

Celgene Corporation (NASDAQ: CELG)

Sector/Industry: Health Care/Biotech



Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
\$122.80	\$101.64	\$147.17	\$94.55	19.48x	\$79.15B	N/A	1.15

Business Description

Celgene is a biopharmaceutical company that discovers, develops, and commercializes primarily cancer drugs. It is global, with operations in 60 countries and sales in 70; however, half of its revenue is generated in the US. Currently, Celgene's R&D expense is 31% of revenue, but their R&D capabilities are unique in that they partner with other research facilities. With this, they can share the cost and the risk. Revlimid is Celgene's primary drug, earning 62.1% of revenue. Its patent expires in 2017 in the US, and 2024 internationally. Celgene is intensively expanding the use of its current drugs in order to gain market, while also developing over 100 other drugs.

Industry Trends

Key drivers in the biotech industry are R&D expenditures and regulatory decisions about patents/pricing. R&D is necessary to expand product portfolio and boost revenue, while matching the growing market demand. Celgene traditionally outpaced peers in R&D spending, and is prepared to do so through 2020. Additionally, the industry faces rigid regulation. The FDA has a thorough and lengthy procedure of approving drugs to market. Patent laws and pricing restrictions influence the success and revenue share of a drug. Celgene has historically pushed their products through FDA regulation quickly, and is filling their pipeline to make up for expiring patented drugs. Finally, they are positioned well to withstand a price drop, as revenues are driven primarily by growth in volume, not price.

Investment Thesis

Celgene is an attractive value investment because of its strong operational performance in the oncology treatment space, expanding portfolio of billion-dollar drugs, and discounted price basis. Celgene commands peer-best 96% gross margin and is on pace to grow EPS by 20% CAGR through 2020. They dominate the myeloma (blood cancer) and psoriasis/arthritis markets, boasting high-teens revenue growth over the previous five years. Near-term, we see the introduction of several billion-dollar drugs (e.g., Ozanimod, Idhifa, luspatercept) as key catalysts. Approvals for alternative applications of current drugs (Rev., Abiraterone & Otezla) may provide additional tailwinds. Longer term, Celgene's pipeline of 100+ drugs and external R&D partnerships will support our investment beyond 2020. Finally, we believe shares are oversold after Q3 results sent shares down ~33%. This creates an attractive entry point for a long-term investment on a fundamentally sound biotech stock poised for growth.

Valuation Assumptions

WACC: 9.80%
Perpetuity Growth Rate: 2.5%
Projection Assumptions 2018-2023:
Revenue Growth: 15% tapered to 12.5%
R&D Expense: 36% tapered to 28%

Key Financials

DCF Stock Price: \$128.93
DCF Weight: 66%
Multiples Price: \$110.54
Multiples Weight: 33%
Price Target: \$122.80

Corporate Social Responsibility

% Women on Board: 33% (peer median: 24%)
% Independent Directors on Board: 75% (peer median: 85.45%)
Sustainalytics Score: 77.39 (peer median: 69.13)
ISS Governance Quickscore: 4 (peer median: 2)
CDP Performance Score: 6 (peer median: 5)

5-Year Stock Performance



Competitive Analysis

Celgene's main competitors are Biogen, Gilead Sciences, and Amgen. Their drug portfolio is diversified among blood and other cancers, while Biogen, Gilead Sciences, and Amgen are focused on neurology, HIV/AIDS, and blood deficiency, respectively. Although they are all drug companies, Celgene dominates the oncology market, especially in blood-based cancers. For reference, Celgene's five largest drugs by percent of revenues and disease type are: Revlimid (62%, blood cancer); Pomalyst (12%, blood); Otezla (9%, psoriasis/arthritis); Abiraterone (9%, breast/pancreatic cancer), and Vidaza (5%, blood).

Competitive Advantages

Compared to its competitors, Celgene has the largest R&D expenditure as a percent of net sales. This allows them to lead the market in drug discovery and patenting. Additionally, through their R&D capabilities and market specialty, Celgene has benefited from pricing power. The prices of their drugs have risen in the past years, yet demand is still met. R&D efficiency and price leadership helps Celgene earn industry-leading gross margins (96% and growing) and impressive EPS growth.

Risks

We recognize a few important risks with our recommendation of Celgene. First, Celgene derives more than 60% of its annual revenues from its blockbuster cancer drug, Revlimid. Failure to diversify revenues through product development may put profitability at risk when the drug's patents expire (2024 in Europe, 2027 in US). Next, recurring sales of their key drugs relies on patent protection. Patents for Celgene's four largest drugs expire between 2023 and 2028. A diversified pipeline of 100+ drugs and releases of new billion-dollar drugs (e.g., Ozanimod, Idhifa) should mitigate these risks. Finally, a recent pipeline miss (Mongerson) and trimmed guidance caused a sell-off in October. Negative investor sentiment may limit upside in the near term. We believe investors will return to the stock as their pipeline materializes in the long-term.

Report Prepared By:

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Sources: Bloomberg, CELG Annual & Quarterly Reports, JP Morgan Research, FDA Research

