

AbbVie Inc ABBV |

Analyst Research Analyst Report Archive Top Rated Stocks in Sector

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



by **Damien Conover**

Authors can be reached at [Analyst Feedback](#)

Morningstar's [Editorial Policies](#)

Analyst Note

[Supported by Robust Humira Sales, AbbVie Posts Strong 2Q: Raising Fair Value Estimate](#)
by Damien Conover, 07/25/2014

Discuss

[See what other investors are saying about ABBV](#)

Investment Thesis 07/25/2014

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. However, with AbbVie's next generation of drugs not likely to reach the market until 2015 and several midsize drugs losing patents in the near term, Humira's cash flows are particularly important.

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, Pfizer's new RA drug, Xeljanz, represents a key new competitor, as it offers similar efficacy and oral dosage (in contrast to twice-monthly Humira injections). 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 in 20% annual revenue declines for Humira by 2019.

Beyond Humira, a combination of products losing patent protection and mature drugs largely represents sales outside of Humira. The company's lipid-lowering drugs--Tricor, Trilipix, and Niaspan--started facing generic competition in 2013. 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 ahead, AbbVie's pipeline is weighted heavily toward 2015 launches, with its hepatitis C drugs representing the crown jewel in the pipeline with upside reaching over \$3 billion annually. Also, the expected acquisition of Shire should create a low tax structure for the overall company and bring in several important neuroscience and rare disease drugs.

Economic Moat 07/25/2014

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 (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 holds a relatively weak pipeline with a high concentration of new drugs in the very competitive hepatitis C market. A stronger pipeline and a more diverse product lineup would be needed for a wide moat rating.

Morningstar's Take ABBV

Analyst		
Price 08-19-2014	Fair Value Estimate	Uncertainty
55.29 USD	51 USD	Medium
Consider Buy	Consider Sell	Economic Moat
35.7 USD	68.85 USD	Narrow
Morningstar Credit Rating		Stewardship Rating
A-		Standard

Bulls Say

- AbbVie supports a strong dividend yield of more than 3%, which should act as valuation support, as the cash flows to support the dividend are very secure over the next few 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.

Bears Say

- Several of AbbVie's pipeline products are partnered with other drug companies, which reduces the profit potential of the new drugs.
- 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 not as strong as the company needs to help ensure long-term growth following the Humira patent loss.

Competitors ABBV

More...

Name	Price	% Chg	TTM Sales \$ mil
AbbVie Inc	\$55.29	1.80	19,258
Johnson & Johnson	\$102.96	0.25	73,540
Novartis AG	\$88.55	0.71	59,629
Roche Holding AG	\$290.24	0.37	51,271
Roche Holding AG ADR	\$36.64	0.71	51,271
Roche Holding AG	\$287.00	0.17	51,271

[Compare These Stocks](#)

Video Reports ABBV

More...



Health Care a Leader in Moat Stocks

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 sales force 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 07/25/2014

We are raising our fair value estimate to \$51 per share from \$49 per share based on increased projections for Humira and AbbVie's hepatitis C drugs. Based on the strong launch from Gilead's hepatitis C drug Sovaldi, we are now expecting peak sales for AbbVie hepatitis C drugs to reach \$4.5 billion. Also, we slightly pushed back our timeline for expected Humira biosimilar competition to begin in 2018. Accounting for more than half of AbbVie's projected 2014 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 10% three-year CAGR for the drug. However, we expect Humira sales will begin to decline approximately 20% by 2019 as generic biologics increase and greater branded competition intensifies, which lowers our 10-year CAGR for the drug to negative 6%. 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 sales five-year CAGR of 5% (excluding the Shire product contributions). Including Shire, our five-year CAGR for sales is 12%. 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 improving margins, largely driven by the higher contribution to total sales by Humira, which carries very high margins. Also, the Shire acquisition allows AbbVie to lower its tax rate from 22% to approximately 13%. For the weighted average cost of capital, we use an 8% rate that combines a 8% cost of equity and market rates for the cost of debt.

Risk 07/25/2014

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. Key emerging competitive threats to Humira include Pfizer's oral RA drug Xeljanz, cheaper generic versions of Remicade in Europe, and several other Phase III drugs that hold very strong efficacy or more convenient dosing than Humira.

Management 07/25/2014

We believe AbbVie's management team has demonstrated Standard stewardship, as the key leaders haven't had much of a track record yet. However, with the likely Shire acquisition, we are seeing our first major use of capital by AbbVie's management team. Strategically, we like the deal as the addition of Shire's drugs helps to reduce the dependence on Humira. However, at the price paid for Shire, we see most of the economic benefits going to Shire shareholders.

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 light pipeline.

Overview

Profile:

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

S&P 500 index data: S&P 500 Copyright @ 2014

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 2014 Morningstar, Inc.