

## Charles River Laboratories

**NHP asset drives margins; DSA recovery timeline uncertain; Mfg rebounds**

Reiterate Rating: BUY | PO: 270.00 USD | Price: 245.12 USD

**4Q sales ~2% ahead, adj. EPS 4c better vs Street**

Charles River Labs (CRL) reported upside 4Q results, with sales of \$1.01bn (-8.2% organic vs. BofAe -9.5%) with better RMS (Research Models & Services) and Mfg (Manufacturing) while DSA (Discovery & Safety Assessment) was in line. Adj EPS of \$2.46 were 4c ahead of the Street. See our earlier [First Look note](#) for more details.

**Key debates: NHP pricing; uncertain DSA recovery timeline**

CRL's initial '24 guide was a mixed bag, as the 0-3% organic growth target was lower than our ~4% est. Both DSA & RMS will each see flat to low single digit (LSD) core sales growth, while Mfg will be up LSD-MSD (mid single digit). The FY24 guide implies a sharp rebound in organic growth in 2H24. While this is like other covered companies and partly driven by easier y/y comparisons, CRL's guide also assumes a positive \$15-35mn impact from NHP (non-human primate) pricing in DSA, which will be the primary growth driver for the segment in FY24 as study volumes remain muted. While we don't think massive NHP price cuts are likely, we were surprised to see mgmt guide for increases. On volumes, DSA faces tough comps in 1H24, cancellations remain elevated, and bookings were down \$150mn q/q in 4Q. While gross the book-to-bill (B2B) remains >1x and net B2B is ~1x, it will take time until cancellations and demand trends normalize.

**Margin expansion driven by Noveprim deal, Mfg rebound.**

Despite lower core growth, CRL expects margins to expand by ~50bps y/y. This is principally driven by Noveprim (reported mostly as part of RMS and some as DSA). As an NHP supplier, legacy Noveprim will contribute \$40-50mn sales in RMS in FY24 as well as a small amount as part of a vertically integrated SA supply chain. A rebound of Contract Manufacturing activity within Mfg as well as restructuring initiatives that would generate \$60-70mn cost savings are also expected to help drive the margin expansion.

**Update estimates, raise PO to \$270 on peer mult. expansion**

Overall, CRL managed through a difficult FY23, but shares are likely to stay controversial given the 2H ramp and NHP pricing debate. We update our estimates and raise our PO to \$270 (from \$225), now based on 16x (was 14x) our 2024E adj. EV/EBITDA, still a discount to the peer group multiple median of 17x (vs 15x prior). We reiterate our Buy rating on CRL's strong competitive position, portfolio diversity, and discount valuation.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	11.12	10.65	11.10	12.35	14.10
GAAP EPS	9.47	9.21	8.08	9.38	11.18
EPS Change (YoY)	7.6%	-4.2%	4.2%	11.3%	14.2%
Consensus EPS (Bloomberg)			10.87	12.39	14.32
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	22.0x	23.0x	22.1x	19.8x	17.4x
GAAP P/E	25.9x	26.6x	30.3x	26.1x	21.9x
EV / EBITDA*	13.2x	12.9x	12.3x	11.4x	10.3x
Free Cash Flow Yield*	2.5%	3.1%	3.9%	4.4%	5.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

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14 February 2024

## Equity

**Key Changes**

(US\$)	Previous	Current
Price Obj.	225.00	270.00
2024E Rev (m)	4,275.0	4,220.0
2025E Rev (m)	4,580.0	4,530.0
2026E Rev (m)	NA	4,925.0
2024E EPS	11.00	11.10
2025E EPS	12.45	12.35
2026E EPS	NA	14.10

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**Stock Data**

Price	245.12 USD
Price Objective	270.00 USD
Date Established	14-Feb-2024
Investment Opinion	B-1-9
52-Week Range	161.65 USD - 257.18 USD
Mkt Val (mn) / Shares Out (mn)	11,676 USD / 47.6
Free Float	98.8%
Average Daily Value (mn)	137.89 USD
BofA Ticker / Exchange	CRL / NYS
Bloomberg / Reuters	CRL US / CRLN
ROE (2024E)	14.8%
Net Dbt to Eqty (Dec-2023A)	64.8%
ESGMeter <sup>TM</sup>	High

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# iQprofile<sup>SM</sup> Charles River Laboratories

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	10.7%	9.5%	9.1%	9.1%	9.0%
Return on Equity	20.7%	16.7%	14.8%	13.7%	12.6%
Operating Margin	21.0%	20.3%	20.9%	21.2%	21.9%
Free Cash Flow	295	365	459	512	608

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.1x	1.2x	1.3x	1.3x	1.3x
Asset Replacement Ratio	1.1x	1.0x	0.9x	1.0x	1.0x
Tax Rate	19.7%	22.8%	24.5%	24.4%	24.3%
Net Debt-to-Equity Ratio	81.8%	64.8%	46.3%	28.3%	14.4%
Interest Cover	14.1x	6.1x	6.7x	7.6x	8.8x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,976	4,129	4,220	4,530	4,925
% Change	12.3%	3.9%	2.2%	7.3%	8.7%
Gross Profit	1,463	1,503	1,505	1,619	1,777
% Change	9.6%	2.7%	0.1%	7.6%	9.7%
EBITDA	991	1,013	1,058	1,145	1,267
% Change	12.7%	2.3%	4.4%	8.2%	10.6%
Net Interest & Other Income	(123)	(128)	(117)	(112)	(107)
<b>Net Income (Adjusted)</b>	<b>571</b>	<b>549</b>	<b>576</b>	<b>642</b>	<b>735</b>
<b>% Change</b>	<b>7.6%</b>	<b>-3.8%</b>	<b>5.0%</b>	<b>11.5%</b>	<b>14.5%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	493	480	420	488	583
Depreciation & Amortization	304	314	318	321	324
Change in Working Capital	(153)	(102)	2	(66)	(70)
Deferred Taxation Charge	(36)	(51)	(50)	0	0
Other Adjustments, Net	12	43	71	77	83
Capital Expenditure	(325)	(319)	(302)	(308)	(312)
<b>Free Cash Flow</b>	<b>295</b>	<b>365</b>	<b>459</b>	<b>512</b>	<b>608</b>
<b>% Change</b>	<b>-44.6%</b>	<b>23.9%</b>	<b>25.8%</b>	<b>11.4%</b>	<b>18.8%</b>
Share / Issue Repurchase	(39)	(24)	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	20	(75)	(125)	(125)	(125)

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	234	277	563	902	1,337
Trade Receivables	752	780	802	861	936
Other Current Assets	453	552	457	490	532
Property, Plant & Equipment	1,466	1,640	1,903	2,166	2,426
Other Non-Current Assets	4,698	4,947	4,876	5,235	5,691
<b>Total Assets</b>	<b>7,603</b>	<b>8,195</b>	<b>8,602</b>	<b>9,654</b>	<b>10,921</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	1,092	1,055	1,034	1,109	1,205
Long-Term Debt	2,708	2,647	2,522	2,397	2,271
Other Non-Current Liabilities	780	834	814	874	950
<b>Total Liabilities</b>	<b>4,579</b>	<b>4,536</b>	<b>4,370</b>	<b>4,380</b>	<b>4,427</b>
<b>Total Equity</b>	<b>3,024</b>	<b>3,659</b>	<b>4,232</b>	<b>5,274</b>	<b>6,495</b>
<b>Total Equity &amp; Liabilities</b>	<b>7,603</b>	<b>8,195</b>	<b>8,602</b>	<b>9,654</b>	<b>10,921</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Healthcare Technology & Distribution

## Company Description

Charles River Labs (CRL) is the leading early-stage drug development contract research organization (CRO). The company provides animal research models and preclinical drug development services to biopharmaceutical companies, government agencies and academic institutions. CRL also offers Manufacturing Support services, including microbial and biologics testing and cell & gene therapy contract development and manufacturing services.

## Investment Rationale

CRL is the leading preclinical contract research organization (CRO). As such, the company is well-positioned to benefit from favorable trends in drug R&D spend, outsourcing, and biotech financing. We believe that CRL can deliver low-double-digit organic revenue growth and higher adj. EPS growth over the next years. Moreover, the company has a proven track record in executing M&A effectively to augment growth and enhance competitive positioning.

## Stock Data

Average Daily Volume 562,559

## Quarterly Earnings Estimates

	2023	2024
Q1	2.78A	2.05E
Q2	2.69A	2.88E
Q3	2.72A	3.08E
Q4	2.46A	3.08E

## Price objective basis & risk

### Charles River Laboratories (CRL)

Our \$270 PO is based on 16x our 2024 adj. EV/EBITDA estimate, which is a discount to the peer group multiple median (17x) across select CRO, Life Sciences Tools and CDMO companies, given CRL's exposure to ongoing headwinds from biotech funding and non-human primate supply issues.

Risks are uncertainty on the rebound of the company's non-human primate supply, integration of recent acquisitions, dilutive M&A, soft drug R&D spend, downturn in biotech financing, retrenched outsourcing, safety assessment overcapacity, lower animal research model volumes, lingering COVID headwinds, and competition, technology and regulatory risks.

## Analyst Certification

I, Derik de Bruin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Avantor, Inc.	AVTR	AVTR US	Michael Ryskin
	Bruker Corporation	BRKR	BRKR US	Derik de Bruin
	Certara	CERT	CERT US	Michael Ryskin
	Charles River Laboratories	CRL	CRL US	Derik de Bruin
	Elanco Animal Health	ELAN	ELAN US	Michael Ryskin
	Exact Sciences	EXAS	EXAS US	Derik de Bruin
	Guardant Health	GH	GH US	Derik de Bruin
	ICON plc	ICLR	ICLR US	Derik de Bruin
	IQVIA Holdings Inc	IQV	IQV US	Derik de Bruin
	LabCorp	LH	LH US	Derik de Bruin
	Maravai	MRVI	MRVI US	Michael Ryskin
	Qiagen	QGEN	QGEN US	Derik de Bruin
	Qiagen N.V.	XQGNF	QIA GY	Derik de Bruin
	Quest Diagnostics	DGX	DGX US	Derik de Bruin
	Stevanato Group S.p.A.	STVN	STVN US	Derik de Bruin
	Thermo Fisher Scientific	TMO	TMO US	Derik de Bruin
	West Pharmaceutical Services	WST	WST US	Derik de Bruin
	Zoetis Inc.	ZTS	ZTS US	Michael Ryskin
<b>NEUTRAL</b>				
	10x Genomics, Inc.	TXG	TXG US	Michael Ryskin
	Agilent Technologies	A	A US	Derik de Bruin
	Danaher Corporation	DHR	DHR US	Michael Ryskin
	Evotec SE	EVO	EVO US	Michael Ryskin
	Hologic, Inc.	HOLX	HOLX US	Derik de Bruin
	IDEXX Laboratories	IDXX	IDXX US	Michael Ryskin
	Mettler-Toledo	MTD	MTD US	Derik de Bruin
	NeoGenomics Inc.	NEO	NEO US	Derik de Bruin
	Revvity Inc	RVTY	RVTY US	Derik de Bruin
	Schrodinger, Inc.	SDGR	SDGR US	Michael Ryskin
	Waters Corp.	WAT	WAT US	Derik de Bruin
<b>UNDERPERFORM</b>				
	Align Technology	ALGN	ALGN US	Michael Ryskin
	Fortrea	FTRE	FTRE US	Derik de Bruin
	Ginkgo Bioworks Holdings, Inc	DNA	DNA US	Derik de Bruin
	Illumina, Inc.	ILMN	ILMN US	Michael Ryskin
	Myriad Genetics	MYGN	MYGN US	Derik de Bruin
	Phibro Animal Health	PAHC	PAHC US	Michael Ryskin



## US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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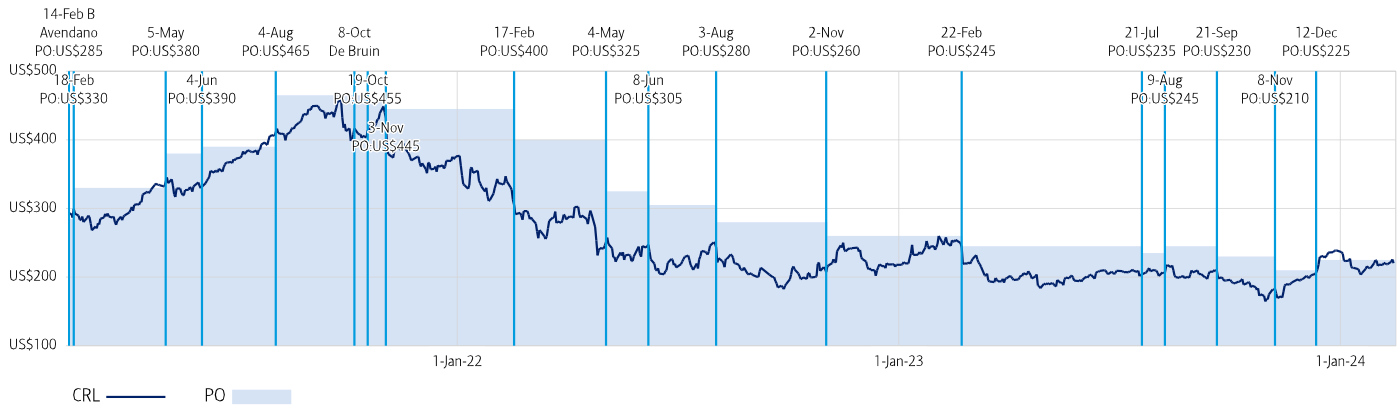
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### Charles River (CRL) Price Chart



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

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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 <sup>R1</sup>	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%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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