

# Harvard Stock Pitch Competition

**Company:** Gilead Sciences   **Current Stock Price:** \$76.21   **Recommendation:** Strong Buy  
**Stock Ticker:** GILD

## Company Background:

Gilead Sciences was founded almost three decades ago as a biopharmaceutical company focusing on the development of treatments for life-threatening diseases. After an initial IPO valuing the company at \$86 million, Gilead grew enormously to its current market capitalization of \$97.6 billion in the space of 24 years. The company's most recent successes have been a result of their sophisticated Hepatitis C treatment lines, which were introduced in 2013 and quickly dominated a previously untapped market. However, Gilead also spends a considerable portion of their research budget on developing treatments for cardiovascular, pulmonary, oncological, liver, and retroviral diseases. Most notably, the company currently receives roughly 40% percent of their annual revenue from HIV treatment related drug lines, a market Gilead dominates.

## Industry Background:

In recent times, increasing costs of research and development combined with regulatory pressures on profit margins globally have forced the major players in the biopharmaceutical industry to an unprecedented amount of activity in mergers and acquisitions. The need for synergies in product development and diversification across many product lines has led the industry to invest more in mergers and acquisitions in the first quarter of 2015 alone than in the entirety of 2014.

Additionally, biopharmaceutical companies across the industry have recently turned to exorbitant price hikes as a means of increasing, or even staying consistent with past revenue generation. As a result, they have come under severe political and regulatory pressure, both domestically and abroad. Both political candidates in the US election have reacted to recent pricing scandals, such as the Mylan EpiPen price hike, with promises of regulatory action that would allow for more competition within the biopharmaceutical industry, leading to a corresponding decrease in projected profit margins.

Even with these considerations, the industry remains healthy with profit margins above 20% on average. Some companies, such as Gilead, generate these massive revenues by specializing in small niche markets with highly inelastic demand for specialized drugs. For instance, Celgene and Biogen, two companies often compared to Gilead, specialize in developing treatments for cancer/inflammatory diseases and neurological disorders, respectively. However, other industry giants, such as Amgen, have achieved massive product diversification to the same effect.

## Investment Thesis:

Recent decline in the revenues generated by Gilead's flagship Hepatitis C drug line, combined with the political pressures on the biopharmaceutical industry have led investors to undervalue Gilead at 6.71 times its earnings. This general sentiment has overlooked Gilead's consistent earnings growth in the last five years, institution of a consistent dividend, and recent mergers and acquisitions that have resulted in increased access to niche, untapped markets ripe for development by Gilead. Considering these factors, we view Gilead Sciences as undervalued and issue a strong buy recommendation for the company's stock.

### Key Profitability Drivers:

- Hepatitis C Products: Gilead's Sovaldi drug line, introduced 2013, quickly dominated the markets and became one of the major drivers of Gilead's profitability. The market's recent undervaluation of Gilead's stock price can be seen as a reaction to a downturn in revenue from this drug line.
- HIV Products: Gilead's Viread pill, an enormously successful, single-pill treatment for HIV, along with other HIV products, currently account for roughly 40% of its annual revenue and are essential to the business.
- Assorted Other Drug Lines: The rest of Gilead's revenue is generated from other products, many of which are in different niche markets explored by the firm's massive investments in research and development.

### Factors For Success:

- Continued Profitability on Existing Drug Lines: Though consumer sentiment has reacted to recent decreases in the revenue from the Hepatitis C drug line, this line and many others continue to produce strong returns for the company that will remain a relevant driver of profitability.
- Mergers and Acquisitions Activity: Recently Gilead has acquired EpiTherapeutics ApS and Nimbus Apollo Inc, while also announcing a partnership with Galapagos NV. These, and other mergers and acquisitions being forecasted by industry analysts, suggest that Gilead is maneuvering its way into new niche markets, which would allow for renewed revenue growth adding to the company's value.

### Financial Summary:

Gilead's balance sheet reflects strong financial health, with the company showing a 103% growth in total assets over the last 3 years to its current \$22.5 billion. The company has no problem covering its liabilities, with a current ratio of 1.6 and debt-to-equity ratio of 1.2.

Additionally, analysis of the income statements reflects a strong growth in the recent history of the company. Gross income has increased by over 200% since 2013, growing from \$9.70 billion to \$22.19 billion. Gilead's profit margin is a 56%, and the company shows significant earnings per share of \$11.35.

### Valuation:

We assumed a 3.77% YoY EBITDA growth rate for the next 5 years. The weighted average cost of capital is 8.2% and the perpetuity growth rate is assumed to be 3.0%. The cash flows are discounted at a rate of 5.2%, yielding a terminal value of **\$178.96**. At the current price, GILD is undervalued by 134.8%, so we recommend the company as a strong buy.

**Table 1. DCF Model Output**

		Total Price Per Share		
		Terminal Perpetuity Growth Rate		
		3.0%	3.5%	4.0%
(WACC)	8.2%	<b>\$178.96</b>	196.57	218.58