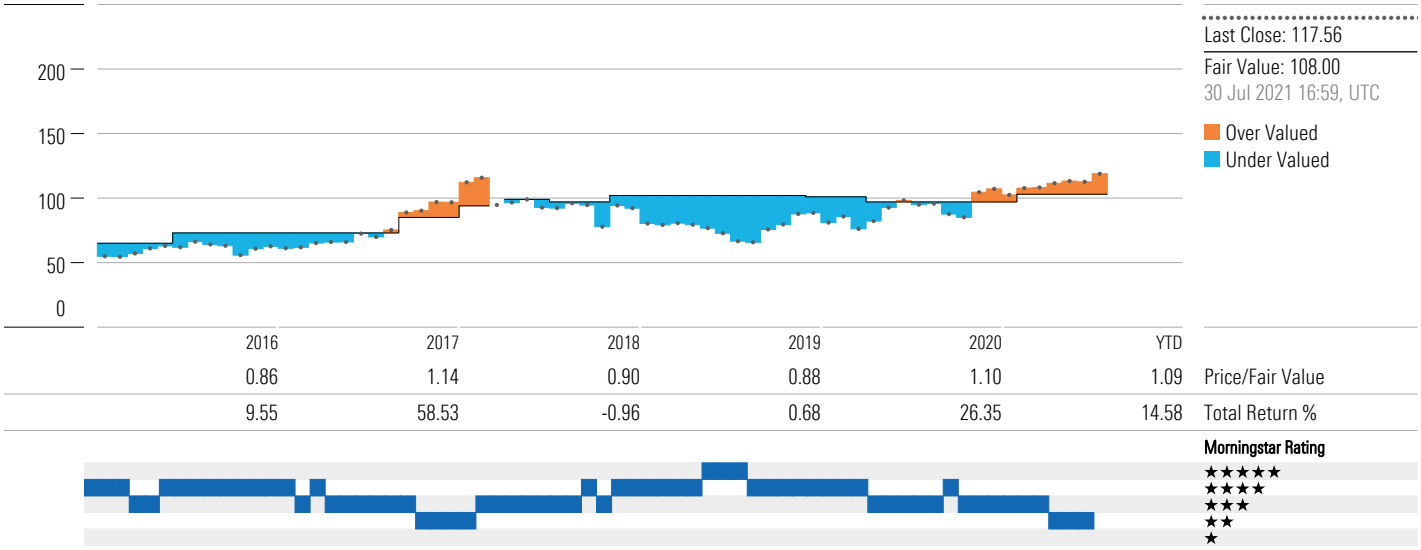
Morningstar Equity Analyst Report | Report as of 30 Jul 2021 17:04, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 1 of 17

AbbVie Inc ABBV ★★★ 30 Jul 2021 17:02, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Moat Trend™	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
117.56 USD	108.00 USD	1.09	209.95 USD Bil	Narrow	Negative	Medium	Standard	
30 Jul 2021	30 Jul 2021 16:59, UTC		29 Jul 2021					7 Jul 2021 05:00, UTC

Price vs. Fair Value



Total Return % as of 29 Jul 2021. Last Close as of 30 Jul 2021. Fair Value as of 30 Jul 2021 16:59, UTC.

Contents

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The primary analyst covering this company does not own its stock.

[1]The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

AbbVie Posts Strong Q2 Results, Driven by New Immunology Drugs and Accelerating Allergan Products

Analyst Note Damien Conover, CFA, Sector Director, 30 Jul 2021

AbbVie reported second-quarter results that were ahead of our projections, and we are raising our fair value estimate to $108 from $103. With this minor increase, we view the stock as slightly overvalued, with some concern that the market is overly focused on recent and likely near-term strong growth rather than the major U.S. biosimilar pressure against Humira starting in 2023. The biosimilar pressure on such a key drug (over a third of total sales) is a key reason for our narrow rather than wide moat rating on the stock despite a remaining portfolio that is executing well.

In the quarter, total sales increased 19% on a comparable operational basis after adjusting for the Allergan acquisition, but we expect decelerating growth by 2023 due to the biosimilar pressure. Despite the approaching pressures, we expect AbbVie's resilient next-generation immunology drugs Skyrizi and Rinvoq to help mitigate Humira biosimilars as the new drugs already represent close to 20% of Humira sales, and we expect further entrenchment in current and new indications to propel growth to represent a third of Humira sales in 2022, the last year of exclusivity for Humira in the U.S. While the Food and Drug Administration is delaying approvals in important new indications for Rinvoq, we believe the drug will gain several important new indications (including atopic dermatitis and ulcerative colitis) with the FDA's safety concerns largely addressed within the label of the drug.

Also helping long-term growth, the recently acquired Allergan products are performing well. We believe

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Sector
Healthcare

Industry
Drug Manufacturers - General

Business Description

AbbVie is a drug company with a strong exposure to immunology and oncology. The company's top drug, Humira, represents close to half of the company's current profits. The company was spun off from Abbott in early 2013. The recent acquisition of Allergan adds several new drugs in aesthetics and women's health.

AbbVie's increased marketing spending on the products are helping to propel growth. In particular, Botox (both cosmetic and therapeutic) is posting excellent growth even after adjusting for an easy year-over-year comparison. Also, the strong launch of acute migraine drug Ubrelvy sets up a good pathway for the likely 2021 approval of atogepant in migraine prevention.

Business Strategy & Outlook Damien Conover, CFA, Sector Director, 4 Feb 2021

While AbbVie holds a strong portfolio of marketed and pipeline drugs, the increasing competition to the company's key drug Humira should slow the growth for the company. At close to 40% of total sales and a higher portion of earnings (due to higher margin revenue), Humira is a key determinant of AbbVie's earnings performance over the next three years.

With approvals in rheumatoid arthritis, psoriasis, and Crohn's disease, Humira holds a wide range of indications, but biosimilar pressure in international markets will likely lead to declining sales over the next few years, and we expect U.S. biosimilar competition to accelerate declines in 2023. Also, branded competition will likely weigh on Humira's growth over the next several years. In particular, new JAK inhibitors and IL-17 and IL-23 antibodies represent major advancements in rheumatoid arthritis and psoriasis, which will likely lead to some market share losses for Humira.

Partly offsetting Humira's eventual declines, AbbVie looks well-positioned with next generation immunology drugs. In particular, recently launched drugs Skyrizi and Rinvoq have shown improved efficacy and safety over Humira and other currently leading treatment options.

Beyond immunology, cancer drug Imbruvica is the next-biggest sales contributor. Imbruvica's strong clinical data in several forms of blood cancer should lead to peak sales above $7 billion. Additionally, the recent acquisition of Allergan brings several new products, including Botox for both cosmetic and therapeutic uses. Botox's strong entrenchment bodes well for the treatment as new competition is emerging. Also, AbbVie holds several mature drugs with patent expirations long past, but with manufacturing or specific dosing complexities, which make generic competition less likely.

Looking forward, AbbVie's pipeline is weighted more toward new cancer and immunology drugs. The company should be able to leverage its solid entrenchment with Humira and Imbruvica to launch the new drugs.

Bulls Say Damien Conover, CFA, Sector Director, 30 Jul 2021

- AbbVie supports a strong dividend yield, which should act as valuation support, as the cash flows to support the dividend look secure over the next few years.
- AbbVie's increasing entrenchment in blood cancers should bode well for growth as pricing power remains solid in this therapeutic area of the pharmaceutical market.
- AbbVie's next generation immunology drugs targeting the IL23 and JAK pathways should help mitigate

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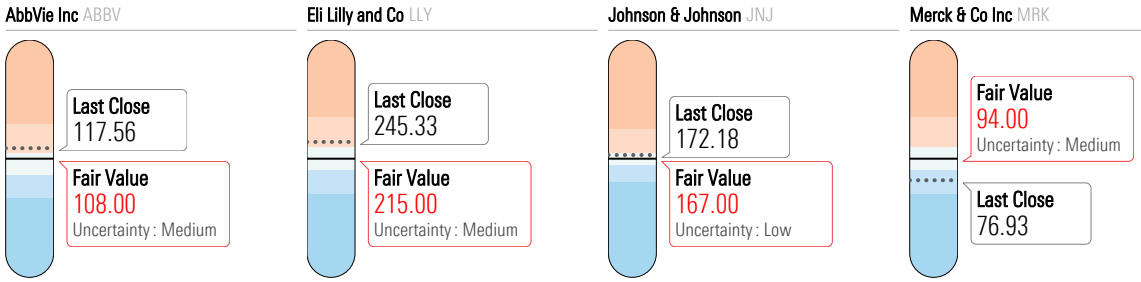
Competitors



	AbbVie Inc ABBV	Eli Lilly and Co LLY	Johnson & Johnson JNJ	Merck & Co Inc MRK
Economic Moat	Narrow	Wide	Wide	Wide
Moat Trend	Negative	Stable	Stable	Stable
Currency	USD	USD	USD	USD
Fair Value	108.00 30 Jul 2021 16:59, UTC	215.00 24 Jun 2021 22:04, UTC	167.00 21 Jul 2021 17:54, UTC	94.00 3 Jun 2021 16:55, UTC
1-Star Price	145.80	290.25	208.75	126.90
5-Star Price	75.60	150.50	133.60	65.80
Assessment	Over Valued 29 Jul 2021	Over Valued 29 Jul 2021	Fairly Valued 29 Jul 2021	Under Valued 29 Jul 2021
Morningstar Rating	★★★30 Jul 2021 17:02, UTC	★★29 Jul 2021 21:24, UTC	★★★29 Jul 2021 21:24, UTC	★★★★29 Jul 2021 21:24, UTC
Analyst	Damien Conover, Sector Director	Damien Conover, Sector Director	Damien Conover, Sector Director	Damien Conover, Sector Director
Capital Allocation	Standard	Standard	Standard	Standard
Price/Fair Value	1.09	1.14	1.03	0.82
Price/Sales	4.13	8.79	5.16	4.15
Price/Book	15.31	34.10	6.88	7.23
Price/Earning	44.19	36.73	25.89	40.70
Dividend Yield	4.27%	1.30%	2.38%	3.33%
Market Cap	209.95 Bil	235.28 Bil	453.42 Bil	194.79 Bil
52-Week Range	79.11—119.13	129.21—248.40	133.65—173.65	15.32—83.72
Investment Style	Large Value	Large Growth	Large Value	Large Value

the competitive threats facing Humira.

Bears Say Damien Conover, CFA, Sector Director, 30 Jul 2021

- Several of AbbVie's pipeline drugs in immunology have mechanisms of action similar to drugs already approved, taking away the first mover advantage for AbbVie.
- The high profit margins on Humira will likely cause an amplified impact on earnings as sales are lost to eventual biosimilar competition.
- The extra debt needed to finance the Allergan deal could put amplified pressure on AbbVie if core assets like Botox and Humira face tougher competition than expected.

Economic Moat Damien Conover, CFA, Sector Director, 4 Feb 2021

We believe AbbVie supports a narrow moat based on patent-protected drugs, intellectual intangibles, and a powerful salesforce. As is the case for most drug firms, the core of AbbVie's moat lies in its portfolio of patent-protected drugs. However, unlike AbbVie's Big Pharma peers, which tend to carry

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wide moats, one drug (Humira) represents the majority of AbbVie's sales (close to 40%) and profits (greater than 50%). As a result of both emerging branded competition to Humira in the immediate term and a potential generic biosimilar threat in the 2023 time frame, we believe excess returns are likely to persist for 10 years, but we cannot be as certain of this for our 20-year outlook, which would be needed for a wide-moat rating. While we do model in U.S. Humira sales declines in 2023, the rate of decline will likely be more gradual than a typical small molecule-branded drug facing generic competition, because of the complexities in developing and marketing a biosimilar (generic biologic).

Nevertheless, AbbVie derives enormous cash flows from its current product portfolio to fund ongoing discovery and development of the next generation of drugs. The large cash flows create an economy of scale that enables AbbVie to fund the average $800 million required for a new drug. While not as strong as other Big Pharma firms, AbbVie's R&D has created a database of intellectual insights that should help increase the odds of successful drug development. Finally, AbbVie's entrenched salesforce in one of the most sought-after therapeutic areas of immunology should help the firm launch its next generation of drugs and make the firm a leading candidate for smaller drug firms needing help to develop and commercialize innovative new drugs.

We think the firm does face environmental, social, and governance (ESG) risks, particularly related to potential U.S. drug price-related policy reform (75% of sales are generated in the U.S.) to increase access by lowering drug prices. Also, ongoing product governance issues (including litigation related to side effects and patents) also weigh on the company. While we have factored these threats into our analysis, we don't see them as material to our moat rating.

Fair Value and Profit Drivers Damien Conover, CFA, Sector Director, 30 Jul 2021

We are increasing our AbbVie fair value estimate to $108 from $103 based on strong performance of the company coming out of the peak of the pandemic with strong sales from several of the acquired Allergan products. On the Allergan acquisition, while it carried a significant premium to the stock price, we viewed Allergan as undervalued. We believe management was opportunistically taking advantage of Allergan's low price combined with the need to reduce AbbVie's dependence on Humira. We model major annual Humira declines beginning in 2019 outside the U.S. and in 2023 in the U.S., following key patent settlements. A key valuation driver to offset eventual likely Humira sales declines is the company's next-generation immunology drugs targeting the IL23 and JAK pathways as these new pathways seem to offer better efficacy and an improved side effect profile over Humira. Further helping offset likely eventual Humira sales erosion, cancer drug Imbruvica holds strong blockbuster potential in leukemia. Also, the company has several other late-stage cancer drugs that should further help mitigate the eventual Humira sales declines. Allergan cash flows should also help mitigate the Humira pressures. On the bottom line, over the next two years we expect improving margins, largely driven by the higher contribution to total sales by specialty drugs, which carry very high margins. Also, AbbVie's partnership

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royalties on Humira began to expire in 2017, helping improve gross margins. For the weighted average cost of capital, we use a 7.5% cost of equity and market rates for the cost of debt.

Risk and Uncertainty Damien Conover, CFA, Sector Director, 4 Feb 2021

Similar to other drug companies, AbbVie faces the risks of new drug failures, reimbursement challenges for new drugs, and drug pricing cuts by large payer groups that are growing increasingly price-sensitive. Further, AbbVie's high concentration of Humira sales makes the company significantly exposed to any new competitive threats to Humira, both from biosimilars and new branded drug competition. Also, AbbVie has taken on significant debt to purchase Allergan, but we expect robust cash flows will help manage the heavy debt load. Overall, we view the firm at a medium uncertainty level.

Our uncertainty rating for AbbVie is not materially affected by environmental, social, and governance, or ESG, risks, although we see access to basic services (tied to potential U.S. policy reform on drug pricing) as the biggest potential ESG risk that the firm needs to manage. AbbVie generates 75% of total sales in the U.S. (a high amount relative to peers) so major pricing reforms could weigh on sales and margins.

We model in policy changes around reforms to Medicare in our base case as we expect a 50% probability of enactment, and we include other lower probability reforms (such as drug price inflation caps and international reference pricing) in our bear case or ESG point system. For example, AbbVie's Humira (immunology) generates over 40% of the firm's total sales, and the drug has significant exposure to the Medicare channel. Additionally, we assume a more than 50% probability of AbbVie seeing future costs related to product governance ESG risks (such as off-label marketing or litigation related to side effects) and model base case annual legal costs at 1.5% of non-GAAP net income (at the midrange relative to peers based on AbbVie's product portfolio having average exposure to future potential litigation).

Capital Allocation Damien Conover, CFA, Sector Director, 30 Jul 2021

AbbVie's capital allocation rating is Standard, which reflects our belief that it possesses a sound balance sheet, a reasonable record of investments, and largely fair shareholder distributions.

We believe AbbVie's balance sheet is sound, with low risk regarding the size of its debt, the business cyclicality facing the firm, and the debt maturity outlook. While an argument could be made to increase the leverage of the balance sheet to be more active in investing, we believe the company, along with most large-cap biopharma firms, should hold ample balance sheet strength to support opportunistic acquisitions as dynamic scientific data emerges that might require relatively quick action. Also, a strong balance sheet helps biopharma firms through most product litigation challenges with minimal concern by the market.

Turning to investments, we believe AbbVie is operating at a reasonable level. While the company only

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spends on research and development at the low- to midteens level as a percentage of sales (below the industry average in the high teens), the company has shown high productivity with strong execution in pipeline development. The strong productivity in creating the next generation of drugs has yielded enough new drugs to help mitigate the major generic competition upcoming for Humira. The strong productivity in innovative new drugs (largely targeting areas of unmet medical need, especially in immunology) also helps fortify the firm's narrow moat and expand the returns on invested capital. However, on the negative side, more investment would likely position the firm for stronger growth potential through the patent loss of Humira.

On the acquisition side and partnership side, AbbVie has executed reasonably well. The largest recent acquisition of Allergan for over $60 billion diversified cash flows and opportunistically added products from a firm trading below its fair value. Allergan also opens a new therapeutic segment in aesthetics that doesn't face the same potential pricing risks as the branded drug segment. Additionally, the 2015 acquisition of Pharmacyclics for over $20 billion looks sound, given that key drug Imbruvica should hit peak annualized sales of close to $7 billion even with some royalties paid to Johnson & Johnson. On the negative side, the failed acquisition of Shire led to a $1.6 billion breakup fee, and the $6 billion acquisition of Stemcentrx looks like poor judgment on a key cancer drug that looks less effective in late-stage clinical studies.

Regarding distributions, we view AbbVie's dividends and share repurchases as about right. Since being divested from Abbott, AbbVie has largely focused on a dividend payout ratio close to 50%, which seems appropriate, given the maturity of the industry. The firm has done several rounds of share repurchases largely at levels that looked undervalued, which seems to be a good use of capital. However, we would argue for more R&D spending to set the firm up for strong growth potential through the Humira patent loss.

Turning to management specifically, AbbVie is led by Rick Gonzalez, who joined Abbott in 1977 and held many managerial posts throughout his career at the firm. However, he only recently led the drug group starting in July 2010 after a brief retirement. His relatively short tenure in the key field of drug commercialization and development is a concern, but execution has been going well under his leadership.

Analyst Notes Archive

AbbVie Posts Solid Q1 as New Drugs Look Increasingly Well Positioned to Mitigate Humira Generics

Damien Conover, CFA, Sector Director, 30 Apr 2021

AbbVie reported strong first-quarter results ahead of our expectations, but we don't expect any major changes to our fair value estimate as we look to model a higher tax rate that partially offsets the strong start to the year. We continue to view AbbVie as fairly valued with a good appreciation of new drugs

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partially offsetting the likely U.S. generic pressure to Humira in 2023. These strong next-generation drugs combined with a growing pipeline support AbbVie's narrow moat.

On the tax side, AbbVie faces a high impact from potential tax reform. With a tax rate of close to 11% in 2020, AbbVie holds one of the lowest tax rates in the major biopharma group. While we had already modeled increases in the tax rate going forward, we expect this increase may accelerate with new U.S. tax reforms.

In the quarter, total sales increased 5% (assuming comparable operations from the Allergan acquisition), buoyed by strong growth from Skyrizi and Rinvoq. Supported by leading efficacy and dosing convenience, Skyrizi continues to take share in psoriasis, and we expect new indications (psoriatic arthritis and Crohn's in 2022) to drive sales close to management's $7 billion expectation by 2025. Rinvoq also looks well positioned for growth with leading efficacy and safety in rheumatoid arthritis and new indications (ankylosing spondylitis, psoriatic arthritis, and atopic dermatitis in 2021). While the Food and Drug Administration has delayed action on new indications for Rinvoq likely due to safety concerns emerging from other JAK inhibitors, we believe the drug will gain the new approvals based on strong safety data from clinical studies.

On the aesthetics portfolio, AbbVie is increasing marketing support ahead of historical Allergan levels, helping to drive major gains in Botox cosmetics and Juvederm.

COVID-19 disruptions did weigh on oncology and hepatitis C sales, but these areas should rebound later in the year as vaccine utilization increases and quarterly comparisons ease.

AbbVie Posts Strong Q4 and Issues Robust 2021 Guidance, Supporting a Fair Value Estimate Increase Damien Conover, CFA, Sector Director, 3 Feb 2021

AbbVie reported strong fourth-quarter earnings and issued robust 2021 guidance above our expectations. We plan to slightly raise our fair value estimate on the basis of the favorable update. The strong traction of the firm's next-generation immunology drugs Rinvoq and Skyrizi are helping to propel the outperformance and position the firm to better mitigate pressure from the likely heavy U.S. biosimilar competition to Humira in 2023. While we don't expect the new immunology drugs to completely offset the loss of U.S. market exclusivity for Humira, the growing entrenchment of new drugs helps support the firm's narrow moat.

In the quarter, total sales increased 7%, after making the adjustment to include Allergan sales in the previous quarter to reach a normalized growth rate excluding the Allergan acquisition impact. We expect recently launched drugs to drive steady overall company growth until the 2023 Humira biosimilar pressure. New indications for Rinvoq (psoriatic arthritis, atopic dermatitis, ankylosing spondylitis, and ulcerative colitis) hold the potential to drive peak annual sales above $5 billion. Similarly, new

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AbbVie Inc ABBV ★★★ 30 Jul 2021 17:02, UTC

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117.56 USD 30 Jul 2021	108.00 USD 30 Jul 2021 16:59, UTC	1.09	209.95 USD Bil 29 Jul 2021	Narrow	Negative	Medium	Standard	7 Jul 2021 05:00, UTC

indications for Skyrizi (psoriatic arthritis and Crohn's disease) along with leading efficacy in psoriasis should also drive peak sales above $5 billion annually. While these sales will not completely offset the almost $20 billion in Humira sales, other growth drivers in oncology (Imbruvica and Venclexta) should also help mitigate the pressure.

While AbbVie is making strides to offset the Humira biosimilar pressure, we believe the firm's ability to drive growth beyond 2023 will be largely driven by its pipeline, which lacks a high number of late-stage assets. However, the early-stage pipeline is focused in the right areas of unmet medical need of oncology, immunology, and neurology, which can advance quickly to the market if favorable data is achieved.

Likely Democrat Senate Control Ups Potential for New Drug Policies, but Major Changes Look Unlikely Damien Conover, CFA, Sector Director, 6 Jan 2021

With the Democrats being very close to winning the remaining two Senate seats in the Georgia runoffs, we expect the Biden administration will seek to implement further healthcare reforms. However, with such a slim possible majority in the Senate, we expect significant compromises that will likely lead to watered-down drug policy changes. We continue to view the biopharma group as undervalued with strong underlying fundamentals, but we expect lingering concern about drug policy changes to weigh on the industry's valuations.

Even with the likely Democratic control of Congress and the executive branch, we expect more-moderate policy changes to U.S. drug prices. We believe the most likely U.S. drug policy change will focus on the out-of-pocket payments for patients in the catastrophic phase in Medicare Part D. With the current system requiring seniors to pay close to 5% of costs of very expensive drugs, patients can be on the hook for over $5,000 per year. With bipartisan support for addressing these costs along with some industry support, we expect policies to change the cost structure, with the drug companies picking up some of these expenses. This change would probably affect the industry by only 2% on the top line but reduce a major voter complaint of high out-of-pocket costs for specialty drugs and could remove the constant threat of drug pricing reform that has weighed on the group's valuation multiples for many years. Although less likely, we also see the potential for inflation caps in Medicare Part D, which could have a 3% negative effect on the top line of this sector. However, we continue to believe that more controlling U.S. drug pricing policies, such as international reference pricing (pricing U.S. drugs at a similar rate to other developed markets) and Medicare drug negotiation, look unlikely to survive such a narrow margin of Democratic power in the Senate.

Implementation of Trump's Recent Efforts to Affect Drug Pricing Seems Unlikely Damien Conover, CFA, Sector Director, 23 Nov 2020

President Donald Trump issued several orders on Nov. 20 designed to lower U.S. drug prices, but we

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AbbVie Inc ABBV ★★★ 30 Jul 2021 17:02, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Moat Trend™	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
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don't expect implementation of the orders due to legal challenges, lack of support from the U.S. Congress and the new Biden administration, and unclear financial impacts. As a result, we don't expect any major impact on the U.S. pricing power of drugs, a core pillar of the moats and valuations in the drug industry.

One of the White House directives focused on pricing 50 of the largest Medicare B drugs (hospital-administered drugs) at the lowest levels paid by developed countries. While this would significantly affect U.S. prices, as we estimate drug pricing in the United States is close to double prices in developed markets, we expect valid industry legal challenges to stop this order. The order doesn't appear to have followed the normal legal process and instead was rushed out for Trump to enact the policy before leaving office. Additionally, we believe the rule is difficult to implement without legislative support from Congress. Further, we don't expect the Biden administration to focus initially on U.S. drug pricing, especially in the form of these recent proposals that lack full legal and congressional support.

A second White House directive targeted the elimination of pricing rebates in the U.S. drug system, an entrenched system that is very complex to undo through presidential order, especially without a clear analysis of financial implications. While we expect the drug industry to support the removal of rebates as drug firms only receive payments excluding rebates, we expect the payer groups will oppose the rule, given the importance of rebates in payer strategies. With a high degree of uncertainty regarding the impact on the federal budget, we expect the payer groups will be successful in stopping this effort to repeal drug price rebating.

While Still Uncertain, U.S. Elections Seem to Ease Concerns on Major Drug Pricing Policy Changes

Damien Conover, CFA, Sector Director, 6 Nov 2020

Although the outcome of the U.S. elections is still uncertain, we expect the likely politically divided Congress with either presidential candidate to pursue modest drug policy reforms that will not materially affect our valuations or moat ratings in the biopharma industry. We continue to view the biopharma group as undervalued and expect strong fundamentals combined with an easing of concerns around major U.S. drug policies to drive stock prices higher.

Over the next two years, we expect moderate policy changes to U.S. drug prices. We view changes to the out-of-pocket payments for patients in the catastrophic phase within Medicare Part D as the most likely potential change. With the current system requiring seniors to pay close to 5% of costs of very expensive drugs, patients can be on the hook for over $5,000 per year. With bipartisan support for addressing these costs, we expect policies to change the cost structure, with the drug companies picking up some of these expenses at a relatively low hit to overall profits. Additionally, in the event of the Affordable Care Act being struck down by the Supreme Court, we would expect the divided government to be unlikely to offer a comprehensive alternative, but we wouldn't expect a major drag on biopharma earnings as the ACA didn't drive gains for the branded drug group.

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Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Moat Trend™	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
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Importantly, we believe the more significant U.S. drug pricing policies look unlikely to surface. We believe the probability of international reference pricing (pricing U.S. drugs at a similar rate to other developed markets) looks lower following an election that is likely to keep Congress divided. Also, we don't view Medicare drug negotiation as likely, given the politically split Congress. Overall, we expect U.S. drug pricing to remain fairly similar to the current structure, which should bode well for the biopharma industry as the group has seen pressure over concerns about potential major U.S. drug policy changes.

AbbVie Posts Strong Q3, Buoyed by New Immunology Drugs That Help Support Long-Term Outlook

Damien Conover, CFA, Sector Director, 30 Oct 2020

AbbVie reported third-quarter results ahead of both our and consensus S&P CapIQ expectations, but we don't expect any major changes to our fair value estimate based on the minor outperformance. We continue to view the company as undervalued with the market likely not ascribing enough value to the firm's recently launched products and growing pipeline, which also help fortify our narrow moat rating for the firm.

In the quarter, total sales increased 4% (on a comparable operational basis assuming the Allergan acquisition closed in January 2019) with strong growth from new immunology drugs Skyrizi and Rinvoq along with oncology drugs Imbruvica and Venclexta offsetting weakness in eye care, aesthetics, and hepatitis C. We expect accelerating total growth until U.S. Humira biosimilars emerge in 2023, as COVID-19 pressure should ease on the aesthetics and eyecare businesses. Also, Skyrizi and Rinvoq look poised for significant gains based on low market share penetration in currently approved indications and major label expansion opportunities, including atopic dermatitis, ankylosing spondylitis, and inflammatory bowel disease (IBD) for Rinvoq and psoriatic arthritis and IBD for Skyrizi. An important head-to-head study of Rinvoq versus market leading drug Dupixent in atopic dermatitis should report in late 2020, and we expect Rinvoq to show a benefit on itch based on the drug's mechanism of action. Overall, we expect these two new immunology drugs to post peak annual sales of over $10 billion, representing just over half of peak annual Humira sales. While the new immunology drugs along with expected continued growth from oncology drugs mitigate some of the biosimilar pressures for Humira, we still expect the company to face heavy pressure starting in 2023. However, we believe the emerging early-stage pipeline focused in oncology and immunology should support steady earnings by 2025, following the worst of the U.S. Humira biosimilar pressure.

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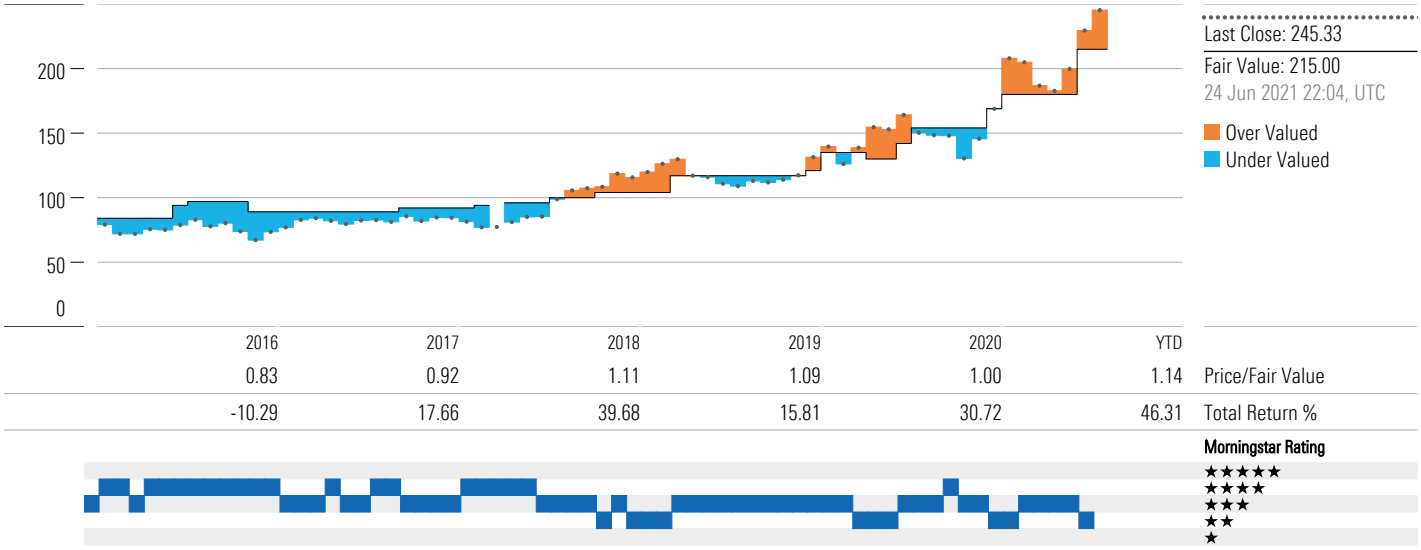
Competitors Price vs. Fair Value

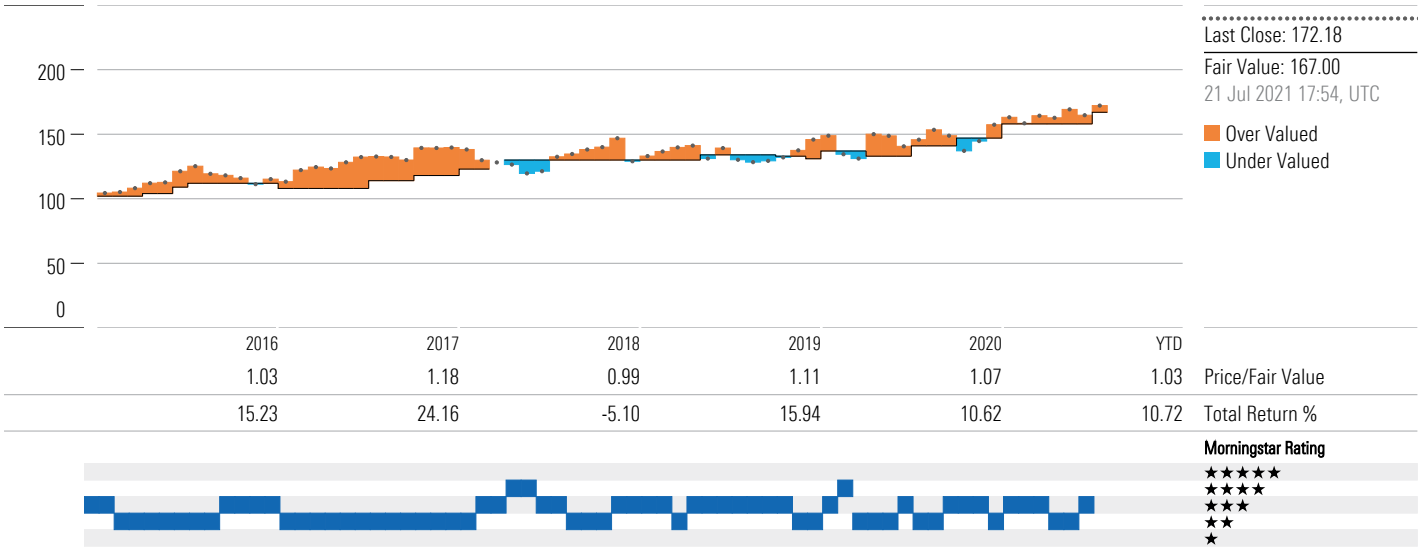
Eli Lilly and Co LLY



	2016	2017	2018	2019	2020	YTD	
	0.83	0.92	1.11	1.09	1.00	1.14	Price/Fair Value
	-10.29	17.66	39.68	15.81	30.72	46.31	Total Return %

Total Return % as of 29 Jul 2021. Last Close as of 29 Jul 2021. Fair Value as of 24 Jun 2021 22:04, UTC.

Johnson & Johnson JNJ



	2016	2017	2018	2019	2020	YTD	
	1.03	1.18	0.99	1.11	1.07	1.03	Price/Fair Value
	15.23	24.16	-5.10	15.94	10.62	10.72	Total Return %

Total Return % as of 29 Jul 2021. Last Close as of 29 Jul 2021. Fair Value as of 21 Jul 2021 17:54, UTC.

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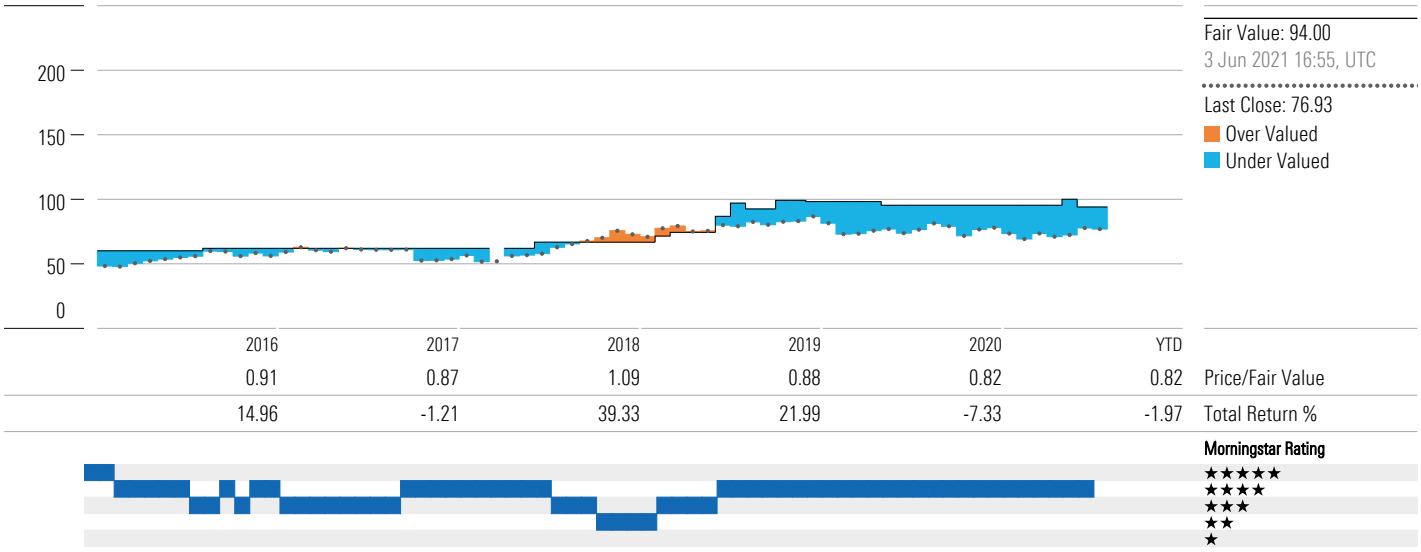
AbbVie Inc ABBV ★★★ 30 Jul 2021 17:02, UTC

Merck & Co Inc MRK



	2016	2017	2018	2019	2020	YTD	
	0.91	0.87	1.09	0.88	0.82	0.82	Price/Fair Value
	14.96	-1.21	39.33	21.99	-7.33	-1.97	Total Return %

Total Return % as of 29 Jul 2021. Last Close as of 29 Jul 2021. Fair Value as of 3 Jun 2021 16:55, UTC.

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Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Moat Trend™	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
117.56 USD	108.00 USD	1.09	209.95 USD Bil	Narrow	Negative	Medium	Standard	
30 Jul 2021	30 Jul 2021 16:59, UTC		29 Jul 2021					7 Jul 2021 05:00, UTC

Morningstar Historical Summary

Financials as of 31 Mar 2021

Fiscal Year, ends 31 Dec	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD	TTM
Revenue (USD Bil)	17	18	19	20	23	26	28	33	33	46	13	50
Revenue Growth %	11.6	5.4	2.2	6.2	14.5	12.2	10.1	16.1	1.6	37.7	50.9	47.4
EBITDA (USD Bil)	4.94	6.98	6.53	3.58	8.20	10.12	10.38	8.31	12.23	12.32	6.71	14.82
EBITDA Margin %	28.3	38.0	34.7	18.0	35.9	39.5	36.8	25.4	36.8	26.9	51.6	29.5
Operating Income (USD Bil)	4.29	6.11	6.00	3.76	7.69	9.54	9.87	6.81	13.37	12.56	4.17	13.13
Operating Margin %	24.6	33.2	31.9	18.9	33.6	37.2	35.0	20.8	40.2	27.4	32.1	26.2
Net Income (USD Mil)	3,433	5,275	4,128	1,774	5,144	5,953	5,309	5,687	7,882	4,616	3,553	5,159
Net Margin %	19.7	28.7	22.0	8.8	22.4	23.1	18.7	17.3	23.6	10.0	27.3	10.2
Diluted Shares Outstanding (Mil)	1,580	1,577	1,604	1,610	1,637	1,631	1,603	1,546	1,484	1,673	1,775	1,746
Diluted Earnings Per Share (USD)	2.17	3.35	2.56	1.10	3.13	3.63	3.30	3.66	5.28	2.72	1.99	2.69
Dividends Per Share (USD)	—	—	1.60	1.66	2.02	2.28	2.56	3.59	4.28	4.72	1.30	4.84

Valuation as of 30 Jun 2021

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Recent Qtr	TTM
Price/Sales	—	2.9	4.4	5.4	4.4	4.1	5.7	4.5	4.0	4.2	3.9	3.9
Price/Earnings	—	10.2	18.5	28.5	34.6	16.9	23.5	19.1	39.1	23.1	41.8	41.8
Price/Cash Flow	—	8.5	14.1	19.6	19.3	13.7	17.5	11.5	9.8	10.7	10.5	10.5
Dividend Yield %	—	—	3.03	2.54	3.41	3.64	2.65	3.89	4.83	4.41	4.4	4.4
Price/Book	—	16.1	23.4	22.4	19.6	15.4	23.0	-46.7	-15.9	12.4	14.5	14.5
EV/EBITDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Operating Performance / Profitability as of 31 Mar 2021

Fiscal Year, ends 31 Dec	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD	TTM
ROA %	16.9	22.7	14.7	6.2	12.7	9.9	7.7	8.7	10.6	3.8	2.4	4.2
ROE %	24.9	69.0	105	56.6	180	138	108	—	—	185	26.5	162.0
ROIC %	24.6	34.5	22.7	11.5	21.6	17.3	14.2	—	—	7.9	4.2	8.3
Asset Turnover	0.9	0.8	0.7	0.7	0.6	0.4	0.4	0.5	0.4	0.4	0.1	0.4

Financial Leverage

Fiscal Year, ends 31 Dec	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Recent Qtr	TTM
Debt/Capital %	0.3	81.3	76.1	85.8	88.1	88.7	85.9	—	—	85.6	84.4	—
Equity/Assets %	61.1	12.5	15.4	6.3	7.4	7.0	7.2	—	—	8.7	9.1	—
Total Debt/EBITDA	0.0	2.2	2.3	4.2	3.9	3.6	3.6	—	—	7.0	12.7	—
EBITDA/Interest Expense	—	67.1	21.8	8.4	11.4	9.7	9.0	6.2	6.9	5.0	10.6	5.9

Morningstar Analyst Historical/Forecast Summary as of 11 Jun 2021

Financials

Fiscal Year, ends 31 Dec	2019	2020	Estimates 2021	2022	2023
Revenue (USD Bil)	33	46	56	59	56
Revenue Growth %	1.6	37.7	22.3	4.8	-5.0
EBITDA (USD Bil)	15	18	29	30	27
EBITDA Margin %	45.1	38.9	51.9	51.9	49.0
Operating Income (USD Bil)	13	11	20	22	19
Operating Margin %	39.0	24.8	35.7	37.0	34.1
Net Income (USD Bil)	13	18	22	23	20
Net Margin %	40.1	38.8	39.8	39.0	35.6
Diluted Shares Outstanding (Mil)	1,484	1,673	1,776	1,767	1,758
Diluted Earnings Per Share(USD)	8.98	10.63	12.56	12.95	11.30
Dividends Per Share(USD)	4.39	4.84	4.95	5.10	5.10

Forward Valuation

	2019	2020	Estimates 2021	2022	2023
Price/Sales	3.9	4.1	3.7	3.6	3.8
Price/Earnings	9.9	10.1	9.5	9.2	10.5
Price/Cash Flow	10.3	11.3	13.3	9.5	9.4
Dividend Yield %	4.96	4.52	4.16	4.29	4.29
Price/Book	—	—	—	—	—
EV/EBITDA	10.6	15.0	9.8	9.4	10.5

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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

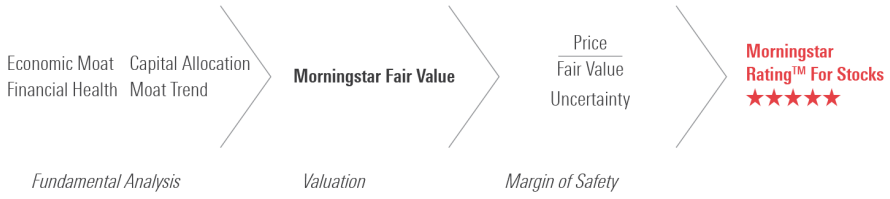
Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to

Morningstar Equity Research Star Rating Methodology



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bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, exposure to material ESG risks, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate. In cases where there is less than a 25% probability of an event, but where the event could result in a material decline in value, analysts may adjust the uncertainty rating to reflect the increased risk. Analysts may also make a fair value adjustment to reflect the impact of this event.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

	Margin of Safety	
Qualitative Analysis Uncertainty Ratings	★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

4. Market Price

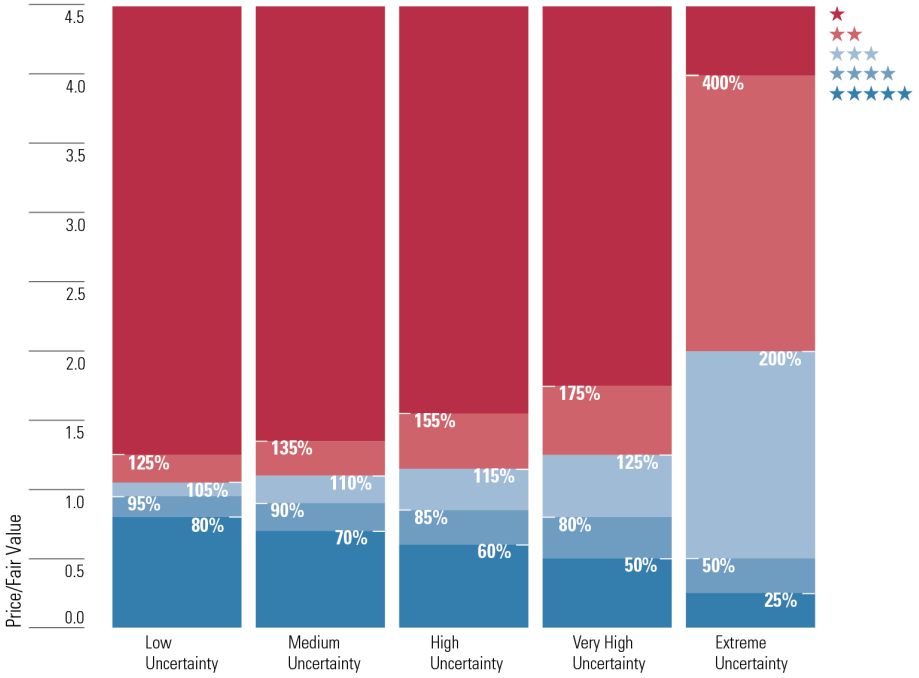
The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com.

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close

Morningstar Equity Research Star Rating Methodology



tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exem-

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plary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Sustainalytics ESG Risk Rating Assessment: The ESG Risk Rating Assessment is provided by Sustainalytics; a Morningstar company.

Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit sustainalytics.com/esg-ratings/

Ratings should not be used as the sole basis in evaluating a company or security. Ratings involve unknown risks and uncertainties which may cause our expectations not to occur or to differ significantly from what was expected and should not be considered an offer or solicitation to buy or sell a security.

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