

Illumina, Inc.

Takeaways from mgmt. meeting: NovaX launch, Backlog, Competition, China

Maintain Rating: UNDERPERFORM | PO: 105.00 USD | Price: 130.14 USD

On the road with Illumina

We hosted Illumina's (ILMN) Jacob Thaysen (CEO), Joydeep Goswami (CFO) and Salli Schwartz (IR) as part of our annual West Coast Bus Trip. Discussions centered on current product cycle dynamics, near-term factors (incl. backlog), end-markets, competition, and margins. While mgmt. struck a positive tone and had a firmly positive outlook on the business longer-term, we maintain our Underperform rating as we continue to think ILMN faces several unique market and business challenges that will be difficult to overcome.

Confident in near-term outlook

Mgmt. remained confident in the near-term (i.e., 2024) outlook and underlying market. On backlog (declined meaningfully entering FY24, [see 02/21 note](#)), mgmt emphasized that it's a function of the broader macro environment, more gradual inventory build for consumables on the NovaX (as Nova6000 consumables draw down), and faster churn/turnover of existing orders. On China, mgmt acknowledged significant uncertainty, both from local competition and the potential effect of the BioSecure Act, but continues to see the region as a major long-term opportunity (once near-term headwinds fade).

Long term market view remains very constructive

On the long-term, ILMN sees several indicators that the NGS market remains robust. Clinical markets are now 45-50% of ILMN consumables revenue, which should be more resilient, durable, and lead to a more protracted upgrade cycle for the NovaX. Mgmt also cited the underlying volume growth as a signal of market demand, although we continue to believe that activity growth is a factor of lower pricing, and would not continue to grow at those levels if price were more stable. ILMN was also very vocal on the potential of new markets (multiomics, single cell) to drive future growth, and we wouldn't be surprised to see more announcements in this area from the company in the near future.

Competition remains a key point

Mgmt addressed competition, but also largely dismissed any new entrants as playing a meaningful role in the company's recent performance. ILMN remains focused on innovation and is looking to stay ahead of competitive entrants by expanding applications, improving workflow, and investing in back-end analytics. To that end, it increasingly seems that price/accuracy are no longer the differentiators that they were in the past, but ILMN argues that despite that, they can maintain a lead vs newcomers. (See our [companion note](#) on meeting with NGS newcomer Element).

Gross margins can grow, but OpEx also required

Mgmt. expects GM to expand through FY24 and is committed to eventually returning to its historical high 60s to low 70s range. That said, OMX is core to the ILMN bull thesis, and we see room for OMX as limited given the emphasis on continued R&D investments.

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Stock Data

| | |
|---------------------------------|------------------------|
| Price | 130.14 USD |
| Price Objective | 105.00 USD |
| Date Established | 8-Feb-2024 |
| Investment Opinion | C-3-9 |
| 52-Week Range | 89.00 USD - 233.42 USD |
| Mrkt Val (mn) / Shares Out (mn) | 20,692 USD / 159.0 |
| Free Float | 99.7% |
| Average Daily Value (mn) | 225.61 USD |
| BofA Ticker / Exchange | ILMN / NAS |
| Bloomberg / Reuters | ILMN US / ILMN.OQ |
| ROE (2024E) | 2.8% |
| Net Dbt to Eqty (Dec-2023A) | 7.6% |

NGS: Next-Generation Sequencing

OMX: Operating Margin Expansion

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Price objective basis & risk

ILLUMINA, INC. (ILMN)

Our \$105 price objective is based on a DCF analysis that assumes a WACC of approximately 9% and a terminal growth rate of 4%. We consider this justified given near-term questions on certain pockets of ILMN's business and related execution, as well as the company's market position and significant TAM. This PO is also equivalent to roughly 25x ILMN's core 2025 EPS (ie. excluding GRAIL), which is on the lower end of its historical P/E multiple, but is justified given poor performance in recent years.

Downside risks to our PO are lower demand elasticity as ILMN further lowers cost of sequencing, lost sales due to challenging macroeconomic conditions for key customer groups, weaker-than-expected academic funding, lower consumable pull-through, competition within the genetic analysis market, regulatory and reimbursement uncertainty in the clinical sequencing markets, acquisition related integration issues, growing concerns over data privacy, and slower-than-expected uptake of new products (esp. NovaSeqX).

Upside risks to our PO are a stronger than expected recovery in instrument placements and overall sequencing demand following near-term market volatility, strong uptake of NovaSeqX product cycle, increased spending by high-throughput customers, better clinical reimbursement/market penetration, cost cuts that drive meaningful margin expansion, and the acquisition of the company.

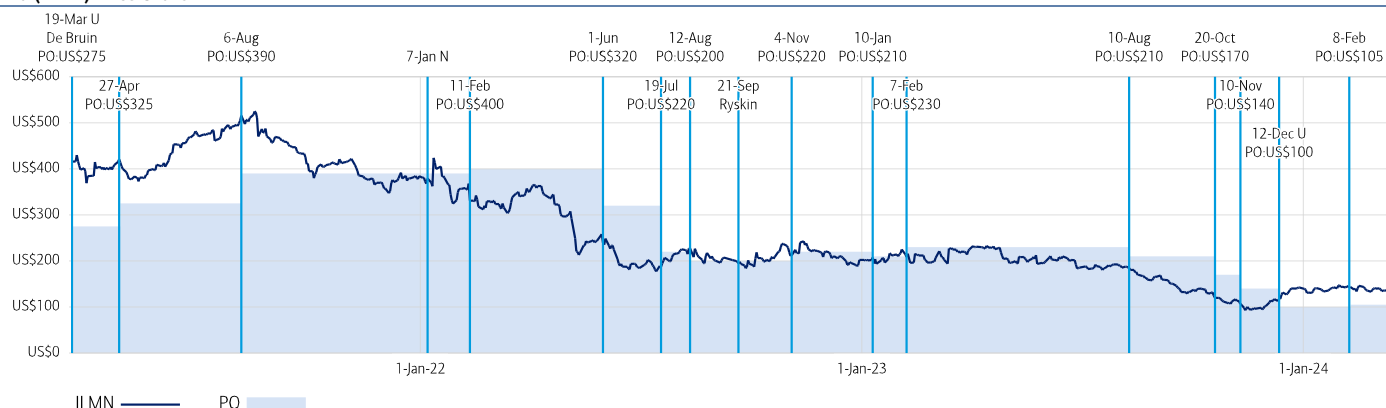
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Illumina (ILMN) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 234 | 60.94% | Buy | 115 | 49.15% |
| Hold | 80 | 20.83% | Hold | 36 | 45.00% |
| Sell | 70 | 18.23% | Sell | 29 | 41.43% |

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1895 | 53.62% | Buy | 1083 | 57.15% |
| Hold | 832 | 23.54% | Hold | 454 | 54.57% |
| Sell | 807 | 22.84% | Sell | 383 | 47.46% |

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|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

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