SIENAcollege

BJORKLUND FUND

November, 10, 2017

Charles River Laboratories CRL

Joshua Weiss

Sector: Healthcare
Industry: Life Sciences Tools and Services
Current Price: $103.11
Target Price: $118.41

Company Description: Charles River Laboratories provides a place where companies in the biotechnology, pharmaceutical and other medical device industries can come to do their pre-testing and clinical laboratory studies. They are one of the leading and most differentiated Contract Research Organization in the world.

BUY

Current Price:	$103.11
Target Price:	$118.41
Market Cap:	5.62B
ROIC:	9.60%
WACC:	8.20%
Avg Volume:	372,831
EDITDA Margin:	24.1%

CRL Stock vs. Pharmaceuticals, Biotechnology and Life Sciences Industry index

Thesis: Charles River Laboratories provides a systematic location for companies to do research and development on new drugs and medicine. Being one of the most differentiated CROs in the world, Charles River Laboratory provides the testing facilities in order to help expedite research programs and help with drug discovery/preclinical drug development. Although they are not responsible for the creation of the drug, they provide everything along the way to help the process of creation.

Catalysts:

- Within the next year, they are expanding their facility in Shanghai to reach full capacity. Quarter 3 earnings come out next week and are expected to beat their earnings.
- Within the next year, they are expanding their facility in Shanghai to reach full capacity.
- New technologies and Medicines to be discovered

Earnings Performance:

The second quarter for Charles River Laboratories was as they described went very robust. They had a revenue of $469 million, which beat their Q2 estimates by 2%. They also recorded an Eps of $1.29, which was 7 cents higher than their expected EPS. Since 2015, they have had high growth in almost all aspects of the company. As of July 1st, 2017 Charles River Laboratories have done extremely well for the year so far. They have a total revenue growth year over year of 21.1%, which has taken a 2% decrease, which they expected. This decrease is most likely from the RMS segment because they aren't receiving as much revenue form that segment since many projects from this segment finished as of late 2016. They had an EBITDA margin of 24.1%. This shows us that Charles River Laboratories operating profitability is a high percentage of their total revenue. A net income of 10.1%, which is the ratio of the company's profitability of their total revenue once all the expenses are subtracted. Gross profit margin represents the percent of total sales revenue that they retain after incurring the direct cost. CRL has a gross profit margin of 39.2%, showing us that they retain a high percentage of their total sales revenue and do not have many direct costs. Lastly, they had an operating margin of 20%, which was an increase of 50 basis points YOY. This was driven mostly through the DSA segment growth. Compared to the industry they are in with an EBITDA margin of 14.83% and a net income growth of 13.61% they exceed the industry in some areas. For a majority of their numbers they are at the industry median or very close to it, which is very good for them considering they are compared against companies that are 10x the market cap that they are. CRL for Q2 has free cash flow of $90.1M, which was an increase of $21.8M from last year. They are expected to have by the end of the year free cash flow in the range of $265-$275M. They also repurchased 244,000 shares in Q2 at $22.5M, which came from their stock repurchase program. This program now has $165.1M to do what they please with it. This is most likely due to the management believing they are undervalued right now and want to reduce the number of outstanding shares.

	Name (BICS Best Fit)	Sales Growth	EBITDA Growth	EBITDA Margin	Operating Income Margin	Net Income Growth	Net Profit Margin	Tax/Sales (%)	Return on Invested Capital	Return on Assets
	Median	11.63%	10.17%	14.83%	11.17%	13.61%	6.67%	2.52%	9.66%	5.01%
100)	CHARLES RIVER LABORAT...	21.12%	24.48%	24.91%	17.51%	21.15%	11.47%	3.29%	9.62%	7.49%
101)	PRA HEALTH SCIENCES INC	17.40%	12.67%	14.83%	11.58%	13.15%	6.67%	1.83%	10.38%	5.01%
102)	INC RESEARCH HOLDINGS...	0.33%	1.30%	14.49%	10.58%	19.27%	6.87%	1.95%	16.07%	8.34%
103)	QUINTILES IMS HOLDING...	56.72%	107.21%	19.33%	9.61%	5.78%	5.04%	2.38%	7.21%	3.60%
104)	TELADOC INC	78.55%	5.55%	-19.47%	-27.60%	-0.87%	-36.04%	1.71%	-13.67%	-11.68%
105)	MEDPACE HOLDINGS INC	5.46%	4.89%	25.95%	14.48%	301.44%	7.97%	3.21%	--	3.57%
106)	ENVISION HEALTHCARE C...	139.46%	56.55%	16.49%	11.17%	46.35%	3.55%	2.69%	6.03%	2.08%
107)	CHEMED CORP	4.44%	12.76%	14.79%	12.63%	20.98%	8.33%	2.52%	23.06%	15.75%
108)	CIVITAS SOLUTIONS INC	2.97%	8.06%	10.30%	5.11%	-15.14%	1.33%	3.08%	4.60%	1.74%

Chart Selected Items For the Fiscal Period Ending Currency	12 months Dec-28-2013A USD	12 months Dec-27-2014A USD	12 months Dec-26-2015A USD	12 months Dec-31-2016A USD	LTM[2] 12 months Jul-01-2017A USD	12 months† Dec-31-2017E USD	12 months Dec-31-2018E USD	12 months Dec-31-2019E USD
Total Revenue	1,165.5	1,297.7	1,363.3	1,681.4	1,807.4	1,847.38	1,974.33	2,107.96
Growth Over Prior Year	*3.2%*	*11.3%*	*5.1%*	*23.3%*	*21.1%*	*9.87%*	*6.87%*	*6.77%*
Gross Profit	399.1	476.0	531.8	662.7	708.7	-	-	-
Margin %	*34.2%*	*36.7%*	*39.0%*	*39.4%*	*39.2%*	*38.89%*	*39.06%*	*39.20%*
EBITDA	252.2	284.0	321.3	402.2	435.9	447.37	487.93	521.71
Margin %	*21.6%*	*21.9%*	*23.6%*	*23.9%*	*24.1%*	*24.22%*	*24.71%*	*24.75%*
EBIT	155.6	191.9	226.4	275.5	301.6	361.55	399.46	429.79
Margin %	*13.4%*	*14.8%*	*16.6%*	*16.4%*	*16.7%*	*19.57%*	*20.23%*	*20.39%*
Earnings from Cont. Ops.	105.4	129.9	152.0	156.1	184.6	-	-	-
Margin %	*9.0%*	*10.0%*	*11.2%*	*9.3%*	*10.2%*	-	-	-
Net Income	102.8	126.7	149.3	154.8	183.1	246.12	268.72	294.83
Margin %	*8.8%*	*9.8%*	*11.0%*	*9.2%*	*10.1%*	*13.32%*	*13.61%*	*13.99%*

Background:

Charles River Laboratories was founded in 1947 by Henry Foster who was a young veterinarian that purchased thousands of rat cages from Virginia to set up a lab in Boston. In order to meet the demand in the region for laboratory animal models, he bred, fed and took care of the animals. He then personally delivered them to local researchers. From starting in one main laboratory to know having 70 facilities in 16 countries across the world, they have expanded massively. They customers they associate themselves with now are leading pharmaceutical, biotechnology, government and academic organizations around the world. They have many different aspects to their service areas, which are basic research, discovery, safety and efficacy, clinical support and manufacturing. As technology keeps on advancing and new diseases emerge, they strive to help support their clients' research every step of the way.

They have a very well diversified portfolio. They cover all aspects starting with the beginning part of basic research by having research models and services to help their clients. The end part with their manufacturing support to help with clinical development and commercialization. Lastly, they have aspects of their business that takes their clients' from the first step of the process to the last step such s their operation and staffing support. The main way they continue to keep diversifying their portfolio is through acquisitions. They have in the last 18 months made 5 acquisitions in order to diversify their portfolio even more in order to create a one-stop shopping for their clients' to get everything done at their locations.

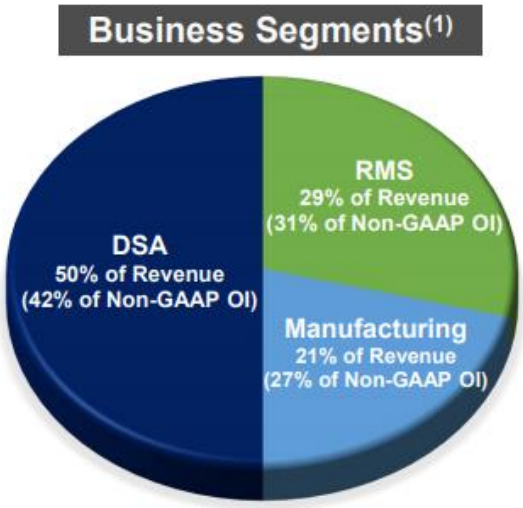
Industry/Competition

The pharmaceuticals, biotechnology and life sciences industry is always adapting to the change in technology and diseases as they come along. Since Charles River Laboratories are involved in all three of these separate industries, they are very differentiated compared to competitors. Most competitors only focus on one aspect within each industry while CRL covers almost all aspects of every industry. The biotechnology industry alone is expected to continue to grow at a 7.4% through 2025. Regenerative medicine and genetics in diagnostics are seen as the key driver of the industries for the future. Alongside these drivers, new technology advancements focusing on the artificial intelligence is expected to open up new paths to progress with research and development. The pharmaceutical industry by 2022 is projected to hit $1.12 trillion, coming from a 6.3% CAGR. Prescription sales not including generics will rise to 4.4%, which will reach $1.006 trillion in 2022. Although the life science industry is very hard to determine the growth rate because it is very subject to change based on new technologies and new discoveries, there is still a great amount of opportunities for the industry. Some opportunities that Greg Rah who is the US/global Life Sciences sector leader believes are the increase in collaboration through industries to try and cut costs. Many clinical trends are expected to drive the innovation of life sciences, which have significant impacts on the product and services offered to patients. Through these different industries having many different drivers of growth, Charles River Laboratories will continue to see strong organic growth through the rest of this decade and into the next. Competition for Charles River Laboratories is not easy to compare with since they do not have many public competitors anymore. However, they do extremely well against their competitors. They are a 1/4th the size of many of their competitors and provide very similar numbers to the few that are publically traded.

Segment Analysis:

Charles River Laboratories divides their business into 3 segments. These 3 segments cover basically everything there is to do for drug research and development expect the creation of the drug. The RMS segment is the segment with the least amount of growth in Q2. As a segment Research Model Services had a revenue of $124 million which was an increase in 1%. The reason for this is that they had a lot of special projects that they were working on that completed in 2016, which was the source of most of this segments revenue. The softness in growth from RMS also comes from the continued reduction of infrastructure in the big drug companies. Although this segment is expected to be in the low single digits for revenue growth for the long term because the segment is matured, the demand in China for Research Models has accelerated faster than expected. With the facility completion in Shanghai in early 2018, operating margins are expected to be in the high 20% for the future, resulting in many free cash flows.

The Manufacturing Support Segment reported an operating margin of 34.2% in Q2. They are very pleased with these results because their long-term target for this segment is an operating margin percent in the low 30s. This segment had an organic growth of 10%, led by the Microbial Solutions and Biologics Testing Solutions businesses. This segment also includes Avian and Biologics, which have been a steady driver of this segment. Revenue continues to increase for Microbial Solutions, as they become a more recognized profile across Europe and Asia. They are very optimistic that the growth will continue to be low double digit from microbial testing solutions to clients. The improvement in Operating Margin mainly comes from the Manufacturing Support Segment. The facility and staff expansion has a large impact on this segment as well. Although the facility in Shanghai is for research, the manufacturing aspect of the facility affects this segment as well. With the continuous expansion globally, the Manufacturing Support Segment will continue to grow.



The last segment is DSA, which spans across many aspects of the company. The Discovery and Safety segment is where I believe the driver of this business will be. Many acquisitions for this segment have been made in the past year and a half in order to expand this segment to provide a step-by-step process for their clients' so they can do all their research at their locations. They can provide anything for their clients' to do their research. In 2014-2015, CRL was a supporting role in half of the 86 new medicines that were approved by the FDA. In Q2, DSA Segment had a 23.7% operating margin, an increase of 250 basis points YOY. This was driven by the safety assessment price increase. They also saw a 9.3% increase in revenue to $252.1M. Overall, CRL believe the DSA Segment will have an organic revenue growth of 10% for 2017, the same as their Manufacturing Segment. EPS for DSA Segment are expected to increase slightly for Q3 of 2016, resulting from a YOY revenue growth of high single digits.

Acquisitions/Global Expansion

Charles River Laboratories have growth their portfolio in the past 15 years through acquisitions. In the last 15 years, they have acquired more than 65 companies to help fill every aspect of the business. They have invested in not only facilities but also staffing to support future growth. They have not been working at full capacity in China and for next year, with the new facility in Shanghai and the expansion of others, they plan to reach sufficient capacity to fulfill the increase in demand. One of the five acquisitions in the past 18 months was the most recent Brains On-Online. They are a leading CRO that provides critical data to advance novel therapeutics for the treatment of CNS diseases. They are considered the world's premier provider of microdialysis. Expanding their Biologics Portfolio by the acquisition of Blue stream was an effort to support biologic and biosimilar development. With clients recognizing the value of their Biologics portfolio, the demand for their services have increased. Two of the more recent acquisitions in the past 18 months as well was Avian and Celsis. Avian provides vaccine services, and although they had some health issues that dragged down the manufacturing segment, they are still very pleased with this acquisition since it is connected to other striving segments. The Celsis acquisition allows them to do bacterial IV and identify exactly what you've identified. They have seen nice growth and development in this area and expect to see continue growth from this acquisition. Having 70 facilities across 16 countries, with the drive to continue to expand and make it a one stop shopping for clients, shows us that they aren't content where they are and want to continue to grow.

Conclusion:

Charles River Laboratories is a well-rounded company that has a role in almost every aspect in the science industries. From helping start the basic research, to preclinical testing and the final commercialization part, Charles River Laboratories is there to provide for their clients. With the consistent revenue growth and the continuous expansion globally through acquisitions, I believe this company is undervalued and will continue to grow through the rest of next year and on.

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Charles River Laboratories International, Inc. (CRL)

CENTER FOR GLOBAL FINANCIAL STUDIES

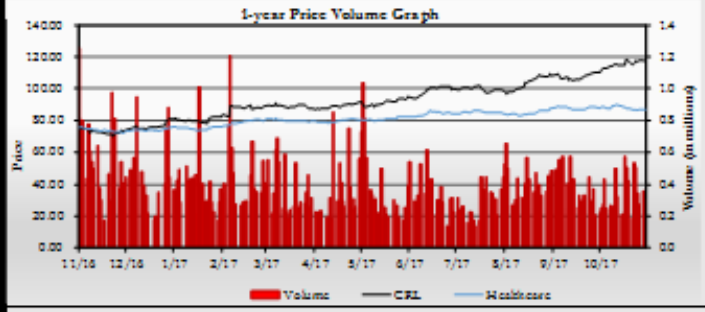
NEUTRAL

Analysis by Joshua Weiss

11/10/2017

Current Price:	$103.11	Intrinsic Value	$109.75
Divident Yield:	0.0%	Target Price	$118.41

Target 1 year Return: 14.84%
Probability of Price Increase: 92.2%



Description

Charles River Laboratories International, Inc., an early-stage contract research company, provides drug discovery and development services worldwide.

General Information

Sector	Healthcare
Industry	Life Sciences Tools and Services
Last Guidance	November 3, 2015
Next earnings date	November 9, 2017
Estimated Country Risk Premium	3.88%
Effective Tax rate	12%
Effective Operating Tax rate	12%

Market Data

Market Capitalization	$5,606.55
Daily volume (mil)	1.77
Shares outstanding (mil)	47.59
Diluted shares outstanding (mil)	48.41
% shares held by institutions	116%
% shares held by investments Managers	82%
% shares held by hedge funds	11%
% shares held by insiders	1.73%
Short interest	2.50%
Days to cover short interest	0.00
52 week high	$110.05
52-week low	$60.51
Volatility	22.50%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
9/24/2016	-1.01%	-4.30%
12/31/2016	5.75%	12.20%
4/1/2017	1.64%	-0.01%
7/1/2017	2.27%	2.77%
9/30/2017	1.32%	-24.32%
Mean	1.81%	-2.95%
Standard error	1.2%	6.1%

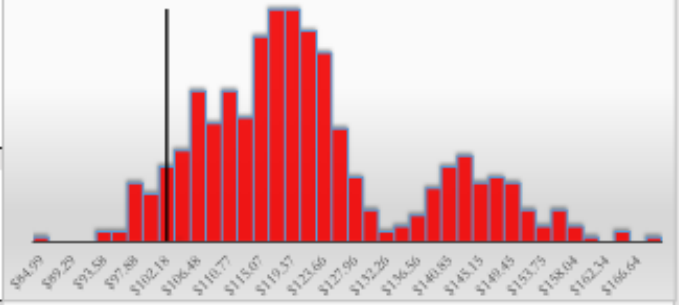
Peers

PRA Health Sciences, Inc.
INC Research Holdings, Inc.
ICON Public Limited Company
IQVIA Holdings Inc.
Medpace Holdings, Inc.

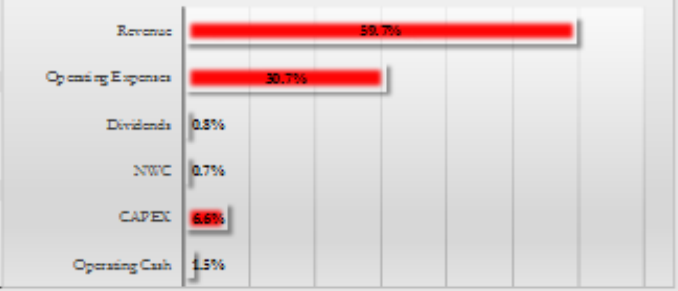
Management	Position	Total compensations growth	Total return to shareholders
Foster, James	Chairman, Chief Executive Of	17.72% per annum over 5y	-2.85% per annum over 5y
Smith, David	Corporate Executive VP & CFO	N/M	0% per annum over 0y
Johst, David	Chief Administrative Officer	15.08% per annum over 5y	-2.85% per annum over 5y
Molho, David c	Corporate EVP and President	19.84% per annum over 5y	-2.85% per annum over 5y
Barbo, William	Chief Commercial Officer and	N/M	N/M
Kroll, Michael	Corporate Senior VP & Chief	N/M	N/M

Profitability	CRL (LTM)	CRL (5 years historical average)	Peers' Median (LTM)
Return on Capital (GAAP)	14.6%	12.01%	12.11%
Operating Margin	14%	12.02%	9.00%
Revenue/Capital (GAAP)	1.03	1.07	1.21
ROE (GAAP)	26.8%	21.3%	14.6%
Net margin	11.5%	10.1%	8.0%
Revenue/Book Value (GAAP)	2.34	2.10	1.82
Invested Funds	**CRL (LTM)**	**CRL (5 years historical average)**	**Peers' Median (LTM)**
Cash/Capital	6.3%	10.6%	15.7%
NWC/Capital	10.6%	7.4%	1.0%
Operating Assets/Capital	42.2%	63.0%	14.8%
Goodwill/Capital	40.0%	18.1%	67.6%
Capital Structure	**CRL (LTM)**	**CRL (5 years historical average)**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.66	0.57	0.56
Cost of Existing Debt	2.4%	3.0%	4.0%
CGFS Rating (F-score, Z-score, and default Probability)	BBB	BBB	A
WACC	5.5%	6.0%	5.0%

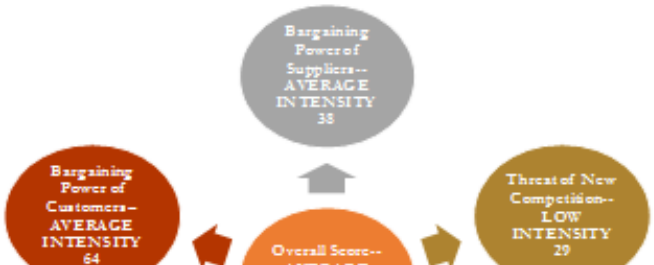
Intrinsic Value Distribution--Probability



Sensitivity Attribution Analysis



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



Valuation

Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	18%	20.1%	1.08
9/30/2018	8%	6.7%	0.82
9/30/2019	7%	6.9%	0.80
9/30/2020	7%	8.1%	0.82
9/30/2021	6%	9.3%	0.82
9/30/2022	2%	10.1%	0.78
9/30/2023	0%	18.4%	0.68
9/30/2024	1%	17.0%	0.61
9/30/2025	1%	17.4%	0.56
9/30/2026	1%	16.0%	0.51
9/30/2027	2%	16.4%	0.48
Continuing Period	2%	15.0%	0.46