

COMPANY UPDATE

Gilead Sciences Inc. (GILD)

Neutral

Equity Research

hepC pricing pressure steeper than expected; cutting estimates**What's changed**

GILD reported 4Q14 revenue of \$7.3 bn ahead of GS/consensus of \$6.8 bn/\$6.7 bn and 4Q14 EPS of \$2.43 vs. GS/consensus of \$2.35/\$2.21. Total hepC sales in 4Q14 were \$3.8 bn (\$1.7 bn Sovaldi and \$2.1 bn Harvoni) ahead of GS/consensus of \$3.7 bn/\$3.5 bn. GILD provided 2015 sales guidance of \$26-27 bn vs. GS new/GS prior/consensus of \$26.3 bn/\$28.1 bn/ \$27.9 bn, R&D was \$3.0-3.3 bn (GS new/prior of \$3.2 bn/\$2.88 bn), SG&A was \$3.0-3.3 bn (GS new/prior/consensus \$3.2 bn/\$2.86 bn), gross margin was 87%-90% and tax rate was 18%-20%. We are updating our EPS estimates to reflect 4Q trends and guidance.

Implications

HepC pricing dynamics surprise to the downside. GILD guided to a 46% gross-to-net on US hepC pricing in 2015 (vs. 22% in 2014) given recent PBM contracts and a mix shift to more government vs. private. While increased volumes are likely to offset some of this, we lower our 2015+ estimates by \$2bn. **GILD became the second biotech company to issue a dividend**, beginning in 2Q15 (\$1.72/share on an annual basis), which equates to a 1.6% yield. While we believe this could be well received by many investors (some had viewed it as a proxy for sustainability of hepC), we note that when weighed against the pricing dynamics we do not believe it is enough to change the debate on the tail. **Finally, GILD reported that there was no signal for Simtuzumab** in two additional Ph2 indications (myelofibrosis and colon cancer). While there are ongoing Ph2 trials (NASH and IPF) expectations are likely to remain low.

Valuation

Our 12-month price target goes to \$85 from \$96 and is based on a DCF assuming a WACC of 8% and a terminal growth rate of 0%.

Key risks

Upside risks: faster sales/earnings growth; higher terminal value.

Downside risks: disappointing hepC sales; competition

INVESTMENT LIST MEMBERSHIP

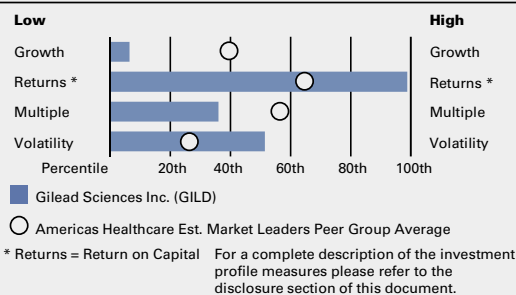
Neutral

Coverage View: Neutral

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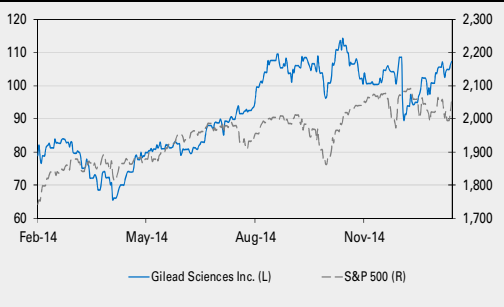
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Investment Profile**Key data**

	Current
Price (\$)	107.18
12 month price target (\$)	85.00
Market cap (\$ mn)	171,059.3

	12/14	12/15E	12/16E	12/17E
Revenue (\$ mn) New	24,889.7	26,764.5	25,667.3	25,361.7
Revenue (\$ mn) Old	24,388.5	28,565.0	27,646.7	27,778.4
EPS (\$ New)	8.09	8.83	9.12	9.84
EPS (\$ Old)	8.02	10.41	10.83	11.89
P/E (X)	11.1	12.1	11.7	10.9
EV/EBITDA (X)	7.9	8.3	8.1	7.1
ROE (%)	100.0	78.4	67.5	57.7

	12/14	3/15E	6/15E	9/15E
EPS (\$)	2.43	2.15	2.21	2.24

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	(2.5)	17.1	36.0
Rel. to S&P 500	(4.1)	10.0	15.5

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 2/03/2015 close.

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Gilead Sciences Inc.: Summary Financials

Profit model (\$ mn)	12/14	12/15E	12/16E	12/17E	Balance sheet (\$ mn)	12/14	12/15E	12/16E	12/17E
Total revenue	24,889.7	26,764.5	25,667.3	25,361.7	Cash & equivalents	10,442.9	15,097.8	13,479.6	21,532.1
Cost of goods sold	(2,964.3)	(3,113.2)	(3,052.9)	(3,026.8)	Accounts receivable	3,611.0	3,525.3	3,409.0	3,395.8
SG&A	(2,756.6)	(3,211.7)	(3,208.4)	(3,170.2)	Inventory	2,310.7	2,088.8	2,019.9	2,012.1
R&D	(2,585.1)	(3,211.7)	(3,080.1)	(2,967.3)	Other current assets	1,507.4	1,479.6	1,471.0	1,470.0
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	17,872.1	22,191.6	20,379.5	28,409.9
ESO expense	(356.0)	(450.0)	(428.1)	(427.3)	Net PP&E	1,595.8	1,872.0	2,101.9	2,302.4
EBITDA	17,624.8	18,273.1	17,369.5	17,203.0	Net intangibles	11,084.0	10,236.9	9,418.0	8,664.5
Depreciation & amortization	(1,041.1)	(1,045.3)	(1,043.6)	(1,005.7)	Total investments	1,375.4	1,375.4	1,375.4	1,375.4
EBIT	16,583.7	17,227.8	16,326.0	16,197.4	Other long-term assets	2,117.6	1,957.2	1,914.2	1,909.3
Net interest income/(expense)	(411.6)	(277.2)	(204.8)	(108.2)	Total assets	34,045.0	37,633.1	35,188.9	42,661.5
Income/(loss) from associates	0.0	0.0	0.0	0.0	Accounts payable	1,431.4	1,293.9	1,251.2	1,246.4
Others	1.6	0.0	0.0	0.0	Short-term debt	1,477.1	1,477.1	1,477.1	1,477.1
Pretax profits	16,173.6	16,950.7	16,121.2	16,089.2	Other current liabilities	3,395.0	3,395.0	3,395.0	3,395.0
Provision for taxes	(2,901.5)	(3,220.6)	(3,063.0)	(3,056.9)	Total current liabilities	6,303.5	6,166.0	6,123.3	6,118.4
Minority interest	41.9	100.0	100.0	100.0	Long-term debt	11,183.1	10,185.2	8,758.6	8,758.6
Net income pre-preferred dividends	13,314.0	13,830.0	13,158.2	13,132.2	Other long-term liabilities	992.8	992.8	992.8	992.8
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	12,175.9	11,177.9	9,751.4	9,751.4
Net income (pre-exceptionals)	13,314.0	13,830.0	13,158.2	13,132.2	Total liabilities	18,479.3	17,343.9	15,874.7	15,869.8
Post tax exceptionals	(1,212.7)	(1,086.3)	(1,066.7)	(1,066.0)	Preferred shares	0.0	0.0	0.0	0.0
Net income (post-exceptionals)	12,101.3	12,743.7	12,091.5	12,066.2	Total common equity	15,268.2	19,991.8	19,016.8	26,494.4
EPS (basic, pre-except) (\$)	8.75	9.54	9.86	10.64	Minority interest	297.4	297.4	297.4	297.4
EPS (diluted, pre-except) (\$)	8.09	8.83	9.12	9.84	Total liabilities & equity	34,045.0	37,633.1	35,188.9	42,661.5
EPS (basic, post-except) (\$)	7.92	8.79	9.06	9.77	Additional financials				
EPS (diluted, post-except) (\$)	7.35	8.14	8.39	9.05	Net debt/equity (%)	14.2	(16.9)	(16.8)	(42.2)
Common dividends paid	0.0	0.0	0.0	0.0	Interest cover (X)	40.3	31.9	33.5	35.6
DPS (\$)	0.00	0.00	0.00	0.00	Inventory days	268.8	257.9	245.6	243.1
Dividend payout ratio (%)	0.0	0.0	0.0	0.0	Receivable days	41.9	48.7	49.3	49.0
					BVPS (\$)	9.27	12.76	13.19	19.86
Growth & margins (%)	12/14	12/15E	12/16E	12/17E	ROA (%)	47.1	38.6	36.1	33.7
Sales growth	122.2	7.5	(4.1)	(1.2)	CROCI (%)	75.9	74.9	74.5	72.7
EBITDA growth	230.5	3.7	(4.9)	(1.0)	Dupont ROE (%)	85.5	68.2	68.1	49.0
EBIT growth	232.5	3.9	(5.2)	(0.8)	Margin (%)	53.5	51.7	51.3	51.8
Net income (pre-except) growth	285.9	3.9	(4.9)	(0.2)	Turnover (X)	0.7	0.7	0.7	0.6
EPS growth	287.6	9.1	3.3	7.9	Leverage (X)	2.2	1.9	1.8	1.6
Gross margin	88.1	88.4	88.1	88.1	Free cash flow per share (\$)	8.04	9.85	10.75	11.42
EBITDA margin	70.8	68.3	67.7	67.8	Free cash flow yield (%)	9.0	9.2	10.0	10.7
EBIT margin	66.6	64.4	63.6	63.9	Note: Last actual year may include reported and estimated data.				
					Source: Company data, Goldman Sachs Research estimates.				
Cash flow statement (\$ mn)	12/14	12/15E	12/16E	12/17E					
Net income	13,314.0	13,830.0	13,158.2	13,132.2					
D&A add-back (incl. ESO)	1,041.1	1,045.3	1,043.6	1,005.7					
Minority interest add-back	41.9	100.0	100.0	100.0					
Net (inc)/dec working capital	(760.1)	197.9	151.2	17.2					
Other operating cash flow	(866.2)	(424.1)	342.6	299.4					
Cash flow from operations	12,753.8	14,749.1	14,795.6	14,554.5					
Capital expenditures	(519.5)	(474.3)	(454.5)	(452.8)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	(940.2)	0.0	0.0	0.0					
Cash flow from investing	(1,459.7)	(474.3)	(454.5)	(452.8)					
Dividends paid (common & pref)	0.0	(2,006.5)	(2,046.2)	(2,082.1)					
Inc/(dec) in debt	7,965.4	0.0	0.0	0.0					
Other financing cash flows	(10,948.2)	(9,620.0)	(15,959.2)	(6,049.3)					
Cash flow from financing	(2,982.7)	(9,620.0)	(15,959.2)	(6,049.3)					
Total cash flow	8,311.4	4,654.9	(1,618.2)	8,052.4					

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Summary of 4Q14 results and model changes

Exhibit 1: Summary of 4Q14 earnings

In \$ mn, except per share data

	2014						
	4Q14 GS	4Q14 Con	4Q14 Actual	4Q13 Actual	Var Act/GS	Var Act/Con	Y/Y
Atripla	\$858	\$878	\$925	\$934	7.8%	5.3%	-0.9%
Truvada	\$802	\$825	\$897	\$814	11.8%	8.7%	10.2%
Viread	\$253	\$262	\$311	\$267	23.0%	18.8%	16.5%
Complera	\$344	\$346	\$348	\$262	1.2%	0.5%	32.9%
Stribild	\$360	\$351	\$385	\$204	7.1%	9.8%	88.9%
Sovaldi	\$1,896	\$2,040	\$1,732	\$139	-8.6%	-15.1%	1142.2%
Letairis	\$80	\$142	\$181	\$139	126.4%	27.2%	30.7%
Ambisome	\$134	\$95	\$144	\$130	7.3%	51.1%	10.8%
Ranexa	\$87	\$130	\$104	\$94	18.9%	-20.1%	11.1%
Net product sales	\$6,716	\$6,545	\$7,222	\$3,043	7.5%	10.3%	137.3%
Royalty & contract revenue	\$97	\$86	\$92	\$77	-5.1%	7.6%	20.0%
Total revenue	\$6,813	\$6,724	\$7,314	\$3,120	7.4%	11.7%	134.4%
COGS	\$672	\$854	\$847	\$777	26.1%	-0.9%	8.9%
R&D	\$647	\$660	\$899	\$512	38.9%	36.2%	75.6%
SG&A	\$783	\$769	\$799	\$471	2.0%	3.9%	69.7%
Operating income	\$4,710	\$4,449	\$4,769	\$1,359	1.2%	7.2%	250.8%
Income tax	\$833	\$780	\$811	\$351	-2.7%	3.9%	131.3%
Non-GAAP net income	\$3,804	\$3,542	\$3,883	\$929	2.1%	9.6%	317.9%
Non-GAAP diluted EPS	\$2.35	\$2.23	\$2.43	\$0.55	3.6%	9.1%	343.3%

Source: Company data, FactSet, Goldman Sachs Global Investment Research.

Changes to our GILD model

We are updating our model for 4Q14 results, current trends and guidance. In particular we are lowering our hepC sales estimates given management commentary around higher than anticipated gross to net in the US in 2015. We now model 46% gross to net vs. prior 15% and this is partially offset by increased volume (275K patients treated in the US vs. prior 200K in 2015).

We are also increasing our opex estimates in 2015 through 2017 given higher than anticipated 2015 expense guidance and current trends. Our tax rate assumptions are also higher at 19% from 16% for 2015-2018 based on GILD guidance of 18% to 20%.

We are also including in our estimates an announced quarterly dividend of \$0.43/share starting in 2Q15. We model 10% annual growth.

As a result of these changes our 2015/16/17/18 EPS estimates change to \$8.83/\$9.12/\$9.84/\$9.12 from \$10.41/\$10.83/\$11.89/\$10.81.

Our 12-month price target decreases to \$85 from \$96 reflecting these changes and is based on a DCF assuming an 8% WACC and 0% terminal growth rate.

Exhibit 2: Changes to our GILD model

In \$mn, except per share data

	2015			2016			2017			2018		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
Atripla	\$3,476	\$3,376	(\$100)	\$3,572	\$3,246	(\$326)	\$3,416	\$3,132	(\$284)	\$2,044	\$2,070	\$26
Truvada	\$2,997	\$3,150	\$153	\$2,638	\$2,931	\$292	\$2,453	\$2,668	\$215	\$1,335	\$1,305	(\$30)
Viread	\$958	\$963	\$5	\$954	\$878	(\$77)	\$833	\$788	(\$46)	\$549	\$580	\$31
Emtriva	\$28	\$28	(\$1)	\$21	\$21	(\$1)	\$22	\$21	(\$1)	\$23	\$23	(\$1)
Complera	\$1,617	\$1,523	(\$94)	\$1,823	\$1,838	\$15	\$2,134	\$2,049	(\$84)	\$1,811	\$1,811	\$0
Stribild	\$1,771	\$1,732	(\$39)	\$2,366	\$2,315	(\$51)	\$2,515	\$2,460	(\$55)	\$2,576	\$2,517	(\$59)
TAF Quad	\$14	\$14	-	\$381	\$381	-	\$904	\$904	-	\$1,498	\$1,498	-
TAF Complera	\$0	\$0	-	\$0	\$0	-	\$13	\$13	-	\$161	\$161	-
TAF Prezista FDC	\$0	\$0	-	\$0	\$0	-	\$0	\$0	-	\$145	\$145	-
Elvitegravir	\$32	\$31	(\$1)	\$49	\$48	(\$1)	\$69	\$68	(\$1)	\$76	\$75	(\$1)
Idelalisib	\$100	\$100	-	\$300	\$300	-	\$600	\$600	-	\$800	\$800	-
Hepsera	\$47	\$41	(\$6)	\$29	\$25	(\$4)	\$13	\$10	(\$3)	\$12	\$9	(\$3)
Sovaldi	\$4,653	\$4,360	(\$293)	\$5,409	\$4,928	(\$481)	\$5,817	\$5,132	(\$685)	\$5,369	\$4,629	(\$740)
Harvoni	\$10,862	\$9,312	(\$1,550)	\$8,662	\$7,266	(\$1,396)	\$7,928	\$6,417	(\$1,511)	\$7,451	\$5,838	(\$1,613)
Sovaldi/Sovaldi combo	\$15,515	\$13,672	(\$1,843)	\$14,070	\$12,193	(\$1,877)	\$13,745	\$11,549	(\$2,196)	\$12,820	\$10,467	(\$2,353)
Letairis	\$469	\$565	\$96	\$117	\$141	\$24	\$59	\$71	\$12	\$59	\$71	\$12
Ambisome	\$440	\$450	\$10	\$183	\$188	\$4	\$37	\$38	-	\$35	\$36	-
Ranexa	\$499	\$517	\$18	\$524	\$543	\$19	\$545	\$565	\$20	\$550	\$570	\$20
Other	\$180	186	\$7	\$198	205	\$7	\$212	219	8	\$222	230	8
Net product sales	\$28,144	\$26,349	(\$1,796)	\$27,226	\$25,252	(\$1,974)	\$27,568	\$25,154	(\$2,414)	\$24,717	\$22,368	(\$2,349)
Royalty & contract revenue	\$421	\$416	(\$5)	\$421	\$416	(\$5)	\$210	\$208	(\$2)	\$210	\$208	(\$2)
Total revenue	\$28,565	\$26,764	(\$1,801)	\$27,647	\$25,667	(\$1,979)	\$27,778	\$25,362	(\$2,417)	\$24,927	\$22,576	(\$2,351)
COGS	\$3,173	\$3,113	(\$60)	\$3,155	\$3,053	(\$102)	\$3,108	\$3,027	(\$81)	\$2,457	\$2,348	(\$109)
Gross profit	\$25,392	\$23,651	(\$1,741)	\$24,492	\$22,614	(\$1,877)	\$24,671	\$22,335	(\$2,336)	\$22,470	\$20,228	(\$2,242)
R&D	\$2,881	\$3,212	\$330	\$2,931	\$3,080	\$150	\$2,987	\$2,967	(\$19)	\$3,116	\$2,822	(\$294)
SG&A	\$2,857	\$3,212	\$355	\$2,875	\$3,208	\$333	\$2,861	\$3,170	\$309	\$2,941	\$3,161	\$219
Operating income	\$19,654	\$17,228	(\$2,426)	\$18,686	\$16,326	(\$2,360)	\$18,823	\$16,197	(\$2,626)	\$16,413	\$14,245	(\$2,168)
Non-GAAP net income	\$16,290	\$13,830	(\$2,460)	\$15,611	\$13,158	(\$2,453)	\$15,850	\$13,132	(\$2,718)	\$13,825	\$11,671	(\$2,154)
Diluted shares outstanding	1565	1566	1	1441	1442	1	1333	1334	1	1279	1280	1
Non-GAAP diluted EPS	\$10.41	\$8.83	(\$1.58)	\$10.83	\$9.12	(\$1.71)	\$11.89	\$9.84	(\$2.04)	\$10.81	\$9.12	(\$1.69)

Source: Goldman Sachs Global Investment Research.

Exhibit 3: GILD catalyst calendar

Timing	Drug	Event
1Q15	Zydelig	Initiate Phase 2 frontline NHL trial
1Q15	GS-5745	Phase 1 data for ulcerative colitis, gastric cancer and pancreatic cancer
April 2015	Sovaldi triple/quad	Short duration data at EASL
2015	Simtuzumab	Top-line Phase 2 data in PSC
2015	GS-4774	Phase 2 data in HBV
2015	Sovaldi	Potential Japanese approval - GT2
2H15	GS-9883	Initiate Phase 2 study
2015	Harvoni	Potential Japanese approval - GT1
3Q15	Sovaldi/GS-5816	Phase 3 data
2H15	GS-9857/Sovaldi/GS-5816	Phase 2 data
Nov 5, 2015	TAF (GS-7340)	FDA decision for TAF Quad
2015	Ranexa	Top-line data from Phase 3 PCI study
4Q15	Simtuzumab	Interim 48-week NASH Phase 2
4Q15	TAF (GS-7340)	File TAF Complera NDA
2016	Simtuzumab	Phase 2 data in PSC
2016	TAF (GS-7340)	Phase 3 TAF Complera data
2018	Simtuzumab	Phase 2 data in IPF

Source: Company data, Goldman Sachs Global Investment Research.

Disclosure Appendix

Reg AC

We, Terence Flynn, Uya Chuluunbaatar and Irene Lau, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

Quantum

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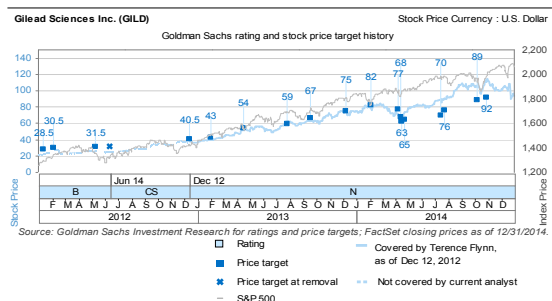
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Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
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Price target and rating history chart(s)



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