We have project leaders for both companies. We have the work streams identified with leaders staffed. We have Wyeth that has a mirror image of our work stream structure so the work streams are working together. So that's – we've launched the joint work stream leader meetings. We meet every day on integration as a leadership team here at Pfizer. And we're now segueing, we'll be – I'll call it soon without giving a date, we'll be talking about in the new organizational structure and who those leaders are going to be.

And then we're moving now to what I'll call baselining and synergy planning. So one of the things you've got to do is baseline, get the beginning inventory right in terms of what functions, what work streams cost how much and from there determine what kind of synergies we can go get within each of the work streams. So we're actually starting that work now.

Bruce Berkowitz: On the area of joint ventures, last year Pfizer ended its joint venture with Nektar resulting in a \$2-and-a-half billion loss. The question is from shareholders, what went wrong and why didn't Exubera catch on?

Jeff Kindler: So this is a great example to use, I think, to demonstrate some of the problems and challenges in the way we used to operate and how we've changed that. So let me take a few minutes to talk about.

First, let me give the short answer, Exubera didn't catch on because doctors and patients didn't think the product was particularly valuable compared to alternatives they had. And this was a case where a product, and for those of you not familiar with it, it was an inhaled insulin device that had been in development for many years before it came to the market. When it was first conceived and even perhaps when it was approved it seemed like a pretty

good idea. By the time it reached the marketplace, other ways in which to deliver insulin to diabetes patients had developed that were quite frankly much, much more user friendly and smaller and easier to use and time had simply passed this idea by.

But I think what's really useful on this to talk about, Bruce, is that in this one case we see so many examples of how we've changed the company. One of the challenges that Frank and I faced when we got in our jobs early on was, we were looking at this product and seeing that it had, quite frankly miserable sales, just miserable sales. And kind of looking around trying to understand who was actually accountable in this organization for the decision-making that had gotten us to that point and who was accountable for deciding what to do next. And the way in which we were organized and it was partly organizational and was also about culture and leadership and accountability. We had the experience where, you know, the research guys were saying we developed this wonderful product, how come the sales guys can't sell it? And the sales guys were saying, why did research stick us with this lousy product?

And it turned out that at the end of the day, the only people with accountability for any of this were Frank and me. So we made the very difficult and tough decision but clearly the right decision to withdraw the product and take that two-and-a-half billion dollar charge. But among the many lessons that we learned from that were one, when we make investments of this kind and this was a result not just of the joint venture with Nektar but also buying out Sanofi's 50 percent interest in it a lot of money was spent to get to that point both from an operating and a capital perspective with very inadequate analysis of the returns, with less discipline than you as a owner who's capital we're spending would like to have seen. And we have completely overhauled that approach. And I can assure you that today every decision to spend any meaningful amount of money is subject to very rigorous scrutiny around returns. And importantly, that there are people accountable for how that money is spent and for achieving success once it's spent. It's not as though you know one group of people comes in and advances the idea and then goes away, and somebody else has to live with it. People have to live with their decisions and they're held accountable for it.

And the second important thing that came out of that was the recognition that this hand off between research and sales had to be revisited because one of the fundamental problems with this product, as I said at the beginning was that by the time it got to the marketplace, the customers weren't interested in it. And the feedback loop from the people closest to the customers back to the people in research wasn't what it needed to be. So the biggest change we made when we adopted our new business unit structure was that today there's a single leader running a business unit, whatever that might be, primary care, specialty care, oncology, etc., who is responsible for the product from the time it is proven to be a proof of concept, that it actually works as a drug, and the decision is made to put it in late stage clinical trial which is when the significant investment is made, all the way through the end of the lifecycle of that product. And that really imposes on that individual the clear accountability and responsibility for making those investment decisions and deciding which products to invest in that are going to be most – best received by our customers which includes the payers that are willing to pay for it.

So what we had recently just to demonstrate to you that this is actually working in practice is that our primary care leader together with his chief medical officer reviewed the portfolio of late stage primary care assets. And there were a couple of products in there that had been rolling along for along period of time and in which we had been investing and that were on their way through the process. And they determined they didn't want to invest in those any more. They had others that they thought were more promising that they could invest in. And as you may have seen that resulted in us discontinuing a program for fibromyalgia and a program for anxiety. That kind of decision making which is exactly the kind of customer focused accountable investment and capital allocation decision making that we need, that kind of decision making had not occurred in the past and that's how we ended up with situations like Exubera.

Now, I don't mean to suggest that we're not going to make mistakes, and we're not going to take risks that don't pan out. It's in the nature of this business to take risks that don't pan out, as you know. And there will be failures and there will be things that don't play out the way we hoped. But I can promise you that the level of evaluations on returns and most important

the identification of clear accountability is vastly better than it was and exactly what you would want to see knowing that it's your money that we're spending. So Frank, do you want to add to that?

Frank D'Amelio: Maybe just a couple of things. First, back to Exubera for a minute. Please know Bruce, that one of the things we did there as we did the analytics is we looked at not only what the sunk cost was but what the ongoing carrying cost would be of keeping that product. That it was significant on an annual basis. And so one of the contributing reasons to the exit beyond the sales not materializing the technology passing us by was it still required ongoing significant capital investment that we conclude we'd be throwing good money after bad.

And just to give you a feel for, I'll call it the capital discipline that we injected into the process. We've done lots on capital allocation in the company. I mean I could spend quite frankly the whole call I could have spent on that. But I'll give you just a couple of little tidbits on different things that we're doing. You know we're acutely focused on cap ex. If you look at the spend over the last couple of years, it was over two billion. Last year it was 1.7 billion. We expect it to come down again this year. Part of how we're doing that, by the way, is you know you want to spend money on cap ex, we need to see project plans with net present values, internal rates of return. So we're looking at that. We brought that kind of discipline. We've done block—I'll call it basic blocking and tackling. When we review a financial plan for the coming year with the board of directors, we're not only reviewing the P&L we're reviewing the balance sheet, the cash flow, and the major elements of all so you know receivables, inventory, payables, cap ex.

We've got that old link where we're spending lots of time on all of that. Because by the way, every one of those is capital. Generation of or use of capital. So we're acutely focused on that. Our days sales outstanding are declining. Our months of hand on inventory are declining. Our DPOs are increasing. And quite frankly, all of the blocking and tackling types of things that you want to do to squeeze as much as you can out of the deployment and the return on capital. We've got different cost of capital by business now and by function. So for example if you were in one business unit, you may have

the cost of capital that's equal to the company's cost of capital. But if you're in a riskier business, you have a riskier project; we'll apply a different cost of capital to it because not all projects, not all businesses have equal risk. So we brought a level of, I'll call it discipline and rigor to that, that didn't exist before.

So there's lots going on in the return on capital area all about improving returns and ultimately improving total shareholder return.

Bruce Berkowitz: Do you have an overall or expected return on the investments that you make in new products?

Frank D'Amelio: So I think we start with obviously you know generating economic profit. And the way I think that about that is you know the return on capital clearly exceeding the cost of capital and we start there because that's that basis for value creation. And then to Jeff's point you know the way this works is you get into these probabilities of success, right. You know every single project has that – what do we call it a probability of technical and regulatory success. You never get 100 percent in this industry. I mean they vary all over the place, but when you put them all together, when you can kind of consolidate them, the output we want is clearly economic profit.

Jeff Kindler: I just if I could, Bruce, add one other thing on this subject. You know in many ways listening to this people might say well, of course, you should be doing all of that and then they're right; we should be doing all of that. Historically, in our industry, you know because of the nature of the kinds of margins that were experienced on these blockbuster drugs and the kind of growth rates they experienced, I think it's fair to say across the industry that there was more focus on the income statement than the balance sheet, and that has clearly changed as Frank just laid out for you in detail. And we've incorporated that into our compensation and our metrics and the way people are expected to do their jobs around here, which again, you may say, "Well, duh," but you know we weren't historically doing that until Frank and I made those changes about a year-and-a-half to two years ago.

As an example, we have, you know, lots of ways of measuring R&D productivity and that itself would be worthy of another phone call. But historically there was a lot of what I'll call input measurements, how many candidate alert notices, how many Phase I starts, et cetera. And so when people would sit around the table and decide whether to start a Phase III trial, there were people at that table who were being compensated based on how many Phase III starts they did. Well, guess what they would decide to do, whether that was the right answer or not. By putting those decisions into the hands of people who's compensation is actually dependent on their producing returns we have much better outcomes over time. And again, it doesn't mean any one project they'll always be right on. But on a portfolio basis they'll be a lot better.

Similarly, we are all now, including Frank and me and the rest of the leadership team, part of our compensation is based on the value of the overall portfolio. Now, Frank mentioned what we called our PTRS, probability of technical and regulatory success. And each and every compound in the pipeline is assessed based on commercial opportunity, competitive set, medical need, etc. etc., and you come up with a number and you probably can say that's the one number it won't be. It will probably be higher or lower but you believe that on a portfolio basis you're going to be more or less right.

What we do now is, we're assessed all of us, in part in our compensation by whether the portfolio at the end of the year is worth more than it was at the beginning of the year because that's what you're paying us to do. You're not paying us for Phase 2 starts or Phase 3 starts. You're paying us for value creation.

So that's just one example of where we've taken the culture and I think made some fairly fundamental changes to focus people on how they spend their – our owner's capital to ensure that we're doing the best job we can of producing returns.

Frank D'Amelio: And Bruce, if I could just you know one other number, our capital last year if you look at the equity on the balance sheet was give or take about 56 to 57 billion. Our GAAP income was eight billion, eight billion and change. If you

just do the math, eight on 56 to 57 is a seventh into 100 is roughly 15 percent. Clearly that's you know from my perspective, that's the bar and we clearly want to continue to improve upon that.

Bruce Berkowitz: Understood. Gentlemen, we have less than 10 minutes left so I'd like to ask one last question before opening up the call to participants. Do you stick by your numbers on cost saves on the Wyeth deal?

Frank D'Amelio: So the short answer is yes. And let me just run the numbers to make sure we're talking about the same set of numbers.

Jeff Kindler: Yes, exclamation point.

Frank D'Amelio: Right. So we said four billion in synergies from the Wyeth transaction, clearly. I call it the bars, at least four billion. We said half of those four billion in synergies from selling, information and administrative costs and half from the combination of R&D and manufacturing. We said 50 percent of that 12 months from the close, 75 percent 24 months and 100 percent basically achieved after 36 months. So that's what we've said. We continue to stand by that. And in addition to that, when we announced the Wyeth transaction, we also announced another \$2 billion synergy program, cost reduction program for Pfizer standalone. So it's a combination of the two billion plus the four billion and the four billion in the timeframes that I talked about. So the answer is yes.

Bruce Berkowitz: Thank you. With only about 10 minutes left, (Britney) – I thank you for those answers, and (Britney) can you please poll participants for a few questions.

Operator: At this time, I'd like to remind everyone if you would like to ask a question, please press star then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Bruce Berkowitz: All right, (Britney), if we can begin. I just ask that only shareholders ask questions at this time, given the limited amount of time that we have. (Britney) begin with the first question please.

Operator: Your first question comes from (Harry Milberger), your line is open.

(Harry Milberger): Just a question. If Pfizer may look cheap in an absolute sense, but given that it's a mishmash of a lot of mergers and a more recent one I just wonder if given the market down so much there's not a lot of simpler stories there who's valuations relative to growth rate would be more attractive. And your ability to analyze something like this, where's your edge, it's a widely followed large company?

Bruce Berkowitz: I guess you're asking the question of me rather than a question of Jeff or Frank so I'll the edges you know triple A quality balance sheet of a company producing vital products and services greatly appeals to me. And I think a company that is somewhat misunderstood. So I think our edge is I would call it informational arbitrage in that I believe the company is being undervalued.

Now, I don't expect Jeff or Frank to answer whether the company is undervalued or overvalued, but time will tell. All I know is that I'm getting older and I'm taking more drugs and they're helping. So, I'm all in favor of the industry and the company and I believe present management and the present company has been charged with the activities of the predecessors and we shall see. Thanks for the questions.

Another question, please.

Operator: Your next question comes from (R.J. Meurer), your line is open.

(R.J. Meurer): This is also a question for Bruce Berkowitz. When Fairholme Funds was first put together one of your primary tenants was to always invest in the jockey. Where do you see the jockey with the Pfizer position?

Bruce Berkowitz: Well, I've taken the time to review what Jeff and Frank have had to say about the business. I've taken a look at what they've done, since they've started their tenure. I believe that they're, you know, under promise over deliver kind of guys. I see the cash flow. At Fairholme we're all about counting cash. And, we tend to ignore the crowd, that's our motto.

So we believe that Pfizer has the right jockeys for this time. And so far, my opinion so good -- we shall see. I think the company did a great job of

husbanding cash during a difficult time and now is utilizing that cash. There seems to be an awful lot of criticism which we shall see how it turns out. But I do believe that Pfizer does have the right jockeys. Thanks for the question.

Next question, please.

Operator: Your next question comes from (James Armstrong), your line is open.

(James Armstrong): Hi. I'm wondering if – this is, I guess, directed at the Pfizer management, whether Pfizer's released a roadmap that essentially shows us how the cash flows will look as we get past the Lipitor expiration.

Frank D'Amelio: Yes, it's Frank. What we've said on cash flow we really is – we just put a target out there for 2012. And that was the 20 plus billion in operating cash flow that I alluded to earlier. And then if you'll recall I talked about when we're generating that kind of cash flow the financial flexibility that it creates for us and the opportunities that come from that flexibility. And I talked about looking at how much we pay in dividend, share buybacks, reinvesting in the business you know looking at our tax rate and how much cash we repatriate and then finally continuing business development opportunities.

So the marker we have out there right now is 20 plus billion. And remember last year our operating cash flow was over 18 billion, 18.2 billion.

(James Armstrong): Right. But have you released, or do you intend to, some details on how that 20 billion is attainable given you know massive shift in Lipitor pricing that will occur?

Frank D'Amelio: Well, I think there so let me stay with this; see if I answer your question. We've talked about a revenue target in 2012 that was approximately 70 billion. If you look at that, it's a combination of Pfizer of Wyeth. We did 48 billion last year. Wyeth did 22 billion. And then what we talk about – what I talk about is so you know clearly we have Lipitor patent expiration in November 2011, that's in the U.S. only. Remember, Lipitor sales last year were about 12 billion and change, about half of those were outside the U.S. and that trend continues to decline.

And what we've said in terms of how do we replace those revenues, because as you replace those revenues you generate the cash flow there's many ways we replace the revenues. One is continuing to grow some of our inline portfolio things like you know Lipitor and Sutent – I'm sorry things like Lyrica, Sutent, Chantix, advancing our pipeline and getting some of those products to come out. And then quite frankly, I call it the one plus one equals more than two with us and with Wyeth. So you know you could look at examples like animal health, we're strong in companion animals and livestock. They're strong in vaccines. We think when we put those two businesses together there's two businesses together there's an incremental blockbuster there for example.

Their Prevnar vaccine which sells very well today. There's opportunities in places like China where they have 450 field force and they only sell directly to clinics. We can go directly to pediatricians with, I'll call it, our almost 2,000 field force. We think there's significant opportunities and not just for Prevnar but for pull through of their nutritional and over the counter products.

They have a big bio-therapeutics business today with Enbrel. We have, you know, a nice strong pipeline there with for example JAK-3. We think we can learn from their Enbrel product that will help us advance our pipeline. Those are just some of the examples that the incremental business will generate and that incremental business helps replace Lipitor which generates the cash flows that you're alluding to.

So those are the things we talk about.

Jeff Kindler: And I think the question also implicitly may be inquiring about margins because – and we have put out a target of high 30s to low 40s operating margins. And you know what I would say to you about that, because I think the question might have been asking you know not just about revenues but profitability as Lipitor and there's no question that Lipitor is a very profitable product.

But you know one thing I hope if nothing else this management team has demonstrated is our understanding of the importance of meeting our earnings

commitments and running the business profitably. And we have said that we will size the business to fit the revenues. And at the beginning of 2007 we put out a target of absolute cost reductions of one-and-a-half to \$2 billion and in January we announced we had achieved \$2.8 billion. So we put out that operating margin target of high 30 to low 40s you know we put those targets out with a lot of thought.

(James Armstrong): Thanks very much.

Bruce Berkowitz: Thank you. (Britney) it is now past 4:00, we have time for one more question, please.

Operator: At this time, there are no further questions.

Bruce Berkowitz: Well, that's great. Well, Jeff, Frank, thank so much for your time, I greatly appreciate it. And for everyone who's called in, thank you for participating in this call. And based on the responses I look forward to future conversations with other CEOs of portfolio companies. In the next few days, please visit www.fairholmefunds.com for transcript of this call and for other relevant information and on Fairholme and our companies. Again, thank you very much. Jeff and Frank, thanks again.

Jeff Kindler: Thank you, Bruce. Thanks, everybody.

Bruce Berkowitz: Bye-bye.

Operator: This concludes today's conference call. You may now disconnect.

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