

## Gilead Sciences – Best in HCV, Top in HIV, Huge upside.

Rating: Buy (29% upside)

Share Price: US \$101.73

Target Price: US \$131.04

### Executive Summary

Gilead has **(1) virtual monopoly status in HCV market** with superb performance from its drugs, Sovaldi and Harvoni which largely contributed to its 122.2% increase in revenue in 2014. Although the Street consensus does not have faith in Gilead pipelines, we have reasons to believe that Gilead has **(2) strong product pipelines** as evident from its recent positive clinical trials results. Currently, it is trading at 9.2x P/E - lower than its peers average and historical average of 20.1x P/E and 19.0x P/E respectively. Conservatively, even with a sluggish growth and no confidence in the pipelines, Gilead should be trading at 12x of our 2015 EPS estimates, \$10.92, which gives us our **12-months Target Price of \$131.00**. Gilead is still a steal at current share price of \$101.73 which offers a 29% upside.

**(1) Virtual monopoly in HCV market** - Gilead has captured more than 90% of the HCV market share with its strong sales from Sovaldi and Harvoni, as they are doctors' preferred choice of drugs for HCV treatment. Its closest competitor AbbVie has approximately 10% of market share. With the launch of Sovaldi and Harvoni in the European and Japanese market, Gilead will undoubtedly dominate the HCV market.

**(2) Strong product pipelines** - Gilead has strong product pipelines as they continue to diversify their product portfolio and is also expected to increase their presence in Oncology, Cardiovascular and Respiratory treatments. Many of the drugs are already in Phase 2 & 3 and will be ready and approved for being marketed, thereby having a huge revenue generation driver in the future. For example, HIV drugs E/C/F/TAF and F/TAF are scheduled to be approved in U.S. and E.U. by Q415 and Q216 respectively.

**(3) Strong balance sheet for acquisition** - Gilead cash pile grew from \$2.1B to \$10B in 2014, and it is now estimated to reach \$25.2B in 2015. Recently, the company raised another \$10B from the debt market to add more cash into its war chest. The management has a strong track record in brilliant acquisition and this goes without question that Gilead has enough capital to finance a new acquisition that will bolster their current drugs portfolio.

### Financial Highlights

Financial Year End: Dec	FY13	FY14	FY15E	FY16E	FY17E
Revenue (USD m)	11,202	24,890	32,590	34,048	35,522
Revenue YoY (%)	15.5%	122.2%	30.9%	4.5%	4.3%
Gross Profit (USD m)	8,343	21,102	28,679	30,132	31,614
Gross Margin (%)	74.5%	84.8%	88.0%	88.5%	89.0%
EBITDA (USD m)	4,869	16,315	22,324	23,493	24,688
EBITDA Margin (%)	43.5%	65.5%	68.5%	69.0%	69.5%
EBIT (USD m)	4,524	15,265	21,213	22,284	23,375
EBIT Margin (%)	40.4%	61.3%	65.1%	65.4%	65.8%
Net Profit (USD m)	3,075	12,101	17,057	17,713	18,659
Net Margin (%)	27.5%	48.6%	52.3%	52.0%	52.5%
Net Profit YoY (%)	18.6%	293.5%	41.0%	3.8%	5.3%
EPS (USD /share)	1.81	7.35	10.92	11.51	12.30
EPS YoY (%)	10.8%	305.0%	46.3%	5.8%	7.2%
Net Gearing (%)	38.5%	15.0%	-14.7%	-43.1%	-58.1%
P/E (x)	40.6	12.71	9.2	9	8.4
EV/EBITDA (x)	24.6	8.7	6.9	6.5	6.2

Source: Company/Analyst Estimates

Company Name: Gilead Sciences, Inc  
Bbg Ticker: GILD US

Share Price: US\$ 101.73  
Target Price: US\$ 131.04 (29% upside)  
Rating: Buy

Market Cap (US\$m): 150,444.2M  
Avg 1mth daily value traded (US\$/day): 1165M/day  
Shares outstand (m): 1467.6M  
Freefloat: 97.98%  
Capital Group Companies Inc, 8.13%  
Major shareholder 2: FMR LLC, 5.9%

### Share performance

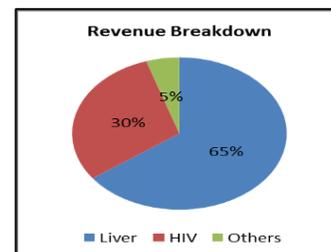


## Company Overview

**Biopharmaceutical company that focus on HIV and liver diseases:** Gilead Sciences is a research-based biopharmaceutical company that focuses on the discovery, development and commercialization of innovative drugs in areas of unmet medical need including human immunodeficiency virus (HIV), liver diseases such as chronic hepatitis C virus (HCV) infection and chronic hepatitis B virus (HBV) infection, oncology and inflammation, and serious cardiovascular and respiratory conditions. It has operations in approximately 30 countries worldwide and has a portfolio of 20 marketed drugs across these areas.

**How Gilead makes money:** Gilead generates revenues from 2 sources - product sales and royalty/contract. Close to 95% of product sales revenue comes from HCV and HIV drugs sales revenue, while the Gilead's royalty and contract revenues are mainly derived from its sales of Tamiflu, a drug for influenza A and B, through Roche.

**Revenue Breakdown:** Gilead's most significant revenue drivers are HCV drugs Sovaldi (Dec 2013) and Harvoni (Oct 2014). The Company's major focus is presently on liver-related diseases. It derives about 65% of its revenues from this segment with another 30% coming from HIV-related drugs. The remaining 5% is spread among oncology, cardiovascular and respiratory drugs. Most of Gilead's revenue comes from the U.S., followed by Europe and other countries (such as Japan and developing countries). In 2014, 73% of revenue comes from U.S., 22% from Europe and 5% from other countries.

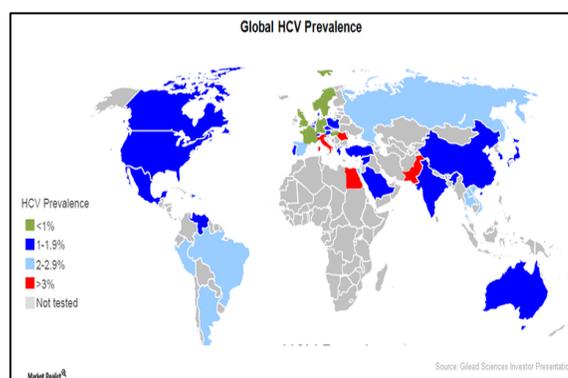


**Strong financials:** Gilead's Gross Margin and Operating Margin are at 85% and 61% respectively, higher than the peers average Gross Margin and Operating Margin of 79% and 25% respectively. This shows that Gilead is way more profitable than its peers. In addition, it is also more efficient than its peers, with Return of Equity (ROE) of 88% higher than its peer average of 30%. One might argue that a high ROE means it is highly leveraged. However, if we look at its FCF to LT Debt ratio, it's more than 1. Gilead has enough earning power to cover its interest payment and also to pay dividend (\$1.72 dividend per share) to shareholders. We forecast that Gilead will be in a net cash position by 2015, which gives it an extremely strong balance sheet to continue supporting its share buyback program, paying higher dividend and make good acquisition to bolster its drugs portfolio.

## Industry Analysis

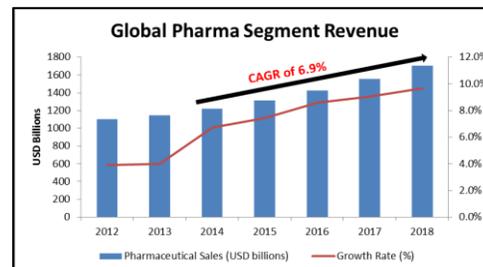
**Recent ugly hit in biotech sector:** Since mid-April, the iShares Nasdaq Biotechnology ETF (NASDAQ:IBB) has dropped about 12% as the biotech industry as investors became more cautious and risk-averse to put their money in this industry. Fundamentally, aside from recent comment from Clinton criticising "Price gouging like this in the specialty drug market is outrageous," the extremely high price of specialty drugs in light of the incident of Turing Pharmaceuticals AG raising the price of a drug by 50-fold after buying it, nothing much has changed. The correction is more sentiment driven rather than a change in fundamentals. This presents a good opportunity for investors to buy good biotech stocks with strong financials, existing drugs and pipelines.

**Increased focus on HCV in the Emerging Markets:** Hepatitis C is a liver disease caused by the hepatitis C virus, ranging in severity from a mild illness lasting a few weeks to a serious, lifelong illness which can be life threatening. Globally, there are about 185 million people afflicted with HCV, most of them in low- and middle income countries, with HCV related complications resulting in 350,000 deaths each year. It is estimated that about 2.6 million people in "Big 5" of Europe and 1.1 million people Japan have chronic HCV infection. The sales of sofosbuvir regimens have just begun in these countries and it will contribute to the company's earnings at least for the next 3-5 years. On top of that, there is still very little market penetration with some of the emerging markets. It is estimated that 82.9 million of people in Asia, Latin America and Eastern Europe has chronic HCV infection. There are 4 million people in the U.S. battling the disease and 1.2 million people are diagnosed in Japan, but the number of new diagnosis in Japan every year totals 350,000, which is far greater than the 150,000 new cases diagnosed every year in America. This indicates the



scale of opportunity available to Gilead Sciences in the HCV treatment market. Gilead's revenues are concentrated in the United States (73%) and Europe (22%) with less than 5% coming from emerging market. We believe that the emerging markets represent a new market that will provide Gilead with solid revenue stream for the next 10-15 years.

**Increased global pharmaceutical spending:** According to a research done by Deloitte, global pharmaceutical sales are projected to increase at a CAGR of 6.9 % during 2014-2018, outpacing the estimated global health care spending rate CAGR of 5.2 % during that same period. This could mean more revenue for Gilead as government increase their health care spending to subsidise expensive drugs to make it more affordable to the people.



**Increase global access for its drugs:** For the years 2014 and 2015, Gilead has announced nonexclusive licensing agreements with 11 Indian generic manufacturers for HCV drugs. This allows the drugs to be distributed across 91 developing market. In addition, Gilead has entered a new agreement with Medicines Patent Pool (MPP) allowing the organisation to sublicense the new TAF-based HIV drugs to generic manufacturers. This agreement is subject to approval from the FDA. If effective, these drugs will be distributed in 112 developing countries around the world. This is likely to lead to big profits for both HCV and HIV drugs in the long run.

### Why Gilead?

**Virtual monopoly in HCV market:** Thanks to its blockbuster drugs Sovaldi and Harvoni, which achieve close to 99% cure rate, Gilead is undoubtedly the market leader in HCV market with close to 91% market share. The closest competitor is Abbvie which only holds around 8% market share.

**Gilead has the best HCV treatment:** Recently, Abbvie Viekira Pak has been approved in Japan and one may wonder how Gilead would capture market share since there is an additional competition in Japan. Studies have shown that Viekira Pak has more side effects than Harvoni/Sovaldi, which makes Harvoni/Solvaldi a safer choice. On top of that, Viekira Pak is only approved for patients with mild hepatic impairment and not recommended for those with severe hepatic impairment; Harvoni/Solvadi is approved for that both mild and severe hepatic impairment.

**Great pipelines for HCV drugs:** Currently, Harvoni is approved in the United States for the treatment of HCV genotype 1 patients only. Gilead Sciences has submitted three supplemental new drug applications to the FDA for expanding the indicated use of Harvoni. If approved, Harvoni will be used to treat HCV, HIV-coinfected patients as well as patients with genotypes 4, 5, or 6 and cirrhotic patients. Gilead is also developing an oral, three-drug regimen currently in phase II and phase III trials. Designed to be effective for all HCV genotypes, the regimen contains sofosbuvir (or SOF); the investigational NS5A inhibitor GS-5816, also called VEL, or Velpatasvir; and GS-9857, an investigational NS3-4A protease inhibitor. If approved, these drugs will likely prove to be major blockbusters for Gilead Sciences. This will strengthen its position as a market leader in HCV arena.

**56% market share in HIV market:** In the HIV arena, Gilead currently owns the major market share at 56%. One of the defining characteristics of Gilead's HIV franchise is its STR (single tablet regimen) products such as Atripla, Complera and Stribild which are 3 of currently only 4 available STRs in the market. This allows them to emerge as the market leader as it will be the preferred drugs prescribed by the doctor. On top of that, Gilead has three TAF-containing drugs under review, expected to be approved by FDA latest by the first half of 2016. With a strong drugs pipeline lining up for Gilead,

### Valuation (12-months Price Target: \$131.00)

Gilead is currently trading at a cheap 2015E PE of 9.2x as compared to his peers that have a median 2015E PE of 20.1x. The Street does not have faith in Gilead's pipelines, which we have reasons to believe that it is a mistake as this will be the area where the next revenue driver will emerge. With a robust balance sheet, strong cash flows and a great drugs pipelines, we believe that Gilead is undervalued as it should be trading at 12x of our 2015 EPS estimates of \$10.92, which gives us our **12-months target price of \$131.04 – 29% upside.**

Historically, Gilead has been trading at 11x to 41x PE with an average PE of 19x. Despite a robust growth in revenue, investors seem to undervalue Gilead's potential as they are uncertain that Gilead will be able to continue to dominate HIV market share as they will face new competition when the patent of Gilead's main HIV drug, Viread, which contains TDF expires in 2018.

Company Name	Market Cap	Gross Margin	Operating Margin	Net Debt /Equity	ROE	P/E			EV/ EBITDA		
	USD b	2014	2014	2014	2014	2014	2014	2015E	2016E	2014	2015E
<b>Gilead Sciences</b>	<b>150,444</b>	<b>85%</b>	<b>61%</b>	<b>15%</b>	<b>88%</b>	<b>13.5</b>	<b>9.2</b>	<b>8.7</b>	<b>9.0</b>	<b>6.6</b>	<b>6.3</b>
Bristol-Meyers Squibb Company	103,052	75%	16%	-27%	13%	38.5	35.1	28.9	30.6	26.9	22.5
Merck & Co	142,494	60%	13%	12%	24%	29.1	14.7	13.6	13.5	10.6	10.0
Abbvie	93,639	78%	17%	381%	57%	15.7	13.3	11.2	24.2	11.6	9.8
Biogen	68,907	88%	41%	-25%	30%	18.6	17.3	15.5	11.4	11.2	10.1
Amgen	108,817	78%	31%	14%	22%	18.5	15.6	14.2	12.9	10.8	10.0
Celgene	90,027	95%	33%	-10%	33%	42.7	24.5	19.8	30.6	20.0	15.3
<b>Average</b>	<b>101,156</b>	<b>79%</b>	<b>25%</b>	<b>57%</b>	<b>30%</b>	<b>27.2</b>	<b>20.1</b>	<b>17.2</b>	<b>20.5</b>	<b>15.2</b>	<b>12.9</b>

Source: Bloomberg, analyst estimates

### Key Assumptions and Forecasts

- We have forecasted **2015 product sales to be \$32.2 Billion**. This is well above management's 2015 full year guidance of \$29 to \$30 Billion and slightly above the average consensus estimates of \$31.54 Billion. We achieved this number by forecasted a **650% increase in Harvoni revenues** and a **68% drop in Sovaldi revenues** for 2015 after carefully examining the current weekly prescription data where the Harvoni is 5 times more likely to be prescribed than Sovaldi. Hence we feel that our increased revenue estimates are justified.
- We estimated 2015 Harvoni and Solvadi combined sales at \$19.2 Billion. At current prescription rates of roughly 12,000 per week and at an average of \$30,000 per script, Gilead will be able to generate \$18.7B in the United States alone. We thus believe our estimates are fairly justified.
- Our 2015E EPS is forecasted to be at \$10.92, lower than consensus estimates \$11.62 as we feel that R&D expense will not be decreasing moving forward (we can evident a downward revision of R&D cost by management) as they push for more new drugs in the pipelines.
- We did not include the forecast of pipeline drugs into our model as it is difficult to predict the probability of FDA approval, and also to remain conservative in our forecast so as to protect our downside.

### Risk

**Declining of HIV market share** - Gilead HIV combos have been losing its market share to Trimeq, a ViiV product (ViiV is majority-owned by GSK). Research suggests that patients have begun to evident a deterioration of their kidney function after years of using tenofovir (a compound for GILD's combos), hence the switch to Trimeq. However, GILD has a good pipeline of TAF-based (TAF is not toxic to kidney) HIV drugs to gain over the loss of market share. A study has been done to compare between TAF and Trimeq, TAF appears to be safer than Trimeq, they produce fewer side-effects related to the bones and kidneys than those caused by TDF-based drugs. All these demonstrate that Gilead TAF-based regimens have good potential to retrieve back its market share from ViiV's Trimeq in the HIV market.

**Declining of HCV market share in the US** - HCV prescriptions in the US are declining according to Symphony Health Data reported by Bloomberg. In comparison, AbbVie's Viekira Pak saw an increase in prescriptions as reported by Symphony Health. Even though the data shows a declining market shares in the US, Gilead has successfully penetrated the European and Japanese market to sell its HCV drugs. The sales from these countries will be able to offset the loss and even ramp up the revenue from HCV drugs.

**Price Control** - In the recent event where Clinton sworn to battle drug companies with plan to reduce drug costs. This could potentially be a huge threat if such price control drug plan is being passed by the Congress. If this happens, there will be a huge downside to Gilead's revenue as price becomes depressed. However, there is very low probability for this to happen as drug companies are well known to support political campaigns; it will be counterproductive to reduce their profits.

## Company Financials and Ratios

### Financial Year End: Dec 31

Income Statement (USD m)	FY13	FY14	FY15E	FY16E	FY17E
<b>Revenue</b>	<b>11,202</b>	<b>24,890</b>	<b>32,590</b>	<b>34,048</b>	<b>35,522</b>
COGS	2,859	3,788	3,585	3,643	3,694
<b>Gross Profit</b>	<b>8,343</b>	<b>21,102</b>	<b>29,005</b>	<b>30,405</b>	<b>31,828</b>
SG&A	1,354	1,933	3,259	3,405	3,552
Research and development expenses	2,120	2,854	3,096	3,235	3,375
<b>EBITDA</b>	<b>4,869</b>	<b>16,315</b>	<b>22,650</b>	<b>23,765</b>	<b>24,901</b>
D&A	345	1,050	1,111	1,209	1,312
<b>EBIT</b>	<b>4,524</b>	<b>15,265</b>	<b>21,539</b>	<b>22,556</b>	<b>23,589</b>
Net Interest Income/ (Expense)	-307	-412	-495	-821	-821
Other Non-Op Income/ (Expense)	-9	3	0	0	0
<b>Profit Before Tax</b>	<b>4,208</b>	<b>14,856</b>	<b>21,044</b>	<b>21,735</b>	<b>22,767</b>
Tax Expense	1,151	2,797	3,788	3,869	4,007
<b>Profit After Tax</b>	<b>3,075</b>	<b>12,101</b>	<b>17,325</b>	<b>17,938</b>	<b>18,835</b>

Balance Sheet (USD m)	FY13	FY14	FY15E	FY16E	FY17E
<b>Asset</b>					
Cash and cash equivalent	2,132	10,128	25,279	37,699	49,750
Account Receivable	2,182	4,635	6,518	6,810	7,104
Inventory	1,697	1,386	1,326	1,348	1,367
Other current assets	986	1,565	2,344	2,379	2,431
<b>Current asset</b>	<b>6,997</b>	<b>17,714</b>	<b>35,468</b>	<b>48,235</b>	<b>60,652</b>
Net Property, Plant and Equipment	1,166	1,674	2,041	2,345	2,589
Intangible/ Goodwill/ Deferred Tax	13,259	12,481	11,655	10,823	9,977
Other non-operating asset	1,157	2,795	2,981	3,010	3,039
<b>Non-current asset</b>	<b>15,582</b>	<b>16,950</b>	<b>16,677</b>	<b>16,178</b>	<b>15,605</b>
<b>Total asset</b>	<b>22,579</b>	<b>34,664</b>	<b>52,145</b>	<b>64,413</b>	<b>76,257</b>
<b>Liability</b>					
Short-term borrowings	2,697	483	1,183	0	1,000
Account Payable	1,256	955	896	911	924
Other short-term liability	2,454	4,323	4,381	4,388	4,398
<b>Current liability</b>	<b>6,407</b>	<b>5,761</b>	<b>6,460</b>	<b>5,298</b>	<b>6,321</b>
Long-term borrowings	3,939	11,921	20,038	21,221	19,221
Other long-term liability	488	1,163	550	550	550
<b>Non-current liability</b>	<b>4,427</b>	<b>13,084</b>	<b>20,588</b>	<b>21,771</b>	<b>19,771</b>
<b>Total liability</b>	<b>10,834</b>	<b>18,845</b>	<b>27,048</b>	<b>27,069</b>	<b>26,092</b>
<b>Equity</b>					
Shareholder Equity	11,745	15,819	25,097	37,344	50,165
<b>Total liability and equity</b>	<b>22,579</b>	<b>34,664</b>	<b>52,145</b>	<b>64,413</b>	<b>76,258</b>

Cash Flow (USD m)	FY13	FY14	FY15E	FY16E	FY17E
<b>CF - Operations</b>					
Net income	3,057	12,059	17,325	17,938	18,835
Depreciation and Amortisation	345	1,050	1,111	1,209	1,312
Other non-cash item	265	227	0	0	0
Net working capital	-562	-518	-3,403	-355	-372
<b>Cash flows from operations</b>	<b>3,105</b>	<b>12,818</b>	<b>15,033</b>	<b>18,791</b>	<b>19,775</b>
<b>CF - Investments</b>					
Capital Expenditures	-190	-557	-652	-681	-710
Other investment items	-64	-1,266	0	0	0
<b>Cash flows from investment</b>	<b>-254</b>	<b>-1,823</b>	<b>-652</b>	<b>-681</b>	<b>-710</b>
<b>CF - Financing</b>					
Dividend Paid	0	0	-2,047	-2,691	-3,014
Repurchase of common stocks	-582	-5,349	-6,000	-3,000	-3,000
Changes in borrowings and other long-term obligations	-4,440	3,153	8,817	0	-1,000
Other financing activities	2,478	-829	0	0	0
<b>Cash flows from financing</b>	<b>-2,544</b>	<b>-3,025</b>	<b>770</b>	<b>-5,691</b>	<b>-7,014</b>
<b>Net increase/(decrease) in cash</b>	<b>307</b>	<b>7,970</b>	<b>15,151</b>	<b>12,420</b>	<b>12,051</b>
Cash and cash equivalent at beginning	1,804	2,113	10,027	25,178	37,598
Effect of exchange rate changes	2	-56	0	0	0
<b>Ending cash balance</b>	<b>2,113</b>	<b>10,027</b>	<b>25,178</b>	<b>37,598</b>	<b>49,649</b>

Ratios	FY13	FY14	FY15E	FY16E	FY17E
Revenue YoY %	15.5%	122.2%	30.9%	4.5%	4.3%
EBITDA YoY %	13.5%	235.1%	38.8%	4.9%	4.8%
EBIT YoY %	12.8%	237.4%	41.1%	4.7%	4.6%
Net Profit YoY %	18.6%	293.5%	43.2%	3.5%	5.0%
EPS YoY %	10.8%	305.0%	48.6%	5.4%	6.9%
EBITDA Margin (%)	43.5%	65.5%	69.5%	69.8%	70.1%
EBIT Margin (%)	40.4%	61.3%	66.1%	66.2%	66.4%
Net Profit Margin (%)	27.5%	48.6%	53.2%	52.7%	53.0%
Net Gearing (%)	38.5%	15.0%	-15.8%	-43.9%	-58.7%
P/E (x)	40.6	12.7	9.2	9.0	8.4
Inventory Days	220	149	138	134	134
Receivable Days	251	328	568	668	687
Payable Days	160	92	91	91	91
Cash Cycle	310	385	615	710	730
<b>Dupont Analysis</b>					
ROE %	28.9%	87.8%	84.7%	57.5%	43.0%
Net Profit Margin (%)	27.5%	48.6%	53.2%	52.7%	53.0%
Asset turn over (x)	0.50	0.72	0.62	0.53	0.47
Leverage (x)	0.57	0.78	0.85	0.57	0.40

**Investor Relations – Sent an email on 14th Oct 2015, Called 4 times with no response - (650) 574-3000**

**Questions**

1. Do you have a geographical breakdown of the revenue for each drug?
2. Drug price has been decreasing and with the recent news regarding drugs price control? Should there be any major concerns over this development? What are the management strategies to address this issue as decreasing drug price will reduce the company's revenue significantly?
3. In the light of recent \$10B debt raised and large cash balances in the balance sheet, investors and analysts are speculating on a new acquisition to bolster the company's drugs portfolio, any guidance with regards to this?
4. Since there is a huge cash reserves and increasing free cash flow, will the company increase the dividend payout ratio moving forward?
5. Recent U.S. scripts data shows that TRx for Sovaldi and Harvoni are decreasing slowly over time. Is the management doing anything to regain its market share in the U.S. other than relying on the FDA approval of new drugs to replace the loss of market shares of Sovaldi and Harvoni?

**Appendix**

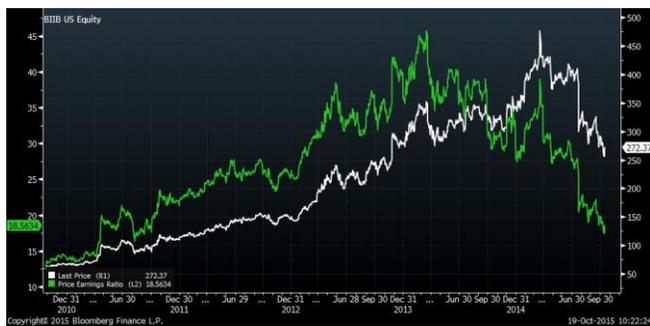
**Price performance vs P/E (Price in white, P/E is green)**



Gilead



AbbVie



Biogen



Celgene



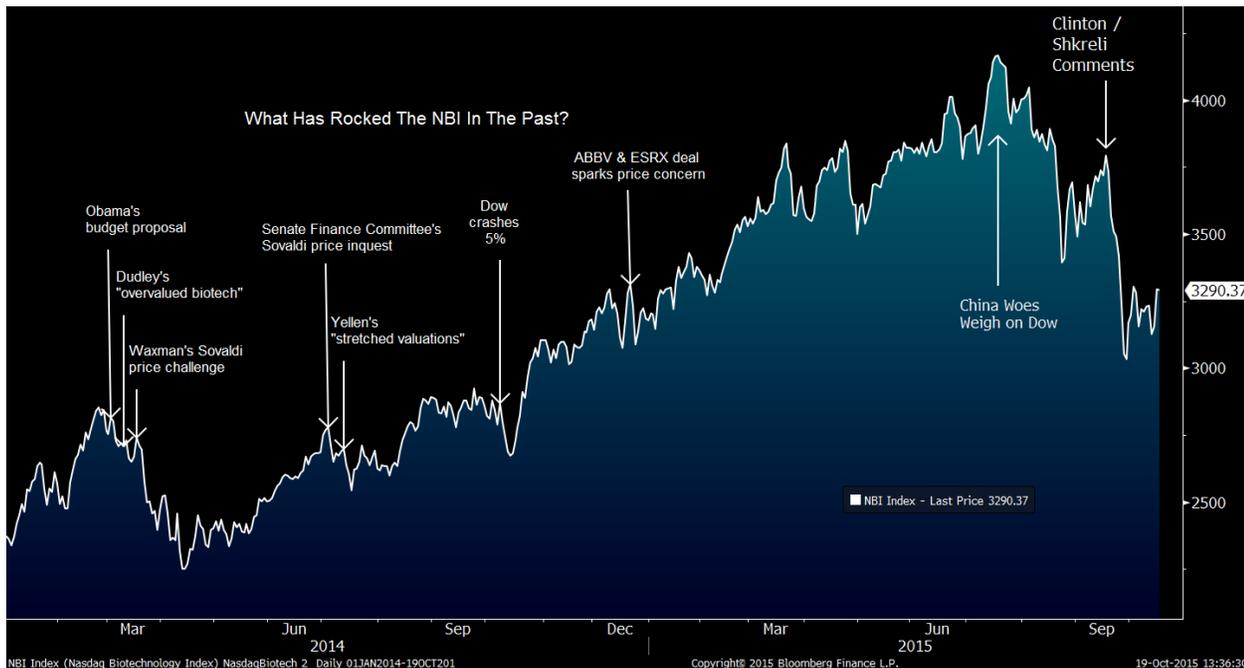
Merck



Amgen

**"Hillary Tweet" Crashes Nasdaq Biotech Index**

Turing's 5,000% price surge for daraprim gave Hillary Clinton a perfect talking point for her presidential campaign, which ignited media scrutiny and triggered a swoon in industry shares. While criticism of rapidly rising and socially insensitive drug costs is warranted, periodic list-price increases are a common practice, and not all drugmakers should be burned at the stake. Clarity on rebates paid by R&D-intensive biotech and pharma companies to payers is lacking, given that such discussions are confidential.



Nasdaq Biotechnology Index