See final page for important disclosures

SALOMON SMITH BARNEY

EQUITY

RESEARCH:

INTERNATIONAL

TEN+

July 2, 2002

United States

9TH ANNUAL

TEN+ List

2002–03

Aetna, Inc.

Air Products & Chemicals, Inc.

Applied Materials, Inc.

Charter One Financial

Cisco Systems, Inc.

Deere & Company

Dell Computer

Devon Energy Corporation

HCA, Inc.

Pfizer

Philip Morris

Prudential Financial, Inc.

Staples, Inc.

Walt Disney Co.

Weyerhaeuser Co.

A member of citigroup

Salomon Smith Barney's 2002–03 TEN+ List

With this report, we are introducing Salomon Smith Barney's TEN+ (***T***en ***E***xceptional ***N***ames ***P***lus) List for 2002–03.

Each year, Salomon Smith Barney analysts are asked to select their best idea or top pick for performance over the next 12 months (midyear to midyear). In the TEN+ process, the analysts' top picks are refined by our TEN+ Selection Committee through a rigorous review that incorporates several disciplines, such as economic, quantitative, and technical analysis. We believe the cumulative experience and different disciplines of our stock selection team will enable us to identify a group of stocks that should outperform the market over the next 12 months.

Salomon Smith Barney's 2002–03 TEN+ List

			Price	52-Wk			Earnings Per Share			P/E Ratio		Proj. 5-Yr		
Company Name	Ticker	Rating	7/1/02	Hi	Low	FY Ends	2001A	2002E	2003E	Cur-E	Next-E	Growth	Div.	Yld.
Aetna, Inc.	AET	1H	$46.51	51.76	24.68	Dec	$ (1.72)	$ 1.47	$ 2.42	31.6	19.22	12.0%	0.04	0.09%
Air Products & Chemicals, Inc.	APD	1M	$50.61	53.05	33.59	Sept	2.37	2.33	2.85	21.7	17.76	0.0	0.82	1.62%
Applied Materials, Inc.	AMAT	1H	$18.03	27.76	13.75	Oct	0.55	0.19	0.83	94.9	21.72	20.0	0.00	0.00%
Charter One Financial	CF	1M	$33.94	36.20	24.70	Dec	1.99	2.21	2.55	15.4	13.31	12.0	0.75	2.22%
Cisco Systems, Inc.	CSCO	1H	$13.09	21.79	11.24	Jul	0.41	0.36	0.53	36.4	24.70	25.0	0.00	0.00%
Deere & Company#	DE	1H	$48.08	49.78	35.00	Oct	0.64	1.10	2.85	43.7	16.87	0.0	0.88	1.83%
Dell Computer	DELL	1H	$25.16	29.67	16.63	Jan	0.66	0.78	1.02	32.3	24.67	10.0	0.00	0.00%
Devon Energy Corporation#	DVN	1M	$49.29	54.49	31.15	Dec	5.05	3.78	4.75	13.0	10.38	0.0	0.20	0.41%
HCA, Inc.	HCA	1M	$46.84	51.90	37.83	Dec	1.94	2.49	2.85	18.8	16.44	12.0	0.00	0.00%
Pfizer	PFE	1L	$33.90	43.90	33.43	Dec	1.31	1.59	1.85	21.3	18.32	16.0	0.44	1.30%
Philip Morris	MO	1H	$44.96	57.72	42.87	Dec	4.04	4.90	5.50	9.2	8.17	13.0	2.32	5.16%
Prudential Financial, Inc.#	PRU	1M	$32.70	35.75	29.30	Dec	1.31	2.30	2.60	14.2	12.58	11.0	0.00	0.00%
Staples, Inc.	SPLS	1H	$19.12	22.14	11.56	Jan	0.66	0.84	1.00	22.8	19.12	15.0	0.00	0.00%
Walt Disney Co.#	DIS	1M	$18.36	28.74	16.98	Sept	0.98	0.60	0.85	30.6	21.60	11.0	0.23	1.25%
Weyerhaeuser Co.	WY	1M	$62.80	67.83	45.70	Dec	1.85	1.40	4.75	44.9	13.22	0.0	1.60	2.55%

Aetna, Inc. (AET–$46.51) 1H

James A. Lane

Company Description

Aetna is one of the largest health benefits management companies in the United States, with more than $18 billion in annualized health benefits and group insurance revenues. In first quarter 2002, the Health Care segment generated 53% of total company operating earnings, Group Insurance generated 39%, and Large Case Pensions generated 8%.

Investment Thesis

- The key driver behind our Buy rating is that Aetna's margins are well below peer company averages, but are projected to rise. Aetna reported an EBITA margin of 3.2% in first quarter 2002, and the company is targeting an EBITA margin of 6% by the end of 2003.

- In our view, Aetna's Group Insurance business is underappreciated. This business segment, which includes group life, disability, and long-term care products, seems on track to meet management's projection of $140–$145 million in operating earnings in 2002.

- Aetna's reinstated share repurchase program may limit dilution for the issuance of common stock equivalents (CSEs). Aetna reported 148.8 million fully diluted shares outstanding in first quarter 2002, and the company is projecting roughly 155 million for full year 2002. This guidance implies nearly 160 million fully diluted shares outstanding by the end of the year.

- Our 12- to 18-month price target on shares of AET is $66, which is based on 10x our current 2004 EBITA estimate of $1,134 million (and assuming net debt of $1.1 billion and 165 million average fully diluted shares outstanding). In our view, a 10x enterprise multiple is reasonable given the enterprise multiples currently being accorded to peer companies with EBITA margins in the area of 6%–7%.

Risks

In our view, there are three key risks to the Aetna story: 1) Aetna's ability to reduce Health Care operating expenses in line with premium revenues, given that the company terminated roughly 2.0 million risk members in first quarter 2002; 2) Aetna's corporate pension liabilities, which will likely cost an estimated $85 million pretax in 2002; and 3) Aetna's ability to predict medical cost trends, given its significant business mix change.

Air Products & Chemicals, Inc. (APD–$50.61) 1M

P.J. Juvekar

Company Description

Air Products is one of the largest industrial gas companies in the world, with revenues of $5.7 billion in fiscal 2001 (ended September). The company produces industrial gases, such as oxygen, nitrogen, hydrogen, and helium, along with other specialty gases. In addition, Air Products also sells chemicals and equipment to offer clients an integrated product. Air Products has the No. 1 position in supplying the semiconductor industry and is the U.S. leader in the chemical and processing industry.

Investment Thesis

- We believe Air Products is the best-positioned company in electronics. While currently in the worst downturn in 25 years, we believe electronics offers long-term growth of 10%–12% and should improve in the second half of 2002. New trends like 300 mm fabs, copper circuits, and optoelectronics play in Air Products' favor, in our view.

- Historically, industrial gases outperform the broader indices during an economic slowdown and continue to outperform in the first phase of an economic recovery when there is inventory building.

- We believe the company's large Gulf Coast hydrogen pipeline gives it exposure to growth markets. Hydrogen usage is expected to increase 10%–15% over next five years.

- The company is reducing capital expenditures and focusing on return on capital. After having spent near $1 billion a year in the 1990s, capital expenditures have been cut to $700 million in fiscal 2001 and should be $600–$650 million for 2002.

- We believe a higher multiple on Air Products will come from the company's superior growth prospects in the long run. Our $57 price target represents 20.0x our fiscal 2003 EPS estimate of $2.85 and 8.5x EV/EBITDA, a premium to the commodity chemicals group due to the better competitive dynamics in gases. Our discounted cash flow analysis suggests a valuation of approximately $55–$57, at a 9% discount rate and 4% terminal growth rate.

Risks

The current semiconductor slowdown could last well into 2002 and we believe this could pose a risk for Air Products. However, there is significant asset leverage in Air Products' plants as operating rates move higher with an improvement in square inches of silicon processed. Another identifiable risk is that the company's chemicals business is highly cyclical and makes the corporate portfolio more cyclical. While this concern is valid, we think that the cyclicality of the chemicals business could be attractive to investors at the bottom of the chemical cycle.

Applied Materials, Inc. (AMAT–$18.03) 1H

Glen S. Yeung

Company Description

Applied Materials, Inc., is the industry bellwether and the dominant supplier of manufacturing equipment for the semiconductor industry. Applied differentiates itself from all its non-Japanese competitors in that it has developed leadership positions in several product areas, including CVD, PVD, etch, high temperature films, ion implant, rapid thermal processing, and chemical-mechanical processing. In 2001, the company accounted for 20% of the $24 billion wafer processing equipment industry.

Investment Thesis

■ The growth cyclical semiconductor equipment industry is coming off one of the worst down cycles in its history. While orders have already shown some improvement in the first quarter of recovery, the inertia that typifies industry recovery has created fits and starts as we turn from the bottom. While the ramp of recovery is macro-dependent, we remain confident that a cyclical recovery of some proportions is under way.

■ As the dominant player with the broadest product portfolio, Applied seems best positioned to capitalize on the industry recovery, in our view. The company's disproportionate exposure to the Asian market (where growth in production facilities is at its greatest) particularly suits the geographic trends in the industry, in our view.

■ This cycle differs from previous cycles in the number of technology transitions being affected by chip makers today. Moves to copper, 300 mm, and 0.13-micron technologies benefit large equipment makers with large R&D budgets, such as Applied.

■ While the volatility of equipment names makes establishing near-term price targets difficult, our 18- to 24-month price target of $38 is derived by discounting the 35x peak historical P/E multiple for Applied Materials by 20%. Applying this discounted multiple of 28x to our targeted peak EPS of $1.30–$1.40 results in an earnings target of $38.

Risks

The major risks to Applied seem to concern the actuality and ramp of a cyclical recovery. As we believe the bottom has clearly passed, the risk lies primarily with the rate of economic recovery, in our view. As with cyclicals, we believe longer-term risk lies in the anticipation of the direction of the cycle.

Charter One Financial (CF–$33.94) 1M

Keith Horowitz, CFA

Company Description

Charter One Financial, headquartered in Cleveland, Ohio, is the 22nd largest U.S. bank, with $38 billion in assets. Operating primarily in large Midwest metro markets and upstate New York, Charter One is one of the premier retail banking franchises in the country.

Investment Thesis

■ We believe Charter One is among the select few retail banks that execute well in retail banking due to a superior efficiency ratio (second-lowest among the top 50 banks), excellent asset quality, and an aggressive sales culture that is focused on taking deposit market share from its less-focused competitors.

■ While other well-managed banks with similar success in retail deposit gathering trade at significant P/E premiums to their peers, CF trades at a 5% P/E discount, which we believe reflects a perception of the company as "just a thrift." Thrifts have typically traded at a 15%–20% P/E discount to banks, reflecting a relatively high concentration in mortgage-related assets and CDs.

■ We believe the market is overlooking Charter One's success in growing high-value checking accounts and improving the profitability of its customer base, which should continue to drive strong double-digit growth in retail banking fees, in our view. Also, the company has been making significant progress in reducing its concentration in lower-yielding "thrift-like" mortgage assets.

■ Our price target of $42 is based on our valuation model and implies that CF's valuation will improve to a 15% P/E premium to its peer regional banks from its current 5% discount. We expect the catalyst to be increasingly evident over the next several quarters, as the favorable mortgage environment likely fades, and we believe strong execution in retail banking is the key driver to its above-average EPS growth.

Risks

Our EPS estimates are roughly linked to a modest economic recovery. However, should the economic environment remain weak, we would expect Charter One's EPS growth to be negatively affected. While this would likely drive Charter One's EPS growth to the high single-digit range, we believe the company's above-average credit quality and deposit pricing flexibility would likely ensure that its EPS growth rate would still be superior to that of the average regional bank.

Cisco Systems, Inc. (CSCO–$13.09) 1H

B. Alex Henderson

Company Description

Cisco Systems is the worldwide leader in networking for the Internet. Cisco's end-to-end networking solutions allow people to access or transfer information using DSL; cable; dial access offload; optical, switching, and routing; and Voice Over IP technologies. Roughly 75% of revenues are from enterprise customers and 25% are from service providers. Within the service provider segment, roughly 35%–45% of revenues come from international markets, 20% come from cable, 15%–20% from ATMs, 20% from core routers, and 15% from optical access technology.

Investment Thesis

■ In the current uncertain telecom environment, we think Cisco's strong position in the enterprise segment should provide protection from the cuts in service provider capex.

■ Cisco has delivered a strong balance of products, end markets, and end-to-end solutions that we believe should allow the company to deliver growth as the global environment gradually recovers.

■ Cisco doesn't always have the best technology, we believe, but it persistently wins in the marketplace. We believe Cisco's core competency is its ability to change and retain customer loyalty, as it can often enter a new category and rapidly dominate it. We think this is the heart of Cisco.

■ We think Cisco's valuation is less expensive than many investors realize. Based on fiscal 2003 earnings estimates, Cisco trades at a modest 24.7x, which is roughly comparable to both Extreme (at 30.3x) and Foundry (at 35.6x), and is substantially less expensive than Juniper (at 284.5x). Coming out of a recession, we believe investors should value Cisco on normalized operating potential, as opposed to depressed estimated earnings. We believe Cisco can sustain 20%-plus growth longer term, and we believe these shares can attain a valuation of at least 2x growth on normalized earnings, which leads us to a $25 target price.

Risks

While we continue to favor the enterprise-focused data networking stocks, there is a risk that profitability of the enterprise customers continues to be affected by a sustained economic slowdown. In our view, if enterprise customers remain unconvinced that an economic recovery is under way, it is likely they will not return to normal purchasing patterns until their own profitability begins to improve.

Deere & Company# (DE–$48.08) 1H

David M. Raso

Company Description

Deere is the world's leading manufacturer of farm equipment, while also producing construction, forestry, and commercial and residential lawn equipment and providing financing and health care services.

Investment Thesis

■ Our attraction to the farm equipment cycle, with shares of DE being the leading large market capitalization way to invest in the cycle, in our view, is threefold. First, the new U.S. farm bill signed into law this spring seems to have provided a positive secular event for the farm economy, assuring U.S. farmers higher and more predictable levels of government financial assistance. The unpredictable nature of government payments under the 1996–2002 U.S. farm bill resulted in U.S. farmers under-buying farm equipment by 15%–20% in the past three years relative to historically high net income. We expect the new farm bill to gradually reverse this trend.

■ Second, a positive cyclical farm economy event seems to be evolving via improving crop supply and demand fundamentals. Major field crop inventories are the lowest in the past three to five years, with the current crop production at risk due to stressful weather. Demand prospects are also improving with China's entry into the WTO, a weaker U.S. dollar, more stable Asian economies versus the last cycle (40% of U.S. farm exports go to Asia), and U.S. government initiatives for increased corn ethanol usage.

■ Finally, cyclical trends in farm equipment appear to be improving. U.S. new farm equipment inventories are the lowest in five years for all major tractor categories, while industry manufacturing capacity has decreased due to industry and plant consolidation.

■ We conservatively view Deere's peak EPS potential at slightly below $5 per share, but industry fundamentals and company cost-cutting initiatives could surprise on the upside. Even a modest U.S. industry retail sales recovery through 2004, combined with current low inventory, suggests that industry production growth in the midteens would still produce negative inventory, highlighting significant production potential during the next cycle. Our 12-month price target for Deere is $53, derived from discounting back the average peak valuation for EV/LTM sales, EV/LTM EBITDA, price to book value, and next-12-month P/E, each metric utilizing a multiple within Deere's historical valuation range. However, continued strong momentum in crop fundamentals would suggest to us that DE could exceed its last cycle peak of $64 in the longer term.

Risks

In addition to the unpredictable nature of crop growing conditions (e.g., due to weather), we believe DE faces historical calendar second half underperformance near term. Near-term equipment demand could soften in response to weak crop conditions, causing Deere production cutbacks. However, we view such a trade-off (i.e., weaker near-term equipment demand for higher crop prices) as a positive, as higher crop prices should bolster the overall prospects for a cyclical farm economy recovery.

Dell Computer (DELL–$25.16) 1H

Richard Gardner

Company Description

Dell is the second-largest vendor of PCs and Intel-based servers worldwide, with 14% and 21% shares, respectively. The company's portfolio also includes workstations, network switches, storage, services, and a variety of third-party products. Dell generated $31.2 billion in revenues last year.

Investment Thesis

■ Slower industry growth, commoditization, and higher ROI hurdles should accelerate share gains by low-cost producer Dell. Gateway, a direct consumer competitor, has 25%–26% operating expenditures versus Dell's 12%; we, therefore, view Gateway's $4 billion in revenues as a significant 18- to 24-month opportunity for Dell. Hewlett-Packard (HP) expects to lose $3–$3.5 billion in revenues during the Compaq merger integration, and we expect Dell to capture the majority of that loss. These two opportunities account for substantially all revenue growth we expect from Dell in the coming year.

■ We expect corporate upgrade demand to improve in 2003, as PCs upgraded before Y2K will be 4–4.5 years old, and the better corporate profits we expect should yield an uptick in IT spending. Given Dell's 30%–35% exposure to large corporate, this should drive significant growth in 2003, in our view.

■ Dell has outperformed PC market unit growth by 13–40 percentage points in every year since 1995. Although this gap should narrow over time (due to the law of large numbers), it seems reasonable to expect more than the ten and three percentage point outperformance, respectively, in our estimates for fiscal years 2003 and 2004 (ending January). Our fiscal 2004 estimate, which is already $0.11 above consensus, seems especially conservative to us.

■ Our $30 price target implies a 28x target P/E ratio. We believe the shares deserve a premium valuation due to superior earnings growth (20% in fiscal 2003 and 30% in fiscal 2004), a negative 40-day cash conversion cycle, a 30%–35% return on invested capital, and strong free cash flow ($1.50 per share in the coming 12 months). Our $30 target implies 11% growth in free cash for ten years and 5% perpetual growth thereafter, which seems attainable given the blended growth rate of Dell's target markets.

Risks

PC industry growth seems to be slowing in the corporate and government segments of the developed world due to saturation and lengthening upgrade cycles. If the upgrade cycle extends to five to six years, PC demand may not improve significantly next year. Dell's largest competitor, HP, has excess channel inventory in the U.S. and European consumer markets, as well as in the European corporate markets, which could prompt an increase in near-term price competition as HP attempts to reduce inventories.

Devon Energy# (DVN–$49.29) 1M

Robert Morris

Company Description

Devon Energy is North America's largest independent producer of crude oil and natural gas. More than 95% of the company's total production is derived from North America, with natural gas accounting for roughly two-thirds of its total North American volumes.

Investment Thesis

■ Devon has essentially completed the integration of Anderson Exploration and Mitchell Energy along with its original non-core property divestiture program. Importantly, the disposed properties represented roughly 14% of the company s total pro forma production, but 20%-plus of its total operating costs. Thus, Devon should emerge from these recent transactions with a leaner cost structure and annual organic production growth of around 5.0%.

■ Proceeds from the company's property divestiture program (roughly $1.4 billion after tax) and excess operating cash flow should be applied toward reducing debt, which should drop its net debt-to-book capitalization ratio to 55% at year-end from 63% at the end of the first quarter.

■ Overall, we believe that Devon provides one of the best opportunities among the large-cap independents given its leaner cost structure and above-average growth profile going forward and its leverage to higher natural gas prices in the longer term. Also, the company's debt level is not a real concern to us, given its low cost and the absence of any major fixed payment obligations until 2005.

■ Over the past five years, our E&P group has traded at an average of 6.0x forward 12-month's cash flow after pro forma adjustments for acquisitions. Devon also trades at 92% of our discounted cash flow based net asset value (NAV) based on year-end 2001 proved reserves with pro forma adjustments for the property divestitures, compared with an average of 102% for our E&P coverage group. Therefore, we have set a 12-month price of $65.00 per share based on the company achieving a multiple of 6.5x our 2003 discretionary cash flow estimate and 122% of NAV.

Risks

Investors should keep in mind the potential risks associated with unexpected movements in natural gas and crude oil prices, as well as the potential impact from political, economic, and meteorological events.

HCA, Inc. (HCA–$46.84) 1M

Deborah J. Lawson

Company Description

HCA, Inc., operates 181 hospitals and 77 free-standing surgery centers in 22 states, England, and Switzerland. The company's primary strategy is to position itself as a comprehensive provider of quality health care services in select urban communities. HCA concentrates on communities that are characterized by highly integrated health care facility networks, where it is a leader or has a reasonable expectation of becoming a leader. HCA is the largest player in the investor-owned hospital space and the leading provider of healthcare in urban markets.

Investment Thesis

■ We believe a more "normalized" Medicare environment, improved commercial insurance rates, and solid volume growth should produce stable, predictable earnings growth of 15%-18% for HCA over the next several years.

■ The company's strong managed care recontracting effort is resulting in significantly improved private pay pricing in the high single digits, on average. HCA continues its focus on local healthcare networks where it has solid competitive positions and negotiating strength with managed care.

■ HCA appears well positioned in a number of the fastest growing markets in large cities across the United States. We expect the company to continue its capital commitments to these and other key markets over the next several years. HCA has targeted capital expenditure (capex) of $1.6 billion and $1.8 billion for 2002 and 2003, respectively. A large percentage of capex will go toward expansion projects that should, in our opinion, continue to generate high returns.

■ We expect the company to generate EPS growth of 15%-18% over the next several years with strong free cash flow with which the company will reduce debt or repurchase stock.

■ Our 2002 and 2003 EPS estimates are $2.49 and $2.85, respectively. We believe shares of HCA represent a compelling value at only 16.4x our 2003 EPS estimate and 6.0x our 2003 EBITDA estimate, a discount to its hospital peer group average. Assuming the shares can trade at 9.5x our estimated 2003 EBITDA of $4.1 billion, we assign a $60 price target.

Risks

While the bulk of government investigations have been settled, lawsuits remain. As hospitals are subject to many legislative and regulatory changes, HCA's operating success depends on its ability to adapt to changes in regulation. Labor costs are a major concern for all hospitals. Specifically, the nationwide shortage of nurses could pressure HCA's overall labor costs.

Pfizer (PFE–$33.90) 1L

George Grofik, CFA

Company Description

Pfizer is a global leader in pharmaceutical sales. In 2002, we expect Pfizer to generate sales approaching $36 billion. With pharma sales of about $25 billion in 2001, Pfizer ranked number one globally. Pfizer has the largest R&D budget ($4.8 billion in 2001) in the industry and we believe is the marketing partner of choice. Pfizer's currently marketed drugs include seven blockbusters with more than $1 billion of sales plus two blockbuster alliance drugs. Pfizer has key franchises in anti-infective, arthritis, cardiovascular, and central nervous system drugs.

Investment Thesis

■ During the 2001-05 interval, Pfizer has the highest projected EPS growth rate among the major U.S. pharmaceutical companies (16%), driven by a stable of blockbuster drugs, low generic risk, and merger-related cost savings. Pfizer appears well positioned to increase its market share and expand profit margins with the largest U.S. sales force (8,200 reps) and maturing blockbuster drugs.

■ Pfizer's next wave of new drugs includes Bextra® for arthritis and pain, the antifungal Vfend® (both 2002 launches); Spiriva® for COPD, darifenacin for overactive bladder, and pregabalin for epilepsy, neuropathic pain and anxiety (all estimated 2003 launches); inhaled insulin for diabetes; and lasofoxifene for osteoporosis (estimated 2004 launches).

■ Pfizer's generic risk is among the lowest of the major pharmaceutical companies with approximately 10% of its 2001 pharma sales exposed to "hard" patent risk over the 2001-05 time frame. In addition, Pfizer is not heavily dependent on new drug approvals to fuel future growth. We believe this positions the company well in the new, conservative FDA environment.

■ Pfizer currently trades at about 18.3x our 2003 EPS estimate of $1.85, or a 10% premium to the industry multiple and a 17% premium to the market. Pfizer's current valuation is approximately 1.5x its long-term growth rate, which represents a discount to the industry average of 1.8x. Our price target of $42 is approximately 23x our 2003 EPS estimate.

Risks

Pfizer's investment risks include near-term competition to several key products such as Lipitor®, Viagra®, and Zoloft®. Investment risks related to the pharmaceutical industry include: increasing political risk, product development risk, regulatory risk, pricing pressures from state discounting initiatives and managed care organizations, and shifting investor sentiment away from "safe haven" securities.

Philip Morris (MO–$44.96) 1H

Bonnie Herzog

Company Description

Philip Morris is a consumer products company that has businesses in the tobacco, food, and beer industries and a market capitalization of more than $100 billion. Its main competitive advantages are brand strength, marketing expertise, and a global infrastructure. Philip Morris has successfully leveraged all three of these competitive advantages over the past decade, in our view, to become the market leader in several industries and market segments.

Investment Thesis

■ Philip Morris remains our SSB 2002 Top Pick. We are recommending the stock for the following key reasons: 1) strong company fundamentals; 2) an attractive dividend (4.0% yield); 3) an aggressive share buyback program; 4) an attractive valuation; and 5) an improving litigation environment.

■ We believe there are a few catalysts that could drive the stock price higher in the next 12 months, including a favorable risk/reward ratio surrounding an individual trial in California (begun June 17), lower settlement payments in 2003, and faster EPS growth (approaching 15% in the next couple of years).

■ We continue to believe the stock is undervalued. Based on our sum-of-the-parts DCF valuation, the market is still giving basically zero value to Philip Morris' U.S. tobacco business, whereas both RJR and Carolina Group are trading with EV/EBITDA multiples of 3.2x and 4.4x. By applying the average of these two multiples, we believe Philip Morris should be trading closer to $70. We maintain our 12-month price target of $67 per share.

Risks

In our opinion, one of the biggest risks currently facing the stock is possible sector rotation out of the "defensive" names. Although we have seen some of this rotation already (and MO has held up quite well), the stock could face some short-term pressure if and when more rotation happens. In addition, as with all the other tobacco companies, Philip Morris faces litigation risk. However, we continue to believe the overall litigation environment is improving, especially as it relates to aggregated claims. Furthermore, the upcoming litigation calendar is relatively quiet in the next several months.

Prudential Financial, Inc.# (PRU–$32.70) 1M

Colin W. Devine, CFA, CMA

Company Description

The Prudential Life Insurance Company of America was established more than 125 years ago, and is one of the largest financial services organizations in the U.S., where its logo and name have household brand recognition. With some 22,000 salespeople worldwide, Prudential has one of the largest sales organizations, serving more than 15 million individual and institutional customers in the U.S. and 30 foreign countries, and, through its retail operation, touches one in every ten U.S. households. Prudential offers a vast array of individual and group insurance products, as well as investment management and advisory services. Ongoing operations are centered on four divisions: 1) U.S. Consumer, 2) Employee Benefits, 3) International, and 4) Asset Management — collectively known as the financial services businesses. By division, first quarter 2002 operating income was divided: 33% U.S. Consumer, 13% Employee Benefits, 38% International, 12%, Asset Mgmt., and 4% Corporate/Other, while revenues were split 36%, 30%, 27%, 6%, and 1%.

Investment Thesis

- With its shares trading at only book value and poised to benefit from several catalysts, including $250 million of incremental expense saves in 2002, we view Prudential as a compelling value play.

- Potential valuation “events” over the next 12 months include: the likely sale of the non-core personal lines property/casualty business; completion of the company’s initial $1 billion share repurchase program by year-end 2002, followed by similar levels in 2003 and 2004; and the reasonable likelihood of an S&P 500 index inclusion.

- While management’s 12% ROE goal in 2004 may be a challenge, we believe Prudential can reach 7.5% in 2002, 8.5% in 2003, and at least 10.5% in 2004. Our price target of $40 equates to a “full” 17.4x our 2002 EPS estimate of $2.30, and 15.4x our 2003 EPS estimate of $2.60, but is only 1.2x book value of $32.97 (excluding FAS 115), versus a peer group average of 1.5x. Our target also reflects our view that the company’s shares will be valued more on future expectations versus current returns. Longer term, we consider Prudential capable of generating sustained 11%–13% EPS growth.

Risks

We believe Prudential’s biggest risks lies with respect to how successful it is in executing the conversion of its securities business into a solely retail brokerage operation.

Staples, Inc. (SPLS–$19.12) 1H

William Julian

Company Description

Staples operates more than 1,400 office product retail stores (with 1,200 in North America and more than 200 in Europe). The company also sells its products through contract, mail order, and an e-commerce site. We expect the company will open 75 new stores in the U.S., 20 in Canada, and 20–25 in Europe this year. A typical Staples superstore is 20,000 square feet and sells approximately 7,500 SKUs.

Investment Thesis

- We believe Staples is taking the necessary steps to reduce expense and re-merchandise its stores to position the company to benefit when sales rebound during the business spending recovery.

- A new CEO focused on profitable growth is beginning his tenure by reducing operating costs by $200 million, most of which should happen this year. The company has realized $40 million in savings in first quarter 2002. We estimate $70 million of savings will come from product line reviews, as the company negotiates favorable terms from its vendors.

- We believe SPLS offers a compelling investment opportunity, trading at just 19.1x our 2003 EPS estimate of $1.00. Our EPS estimate assumes an operating margin of 5.9%, still shy of the pre-recession peak of 6.3%. With the potential for a stronger economic recovery in 2003, we suspect the margin could expand further, adding 2.5 cents per share per 10 basis points of operating margin expansion. Historically, Staples shares trade at 27x forward EPS estimates. Importantly, due to the cost savings planned for 2002, we believe our $0.84 EPS estimate is achievable with no material rebound in sales. Our $25 price target implies a 25x our 2003 EPS estimate, which is below the company’s historical forward P/E range.

Risks

The office products retail industry is highly competitive, with three expanding national chains and a highly fragmented group of independent and small regional competitors all vying for market share. In addition, non-specialty retailers such as warehouse clubs, discounters, and, recently, drugstores, have been allocating more square footage to the category during peak selling seasons. Exposure to international markets provides risks such as currency exchange, political turmoil, cultural differences, and the need for strong management worldwide.

Walt Disney Co.# (DIS–$18.36) 1M

Jill S. Krutick

Company Description

Walt Disney is a diversified entertainment company with operations in Media Networks, Studio Entertainment, Theme Parks and Resorts, and Consumer Products. Owned brands include ABC Television, The Disney Channel, ESPN, Lifetime, and film studios Buena Vista and Miramax. Disney operates the Walt Disney World Resort in Florida, Disneyland and California Adventure in California, and theme parks overseas. The company also licenses its intellectual property for use in consumer products.

Investment Thesis

■ After being challenged by a soft economy and advertising climate, Disney's cyclical businesses appear to be making a comeback. Its theme parks have seen sequential improvement in attendance. The company has aggressively cut costs out of Theme Parks, and, when that division further recovers, we believe free cash flow should snap back with force. The ABC lineup has been retuned, and, in what appears to be a positive upfront market, we estimate the network booked $1.5 billion, marking a better-than-expected first step in invigorating the lagging network.

■ After our recent meetings with management, we believe that, while the cyclical segments remain pressured, cost-cutting is mitigating the downside, positioning Disney for a rebound. We see strength in the fiscal fourth quarter as we expect film product flows and the ad market to gradually improve. Longer term, a turnaround in consumer products in late 2002 could also provide an additional catalyst.

■ We believe management's consistent ability to build new businesses from successful content and to gain market share (in home video, cable networks, and theme parks) differentiates Disney and should allow it to shine over time. Disney trades at 10x 2003 EV/EBITDA, a 10% discount to the group average, and below the company's five-year 11.2x–18.8x range. With some improvement at ABC and at the Theme Parks, we think the shares could reasonably trade to a 2003 EV/EBITDA multiple closer to the midpoint of that five-year range. Assuming a 14x 2003 EV/EBITDA multiple on our 2003 EBITDA estimate of $4.7 billion produces a $28 price target. Furthermore, we believe the stock could cross $30, with sustained evidence of a turnaround in Consumer Products or the ABC Network.

Risks

Risks include the volatility of the advertising cycle and the ability to turn around Broadcasting, the economic and political sensitivity of theme parks, the volatility of filmed entertainment, the success of new parks, and the ability of the consumer products division to rebound.

Weyerhaeuser Co. (WY–$62.80) 1M

Chip Dillon, CFA

Company Description

As a result of its recent acquisition of Willamette Industries, Weyerhaeuser became the second-largest global producer of containerboard and uncoated free sheet (copy paper), while also increasing its presence in the U.S. wood products market. The company derives 50% of normalized (or midcycle) earnings from paper, 40% from wood products, and the remaining 10% from its real estate operations. In addition, the company owns 7.4 million acres of timberlands.

Investment Thesis

■ Weyerhaeuser has significant exposure to the wood products cycle — a business we believe will continue to benefit from a favorable supply/demand balance. The demand side appears bright to us due to demographics, immigration, and record low interest rates, while the tariff on Canadian lumber imports, coupled with mill closures, has resulted in reduced supply.

■ CEO Steve Rogel served as Willamette's CEO in the mid-1990s. Due to his familiarity with the acquired (Willamette) assets, we see much larger merger than indicated ($300 million) in merger synergies. We believe the synergy news should be strong over the next four to six quarters.

■ Weyerhaeuser's paper operations are tied to containerboard and uncoated free sheet — the two grades we believe are best positioned to benefit in a pricing upcycle. Both grades should benefit from a record-best three-year capacity outlook, in our view.

■ We rate Weyerhaeuser 1M (Buy, Medium Risk), with a $77 price target. This price target is based on expected peak (2004) EPS of $7.35, implying a 10.5x P/E multiple. Our implied peak P/E ratio of 10.5x is below the multiples reached at the past two peaks (late 1980s and mid-1990s).

Risks

We believe the stock would come under pressure in a highly inflationary environment that forces Fed Chairman Alan Greenspan to raise interest rates aggressively. Due to the acquisition of Willamette, the company has $12.5 billion in net debt — putting debt-to-total capitalization in the mid-60%'s on a book value basis (though under 50% on a market basis).

Performance Results: 2001–02 TEN+ List

In the table below, we provide the hypothetical performance, assuming each of last year's stocks could have been purchased in equal dollar amounts at the close of July 10, 2001, and were held until July 1, 2002. These data include performance on a price-only basis, as well as with dividends. These results exclude transaction costs. The performance is compared with that of the S&P 500 for the same period (price only and with dividends reinvested).

2001/02 Ten Plus List	Ticker	Price 7/1/2002	Price 7/11/2001	% Change	Dividends	Price plus Dividends	Total Return
Abbott Laboratories	ABT	37.30	50.18	-25.7%	0.87	38.17	-23.9%
Altera	ALTR	12.72	28.91	-56.0%	0.00	12.72	-56.0%
Analog Devices	ADI	27.99	39.20	-28.6%	0.00	27.99	-28.6%
AOL Time Warner	AOL	13.51	48.50	-72.1%	0.00	13.51	-72.1%
Electronic Data Systems	EDS	30.45	59.05	-48.4%	0.60	31.05	-47.4%
Ford Motor Company	F	15.52	25.32	-38.7%	0.65	16.17	-36.1%
Freddie Mac	FRE	60.82	66.76	-8.9%	0.84	61.66	-7.6%
Jones Apparel Group	JNY	36.60	39.40	-7.1%	0.00	36.60	-7.1%
Lincoln National	LNC	41.70	49.38	-15.6%	1.25	42.95	-13.0%
Pfizer	PFE	33.90	38.85	-12.7%	0.48	34.38	-11.5%
Tyco International	TYC	13.75	50.50	-72.8%	0.05	13.80	-72.7%
Wal-Mart Stores	WMT	54.40	48.85	11.4%	0.29	54.69	12.0%
Waste Management	WMI	25.79	30.25	-14.7%	0.01	25.80	-14.7%
Wells Fargo	WFC	49.33	45.29	8.9%	1.06	50.39	11.3%
Weyerhaeuser	WY	62.80	58.05	8.2%	1.60	64.40	10.9%
Performance:				**-24.86%**			**-23.78%** *with dividends*
S&P 500	SPX	968.65	1180.18	**-17.92%**			**-16.87%** *with dividends reinvested*

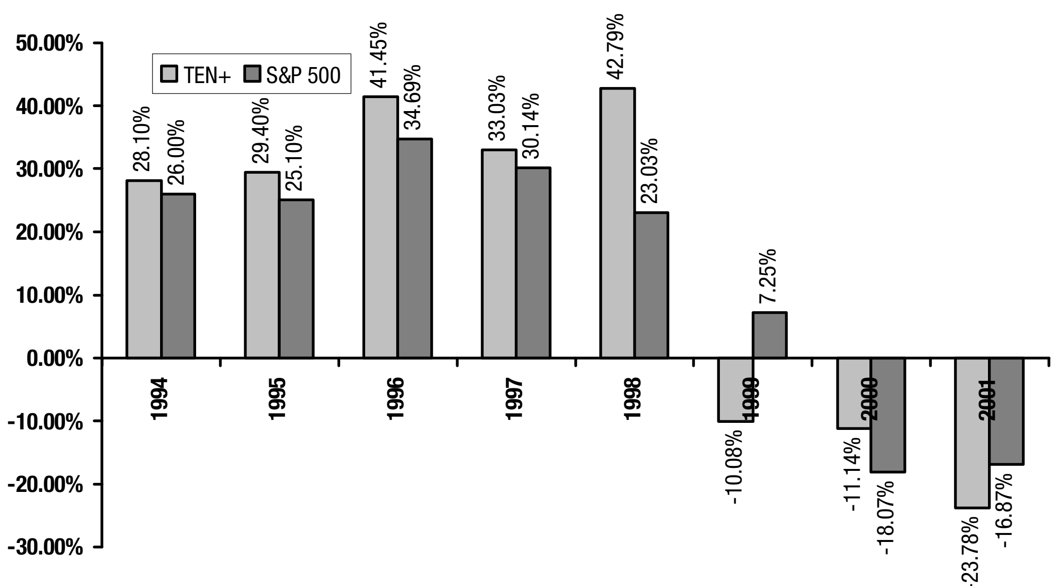
TEN+ List: Historical Performance Results

TEN+ Historical Performance vs. the S&P 500 — 1994–2001

Year	Initial Date	End Date	TEN+ % Gain/Loss	S&P 500 Total Return	# of Stocks Up	Down	Unch'd.
1994	6/30/1994	6/30/1995	28.10%	26.00%	8	2	—
1995	7/3/1995	6/28/1996	29.40%	25.10%	14	1	—
1996	6/28/1996	6/30/1997	41.45%	34.69%	15	0	—
1997	6/30/1997	6/30/1998	33.03%	30.14%	12	3	—
1998	7/2/1998	7/2/1999	42.79%	23.03%	11	4	—
1999	7/7/1999	7/7/2000	-10.08%	7.25%	4	11	—
2000	7/11/2000	7/9/2001	-11.14%	-18.07%	6	9	—
2001	7/10/2001	7/1/2002	-23.78%	-16.87%	3	12	—
Cumulative Compound Return:			**171.2%**	**148.3%**			
Compound Average Annual Return:			**13.3%**	**12.1%**			

*The TEN+ List performance results are inclusive of dividends received, although not reinvested. These results exclude transaction costs.

*The S&P 500 performance results include the reinvestment of dividends.



Past performance may not be indicative of, and does not guarantee, future performance.

Notes

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IMPORTANT DISCLOSURES

A member of Jill Krutick's team currently holds a long position in the common shares of Walt Disney Co

George Grofik currently hold long positions in the common shares of Pfizer.

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