



Investment Research CenterSM

Provided by Arlington Public Library

We want to hear from you! Please follow the link located [here](#) to participate in our annual

Home	Companies	Funds	ETFs	Markets	Articles & Videos	Portfolio	Help & Education	Newsletter
------	-----------	-------	------	---------	-------------------	-----------	------------------	------------

AbbVie Inc ABBV |

Quote	Chart	Stock Analysis	Performance	Key Ratios	Financials	Valuation	Insiders	Shareholders	Transcr
-------	-------	-----------------------	-------------	------------	------------	-----------	----------	--------------	---------

Analyst Research Analyst Report Archive Top Rated Stocks in Sector

AbbVie's outlook depends on late-stage pipeline drugs being able to offset Humira competition.



by
[Damien Conover](#)
Sector Director

Analyst Note 11/09/2016

The presidential election of Donald Trump combined with the Republicans retaining majorities in Congress leads to greater uncertainty for healthcare stocks. While Trump and the Republicans have been clear on the desire to repeal the Affordable Care Act (ACA), there is less clarity on their healthcare policies, except for the focus on reducing regulations. We suspect as plans take shape to repeal the ACA, the likely outcome will be more of a modification than a complete repeal as several groups have benefited from the legislation.

If the ACA were repealed, the outcome will likely mean a lower demand for healthcare combined with less industry fees and profit restrictions. The passage of ACA was largely a compromise with industry stakeholders, mandating increased insurance coverage in return for lower costs. Reversing this mandate is largely a net neutral to the healthcare sector, with the drug, biotech, and insurance industries slightly benefiting, hospitals and drug supply chain firms negatively impacted, and the remaining industries less influenced.

On stock valuations, a repeal of the ACA would create some changes to healthcare fair values, but without clarity on the Republican plans, we have not made any changes to our fair value estimates. The drug industry would likely lose some volume gains as the close to 20 million newly insured patients from the ACA will likely lose some insurance coverage and spend less, but the mandated costs of ACA would likely more than offset the lost revenue. Similarly, for managed care organizations, the increased profitability without ACA restrictions would likely more

Morningstar's

Analyst

Price 11-15-2016
62.87 USD

Consider Buy
51.1 USD

Stewardship Rating
Standard

Bulls Say

- AbbVie supports a should act as valu the dividend are f
- AbbVie's increasin bode well for grow strong in this area
- AbbVie's next gen and JAK pathways headwinds facing

Bears Say

- Several of AbbVie other drug compa of the new drugs.
- The side effects er weigh on the com market.
- AbbVie's pipeline the eventual sales increased biosimil

than offset lost volumes. However, hospitals would face challenges due to the likely reversal of the declines in uncompensated care and higher volumes from the newly insured patients. Also, drug supply chain firms from Pharmacy Benefit Managers to drug distributors would face headwinds due to the lost benefit of drug demands from the newly insured patients.

Competitors ABBV

Name
AbbVie Inc
Johnson & Johnson
Pfizer Inc
Novartis AG ADR
Novartis AG
Merck & Co Inc

Investment Thesis 06/10/2016

Armed with a best-in-class immunology drug Humira, AbbVie is well-positioned to drive strong cash flows to support the company's next generation of pipeline drugs. At over 50% of total sales and a higher portion of earnings (due to higher margin revenue), Humira is well positioned to drive the majority of AbbVie's performance over the next three years. With approvals in rheumatoid arthritis, psoriasis, and Crohn's disease, Humira should continue to grow in these markets as penetration rates are below 25% on average. With leading efficacy and a favorable side-effect profile, we expect Humira to continue to post double-digit growth over the next couple of years.

Despite a strong near-term outlook for Humira, uncertainty around encroaching competition will likely weigh on investor sentiment toward the company. In particular, new JAK inhibitors and IL-17 antibodies represent major drug advancements in rheumatoid arthritis and psoriasis, which will likely lead to some market share losses for Humira. Also, while Humira's biologic composition may deter generic completion following the late-2016 patent loss in the U.S. and the 2018 patent loss in Europe, we model close to 20% annual revenue declines for Humira by 2019.

Beyond Humira, cancer drug Imbruvica is poised to become the next biggest sales contributor. Imbruvica's strong clinical data in several forms of blood cancer should lead to peak sales above \$6 billion. AbbVie's remaining drugs are largely mature with patent expirations long past, but have manufacturing or specific dosing complexities which make generic competition less likely.

Looking ahead, AbbVie's pipeline is weighted heavily toward new cancer drugs. In particular, AbbVie's pipeline should lead to an increasingly strong position in blood cancer. The company should be able to leverage its solid entrenchment with Imbruvica to launch the new drugs.

Economic Moat 06/10/2016

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 wide moats, one drug (Humira) represents the majority of AbbVie's sales (more than 50%) and profits (greater than 70%). As a result of both emerging branded competition to

Humira in the immediate term and a potential generic biosimilar threat in the 2017-18 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. Further supporting our narrow moat rating, AbbVie needs to improve its pipeline to be more ready for the eventual biosimilar competition to Humira.

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 company a leading candidate for smaller drug firms needing help to develop and commercialize innovative new drugs.

Valuation 06/10/2016

We are increasing our AbbVie fair value estimate to \$73 from \$65 largely due to increased expectations for the company's next generation immunology drugs targeting the IL23 and JAK pathways as these next pathways seem to offer better efficacy and an improved side effect profile. However, our \$28 billion 2020 total sales projection remains well below management's guidance of \$37 billion, with the primary difference regarding immunology drug Humira. While management is projecting 2020 Humira sales at more than \$18 billion, we project Humira sales at \$10 billion. We anticipate quicker launches of biosimilar versions of Humira after the December 2016 patent loss in the U.S. However, AbbVie believes other less-powerful patents will keep biosimilars off the market much longer. Helping offset the likely eventual Humira sales declines, cancer drug Imbruvica holds strong blockbuster potential in blood cancers. Also, the company has several other late-stage cancer drugs that should further help mitigate the eventual Humira sales declines. On the bottom line, over the next three years we expect improving margins, largely driven by the higher contribution to total sales by specialty drugs, which carry very high 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 06/10/2016

Similar to other drug companies, AbbVie faces the risks of new product 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 competition.

Management 06/10/2016

We believe AbbVie's management team has demonstrated Standard stewardship, as the key leaders haven't had much of a track record yet. While the failed acquisition attempt for Shire is concerning, we believe the new abrupt U.S. Treasury laws largely caused the acquisition to collapse, somewhat giving management a pass. Nevertheless, the \$1.6 billion breakup fee related to the failed Shire deal does show that management didn't gauge the political landscape correctly. Further, the \$21 billion Pharmacyclics acquisition appears to be a fair use of capital if Imbruvica reaches our \$6 billion peak sales projection.

Turning to management specifically, AbbVie is led by Rick Gonzalez, who joined Abbott in 1977 and held many managerial posts throughout his career there. 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. Backing up Gonzalez, CFO Bill Chase has been with Abbott for more than 20 years. Chase's background in licensing and acquisitions will be helpful, as AbbVie will need to redeploy the strong cash flows from Humira into acquisitions and partnering to augment the company's developing pipeline.

Overview

Profile:

AbbVie is a pharmaceutical company with a strong exposure to immunology and oncology. The company's top drug, Humira, represents over half of the firm's current profits. The company was spun off from Abbott in early 2013.

S&P 500 index data: S&P 500 Copyright @ 2016

All data from Morningstar except U.S. intraday real-time exchange quotes, which are provided by BATS when available. End-of-day quotes for Nasdaq, NYSE, and Amex securities will appear 15 minutes after close. Graph times are Eastern Standard. @ Copyright 2016 Morningstar, Inc.

Contact us. Please read our User's Agreement and Troubleshooting documents.
©2016 Morningstar, Inc. All rights reserved.