Gilead Sciences (GILD)

Raimondas Lencevicius

Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Gilead Sciences – business

- Truvada, Atripla, Viread, and Emtriva – HIV
- Hepsera - chronic hepatitis B
- AmBisome - invasive fungal infections
- Letairis - pulmonary arterial hypertension
- Ranexa -chronic angina
- Vistide, an antiviral medication that targets cytomegalovirus retinitis in patients with AIDS
- Cayston, an inhaled antibiotic used as a treatment to enhance respiratory systems
- Tamiflu, an oral antiviral for the treatment and prevention of influenza A and B;
- Macugen, neovascular age-related macular degeneration
- Phase III clinical trials consist of Ambrisentan, idiopathic pulmonary fibrosis and pulmonary hypertension; Elvitegravir, combination therapy for HIV; and combination of tenofovir disoproxil fumarate, emtricitabine, and TMC278 for the treatment of HIV/AIDS
- Phase II clinical trials products comprise Aztreonam, Cicletanine, Cobicistat, combination of elvitegravir, cobicistat, and Truvada, GS 9190, GS 9310/11, and GS 9450, Ranolazine

Gilead Sciences – Misc thoughts

- What can go wrong?
  - Pipeline issues
  - Competition from other drugs
  - I am not an expert on bio-pharmas, no evaluation on competitiveness of the drugs, pipeline, etc.
  - Health legislation. Gilead acknowledged negative impact
  - Side effects / lawsuits

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Patents / uniqueness of drugs
  - What does it take to sustain the moats? R&D
  - Bargaining power of suppliers/customers? Healthcare insurance possibly has a high bargaining power
- Is it a low risk business? Not in the R&D. Somewhat low risk in existing products
- Is there high uncertainty? Yes, in R&D
- How capital intensive is the business?
- Future growth – unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions?
  Possibly in a boom now

Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Is it a good business?

- 3 year history of profits (2006 losses due to?)
- ROE:
  - 24.00 26.90- 65.50 46.70 48.40 2009:40.4 2010q1:45.4
- Margins
  - 2007: 38 2008: 37.7 2009: 37.6 2010q1: 40.8
- Growing earnings
- No dilution
- Very strong balance sheet
  - Cash+short term investments cover debt
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - =852*4/(7500+1300-4600) = 81% 2010q1

Is it a good business? Cash flow

- Strong cash flow
  - Q1 670M operating cash flow, 660M FCF (FCF = OCF – capital expenditures)
  - Operating cash flow higher than earnings per share – not in Q1
  - Free Cash Flow/Share higher than dividends paid – no dividends

Is business cheap? – Buffettology calculations

- ROE 45%, ROIC 81% - assume 30%
- Earnings in 10 years = ROE*Equity*$(1+ROE)^9$ = $23.8B
- Equity in 10 years = Equity*$(1+ROE)^9$ = 79.5B
- Market cap = 23.6B x P/E (15) = $358B
- Rate of return = ~24% after tax (calculations omitted)
- If we assume 25% ROE: 18%

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of ~3.4B
  - 10% growth for 5 years, leveling after that
    - 10% discount -> $51B current valuation (if you buy company at <$51B, you will get 10% return or higher)
    - 15% discount -> $33B current valuation
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $30B current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $41B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 3.4B / (34B+1.3B-4.6B) = 11%
- What makes up the margin of safety? High ROE, high expected earnings
- Is there a sufficient margin of safety? Maybe

Is business cheap? – Graham investment considerations

- N/A for Gilead – included for completeness
- >4.5 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)

Extra

- MY COMPETITORS
  o Are respected investors betting against me?
  o Short selling
  o Institutional %
  o Hedge fund activity
  o Why don't others see the value?
- DUE DILIGENCE PROCESS
  Suggested (minimum) checklist for thoroughly researching a company:
  o Annual reports / 10-K's – five years (including those of competitors). Read the footnotes.
  o 10-Q's and Proxy Statements – one year, including transcripts of earnings calls (include those of competitors). Seeking Alpha is a good source of transcripts.
  o Build a 10-year spreadsheet on the company, by operating segment if applicable. Don't rely on third party sources for anything more than preliminary research. Going to primary sources will not only ensure the data's accuracy, but also force you to think about the numbers and what they mean.
  o All available relevant articles in the business trades and press. In addition to the general Internet (Google, Bing, etc.), many libraries offer excellent free online databases, such as Proquest.
  o Build a database of all relevant private market transactions (minimum 5 years).
  o Compare relevant valuation metrics for company to those of competitors (P/S, P/B, P/E, EV/EBIT, EV/EBITA, P/(Owner Earnings). Include an analysis of any industry specific metric, for example, ROA for banks.
  o Study who owns the stock (and who doesn't). (You may be able to find information on the company in reports and letters of quality institutional investors that own the stock.) Are insiders buying or selling? Do they have "skin in the game"? What about the directors?