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investment report

Bausch & Lomb (BOL)

business overview

Bausch and Lomb (BOL), established in Rochester, NY in 1853, is a company focused on creating eye care products for both individual and surgical use. Its products are divided in five different categories. As of 2004, 30% of revenues came from contact lens sales, 24% came from pharmaceutical products, 23% came from contact lens care solutions (its most famous being ReNu), 16% came from cataract and vitreoretinal surgery equipment, and 7% came from refractive surgery products. The company is the leader in the contact lens care market and 4th in the cataract and vitreoretinal surgery equipment market. The company focuses on three different geographical regions – the Americas, Europe, and Asia.

As of 2004 the company posted revenues of \$2.2 billion and employed 14,000 people. That same year Bausch and Lomb had 54,504,000 outstanding shares with income per share being \$2.93. Its average historical P/E ratio is 19.3. Bausch and Lomb continues to develop its R&D division, with \$163,000,000 being dedicated to the division in 2004. On November 16, 2006 Bausch and Lomb revealed new technologies for cataract, vitreoretinal, and refractive surgeries at the American Academy of Ophthalmology Annual Meeting.

Bausch and Lomb's CEO since 2001 is Ronald L. Zarrella. Before that time Mr. Zarrella had been with General Motors. In 2002 he was accused of lying about having a degree from Stern Business School, NYU. In May 2006 Bausch and Lomb faced a major recall of its ReNu with MoistureLoc solution after cases of Fusarium infections appeared in users of the solution. Litigation is still pending but Bausch and Lomb is expected to face over \$1 billion in liabilities. Shortly after the recall Bausch and Lomb's stock price fell below \$45, its lowest in the last year. Analysts forecast a bleak outlook for Bausch and Lomb in the next few years.

competition *From finance.google.com*

Novartis AG (ADR)	NVS
Alcon, Inc.	ACL
The Cooper Companies, Inc.	COO
STAAR Surgical Company	STAA
Akorn, Inc.	AKN
Advanced Medical Optics, Inc.	EYE
Escalon Medical Corp.	ESMC
Allergan, Inc.	AGN
1-800 CONTACTS, INC.	CTAC
ISTA Pharmaceuticals, Inc.	ISTA



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Bausch & Lomb's products can be divided into five general categories: contact lenses, lens care, pharmaceuticals, cataract and vitreoretinal surgery products, and refractive surgery products. In total, Bausch & Lomb's pharmaceutical branch brought approximately 24% of consolidated 2004 revenues. However, all four of the prescription drugs (Alrex, Lotemax, OptiPranolol, and Zylet) have a generic substitute on the market. Thus, any growth in the pharmaceuticals will most likely be a result of the new over-the-counter line, including ophthalmics and vitamins. There are many other similar well-established products on the market already, including Visine, so growth seems tenuous at best.

In 2004, refractive surgery products accounted for 7% of consolidated revenues. Likewise, cataract surgery products constituted 16%. Both of these values have the potential to rise, especially as refractive surgeries become more popular, but there are other producers of nearly identical products, including the medical supply specialist, Becton, Dickinson, and Co.

Overall, contact lenses and lens care encompass over 50% of the consolidated revenues of 2004. However, with the increase in competition from companies such as Ciba-Vision, Alcon, and Johnson & Johnson, it seems as if B&L will be losing some of their original niche in the market. At the present time, J&J produces the most popular line of contact lenses, Acuvue, including the daily disposable AcuvueDaily, which eliminates all need of lens care. B&L has since followed suit with their own line, but with only one option compared to Ciba-Vision's four. The trend away from lens care will surely hurt B&L's sales, and they don't seem to be adapting fast enough to ward off competitors.

financials *From finance.yahoo.com*

(In millions of USD)

	Quarterly (Sep '05)	Annual (2004)	Annual (2003)
Income Statement			
Total Revenue	588.70	2,232.30	2,019.50
Gross Profit	353.80	1,297.40	1,161.50
Operating Income	72.00	279.60	235.60
Net Income	17.90	159.60	125.50
Balance Sheet			
Total Current Assets	1,485.50	1,380.50	1,421.40
Total Assets	3,064.40	3,022.10	3,006.40
Total Current Liabilities	810.50	832.50	876.40
Total Liabilities	1,595.90	1,595.20	1,803.00
Total Equity	1,468.50	1,426.90	1,203.40
Cash Flow			
Net Income/Starting Line	-	159.60	125.50
Cash from Operating	-	280.50	248.20
Cash from Investing	-	-121.60	-94.10
Cash from Financing	-	-225.30	-79.60
Net Change in Cash	-	-60.80	97.50
	Quarterly (Sep '05)	Annual (2004)	Annual (T1M)
Net Profit Margin	3.33%	7.35%	6.53%
Operating Margin	12.23%	12.53%	12.59%
EBITD Margin	-	18.13%	-
Return on Average Assets	2.60%	5.44%	5.02%
Return on Average Equity	4.96%	12.13%	10.72%



Unfortunately, due to Bausch and Lomb's failure to produce a timely 10-K for 2005, 10-Qs for recent quarters, and its recent recall problem it is difficult to get a proper gauge on Bausch and Lomb's financial predicament.

Still, some interesting facts arise. Although financials seemed to be improving from 2003 to 2004, 2005 looked less promising. Assets still seemed to be going up but the profit margins and returns seemed to be slowing down. The company's most promising stat is its continued increase in R&D spending. However, whether this would be enough to make up for the possible liability losses and earnings cuts the company faces remains to be seen. Additionally, official analyst projections forecast 2007 as a severely depressed year for the company. With its mounting issues and underperformance, this may be very bad news for Bausch and Lomb.

valuation

BOL's current price of a little under \$50 and its relatively low PE ratio of 18 may cause some to speculate that the stock is undervalued. However, a look at Bausch and Lomb's unstable history since 2005 and predicted slow growth rate demonstrate that the stock is aptly valued.

BOL historically traded at over \$80 in 2005, but fell to just a little over \$60 at the end of its second quarter when it failed to file the appropriate SEC filings. It took yet another hit in April, 2006 when Bausch and Lomb recalled ReNu, taking the price down to its current trading price of a little under \$50. A glimpse at the capabilities of the brand prior to 2005 may offer some hope of a strong turnaround of BOL in the future. However, such an improvement would entail a jump from 3% operating margin to the 9% operating margin that is predicted in BOL's 2007 guidance. This drastic of an improvement is hard to believe in light of the company's accounting difficulties, the damage done to the name due to the recall, and the strong showing of its industry competitors in the market.

Thus, while BOL's PE ratio of 18.7 is relatively low in comparison to the industry's PE ratio of 27.5, it is aptly so as many investors are correct in not taking confidence in the stock. This is further reinforced by BOL's low Price to Book ratio of 1.8 and its low Price to Sales ratio of 1.15.





Valuation Ratios	BOL	Industry	Sector	S&P 500
<u>P/E Ratio</u>	18.68	27.49	25.11	20.25
<u>P/E High (Last 5 Y)</u>	130.76	54.56	47.78	36.88
<u>P/E Low (Last 5 Y)</u>	20.29	20.67	20.35	14.38
<u>Price/Book (MRQ)</u>	1.84	4.59	5.14	3.85
<u>Price/Sales (TTM)</u>	1.15	4.23	5.34	2.83
<u>Price/Cash Flow/share (TTM)</u>	17.06	21.54	19.24	14.27
<u>Price/Free Cash/share (TTM)</u>	7.65	33.79	35.01	30.93

investment opportunities

continued R&D

Bausch and Lomb has been continuing its expansion in the R&D division, with allotment increasing from \$150 million in 2003 to \$163 million in 2004. Its recent presentation of ophthalmologic surgery innovations suggests a shift of focus from its damaged contact lens care division to a possibly more profitable division where there is more room for growth for the company. The company repeatedly expresses its commitment to R&D in its annual reports.

market difficulties

On November 21, 2006, one of Bausch and Lomb's competitors, Advanced Medical Optics, announced a three million unit recall of their own MoisturePLUS contact lens solution. From the company's point of view, this may even the playing field in contact lens care products. Not only will this lower possible market share for this particular competitor, it may also diffuse scrutiny from Bausch and Lomb to the entire industry, allowing the company to catch up with its competitors.

strong brand

Although Bausch and Lomb has been hurt by the recall scandal of 2006, it has not completely lost its market share. Its contact lens solution brand ReNu continues to be a well-known and well-used product around the world. Its technologies in ophthalmologic surgeries are commonly used and its recent technological improvement in this field present opportunities for growth for the company. Its stock price has rebounded somewhat since May, trading under the \$50 mark currently, suggesting renewed investor interest.

investment risks

accounting concerns

As of November 2006, Bausch and Lomb has filed for an extension on its second and third quarter 10-Qs and its 2005 10-K. The company states that it is working on revising its accounting practices considering recent changes in the company's interests in Asia. Analysts and investors expect the company to lower its previously stated earnings for the quarters in question.



global presence

As a company with large markets in global regions other than North America, Bausch and Lomb is subject to global financial difficulties. Its biggest worries include interest rates and foreign currency exchange. Although the company is attempting to curb these difficulties with programs involving interest rate swap and interest rate lock and cap agreements, its future in the global markets remains unsteady.

recall repercussions

Despite an optimistic outlook, Bausch and Lomb has yet to feel the full effects of its MoistureLoc recall in May of this year. The company is still in litigation and experts predict that over \$1 billion in liabilities will be rewarded to the victims of the fungal outbreak. This may have disastrous results on the company's balance sheets and its resulting stock price.

underperformance

Even without the May recall, Bausch and Lomb has been severely underperforming in the market in general. Its competitors are working with much higher p/e ratios and as a result, have much higher stock prices. Alcon, Inc. in particular has been closing out at over \$100 per share while Bausch and Lomb struggles to beat the \$50 mark.