

Lindenwood University

Project I

Equity Evaluation

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FIN 32010: Corporate Finance I

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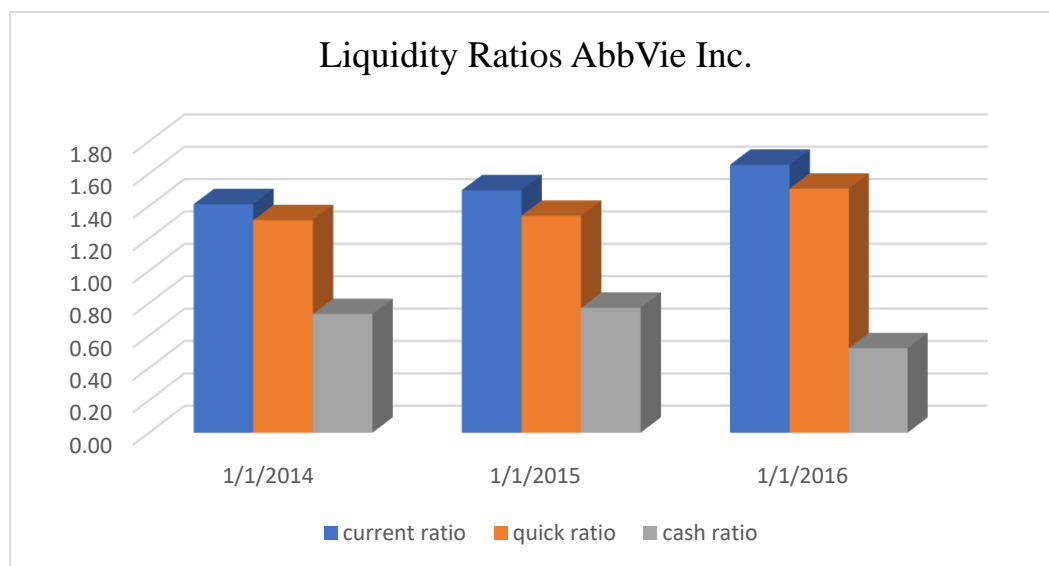
Background History of AbbVie Inc.

AbbVie, Inc. is a biopharmaceutical company. It takes part in the development, manufacture, and sale of pharmaceutical items. The AbbVie's products are utilized to treat rheumatoid arthritis, psoriasis, Crohn's disease, HIV, cystic fibrosis complications, low testosterone, thyroid disease, Parkinson's disease, ulcerative colitis, and complications associated with chronic kidney disease, among other indications. It also develops such medical specialties as immunology, hepatitis C, oncology, Neuroscience, including Alzheimer's disease. AbbVie, Inc. was founded on 10 April 2012, but originated in 2013 and is headquartered in North Chicago, IL. On October 19, 2011, Abbott Laboratories reported that it wanted to isolate into two traded open market organizations, one concentrated on broadened restorative items and the other on exploring based pharmaceuticals. The medical items company held the Abbott name, and research-based pharmaceuticals organization was named AbbVie. The official date was January 1, 2013, since two companies have separated and AbbVie appeared on the New York Stock Exchange (ABBV) on the next day, January 2, 2013. AbbVie was founded by Richard A. Gonzalez, who was a 30 year Abbott veteran previously as Executive Vice President of Pharmaceuticals. In addition, he filled as Abbott's president and Chief Operating Officer, before a short period of retirement in 2007. AbbVie features a medicine, Humira, which reached \$10 billion in global sales. According to the Wall Street Journal as of January 2016 ibrutinib, a specialty drug, cost US\$116,600 to \$155,400 a year wholesale in the United States. In spite of discounts and medical insurance, the prohibitive price causes some patients do not fill their prescriptions. AbbVie estimates global sales of the drug at \$1 billion in 2016 and \$5 billion in 2020. We used ratio analysis in order to demonstrate the measurement of liquidity and its assets. In order to be able to forecast the future

for each company, we should analyze the current assets and overall performance in pharmaceutical market industry.

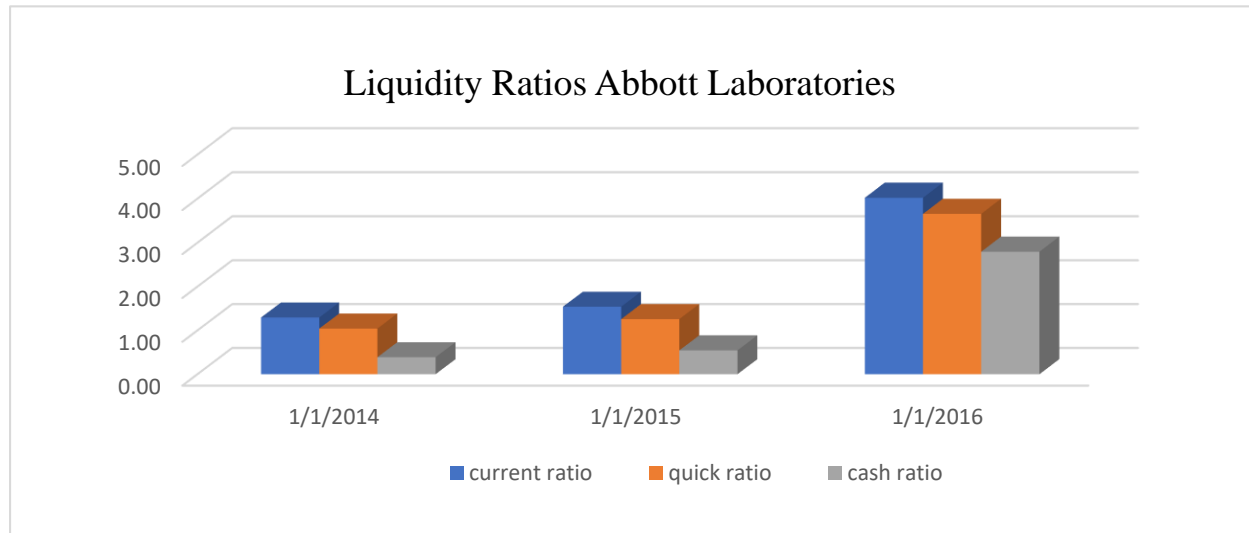
Ratio analysis: Short term Solvency

Regarding the ratios, we would like to represent the graphs that relates to the company AbbVie and our major competitor, Abbott Laboratories. The main goal of using ratios is to calculate the industry average. After researching AbbVie, we made a conclusion that after separation of Abbott Laboratories, AbbVie plays a big role as a competitor especially in pharmaceutical industry.

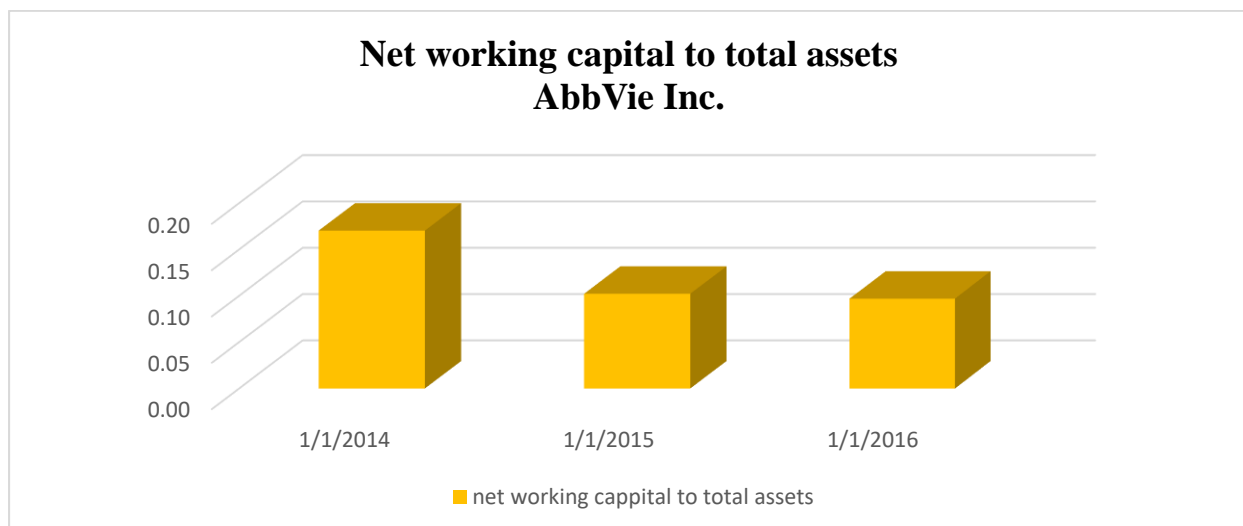


The chart above shows the trends of the three most important liquidity ratios: Current, Quick ratio, and Cash ratio of AbbVie Inc. comparing them to its major competitor Abbott Laboratories. From the last three years the current ratio of AbbVie increased from 1.41 to 1.50 to 1.65 on the other hand, our competitor's current ratio is 1.30 in 2014 is largely increased to 4.02 in 2016 which makes it higher than AbbVie's current ratio. If the current ratio is higher than 1.0, it emphasizes the company as well-positioned because it is able to cover its current assets or short-

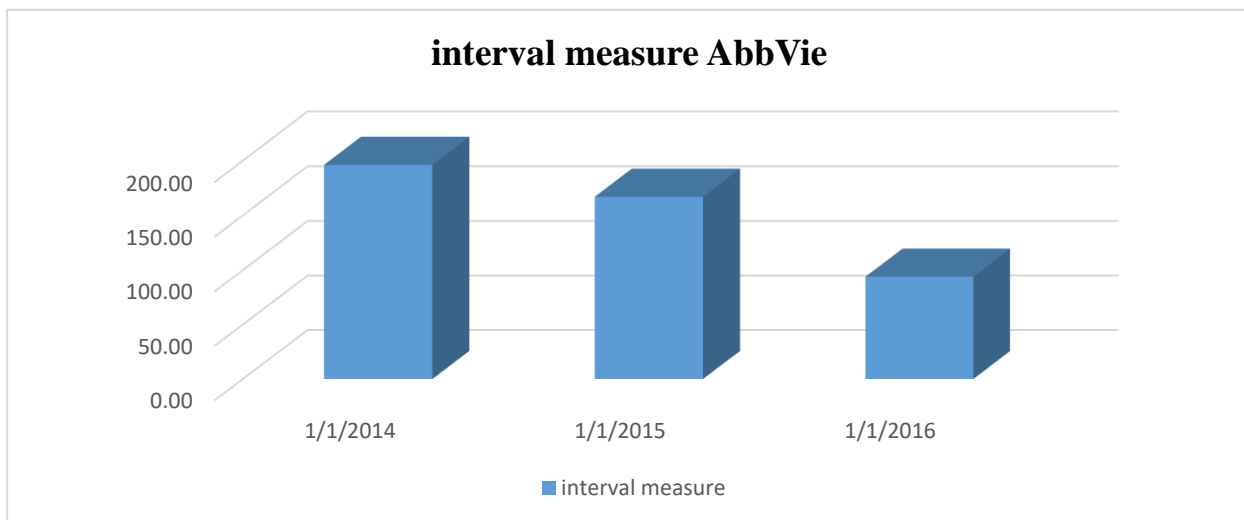
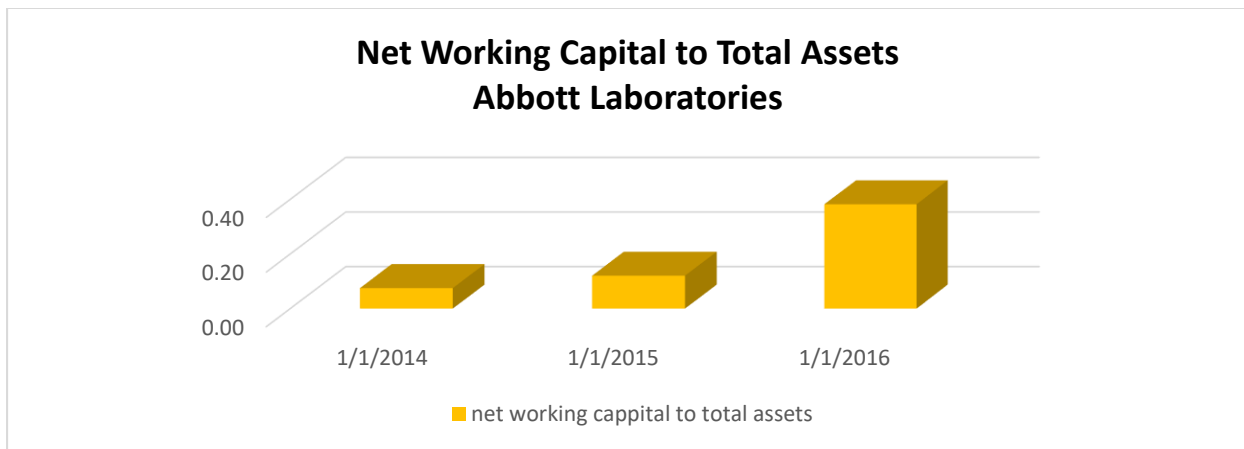
term liabilities. Both of companies are in a good position of paying their short-term obligations back with their short-term assets. Abbott laboratories has a relatively higher current ratio comparing to AbbVie Inc. that means our competitor may not be safer. Acceptable current ratios vary from industry to industry. However, the current ratio of Abbott Laboratories is more than 3.0, which means the company is not using its short-term financing facilities properly. It is mostly associated with the working capital management issues. In collusion, AbbVie's is capable to pay its debt to the creditor, so it is stable and demonstrates the short-term financial strength. The next indicator on the graph, which orange colored column, quick ratio. AbbVie's quick ratio is relatively stable to Abbott Laboratories that states a better ability to quicker meet short-term financial liabilities. While Abbvie's quick ratio is 1.31, then 1.34, and 1.51 in 2016. While Abbott has 3.65. Our opponent might experience the revenue growth and converting accounts receivables into cash quickly. The higher quick ratio coefficient, the more liquid the company is. Regarding to short-term liabilities, Abbott has a higher potential to perform current liabilities due to liquid assets. The last indicator of the liquidity ratios is cash ratio. It is cash or cash equivalents to its current liabilities. This indicator allows us to figure if the company has enough resources that are capable to fit within requirements of creditors in emergency situations such as debt. The most recommended values of cash ratios is from 0.2 to 0.5. Higher than the normal coefficient may result in the company's inefficiency of asset structure. Abbott Laboratories must have a large amount of cash on hand since it has a larger coefficient.

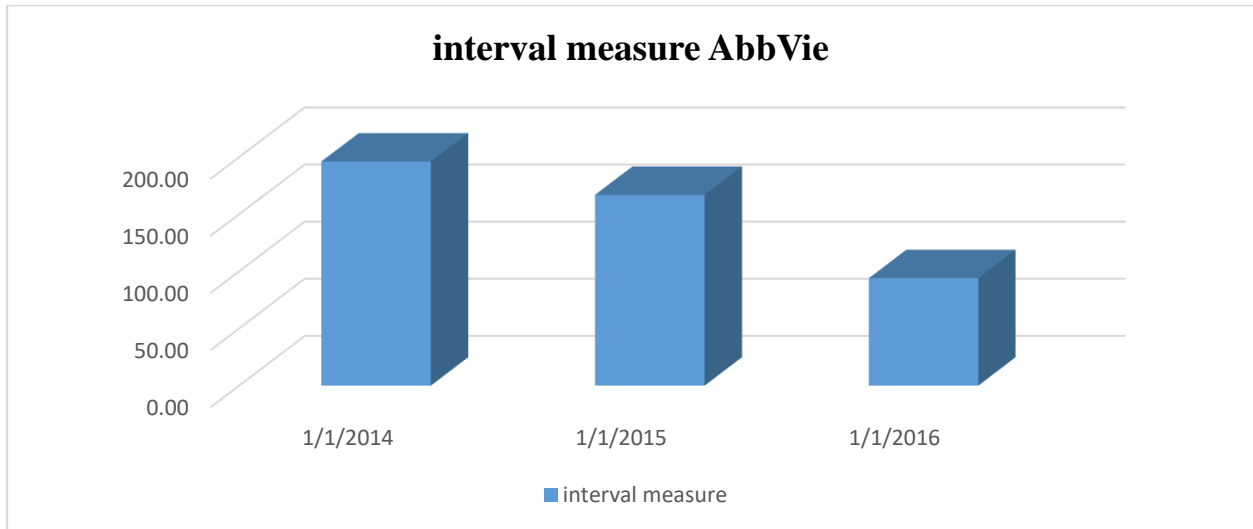


Net working capital is very important indicator that defines the capability of company to pay the debt from the most liquid assets and direct money into its further development. All we have to remember is that the net working capital is the short-term indicator that lasts for twelve months, for example, when the most debt of the company might occur for the next year, it would not appear on current coefficient of net working capital. Both companies have the positive figure, so AbbVie and Abbott obtain short-term receivable more than its short-term payables.

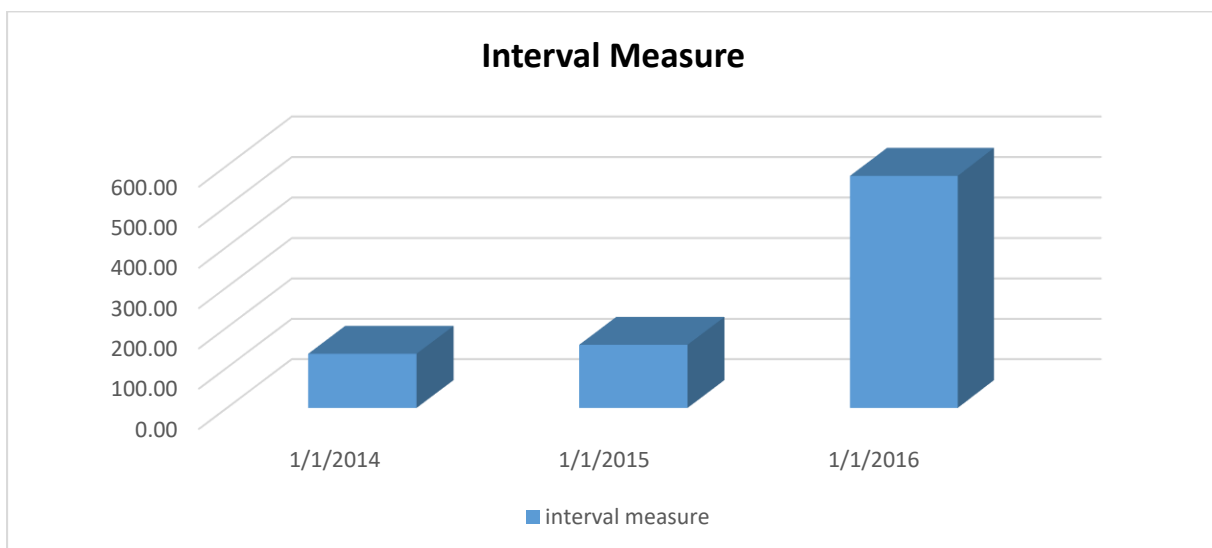


A company with a higher positive net working capital has to take more new business opportunities and the company's assets are able for the further investment. The closest indicator to 1.0 was obtained by Abbott Laboratories (0.40) and this company should invest more for its future growth. However, as we see on the both charts, AbbVie has decreased the amount of net working capital from 2014 to 2016 to 0.10, but Abbott increased drastically by reaching the point 0.40.



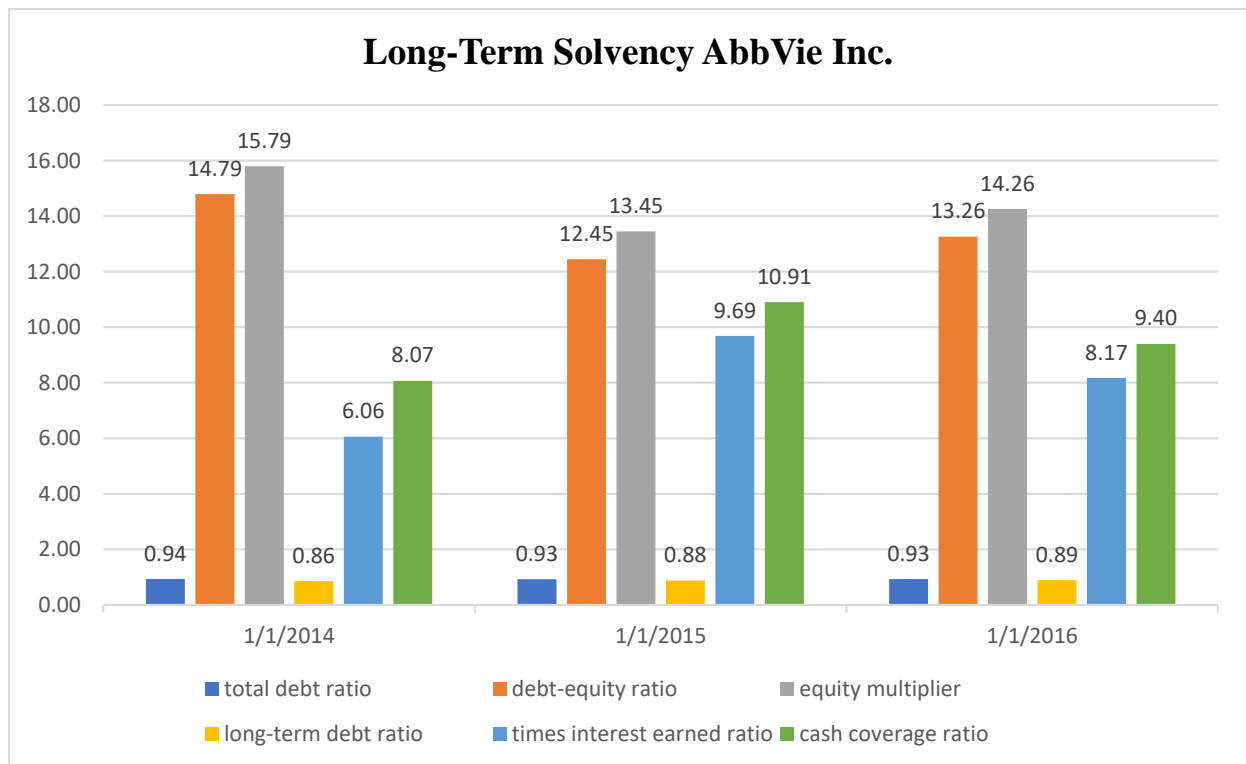


Interval measure basically indicates how many days the company holds their cash in order to do cash operations. After calculating the interval measure of both companies we are able to have the idea of approximate number of days each company needs to operate with the capital on hand and how long a business can proceed when current costs exceed current income. The interval measure of Abbott has a larger number that means than AbbVie in 2016 required more days to proceed its operations. The most accurate number in 2016 was 93.99 for AbbVie Inc. comparing to our competitor, which is 574.55.



Long Term Solvency

The next following chart demonstrates the total debt ratio, long-term debt ratio, debt-equity ratio, equity multiplier, times interest earned ratio, equity multiplier and cash coverage ratio. This particular analysis includes both companies Abbott Laboratories and AbbVie Inc.



The long term proportions are planned to address the company's long-term capacity to meet its obligations, or, basically, its financial leverage. When some firms have been struggling with borrowing money for their equipment, other companies are debt-free. For the analysis, our purpose is to determine which debt is sustainable. Borrowing money might be a good sign sometimes, because it is expecting potential growth on sales of the company. A figure of total debt of 0.50 or less should be perfect. We should not let more than a half of debt to be financed with assets of the company. AbbVie's total debt ratio is 0.94 in 2014, 0.93 in 2015, and 0.93 in 2016, Abbott's is 0.61, which is much healthier financially than our company.

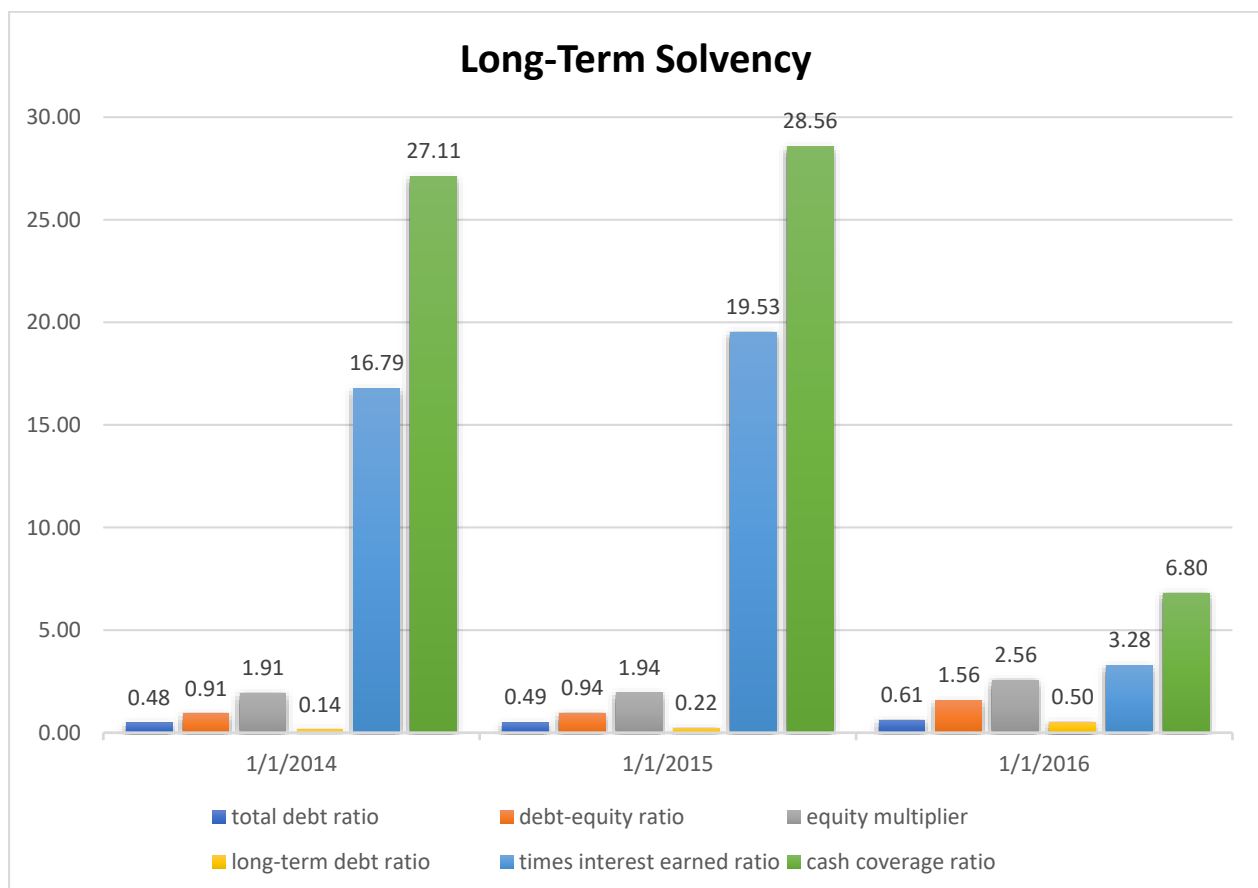
Capital structure risk mostly found in the debt-to-equity risk. This particular ratio is one of the most important to indebtedness ratios showing at the long term solvency graph above for the AbbVie Inc. and below for Abbott laboratories. The higher this ratio is, the higher financial risk is expecting when company uses debt capital. The suitable option for this ration is recommended by investors to be from 1 to 3. At this point, company may use the debt capital undoubtedly without any high risk. The results provided based on the theoretical studies in general, by in reality each company should look at its own characteristics in order to perform efficiently in the market. AbbVie's indicator of this particular ratio is 14.79, 12.45 and 13.26. While Abbott Laboratories has 1.56. "Lower number of debt-to-equity ratio shows that a company less dependent on borrowing for its operations", according to Investopedia.com.

Equity multiplier is a ratio that shows that the particular company can be able to finance its purchases by incurring debt or issuing more stocks. AbbVie's equity multiplier is 14.26 comparing to Abbott's 2.56. AbbVie's operations are showing a higher risk if profits drop, the debt burden turns out to be substantially harder to benefit.

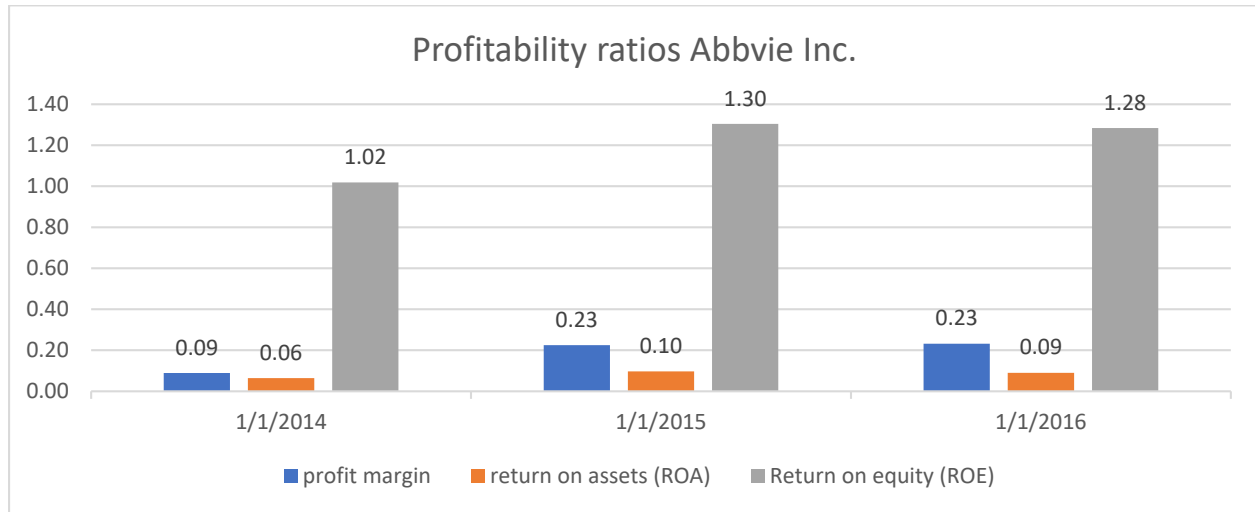
Long-term debt ratio is calculated by showing the percent of the assets of the company financed with loans that lasts more than one year. It requires a stable position of a company to meet loans. The company is suggested to be less depended on debt for sustainable growth. In the chart shown above, AbbVie's company performance in long-term debt ratio 0.86, 0.88, 0.89. In comparison, Abbott Laboratories has 0.50 in the last year. The AbbVie has a higher degree of risk to not be able to repay its debts, so Abbott laboratories has an absolute advantage to AbbVie's Inc. Moreover, both companies have ratios below 1.0, so it might not be too harmful, but the best option would be below 0.50.

Times interest earned ratio emphasizes the amount of company's income that can be used to cover interest expenses in the future. It measures a firm's ability in order to make interest and debt service payments especially for the long period of time. The ratio of interest earned will demonstrate the frequency of the interest payments that a company will pay before tax. AbbVie's company performs very well 6.06 (2014), 9.69 (2015), 8.17(2016). While the Abbott's figure in 2016 is 3.28. Higher ratio was performed by AbbVie's company that is considered less risky while Abbott indicated at higher credit risk than AbbVie.

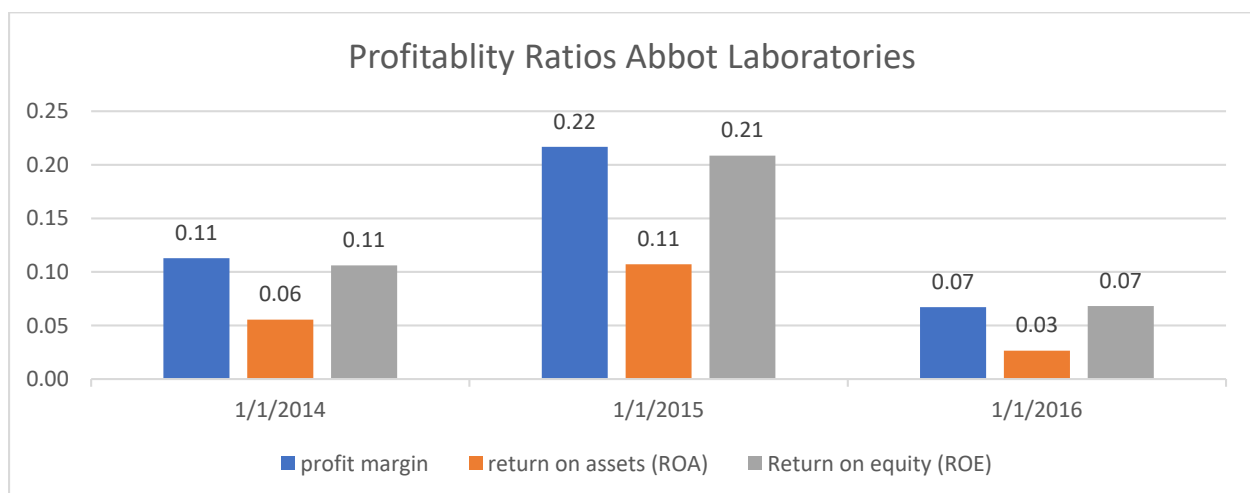
Cash coverage ratio usefulness is defined by how much cash is available for a borrower's interest expense payments. Company's financial position



Profitability Ratios

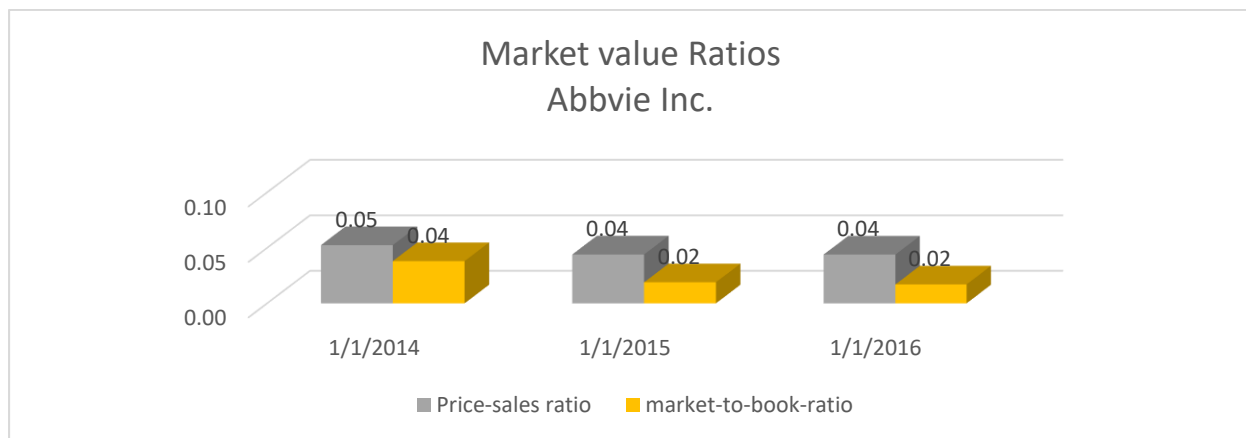


On the first look at the profit ratios of Abbvie Inc, the company is profitable because the ratios are positive. Then, looking the profit ratio has increased since 2014, from 9% to 23% and maintains stable. Moreover, ROA analyses the efficiency of the assets to generate revenues. The company has not had considerable changes since 2014, by an increase of four percent. In addition, the return on equity is considerably much higher than the competition. The high percentage of ROE leads to greater returns to investors, making the company more attractive to invest.



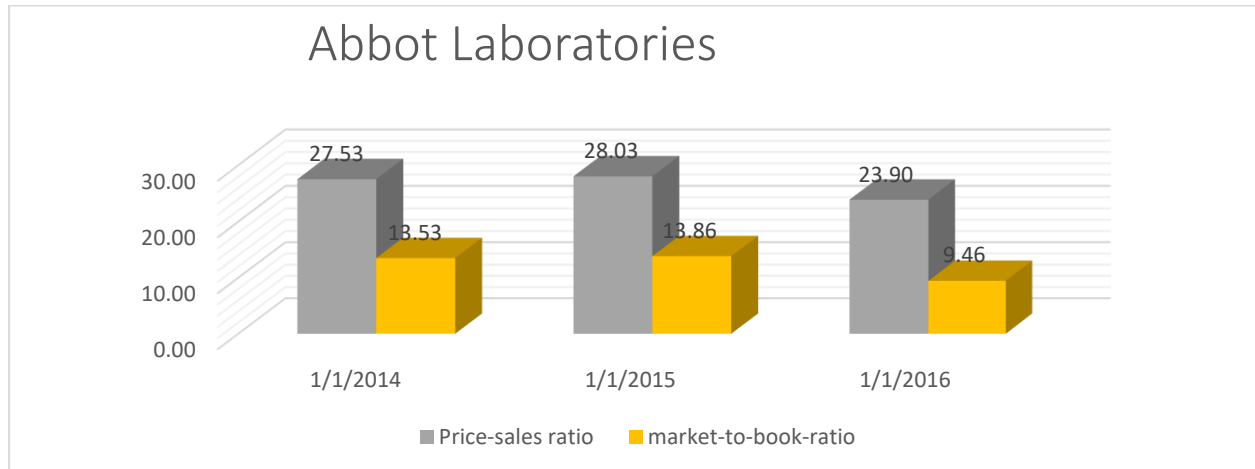
On the other hand, the profitability ratios of Abbot Laboratories are more volatile. The ratios have increased and decreased, making the company look riskier and less stable. In 2014, the profit margin of the company was greater than Abbie Inc's, but the situation has changed for 2016. The main competitor has a profit margin two times below Abbvie Inc. However, the return on assets both companies have the same fluctuation trends, but the competitor has a deeper drop in the last year. Finally, there is an enormous difference in ROE between both companies where the competitor is losing the attention.

Market Value Ratios

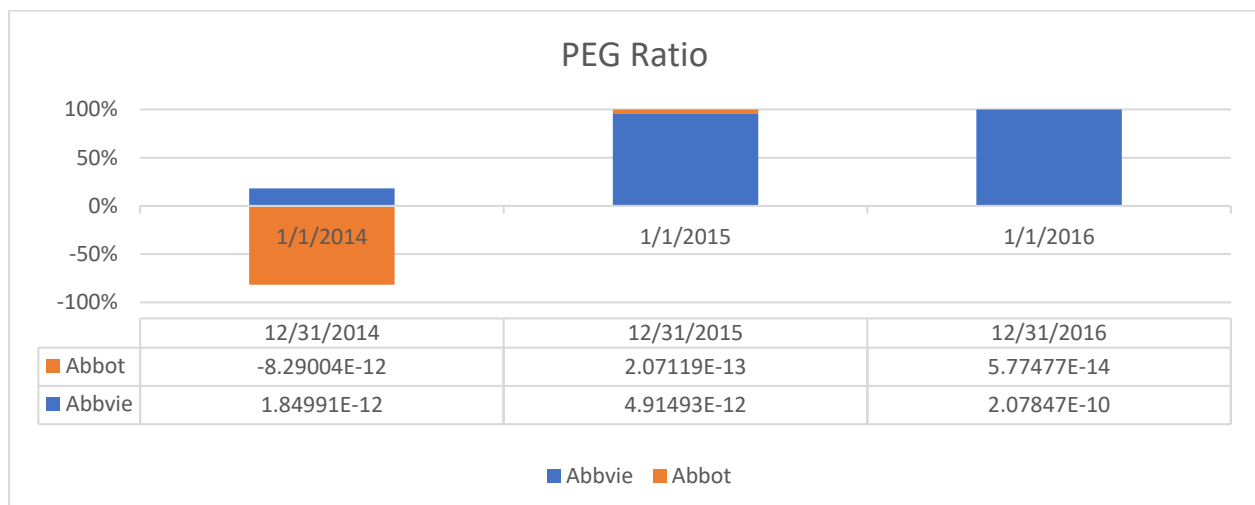


The market value ratios show the actual value of the company by the stock price and its dividends. Companies can have stock overvalued or undervalued, such decision can be done by using these ratios. For example, the Market to Sales Ratio shows how much the shareholders paid for a share compared to the revenue in sales that the company generates per share. A lower price to sales ratio is better for investors because it means a lower cost per unit of sale.

According to Patrick Gleeson, "a low price-to-book ratio is another indication that a stock may be undervalued" because it means that investors are not sure about company managers generating future cash flows.



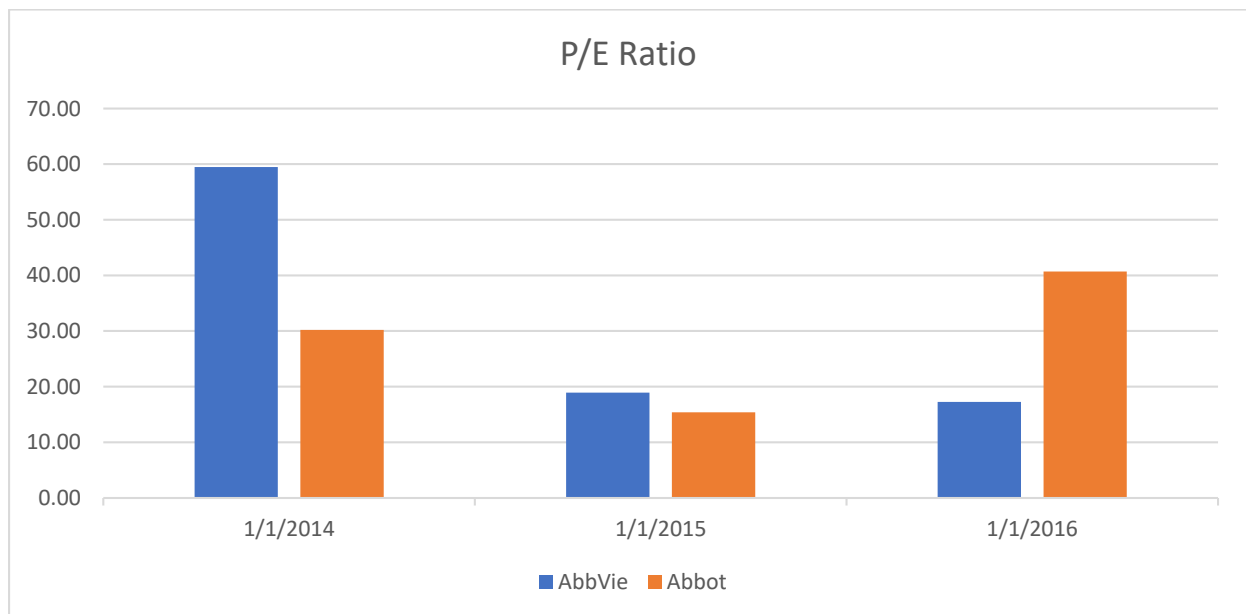
After looking at the price-sales ratio and the market-to-book value ratio, Abbvie Inc's stock is undervalued because investors are paying too little in comparison to the revenues on sale and investor are not sure about managers ability to generate future cash flows.



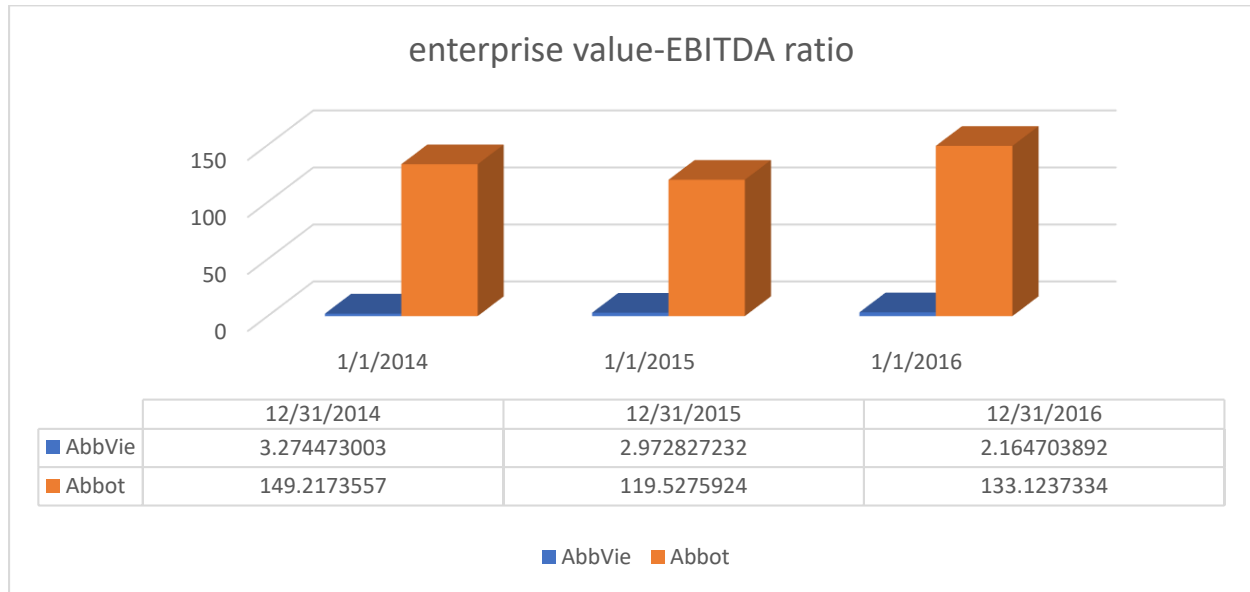
“Theoretical perfect correlation between market value and projected earnings growth assigns a PEG ratio value of 1 to a stock. PEG ratios higher than 1 are generally considered unfavorable, suggesting a stock is overvalued” (J.B. Maverick)

According to the graph comparing both companies, AbbVie Inc. is an undervalued stock which might increase its price in the future because the ratio is less than one. On the other hand, Abbot laboratories had a negative PEG in 2014 which means that the company had negative earnings on that moment. However, the competitor has higher numbers in comparison to AbbVie Inc. which is not too attractive to investors.

According to Joshua Kenon, "the p/e ratio is the price an investor is paying for \$1 of a company's earnings or profit." Therefore, this ratio can be used as an indicator to know the investor's expectations of the company. A high P/E ratio means that shareholders are anticipating a big growth in the future. However, when the P/E ratio is too high the company could not be able to meet investor expectations. In comparison to a low P/E ratio that might show an undervalued stock.

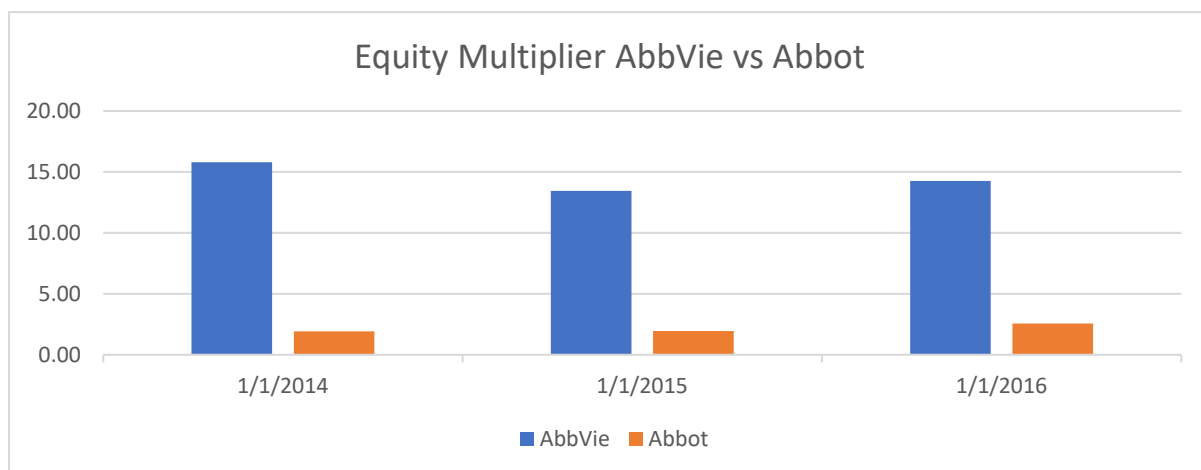


In 2014, AbbVie Inc had a high P/E ratio which led to an increase in the rest of the ratios in 2015. On the other hand, the ratio shows that the company has a low number which means an under evaluation of the company because the other ratios show a future growth.

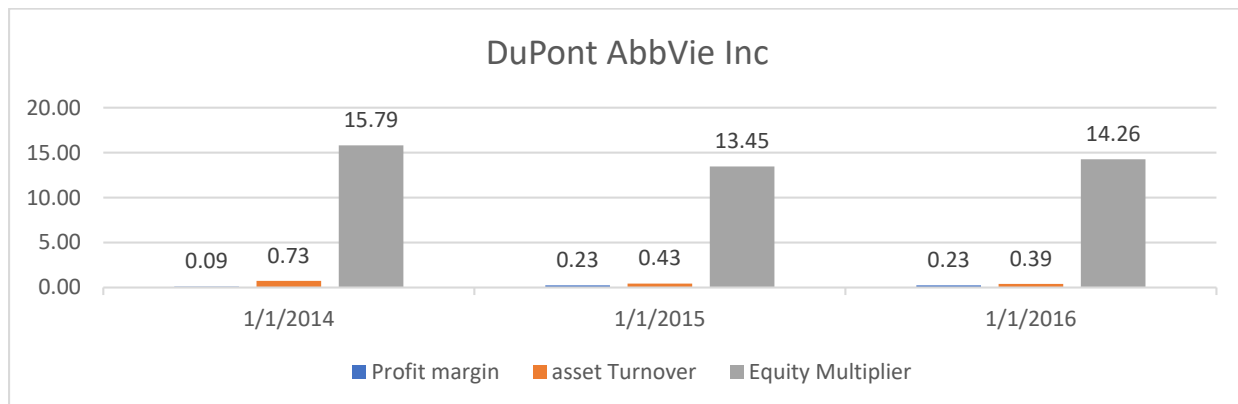


"This popular metric is widely used as a valuation tool, allowing investors to compare the value of a company, debt included, to the company's cash earnings less noncash expenses." (J.B Maverick) Also, it is helpful for comparing companies which share the same industry. According to Maverick, an average below 10 in the ratio is seen as healthy. The graph showed before, it makes obvious the advantage of AbbVie Inc. over its competitor. The low numbers of AbbVie Inc represent a healthy company in the Industry.

DuPont Analysis

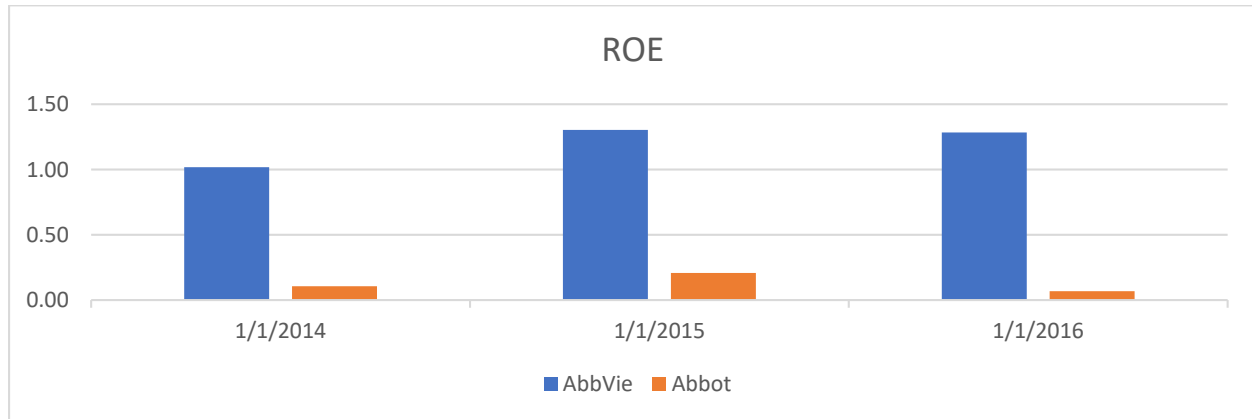


The equity multiplier is the biggest concern of Abbvie Inc. A higher ratio in the equity multiplier means that an important part of the assets was founded by debt instead of equity. Abbvie Inc is considered a risky company by analyzing this ratio. On the other hand, a higher equity multiplier or a higher financial leverage increase ROE. In addition, debt has tax advantages referring to borrowing.

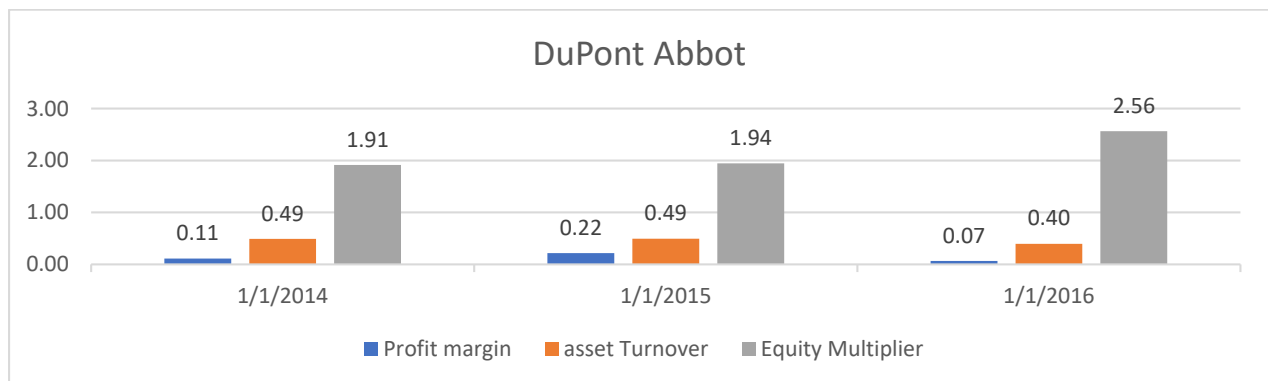


After discussing the disadvantage and the advantages of the equity multiplier which is stable. However, there is a dropped from 0.73 to 0.43. It means that Abbvie Inc. is decreasing its assets performance to generate revenue. Besides, the profit margin is increasing, the assets can be used in a better way to improve ROE.

In the end, the company keeps a stable profit margin and an equity multiplier. The inefficiency of the assets is considered a materiality for investors. the company must increase its sales or decrease its average total assets in order to improve this number.



Abbot Laboratories represents a more conservative firm which does not depend on debt. It is considered a less risky company in comparison with Abbvie Inc. However, It has been decreasing earnings in the last couple of year and it does not offer a great return for investors.



Pro forma

For the next part of the project, NASDAQ's forecast is going to be the main resource for the estimations. The average growth rate would be 14.1 percent. For simplification purposes, the growth rate is estimated to be constant.

The sustainable growth rate is the maximum growth rate that a firm can have without getting more debt. In 2014, Abbvie Inc. showed a negative internal (-3.12%) and negative

sustainable growth rate (-34%) those percentages are due to the paid of dividends in 2014. Also, it means the earnings were not enough to cover the debt.

The following years the company got back on track. Abbvie Inc. improves it's earning and it is able to cover a partial portion of the debt. On the other hand, the company has a stable growth rate at 3.61 percent in 2015, and 3.5% percent in 2016. However, the internal growth rate should be improved, taking into consideration that the sustainable growth is high at 93%.

Using NASDAQ's forecast of earnings for Abbvie Inc. for the following 5 years in average which is 14.10%. The company would need around two and a half million (\$2,527,586.) to cover the increase in assets. The Proforma was elaborated by adding the estimated percent growth to the revenues and the cost of revenues. In addition, the assets on the balance sheet changed with an addition of the 14.10 percent as well, but the liabilities and the equity were not affected by the growth rate. However, to get the necessary funds to cover the difference between the assets and the liabilities plus the equity, there must be analyzed different ways to get the money. Taking into consideration that the equity multiplier is high, the financial leverage shows that the company is funding a high debt. Therefore, the best option to get the funds from an external resource would be by issuing more stock or reissuing their treasury stock. On the other hand, if the company keeps getting more debt, would be dangerous because would be difficult for the company to repay the whole debt.

Moreover, the news changes the perspective of AbbVie's future. According to Tomi Kilgore, the corporation is going to raise its dividends and it would buy back some of its stock. The company has grown drastically the last couple of years. So, managers might want to slow

down the growth in order to be able to support it. Furthermore, the company is not looking for more funds, it is looking slow down the growth rate.

Stock Valuation

For this part of the project, the stock valuation is made by using two different methods. First, the valuation using multiples because this method is useful when companies have erratic dividend growth rates. AbbiVie Inc has adjusted several times its dividends and it would change them even more. The valuations using multiples were done by multiplying the P/E ratio by the earnings per share, the company got \$113.14 of stock price valuation. The price on February 15, closed at \$111.04 which means that the stock is been undervalued. Additional, the second method used was the constant growth rate assuming that the company will keep growing in the future. Looking at the future dividend payment and the growth on itself, the price of the stock would get higher. In the end, by evaluating both results from the different methods, the average is \$119.92 per share which is a difference of \$8.88 per share. The company is being undervalued, and investors should take advantage of this.

According to the article "AbbVie stock rises after dividend boosted 35%, new \$10 billion buyback program" by Tomi Kilmore, published on the website MarketWatch.com. The company is going to boost its stock in an enormous way because they are paying incredible dividends to the stockholders. Therefore, the demand for AbbVie's stock is going to have a positive change, making the shares more valuable to investors.

Buy/ Sell/ hold

AbbVie Inc. is the relatively new company which started its operation in 2013. The company is based on debt because the most prominent part of its assets is covered by

liabilities. Nonetheless, the company is highly profitable and is able to pay and do not get absorbed by interest on the debt. In addition, from a liberal point of view, debt is not such evil thing because it possesses advantages on taxes. By looking market valuation ratios and the stock valuation, the company is being undervalued. Investors make enormous returns by taking advantage of the inefficiency of the market. In this case, the undervalued stock is a considerable opportunity for investors to buy AbbVie's stock for two reasons. One, the company has high dividends which are great returns for the investors. Second, the stock is forecast to grow much higher than the actual price.

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