

March 14, 2018

Charles River Laboratories (CRL)

Theo Wind

Sector: Healthcare

Industry: Healthcare Services

Current Price: \$104.53

Target Price: \$129.22

Charles River Laboratories provides tools for research and support services for drug companies. The company offers animals to aid in the development and discovery of new drugs, devices, and therapies. They serve pharmaceutical and biotech companies as well as hospitals, and academic institutions worldwide.



BUY

Current Price: \$104.53
 Target Price: \$129.22
 Market Cap: \$5.01B
 Beta: 1.2
 Cash ROIC/WACC: 1.81
 Cash WACC: 7.5%
 Debt Rating: BBB-

Catalysts:

- Short Term(within the year): Merger with MPI Research Inc.
- Mid Term(1-2 years): Record funding for biotech and pharmaceutical research
- Long Term(3+): Other mergers and acquisitions to help expand the business and achieve managements goals of doubling size of the business

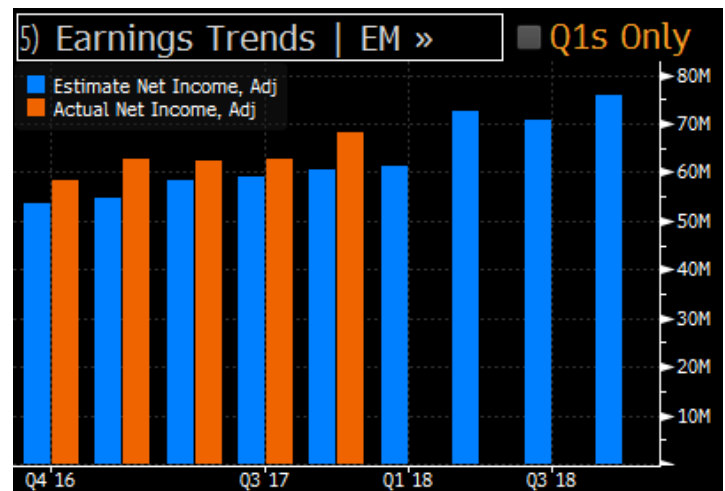
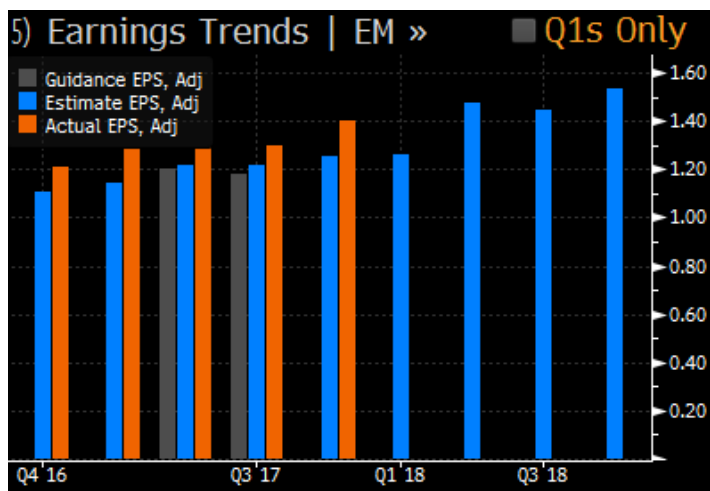
Thesis:

Charles River Laboratories serves an important role in the pharmaceutical and biotech industries. They provide lab rats, mice, and chickens used for testing medical devices and drugs. The biotech industry continues to grow, last year growing by 37% and CRL worked with 74% of the drugs that were approved last year. CRL intends to improve their position through internal initiatives and strategic acquisitions. Charles River has a sterling reputation in the pharmaceutical and biotech industry so they are primed to take an even bigger part in the market. Also, they have been able to continually beat analysts' estimates in revenue and EPS. Charles River is a company that provides products that are necessary for drug development and are the leaders in the growing industry. CRL is currently underpriced because of the growth potential as well as the internal commitment to improving market share as well as margins.

Earnings Performance:





Charles River's strong earnings performance over the last five quarters has been exceptional. The graph below on the left shows their adjusted EPS over the last five quarters. Charles River has been able to significantly beat analysts' estimates in EPS beating them in all five quarters. They released guidance for quarters two and three of 2017 that analysts believed set the bar to low, however they were able to outperform not only their guidance but also estimates. The downside to this would be that now analysts expect them to beat estimates, however I do not believe this should be a problem for CRL as they have both growth and cost cutting objectives in their sights for 2018.

The second graph below on the right shows their adjusted net income compared to analysts estimates. Again, they have been able to outperform the analysts estimates consistently. This is a great signal to investors because this proves their ability to control costs. Their cost control has been seen especially visible in their SGA decreasing it by about 2% from 2015. Also, their adjusted net income has constantly been growing over the last five quarters, therefore they do not suffer from seasonality, and continue to grow. Charles River has been able to outperform estimates and will continue to do so in the future.



Segment Analysis:

Charles River Laboratories has three major segments in the company: Discovery and Safety Assessment, Research Models and Services, and Manufacturing Support. The first segment Discovery and Safety Assessment has grown over the last four years to make up approximately 53% of the business. This segment offers both discovery and safety assessment services for both in vitro and in vivo studies. In vitro studies are when the studies are performed on non-living organisms compared to in vivo studies that use living organisms. They support a variety of therapeutic areas including oncology, central nervous system, bone and musculoskeletal, inflammation, metabolic diseases, respiratory and fibrotic diseases, cardiovascular, gastrointestinal, genitourinary, anti-infectives, and ophthalmology. The second segment that makes up approximately 26% of CRL's revenue is the Research Models and Services segment. This segment is designed to support the the basic research models and screening of non-clinical drugs. They currently have three service offerings in research models services: Genetically Engineered Models and Services, Insourcing Solutions, and Research Animal Diagnostic Services. The third segment that CRL operates is the manufacturing support that makes up approximately 21% of the business. This segment provides microbial solutions, biologics testing solutions, and avian vaccine solutions. The total revenues have grown over the past four years, however only the discovery and safety assessment and manufacturing support services have consistently been able to grow revenue. The research models and services revenue has been declining however this is because they have been moving away from this segment. They have decreased the percentage from 39% to approximately 26.6%. I believe CRL has each segment under control because they moving away from the research models and services segment towards the more successful discovery and safety assessment segment.

In Millions of USD except Per Share 12 Months Ending	2014 Y 12/27/2014	2015 Y 12/26/2015	2016 Y 12/31/2016	2017 Y 12/30/2017
 Revenue	1,297.7 100.0%	1,363.3 100.0%	1,681.4 100.0%	1,857.6 100.0%
 Discovery and Safety Assessm...	538.2 41.5%	612.2 44.9%	836.6 49.8%	980.0 52.8%
 Research Models and Services	507.3 39.1%	473.2 34.7%	494.0 29.4%	493.6 26.6%
 Manufacturing Support	252.1 19.4%	277.9 20.4%	350.8 20.9%	384.0 20.7%

Growth:

Charles River recently acquired MPI Research Inc on April 3, 2018 for \$800M in cash. MPI is a leading non-clinical contract research organization (CRO). They provide testing services to biopharmaceutical and medical device companies across the globe. Charles River believes that this acquisition will allow them to increase their ability to partner with customers in the drug development and discovery industries. This also increases the CRO business of Charles River, which will drive revenue growth. This merger shows that even though Charles River has a significant portion of the market share, that they are not satisfied and want to continue to grow the business bigger.

The industry they are in is also growing. The biotech industry grown 37% in 2017 from 2016, and the FDA approved 46 drugs, which is twice the amount approved in 2016. Of the 46 drugs that were approved, CRL worked on 74% of the 46 approved drugs. This shows the pure market share that CRL has in the industry as there are hundreds of drugs that are submitted for FDA approval and to still have almost three quarters of the market share is very impressive. They still want to grow this percentage as can be seen with their recent acquisition of MPI. CRL has organic revenue growth in the high single digit range, while maintaining revenue growth in the low double digits. This shows CRL's ability to capitalize on growth opportunities in the market. CRL has also been able to consistently improve their EBITDA margin year over year since 2014 from 14.6% to 16.9%, which is why this is the number I expected them to keep improving upon when valuing them in the proforma.

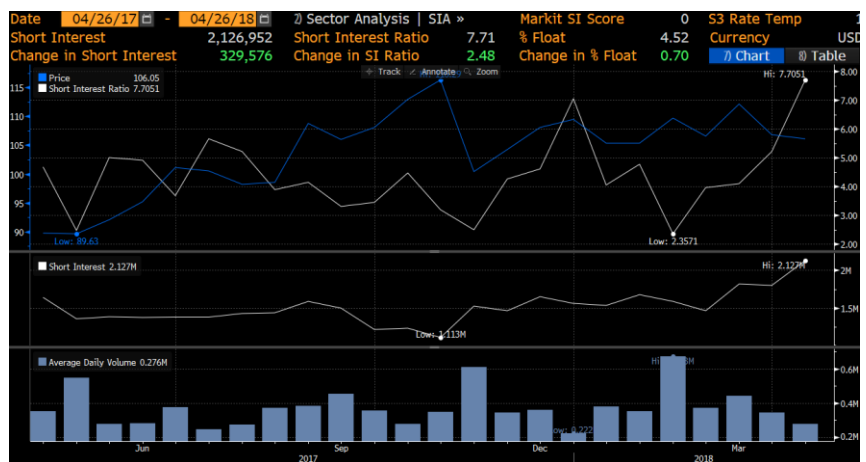
Competitors:

Charles River compares favorably to their competitors in multiple categories. The first category I looked at was EBITDA margin. I thought the EBITDA margin was important because it shows the ability of the firm to control costs. Charles River had an adjusted EBITDA margin of 23.50% over last year. This compares with the median of 13.41% for their competitors. Charles River has proven their ability to control their costs better than any of their competitors and have plans to try increase their margins more. The second ratio I looked at the ROIC/WACC ratio for CRL compared to the competitors. This shows the ability of CRL to create profits. They currently fall one point below the median of their competitors, but basically fall right in line with the industry. The third metric I looked at was return on equity over the past year. CRL had an ROE of 22.19% which blows their competitors away. They have been able to return the most to shareholders over the past year. Therefore, based on these three metrics I would say that CRL has outperformed the competitors, and will continue to do so in the future as they look to grow market share and revenue, while still cutting costs.

Name	Ticker	Mkt Cap	EBITDA Mrgn Adj:Y	ROIC/WACC Ratio	ROE:Y
Median		3.17B	13.41%	0.68	12.68%
100) CHARLES RIVER LABORA...	CRL US	5.05B	23.50%	0.67	22.19%
101) GMS INC	GMS US	1.29B	7.62%	0.68	13.55%
102) BMC STOCK HOLDINGS INC	BMCH US	1.19B	5.46%	0.66	8.73%
103) OWENS CORNING	OC US	7.40B	19.20%	0.91	11.81%

Short Interest/Ownership:

The short interest for Charles River can be seen on the right. As you can see it has increased significantly over the last couple months. I am not really sure what caused this spike in short interest as their price per share has stayed relatively constant over the same time period. I believe that this might signify a good time to buy the stock because there has been a lot of people betting against it, so it is currently cheaper than it normally would be in the market.



Top Ownership Type (%)			
54) Ownership Type	04/23/17	Curr	Change
41) Investment Advisor	77.28	85.85	+8.57
42) Hedge Fund Manager	14.90	7.78	-7.12
43) Pension Fund	2.01	2.12	+0.11
44) Individual	1.89	1.42	-0.47
45) Bank	1.33	1.00	-0.33
46) Sovereign Wealth Fund	1.37	0.81	-0.56
47) Insurance Company	0.77	0.52	-0.25
48) Corporation	0.00	0.18	+0.18
49) Government	0.24	0.17	-0.07

The ownership summary can be seen on the left. This represents the changes in ownership over the past year. The top line shows almost an 8% increase in investment advisor activity. This is significant because this type of investor cannot go short on a stock, so the 8.5% increase represents them betting long on Charles River. The second line shows the Hedge Fund manager change which is about 7%. This is interesting because it could mean they are getting out of long or short positions. However, hedge funds still represent the second largest ownership group in Charles River which I believe is a positive sign as I believe most investors would be long on this stock.

Conclusion:

Charles River Laboratories has continued to be the leader in their industry capturing about 75% of the market. However, they are not satisfied just maintaining the status quo. They have gone out to improve their CRO side of the business by acquiring MPI research. This acquisition will help Charles River to improve their ability to acquire customers earlier in the research process. This will help to improve their revenue margins and diversify their sales. Another reason why CRL is a buy is because they have been able to consistently improve their margins year over year by an average of about a percent. This returns more value to shareholders and proves that they are still looking for ways to cut costs to improve their profit margins. Another positive sign for CRL is that funding in the biochem and pharmaceutical industry was the second largest in recent history causing the FDA to approve almost double the amount of drugs in 2016. Charles River worked with 74% of the companies who had their drugs approved by the FDA. CRL still has their sights set on growth, they believe they can almost double the amount of business they currently do in the coming years. While this may be an aggressive estimation on their part, I do believe there is significant room to grow with their great reputation in the industry and their motivation to continue to grow through acquisitions. CRL is also underpriced because there has been an increase in short interest for no real reason that I could find, so I believe their stock price is not fairly valued. CRL is an industry leader proven to pursue growth and an ability to control costs, I believe they are undervalued and should be a buy at this time.

Charles River Laboratories International, Inc. (crl)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Al Capone

Current Price: \$105.21

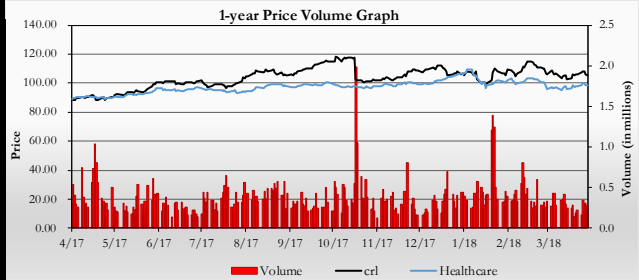
Intrinsic Value: \$115.22

4/27/2018

Divident Yield: 0.0%

Target Price: \$129.22

Target 1 year Return: 22.82%
Probability of Price Increase: 100%



Description	
Charles River Laboratories International, Inc., an early-stage contract research company, provides drug discovery, non-clinical development, and safety testing services worldwide.	
General Information	
Sector	Healthcare
Industry	Life Sciences Tools and Services
Last Guidance	February 12, 2018
Next earnings date	May 10, 2018
Market Assumptions	
Estimated Equity Risk Premium	5.64%
Effective Tax rate	22%

Market Data	
Market Capitalization	\$5,044.74
Daily volume (mil)	0.15
Shares outstanding (mil)	47.95
Diluted shares outstanding (mil)	48.56
% shares held by institutions	109%
% shares held by investments Managers	88%
% shares held by hedge funds	7%
% shares held by insiders	1.61%
Short interest	3.75%
Days to cover short interest	4.49
52 week high	\$119.05
52-week low	\$86.66
Volatility	23.55%

Past Earning Surprises		
Quarter ending	Revenue	EBITDA
12/31/2016	5.75%	15.77%
4/1/2017	1.64%	-0.90%
7/1/2017	2.27%	3.47%
9/30/2017	1.32%	-2.37%
12/30/2017	0.62%	9.91%
Mean	2.32%	5.18%
Standard error	1.0%	5.1%

Market and Credit Scores	
Recommendation (STARS) Value	-4
Recommendation (STARS) Description	Buy
Quality Ranking Value	B
Quality Ranking Description	Below Average
Short Score	-0
Market Signal Probability of Default % (Non-Ratings)	-0.362%
CreditModel Score (Non-Ratings)	bbb-

Industry and Segment Information	
LTN Revenues by Geographic Segments	LTN Revenues by Business Segments
U.S.--52%	Rms--27%
Europe--31%	Dsa--53%
Canada--11%	Manufacturing--21%
Asia Pacific--7%	--
Other--0%	--

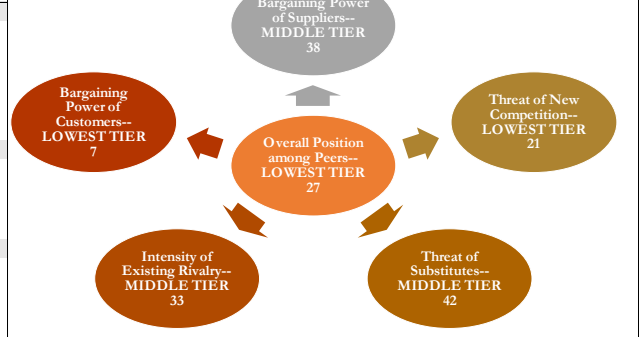
Management		Position		Total Compensations Growth	
Foster, James	Chairman & CEO	14.81%	per annum over 6y	6.7%	per annum over 6y
Molho, Davide	President & COO	17.44%	per annum over 6y	6.7%	per annum over 6y
Smith, David	Corporate Executive VP & CFO	10.69%	per annum over 2y	16.91%	per annum over 2y
Johst, David	Chief Administrative Officer, Corporate Executi	13.99%	per annum over 6y	6.7%	per annum over 6y
Barbo, William	Chief Commercial Officer & Corporate Executive	32.45%	per annum over 1y	43.65%	per annum over 1y
Knell, Michael	Corporate Senior VP & Chief Accounting Officer				

Stock Price Growth During Tenure	
6.7%	per annum over 6y
6.7%	per annum over 6y
16.91%	per annum over 2y
6.7%	per annum over 6y
43.65%	per annum over 1y

Peers	
Syneos Health, Inc.	--
PRA Health Sciences, Inc.	--
IQVIA Holdings Inc.	--
ICON Public Limited Company	--
Medpace Holdings, Inc.	--

Profitability		Invested Funds	
Return on Capital (GAAP)	8.4%	Cash/Capital	7.6%
Operating Margin	12%	NWC/Capital	5.8%
Revenue/Capital (GAAP)	0.70	Operating Assets/Capital	49.9%
ROE (GAAP)	17.1%	Goodwill/Capital	36.6%
Net margin	7.7%	Capital Structure	
Revenue/Book Value (GAAP)	2.22	Total Debt/Market Capitalization	0.57

Peers' Median (LTM)	
12.70%	11.47%
14.71%	16.27%
0.86	0.70
24.6%	14.8%
8.9%	11.1%
2.76	1.34



Capital Structure		Peers' Median (LTM)	
Cost of Debt	2.5%	8.9%	9.9%
CGFS Rating (F-score, Z-score, and default Probability)	BB	9.0%	-0.5%
WACC	9.4%	58.8%	6.9%
		23.2%	83.7%
		Peers' Median (LTM)	
		0.62	0.62
		3.4%	4.4%
		Peers' Median (LTM)	
		8.0%	8.0%

Forecast Assumptions		Valuation	
Revenue Growth CAGR	9%	Intrinsic Value Distribution--Probability (Upside)=100%	
Average Operating Margin	21%	[Bar chart showing intrinsic value distribution]	
Average Net Margin	12%		
Growth in Capital CAGR	11%		
Growth in Claims CAGR	1%		
Average Return on Capital	11%		
Average Return on Equity	15%		
Average Cost of Capital	10%		
Average Cost of EquityKc	11%		

Sensitivity Attribution Analysis	
Revenue	47.3%
Operating costs	48.1%
Capital expenditures	4.3%
Discount Rate	0.3%