AbbVie Inc ABBV [XNYS] | ★★★

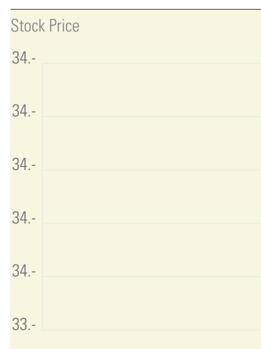
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
34.6 USD	38.00 USD	26.60 USD	51.30 USD	Medium	Narrow	Standard	A	Drug Manufacturers - Major

AbbVie's outlook is highly dependent on a well-positioned Humira.

by Damien Conover, CFA
Director
Analyst covering this company do not own its stock.

Pricing as of Jan 15, 2013.
Rating as of Jan 15, 2013.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Thesis Jan. 04, 2013

Armed with the 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. However, with AbbVie's next generation of drugs not likely to reach the market until 2015 and several midsized drugs losing patent protection, Humira's cash flows are particularly important. Furthermore, the company also holds a portfolio of hard-to-make drugs that will help supplement Humira's growth.

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 five years. With approvals in rheumatoid arthritis (RA), psoriasis, and Crohn's disease, Humira is well positioned for growth in these markets as penetration rates are below 20% on average. Despite the low penetration, these markets already represent multibillion-dollar opportunities. Furthermore, 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, Pfizer's PFE new RA drug, tofacitinib, represents a key new competitor, as it offers patients efficacy potentially as good as Humira in an oral form (in contrast to twice-monthly Humira injections). However, tofacitinib's side-effect profile is still not fully clear and represents some risks, which may delay physician acceptance unless patients fail an anti-TNF-alpha drug like Humira. Additionally, many Phase III RA drugs will likely reach the market over the next three years.

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. With the high degree of complexity in developing generic biologics, we anticipate a much smaller degree of generic erosion following Humira's patent loss. We model in 20% annual revenue declines for Humira following the loss of exclusivity.

Turning to the remainder of the company, a combination of products losing patent protection and mature drugs largely represent sales outside of Humira. The company's lipid-lowering franchises--Tricor, Trilipix, and Niaspan--will all face generic competition in 2013-14. In addition, many of the other remaining products have already lost patent protection, but due to manufacturing complexities have been able to retain a significant portion of sales.

Looking toward the future, AbbVie's pipeline is weighted heavily toward 2015 launches, with its hepatitis C drugs representing the crown jewel in the pipeline. While AbbVie holds other pipeline drugs, the company's next-generation hepatitis C drugs offer the potential to replace Humira sales if successful in Phase III development. Additionally, we expect AbbVie will redeploy capital through bolt-on acquisitions to strengthen its internal pipeline.

Valuation, Growth and Profitability

Our fair value estimate for AbbVie is $38 per share. Accounting for more than half of AbbVie's projected 2012 sales, Humira is the key driver of its valuation and outlook. We believe Humira's leading efficacy and relatively clean side-effect profile in underpenetrated treatment areas, including RA, psoriasis, and inflammatory bowel disease, will drive an 11% five-year CAGR for the drug. (In the analysis of the therapeutic areas below, we highlight Humira's competitive positioning.) However, we expect Humira sales will begin to decline approximately 20% beginning in 2018 as generic biologics increase and greater branded competition intensifies, which lowers our 10-year CAGR for the drug to -4%.

Aside from Humira, AbbVie holds several drugs that are losing patent protection over the next five years, which offsets the near-term Humira growth and results in a total

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Johnson & Johnson	USD	200,556	65,921	15,665	8,504
Pfizer Inc	USD	195,992	62,225	16,483	9,694
Merck & Co Inc	USD	130,328	47,824	8,903	6,773
Eli Lilly and Company	USD	61,841	22,693	4,738	4,120

sales five-year CAGR of 5%. Over the longer term, we expect pipeline products will help mitigate the heavy Humira declines in 2018. On the bottom line, over the next five years we expect slightly improving margins, largely driven by the higher contribution to total sales by Humira, which carries very high margins. However, we expect margins will fall toward the back half of our 10-year explicit forecast period as sales from Humira decline. For the weighted average cost of capital, we use an 8% rate that combines a 10% cost of equity and market rates for the cost of debt.

Risk

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 very exposed to any new competitive threats to Humira.

Bulls Say

- AbbVie will pay $1.60 per share in dividends, which should act as valuation support, as the cash flows to support the dividend are very secure over the next five years.
- We believe Humira represents one of the best immunology drugs for RA, Crohn's disease, and psoriasis, and we expect it will continue to penetrate these markets.
- The new competitive RA threat from Pfizer's Xeljanz will not likely take much share from Humira initially as Xeljanz's safety and efficacy profile is still uncertain and the drug requires heavy monitoring during usage.
- The company's hepatitis C pipeline drugs could take a meaningful piece of a market that should grow to over $20 billion by 2020.

Bears Say

- We expect AbbVie to lose close to $2 billion in sales over the 2013-14 time period as patents expire on cardiovascular drugs Niaspan, Trilipix and Tricor.
- The poor competitive position of HIV drug Kaletra will likely mean a slow sales decline over the next four years, creating a drag on overall company growth.
- Besides the hepatitis C drugs, AbbVie's pipeline prospects are as strong as the company needs to help ensure long-term growth following the Humira patent loss.
- New product launches and successful acquisitions are needed to support the company's dividend following the Humira patent loss.

Financial Overview

Financial Health:Over the next five years, AbbVie should generate very strong cash flows driven by Humira sales. After the Humira patent losses in the 2017-2018 time frame, we expect cash flow will fall significantly. However, successful pipeline development should help mitigate the loss of Humira.

Company Overview

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

Management: We believe AbbVie's management team has demonstrated standard stewardship, as the key leaders haven't had much of a track record yet and many decisions were overseen by Abbott's leadership, which had to balance a more diversified company. However, AbbVie's departure from Abbott highlights the company's high degree of exposure to Humira. Under Abbott's umbrella, AbbVie didn't create enough pipeline products both internally and through acquisitions to create the wide moat that many of its more diversified peers hold. The company's relatively poor

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positioning is a concern, but holding AbbVie management accountable is difficult given that AbbVie wasn't calling all the shots as part of Abbott.

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. Backing up Gonzalez, CFO Bill Chase has been with Abbott for over 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 light pipeline.

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AbbVie Inc(USD) ABBV

Last Close $	Sales $Mil	Mkt Cap $Mil	Industry	Currency
$34.09	$18,038	$53,862	Drug Manufacturers - Major	USD

AbbVie Inc is a pharmaceutical company with a portfolio of pharmaceuticals and biologics sold worldwide. Its products are used to treat diseases including rheumatoid arthritis, psoriasis, Crohn's disease, HIV, cystic fibrosis complications.

Morningstar Rating	Fair Value Uncertainty	Fair Value	Economic Moat	Style	Sector
★★★★ As of 01-14-2013	Medium	$38.00	Narrow		

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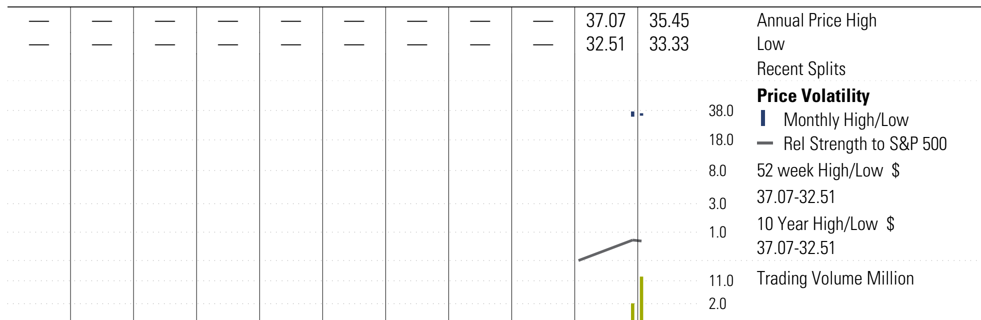
Phone: +1 847-932-7900
Website: http://www.abbvie.com

									2012	YTD	
—	—	—	—	—	—	—	—	—	37.07	35.45	Annual Price High
—	—	—	—	—	—	—	—	—	32.51	33.33	Low
											Recent Splits



Price Volatility
- Monthly High/Low
- Rel Strength to S&P 500

52 week High/Low $
37.07-32.51
10 Year High/Low $
37.07-32.51
Trading Volume Million

									2012	YTD	Stock Performance
—	—	—	—	—	—	—	—	—	—	1.0	Total Return %
—	—	—	—	—	—	—	—	—	—	-2.2	+/- Market
—	—	—	—	—	—	—	—	—	—	-3.6	+/- Industry
—	—	—	—	—	—	—	—	—	—	1.2	Dividend Yield %
—	—	—	—	—	—	—	—	—	—	53862	Market Cap $Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials (USD)
—	—	—	—	—	—	—	14214	15638	17444	18038	Revenue $Mil
—	—	—	—	—	—	—	71.5	72.6	73.4	75.5	Gross Margin %
—	—	—	—	—	—	—	4932	4717	3621	5375	Oper Income $Mil
—	—	—	—	—	—	—	34.7	30.2	20.8	29.8	Operating Margin %
—	—	—	—	—	—	—	4637	4178	3433	4893	Net Income $Mil
—	—	—	—	—	—	—	—	—	—	—	Earnings Per Share $
—	—	—	—	—	—	—	—	—	—	—	Dividends $
—	—	—	—	—	—	—	—	—	—	—	Shares Mil
—	—	—	—	—	—	—	—	—	—	9.92	Book Value Per Share $
—	—	—	—	—	—	—	5367	4976	6247	6452	Oper Cash Flow $Mil
—	—	—	—	—	—	—	-313	-448	-356	-343	Cap Spending $Mil
—	—	—	—	—	—	—	5055	4528	5891	6109	Free Cash Flow $Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
—	—	—	—	—	—	—	—	19.8	16.8	21.5	Return on Assets %
—	—	—	—	—	—	—	—	26.6	24.6	31.2	Return on Equity %
—	—	—	—	—	—	—	—	0.74	0.86	0.79	Asset Turnover
—	—	—	—	—	—	—	32.6	26.7	19.7	27.1	Net Margin %
—	—	—	—	—	—	—	—	1.3	1.6	1.6	Financial Leverage

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	09-12	Financial Health (USD)
—	—	—	—	—	—	—	—	—	—	—	Long-Term Debt $Mil
—	—	—	—	—	—	—	—	15703	12224	15669	Total Equity $Mil
—	—	—	—	—	—	—	—	—	—	—	Debt/Equity
—	—	—	—	—	—	—	—	4457	1457	5563	Working Capital $Mil

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM	Valuation
—	—	—	—	—	—	—	—	—	—	—	Price/Earnings
—	—	—	—	—	—	—	—	—	—	—	P/E vs. Market
—	—	—	—	—	—	—	—	—	—	3.0	Price/Sales
—	—	—	—	—	—	—	—	—	—	3.4	Price/Book
—	—	—	—	—	—	—	—	—	—	8.3	Price/Cash Flow

Growth Rates Compound Annual

Grade:	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	11.6	—	—	—
Operating Income %	-23.2	—	—	—
Earnings/Share %	—	—	—	—
Dividends %	—	—	—	—
Book Value/Share %	—	—	—	—
Stock Total Return	—	—	—	—
+/- Industry	—	—	—	—
+/- Market	—	—	—	—

Profitability Analysis

Grade:	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	31.2	—	17.2	20.7
Return on Assets %	21.5	—	8.2	8.5
Revenue/Employee $K	0.0	0.0	—	1090.4
Fixed Asset Turns	8.4	—	3.8	7.0
Inventory Turns	4.6	—*	2.6	13.4
Gross Margin %	75.5	—	71.0	43.8
Operating Margin %	29.8	—	22.3	19.3
Net Margin %	27.1	—	16.4	13.3
Free Cash Flow/Rev %	33.9	—	20.9	12.0
R&D/Rev %	15.0	—	14.8	—

Financial Position (USD)

Grade:	12-11 $Mil	09-12 $Mil
Cash	27	2761
Inventories	872	959
Receivables	3817	3098
Current Assets	7354	10931
Fixed Assets	2144	2139
Intangibles	9010	8523
Total Assets	19657	22730
Payables	417	424
Short-Term Debt	—	—
Current Liabilities	5897	5368
Long-Term Debt	—	—
Total Liabilities	7433	7061
Total Equity	12224	15669

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	—	—	16.8	15.0
Forward P/E	10.9	—	—	13.1
Price/Cash Flow	8.3	—	10.7	9.2
Price/Free Cash Flow	8.8	—	13.2	75.1
Dividend Yield %	1.2	—	3.7	2.3
Price/Book	3.4	—	2.9	2.1
Price/Sales	3.0	—	2.7	2.5
PEG Ratio	—	—	—	1.7

*3Yr Avg data is displayed in place of 5 Yr Avg

Quarterly Results (USD)

Revenue $Mil	Dec	Mar	Jun	Sep
Most Recent	4864.0	4172.0	4492.0	4508.0
Previous	—	3896.0	4274.0	4408.0
Rev Growth %	**Dec**	**Mar**	**Jun**	**Sep**
Most Recent	10.3	7.1	5.1	2.3
Previous	—	—	9.7	3.1
Earnings Per Share $	**Dec**	**Mar**	**Jun**	**Sep**
Most Recent	—	—	—	—
Previous	—	—	—	—

Close Competitors

	Mkt Cap $Mil	Rev $Mil	P/E	ROE%
Johnson & Johnson	201083	65921	23.9	13.6
Pfizer Inc	196875	62225	20.8	11.3

Major Fund Holders

	% of shares
SPDR S&P 500	0.00
Health Care Select Sector SPDR	0.00
iShares Core S&P 500 ETF	0.00

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Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

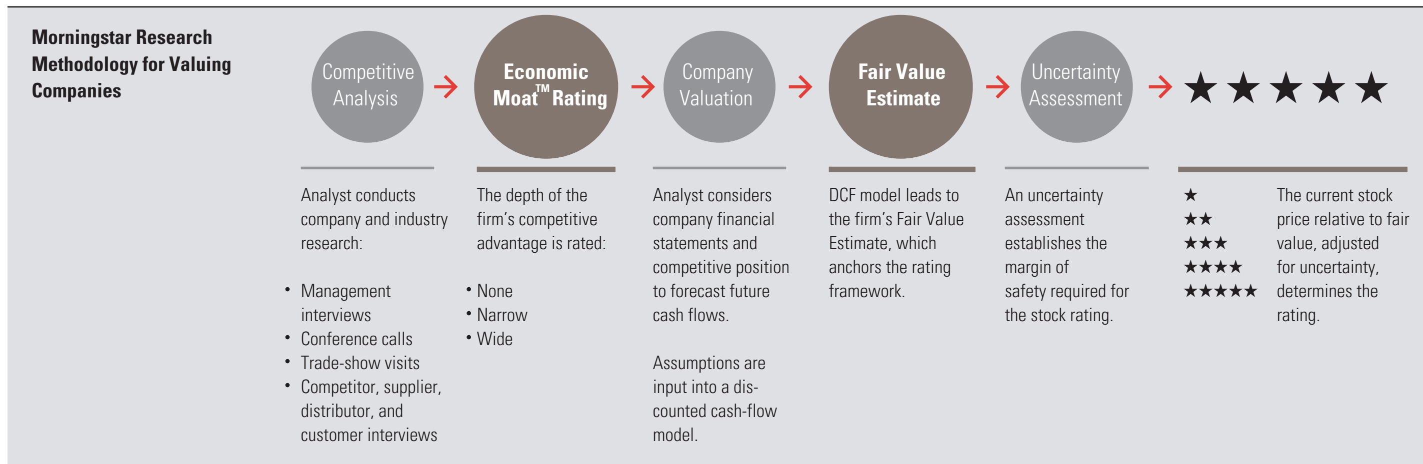
Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such



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economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

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