Amgen (AMGN)

Raimondas Lencevicius
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 \textit{(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**
- Growing earnings
- No dilution
- Very strong balance sheet
  - Cash+short term investments cover debt
- **ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)**
  - =1167*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 = ROE*Equity*(1+ROE)^9 = $15.8B
- Equity in 10 years = Equity*(1+ROE)^9 = 93B
- Market cap = 23.6B x 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 )