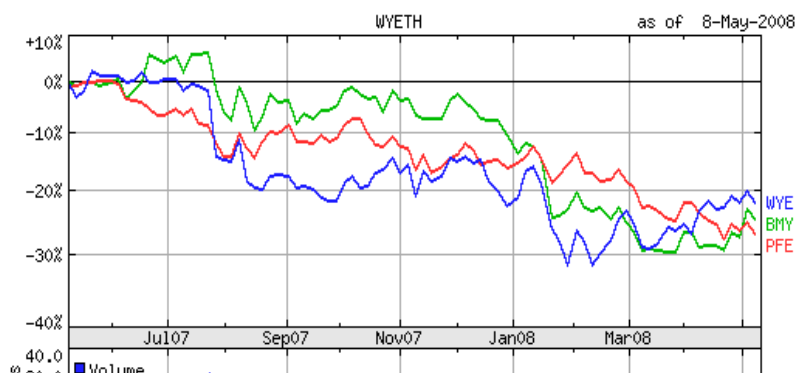


## Taking a k at the Drug Stocks

For many years, the major pharmaceutical stocks were considered a safe haven or a great defensive place to be during an economic downturn.

However, threats of generic competition, patent expirations, FDA warnings and political finger-wagging have taken its toll on the industry. Many analysts also cite a dearth of new “blockbuster” drugs in the pipeline. As a result of all this hoopla, drug stocks are down an average 25% in the past year.



Yet, humans still get sick, in good times or bad, and mankind’s quest to conquer disease and defer mortality will always be fashionable.

Is it the time to buy the drug stocks or will the pain (no pun intended) linger?

In this edition of the Merriam Report Quarterly, we will put our innovative dual cash-flow analysis to task and take a good look under the hood of **Pfizer (PFE), Bristol Myers (BMJ) and Wyeth (WYE).**

### Analysis Overview

**Merriam Report Signals:** Although Pfizer has the highest dual-cash flow figures of this group, only Wyeth shows the best overall improvement (for all periods and the average). Signals for Wyeth are both bullish, while signals for Pfizer and Bristol Myers are mixed.

**Accrual Ratios:** Bristol Myers displays the best overall accrual ratios, but the Q1 number declined from the previous period and is lower than the average. Pfizer’s latest quarter figure shows the best improvement (for all periods and the average). Wyeth’s latest accrual figure is the most bearish of the group, but it has improved each of the past three quarters and the Q1 2008 number is better than its average.

#### Revenue Metrics (best improvement)

- Research & Development: **Wyeth**
- Cost-of-Sales: **Pfizer**
- S/G/A: **Pfizer**
- Payables: **Wyeth**

#### Capital Productivity (best improvement):

- Inventory / Revenues: **Pfizer**
- Receivables / Revenues (lowest per \$ of sales): **Wyeth**
- Inventory & Receivables / Revenues (lowest per \$ of sales): **Wyeth**
- P,P&E / Revenues: **Bristol Myers**

### Earnings Quality

**Bristol Myers:** Deteriorating

**Pfizer:** Improving

**Wyeth:** Improving

### Financial Statements

**Revenues and Earnings:** All three companies reported increases in Q1 2008 EPS on declining revenues. Sales at PFE fell 8%, vs. -3.7% at BMJ and -1% at WYE.

**Accounts Receivable:** Receivables at each company grew faster than sales in the latest period. Wyeth experienced the greatest increase (up 19.6%), but Days-Sales-Outstanding remain the lowest at 67 days versus 80 days for PFE and BMJ. According to PFE’s 10-Q for March, the increase in accounts receivable “reflects recurring business trends that impact the timing of revenues within the first quarter compared to the prior year’s fourth quarter, due to customer purchasing patterns and price increases that occur in the beginning of the year”.

**Inventory:** Q1 inventory levels rose 8% and 5.1% for BMJ and WYE respectively. PFE reported a 2.9% decline of inventory for the similar period.

# The Merriam Report Quarterly

May 2008

2

**Property, Plant & Equipment:** PP&E in the latest period rose 4.2% at WYE vs. modest declines for PFE and BMY. It appears PFE and BMY are trying to adjust “capacity” to match slowing sales. Cost-cutting won’t help operating margins, but it will limit the erosion of returns-on-assets.

The increase in Wyeth’s P,P &E is consistent with their inventory build-up in Q1, but we would also note Bristol’s rising inventory came on the heels of falling capacity.

**Accounts Payable:** Payables have been rising at BMY for the past two quarters. PFE and WYE saw modest declines in Q4 followed by 16% declines in the most recent period.

## Conclusion

If you look at the charts of these stocks, it would be easy to make a case for buying all three. They look cheap at these levels. However, earnings quality is a whole different matter and the Merriam Report’s innovative analysis is designed to help clarify this most important issue.

**Dividends:** PFE and BMY are currently offering some tempting yields. Pfizer’s dividend is 6.4%, attractive for a AAA rated company (one of the few left). Yet, this is only nominally better than the company’s 4.65% senior notes due 2018, which happen to be trading a bit below par value.

Bristol’s current yield is 5.3%, but credit quality is below Pfizer’s. In contrast, many of the BMY bonds are trading at or over par. Such disparity between Bristol’s debt and equity suggests that a 5.3% dividend may not be enough juice to compensate an investor wanting to own the stock.

	BMY	PFE	WYE	
<b>Dividend Yield</b>	5.3%	6.3%	2.4%	It would appear that investors prefer the comfort of an overpriced BMY bond.
<b>Payout Ratio</b>	107%	109%	32%	Payout ratios for PFE and BMY currently exceed the earnings generated. In
<b>Cash Per Share</b>	\$ 1.33	\$ 4.23	\$ 10.00	contrast, WYE’s more petite 2.4% yield is only 32% of earnings.

It doesn’t require an abacus to realize, that without a catalyst to drive earnings growth, the juicier dividends of PFE and BMY could be threatened. In addition, R&D spending for both has declined an average 1% in the past year.

With only \$1.33 a share in cash, BMY may be most susceptible to a dividend cut. Further deterioration in their balance would also limit any potential takeover premium should they become a target. PFE has over \$4 a share in cash, but as the 800 pound gorilla, management will likely use its war chest to pump up R&D or buy future earnings growth via acquisitions.

Wyeth (WYE) appears to be the most interesting of the three stocks reviewed. Earnings quality is rising and management is keen to increase capital productivity. Although our research is primarily focused on earnings quality and cash flow analysis, investors may want to consider other positives about WYE:

- Fen-Phen litigation is winding down
- The balance sheet has \$10 a share in cash
- A promising biologics unit
- Quality management
- Potential for dividend growth
- Unique takeover appeal

## Recommendations

Wyeth: **BUY**

Pfizer: **HOLD** (or consider swapping into Pfizer 4.65% bonds due 2018 if below par)

Bristol Myers: **AVOID** (or consider the 6.25% third party trust preferred units tied to Bristol Myers Debentures due 8/01/2097 if under par. Symbol: XFR)

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[www.merriamreport.com](http://www.merriamreport.com)

Merriam Reports on each company mentioned are included with this newsletter.

# The Merriam Report Quarterly

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## Disclosure(s) of Holdings

As of the date of publication, MIS and/or its clients owned positions in **Bristol Myers (BMY), Pfizer (PFE) and Wyeth (WYE)**.

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Newsletter Editor: J.S. Merriam

Research Assistant: Luis Sandeval

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Your comments, suggestions and inquiries are welcome and important to us. You can contact us by email at [customerservice@merriamreport.com](mailto:customerservice@merriamreport.com) . We look forward to hearing from you.

# The Merriam Report

## BMJ

3/31/08 Bristol Myers

All amounts in millions except for earnings per share

Quarterly period ending:	3/31/2007	6/30/2007	9/30/2007	12/31/2007	3/31/2008	Averages
Earnings Per Share (Incl. Ext. Items)	\$ 0.350	\$ 0.360	\$ 0.430	\$ (0.050)	\$ 0.330	\$ 0.284
% Change in E.P.S. (from prev. qtr.)		2.9%	19.4%	-111.6%	760.0%	167.7%
Total Revenues	4317.00	4928.00	5050.00	5381.00	5181.00	4971.40
% Change in Revenues (from prev. qtr.)		14.2%	2.5%	6.6%	-3.7%	4.9%
Cost of Revenues	1340.0	1549.0	1622.0	1817.0	1657.0	1597.0
Accounts Receivable:	3381.0	3632.0	3704.0	4240.0	4541.0	3899.6
% Change in Receivables (from prev. qtr.)		7.4%	2.0%	14.5%	7.1%	7.7%
DSO's (# of days it took customers to pay)	71.3	67.1	66.7	71.7	79.8	71.3
Inventories:	2096.0	2224.0	2269.0	2162.0	2336.0	2217.4
% Change in Inventory (from prev. qtr.)		6.1%	2.0%	-4.7%	8.0%	2.9%
Inventory as a % of Sales	48.6%	45.1%	44.9%	40.2%	45.1%	44.78%
Prepaid Expenses:	385	372	352	310	388	361.4
Other Current Assets:	684.0	670.0	687.0	1411.0	678.0	826.0
Property, Plant & Equip. (net):	5709.0	5768.0	5853.0	5650.0	5567.0	5709.4
% Change in P,P& E (from prev. qtr.)		1.0%	1.5%	-3.5%	-1.5%	-0.6%
Accounts Payable:	1315.0	1406.0	1343.0	1442.0	1575.0	1416.2
% Change in Payables (from prev. qtr.)		6.9%	-4.5%	7.4%	9.2%	4.8%
<b>Quarterly period ending:</b>	<b>3/31/2007</b>	<b>6/30/2007</b>	<b>9/30/2007</b>	<b>12/31/2007</b>	<b>3/31/2008</b>	
Total Liabilities:	15830.0	16413.0	14945.0	15610.0	15764.0	15712.4
Shareholder equity:	10261.0	10762.0	11153.0	10562.0	10561.0	10659.8
Retained Earnings (Accum. Deficit)	20011.0	20161.0	20463.0	19762.0	19808.0	
<b>Operating Cash Flow (OCF)</b>	<b>22467.0</b>	<b>22931.0</b>	<b>23494.0</b>	<b>22512.0</b>	<b>22466.0</b>	22774.0
% Change in OCF (from prev. qtr.)		2.1%	2.5%	-4.2%	-0.2%	0.0%
<b>Balance Sheet Cash Flow (BSCF)</b>	<b>10065.0</b>	<b>10333.0</b>	<b>8859.0</b>	<b>8207.0</b>	<b>8582.0</b>	9209.2
% Change in BSCF (from prev. qtr.)		2.7%	-14.3%	-7.4%	4.6%	-3.6%
<b>Spread between OCF &amp; BSCF</b>	12402.0	12598.0	14635.0	14305.0	13884.0	13564.8
<b>Ratios</b>						
<b>Spread to Revenues</b>	2.873	2.556	2.898	2.658	2.680	2.733
<b>Spread to OCF</b>	0.552	0.549	0.623	0.635	0.618	
<b>MR Dual Cash-Flow Figure</b>	3.425	3.106	3.521	3.294	3.298	

# The Merriam Report

2.733

Bristol Myers

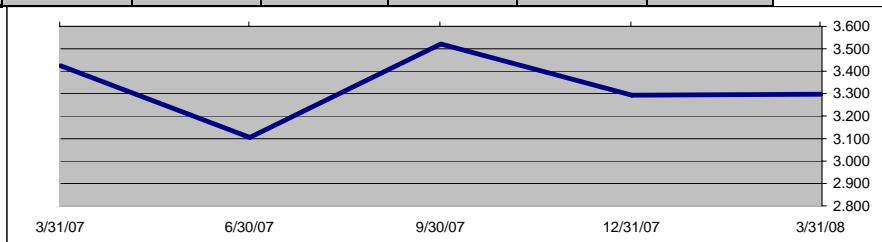
**BMJ** 3/31/08

Quarterly period ending:

	3/31/07	6/30/07	9/30/07	12/31/07	3/31/08
<b>MR Dual Cash-Flow Figure</b>	3.425	3.106	3.521	3.294	3.298

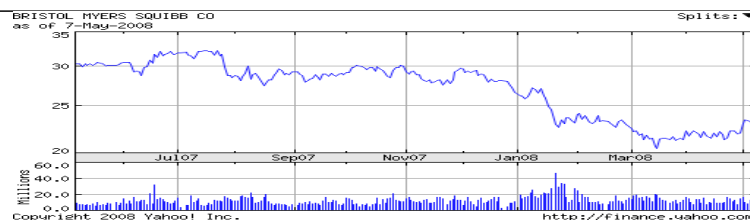
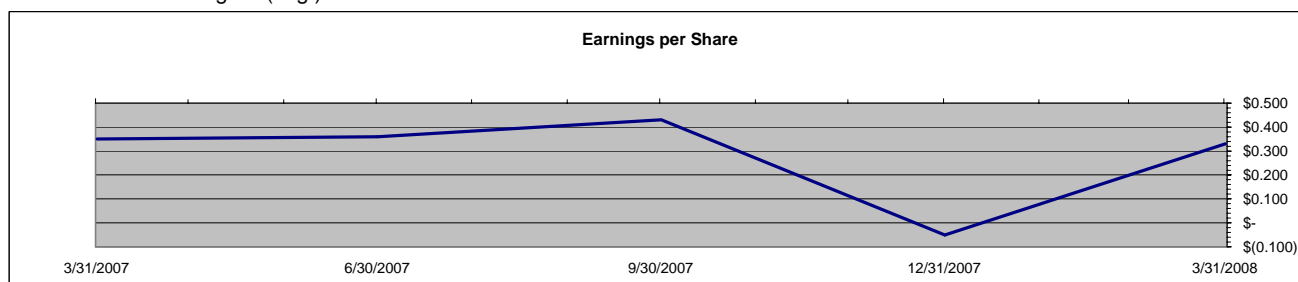
**Merriam Report Signals:**

- Recent Bearish
- Confirmed Bearish**
- Recent Bullish
- Confirmed Bullish



MR Dual Cash-Flow Figure (avg.)

3.329



**Accrual Ratios**  
Average Accruals

	3/31/07	6/30/07	9/30/07	12/31/07	3/31/08
Accrual Ratios	-2.47%	-3.48%	-7.33%	-9.20%	<b>-4.43%</b>
Average Accruals	-5.38%				

**Revenue Metrics (as % of Sales)**

	Recent Qtr.	Combined Avg.
Research & Development	15.34%	16.49%
Cost of Sales	31.98%	32.12%
S/G/A	29.97%	31.87%
Payables	30.40%	28.49%

Accrual reading slips after 4 quarters of improvement.

**Capital Productivity**

	Recent Qtr.	Combined Avg.
Inventory / Revenues	\$ 0.45	\$ 0.446
Receivables / Revenues	\$ 0.88	\$ 0.784
Inventory & Receivables / Revenues	\$ 1.33	\$ 1.230
P,P&E / Revenues	\$ 1.07	\$ 1.15

**Summary :** Bristol Myers is a major drug manufacturer

**Merriam Report Signals:** Dual-cash flow indicators for quarter ending March 31, 2008 are mixed (confirmed bearish and recent bullish). We can't get too excited about the recent bullish signal, as March's dual cash figure is only .004 higher than December's figure. In addition, the spread between operating cash-flow and balance sheet cash-flow is weakening.

**Financial Statements:** Q1 sales fell 3.7%, the first revenue decline in four quarters. Accounts receivable have expanded faster than revenues over the past few periods, which has pushed days-sales-outstanding to almost 80 days by end of March 2008. This is the highest DSO in all five periods examined.

First quarter inventory levels rose 8% over the previous period and about three times faster than sales. Accounts Payable for Dec. and March also expanded faster than revenues. This is in contrast to declining Property, Plant and Equip. for the same periods.

**Accrual Ratios:** According to the MR model, a ratio of -5 or less is very bullish and a ratio of +5 or more is very bearish. Although BMJ's March 2008 ratio of -4.43% is considered quite bullish, it has slipped for the first time in five periods shown and is worse than the average.

Revenue Metrics show improvements in cost of sales and operating expenses, declines in R&D and Accounts Payable. Capital Productivity declined in each area except PP&E which improved nicely.

**Earnings Quality: Declining**

**Recommendation: AVOID**

# The Merriam Report

PFE

3/30/08

Pfizer

All amounts in millions except for earnings per share

Quarterly period ending:	3/31/2007	6/30/2007	9/30/2007	12/31/2007	3/30/2008	Averages
<b>Earnings Per Share (Incl. Ext. Items)</b>	\$ 0.480	\$ 0.180	\$ 0.110	\$ 0.400	\$ 0.410	\$ 0.316
% Change in E.P.S. (from prev. qtr.)		-62.5%	-38.9%	263.6%	2.5%	41.2%
<b>Total Revenues</b>	<b>12474.00</b>	<b>11084.00</b>	<b>11990.00</b>	<b>12870.00</b>	<b>11848.00</b>	12053.20
% Change in Revenues (from prev. qtr.)		-11.1%	8.2%	7.3%	-7.9%	-0.9%
<b>Cost of Revenues</b>	<b>1887.0</b>	<b>2109.0</b>	<b>4618.0</b>	<b>2625.0</b>	<b>1986.0</b>	2645.0
Accounts Receivable:	10455.0	9497.0	9942.0	9843.0	10432.0	10033.8
% Change in Receivables (from prev. qtr.)		-9.2%	4.7%	-1.0%	6.0%	0.1%
DSO's (# of days it took customers to pay)	76.3	78.0	75.5	69.6	80.1	75.9
Inventories:	5694.0	5734.0	5210.0	5302.0	5148.0	5417.6
% Change in Inventory (from prev. qtr.)		0.7%	-9.1%	1.8%	-2.9%	-2.4%
Inventory as a % of Sales	45.6%	51.7%	43.5%	41.2%	43.5%	45.10%
Prepaid Expenses:	3231	3564	3749	5498	5939	4396.2
Other Current Assets:	25.0	34.0	115.0	114.0	87.0	75.0
Property, Plant & Equip. (net):	16481.0	16298.0	15714.0	15734.0	15383.0	15922.0
% Change in P,P & E (from prev. qtr.)		-1.1%	-3.6%	0.1%	-2.2%	-1.7%
Accounts Payable:	2037.0	1845.0	2298.0	2270.0	1909.0	2071.8
% Change in Payables (from prev. qtr.)		-9.4%	24.6%	-1.2%	-15.9%	-0.5%
<b>Quarterly period ending:</b>	<b>3/31/2007</b>	<b>6/30/2007</b>	<b>9/30/2007</b>	<b>12/31/2007</b>	<b>3/30/2008</b>	
Total Liabilities:	37995.0	42309.0	42420.0	50258.0	51133.0	44823.0
Shareholder equity:	72488.0	68094.0	66610.0	65010.0	67417.0	67923.8
Retained Earnings (Accum. Deficit)	53063.0	50304.0	51063.0	49660.0	52436.0	
<b>Operating Cash Flow (OCF)</b>	<b>103376.0</b>	<b>96366.0</b>	<b>96749.0</b>	<b>93634.0</b>	<b>99322.0</b>	97889.4
% Change in OCF (from prev. qtr.)		-6.8%	0.4%	-3.2%	6.1%	-0.9%
<b>Balance Sheet Cash Flow (BSCF)</b>	<b>22247.0</b>	<b>27369.0</b>	<b>26316.0</b>	<b>32533.0</b>	<b>32766.0</b>	28246.2
% Change in BSCF (from prev. qtr.)		23.0%	-3.8%	23.6%	0.7%	10.9%
<b>Spread between OCF &amp; BSCF</b>	81129.0	68997.0	70433.0	61101.0	66556.0	69643.2
<b>Ratios</b>						
<b>Spread to Revenues</b>	6.504	6.225	5.874	4.748	5.617	5.794
<b>Spread to OCF</b>	0.785	0.716	0.728	0.653	0.670	
<b>MR Dual Cash-Flow Figure</b>	7.289	6.941	6.602	5.400	6.288	

# The Merriam Report

5.794

Pfizer

PFE

3/30/08

Quarterly period ending:

3/31/07

6/30/07

9/30/07

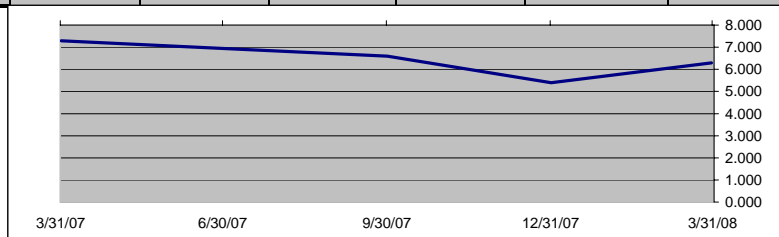
12/31/07

3/30/08

<b>MR Dual Cash-Flow Figure</b>		7.289	6.941	6.602	5.400	6.288
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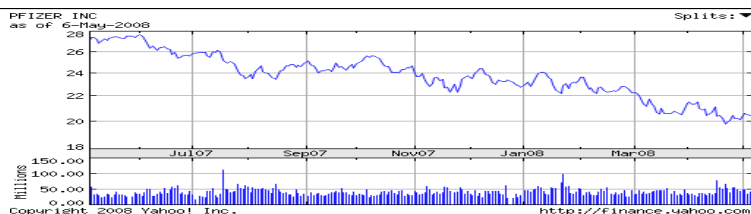
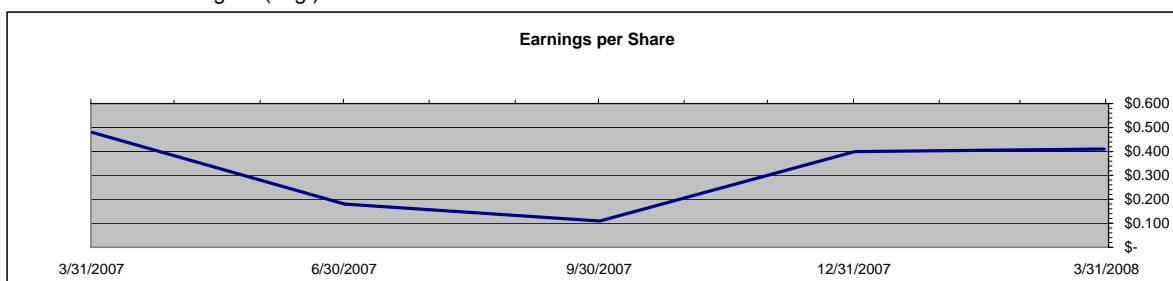
**Merriam Report Signals:**

- Recent Bearish
- Confirmed Bearish
- Recent Bullish
- Confirmed Bullish



MR Dual Cash-Flow Figure (avg.)

6.504



Accrual Ratios  
Average Accruals

6.33%  
5.41%

7.16%

7.56%

6.42%

-0.41%

**Revenue Metrics (as % of Sales)**

Research & Development  
Cost of Sales  
S/G/A  
Payables

Recent Qtr.
15.12%
16.76%
29.47%
16.11%

Combined Avg.  
16.39%  
21.94%  
31.72%  
17.19%

Bullish accrual trend last few periods

**Capital Productivity**

Inventory / Revenues  
Receivables / Revenues  
Inventory & Receivables / Revenues  
P,P&E / Revenues

Recent Qtr.
\$ 0.43
\$ 0.88
\$ 1.31
\$ 1.30

Combined Avg.  
\$ 0.449  
\$ 0.832  
\$ 1.282  
\$ 1.32

**Summary :** Pfizer is a major drug manufacturer.

**Merriam Report Signals:** Dual cash-flow indicators for the quarter ending March 31, 2008 are mixed (confirmed bearish and recent bullish). Spreads are improving.

**Financial Statements:** Q1 accounts receivable jumped 6% on an 8% decline in sales for the same period, pushing days sales-outstanding to 80 days, the highest of all periods examined.

Declines in inventory levels and P,P&E are in line with lower revenues for the recent period. Accounts payable declined 16% during Q1, a noticeable drop compared to an average -0.5% decline of all periods.

**Accrual Ratios:** According to the MR model, an accrual ratio of -5 or less is very bullish and a ratio of +5 or above is very bearish. PFE's Q1 accrual figure of -0.41 marks the third quarter of improvement and it is significantly better than the average for all periods.

Revenue Metrics show improvement in all categories except for R&D. Capital productivity was mixed, with improvements in inventory and P,P&E offset by declines for inventory and combined inventory/receivables.

**Earnings Quality: Improving**

**Recommendation: HOLD (Note: consider buying the 4.625% senior notes due 2018 under par)**

# The Merriam Report

WYE

3/31/08

WYETH

All amounts in millions except for earnings per share

Quarterly period ending:	3/31/2007	6/30/2007	9/30/2007	12/31/2007	3/31/2008	Averages
Earnings Per Share (Incl. Ext. Items)	\$ 0.920	\$ 0.870	\$ 0.840	\$ 0.750	\$ 0.890	\$ 0.854
% Change in E.P.S. (from prev. qtr.)		-5.4%	-3.4%	-10.7%	18.7%	-0.2%
Total Revenues	5368.69	5648.05	5619.54	5763.53	5710.65	5622.09
% Change in Revenues (from prev. qtr.)		5.2%	-0.5%	2.6%	-0.9%	1.6%
Cost of Revenues	1474.5	1530.2	1617.6	1691.4	1562.0	1575.1
Accounts Receivable:	3415.0	3688.1	3779.3	3528.0	4217.8	3725.6
% Change in Receivables (from prev. qtr.)		8.0%	2.5%	-6.6%	19.6%	5.8%
DSO's (# of days it took customers to pay)	57.9	59.4	61.2	55.7	67.2	60.3
Inventories:	2690.5	2875.8	3073.6	3035.4	3190.1	2973.1
% Change in Inventory (from prev. qtr.)		6.9%	6.9%	-1.2%	5.1%	4.4%
Inventory as a % of Sales	50.1%	50.9%	54.7%	52.7%	55.9%	52.85%
Prepaid Expenses:	0	0	0	0	0	0.0
Other Current Assets:	2942.5	3038.3	3048.3	2972.5	2969.1	2994.1
Property, Plant & Equip. (net):	10203.6	10333.7	10716.8	11072.2	11532.2	10771.7
% Change in P,P& E (from prev. qtr.)		1.3%	3.7%	3.3%	4.2%	3.1%
Accounts Payable:	1076.6	1091.0	1287.5	1268.6	1063.3	1157.4
% Change in Payables (from prev. qtr.)		1.3%	18.0%	-1.5%	-16.2%	0.4%
Quarterly period ending:	3/31/2007	6/30/2007	9/30/2007	12/31/2007	3/31/2008	
Total Liabilities:	24624.1	25054.3	25874.7	24506.7	24148.4	24841.6
Shareholder equity:	15017.0	16213.7	17021.1	18210.5	19308.2	17154.1
Retained Earnings (Accum. Deficit)	8855.6	9121.4	9497.0	10417.6	10964.1	
Operating Cash Flow (OCF)	10978.4	12125.6	12727.8	14520.6	15549.9	13180.5
% Change in OCF (from prev. qtr.)		10.4%	5.0%	14.1%	7.1%	9.1%
Balance Sheet Cash Flow (BSCF)	17190.0	17237.0	17759.7	16737.6	15898.2	16964.5
% Change in BSCF (from prev. qtr.)		0.3%	3.0%	-5.8%	-5.0%	-1.9%
Spread between OCF & BSCF	-6211.6	-5111.4	-5031.9	-2217.0	-348.2	-3784.0
<b>Ratios</b>						
Spread to Revenues	-1.157	-0.905	-0.895	-0.385	-0.061	-0.681
Spread to OCF	-0.566	-0.422	-0.395	-0.153	-0.022	
MR Dual Cash-Flow Figure	-1.723	-1.327	-1.291	-0.537	-0.083	

# The Merriam Report

-0.681

WYETH

WYE

3/31/08

Quarterly period ending:

3/31/07

6/30/07

9/30/07

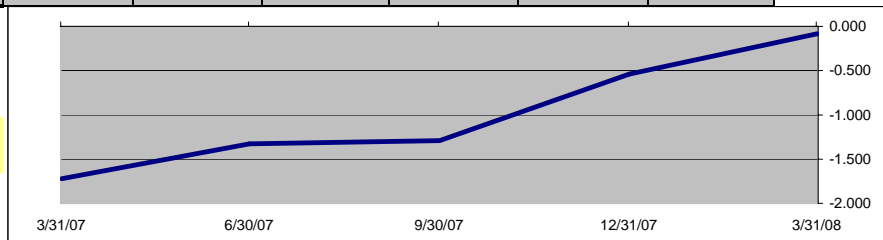
12/31/07

3/31/08

MR Dual Cash-Flow Figure	-1.723	-1.327	-1.291	-0.537	-0.083
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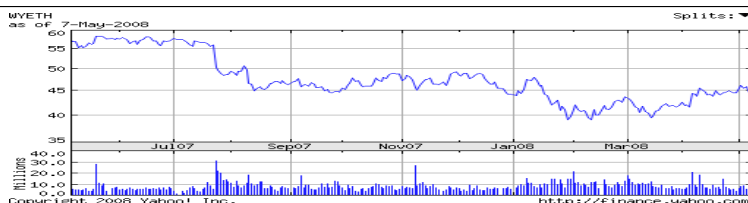
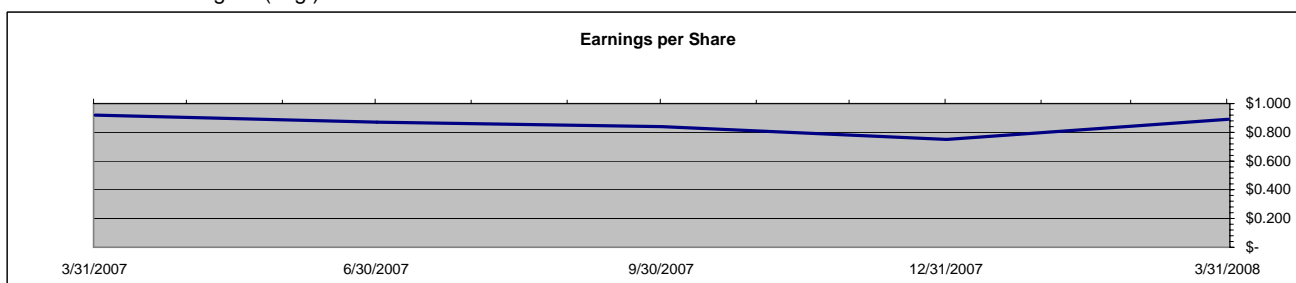
## Merriam Report Signals:

Recent Bearish  
Confirmed Bearish  
**Recent Bullish**  
**Confirmed Bullish**



MR Dual Cash-Flow Figure (avg.)

-0.992



<b>Accrual Ratios</b>	3/31/07	6/30/07	9/30/07	12/31/07	3/31/08
Average Accruals	2.96%	4.69%	3.52%	3.14%	2.58%

## Revenue Metrics (as % of Sales)

	Recent Qtr.	Combined Avg.
Research & Development	14.70%	14.57%
Cost of Sales	27.35%	28.02%
S/G/A	30.16%	30.15%
Payables	18.62%	20.59%

Accrual trend improving

## Capital Productivity

	Recent Qtr.	Combined Avg.
Inventory / Revenues	\$ 0.56	\$ 0.529
Receivables / Revenues	\$ 0.74	\$ 0.663
Inventory & Receivables / Revenues	\$ 1.30	\$ 1.191
P,P&E / Revenues	\$ 2.02	\$ 1.92

## Summary : Wyeth is a major drug manufacturer

**Merriam Report Signals:** Dual-cash flow indicators for the quarter ending March 31, 2008 are **both** bullish. Dual cash-flow spreads are improving significantly.

**Financial Statements:** Q1 2008 sales declined 1% from Q4 2007. Accounts receivable, inventory and P,P&E expanded faster than sales in the latest period. Days-sales-outstanding has risen to 67 days by end of March 2008, the highest level in all periods shown.

First quarter inventory levels rose over 5%, but they are in-line with increases of P,P&E for the same period. Q1 accounts payable declined 16% from Q4.

**Accrual Ratios:** According to the MR model, a ratio of -5 or less is very bullish and a ratio of +5 or more is very bearish. WYE's March 2008 ratio of +2.58% has a bearish bias, but has improved each period since Q2 2007 and is better than the average.

Revenue Metrics show improvements accross the board, except for S,G&A, which slipped modestly. Capital Productivity declined in all categories during the most recent quarter.

**Earnings Quality: Improving**

**Recommendation: BUY**