

Amgen (AMGN)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Amgen - business

Amgen - Misc thoughts

- What can go wrong?
 - Pipeline issues
 - Competition from other drugs
 - I am not an expert on bio-pharmas, no evaluation on competitiveness of the drugs, pipeline, etc.
 - Health legislation.
 - Side effects / lawsuits

Strategic considerations

- Moat (*switching costs, habit, low cost*):
 - What are the moats? Patents / uniqueness of drugs
 - What does it take to sustain the moats? R&D
 - Bargaining power of suppliers/customers? Healthcare insurance possibly has a high bargaining power
- Is it a low risk business? Not in the R&D. Somewhat low risk in existing products
- Is there high uncertainty? Yes, in R&D
- How capital intensive is the business?
- Future growth - unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Sustainable

Management

- I don't usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Is it a good business?

- 7 year history of profits
- ROE:
 - 11.70 12.00 18.00 15.60 17.70 20.60 2009:20.30 2010q1:20.5
- Margins
 - 2008: 28 2009:31.5 2010:32.5
- Growing earnings
- No dilution
- Very strong balance sheet
 - Cash+short term investments cover debt
- $ROIC = \text{Earnings} / (\text{Equity} + \text{Debt} - \text{Cash}) = \text{Earnings} / (\text{Assets} - \text{non-debt liabilities} - \text{Cash})$
 - $= 1167 \times 4 / (22667 + 11500 - 14000) = 23\%$ 2010q1

Is it a good business? Cash flow

- Strong cash flow
 - Q1 913M operating cash flow, 820M FCF (FCF = OCF - capital expenditures)
 - Operating cash flow higher than earnings per share - not in Q1
 - Free Cash Flow/Share higher than dividends paid - no dividends

Is business cheap? - Buffettology calculations

- ROE 20%, ROIC 23% - assume 17%
- Earnings in 10 years = $\text{ROE} \times \text{Equity} \times (1 + \text{ROE})^9 = \15.8B
- Equity in 10 years = $\text{Equity} \times (1 + \text{ROE})^9 = 93\text{B}$
- Market cap = $23.6\text{B} \times \text{P/E (15)} = \200B
- Rate of return = **-14.4%** after tax (calculations omitted)
- If we assume 20% ROE: 18.8%

Is business cheap? DCF

- Discounted cash flow
 - Current earnings of ~4.6B
 - 10% growth for 5 years, leveling after that
 - 10% discount -> \$69B current valuation (if you buy company at <\$69B, you will get 10% return or higher)
 - 15% discount -> \$44.7B current valuation
 - 5% growth for 10 years, leveling after that
 - 15% discount -> \$41.2B current valuation
 - 10% growth for 10 years, leveling after that
 - 15% discount -> \$56B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
 - $4.6B / (51B + 10.5B - 13.4B) = 9.6\%$
- What makes up the margin of safety? High ROE, high expected earnings
- Is there a sufficient margin of safety? Maybe

Is business cheap? - Graham investment considerations

- N/A for Amgen - included for completeness
- >2.2 P/Book - not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)