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ANALYST QUICK NOTES

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Gilead Sciences Inc. (NGS: GILD: HOLD)
Target Price: NM
David Toung
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Overview

- We highlight GILD today because we want to point out the impact on margins and earnings from declining sales of hep C drugs, which have worsened in 2017 after steep slides in 2016, according to prescription data. We point out heightened risk in the stock, based on our analysis.
- We published a note on March 24 lowering our estimates for adjusted EPS to $8.14 from $10.75 for 2017 establishing a new estimate of $7.45 for 2018, both below consensus.
- Through the first two months of this year, U.S. Harvoni scripts have fallen 42% y/y on the retail side and 52% in the institutional channel, according to Symphony Health Solutions. The institutional channel is much larger than retail channel. By comparison, Harvoni sales fell 43% in 4Q16. Harvoni accounts for 30% of Gilead's product revenue.
- We point out that the prescription data does not include pricing data. Harvoni ASPs have eroded every year since 2015. The ASP was about $31,000 for a 28-day supply when the drug was launched in 4Q14 and fell to $15,000 in 2016, with prices in certain public programs such as Medicaid and federal 340B programs below $10,000. We see additional erosion in 2017.
- When we combine falling prescriptions with price erosion, we can see Harvoni sales declining more than 50% in 1Q17.
- The falloff in prescriptions is even steeper for Sovaldi, another hep C product from Gilead.
- We had anticipated that the 3Q16 launch of Epclusa, a pan-genotypic version of Gilead's hep C drug, would offset the declines in Harvoni and Sovaldi, but Epclusa scripts seem to have peaked in 4Q16 and are declining so far this year.
- We see greater pressure on the operating margin as Gilead is increasing its spend on SG&A (to support marketing for its HIV drugs) and on R&D (as its key pipeline drugs in immunology and NASH are in Phase III trials). If approved, the new drugs are not likely to be launched until late 2019 or in 2020.
- So why we do we not find the valuation attractive in a stock that trades at 9.1-times our 2018 EPS estimate? Because we see more downside risk to hep C sales, margins and EPS.

- Could GILD use M&A to pull itself out of this situation? Hep C sales represented almost 50% of revenue ($14.8 billion) in 2016. Any acquisition that could offset the hep C decline would have to be a huge deal and at big price tag (>$50 billion), with a lot of deal and integration risk.
- When we have access to prescription data for 2017 through the first two weeks of March and will can update our findings accordingly.
