# Gilead Sciences Inc GILD (NAS) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Industry Group |
|---|---|---|---|---|---|---|---|---|
| 113.96 USD | 114.00 USD | 79.80 USD | 153.90 USD | Medium | Wide | Stable | Exemplary | Biotechnology |

## Gilead Sees Strong 1Q, Raises Guidance; High Cash Levels Mean Acquisitions Will Be Tough to Avoid

Updated Forecasts and Estimates from 17 May 2015

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The primary analyst covering this company does not own its stock.

Research as of 30 Apr 2015
Estimates as of 17 May 2015
Pricing data through 05 Jun 2015
Rating updated as of 05 Jun 2015

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

**Contents**



### Investment Thesis 17 Mar 2015

Gilead's focus on infectious disease has paid off in spades. With a small salesforce, inexpensive manufacturing, and selective research and development, it generates stellar profit margins, and the firm's pipeline is extending its reach into other high-margin markets like hepatitis C and hematological oncology. With the approval of hepatitis C drug Sovaldi in late 2013, we think Gilead's competitive advantages have strengthened, moving it into wide-moat territory.

Gilead's tenofovir molecule--in Viread, Truvada, and all single-tablet regimens--forms the heart of the firm's $10 billion HIV franchise. Its newest single-tablet regimens, Complera and Stribild, are seeing rapid uptake and strong reimbursement. Such regimens offer patients convenience and affordability, as they are less likely to miss doses and develop drug resistance, and they only need to make one copayment. Gilead will see new competitive threats in HIV; Glaxo could introduce a Truvada/Tivicay single-tablet regimen once Truvada patents begin to expire in 2018, and generic versions of Atripla should be available beyond 2021. However, we think Complera and Stribild will have a strong grasp on the market by this time, resetting the firm's HIV patent cliff into the 2020s. Gilead's pipeline drug TAF appears to have bone and renal safety advantages over tenofovir, and the first TAF combination regimen is poised to reach the market by the end of 2015.

Management is diversifying with acquisitions, including the $11 billion Pharmasset deal and key hepatitis C drug Sovaldi. While AbbVie launched its all-oral regimen in late 2014 and Bristol and Merck also look capable of launching competitive regimens by 2016, Gilead's regimens set a high bar. Sovaldi and Harvoni (a combination of Sovaldi and ledipasvir launched in October 2014) saw $12.4 billion in sales in 2014. While negotiated discounts have rapidly increased, the number of patients seeking therapy is set to increase, and we think Gilead will see more than $14 billion in hepatitis C sales in 2015, or 80% of the global market. Gilead's first cancer drug, Zydelig (idelalisib), launched in 2014, and we forecast $3 billion in peak sales in CLL and NHL.

### Vital Statistics

| | |
|---|---|
| Market Cap (USD Mil) | 167,476 |
| 52-Week High (USD) | 116.83 |
| 52-Week Low (USD) | 78.50 |
| 52-Week Total Return % | 37.6 |
| YTD Total Return % | 20.9 |
| Last Fiscal Year End | 31 Dec 2014 |
| 5-Yr Forward Revenue CAGR % | 1.4 |
| 5-Yr Forward EPS CAGR % | 5.2 |
| Price/Fair Value | 1.00 |

### Valuation Summary and Forecasts

| Fiscal Year: | 2013 | 2014 | *2015(E)* | *2016(E)* |
|---|---|---|---|---|
| Price/Earnings | 34.8 | 11.7 | *11.0* | *11.8* |
| EV/EBITDA | 24.6 | 8.8 | *8.6* | *9.6* |
| EV/EBIT | 26.5 | 9.4 | *9.0* | *10.1* |
| Free Cash Flow Yield % | 2.5 | 8.7 | *8.4* | *8.7* |
| Dividend Yield % | — | — | *1.2* | *1.6* |

### Financial Summary and Forecasts (USD Mil)

| Fiscal Year: | 2013 | 2014 | *2015(E)* | *2016(E)* |
|---|---|---|---|---|
| Revenue | 11,202 | 24,891 | *29,289* | *26,927* |
| Revenue YoY % | 15.5 | 122.2 | *17.7* | *-8.1* |
| EBIT | 4,524 | 15,266 | *18,723* | *16,652* |
| EBIT YoY % | 12.8 | 237.4 | *22.7* | *-11.1* |
| Net Income, Adjusted | 3,451 | 13,315 | *16,244* | *14,622* |
| Net Income YoY % | 11.9 | 285.9 | *22.0* | *-10.0* |
| Diluted EPS | 2.16 | 8.09 | *10.35* | *9.64* |
| Diluted EPS YoY % | 18.8 | 274.2 | *27.9* | *-6.9* |
| Free Cash Flow | 2,846 | 11,010 | *14,003* | *14,460* |
| Free Cash Flow YoY % | -133.3 | 286.9 | *27.2* | *3.3* |

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.
Analyst Note: Adjusted EPS excludes stock-based comp, amortization, acquisition costs

### Profile

Gilead Sciences develops and markets therapies to treat life-threatening infectious diseases, with the core of its portfolio focused on HIV and hepatitis B and C. The acquisitions of Corus Pharma, Myogen, CV Therapeutics, Arresto Biosciences, and Calistoga have broadened this focus to include pulmonary and cardiovascular diseases and cancer. Gilead's acquisition of Pharmasset brought rights to hepatitis C drug Sovaldi, which is also part of the recently approved combination regimen Harvoni.

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## Morningstar Analysis

**Gilead Sees Strong 1Q, Raises Guidance; High Cash Levels Mean Acquisitions Will Be Tough to Avoid** 30 Apr 2015

We're maintaining our $114 fair value estimate for Gilead Sciences, which reported a 52% increase in sales to $7.6 billion and a 99% increase in adjusted EPS to $2.94 in the first quarter. Management boosted its 2015 product sales guidance to $28 billion-$29 billion based largely on expected continued strong uptake of hepatitis C combo pill Harvoni. Despite the tough environment for Harvoni reimbursement and Merck's potential launch later this year, we believe Gilead's portfolio and pipeline are diverse and innovative, and the firm's wide moat looks secure.

In hepatitis C, sales of Sovaldi and Harvoni combined grew to $4.6 billion in the first quarter, up 19% from the fourth quarter and essentially doubling since the first quarter last year, as volume increases are outweighing the impact of higher discounting. Sovaldi is now approved in Japan for genotype 2 patients, which should boost international sales growth beginning in the second half of 2015.

Other antiviral products (mostly HIV) grew 9% to $2.4 billion despite lower inventories and higher discounting in the U. S., as newer regimens Complera (27% growth) and Stribild (66%) continue to see strong uptake. TAF-based versions of Truvada, Complera, and Stribild should all reach the market by mid-2016, giving the firm time to begin converting patients before HIV patents begin to expire in 2018.

Gilead's $14.5 billion cash balance raises the question of what it will acquire next. Even with the new dividend program ($2 billion in 2015), a three-year $15 billion share repurchase program (started in April), and lagging rebates owed for previous hepatitis C sales, Gilead will still have plenty of cash for acquisitions. Management said that it feels ready to consider new deals tied to Gilead's focus therapeutic areas, but will likely target firms with programs in Phase II or earlier. Hepatitis B, oncology, and immunology (e.g., fibrosis and autoimmune diseases) seem like the most likely areas of interest.

Diving deeper into hepatitis C results, we think higher eligibility is contributing to a dramatic increase in patients treated so far in 2015. Gilead still appears to be assuming a 46% discount to list prices for its hepatitis C therapies in the U.S. this year, but now views capacity of the U.S. health-care system ahead of its previous 250,000 patient/year guidance, perhaps approaching 300,000. As many of the negotiated contracts with payers went into effect during the first quarter, we expect that discounts weren't as severe in the first quarter, but will ramp higher for the remainder of the year. We still think Gilead has a leading pipeline for pan-genotypic regimens with potentially shorter durations of treatment, and with 1.6 million diagnosed with hepatitis C in the U.S., that could make even a lower-growth market an attractive opportunity for several years.

Despite a flattening U.S. HCV market, we see growth prospects beyond 2015 in Europe and Japan. The big five European markets and Japan together have similar numbers of diagnosed hepatitis C patients as the U.S., with Japan standing out as the largest single market opportunity outside the U.S. We expect European growth to accelerate in 2015 as reimbursement discussions proceed, but competition also looks strong in this market, given the higher proportion of patients with Genotype 1b (where efficacy is generally strong across treatment options). However, the higher prevalence of Genotype 2 in Japan gives Gilead an edge in this market.

**Valuation, Growth and Profitability** 17 Mar 2015

Our fair value estimate for Gilead stands at $114 per share, as increases to our near-term hepatitis C estimates and a slightly lower cost of capital are countered by lower HIV sales assumptions in the long term. Overall, we now assume global Gilead hepatitis C sales of $14.4 billion in 2015 (up from $12.5 billion). We think higher discounting in 2015 will be more than countered by a strong increase in the number

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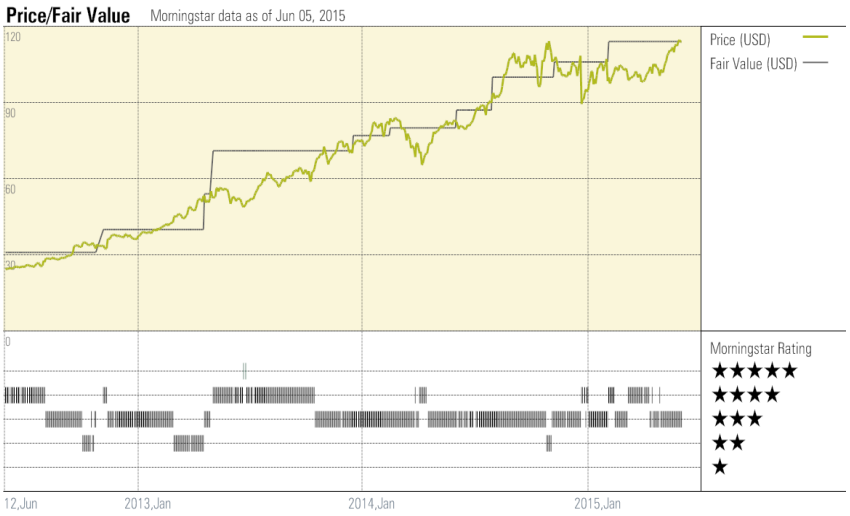


of patients treated and Gilead's ability to maintain strong global market share. We expect Gilead's hepatitis C sales to peak in 2015, with sales declining to $11.9 billion in 2016 and $10 billion by 2024. We think U.S. treatment rates could flatten in 2016 as warehoused patients and those with cirrhosis will have been treated, and we think market growth beyond this year--due to improved diagnosis and treatment rates--will be spread among more competitors. We also think U.S. rebates are poised to increase slowly from the anticipated 46% level in 2015, reaching 55% by 2024.

Overall, we think Gilead's HIV franchise will peak at $11.1 billion in 2017, with relatively flat sales from 2018 until heavier generic competition begins in 2022. We now assume that the TAF (next-generation Viread) quad regimen will receive FDA approval in late 2015, but we have also lowered our long-term Stribild sales estimates. We continue to view Stribild and Complera generics as strong long-term competition for TAF-based regimens.

After more than doubling revenue in 2014, we expect Gilead to see low-single-digit top-line growth over the next few years, on average. Sovaldi and Harvoni's high gross margins, strong operating leverage, and lower tax rate, as well as share buybacks (as Gilead will have to put massive cash flows to work either via acquisitions or returns to shareholders) should allow for mid-single-digit EPS growth during this time. Gilead saw a 61% operating margin in 2014, and we think Gilead will be able to maintain these margins despite new competitive threats.

We now assume a 7.2% cost of capital for Gilead (down from 7.6%). While we still rate the systematic risk surrounding Gilead shares as below average, we're lowering our cost of equity assumption from 8% to 7.5% as part of a broader change in our valuation methodology, to better align our capital cost assumptions with the returns equity investors are likely to demand over the long run. We also assume a 5.8% pre-tax cost of debt (up from 3.9%) to reflect a more normalized long-term rate environment.

**Scenario Analysis**

Gilead's portfolio is now more diverse, as its HIV focus has expanded with exposure to hepatitis C and cancer markets, but we still think the firm warrants a medium uncertainty rating, due to the potential volatility in hepatitis C market demand and pricing. In a bullish scenario, we expect Gilead to achieve stronger conversion to newer HIV products and stronger U.S. hepatitis C pricing power. In this scenario, we assume HIV franchise sales peak at $12.2 billion in 2021, largely due to the smaller impact that Atripla and Truvada generics would have on the firm's top line by this time. We also assume less aggressive rebating in the U.S. hepatitis C market our bull-case scenario (flat at 2015 levels), resulting in $11.4 billion in hepatitis C sales for Gilead in 2024. We also use a slightly higher (5%) earnings-growth rate in stage II (post-2024) of our model. This results in a fair value estimate of $160 per share.

In a more pessimistic scenario, we assume that Complera and Stribild are unable to gain a significant share of the HIV market due to lack of perceived efficacy, safety, or

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convenience benefits to older regimens. HIV franchise sales peak in 2017 at $10.7 billion, but then fall rapidly owing to the severe pressure this scenario incorporates following Viread's patent expiration. In this scenario, efforts to expand R&D capabilities and non-HIV-related salesforces counter the benefit of the Bristol agreement expiration on Gilead's gross margin. We also assume additional price competition in the hepatitis C market, with rebates eventually rising above 60% for the U.S. market. This results in $9 billion in hepatitis C sales for Gilead in 2024. We also use a slightly lower (0%) earnings-growth rate in stage II (post-2024) of our model. This yields a $95 per share fair value estimate.

**Economic Moat**

We assign Gilead a wide economic moat rating. We think patent protection on newer HIV regimens as well as the recent Food and Drug Administration approval of Gilead's oral hepatitis C drug Sovaldi (sofosbuvir) will be enough to ensure strong returns for the next couple of decades, making visibility on profits clearer at Gilead than at many of its large-cap biotech peers. We think Gilead is capable of achieving more than $14 billion in hepatitis C-related sales in 2015, or roughly 80% of our estimate of the global market this year. Gilead's expertise in infectious diseases and single-pill formulations is a part of its research and development strategy, which we see as one of the strongest intangible assets supporting the firm's wide moat.

Gilead's moat was formed by its leadership position in the treatment of HIV, with three patented products that form the backbone of today's treatment regimens. Despite numerous competitors, the company has established leading market share and spectacular profitability with its convenient, effective, and safe treatments. Gilead now serves about 85% of treated HIV patients in the United States. Management has done an excellent job of maximizing sales of the tenofovir molecule, which is present in Viread, Truvada, Atripla, Complera, and Stribild. That said, key patents begin to expire in 2018, and improvement beyond the firm's most recently approved products such as Stribild and Complera will be difficult to achieve, limiting the profit potential for this franchise beyond the 2020s.

However, we think the firm has shown that it can translate its extensive understanding of the drug discovery and development process in HIV into new therapeutic areas, allowing it to achieve wide-moat status. Despite initial criticism of the high price that Gilead paid for Pharmasset in early 2012, we think the $11 billion acquisition gave Gilead the most valuable hepatitis C drug in the industry and also demonstrated the firm's ability to recognize the potentially unique nature of Sovaldi's safety and efficacy profile compared with other, toxic nucleotide analogs. We think the firm's experience with another nucleotide analog, tenofovir, a key ingredient in all of Gilead's HIV combination regimens, probably contributed to its recognition of Sovaldi's value at an early stage in its development.

We think Sovaldi could redefine Gilead as a powerhouse in the broader infectious disease market. The drug is leading the way for all-oral treatments in the fast-growing hepatitis C market, and we expect Gilead has a multi-billion-dollar product, with longevity extending as far as 2029. We think the low resistance potential and pan-genotypic efficacy of Sovaldi will allow Gilead to retain a significant portion (more than 50%) of the global market in the long run, despite emerging competition from firms like AbbVie and Bristol.

**Moat Trend**

We assign Gilead a stable moat trend rating. Gilead's product platform reflects a growing record of recognizing potential in infectious disease, from the discovery of foundational HIV drug tenofovir to deals that brought rights to emtricitabine (another ingredient in all of Gilead's combination regimens) elvitegravir (the integrase inhibitor in Stribild), and now Sovaldi. Gilead's oncology pipeline is

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## Morningstar Analysis

also growing and advancing, and we think the firm's smart acquisitions and the potential for future combination regimens in hematological oncology are further diversifying the firm and strengthening its intangible assets. However, we think Gilead's HIV-related patent exposure and price competition in the hepatitis C market are preventing its moat from expanding further.

We're seeing growing evidence that the firm's acquisition strategy could serve it well in the field of oncology, following the acquisitions of Calistoga, CGI, Arresto, and YM Biosciences. Gilead's first oncology therapy, Zydelig (idelalisib, via Calistoga), launched in 2014, and we're bullish on the potential for the drug to combine well with standards of care (like Roche's Rituxan/Gazyva) and other products in Gilead's oncology pipeline.

Gilead's products are not biologics, so the firm will be vulnerable to generic versions of many of its current HIV products within a decade. However, its newest HIV regimens Complera and Stribild are seeing strong launches, and we think the products offer enough of a benefit to older standards of care (namely, Atripla and a combination of Truvada and Merck's integrase inhibitor, Isentress) that Gilead will successfully achieve significant conversion of patients to these newer regimens, extending patent protection on its HIV franchise and preventing moat erosion. With Stribild, Gilead can also retain all of the economics behind its HIV sales, rather than sharing with a partner as it does for Complera (Johnson & Johnson) and Atripla (Bristol-Myers Squibb), benefiting the firm's return on invested capital. That said, the approval of Glaxo's integrase inhibitor Tivicay could bring strong competition for Stribild; Glaxo has already filed for FDA approval of an in-house combination tablet (Epzicom/Tivicay), and more important, could create a Truvada/Tivicay pill once Truvada's patents begin expiring in 2018.

In addition, global pricing pressure and consolidation of pharmacy-benefit managers could reduce Gilead's ability to charge price premiums for new drugs or extend patent protection. For example, Express Scripts could exclude Stribild from its formularies once safe and effective competition--like Gilead's own Atripla and Complera--lose patent protection. Payers are already aggressively negotiating with drug firms in hepatitis C, and while Gilead appears to be gaining the majority of contracts and access to patients, it is sacrificing on price.

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## Bulls Say/Bears Say

**Bulls Say**

- Gilead markets the three single-tablet regimens for HIV: Atripla, Stribild, and Complera. Once-daily dosing greatly increases patient compliance and reduces the risk of drug resistance.
- Guidelines that aim to improve diagnosis and treatment rates provide strong tailwinds for growth in the HIV and hepatitis C markets.
- With the approval of Sovaldi and Harvoni, Gilead is the market leader in all-oral hepatitis C treatments. None of Gilead's competitors have other proven nucleotide analogs approaching the market, making the $11 billion acquisition of Pharmasset look like a bargain.

**Bears Say**

- Gilead's HIV franchise historically provided three fourths of sales. Heavy dependence on tenofovir, which loses exclusivity in 2018, puts pressure on Gilead's hepatitis C portfolio to support long-term growth.
- Pricing pressure and reduced willingness to pay for convenience could weigh on Gilead's growth. Atripla will become a formidable generic competitor to Gilead's newer HIV products by 2021, and competing hepatitis C regimens are giving PBMs the ability to negotiate aggressively.
- Ongoing litigation with Merck and AbbVie could shave off some of Gilead's Sovaldi profits.

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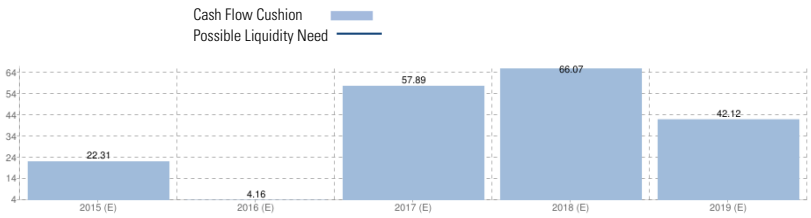
**Five Year Adjusted Cash Flow Forecast** (USD Mil)

| | 2015(E) | 2016(E) | 2017(E) | 2018(E) | 2019(E) |
|---|---|---|---|---|---|
| Cash and Equivalents (beginning of period) | 11,726 | 18,089 | 23,588 | 30,302 | 37,083 |
| Adjusted Available Cash Flow | 12,483 | 12,273 | 12,076 | 12,159 | 11,735 |
| Total Cash Available before Debt Service | 24,209 | 30,363 | 35,664 | 42,461 | 48,818 |
| Principal Payments | -483 | -6,714 | — | — | -500 |
| Interest Payments | -525 | -516 | -542 | -570 | -588 |
| Other Cash Obligations and Commitments | -78 | -71 | -74 | -73 | -71 |
| Total Cash Obligations and Commitments | -1,085 | -7,302 | -616 | -643 | -1,159 |

**Cumulative Annual Cash Flow Cushion**




**Adjusted Cash Flow Summary**

| | USD Millions | % of Commitments |
|---|---|---|
| Beginning Cash Balance | 11,726 | 108.5 |
| Sum of 5-Year Adjusted Free Cash Flow | 60,727 | 562.0 |
| Sum of Cash and 5-Year Cash Generation | 72,453 | 670.6 |
| Revolver Availability | — | — |
| Asset Adjusted Borrowings (Repayment) | — | — |
| Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments | 72,453 | 670.6 |
| Sum of 5-Year Cash Commitments | -10,805 | — |

## Financial Health

Gilead's credit profile remains solid, as the Sovaldi launch has lived up to the hype and should have legs despite push back from third party payers on price. The firm's cash flow has risen rapidly to $12 billion in 2014 from $3 billion in 2013 prior to Sovaldi's launch. We currently estimate annual free cash flow could rise to about $14 billion by 2019, which could further improve Gilead's financial flexibility. Given its much higher bottom line, Gilead's leverage has remained relatively stagnant even as debt has risen since our last update. At the end of December, the company owed $12.4 billion in debt, which was nearly covered by its $11.7 billion cash position. With only $3.2 billion of that cash held overseas at that time, we do not expect the company to need external financing in the immediate future, which could cause leverage to trend downward as profits grow. On a trailing 12-month basis, debt/EBITDA stood at just 0.8 times on a gross basis (down from about 2 times at the end of 2013) and interest coverage has ballooned to about 30 times pro forma for the new debt costs. At the end of December, the firm's capital structure consisted of senior unsecured notes and convertible notes (in-the-money 2016 notes); key senior note maturities due within the next five years include $700 million due 2016 and $500 million due 2019. Given these easily manageable intermediate-term debt maturities and Gilead's large ongoing cash flows, we weren't surprised to see the firm boost plans to return more cash to shareholders. In February, Gilead's board added a new $15 billion share repurchase program to the $3 billion program that remained outstanding at the end of 2014. The company also instituted a dividend that will push out over $2 billion in cash annually. Overall, we believe Gilead's substantial free cash flow prospects will be sufficient to manage these increasing returns to shareholders. We would not be surprised to see Gilead make acquisitions with excess cash flow to continue diversifying its business, as well.

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**Enterprise Risk**

Increasing competition and pricing pressures in the HIV and hepatitis C markets are risks for Gilead. If Gilead's HIV franchise does not maintain its superior efficacy and safety status, a large portion of its sales foundation could be at risk. Key patents on Gilead's top marketed HIV products will expire by 2021, and the firm will need to see significant switching to newer products Complera and Stribild to counter the negative impact from generic competitors. More than 60% of Gilead's U.S.-based HIV sales volume represents government purchases, and higher rebates on some of these sales were implemented in 2010. Austerity measures also had a higher-than-average impact on prices in Europe in 2010, and escalating overall health-care costs and tight budgets could lead to continued, elevated pricing pressure in both the U.S. and Europe. Gilead also paid a significant premium to acquire Myogen, and the failure of darusentan puts even more pressure on Letairis to make this deal accretive. That said, the $11 billion Pharmasset acquisition is largely derisked, as Sovaldi and Harvoni brought in more than $12 billion in revenue in 2014. However, growth beyond 2014 is still uncertain, as competition is emerging and as pharmacy benefit managers like Express Scripts aggressively negotiate pricing.

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## Management & Ownership

### Management Activity

| Name | Position | Shares Held | Report Date* | InsiderActivity |
|---|---|---|---|---|
| DR. JOHN C. MARTIN,M. D. | CEO/Chairman of the Board/ Director,Director | 4,255,876 | 01 Jun 2015 | 450,000 |
| DR. JOHN F. MILLIGAN, PHD | COO/President | 1,029,108 | 07 May 2015 | 100,000 |
| MR. ETIENNE F. DAVIGNON | Director | 837,605 | 05 May 2015 | — |
| DR. NORBERT W. BISCHOFBERGER, PHD | Executive VP, Divisional/Chief Scientific Officer | 165,168 | 15 May 2015 | 210,000 |
| MR. GREGG H. ALTON | Executive VP, Divisional/Secretary | 141,422 | 01 Jun 2015 | 66,000 |
| MR. PER WOLD-OLSEN | Director | 90,077 | 05 May 2015 | — |
| MR PAUL RUTHERFORD CARTER | Executive VP, Divisional | 47,632 | 01 Jun 2015 | 13,000 |

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

### Fund Ownership

| Top Owners | % of Shares Held | % of Fund Assets | Change (k) | Portfolio Date |
|---|---|---|---|---|
| VA CollegeAmerica Growth Fund of America | 2.32 | 2.46 | 104 | 31 Mar 2015 |
| VA CollegeAmerica Invmt Co of America | 1.90 | 3.88 | 1,052 | 31 Mar 2015 |
| Vanguard Total Stock Mkt Idx | 1.79 | 0.65 | 77 | 30 Apr 2015 |
| Fidelity® Contrafund® Fund | 1.29 | 1.73 | -382 | 30 Apr 2015 |
| VA CollegeAmerica Cap World Gr and Inc | 1.18 | 2.07 | 11 | 31 Mar 2015 |
| **Concentrated Holders** | | | | |
| ProFunds VP Biotechnology | 0.01 | 18.26 | 3 | 31 Mar 2015 |
| Market Vectors® Biotech ETF | 0.08 | 15.92 | — | 04 Jun 2015 |
| Vanguard Market Neutral | — | 15.31 | — | 31 Mar 2015 |
| ProFunds Biotechnology UltraSector Fund | 0.06 | 11.67 | 24 | 31 Jan 2015 |
| Merchbanc SICAV Cube | — | 10.96 | — | 31 Oct 2014 |

### Institutional Transactions

| Top 5 Buyers | % of Shares Held | % of Fund Assets | Shares Bought/ Sold (k) | Portfolio Date |
|---|---|---|---|---|
| Swedbank Robur Fonder AB | 0.27 | 2.92 | 4,019 | 31 Dec 2014 |
| Walter Scott & Partners Limited | 0.52 | 3.53 | 3,552 | 31 Mar 2015 |
| Capital Research Global Investors | 6.84 | 3.39 | 3,112 | 31 Mar 2015 |
| Renaissance Technologies Corp | 0.27 | 0.84 | 3,091 | 31 Mar 2015 |
| Robeco Investment Management, Inc. | 0.29 | 0.62 | 2,695 | 31 Mar 2015 |
| **Top 5 Sellers** | | | | |
| T. Rowe Price Associates, Inc. | 3.17 | 0.95 | -4,752 | 31 Mar 2015 |
| Marsico Capital Management, LLC | 0.18 | 2.23 | -3,403 | 31 Mar 2015 |
| J.P. Morgan Investment Management Inc. | 1.04 | 0.63 | -3,248 | 31 Mar 2015 |
| American Century Inv Mgt, Inc. | 0.54 | 0.87 | -2,808 | 31 Mar 2015 |
| Winslow Capital Management, LLC | 0.31 | 1.40 | -2,549 | 31 Mar 2015 |

### Management 04 Feb 2015

We assign Gilead exemplary marks for stewardship based on its moat-building investment strategies, good allocation of capital, and superior board independence and qualifications. Gilead has made several acquisitions and collaborative deals over the years that have supported its infectious disease portfolio. For example, the acquisition of Triangle in 2003 brought Emtriva, a critical component of Truvada and all of the firm's single-tablet HIV regimens. While outside of Gilead's therapeutic area focus, the acquisition of CV Therapeutics was also a wise investment, as angina drug Ranexa is growing strongly. In addition, our investment thesis rests on the (now largely proven) theory that the $11 billion bet on Pharmasset--and hepatitis C drug Sovaldi--was an excellent use of capital.

Chairman and CEO John Martin is the only insider on Gilead's 11-member board, which has an independent lead director. Experienced board members offer a diverse skill set, including expertise in public policy, infectious disease, and global health initiatives. Martin, who was previously Bristol-Myers' director of antiviral chemistry and has more than a quarter-century of experience, replaced Gilead's founder as CEO in 1996. We like that management is rewarded for R&D progress rather than earnings per share. Gilead's decision to boost share repurchases has been a smart one, in our view, as shares have traded below our fair value estimate over the past two years. We see the blood cancer market as a key area of growth for Gilead going forward, and this will be supported by the recent hiring of Dr. Philippe Bishop (formerly at Roche) to head its oncology efforts.

# Gilead Sciences Inc GILD (NAS) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Industry Group |
|---|---|---|---|---|---|---|---|---|
| 113.96 USD | 114.00 USD | 79.80 USD | 153.90 USD | Medium | Wide | Stable | Exemplary | Biotechnology |

## Analyst Notes

**Raising Our Gilead Fair Value Estimate on Higher HCV Treatment Numbers, Despite Higher Discounting** 04 Feb 2015

Gilead Sciences reported fourth-quarter results and 2015 guidance that were ahead of our expectations, and the new quarterly dividend and aggressive $15 billion share-repurchase program give us an answer for how the firm will use the tremendous cash flow from its HIV and hepatitis C portfolio (almost $13 billion in operating cash flow in 2014). We expect to raise our fair value estimate as we increase our assumptions for 2015 and beyond and as we give the firm credit for some of the earlier-stage programs in development, in oncology and inflammatory diseases. Overall, despite the tough negotiating environment for Harvoni reimbursement and new competitors launching over the next couple of years, we believe Gilead's portfolio and pipeline are diverse and innovative, and the firm's wide moat looks secure.

Gilead's $3.8 billion in hepatitis C revenue in the fourth quarter ($12.4 billion for the year) was higher than our $3.5 billion estimate for the quarter (and $12.1 billion estimate for the year), as Harvoni saw $2 billion in sales in the U.S. market in its first quarter. While our HIV sales estimates were in line with the company's results and we're comfortable with our HIV projections, Gilead forecasts total product sales in 2015 of $26 billion-$27 billion, which we believe is ahead of our projection of $24 billion largely because of our lower hepatitis C estimates. Hepatitis C discounts are rising higher than we expected in 2015, but our assumption for the number of patients treated will also increase as a result of anticipated higher eligibility, and we expect this to lead to a net increase in our hepatitis C projections.

We think higher eligibility will lead to a dramatic increase in patients treated in 2015, as fewer patients could be denied treatment. Gilead did offer some insights into U.S. reimbursement and potential treated patients in 2015, as the firm assumes it will see a 46% discount to list prices for its hepatitis C therapies this year, and as many as 250,000 patients could be treated by the U.S. health-care system at full capacity. On discounts, this is much higher than the 22% rate we had in our model for 2015 and closer to our long-term assumption approaching 50%. However, Gilead's negotiation process was not solely dictated by new competition from AbbVie, but also by a desire to increase eligibility for insurance coverage among hepatitis C patients with lower fibrosis scores (that is, healthier patients). Gilead noted that 60% of covered lives in the U.S. have now been negotiated with payers, and of these, its hepatitis C regimens are available to 80% of patients.

If the U.S. health-care system does approach hepatitis C treatment capacity in 2015, there could still be several years of solid performance for Gilead, given its leading pipeline for pan-genotypic regimens with potentially shorter durations of treatment, as well as the 1.6 million diagnosed with hepatitis C in the U.S. However, this would imply that growth prospects beyond 2015 will be focused on Europe and Japan. The big five European markets and Japan together have similar numbers of diagnosed hepatitis C patients as the U.S., with Japan standing out as the largest single market opportunity outside the U.S. We expect European growth to accelerate in 2015 as reimbursement discussions proceed, but competition also looks strong in this market, given the higher proportion of patients with Genotype 1b (where efficacy is generally strong across treatment options). However, the higher prevalence of Genotype 2 in Japan gives Gilead an edge in this market, and we expect the firm could begin to book sales in this indication in the second half of 2015.

**AbbVie's Viekira Favored by Express Scripts Over Gilead's Harvoni; Maintaining Our FV Estimates** 22 Dec 2014

AbbVie received FDA approval on Dec. 19 for its all-oral

# Gilead Sciences Inc GILD (NAS) | ★★★

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|---|---|---|---|---|---|---|---|---|
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## Analyst Notes

hepatitis C treatment Viekira for genotype 1 patients, who represent about three quarters of hepatitis C patients in the U.S. market. In addition, Express Scripts announced Dec. 22 that Sovaldi, Harvoni, and Olysio are being removed from its national formulary for 2015, in favor of Viekira (which is now part of a multiyear agreement that provides a significant discount to Viekira's list price, according to Express Scripts). We're not making any changes to our fair value estimates for Gilead and AbbVie, as we had already assumed that Gilead would lose 30% of the U.S. genotype 1 hepatitis C market (and a slightly higher percentage of patients, after factoring in price discounts) to AbbVie in 2015. Given Express Scripts' roughly 30% share of U.S. prescriptions and the 30% of Express Scripts customers who follow the national formulary, this translates to minimum of 10% of U.S. genotype 1 patients who will take AbbVie's regimen next year.

Overall, we think Gilead will see U.S. hepatitis C sales of $7.9 billion in 2015, versus $2.3 billion for AbbVie. For AbbVie, we expect the robust high-margin hepatitis C sales to boost 2015 earnings per share by 35%, well ahead of consensus expectations. For Gilead, we assume global hepatitis C sales of $10.9 billion in 2015 (down from $11.5 billion), which remains well below consensus expectations. We don't expect this news to affect the moat ratings for these firms; we still think that Gilead warrants a wide moat rating, and that a pan-genotypic hepatitis C regimen in the pipeline, progress in oncology, continued HIV innovation and leadership, and a strong track record in business development will allow the firm to see growth beyond what might be a tough 2015-16.

At about $83,000 for 12 weeks, Viekira's list price is about a 10% discount to Gilead's $95,000 list price for 12 weeks of Harvoni, also approved in genotype 1 patients. However, average list price per patient could be a slightly different story, as we have previously estimated that Harvoni's average list price (factoring in eight- and 24-week regimens) is likely closer to $90,000, and we think Viekira's list price could actually be slightly higher than this amount, after including patients who require 24 weeks of therapy (genotype 1a cirrhotics). However, if we assume that AbbVie's discounted price must put it at least on par with Gilead's discounted price for Harvoni's eight-week regimen, this implies that the firm is offering Express Scripts a much steeper discount (potentially 30%) that more than counters this list price differential.

From AbbVie's perspective, this is a steeper discount than we had previously assumed, but it will also likely increase the number of patients receiving therapy, as Express Scripts is not limiting treatment to patients with higher fibrosis scores as it had been with Gilead's regimens. For Gilead, given that it still holds the leading therapy in efficacy, convenience, and safety (most Viekira patients need to take ribavirin, adding anemia and fatigue to its side-effect profile), we don't expect discounts to rise this steeply overall. Therefore, we think the Express Scripts decision fits with the significant step-up in rebates we had assumed in our Gilead model (rising from 12% in 2014 to 22% in 2015), as it will no doubt need to negotiate steeper discounts to keep other private payer formulary positions.

# Gilead Sciences Inc GILD (NAS) | ★★★

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|---|---|---|---|---|---|---|---|---|
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## Morningstar Analyst Forecasts

### Financial Summary and Forecasts

Fiscal Year Ends in December

| Growth (% YoY) | 3-Year Hist. CAGR | 2012 | 2013 | 2014 | Forecast 2015 | Forecast 2016 | 5-Year Proj. CAGR |
|---|---|---|---|---|---|---|---|
| Revenue | *43.7* | 15.7 | 15.5 | 122.2 | *17.7* | *-8.1* | *1.4* |
| EBIT | *59.1* | 5.8 | 12.8 | 237.4 | *22.7* | *-11.1* | *1.7* |
| EBITDA | *58.6* | 4.8 | 13.5 | 235.1 | *20.5* | *-10.5* | *1.5* |
| Net Income | *63.4* | 1.0 | 11.9 | 285.9 | *22.0* | *-10.0* | *2.0* |
| Diluted EPS | *27.9* | -52.9 | 18.8 | 274.2 | *27.9* | *-6.9* | *5.2* |
| Earnings Before Interest, after Tax | *59.3* | -7.5 | 17.6 | 271.5 | *21.4* | *-10.5* | *1.6* |
| Free Cash Flow | *15.4* | -219.6 | -133.3 | 286.9 | *27.2* | *3.3* | *4.9* |

| Profitability | 3-Year Hist. Avg | 2012 | 2013 | 2014 | 2015 | 2016 | 5-Year Proj. Avg |
|---|---|---|---|---|---|---|---|
| Operating Margin % | *47.7* | 41.3 | 40.4 | 61.3 | *63.9* | *61.8* | *62.5* |
| EBITDA Margin % | *51.1* | 44.2 | 43.5 | 65.6 | *67.2* | *65.3* | *65.9* |
| Net Margin % | *38.7* | 31.8 | 30.8 | 53.5 | *55.5* | *54.3* | *54.8* |
| Free Cash Flow Margin % | *-6.2* | -88.2 | 25.4 | 44.2 | *47.8* | *53.7* | *51.5* |
| ROIC % | *39.6* | 31.2 | 23.7 | 63.8 | *68.3* | *56.2* | *56.1* |
| Adjusted ROIC % | *37.4* | 29.0 | 22.5 | 60.6 | *65.3* | *53.9* | *53.8* |
| Return on Assets % | *23.3* | 13.5 | 14.0 | 42.3 | *38.7* | *29.7* | *28.3* |
| Return on Equity % | *94.8* | 32.3 | 54.1 | 198.1 | *106.9* | *57.4* | *55.1* |

| Leverage | 3-Year Hist. Avg | 2012 | 2013 | 2014 | 2015 | 2016 | 5-Year Proj. Avg |
|---|---|---|---|---|---|---|---|
| Debt/Capital | *0.66* | 0.47 | 0.89 | 0.63 | *0.50* | *0.29* | *0.30* |
| Total Debt/EBITDA | *2.09* | 1.92 | 3.28 | 1.08 | *0.90* | *0.65* | *0.72* |
| EBITDA/Interest Expense | *22.46* | 11.88 | 15.86 | 39.64 | *37.49* | *34.10* | *33.37* |

### Valuation Summary and Forecasts

| | 2013 | 2014 | 2015(E) | 2016(E) |
|---|---|---|---|---|
| Price/Fair Value | 0.98 | 0.89 | — | — |
| Price/Earnings | 34.8 | 11.7 | *11.0* | *11.8* |
| EV/EBITDA | 24.6 | 8.8 | *8.6* | *9.6* |
| EV/EBIT | 26.5 | 9.4 | *9.0* | *10.1* |
| Free Cash Flow Yield % | 2.5 | 8.7 | *8.4* | *8.7* |
| Dividend Yield % | — | — | *1.2* | *1.6* |

### Key Valuation Drivers

| | |
|---|---|
| Cost of Equity % | 7.5 |
| Pre-Tax Cost of Debt % | 5.8 |
| Weighted Average Cost of Capital % | 7.2 |
| Long-Run Tax Rate % | 20.0 |
| Stage II EBI Growth Rate % | 2.0 |
| Stage II Investment Rate % | 22.2 |
| Perpetuity Year | 20 |

Additional estimates and scenarios available for download at http://select.morningstar.com.

### Discounted Cash Flow Valuation

| | USD Mil | Firm Value (%) | Per Share Value |
|---|---|---|---|
| Present Value Stage I | 92,895 | 53.0 | 63.11 |
| Present Value Stage II | 33,844 | 19.3 | 22.99 |
| Present Value Stage III | 48,452 | 27.7 | 32.92 |
| **Total Firm Value** | **175,192** | **100.0** | **119.03** |
| Cash and Equivalents | 11,726 | — | 7.97 |
| Debt | -17,668 | — | -12.00 |
| Preferred Stock | — | — | — |
| Other Adjustments | -5,000 | — | -3.40 |
| **Equity Value** | **164,250** | **—** | **111.59** |
| Projected Diluted Shares | 1,472 | | |
| **Fair Value per Share** (USD) | — | | |

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

# Gilead Sciences Inc GILD (NAS) | ★★★

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## Morningstar Analyst Forecasts

**Income Statement** (USD Mil)

| Fiscal Year Ends in December | 2012 | 2013 | 2014 | *Forecast* 2015 | *Forecast* 2016 |
|---|---|---|---|---|---|
| **Revenue** | **9,703** | **11,202** | **24,891** | ***29,289*** | ***26,927*** |
| Cost of Goods Sold | 2,471 | 2,859 | 3,788 | *4,122* | *3,812* |
| **Gross Profit** | **7,231** | **8,343** | **21,102** | ***25,167*** | ***23,115*** |
| Selling, General & Administrative Expenses | 1,461 | 1,699 | 2,983 | *3,222* | *3,231* |
| Research & Development | 1,760 | 2,120 | 2,854 | *3,222* | *3,231* |
| Other Operating Expense (Income) | — | — | — | — | — |
| Depreciation & Amortization (if reported separately) | — | — | — | — | — |
| **Operating Income (ex charges)** | **4,010** | **4,524** | **15,266** | ***18,723*** | ***16,652*** |
| Restructuring & Other Cash Charges | — | — | — | — | — |
| Impairment Charges (if reported separately) | — | — | — | — | — |
| Other Non-Cash (Income)/Charges | — | — | — | — | — |
| **Operating Income (incl charges)** | **4,010** | **4,524** | **15,266** | ***18,723*** | ***16,652*** |
| Interest Expense | 361 | 307 | 412 | *525* | *516* |
| Interest Income | -37 | -9 | 3 | *117* | *181* |
| **Pre-Tax Income** | **3,612** | **4,208** | **14,857** | ***18,316*** | ***16,317*** |
| Income Tax Expense | 1,038 | 1,151 | 2,797 | *3,448* | *3,072* |
| Other After-Tax Cash Gains (Losses) | — | — | — | — | — |
| Other After-Tax Non-Cash Gains (Losses) | — | — | — | — | — |
| (Minority Interest) | 18 | 18 | 42 | *42* | *42* |
| (Preferred Dividends) | — | — | — | — | — |
| **Net Income** | **2,592** | **3,075** | **12,102** | ***14,910*** | ***13,287*** |
| Weighted Average Diluted Shares Outstanding | 1,694 | 1,596 | 1,646 | *1,570* | *1,517* |
| **Diluted Earnings Per Share** | **1.53** | **1.93** | **7.35** | ***9.50*** | ***8.76*** |
| Adjusted Net Income | 3,084 | 3,451 | 13,315 | *16,244* | *14,622* |
| **Diluted Earnings Per Share (Adjusted)** | **1.82** | **2.16** | **8.09** | ***10.35*** | ***9.64*** |
| Dividends Per Common Share | — | — | — | *1.29* | *1.81* |
| **EBITDA** | **4,288** | **4,869** | **16,316** | ***19,666*** | ***17,595*** |
| **Adjusted EBITDA** | **4,288** | **4,869** | **16,316** | ***19,666*** | ***17,595*** |

# Gilead Sciences Inc GILD (NAS) | ★★★

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|---|---|---|---|---|---|---|---|---|
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## Morningstar Analyst Forecasts

**Balance Sheet** (USD Mil)

| Fiscal Year Ends in December | 2012 | 2013 | 2014 | Forecast 2015 | Forecast 2016 |
|---|---|---|---|---|---|
| Cash and Equivalents | 2,582 | 2,571 | 11,726 | *18,089* | *23,588* |
| Investments | — | — | — | — | — |
| Accounts Receivable | 1,751 | 2,182 | 4,635 | *5,454* | *5,014* |
| Inventory | 1,745 | 1,697 | 1,386 | *2,371* | *2,193* |
| Deferred Tax Assets (Current) | — | 331 | 508 | *508* | *508* |
| Other Short Term Assets | 798 | 656 | 1,057 | *1,057* | *1,057* |
| **Current Assets** | **6,876** | **7,436** | **19,312** | ***27,480*** | ***32,360*** |
| Net Property Plant, and Equipment | 1,100 | 1,166 | 1,674 | *2,099* | *2,549* |
| Goodwill | 1,061 | 1,169 | 1,172 | *1,172* | *1,172* |
| Other Intangibles | 11,736 | 11,900 | 11,073 | *10,255* | *9,437* |
| Deferred Tax Assets (Long-Term) | 131 | 190 | 236 | *236* | *236* |
| Other Long-Term Operating Assets | 176 | 199 | 466 | *466* | *466* |
| Long-Term Non-Operating Assets | 159 | 519 | 731 | *731* | *731* |
| **Total Assets** | **21,240** | **22,579** | **34,664** | ***42,439*** | ***46,951*** |
| Accounts Payable | 1,327 | 1,256 | 955 | *1,129* | *1,044* |
| Short-Term Debt | 1,169 | 6,746 | 483 | *6,714* | — |
| Deferred Tax Liabilities (Current) | — | — | — | — | — |
| Other Short-Term Liabilities | 1,773 | 2,372 | 4,323 | *4,323* | *4,323* |
| **Current Liabilities** | **4,270** | **10,375** | **5,761** | ***12,167*** | ***5,367*** |
| Long-Term Debt | 7,055 | 9,203 | 17,185 | *10,971* | *11,471* |
| Deferred Tax Liabilities (Long-Term) | — | 83 | 51 | *51* | *51* |
| Other Long-Term Operating Liabilities | 364 | 405 | 1,112 | *1,112* | *1,112* |
| Long-Term Non-Operating Liabilities | — | — | — | — | — |
| **Total Liabilities** | **11,689** | **20,066** | **24,109** | ***24,301*** | ***18,001*** |
| Preferred Stock | — | — | — | — | — |
| Common Stock | 1 | 2 | 2 | *2* | *2* |
| Additional Paid-in Capital | 5,650 | 5,387 | 2,391 | *2,391* | *2,391* |
| Retained Earnings (Deficit) | 3,705 | 6,105 | 12,732 | *25,617* | *36,164* |
| (Treasury Stock) | — | — | — | *-5,000* | *-10,000* |
| Other Equity | -46 | -9,438 | -4,963 | *-5,264* | — |
| **Shareholder's Equity** | **9,310** | **2,056** | **10,162** | ***17,745*** | ***28,557*** |
| Minority Interest | 241 | 375 | 393 | *393* | *393* |
| **Total Equity** | **9,551** | **2,431** | **10,555** | ***18,138*** | ***28,950*** |

# Gilead Sciences Inc GILD (NAS) | ★★★

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|---|---|---|---|---|---|---|---|---|
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## Morningstar Analyst Forecasts

**Cash Flow** (USD Mil)

| Fiscal Year Ends in December | 2012 | 2013 | 2014 | Forecast 2015 | Forecast 2016 |
|---|---|---|---|---|---|
| Net Income | 2,574 | 3,057 | 12,059 | *14,868* | *13,245* |
| Depreciation | 83 | 103 | 125 | *125* | *125* |
| Amortization | 195 | 242 | 925 | *818* | *818* |
| Stock-Based Compensation | 209 | 252 | 360 | *389* | *390* |
| Impairment of Goodwill | — | — | — | — | — |
| Impairment of Other Intangibles | — | — | — | — | — |
| Deferred Taxes | -39 | -98 | -236 | — | — |
| Other Non-Cash Adjustments | -3 | 112 | 103 | — | — |
| (Increase) Decrease in Accounts Receivable | 198 | -315 | -2,578 | *-819* | *440* |
| (Increase) Decrease in Inventory | -350 | -343 | 143 | *-985* | *178* |
| Change in Other Short-Term Assets | -129 | -170 | -371 | — | — |
| Increase (Decrease) in Accounts Payable | 117 | -98 | -289 | *174* | *-85* |
| Change in Other Short-Term Liabilities | 341 | 364 | 2,577 | — | — |
| **Cash From Operations** | **3,195** | **3,105** | **12,818** | ***14,570*** | ***15,111*** |
| (Capital Expenditures) | -397 | -191 | -557 | *-550* | *-575* |
| Net (Acquisitions), Asset Sales, and Disposals | -10,752 | -379 | — | — | — |
| Net Sales (Purchases) of Investments | — | — | — | — | — |
| Other Investing Cash Flows | -697 | 315 | -1,266 | — | — |
| **Cash From Investing** | **-11,846** | **-254** | **-1,823** | ***-550*** | ***-575*** |
| Common Stock Issuance (or Repurchase) | -201 | -269 | -5,018 | *-5,000* | *-5,000* |
| Common Stock (Dividends) | — | — | — | *-2,025* | *-2,740* |
| Short-Term Debt Issuance (or Retirement) | — | — | — | *6,231* | *-6,714* |
| Long-Term Debt Issuance (or Retirement) | 308 | -5,480 | -940 | *-6,214* | *500* |
| Other Financing Cash Flows | 457 | 3,205 | 2,933 | *-347* | *-348* |
| **Cash From Financing** | **563** | **-2,544** | **-3,025** | ***-7,355*** | ***-14,302*** |
| Exchange Rates, Discontinued Ops, etc. (net) | 8 | 2 | -56 | *-301* | *5,264* |
| **Net Change in Cash** | **-8,080** | **309** | **7,914** | ***6,363*** | ***5,498*** |

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|---|---|---|---|---|---|---|---|---|
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## Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

### Valuation Analysis

| | | Price/Earnings | | | EV/EBITDA | | | Price/Free Cash Flow | | | Price/Book | | | Price/Sales | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Price/Fair Value | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) |
| Pfizer Inc PFE USA | 1.00 | 13.7 | 15.2 | 14.1 | 10.3 | 10.4 | 9.7 | 12.5 | 17.3 | 16.0 | 2.7 | 3.1 | 3.0 | 4.0 | 4.3 | 4.1 |
| Merck & Co Inc MRK USA | 0.85 | 16.3 | 17.2 | 15.1 | 12.4 | 12.3 | 10.8 | 24.6 | 14.8 | 15.7 | 3.3 | 3.8 | 3.8 | 3.8 | 4.3 | 3.9 |
| GlaxoSmithKline PLC GSK USA | 0.91 | 14.6 | 15.1 | 14.8 | 26.9 | 14.3 | 14.2 | 28.7 | 29.6 | 22.2 | 26.8 | 132.0 | NM | 5.0 | 4.3 | 4.2 |
| Abbott Laboratories ABT USA | 0.99 | 29.6 | 22.7 | 20.7 | 18.2 | 15.2 | 14.1 | 39.1 | 34.8 | 22.3 | 3.2 | 3.3 | 3.1 | 3.4 | 3.4 | 3.3 |
| Vertex Pharmaceuticals Inc VRTX USA | 0.96 | NM | NM | 29.9 | NM | NM | 28.8 | NM | NM | 35.4 | 26.7 | 53.8 | 22.1 | 49.5 | 30.1 | 11.0 |
| Average | | 18.6 | 17.6 | 18.9 | 17.0 | 13.1 | 15.5 | 26.2 | 24.1 | 22.3 | 12.5 | 39.2 | 8.0 | 13.1 | 9.3 | 5.3 |
| **Gilead Sciences Inc GILD US** | **1.00** | **11.7** | ***11.0*** | ***11.8*** | **8.8** | ***8.6*** | ***9.6*** | **11.5** | ***11.9*** | ***11.5*** | **13.9** | ***9.4*** | ***5.9*** | **5.7** | ***5.7*** | ***6.2*** |

### Returns Analysis

| | | ROIC % | | | Adjusted ROIC % | | | Return on Equity % | | | Return on Assets % | | | Dividend Yield % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Total Assets (Mil) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) |
| Pfizer Inc PFE USA | 169,274 USD | 9.6 | 9.4 | 9.7 | 14.0 | 14.7 | 16.2 | 12.4 | 12.7 | 14.8 | 5.4 | 5.3 | 6.3 | 3.4 | 2.6 | 2.8 |
| Merck & Co Inc MRK USA | 98,335 USD | — | — | — | 8.1 | 15.8 | 21.2 | 24.2 | 10.9 | 17.7 | 11.7 | 5.1 | 7.9 | 3.2 | 3.0 | 3.4 |
| GlaxoSmithKline PLC GSK USA | 40,651 USD | — | — | — | 9.7 | 15.9 | 16.9 | 49.0 | 121.8 | NM | 6.7 | 8.0 | 10.1 | 3.4 | 3.6 | 3.5 |
| Abbott Laboratories ABT USA | 41,275 USD | — | — | — | 16.6 | 26.3 | 31.6 | 9.9 | 11.5 | 12.5 | 5.0 | 6.3 | 7.3 | 2.0 | 1.9 | 1.9 |
| Vertex Pharmaceuticals Inc VRTX USA | 2,335 USD | — | — | — | -16.2 | -6.4 | 22.5 | -60.8 | -60.2 | 83.6 | -31.7 | -24.0 | 36.5 | — | — | — |
| Average | | 9.6 | 9.4 | 9.7 | 6.4 | 13.3 | 21.7 | 6.9 | 19.3 | 32.2 | -0.6 | 0.1 | 13.6 | 3.0 | 2.8 | 2.9 |
| **Gilead Sciences Inc GILD US** | **34,664** USD | **63.8** | ***68.3*** | ***56.2*** | **60.6** | ***65.3*** | ***53.9*** | **198.1** | ***106.9*** | ***57.4*** | **42.3** | ***38.7*** | ***29.7*** | **—** | ***1.2*** | ***1.6*** |

### Growth Analysis

| | | Revenue Growth % | | | EBIT Growth % | | | EPS Growth % | | | Free Cash Flow Growth % | | | Dividend/Share Growth % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Revenue (Mil) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) | 2014 | 2015(E) | 2016(E) |
| Pfizer Inc PFE USA | 49,605 USD | -3.8 | -2.3 | 6.8 | -17.5 | 17.9 | 10.4 | 2.4 | -1.5 | 8.1 | -6.0 | -129.7 | -377.9 | — | 11.1 | 8.1 |
| Merck & Co Inc MRK USA | 42,237 USD | -4.1 | -7.2 | 8.0 | -13.1 | 34.0 | 27.5 | 0.1 | -2.0 | 14.0 | 67.0 | -89.1 | 490.3 | 2.6 | — | 14.0 |
| GlaxoSmithKline PLC GSK USA | 23,006 USD | -13.2 | 3.9 | 1.5 | -39.1 | 78.5 | 1.7 | -15.0 | -4.3 | 2.2 | -43.0 | 71.5 | -45.2 | 4.9 | — | — |
| Abbott Laboratories ABT USA | 20,247 USD | -7.3 | 3.7 | 4.8 | -10.1 | 31.8 | 13.0 | -7.5 | 39.8 | 10.0 | -340.4 | 171.9 | -59.8 | 56.8 | 5.0 | 5.0 |
| Vertex Pharmaceuticals Inc VRTX USA | 580 USD | -52.1 | 77.7 | 173.7 | 221.7 | -35.5 | -339.5 | 140.3 | -45.4 | -459.3 | -887.9 | -25.5 | -242.9 | — | — | — |
| Average | | -16.1 | 15.2 | 39.0 | 28.4 | 25.3 | -57.4 | 24.1 | -2.7 | -85.0 | -242.1 | -0.2 | -47.1 | 21.4 | 8.1 | 9.0 |
| **Gilead Sciences Inc GILD US** | **24,891** USD | **122.2** | ***17.7*** | ***-8.1*** | **237.4** | ***22.7*** | ***-11.1*** | **274.2** | ***27.9*** | ***-6.9*** | **286.9** | ***27.2*** | ***3.3*** | **—** | **—** | ***40.0*** |

# Gilead Sciences Inc GILD (NAS) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Industry Group |
|---|---|---|---|---|---|---|---|---|
| 113.96 USD | 114.00 USD | 79.80 USD | 153.90 USD | Medium | Wide | Stable | Exemplary | Biotechnology |

## Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

### Profitability Analysis

| | | Gross Margin % | | | EBITDA Margin % | | | Operating Margin % | | | Net Margin % | | | Free Cash Flow Margin % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Net Income (Mil) | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* |
| Pfizer Inc PFE USA | 14,587 USD | 80.7 | *81.1* | *80.5* | 38.4 | *43.3* | *43.2* | 27.2 | *32.8* | *33.9* | 29.4 | *28.9* | *28.9* | 31.6 | *25.0* | *25.4* |
| Merck & Co Inc MRK USA | 10,215 USD | 60.3 | *75.4* | *75.9* | 31.9 | *37.6* | *39.6* | 16.0 | *23.1* | *27.3* | 24.2 | *24.9* | *26.1* | 15.5 | *28.7* | *25.1* |
| GlaxoSmithKline PLC GSK USA | 4,584 USD | 68.2 | *68.9* | *68.8* | 22.1 | *33.8* | *33.5* | 15.6 | *26.9* | *26.9* | 19.9 | *17.7* | *17.5* | 17.3 | *14.5* | *19.1* |
| Abbott Laboratories ABT USA | 2,328 USD | 54.5 | *57.0* | *58.0* | 19.3 | *22.4* | *23.0* | 11.7 | *14.8* | *16.0* | 11.5 | *15.4* | *16.1* | 8.6 | *9.9* | *14.7* |
| Vertex Pharmaceuticals Inc VRTX USA | -511 USD | 93.2 | *92.1* | *92.0* | -99.6 | *-33.4* | *37.8* | -110.5 | *-40.1* | *35.1* | -88.1 | *-27.5* | *36.2* | -97.2 | *-38.2* | *31.1* |
| Average | | 71.4 | *74.9* | *75.0* | 2.4 | *20.7* | *35.4* | -8.0 | *11.5* | *27.8* | -0.6 | *11.9* | *25.0* | -4.8 | *8.0* | *23.1* |
| **Gilead Sciences Inc GILD US** | **13,315** USD | **84.8** | ***85.9*** | ***85.8*** | **65.6** | ***67.2*** | ***65.3*** | **61.3** | ***63.9*** | ***61.8*** | **53.5** | ***55.5*** | ***54.3*** | **49.3** | ***47.9*** | ***54.0*** |

### Leverage Analysis

| | | Debt/Equity % | | | Debt/Total Cap % | | | EBITDA/Interest Exp. | | | Total Debt/EBITDA | | | Assets/Equity | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Total Debt (Mil) | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* |
| Pfizer Inc PFE USA | 36,682 USD | 51.5 | *50.2* | *46.9* | 34.0 | *33.4* | *31.9* | 14.0 | *22.5* | *26.2* | 1.9 | *1.6* | *1.5* | 2.4 | *2.4* | *2.3* |
| Merck & Co Inc MRK USA | 21,403 USD | 44.0 | *64.5* | *59.9* | 30.6 | *39.2* | *37.4* | 18.4 | *18.4* | *15.6* | 1.6 | *1.9* | *1.6* | 2.0 | *2.3* | *2.2* |
| GlaxoSmithKline PLC GSK USA | 18,784 USD | 440.6 | *2,412.3* | *-3,374.2* | 81.5 | *96.0* | *103.1* | 7.0 | *12.2* | *13.8* | 3.7 | *2.3* | *2.3* | 9.5 | *46.7* | *-63.1* |
| Abbott Laboratories ABT USA | 7,845 USD | 36.4 | *31.9* | *27.6* | 26.7 | *24.2* | *21.6* | 24.9 | *25.9* | *27.9* | 2.0 | *1.5* | *1.3* | 1.9 | *1.7* | *1.7* |
| Vertex Pharmaceuticals Inc VRTX USA | 295 USD | 27.4 | *48.6* | *19.9* | 21.5 | *32.7* | *16.6* | -7.9 | *-4.7* | *14.6* | -0.5 | *-0.8* | *0.3* | 2.2 | *3.1* | *1.9* |
| Average | | 120.0 | *521.5* | *-644.0* | 38.9 | *45.1* | *42.1* | 11.3 | *14.9* | *19.6* | 1.7 | *1.3* | *1.4* | 3.6 | *11.2* | *-11.0* |
| **Gilead Sciences Inc GILD US** | **17,668** USD | **173.9** | ***99.7*** | ***40.2*** | **63.5** | ***49.9*** | ***28.7*** | **39.6** | ***37.5*** | ***34.1*** | **1.1** | ***0.9*** | ***0.7*** | **3.4** | ***2.4*** | ***1.6*** |

### Liquidity Analysis

| | | Cash per Share | | | Current Ratio | | | Quick Ratio | | | Cash/Short-Term Debt | | | Payout Ratio % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Market Cap (Mil) | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* | 2014 | *2015(E)* | *2016(E)* |
| Pfizer Inc PFE USA | 209,915 USD | 5.62 | *2.72* | *3.14* | 2.67 | *1.92* | *2.07* | 2.41 | *1.65* | *1.78* | 7.03 | *3.78* | *4.32* | 55.7 | *62.1* | *57.3* |
| Merck & Co Inc MRK USA | 166,660 USD | 5.37 | *4.91* | *5.11* | 1.77 | *1.70* | *1.70* | 1.47 | *1.51* | *1.51* | 5.81 | *6.68* | *6.03* | 43.4 | *100.1* | *73.7* |
| GlaxoSmithKline PLC GSK USA | 102,782 USD | 0.92 | *1.20* | *1.02* | 1.10 | *1.25* | *1.18* | 0.79 | *0.94* | *0.86* | 1.50 | *1.88* | *1.58* | 139.4 | *120.4* | *100.8* |
| Abbott Laboratories ABT USA | 72,130 USD | 2.66 | *3.94* | *3.93* | 1.66 | *3.03* | *3.21* | 1.36 | *2.61* | *2.77* | 0.92 | *5.03* | *6.77* | 62.9 | *55.9* | *51.5* |
| Vertex Pharmaceuticals Inc VRTX USA | 31,042 USD | 5.89 | *3.26* | *6.13* | 4.20 | *2.98* | *4.41* | 4.12 | *2.79* | *4.01* | 97.64 | — | — | — | — | — |
| Average | | 4.09 | *3.21* | *3.87* | 2.28 | *2.18* | *2.51* | 2.03 | *1.90* | *2.19* | 22.58 | *4.34* | *4.68* | 75.4 | *84.6* | *70.8* |
| **Gilead Sciences Inc GILD US** | **167,476** USD | **7.12** | ***11.52*** | ***15.55*** | **3.35** | ***2.26*** | ***6.03*** | **3.11** | ***2.06*** | ***5.62*** | **24.28** | ***2.69*** | — | — | ***13.6*** | ***20.6*** |

# Research Methodology for Valuing Companies

**Components of Our Methodology**

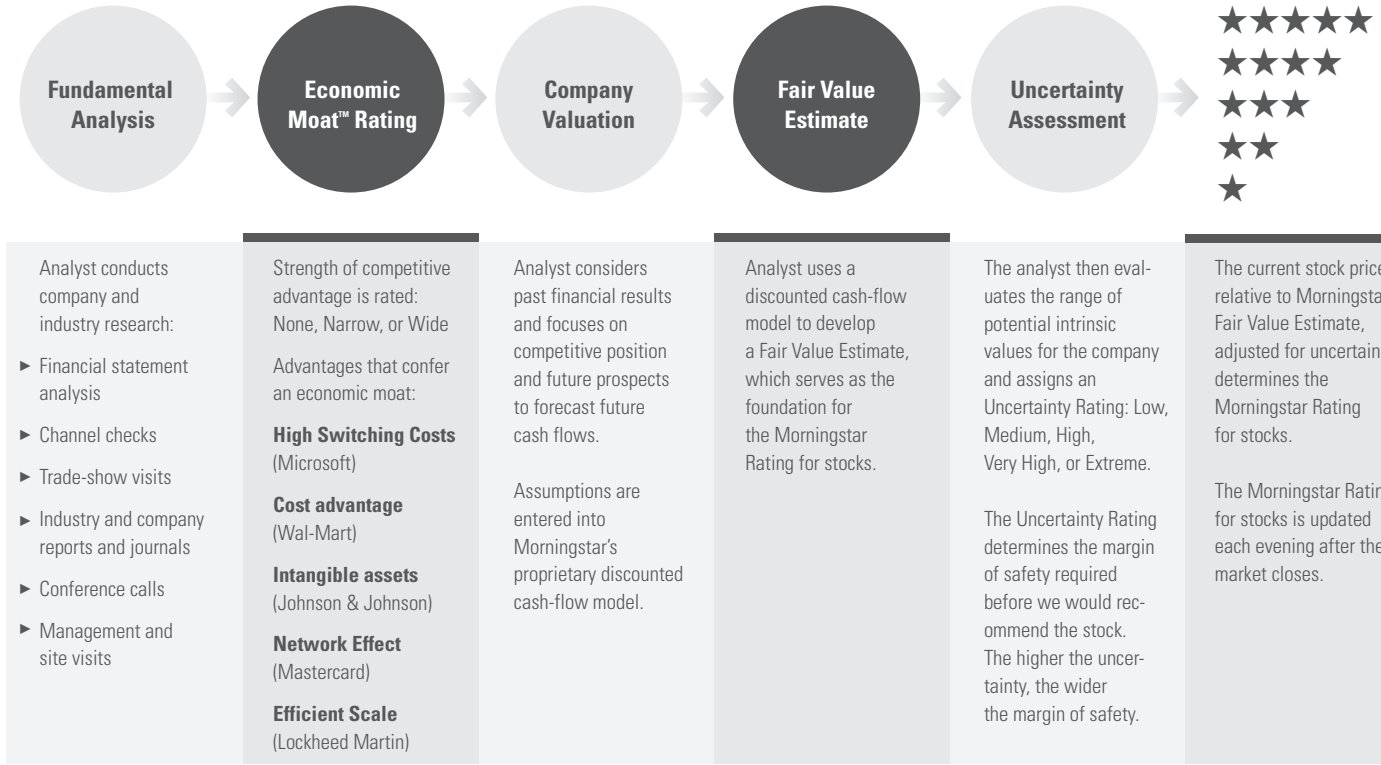
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

**Morningstar Research Methodology for Valuing Companies**



# Research Methodology for Valuing Companies

**Detailed Methodology Documents and Materials***

- ► Comprehensive Equity Research Methodology
- ► Uncertainty Methodology
- ► Cost of Equity Methodology
- ► Morningstar DCF Valuation Model
- ► Stewardship Rating Methodology

* Please contact a sales representative for more information.

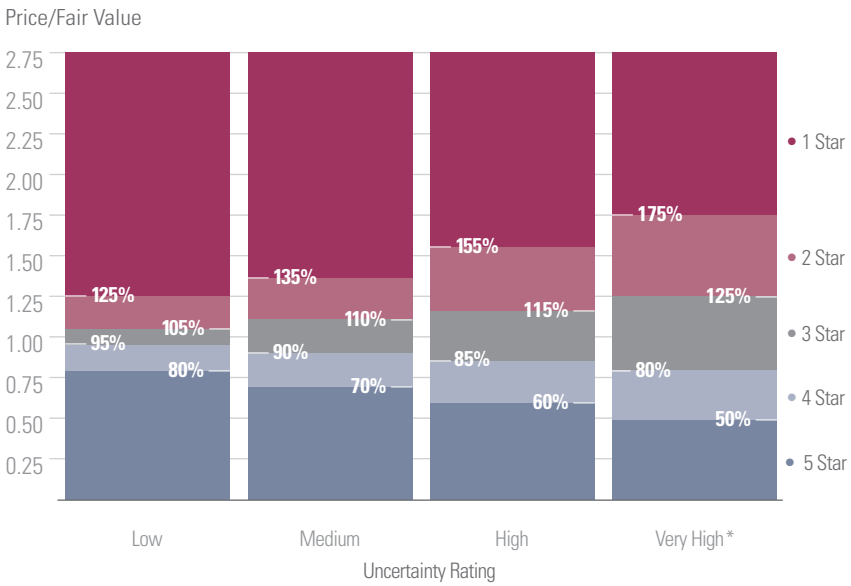
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

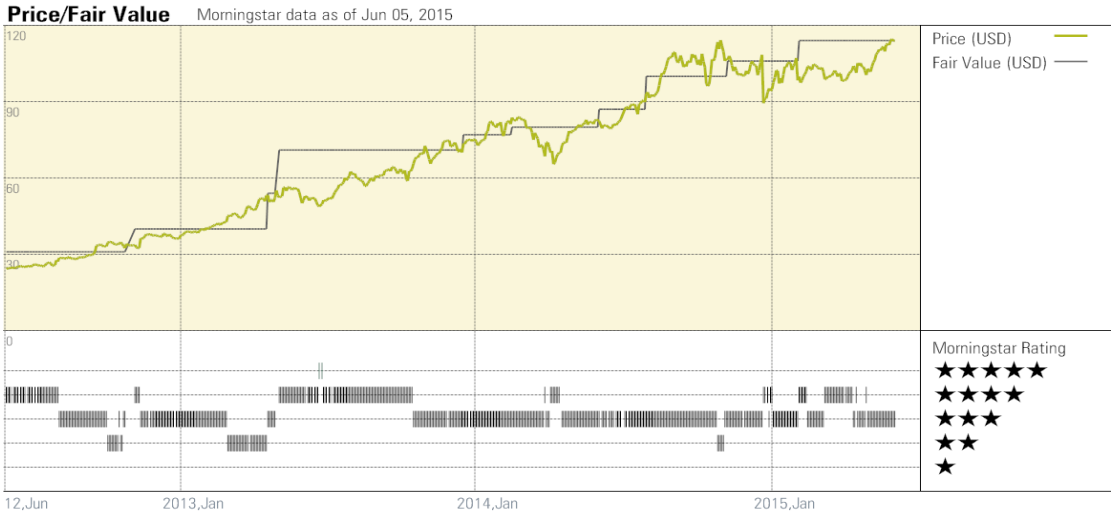
**Morningstar Margin of Safety and Star Rating Bands**




* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

# Gilead Sciences Inc GILD (NAS) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Industry Group |
|---|---|---|---|---|---|---|---|---|
| 113.96 USD | 114.00 USD | 79.80 USD | 153.90 USD | Medium | Wide | Stable | Exemplary | Biotechnology |



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# Gilead Sciences Inc GILD (NAS) | ★★★

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