

Gilead Sciences

4Q Snapshot - Performance Exceeds Expectations
but High Discounting Again Brings Tail into Question

We are reiterating our OW rating on GILD following last night's 4Q report that while strong, wasn't without a curve ball (baseball analogy for those dreaming of *spring* training). Namely, GILD's expectation for the gross-to-net on HCV products to be ~46%, more than double the 22% at the end of 2014, caught just about everyone by surprise. These discounts seem to be largely contingent on increased patient volumes that should help offset the impact in the near term but again call into question the HCV tail. The volume offset is highlighted by 2015 net product sales guidance of \$26-27B vs. our previous \$26.7B estimate. Assuming patient volumes do in fact make up for discounts (even if not completely), the bottom line is that GILD's HCV business will still be a *significant* source of revenue and earnings growth as well as cash flow generation. The key question in our minds remains how GILD leverages HCV into the next phase of the company's evolution. On that front GILD was clear that its newly announced dividend and aggressive share repo program won't impact its appetite for BD/pipeline investment.

- **Key update #1: 2015 HCV gross-to-net expected to be ~46%...prompting emphasis on increased patient volumes.** The more than doubling in discounting is driven by both negotiations with payors and a higher % of public payor patients (with rebates to Medicaid and the VA exceeding 50%). GILD emphasized this level of discounting is designed to increase patient access and believes there is the capacity to treat 250K+ pts (all genotypes) in the US in 2015. On payor negotiation progress, GILD indicated ~60% of covered lives in the US have been negotiated, and estimates 80% of these covered patients have access to GILD products. It also indicated that it is confident that terms negotiated thus far will last through the year.
- **Key update #2: GILD announces a \$0.43/sh dividend and a new \$15B buyback program.** After much debate/speculation on the issue, GILD will begin paying a dividend equal to \$1.72/sh annually, representing an ~1.6% yield. GILD intends to grow it over time, but still views repurchases as the larger component of the capital return strategy for the time being. Nevertheless, we expect this dividend to broaden GILD's investor base. There is ~\$3B remaining under the current \$5B repurchase program (approved last May), and GILD announced a new \$15B program (good for 5 yrs after completion of May'14 program). GILD reiterated the level at which it repurchases shares has more to do with valuation (vs. targeting a specific payout ratio).

Overweight

GILD, GILD US

Price: \$107.18

▼ **Price Target: \$116.00**
Previous: \$117.00

Biotechnology

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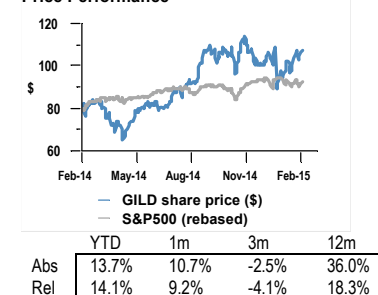
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Price Performance



Gilead Sciences, Inc. (GILD;GILD US)

FYE Dec	2013A	2014A	2015E (Prev)	2015E (Curr)	2016E (Prev)	2016E (Curr)
EPS Reported (\$)						
Q1 (Mar)	0.48	1.48	-	-	-	-
Q2 (Jun)	0.50	2.36	-	-	-	-
Q3 (Sep)	0.52	1.84	-	-	-	-
Q4 (Dec)	0.55	2.43	-	-	-	-
FY	2.05	8.10	9.05	8.21	10.39	9.67
Bloomberg EPS FY (\$)	2.00	7.88	-	9.80	-	10.65

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data

Price (\$)	107.18
Date Of Price	03 Feb 15
52-week Range (\$)	116.83-63.50
Market Cap (\$ mn)	161,698.60
Fiscal Year End	Dec
Shares O/S (mn)	1,509
Price Target (\$)	116.00
Price Target End Date	31-Dec-15

See page 8 for analyst certification and important disclosures.

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- **4Q14 Non-GAAP EPS of \$2.43 was meaningfully ahead of JPMe/cons of \$2.23/\$2.21.** Total revenue of \$7.3B was ahead of JPMe/Bloomberg cons of \$6.8B/\$6.7B; 4Q total product sales of \$7.2B were ahead of JPMe/cons of \$6.7/\$6.6B. Sovaldi sales of \$1.73B vs. JPMe of \$1.94B and Harvoni sales of \$2.1B vs. JPMe of \$1.57B. On Harvoni uptake, the co noted that 7 of 10 HCV pts initiating treatment in 4Q started on Harvoni. Total non-GAAP OpEx was \$2.5B vs. JPMe/company cons of \$2.2B. See the variance table on p.3 for more details.
- **2015 product rev guidance brackets our previous estimate, highlighting the price vs. volume relationship.** GILD provided 2015 guidance for net product revs of \$26-27B vs. JPMe of \$26.7B and a non-GAAP gross margin of 87-90% vs. JPMe of 88%. On expenses, GILD guided to R&D expense of \$3-3.3B, SG&A expense of \$3-3.3B, and a non-GAAP effective tax rate of 18-20% vs. JPMe of 19%.
- **Updating model:** We updated our model for 4Q results, 2015 guidance, and the dividend. See the summary of key changes on p.4 for a more detailed overview. Overall, the biggest changes to our model came from increased gross-to-net on HCV revenues (to 46% from 22% in 2015), which was partially offset by increased patient volume assumptions (we now assume ~220K pts treated in the US in 2015 vs. ~175K prvsly). Our peak HCV sales estimate is now \$15B in 2016 vs. 16.5B in 2017 prvsly. We also increased expense assumptions in 2015 based on company guidance/commentary around pipeline advancement. On valuation basis, the net effect of our changes was relatively modest, and we are lowering our FY15 price target to \$116 vs. \$117.
- **Balance sheet update.** GILD ended 4Q with \$11.7B in cash and investments and ~\$13B in debt. During the quarter GILD generated \$12.8B in operating cash flow, and used \$5.3B for share repurchases. Based on our updated model, we expect GILD to generate ~\$30B in cash over the next 3 years and ~\$60B over the next 5 years. We continue to believe this unprecedented CF generation in the biotech industry gives the company significant strategic flexibility.
- **Upcoming events: continued focus on HCV market dynamics, with HCV next-gen regimen data updates coming at EASL.** We expect HCV Rx trends, quarterly reports, and payer updates will all continue to be significant drivers in 2015. Also in the HCV world, we expect approval of Sovaldi and Harvoni in Japan in 1H15. On a pipeline front, we should see some data from the 9857/5816/sof triple regimen for 4 or 6 weeks in April at EASL (4/22-26, Vienna), and we anticipate top-line Phase 3 data from 5816/sof in 3Q15. We expect regulatory filings to expand Harvoni's label into GT3 and also look for the addition of the 12wk+RBV regimen for cirrhotic patients in 2H. In HBV, we anticipate top-line Phase 1 data of GS-4774 in 1H15. In HIV, we expect filings for F/TAF in 2Q and anticipate approval of E/C/F/TAF in the US in 4Q15. Top-line data from simtuzumab in NASH and PFC is anticipated in 4Q15.

Variance Table

Figure 1: GILD 4Q14 Variance

	4Q14			
	Actual	JPMe	Consensus	delta vs. cons
Sovaldi	\$1,732	\$1,936	\$2,000	-\$268
Harvoni	\$2,107	\$1,566	\$1,500	\$607
Atripla	\$925	\$905	\$859	\$66
Truvada	\$897	\$894	\$813	\$84
Complera/Eviplera	\$348	\$354	\$342	\$6
Stribild	\$385	\$349	\$348	\$37
Viread	\$311	\$270		
Zydelig	\$17	\$14		
Total Product Revenues	\$7,222	\$6,736	\$6,634	\$588
Total Revenues	\$7,314	\$6,811	\$6,742	\$572
Non-GAAP COGS	\$847	\$882	\$862	-\$15
Non-GAAP R&D	\$899	\$600	\$639	\$260
Non-GAAP SG&A	\$799	\$711	\$748	\$51
Non-GAAP OpEx	\$2,545	\$2,193	\$2,249	\$296
Non-GAAP Net Income	\$3,883	\$3,642	\$3,555	\$328
Non-GAAP Diluted EPS	\$2.43	\$2.23	\$2.21	\$0.22

Source: Company reports and J.P. Morgan estimates, Bloomberg, Factset.

JPM Model Changes

Figure 2: Changes to our Model

	2015E (us\$m)		2016E (us\$m)	
	old	new	old	new
Revenues:				
Sovaldi	6,714	6,309	6,649	6,314
Harvoni	7,130	6,749	9,058	8,605
Atripla	3,246	3,138	2,960	2,849
Truvada	3,290	3,323	2,765	2,857
Complera/Eviplera	1,512	1,514	1,725	1,742
Stribild	1,773	1,773	1,900	1,900
Viread	1,042	1,064	1,085	1,109
Zydelig	223	226	519	519
Total Product Revenues	26,700	26,093	29,524	29,128
Total Revenues	27,093	26,574	29,921	29,614
Non-GAAP Expenses:				
COGS	3,204	3,257	3,543	3,636
R&D	2,380	3,261	2,407	3,359
SG&A	2,809	3,271	2,841	3,369
non-GAAP Net Income	14,791	13,382	16,785	15,428
non-GAAP EPS	9.05	8.21	10.39	9.67

Source: Company reports and J.P. Morgan estimates.

Upcoming Events

Figure 3: GILD Upcoming Events

Anticipated Newsflow Highlights

Program	Event	Expected Timing	Significance
HIV/AIDS	Potential Approval for E/C/F/TAF	2H15	Medium
Liver Disease	Phase 2 data from 9857/5816/sof 4 and 6wk trials	2Q15	High
	Top line Phase 3 Data from 5816/sofosobuvir trials	3Q15	High
	Potential TAF HBV regulatory filings	2016	Low

Source: Company reports and J.P. Morgan estimates.

Figure 4: GILD Income Statement

Gilead Income Statement

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	2013E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E	2017E	2018E	2019E
Product Sales :											
Sovaldi	139	10,283	1,389	1,445	1,577	1,898	6,309	6,314	6,444	4,855	2,226
Harvoni		2,127	1,410	1,574	1,699	2,066	6,749	8,605	6,674	3,706	2,121
5816/sof		-	-	-	-	-	-	-	1,380	5,607	8,200
Atripla	3,648	3,470	754	810	811	763	3,138	2,849	2,765	2,356	2,250
Truvada	3,136	3,339	844	864	815	800	3,323	2,857	2,156	1,626	494
F/TAF							-	404	789	1,184	1,249
Complera/Eviplera	809	1,228	358	375	383	398	1,514	1,742	1,926	2,117	2,190
Stribild	539	1,198	411	438	453	472	1,773	1,900	1,528	943	899
E/C/F/TAF			-	-	-	-	-	607	1,268	2,510	3,765
Viread	959	1,058	219	255	286	303	1,064	1,109	1,155	-	-
TAF								-	50	130	317
Other	110	88	21	21	22	22	86	84	82	80	78
Total Antiviral	9,341	22,791	5,405	5,782	6,046	6,722	23,956	26,471	26,218	25,115	23,788
Zydlig		23	38	52	61	75	226	519	891	1,242	1,495
Letairis	520	595	172	182	186	195	735	882	1,059	424	339
Ranexa	449	510	124	134	142	156	555	605	658	716	358
Other product sales	494	555	154	155	155	156	620	651	683	718	753
Product Sales	10,804	24,474	5,893.3	6,305.6	6,590.1	7,303.7	26,093	29,128	29,509	28,214	26,734
Royalty, contract and other revenues	398	416	154	146	88	93	481	486	491	496	501
Total Revenues	11,202	24,890	6,047	6,452	6,678	7,396	26,574	29,614	30,000	28,710	27,234
Bloomberg Consensus as of 02/03/2015		24,328	7,209	7,320	7,346	7,379	28,511	30,034	31,392	32,115	31,534
COGS	2,859	3,788	943	993	1,021	1,114	4,071	4,545	4,604	4,402	4,171
R&D	2,120	2,854	892	895	897	900	3,583	3,691	3,802	3,916	4,033
SG&A	1,699	2,983	877	882	886	891	3,536	3,642	3,752	3,864	3,980
Total Operating Expenses	6,678	9,625	2,712	2,769	2,805	2,905	11,191	11,878	12,158	12,182	12,185
Operating Income	4,524	15,265	3,335	3,683	3,873	4,492	15,383	17,736	17,842	16,527	15,050
Interest Expense	(307)	(412)	(127)	(127)	(127)	(127)	(509)	(467)	(467)	(467)	(457)
Other income (expense), net	(9)	3	(5)	(5)	(5)	(5)	(20)	-	-	-	-
Income before taxes	4,208	14,856	3,203	3,550	3,741	4,359	14,854	17,269	17,375	16,060	14,593
Provision for Income Taxes	1,151	2,797	609	675	711	828	2,822	3,281	3,301	3,051	2,919
Net Income	3,057	12,059	2,594	2,876	3,030	3,531	12,032	13,987	14,074	13,009	11,674
Net loss attributable to noncontrolling interest	18	42	4	4	4	4	14	-	-	-	-
Net Income attributable to GILD	3,075	12,101	2,598	2,879	3,034	3,535	12,046	13,987	14,074	13,009	11,674
GAAP Basic EPS	2.01	7.95	1.71	1.90	2.01	2.35	7.98	9.48	9.56	8.80	7.82
GAAP Diluted EPS	1.82	7.36	1.58	1.76	1.86	2.18	7.38	8.75	9.36	8.61	7.65
Bloomberg Consensus as of 02/03/2015			2.30	2.37	2.39	2.43	8.99	9.68	10.04	11.17	11.37
Non-GAAP Diluted EPS	2.05	8.10	1.78	1.96	2.07	2.39	8.21	9.67	10.35	9.58	8.61
Bloomberg Consensus as of 02/03/2015			2.46	2.52	2.54	2.56	9.79	10.65	11.25	12.14	12.11
Basic Shares Outstanding	1,529	1,522	1,517	1,512	1,507	1,502	1,510	1,475	1,471	1,479	1,492
Diluted Shares Outstanding	1,686	1,644	1,640	1,635	1,630	1,625	1,632	1,598	1,504	1,511	1,525
Non-GAAP Diluted Shares	1,685	1,644	1,639	1,634	1,629	1,624	1,630	1,596	1,501	1,509	1,523

Source: J.P. Morgan estimates, Company data.

Investment Thesis, Valuation and Risks

Gilead Sciences (*Overweight; Price Target: \$116.00*)

Investment Thesis

We have an OW rating on GILD. In 2015, we expect focus will largely remain on HCV market dynamics, and we think clarity on pricing/competition will contribute to near-term upside while 1) giving GILD's pipeline time to mature and 2) facilitate acquisitions/further pipeline investment, which we believe will give greater confidence in outer-year revenues leading to further appreciation in GILD shares. Additionally, GILD has several drug candidates to watch in its pipeline, including products in potential key (large) markets such as HBV and RSV.

Valuation

Our YE15 price target for GILD is \$116. Our DCF-based valuation assumes a 10% discount rate and a 1% terminal growth rate. Our price target calculates the terminal value off of 2022; however, it's important to note that, not surprisingly, there is sensitivity around the terminal value year. This issue highlights the importance of the "what's next" question given the anticipated y-o-y decrease in free cash flow in the outer years. In our opinion, it's difficult to value GILD based on a P/E multiple given the potential lumpiness in future earnings.

Risks to Rating and Price Target

Key downside risks include 1) commercial risk to the HIV franchise, 2) failure of Sovaldi/Harvoni to meet Street expectations and continued pricing/competition concern in HCV, and 3) clinical and regulatory risk for the additional key pipeline candidates (e.g., 5816/sof and TAF).

Gilead Sciences: Summary of Financials

Income Statement - Annual	FY14A	FY15E	FY16E	FY17E	Income Statement - Quarterly	1Q15E	2Q15E	3Q15E	4Q15E
Revenues	24,890	26,574	29,614	30,000	Revenues	-	-	-	-
Cost of products sold	(3,788)	(4,071)	(4,545)	(4,604)	Cost of products sold	-	-	-	-
Gross profit	-	-	-	-	Gross profit	-	-	-	-
SG&A	(2,983)	(3,536)	(3,642)	(3,752)	SG&A	-	-	-	-
R&D	(2,854)	(3,583)	(3,691)	(3,802)	R&D	-	-	-	-
Operating income	15,265	15,383	17,736	17,842	Operating income	-	-	-	-
EBITDA	15,265	15,383	17,736	17,842	EBITDA	-	-	-	-
Net interest (income) / expense	(412)	(509)	(467)	(467)	Net interest (income) / expense	-	-	-	-
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Income taxes	(2,797)	(2,822)	(3,281)	(3,301)	Income taxes	-	-	-	-
Net income - GAAP	13,314	13,382	15,428	15,544	Net income - GAAP	-	-	-	-
Net income - recurring	13,314	13,382	15,428	15,544	Net income - recurring	-	-	-	-
Diluted shares outstanding	1,644	1,630	1,596	1,501	Diluted shares outstanding	-	-	-	-
EPS - excluding non-recurring	8.10	8.21	9.67	10.35	EPS - excluding non-recurring	-	-	-	-
EPS - recurring	8.10	8.21	9.67	10.35	EPS - recurring	-	-	-	-
Balance Sheet and Cash Flow Data	FY14A	FY15E	FY16E	FY17E	Ratio Analysis	FY14A	FY15E	FY16E	FY17E
Cash and cash equivalents	11,747	20,627	26,414	34,740	Sales growth	122.2%	6.8%	11.4%	1.3%
Accounts receivable	4,635	4,949	5,515	5,587	EBIT growth	237.4%	0.8%	15.3%	0.6%
Inventories	1,386	1,386	1,386	1,386	EPS growth - recurring	295.6%	1.4%	17.7%	7.1%
Other current assets	2,353	2,471	2,769	2,801	Gross margin	-	-	-	-
Current assets	20,140	29,451	36,103	44,532	EBIT margin	61.3%	57.9%	59.9%	59.5%
PP&E	1,674	1,275	1,323	1,367	EBITDA margin	61.3%	57.9%	59.9%	59.5%
Total assets	34,848	44,264	50,810	59,131	Tax rate	18.8%	19.0%	19.0%	19.0%
Total debt	13,950	15,150	11,250	11,250	Net margin	53.5%	50.4%	52.1%	51.8%
Total liabilities	19,006	20,754	17,154	17,248	Net Debt / EBITDA	14.4%	(35.6%)	(85.5%)	(131.7%)
Shareholders' equity	15,842	23,511	33,656	41,883	Net Debt / Capital (book)	12.2%	(30.4%)	(82.0%)	(127.7%)
Net income (including charges)	12,059	12,032	13,987	14,074	Return on assets (ROA)	46.4%	33.8%	32.5%	28.3%
D&A	355	356	357	358	Return on equity (ROE)	96.5%	68.0%	54.0%	41.2%
Change in working capital	(2,535)	(314)	(566)	(72)	Enterprise value / sales	6.6	5.9	4.9	4.6
Other	-	-	-	-	Enterprise value / EBITDA	10.7	10.2	8.3	7.7
Cash flow from operations	9,879	12,074	13,778	14,360	Free cash flow yield	5.7%	7.1%	8.2%	9.1%
Capex	(150)	(150)	(150)	(150)					
Free cash flow	10,063	12,336	14,007	14,588					
Cash flow from investing activities	(250)	(250)	(250)	(250)					
Cash flow from financing activities	(2,916)	(2,944)	(7,741)	(5,784)					
Dividends	-	(1,944)	(2,791)	(2,784)					
Dividend yield	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

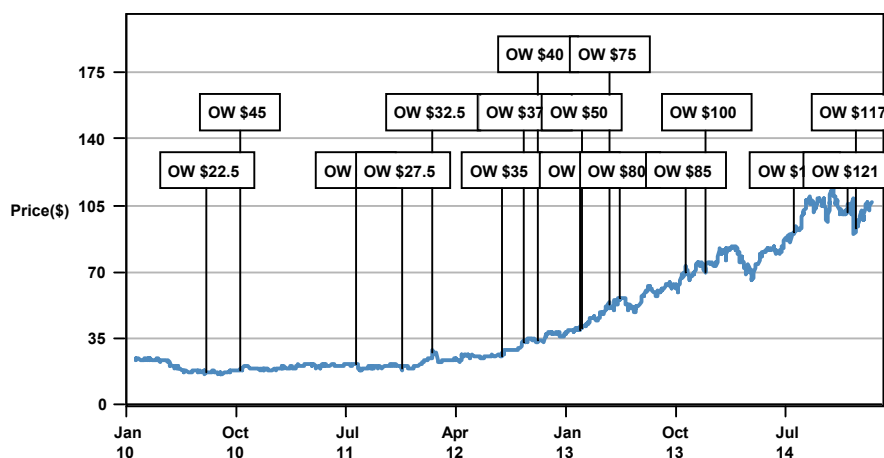
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Gilead Sciences (GILD, GILD US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Jul 21, 2010.

Date	Rating	Share Price (\$)	Price Target (\$)
21-Jul-10	OW	16.46	22.50
13-Oct-10	OW	18.34	45.00
27-Jul-11	OW	21.48	25.00
22-Nov-11	OW	19.38	27.50
03-Feb-12	OW	27.35	32.50
27-Jul-12	OW	25.84	35.00
17-Sep-12	OW	32.90	37.50
24-Oct-12	OW	34.17	40.00
05-Feb-13	OW	39.59	45.00
12-Feb-13	OW	40.40	50.00
19-Apr-13	OW	53.17	75.00
17-May-13	OW	56.30	80.00
30-Oct-13	OW	69.50	85.00
18-Dec-13	OW	70.08	100.00
24-Jul-14	OW	90.54	110.00
04-Dec-14	OW	101.82	121.00
23-Dec-14	OW	92.90	117.00

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