SIENA college

Siena Market Line
1st week of April 2016

AbbVie Inc.

NASDAQ:ABBV

Analyst: Arthur Jeannerot
Sector: Healthcare

BUY

Price Target: $68.5

Key Statistics as of April 3, 2016

Market Price:	$56.12
Industry:	Biotechnology
Market Cap:	$92.89B
52-Week Range:	$45.45-71.60
Beta:	1.19

Thesis Points:

- AbbVie generates over $20B in annual sales in more than 170 countries.
- Sales of established drugs allow heavy investing in R&D.
- Concerns over Humira's intellectual property have been blown out of proportion.

Company Description:

AbbVie was founded in 2013 as a spinoff of Abbott Laboratories' (ABT) biopharmaceutical division. The company develops, manufactures, and distributes prescription drugs in over 170 countries. Its product portfolio comprises over 40 drugs, including the best-selling drug in the world Humira, which generated sales of more than $14 billion in 2015. The company is at a turning point, as it seeks to diversify its revenue streams in order to reduce its reliance on Humira, which will soon be off-patent. This overreliance on one product is one of the reasons the stock has performed poorly lately, but thanks to a recent favorable patent ruling and extensive intellectual property around Humira, those concerns should prove less threatening than previously anticipated.

Thesis

AbbVie is one of the leading biopharmaceutical companies, with over 40 products on the market and an additional 50 drug candidates being developed. The company is at the forefront of innovation, and has entered into collaboration agreements with companies such as Calico, Google's life-sciences branch, and Infinity (INFI). The company's strategy involves taking on lots of debt in order to fund R&D efforts which ultimately lead to the commercialization of a new drug. As a result, the company is more leveraged than its peers, but is also more profitable.

Company History

AbbVie was created on January 1st, 2013 when it was spun off from Abbott Laboratories in order to separate the company's pharmaceutical research division from its diagnostic and device business. As a result, the company's history as a public company is short, even though it has years of experience developing and bringing to market new drugs. AbbVie started with a product portfolio of ten drugs, including three with annual sales of $1 billion or more (known as blockbusters).

Porter's 5 Forces

The bargaining power of suppliers is low, as AbbVie has agreements with several third parties for the supplying of raw materials. According to the company, none of those agreements are material because they don't put the company's business at risk. AbbVie always carries significant inventory of its key production inputs in order to be able to face an eventual disruption in the supply chain.

The bargaining power of customers is relatively high, as AbbVie distributes its products to a broad range of customers including but not limited to wholesalers, distributors, and government agencies. As a result, certain customers represent a significant portion of AbbVie's business, notably in the United States where almost all of the company's revenue comes from three wholesalers. Therefore, AbbVie's business could be severely affected by the loss of one of those customers.

The threat of substitutes is also high, as is often the case in the pharmaceutical industry. Even though AbbVie's leading product is currently one of the best in class treatments for several indications, this situation could evolve at any time as other firms advance their clinical development. The most important attributes of a drug are effectiveness, safety and price and if certain substitutes for AbbVie's products manage to be more attractive on any of those aspects, it could impact the company's business.

The threat of new competitors is also high, especially when the intellectual property surrounding a product expires. This usually results in a flurry of new competing products, which are usually cheaper and quickly gain market share. The threat of competition fur Humira, AbbVie's flagship product, is currently one of the main concerns of the company and is one of the biggest value drivers.

The intensity of existing rivalry is also high, as the biopharmaceutical industry is very competitive and companies are constantly developing new products. For AbbVie, competition consists mostly of biosimilars such as generic versions of its formerly patented drugs.

Humira

Humira is AbbVie's best-selling drug by far and, with sales of $14.01 billion in 2015 it is also the best-selling drug in the world. Humira is approved to treat a variety of autoimmune disorders, including but not limited to rheumatoid and psoriatic arthritis, Crohn's disease and plaque psoriasis. It is commercialized in over 60 countries including North America, the European Union, Japan, Brazil and Australia. Humira was first commercialized in January 2003 and quickly achieved blockbuster status, reaching $1 billion in sales in 2004 and $10 billion in 2013. Unfortunately for AbbVie, monopolies don't last forever and the patents that protect Humira will expire soon. In the United States, the composition patent on Humira will expire in December 2016, opening the way for competitors to market their biosimilar version. However, Humira is covered by a flurry of other patents, including 70 that expire between 2022 and 2034, which will make it harder for competitors to create a generic version. According to the company's CEO, those patents should protect Humira from biosimilars until 2022. This makes a big difference as it could translate into tens of billions of dollars of extra revenue for AbbVie. Furthermore, the company keeps researching new indications for Humira such as rheumatology, gastroenterology and ophthalmology.

Other blockbusters

Apart from Humira, AbbVie owns a few other drugs that have reached or have the potential to reach blockbuster status.

Viekira was approved in December 2014 for the treatment of genotype 1 chronic hepatitis C in adults. The drug was successfully launched in the U.S and Europe, and quickly gained traction to become AbbVie's second best-selling drug with revenues of $1.6 billion in 2015. Viekira represents a tremendous opportunity for AbbVie, notably in Japan, the second largest market for hepatitis C where Viekira was approved in September of last year.

Imbruvica is an oral, once-daily treatment for adults with previously treated chronic lymphocytic leukemia (CLL) or mantle cell lymphoma (MCL) as well as Waldenström's macroglobulinemia. AbbVie bought the rights to Imbruvica last year when it acquired Pharmacyclics, Inc. The drug generated $754 million of revenue in 2015 and is expected to bring in $1 billion in 2016 and $5 billion in 2020.

Duopa is a prescription gel used to treat patients with advanced Parkinson's disease. Duopa represents a promising new treatment for patients with severe Parkinson's disease, as its innovative mode of delivery allows it to be administered over a continuous period of up to 16 hours. Duopa has been commercialized in Europe since 2004 under the name Duodopa, but was only approved by the FDA in January 2015. Therefore, the product is just starting to penetrate the U.S market, where the company believes it can reach around 190,000 patients. AbbVie believes Duopa sales should exceed $1 billion by 2020, which represents an increase of more than four times over the $231 million of revenue for 2015.

Pipeline

With sales of more than $20 billion in 2015, AbbVie can afford to invest heavily in R&D in order to be ready when sales of Humira start to decline. The company is currently running clinical trials on 47 different indications, with 13 in Phase I, 17 in Phase II and 17 in Phase III. The pipeline is mostly focused on oncology, with treatments such as Imbruvica for different forms of leukemia, or Veliparib for breast and lung cancer as well as ovarian cancer. The company's R&D spending has grown around 20% per year, from $2.9 billion in 2013 to $4.3 billion in 2015, which represents about 18.8% of revenue as opposed to 15.4% in 2015.

Pharmacyclics Acquisition

On March 4 2015, AbbVie announced the acquisition of Pharmacyclics, a Sunnyvale, Calif. biopharmaceutical company focused on the development of therapies for cancers and immune-mediated diseases. AbbVie's $20.8 billion offer represented a 44% premium over Pharmacyclics' value, and was paid with $12.4 billion in cash and the rest in AbbVie stock. The acquisition makes sense because it falls within the company's strategy, allowing it to diversify its revenue stream while also broadening its pipeline.

Financials

In 2015, AbbVie's revenues grew 15% to reach $22.9 billion, while adjusted EBITDA grew 29% to $14.9 billion. This improvement in profitability is the result of a continuing improvement in gross margin, which rose from 76% to 80% over the past two years. The increase in gross margin is attributable to a more favorable product mix, price increases, and operational improvements. Selling, general and administrative expenses have also remained steady around 28% of sales, which translates into greater operating income. It is important to note that SG&A were much higher in 2014 due to a one-time payment of $1.7 billion related to the cancellation of the proposed merger with Shire. As a result, net margin also increased slightly, from 21.85% in 2013 to 22.4% in 2015. The company has $29.2 billion in long-term debt, which is a sharp increase from last year's $10.5 billion. This increase is mainly due to the issuance of $16.7 billion of senior notes, which was necessary to finance the $20.8 billion acquisition of Pharmacyclics. AbbVie has $2 billion in debt due in 2016, $4 billion maturing in 2017, $6 billion maturing in 2018, and $21 billion maturing between 2020 and 2045. The company generated $7.5 billion of operating cash flows in 2015, a 20% increase over 2013's $6.3 billion. The net increase in cash was only $351 million in 2015, reflecting the $11.5 billion cash outflow required to acquire Pharmacyclics. The company has been paying a dividend since it became independent in 2013, and has increased the amount every year from $1.60 in 2013 to $1.75 in 2014 and $2.1 in 2015, representing a 14.56% compound annual growth rate. Management also announced it was raising the quarterly dividend from $0.51 to $0.57, which results in a total payout of $2.28 for 2016 and a forward dividend yield around 4%. AbbVie has also been repurchasing stock aggressively, in part to finance the stock portion of the Pharmacyclics acquisition. In 2015, the company repurchased a total of 119 million shares for approximately $7.8 billion, and still has $1.9 billion remaining in its share repurchase program.

Valuation

In order to value AbbVie, I used a proforma model with a focus on invested capital. The model is based on a 10-year forecast, with a long-term growth rate of 3%, and the summary of the valuation is attached to the last page of this report. The risk premium and effective corporate tax rate were calculated using a weighted average of the company's revenue by geography. This results in a risk premium of 7.13% and an effective corporate tax rate of 33.9%. The forecast also includes some of the company's targets, such as sales of $37 billion in 2020, and operating margin at 50% at maturity. The ROIC/WACC ratio, which stood at 4.15 for 2015, is expected to slowly decrease to a more realistic 1.3 in the continuing period. The model also capitalizes R&D and SG&A expenses over a 10-year life, and both are forecasted at 25% of revenue for the continuing period. Those assumptions result in an intrinsic value of $57.15 and a 12-month price target of $69.27.

Conclusion

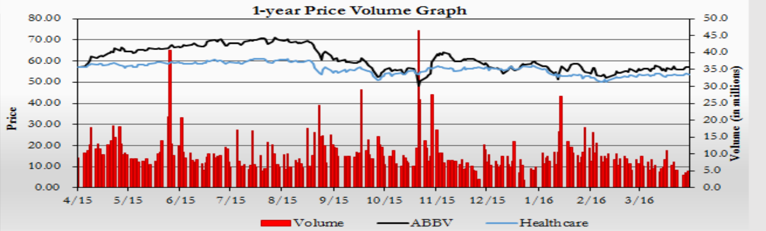
Even though its history as an independent, publicly-traded company is short, AbbVie has demonstrated its capacity to create value. Over the past years, it has managed to do so by increasing sales and decreasing costs, which resulted in a greater NOPAT margin. The company's ability to create value is also illustrated by its ROIC/WACC greater than 1, which means that invested capital returns more than its cost. The stock currently appears undervalued due to concerns about the company's sales growth, which might come under pressure next year as Humira's composition patent expires in the U.S. However, I believe those fears have been blown out of proportion, and that AbbVie has what it takes to keep Humira sales growing until 2020, which will result in a much higher stock price. I recommend a buy on ABBV with a 1-year price target of $69.27, which translates into an upside potential of 27%.

Siena Market Line
1st week of April 2016

CENTER FOR GLOBAL FINANCIAL STUDIES

AbbVie Inc. (ABBV) — **BULLISH**

Analysis by Arthur Jeannerot	Current Price: $56.12	Intrinsic Value $57.15	Target 1 year Return: 27.23%
4/2/2016	Divident Yield: 3.8%	Target Price $69.27	Probability of Price Increase: 93.9%



Description

AbbVie Inc. discovers, develops, manufactures, and sells pharmaceutical products worldwide.

General Information

Sector	Healthcare
Industry	Biotechnology
Last Guidance	November 3, 2015
Next earnings date	April 24, 2016
Estimated Country Risk Premium	7.13%
Effective Tax rate	34%
Effective Operating Tax rate	1%

Market Data

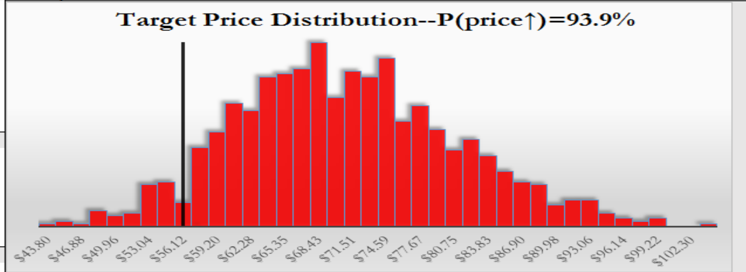
Market Capitalization	$92,890.36
Daily volume (mil)	4.53
Shares outstanding (mil)	1617.74
Diluted shares outstanding (mil)	1637.00
% shares held by institutions	55%
% shares held by investments Managers	57%
% shares held by hedge funds	4%
% shares held by insiders	0.09%
Short interest	1.47%
Days to cover short interest	2.69
52 week high	$71.60
52-week low	$45.45
Levered Beta	1.30
Volatility	0.00%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2014	1.90%	-11.94%
3/31/2015	1.15%	9.84%
6/30/2015	-2.08%	-1.41%
9/30/2015	0.88%	-15.13%
12/31/2015	0.27%	5.24%
Mean	0.42%	-2.68%
Standard error	0.7%	4.8%

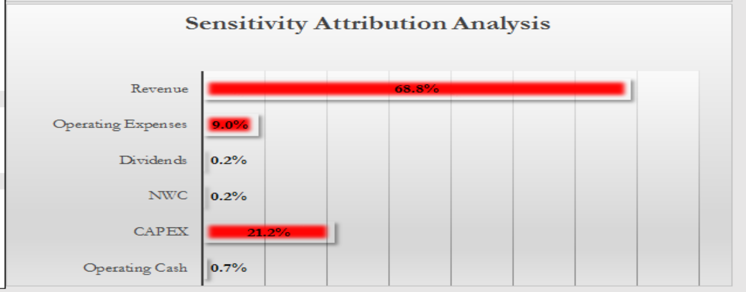
Peers

Eli Lilly and Company
Bristol-Myers Squibb Company
Merck & Co. Inc.
Pfizer Inc.
Amgen Inc.
Gilead Sciences Inc.
Biogen Inc.
Regeneron Pharmaceuticals, Inc.

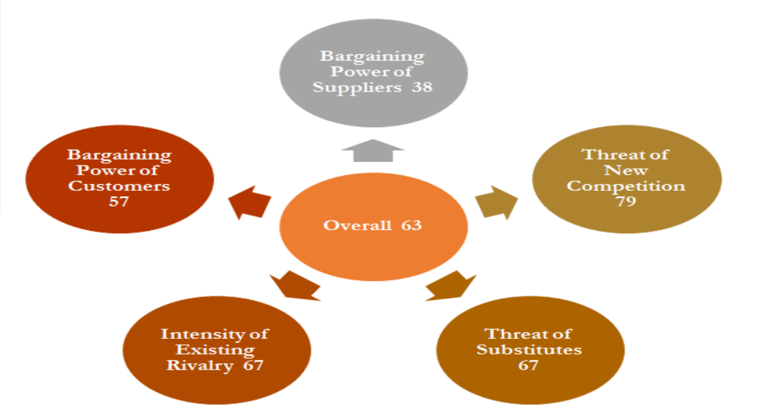


Management	Position	Total compensations growth	Total return to shareholders
Gonzalez, Richard	Chairman, Chief Executive Of	22.32% per annum over 5y	N/M
Chase, William	Chief Financial Officer and	43.03% per annum over 4y	N/M
Severino, Michael	Chief Scientific Officer and	-42.79% per annum over 1y	-5.99% per annum over 1y
Schumacher, Laura	Executive Vice President of	4.15% per annum over 6y	N/M
Alban, Carlos	Executive Vice President of	16.01% per annum over 4y	N/M
Saleki-Gerhardt, Azita	Senior Vice President of Ope	N/M	N/M

Profitability	ABBV (LTM)	ABBV (5 years historical average)	Industry (LTM)
ROIC	46.5%	33.86%	13.66%
NOPAT Margin	90%	48.07%	21.7%
Revenue/Invested Capital	0.52	0.70	0.63
ROE	50.6%	20.33%	15.42%
Adjusted net margin	88%	47.50%	18.5%
Revenue/Adjusted Book Value	0.58	0.43	0.83
Invested Funds	**ABBV (LTM)**	**ABBV (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	11.1%	15.6%	30%
Estimated Operating Cash/Total Capital	10.2%	11.8%	N/A
Non-cash working Capital/Total Capital	-0.7%	1.8%	7%
Invested Capital/Total Capital	99.0%	96.1%	63%
Capital Structure	**ABBV (LTM)**	**ABBV (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.32	0.15	0.16
Cost of Existing Debt	5.20%	-10.09%	4.01%
Estimated Cost of new Borrowing	2.98%	4.01%	4.01%
CGFS Risk Rating	5.20%	B	CC
Unlevered Beta (LTM)	3.08%	1.30	0.89
WACC	5.20%	11.71%	9.11%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	14.5%	90.2%	4.15
12/31/2016	13.6%	43.3%	1.46
12/31/2017	9.9%	43.6%	1.40
12/31/2018	8.4%	44.2%	1.42
12/31/2019	10.0%	43.2%	1.42
12/31/2020	9.0%	41.1%	1.38
12/31/2021	8.1%	37.1%	1.26
12/31/2022	4.9%	35.5%	1.19
12/31/2023	3.5%	34.1%	1.14
12/31/2024	3.3%	32.7%	1.10
12/31/2025	3.0%	31.4%	1.06
Continuing Period	3.0%	37.9%	1.30

Period	Invested Capital	Net Claims	Price per share
Base Year	$22,337.38	$31,155.17	$55.70
12/31/2016	$24,936.94	$26,194.04	$67.19
12/31/2017	$35,054.85	$18,840.41	$77.89
12/31/2018	$38,584.90	$9,464.78	$89.29
12/31/2019	$44,313.41	$864.84	$100.69
12/31/2020	$74,845.30	-$8,300.31	$112.44
12/31/2021	$87,354.93	-$17,248.23	$124.78
12/31/2022	$96,139.27	-$28,262.97	$137.61
12/31/2023	$104,449.72	-$40,357.84	$150.81
12/31/2024	$113,842.76	-$52,665.70	$164.32
12/31/2025	$123,044.42	-$65,287.74	$178.17
Continuing Period			