

Stock Rating  
**Overweight-V**

Industry View  
**Attractive**

February 21, 2008

## Covidien

### Quick Comment: Win vs. Applied Medical Removes Risk

**Impact on Our Views:** Last night's ruling in favor of Covidien removes a risk that we had noted in our most recent earnings note (see our report, *F1Q08: Strong Results with Good Management*, dated 2/7/08). Specifically, we think that Covidien could have faced damages and associated legal costs of around \$400 million. Yesterday's jury verdict removes this potential liability.

**What's New:** On Wednesday, February 20, a California Federal Circuit court ruled in favor of Covidien versus Applied Medical Resources regarding surgical trocars. In response to a suit brought by Applied Medical, Covidien claimed non-infringement and was seeking invalidity due to obviousness. The jury did find the patents to be valid; however, it was found that Covidien did not infringe. Applied Medical has historically been a problematic company for Covidien, as Covidien was previously liable in another patent infringement case involving a similar set of products.

**Investment Thesis:** We view the court ruling last night as reducing the risk for legal settlement or loss to Applied Medical. We reiterate our Overweight-V rating on COV and continue to view the stock as one of our top three picks.

*Morgan Stanley is currently acting as financial advisor to Covidien Ltd. ("Covidien") in connection with the announced acquisition of its Retail Products business by First Quality Enterprises, Inc.*

*Covidien has agreed to pay fees to Morgan Stanley for its financial services, including transaction fees that are subject to the consummation of the proposed transaction. Please refer to the notes at the end of this report.*

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#### Key Ratios and Statistics

Reuters: COV.N Bloomberg: COV US

Hosp. Supplies & Medical Technology / United States of America

<b>Price target</b>	<b>\$52.00</b>
Shr price, close (Feb 20, 2008)	\$43.35
Mkt cap, curr (mm)	\$21,810
52-Week Range	\$49.70-36.91

Fiscal Year ending	09/07	09/08e	09/09e	09/10e
<b>ModelWare EPS (\$)*</b>	<b>2.63</b>	<b>2.41</b>	<b>2.78</b>	<b>3.19</b>
<b>Prior ModelWare EPS (\$)</b>	-	-	-	-
<b>P/E</b>	<b>15.8</b>	<b>18.0</b>	<b>15.6</b>	<b>13.6</b>
<b>Consensus EPS (\$)</b>	<b>2.72</b>	<b>2.45</b>	<b>2.76</b>	<b>3.10</b>
Div yld (%)	0.0	1.5	1.5	1.5

\* = Please see explanation of Morgan Stanley ModelWare later in this note.  
e = Morgan Stanley Research estimates

#### Quarterly ModelWare EPS

Quarter	2007		2008e	
	2006	Prior Current	Prior Current	
Q1	-	- 0.69	-	0.59a
Q2	-	- 0.68	-	0.58
Q3	-	- 0.64	-	0.62
Q4	-	- 0.62	-	0.62

e = Morgan Stanley Research estimates, a = Actual company reported data

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**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of January 31, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>1048</b>	<b>44%</b>	<b>333</b>	<b>45%</b>	<b>32%</b>
<b>Equal-weight/Hold</b>	<b>986</b>	<b>41%</b>	<b>308</b>	<b>42%</b>	<b>31%</b>
<b>Underweight/Sell</b>	<b>346</b>	<b>15%</b>	<b>98</b>	<b>13%</b>	<b>28%</b>
<b>Total</b>	<b>2,380</b>		<b>739</b>		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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**Overweight (O).** The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

**Equal-weight (E).** The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

**Underweight (U).** The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

**More volatile (V).** We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

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**Attractive (A):** The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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### Industry Coverage:Hosp. Supplies & Medical Technology

Company (Ticker)	Rating (as of)	Price (02/20/2008)
<b>David R. Lewis</b>		
Abiomed (ABMD.O)	O-V (06/01/2007)	\$14.74
American Medical Systems Holdings, Inc. (AMMD.O)	O (12/18/2007)	\$14.56
Beckman Coulter (BEC.N)	E (07/11/2007)	\$67.7
Gen-Probe Inc. (GPRO.O)	O (12/20/2006)	\$51.35
Haemonetics Corporation (HAE.N)	E (12/20/2006)	\$58.04
Intuitive Surgical Inc. (ISRG.O)	E (10/02/2007)	\$291.43
ev3, Inc. (EVVV.O)	E (02/21/2008)	\$8.19
<b>Matt Miksic</b>		
Hospira (HSP.N)	O (03/01/2007)	\$41.21
Integra Lifesciences (IART.O)	E (08/03/2007)	\$43.39
LifeCell Corporation (LIFC.O)	E (10/02/2007)	\$36.6
NuVasive (NUVA.O)	O (10/16/2006)	\$39.11
Respironics, Inc. (RESP.O)	++	\$65.61
Stryker Corporation (SYK.N)	E (10/28/2005)	\$67.35
Zimmer Holdings, Inc. (ZMH.N)	O (04/28/2006)	\$76.94
<b>Glenn Reicin</b>		
Abbott Laboratories (ABT.N)	O (11/15/2006)	\$55.61
Baxter International (BAX.N)	O (06/23/2004)	\$60.42
Becton Dickinson (BDX.N)	O (08/08/2007)	\$90.03
Boston Scientific (BSX.N)	O (01/17/2008)	\$12.61
Covidien (COV.N)	O-V (07/09/2007)	\$43.35
Edwards Lifesciences (EW.N)	U (03/08/2007)	\$43.25
EnteroMedics Inc. (ETRM.O)	E-V (12/26/2007)	\$8.49
Hansen Medical, Inc. (HNSN.O)	E (11/01/2007)	\$17.8
Johnson & Johnson (JNJ.N)	E (01/30/2006)	\$63.23
Medtronic (MDT.N)	E (10/31/2007)	\$49.41
St. Jude Medical (STJ.N)	O (11/20/2006)	\$43.6

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