

March 31, 2019

## Charles River Laboratories: (CRL)

John Cote

Sector: Life Sciences Tools and Services

Industry: Health Care Services

Current Price: \$142.90

Target Price: \$146.20

**Company Description:** Charles River Laboratories provides research tools and support services for drug discovery and development. CRL offers animal research models in research and development for new drugs, devices, and therapies. CRL serves pharmaceutical and biotechnology companies, hospitals, and academic institutions worldwide. CRL is the leading early-stage contract research organization who focuses on expanding their global scale, enhancing their scientific expertise, providing a more seamless and flexible client experience, improving operating efficiency, and providing the individualized support in which their clients require to expedite their drug research efforts to meet their extensive scientific needs.

### BUY/HOLD/SELL

Current Price: \$142.90  
 Target Price: \$146.20  
 Market Cap: 7,004.9M  
 Beta: 1.0  
 EBITDA Margin: 23% adj.  
 EPS. Adj.: \$4.96M



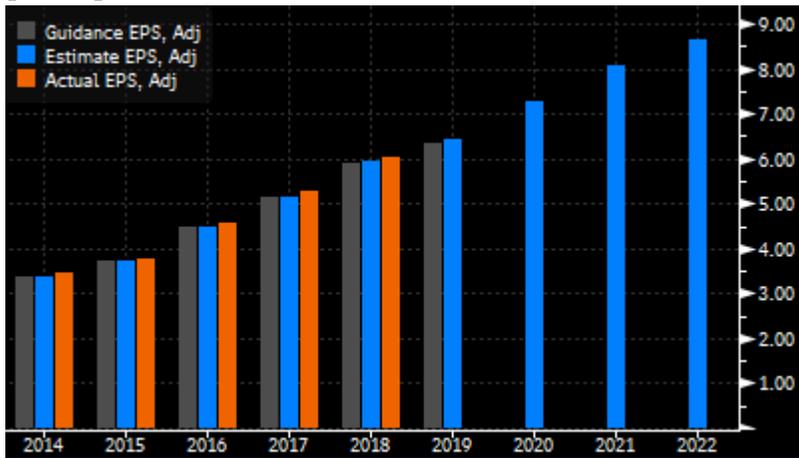
**Thesis:** Charles River Laboratories is poised to build off a strong FY 2018 where the company saw 11.4% organic growth. Acquisitions and partnerships give CRL access to emerging companies and new revenue opportunities from its strategic partnerships. CRL has the highest organic growth among peers and is set up for a strong growth by all three business segments.

### Catalysts:

- Short Term(within the year): Acquisition of Citoxlab which will strengthen their Discovery and Safety Assessment business.
- Mid Term(1-2 years): New model for oncology research which eliminates time, energy, and resources to initiate short-term in vivo studies
- Long Term(3+): New drug discovery and development programs

### Earnings Performance:

In 2018, revenue increased by 22% from 2017 and has organic growth of 8.7%. All three business segments of CRL had organic growth from 2017. In the fourth quarter of 2018, CRL had revenue growth of 26% due to acquisitions which contributed 15.7% growth however, excluding the effects of the acquisitions, Q4 had organic revenue growth of 11.4% which was driven by all three business segments. In 2018, the FDA approved a record 59 drugs, nearly triple the approvals from 10 years ago. Due to their unique, early-stage portfolio, extensive scientific expertise, and client-centered approach, CRL worked on 85% of the approved drugs in 2018. Looking at CRL's adjusted EPS, you can see that they have surpassed estimates each year and are projected to continue growing.



## Business Segments:

Charles River Laboratories is broken up into three business segments (Research Models and Services, Discovery and Safety Assessment, Manufacturing Support). Charles River Laboratories holds market-leading positions through these three segments.

**Research Models and Services (RMS):** This segment produces and sells research model strains primarily purpose-bred rats and mice for use by researchers. It also provides a range of services to assist its clients in supporting the use of research models in research and screening non-clinical drug candidates, including genetically engineered models and services, insourcing solutions, and research animal diagnostic services. In the fourth quarter of 2018, this segment had organic revenue growth of 8.1% driven primarily by higher revenue for research model services, as well as increased demand for research models in China. For 2018, this segment has organic revenue growth of 3.7%.

**Discovery and Safety Assessment (DSA):** This segment offers early and in vivo discovery services for the identification of druggable target through delivery of non-clinical drug and therapeutic candidates ready for safety assessment; and safety assessment services, such as bioanalysis, drug metabolism, pharmacokinetics, safety pharmacology, toxicology, and pathology services. In the fourth quarter of 2018, this segment had organic revenue growth of 12.9%, which was driven by both the Safety Assessment and Discovery Services businesses. By clients, DSA revenue increase was driven primarily by robust demand from biotechnology clients. For 2018, this segment had organic revenue growth of 10.4%.

**Manufacturing Support (Manufacturing):** This segment provides in vitro methods for conventional and rapid quality control testing of sterile and non-sterile biopharmaceuticals, and consumer products. It also

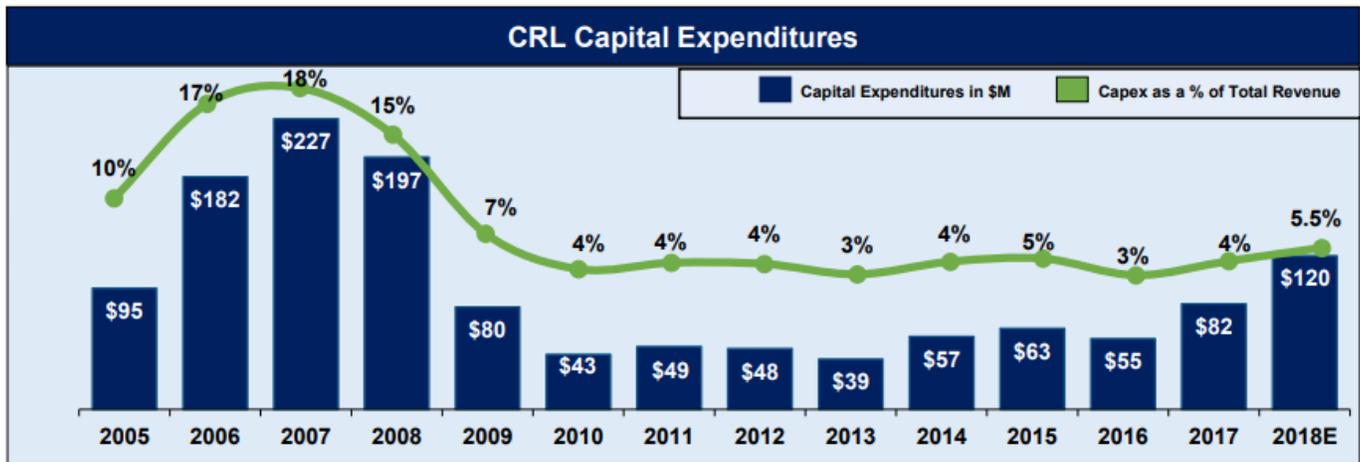
offers specialized testing of biologics that are outsourced by pharmaceutical and biotechnology companies; and avian vaccine services that provide specific-pathogen-free fertile chicken eggs, SPF chickens, and diagnostic products used to manufacture vaccines. In the fourth quarter of 2018, this segment has organic revenue growth of 11.4%, driven primarily by robust demand in the Microbial Solutions and Biologics Testing Solutions businesses. In 2018, this segment had organic revenue growth of 10.9%.

## Recent Acquisitions/Investments:

In 2018, Charles River Laboratories had two major acquisitions, which included MPI Research and KWS BioTest. These two acquisitions contributed 15.7% to consolidated fourth-quarter revenue growth. In addition, CRL proposed the acquisition of Citoxlab, which would be another strategic expansion of their portfolio.

Event	Strategic Rationale
<b>WIL Research</b> April 2016	➤ Expanded global footprint in <b>safety assessment</b> and exposure to biotech
<b>Blue Stream</b> June 2016	➤ Created a comprehensive portfolio of both bioanalytical and biosafety testing services to support <b>biologic and biosimilar development</b>
<b>Agilux Laboratories</b> September 2016	➤ Established a more comprehensive suite of <b>integrated bioanalytical, DMPK, and pharmacology services</b>
<b>Brains On-Line</b> August 2017	➤ Established CRL as the premier single-source provider for a broad portfolio of <b>CNS discovery services</b>
<b>KWS BioTest</b> January 2018	➤ Established CRL as a premier source for <b>immuno-oncology discovery services</b>
<b>MPI Research</b> April 2018	➤ Enhanced our position as <b>the premier global early-stage CRO</b> and provided <b>needed capacity</b> to meet current and future demand

**Citoxlab:** CRL signed a binding offer to acquire Citoxlab for \$510M in cash. This proposed acquisition would further strengthen their business and enhance their ability to achieve their long-term goals. With operations in Europe and North America, Citoxlab is a premier, non-clinical CRO providing a broad suite of early-stage services for biopharmaceutical, agricultural and industrial chemical, and medical device companies worldwide. Citoxlab would enhance CRL's capabilities in regulated safety assessment, non-regulated discover, and medical device testing services. Citoxlab enhances CRL's ability to partner with clients across the drug discovery and development continuum and drives profitable revenue growth and immediate EPA accretion. Acquisition of Citoxlab would enhance CRL's presence in Europe, particularly Eastern Europe. Citoxlab currently generates 60% of their revenue from its European operations. Citoxlab is expected to grow at a high-single-digit rate organically. Acquisition of Citoxlab would further solidify CRL's leading position in the \$4-\$5B outsourced safety assessment market.

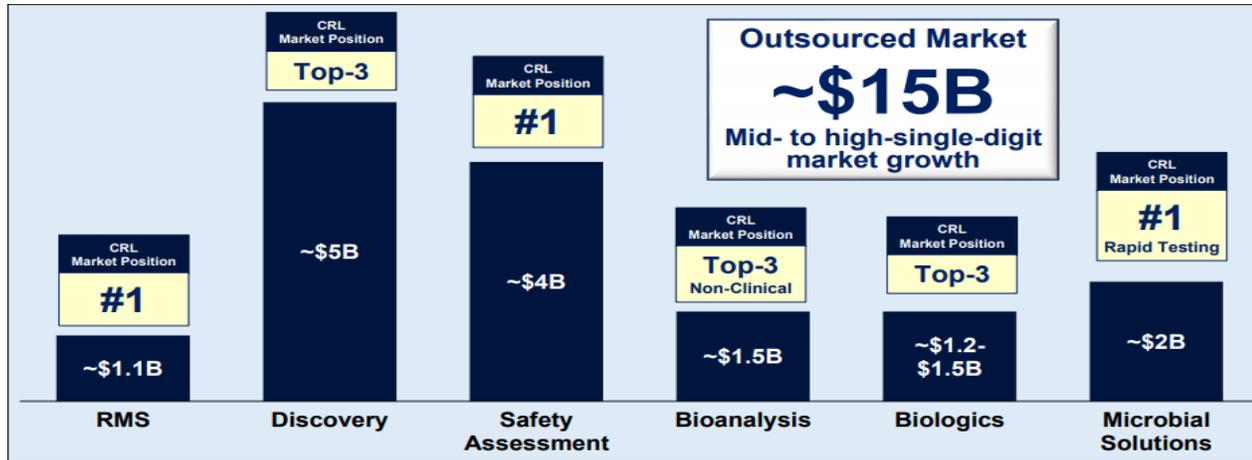


Looking at CRL’s CAPEX spending, you can see that since 2008, CRL has been keeping a steady CAPEX as a percentage of revenues because the company is continuing to grow. From 2006 to 2008, CRL built new facilities in order to keep up with the demand of customers and since 2008, CRL has been utilizing these larger facilities efficiently.

## 2019 Outlook:

Excluding the acquisition of Citoxlab, CRL is expected to benefit from higher revenue and modest operating margin improvement. Current business trends support that their robust client demand will continue in 2019. CRL’s investments to support growth enhance their scientific capabilities, including the acquisition of Citoxlab. Acquisitions like Brains On-Line and KWS BioTest and strategic alliances with companies like Distributed Bio and Atomwise, are initiatives that will accelerate add cutting-edge technology to further differentiate themselves from the competition. With the acquisition of Citoxlab, CRL’s presence in Europe will increase because Citoxlab currently operates in 9 sites in 6 countries. The Citoxlab acquisition will further expand CRL’s small and mid-sized biotechnology client base which is CRL’s fastest-growing client segment. Citoxlab is expected to grow at a high-single-digit rate organically and will have a revenue contribution of about \$120M in 2019 and about \$200M in 2020. In addition, CRL continues to add capacity in China to support the robust market demand and intends to continue to invest in Beijing and Shanghai and expand into other large research hubs in China. Looking at the picture below, CRL has significant, addressable market

opportunity and an unmatched portfolio.



By 2023, CRL plans to transform the industry with a best-in-class technology platform by building a digital enterprise. This will enable clients to have real-time access to data which is the core of CRL’s business.

Looking at the short interest graph below, you can see that investors aren’t seeing the price to decrease due to the low short interest ratio. CRL has a current short interest ratio of 3.41, which has been relatively stable since the price increase. With that being said, the price movement was justified.



## Conclusion:

Taking into account the strong previous earnings performance, strong current earnings performance, mergers and acquisitions, and being the premier, early-stage contract research organization, CRL should be poised for another year of strong organic growth. With recent acquisitions like Citoxlab and significant addressable

market opportunity, my predictions for CRL growth leads to share price appreciation both short term and long term. My target price for CRL is \$146.20 for a return of 20%.

Charles River Laboratories International, Inc.	Symbol: crl
Analyst	John Cote
Buy below	\$121.84
Sell above	\$163.56
Probability of Price Increase	93%
Last Price	\$143.89
Intrinsic Value	\$136.30
Target Dividends	\$0.00
Target Price	\$146.21

Financials			
	crl (LTM)	crl Historical	Peers' Median (LTM)
<b>Profitability</b>			
Return on Capital	7.6%	11.47%	15.25%
Adjusted EBITDA Margin	18.6%	14.88%	17.93%
Return on Equity	17.2%	19.1%	16.0%
Adjusted Net margin	8.9%	8.6%	10.0%
<b>Invested Funds</b>			
Cash/Capital	7.0%	9.5%	14.7%
NWC/Capital	5.9%	12.9%	8.8%
Operating Assets/Capital	47.8%	52.6%	34.9%
Goodwill/Capital	39.3%	23.1%	38.6%
<b>Capital Structure</b>			
Total Debt/Market Cap.	0.33	0.28	0.09
Reported Cost of Borrowing	4.5%		3.8%
<b>Cash Interest/Total Debt</b>			
	2.9%		3.8%
<b>CGFS Credit Rating</b>			
CGFS Credit Rating	B		BBB
<b>Credit Model Rating</b>			
Credit Model Rating	bbb-		bbb to bbb+
<b>Probability of Default</b>			
	0.23%		0.08%
<b>Cost of Capital</b>			
	<b>CGFS Credit Rating</b>	<b>Credit Model Rating</b>	<b>Probability of Default</b>
Implied Cost of Borrowing (crl)	5.6%	5.6%	5.6%
Implied Cost of Borrowing (Peers)	4.8%	5.3%	5.2%
Cost of New Debt Estimate	5.0%		
Market Risk Premium Estimate	4.0%		
Cost of Equity Estimate	9.0%		
WACC Estimate	9.0%		

Quarterly Earning Surprises (Actual Vs. Median Estimates)	
<b>Revenue</b>	
12/30/2017	0.62%
3/31/2018	3.13%
6/30/2018	2.50%
9/29/2018	3.02%
12/29/2018	1.95%
Mean (Standard Error)	2.24% (1.01%)
<b>EBITDA</b>	
12/30/2017	-73.77%
3/31/2018	-15.26%
6/30/2018	-31.35%
9/29/2018	-18.68%
12/29/2018	-10.36%
Mean (Standard Error)	2.24% (6.52%)

Valuation						
DCF Valuation						
	Revenues	Net Margin	LFCF	Ke	ROE	Price Per Share
Base Year (Actual)	\$2,266.10	9%	-\$39.20	8.53%	17.21%	\$142.25
year 1	\$2,635.00	11%	\$282.06	9.00%	19.85%	\$149.15
year 2	\$2,894.11	12%	\$338.51	9.00%	19.18%	\$155.60
year 3	\$3,097.81	13%	\$385.70	9.00%	17.92%	\$161.50
year 4	\$3,305.17	14%	\$468.95	9.00%	18.04%	\$166.15
year 5	\$3,515.00	16%	\$577.47	9.00%	18.40%	\$169.49
year 6	\$3,726.04	16%	\$603.56	9.00%	16.14%	\$172.66
year 7	\$3,949.60	16%	\$618.82	9.00%	14.20%	\$175.82
year 8	\$4,171.47	15%	\$634.14	9.00%	12.71%	\$178.96
year 9	\$4,392.55	15%	\$648.81	9.00%	11.52%	\$182.10
year 10	\$4,612.18	14%	\$662.19	9.00%	10.54%	\$185.27
year 11	\$4,824.00	14%	\$673.52	9.00%	9.70%	\$188.51
year 12	\$5,025.90	14%	\$682.69	9.00%	8.96%	\$191.86
year 13	\$5,215.77	13%	\$690.48	9.00%	8.33%	\$195.37
year 14	\$5,391.56	13%	\$696.70	9.00%	7.77%	\$199.16
year 15	\$5,551.32	12%	\$685.17	9.00%	7.10%	\$217.09
Continuing Period	\$5,693.19	16%	\$655.69	9.00%	9.00%	
Relative Valuation				Asset Based Valuation		
Multiple	EV/Rev (FW)	EV/EBITDA (FW)	P/BV (TTM)	P/E (FW)	Recovery Rate	100%
Median (Peers)	3.6x	16.3x	5.5x	24.5x	Capital	\$9,300.89
Base	Revenue (NTM)	EBITDA (NTM)	Book Value (LTM)	Net Income (NTM)	Intangibles	\$1,858.02
crl	\$2,703.15	\$302.04	\$1,374.54	\$302.04	Claims	\$4,131.83
Implied EV	\$9,632.35	\$4,928.23				
Total Net Claims	\$1,448.31	\$1,448.31				
Implied EQ	\$8,184.04	\$3,479.92	\$7,569.91	\$7,402.55		\$3,311.04
Valuation Summary						
Model	Intrinsic Value		Target Price		Weight	
DCF Valuation	\$142.25		\$149.15		60.00%	
EV/Rev (FW)	\$164.80		\$179.63		25.00%	
EV/EBITDA (FW)	\$70.07		\$76.38		0.00%	
P/BV (TTM)	\$152.43		\$166.15		15.00%	
P/E (FW)	\$149.06		\$162.48		0.00%	
Asset Based Valuation	\$66.67		\$72.67		0.00%	
Price per Share	\$149.42		\$159.32		100%	

