

Classification: Public

Gilead Sciences (Buy, CP: \$82.02, TP: \$132.00, GILD.OQ, Robyn Karnauskas)

4Q13 update: light taxes create more leverage for Sovaldi

4Q13 product revenues beat consensus by ~\$250M led by inventory & Sovaldi

Sovaldi 4Q13 sales were \$139M vs. \$75M consensus. Pure demand was roughly \$50M in the quarter. Remainder of sales came from inventory stocking & purchase for clinical trials. On the HIV front, mgmt noted that 1Q14 will be weaker with similar trends to 1Q13. This trend is driven by increased purchasing in 4Q13 & being at higher end of inventory range before '14 price increases. '14 guidance for base biz is \$11.3-\$11.5B. We are at \$11.5B. Reiterate Buy on valuation.

We have increased our Sovaldi numbers in '14 by \$700M to \$5.7B

We have taken up our numbers for US & EU Sovaldi over 2014 based on two trends 1) faster than expected launch in EU in a few countries (we previously assumed no sales in 1Q in EU) and 2) strong than expected new script trends in the US. Our new WW quarterly estimates are \$1.21B, \$1.91B, \$1.32B, and \$1.27B. In Gilead's early survey work, mgmt has found that the Sovaldi mix roughly reflects real world US genotypic mix (70% GT1 and 30% in GT 2 & 3).

We calculate every 1K new starts to Sovaldi could add \$250M-\$300M in revs

We assume warehousing in 2Q since we expect Sovaldi interferon free combo in mid 4Q14. We assume monthly new starts declining to ~4000/mo avg. in 2Q/3Q from the highs of ~13K in 1Q.

Mgmt color on taxes: supply arrangements allow US sales to have tax benefit

Mgmt noted that every \$1B of Sovaldi sales led to a lower tax rate of .75-1% irrespective of where the sales are located. Before the call, GILD had noted potential tax benefit over time from greater ex-US sales and IP in Ireland. On call today, we learned of new structuring supply arrangement that allows for US sales to flow out of Ireland manufacturing facility. These benefits will continue over a multi-year period but the magnitude of impact is greater in the near-term. The company has not given long-term tax guidance yet.

We estimate '14 tax rate at 23% which could further decrease to 18% over time if Sovaldi hits our revenue estimate

On core biz basis, there was no impact from R&D tax in 2014. This one-time benefit lead to a .5-.75% hit to their tax rate. We calculate 2014 tax rate at ~23.5% (28.5% core biz, then subtract 5% impact of \$5.7B Sovaldi sales). This math is based on our numbers suggest an implied Sovaldi tax rate at ~13% using revenue weighted calculations. This makes our weighted avg. tax rate for 2015 at ~21%. Every 100bps tax rate impacts 2015 EPS by 10c (1.3% our of '14 EPS).

Generic Sustiva will benefit COGS over next three years. We model COGS of 20% in '14 vs. 12% in '16

Sustiva (a component of Atripla not made by GILD) is going generic this year in Europe. In US, it will go generic in 2015. There is a step-down function of the royalty payments over three years according to mgmt.

Valuation & risks – Gilead still remains our top pick in large cap

We value GILD at \$132/sh using 17X 2015 multiple (10% discount to its biotech peers due to patent cliff on base biz). Our new '15 EPS is \$7.75/sh. Risks: weak sovaldi launch, poor base biz performance

Please click on below link for full report:

<http://pull.db-gmresearch.com/p/442-7CA3/21291538/0900b8c087e1098b.pdf>

Regards,

EVS Equity Focus

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