

The University of Connecticut  
MBA Student Managed Fund  
Analyst Report



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## Company Description

Gilead Sciences, Inc. (Gilead) is a research-based biopharmaceutical company that discovers, develops, and commercializes therapeutics to advance the care of patients suffering from life-threatening diseases. The Company's primary areas of focus include HIV/AIDS, liver disease and serious cardiovascular and respiratory conditions. Gilead Sciences, Inc., incorporated in Delaware in 1987, is research-based biopharmaceutical companies that discovers, develops and commercializes innovative medicines in areas of unmet medical need with headquarter in Foster City, California.

Company is the market leader in HIV, with annual sales of ~\$9bn. Following the company's 2011 acquisition of Pharmasset, Gilead is poised to be the market leader in Hepatitis C (HCV), driven primarily by Sovaldi (sofosbuvir), a NS5B inhibitor which has demonstrated high cure (SVR12) rates, a favorable side-effect profile and once-daily dosing. Further sofosbuvir-based regimens to be a ~\$ 14bn peak sales opportunity. Oncology is the newest area of focus for Gilead, driven by idelalisib, a PI3K-delta inhibitor currently under FDA review for indolent non-Hodgkin's lymphoma (iNHL) and in Phase III for chronic lymphocytic leukemia (CLL). We estimate idelalisib to be a \$1.8bn opportunity.

## Products

Gilead primary areas of focus include HIV/AIDS, liver disease and serious cardiovascular and respiratory conditions.

Gilead current product line:

- HIV/AIDS: Atripla, Complera, Emtriva, Stribild, Truvada, Tybost, Viread, Vitekta
- Liver Diseases: Harvoni, Hepsera, Sovaldi, Viread
- Hematology/Oncology: Zydelig
- Cardiovascular: Letairis, Lexiscan, Ranexa
- Inflammation / Respiratory: Cayston, Tamiflu
- Other: AmBisome, Macugen

Company	
Gilead Sciences, Inc.	GILD
Rating	Buy
Target Price	\$112.30
Closing Price (4/25/2016)	\$102.29
Potential Upside	9.3%

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## Industry Analysis

The biotechnology industry employs biological and biochemical knowledge to develop, manufacture and trade products and processes for the diagnosis and treatment of diseases and ailments. It also develops genetically modified plant and animal species and food varieties. The industry has a noncyclical growth profile, which is insensitive to overall economic conditions. The industry focuses on specialty markets with primary sales and efforts targeted towards specialists such as hematologists, oncology physicians, rheumatologists and dermatologists. Consequently, the industry is highly reliant on research and development (R&D). US biotech companies dominating the market include larger players like Amgen (AMGN), Gilead (GILD) and Biogen (BIIB). Medical spending is expected to grow significantly in the coming quarters due to an aging population, increasing obesity and demand for quality treatment. Healthcare service providers have shown a willingness to incur higher costs to treat diseases and this supports margin expansion for successful treatments. US healthcare spending for the next decade is expected to be around \$4.2 trillion or 20% of GDP. The biotechnology pipeline has become an important consideration for the pharmaceutical industry and its suppliers. The industry has witnessed an increase in financing and multi-billion-dollar mergers and acquisitions. R&D spending remains robust. The US continues to dominate in R&D spending, with approximately 81 cents of global expenditures being domestic.

An average drug takes about 10 to 15 years from pre-clinical development to market approval. According to the FDA, for every 20 drugs that enter the clinical testing stage, only a few pass trial and gain approval. The traditional sales and profit metrics do not completely reveal the biotech companies' otherwise lengthy, cost-intensive product-development periods. It is essential for investors to consider the number of products the biotech companies have in their pipeline, the time necessary for development and the potential market size of drugs. Patents held, effectiveness of these patents to protect market share, cash position, and current leverage position all impact biotech company outlook. Finally, R&D effectiveness, management competency and potential synergies from new or proposed M&A activities are important factors for investors to consider.

## Investment Thesis

GILD's revenue growth has slightly outpaced the industry average of 8.1%. Since the same quarter one year prior, revenues rose by 16.3%. Growth in the company's revenue appears to have helped boost the earnings per share.

GILEAD has improved earnings per share by 45.9% in the most recent quarter compared to the same quarter a year ago. The company has demonstrated a pattern of positive earnings per share growth over the past two years. We feel that this trend should continue. During the past fiscal year, GILEAD SCIENCES INC increased its bottom line by earning \$11.92



versus \$7.38 in the prior year. This year, the market expects an improvement in earnings (\$12.21 versus \$11.92).

The net income growth from the same quarter one year ago has greatly exceeded that of the S&P 500, but is less than that of the Biotechnology industry average. The net income increased by 34.3% when compared to the same quarter one year prior, rising from \$3,486.72 million to \$4,683.00 million. The company's current return on equity greatly increased when compared to its ROE from the same quarter one year prior. This is a signal of significant strength within the corporation. Compared to other companies in the Biotechnology industry and the overall market, GILEAD SCIENCES INC's return on equity significantly exceeds that of both the industry average and the S&P 500.

Gilead's focus on infectious disease has paid off in. With a small salesforce, inexpensive manufacturing, and selective research and development, it generates stellar profit margins, and the firm's pipeline is extending its reach into other high-margin markets like hepatitis C and hematological oncology. With the approval of hepatitis C drug Sovaldi in late 2013, Gilead's competitive advantages have strengthened, moving it into wide-moat territory. Gilead will see new competitive threats in HIV; Glaxo could introduce a Truvada/Tivicay single tablet regimen once Truvada patents begin to expire in 2018, and generic versions of Atripla should be available beyond 2021. However, we think Complera and Stribild will have a strong grasp on the market by this time, resetting the firm's HIV patent cliff into the 2020s.

In summary, Gilead's substantial pipeline offers numerous opportunities for continued growth, both in the short and longer term, and the financial strength of the company allows it to be thoughtful and opportunistic in pursuing partnerships or acquisitions that will further expand the future portfolio of products.

### Investment Risks

- A large slowdown in Harvoni sales due to competition.
- More than 60% of Gilead's U.S.- based HIV sales volume represents government purchases, and higher rebates on some of these sales were implemented in 2010. Austerity measures also had a higher-than-average impact on prices in Europe in 2010, and escalating overall health-care costs and tight budgets.
- Possible government regulations putting pricing pressure on the company.
- Key patents begin to expire in 2018, and next-generation products could struggle to provide sufficient differentiation for reimbursement in all key markets. This puts pressure on the HIV franchise beginning around 2021.



## Financial Analysis

	2013	2014	2015	Q2-2015	Q3-2015	Q4-2015
Revenue	11,202.0	24,890.0	32,639.0	8,244.0	8,295.0	8,506.0
Operating Profit	4,524.0	15,265.0	22,193.0	5,616.0	5,585.0	5,621.0
Net Income	3,075.0	12,101.0	18,108.0	4,492.0	4,600.0	4,683.0
Revenue Growth %	15.5	122.2	31.1	26.2	37.3	16.3
EBITDA	4,869.0	16,315.0	—	5,889.0	5,863.0	—
Operating Profit %	40.4	61.3	68.0	68.1	67.3	66.1
Profit Margin	27.5	48.6	55.5	54.5	55.5	55.1
D/E	56.5	78.4	—	73.8	123.9	—
EPS	2.0	8.0	12.4	3.1	3.1	3.3
PE Ratio	40.6	12.7	8.5	12.1	8.9	8.5
Current Ratio	1.1	3.1	3.4	2.0	2.8	3.4
ROE	29.7	90.3	104.8	92.9	109.1	104.8
ROA	14.0	42.3	41.9	42.8	42.6	41.9
Dividend Per share	0.0	0.0	1.3	0.4	0.4	0.4

## Valuations

### Relative Valuation:

	Industry Average	GILD US	AMGN US	CELG US	BIIB US
Mkt Cap (USD bi)	95,202.93	128,711.80	113,084.41	81,629.23	57,386.28
P/E	21.69	7.49	16.41	46.24	16.63
P/B	7.67	6.64	4.04	13.88	6.12
Dividend Yield	0.89	1.44	2.10	0.00	0.00
PEG Ratio	2.14	4.63	1.60	0.86	1.47
Trailing 12M EPS	9.94	12.37	9.25	2.34	15.82
5 yr-Rev'n Grth	19.69	33.60	7.58	19.17	18.42
Profit Margin	34.69	55.06	32.51	21.89	29.29
Operat. Profit M	44.77	66.08	36.72	35.12	41.14
Debt/Equity	136.65	-	112.37	240.76	69.61
Net Sales T12M	18,580.19	32,639.00	21,662.00	9,256.00	10,763.76
Net Income	8,572.05	17,075.16	8,278.01	4,822.00	4,113.00



### Discounted Cash Flow:

	2010-15	2016-20
Avg Revenue growth	38%	-2%
Avg EBITDA Margin	55%	64%
Avg Net Income Margin	40%	52%
Avg Debt/Equity	66.38	-
Avg FCF / Margin	43%	52%
Cost of Debt (After Tax)		1.9%
Tax Rate		22%
Cost of Equity		10.1%
WACC		9.0%
Perpetuity growth rate		2.5%

Target Price: \$112.30

### CSR Commentary

While Gilead Sciences (GILD) has lower than industry average Bloomberg ESG disclosure scores, company has some strong competitive advantages which make it a fundamentally strong company and good investment for the MBA Student Managed Fund. Also based on Sustainalytics ESG rating, Gilead has above average ESG rating in their industry.

Few of the strong fundamental characteristic of the company are;

### Fundamental Strength:

- Very strong gross margin (87.2%) and operating margin (54.8). further the margin has been continuously increasing over past years
- Very strong balance sheet with low leverage and strong cash balance.
- Above industry average performance on most of the financial ratios (Rev Growth, Net Income Growth, Operating Margin, ROA, ROE, Debt/Equity)
- Management has diversified its product portfolio with acquisition of Pharmasset deal and key hepatitis C drug Sovaldi. Which provide more strong revenue and margin visibility during coming years.

### Environmental Policy:

- Gilead has been evaluating their level of environmental impact and have identified ways to reduce their energy consumption. Some factors that contribute to Gilead environmental impact include greenhouse gas emissions produced by employee commutes, the energy and water consumed by facilities, and the use of hazardous materials such as chemicals, viruses and radioactive compounds in R&D facilities.



- Pursuant to evaluation, company have taken some measures to address these impacts. For example, company have established employee commuter programs, evaluated the energy efficiency of buildings, and installed low-flow water fixtures.
- Gilead have also implemented proactive programs to minimize the occurrence of hazardous materials incidents and to reduce the risk of accidental environmental contamination and worker injury.

### Social Policy:

- Through Gilead Foundation, a non-profit organization established in 2005, company seeks to improve the health and well-being of underserved communities around the world. The Gilead Foundation provides grants to programs in the United States and internationally.
- Gilead manufacturers of intermediate products affirmatively state in their agreements with company that they will comply with applicable laws, which would include laws that prohibit human slavery and trafficking.
- Gilead provides funding for projects that relate to at least one of five core therapeutic areas: HIV/AIDS, liver diseases, hematology and oncology, inflammatory and respiratory diseases, and cardiovascular conditions.
- Gilead condemn the use of forced labor and human trafficking as well as discrimination based on race, color, gender, religion, disability, sexual orientation, gender identity or expression. Gilead select suppliers who share our ethical standards.

### Governance Policy:

- Gilead has a very strong ISS Governance QuickScore of 3 (A score of 1 indicates lower governance risk, while a 10 indicates higher governance risk). Further companies Audit & Risk Oversight score is 1 which indicate a very strong governance structure.
- The average ISS Governance QuickScore for top 10 Biotech companies is 4.8 and Gilead has 4<sup>th</sup> best rating among top 10 US Biotech firms.