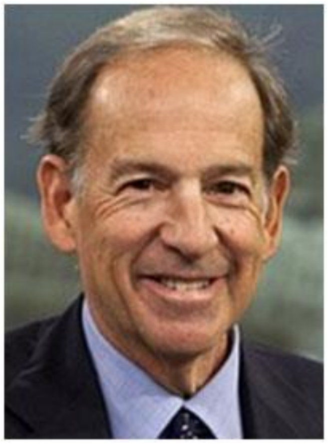
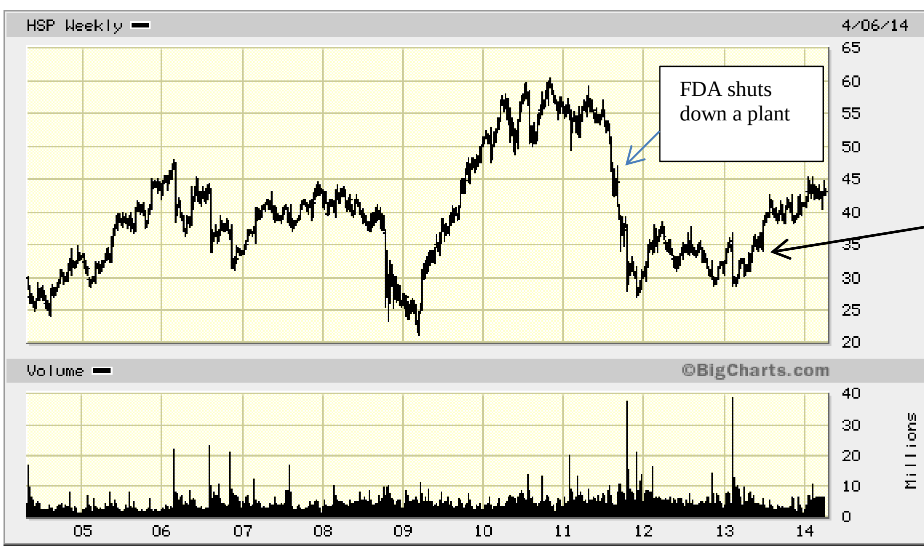
Case Study: Michael F. Price Discusses Hospira (HSP-NYSE) on London May 9, 2013



Michael Price – MFP Investors
Michael Price started his career in 1975 as a research assistant at Heine Securities later known as Mutual Shares, which then had $5 million in assets. By 1988 Michael was the sole owner of the company and he increased the value of assets under management to over $17 billion before selling the business to Franklin Resources Inc. for $670 million in 1996. Michael now manages his wealth through MFP Investors. Both Peter Cundill and Seth Klarman (who began his career working for Michael) have credited Michael with teaching them how to take the net-net concept one step further to value all of a company's assets. Peter wrote in his journal that he read *Outstanding Investors Digest* "to find out what Mike Price is doing" on the basis that "good poets borrow and great poets steal".

Hospira (HSP) *(Thanks to www.greenbackd.com)*



Michael Price

Mentions HSP when it traded at $32 per share and suggests an intrinsic value of $45 per share or 42% higher.

Video Lecture: http://youtu.be/Nph-sDz1EtA

SEARCH STRATEGY

Wait for bad news; wait for things (news/events) that can drastically affect the company. Be prepared to act on it. At MFP, we spend all our time determining intrinsic values ("IVs"). Try to lead them. Determine IV before hand, so you can act quickly when events push prices below IV. The Sell-Side talks about this last quarter. How the hell helpful is that? I don't think one or two quarters matters or even a year's worth of earnings reports. Understand what **MIGHT HAPPEN** not what DID HAPPEN.

Get prepared and wait for these opportunities like HSP, today *(Nov. 8, 2013)* at $32. It will be worth $45 in a year. Management has said they have fixed problems at tge plant, the balance sheet is clean. Management will buy back stock. The company has $2.00 per share in earnings cash flow and in a year it will have $3 per share. A fifteen multiple gives you $45. ..

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Hospira (HSP)[1] is a manufacturer of generic drugs, a pharmaceutical company. The Federal Drug Administration (FDA) regulates their plants for certain standards of cleanliness and to ensure the bio equivalency of their drugs.

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[1] Hospira's narrow economic moat results from specialization in two defensible industries: injectable pharmaceuticals and medication-management devices. Despite near-term strains, Hospira should remain a dominant player in its markets thanks to its manufacturing capabilities, economies of scale, and hospital-based salesforce.

Hospira is the largest manufacturer of injectable drugs. Based on units, Hospira has approximately 34% market share, which is more than double the next largest competitors, including Fresenius and Hikma. High-value generic products at peers like Fresenius and Novartis diminish Hospira's market share lead when based on value, but Hospira nonetheless maintains its top spot with nearly 16% market share based on dollars, by our estimate. Although other peers like Hikma have large manufacturing levels, the low value of this company's more heavily commoditized products place it lower on the value share ladder.

Hospira has large economies of scale in injectable-drug manufacturing, a more complex segment of the generic drug industry. As a result of more difficult manufacturing requirements, generic injectable drugs commonly face less significant pricing pressure than generic versions of conventional small-molecule pills. Manufacturing injectables requires specialized equipment to mix large volumes of liquids and fill specialized containers, such as syringes. The process also requires a sterile environment because large batches of product can be easily contaminated. Additionally, injectables are often temperature sensitive and may require refrigeration throughout the distribution process.

Hospira's focus in the niche categories of oncology and beta-lactam antibiotic injectable drugs also raises the company's competitive edge, in our view. Nearly 80% Hospira's generic drug pipeline value is in these two drug segments, which have more complex raw material and manufacturing requirements. Hospira is also becoming more vertically integrated in these categories, which helps raise the incremental profitability of these higher-value products.

Hospira's entry into the biosimilars market should also raise the company's share of high value injectable products. Biosimilars, or near-generic equivalents of biologic drugs, are complex and large molecules derived from living organisms. Biosimilars coming off patent over the next decade offer big opportunities for generic drug manufacturers, but the very high development, manufacturing, and regulatory hurdles for these products will minimize competitor entry. Hospira, Teva, and Novartis lead the market for biosimilars in Europe, and Hospira hopes to be a leader in the nascent U.S. biosimilars market. Through a joint venture with Celltrion, Hospira has 11 biosimilars in its pipeline, including biosimilar versions of Epogen, Neupogen, Neulasta, Rituxan, Avastin, Remicade, Herceptin, Humira, Enbrel, Erbitux, and Synagis. Hospira has already received approvals for biosimilar versions of Epogen, Neupogen, and Remicade in Europe.

Hospira's other operating segment, medication-management devices (mainly intravenous infusion pumps), introduces high switching costs once a hospital has committed to a device. Hospira has approximately 25% infusion

So HSP was earning $3 EPS and was an absolute growth stock that never disappointed Wall Street up until 2010. Earnings were growing at a nice rate.

Then one day, the FDA shuts down one of HSP's larger plants. The stock opens at $28, down $17 points from $45. So what happens when a company has 200 million outstanding shares and the stock declines 17 points—HSP loses $3.5 billion of market cap. I do not believe it will cost $3.5 billion to fix the plant to FDA's standards. HSP has 17 plants and the FDA closed only ½ of one plant.

The stock market puts $3.5 billion discount on the bad news from Hospira. The market is OVER-discounting or over extrapolating the bad news (perhaps to ALL of Hospira's business).

THAT situation—a good company hit with a temporary/fixable problem goes on sale—is what value guys wait for.

HSP was consistently growing, earning $3 EPS and trading at 15 times earnings. It was owned by all the growth guys. **So what happens when a stock goes from $45 to $28 or 17 points?** The growth guys are selling to the value guys and the value guys, at $28 per share, are saying that the company will be hit now for $1 per share (earning $2.00 per share temporarily) but will be back to $3.00 per share after the company fixes the plant, buys back stock, etc. It will take two years to get back to earning $3 per share and cost the company about $500 million or a $1 billion to fix the large plant. Meanwhile, the company will earn 50 cents or a $1 less than it would with the plant operating normally ($2.00 to $2.50 per share), but the intrinsic value of the company is about $45 with a 15 multiple on normalized earnings of $3.00 per share in two to three years that the company should earn once they get religion and run their plants a bit better.

Then the growth guys will come back into the stock and then the value guys sell to the growth guys. *The circle of the markets! (Editor)*

You look for the most down stocks; down 25 to 35%. I look for the growth guys looking to sell the value guys. Ask yourself if the discount is great enough. WAIT FOR BAD NEWS.

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pump market share within a relative oligopoly with CareFusion, Hospira, Baxter, and B. Braun comprising nearly 80% of the market. These devices have a long life (with an approximate five-year replacement cycle) and hospitals often stick with familiar brands. These devices provide a recurring revenue stream from higher-margin dedicated consumables. Hospira, Baxter, and Fresenius are also among the primary manufacturers of IV solutions used by infusion pumps. Increased scrutiny by the U.S. Food and Drug Administration of the 510(k) approval process for infusion pumps should minimize competitor entry. Additionally, Hospira's high-end infusion pumps offer clinical information technology networking software through MedNet, which helps these devices become embedded in customer operations as hospitals seek to lower medication administration costs and increase drug safety. Once a device and its corresponding software are integrated into a hospital's IT infrastructure, transferring to competitive products becomes less likely. At the end of 2012, Hospira had an installed base of roughly 575,000 devices.

Although its two operating segments do not share manufacturing synergies, Hospira does gain selling and marketing advantages through its broad product offerings. Unlike most generic drug manufacturers, which sell to a concentrated number of pharmacies and pharmacy benefit managers, Hospira sells most of its products directly to a more fragmented customer base of hospitals, clinics, and hospital purchasing organizations. Hospira gains an advantage over competitors by offering a wide scope of hospital-oriented products, including infusion pumps and associated IV solutions, injectable pharmaceuticals, and needle stick safety components.

Michael F. Price 13F

% of Portfolio as of 12/31/13	
Hess Corporation	7.48%
Intel Corporation	6.2%
FXCM INC. CLASS A COMMON STOCK	3.87%
Alleghany Corp.	3.85%
Boston Scientific Corporation	3.1%

END