

Cash in on Healthcare Reform: 8 Top Medical Stocks to Profit from in 2010

By Chloe Lutts, Editor of Dick Davis Digest

When we asked the editors of the leading investment newsletters to pick their single favorite stock for our annual special issue of Dick Davis Digest that includes our top picks for 2010, a surprisingly large percentage of the submissions we received were companies in the health and medical industries. It would seem that, regardless of what Congress eventually decides to do with the U.S. healthcare system, it's a great place to look for profits. Below, eight stocks that the experts expect to outperform in 2010.

Abbott Laboratories (NYSE: ABT)



“Abbott Labs is a diversified healthcare products firm with a storied performance history. The company hasn’t experienced a decline in annual earnings since 1971. Abbott’s four main operating segments are U.S. Pharmaceuticals (57% of revenue), Diagnostic Products (12%), Nutritional (17%) and Vascular (7%). The company has remarkable financial metrics: a 16% net profit margin and 19% return-on-equity with modest debt. Abbott’s sales growth has slowed due to the weak economy and fluctuations in the U.S. dollar. Earnings growth remains solid, led by over 20% growth in the company’s top-selling drug, Humira. Abbott will spend about \$2.7 billion on R&D in 2009, and a number of the firm’s drugs are currently in clinical trials. Furthermore, Abbott is adding to its product stable by making acquisitions. The company recently bought medical-optics firm Visiogen for \$400 million and Solvay Pharmaceuticals for \$6.6 billion. The stock yields 2.9%, and management repurchased over \$800 million of stock in the first three quarters of 2009. Abbott’s products are largely recession resistant. Earnings are expected to grow more than 10% in 2010. Buy below \$54.”
Steven Check, The Blue Chip Investor, www.checkcapital.com, 800-710-5777, 1/10

Alcon (NYSE: ACL)



“You may recognize Alcon from the supermarket aisles as one of the top producers of contact lens solution. But ACL does far more than this, focusing on eye care products of all kinds that include high-tech surgical devices and blockbuster pharmaceuticals in addition to consumer products. Alcon is also the largest maker of

equipment for cataract removal and laser vision correction. The company's pharmaceutical line includes glaucoma treatments, anti-infectives and allergy relievers. Most health care stocks are currently surging, since prescription drugs and other treatments have seen strong sales even as spending for luxuries has been weak. But the real potential of ACL lies in the treatment of age-related macular degeneration, which is the leading cause of vision loss in people over 50. Macular degeneration obscures central vision, and in severe cases, blindness is also possible. On September 14, Alcon bought Swiss biotech ESBATech AG for \$150 million in cash plus milestone payments of up to \$439 million. ESBATech is a development-stage firm with no products on the market, but is working on treatments for macular degeneration and other conditions. On October 23, Alcon inked a deal with privately held Potentia Pharmaceuticals of Louisville, Kentucky, for a license to develop Potentia's POT-4, which is intended to treat macular degeneration. About 1.75 million Americans live with advanced macular degeneration, and the number is expected to grow to 3 million by 2020. Alcon is really doing well right now, but I expect numbers to pick up even more with the addition of macular degeneration treatments to its bottom line. In the third quarter, Alcon's sales rose 5.9% to \$1.614 billion compared with \$1.524 billion in the same quarter a year ago. During the same period, its earnings declined to \$515 million or \$1.71 per share compared with \$627 million or \$2.07 per share, when it included an extraordinary \$178 million tax gain. The analysts were expecting earnings of \$1.45 per share and \$1.54 billion in sales, so Alcon posted an 11% earnings surprise and a 4.8% sales surprise. Looking forward, Alcon raised its forecast for its full year, which excludes one-time costs and benefits, to a range of \$6.60 to \$6.70 per share, up from its previous forecast three months earlier of \$6.25 to \$6.40 per share."

Louis Navellier, Blue Chip Growth Letter, www.bluechipgrowth.com, 800-718-8289, 1/10

AspenBio Pharma (Nasdaq: APPY)



"AspenBio Pharma is a Colorado-based biotech with two shots on goal.

The first is an equine/bovine synthetic growth hormone that the company has licensed to Novartis. This is a high-margin, royalty collaboration arrangement with products due to market in 2012 or 2013. While this could result in attractive earnings a few years from now, the more immediate catalyst is the company's blood-based appendicitis test. The test has been submitted to the FDA for approval and the company is currently preparing responses to the first set of FDA questions. We expect this back-and-forth process to take another three to six months, at which time we're hoping for FDA approval of the first ever human blood test for appendicitis. The global markets are very large for this type of test, and given mid-2010 approval, the test should be on the market by early 2011. The primary risk is that the FDA requires more trial data, but at this point the company is confident of approval using current data. Aspen has also developed its own blood diagnostic reader for emergency room settings, thereby increasing the long term margin and earnings potential. Considering this could be a multi-hundred million dollar opportunity, we think today's \$60 million valuation is very attractive for aggressive investors."

Jim Kennedy, The Marathon Perspective, www.insidemarathon.com, 410-472-3386, 12/09

Boston Scientific (NYSE: BSX)



"Boston Scientific has seen the best of times and the worst of times. Currently it's experiencing the latter. Earlier in the decade, on the strength of its drug-coated stent technology, BSX soared. Eventually, as the shares came back to earth, management woefully overpaid to acquire Guidant, a maker of cardiac rhythm devices (pacemakers etc.), in a battle with Johnson & Johnson (JNJ). There ensued a Job-like series of reversals as Boston Scientific discovered Guidant had more problems than anyone anticipated. BSX experienced its own reversals, none worse than losing its lead in stents to Abbott

Labs. All stent makers were pole-axed by some preliminary research that questioned the effectiveness of drug-coated stents. Add to this anxiety over what healthcare reform will do to device makers, and you have a perfect storm. Guidant finally is regaining market share. Boston has a legitimate shot at retaking the technological lead in drug-coated stents. Its other lines, particularly minimally invasive surgical tools, are healthy but ignored. Investors hate the shares. We like that.”

Steve Horwitz, Sound Advice, www.soundadvice-newsletter.com, 800-825-7007, 12/09

CVS Caremark (NYSE: CVS)



“It’s not easy to recover from losing \$4.8 billion in 2010 contracts, as CVS Caremark announced in November. That loss alone could potentially deflate the pharmacy-benefit-management (PBM) unit’s operating income by 10% to 12% next year. While CVS won’t restore the PBM business all at once, it has made efforts to steady the ship. A new president was slated to take the helm January 4, and a new \$998 million contract will begin in September. Lost in the fuss over the PBM is the retail-pharmacy unit, which boosted revenue 16% and operating profits 9% in the nine months ended September. Same-store sales rose 5% in the nine months ended September. As expected, the stock got dinged after news about the contract losses hit the market. But even with the diminished outlook, CVS looks attractive at its current valuation. CVS trades 13% below its sector average based on projected earnings in the next fiscal year. Per-share earnings are expected to grow 8% in 2009 and rise at a 12% clip over the next five years. CVS Caremark a Long-Term Buy.”

Richard J. Moroney, CFA, Dow Theory Forecasts, www.dowtheory.com, 800-233-5922, 1/10

Mylan (Nasdaq: MYL)



“We have recently added several pharmaceutical stocks to our client portfolios. Many stocks in this industry have broken out of long-term downtrends on relative strength. The industry has seen a pickup in consolidation recently with deals between Merck and Schering-Plough as well as Pfizer and Wyeth.

It is likely this merger and acquisition trend will continue in the industry. Over the past several years generic drugs have seen a larger share of the drug market compared to branded drugs. From 2010 to 2012 there are ten drugs with over \$1 billion in annual sales that will have patents expire including Lipitor, Plavix, Flomax and Seroquel. In Obama’s healthcare plan, the government will encourage the use of generic drugs, benefiting some of the stocks we own in this group. Mylan Labs is a \$5 billion company in which nearly 80% of revenue is from generic drug sales. In 2007 they acquired Merck’s generic business. Mylan’s North American generic business generated \$1.85 billion in revenue in 2008. Foreign generic sales topped \$2 billion. It is expected that Mylan will have a generic version of Plavix when it goes off patent in 2011. Mylan broke out of a downtrend earlier this year and broke out of a second downtrend just recently—very bullish.”

Ronald Sadoff, Major Trends, www.sadoffinvestments.com, 414-352-8460, 1/10

Natus Medical (Nasdaq: BABY)



“Natus Medical provides healthcare products for babies. Their products are used to detect a wide variety of newborn problems, as well as monitor and treat common newborn ailments. The company is growing rapidly with sales increasing by 39.2% annually over the last five years and profits up 43.4% annually. The company acquired Hawaii Medical in July. Hawaii manufactures and markets single-use disposable products used in hospitals, NICUs and nurseries. Hawaii’s last 12 months revenues before the acquisition were \$3.2 million. In September Natus acquired Alpine Biomed. Alpine Biomed provides equipment for the diagnosis of neurological disorders. Alpine’s last 12 month sales prior to the purchase were \$35 million. Alpine’s

broad range of products includes advanced electromyography systems for the diagnoses of peripheral nervous system dysfunctions as well as devices for routine EEG and long term epilepsy monitoring. With the acquisition, Natus becomes a worldwide leader in neurology. Third quarter 2009 results were impacted by \$460 thousand in charges because of the company's acquisitions. Excluding these costs, earnings were \$4.0 million, or \$0.14 per share. I expect the company will earn \$0.40 per share this year. Natus expects the acquisitions to contribute to 2010 profits and provided guidance for revenues of \$196 million and earnings per share to range from \$0.49-\$0.51. I expect earnings of \$0.65 per share in 2011. Applying a P/E ratio of 30x provides my 12-18 month target price of \$20.00 per share. Natus has excellent long-term potential—BUY!”

Eric Dany, Stock Prospector, www.prospectornewsletters.com, 866-541-5299, 12/09

Stryker (NYSE: SYK)

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“Stryker’s orthopedic division (59% of sales) designs and manufactures implants for hip, knee, spinal, and cranial replacement and repairs. Its Med Surge division (41% of sales) produces operating room equipment. In spite of the slow economy, which has created budget restrictions at hospitals, and the fact that some orthopedic procedures—such as hip replacements—are elective and easily postponed, Stryker’s sales and earnings have held up surprisingly well. The company’s balance sheet is strong, with more than \$2 billion in cash, and no long-term debt, which puts the company in an excellent position to make acquisitions at recession-depressed stock prices. However, even without acquisitions, we expect the aging of the population and the company’s pipeline of new products will continue to fuel growth, especially if the global economic recovery continues (36% of Stryker’s sales are in foreign countries.) The stock is selling at roughly 15 times estimated 2010 earnings, significantly below its average P/E ratio over the years. We believe it has room to move to the upside, and our 12 month upside target is 65. We suggest a mental protective stop at 41.90. Risks include whether potential changes in healthcare coverage being debated in Congress will be beneficial or detrimental to Stryker, and of course a possible stock market decline that could affect good stocks as well as bad.”

Sy Harding, Long and Short Stock Advisor, www.longandshortstockadvisor.com, 386-943-8014, 12/09

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DICK DAVIS
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