



COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

Key Metrics

LLY - NYSE (as of 08/29/17)	\$78.55
2 Year Price Target	\$94.00
52-Week Range	\$64.25 - \$86.71
Shares Outstanding (mm)	1,057
Market Cap. (\$mm)	\$86,483
1-Mo. Average Daily Volume (000s)	828
Institutional Ownership	77.6%
Debt / Total Capital	42.3%
ROE (TTM)	16.8%
Book Value / Share	\$13.34
Price / Book Value	5.9x
Indicated Dividend / Yield	\$2.08 2.6%
TTM Operating Margin	20.3%

Non-GAAP EPS FY 12/31

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.83		\$0.98A	\$1.06	\$1.06
2Q	\$0.86		\$1.11A	\$1.21	\$1.20
3Q	\$0.88	\$1.04	\$1.04	\$1.19	\$1.18
4Q	\$0.95	\$1.00	\$1.00	\$1.08	\$1.06
Year	\$3.52	\$4.13	\$4.13	\$4.54	\$4.51
P/E	22.3x		19.0x		17.4x

Figures may not add up due to rounding

Revenue (\$billions)

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$4.87		\$5.23A	\$5.46	\$5.46
2Q	\$5.40		\$5.82A	\$5.92	\$5.91
3Q	\$5.19	\$5.54	\$5.54	\$5.86	\$5.84
4Q	\$5.76	\$5.85	\$5.85	\$5.99	\$5.96
Year	\$21.22	\$22.44	\$22.44	\$23.22	\$23.16

Company Description – Eli Lilly & Company is a multinational biopharmaceutical company focused on developing and marketing innovative medicines in the areas of endocrinology, oncology, neuroscience, pain, and autoimmune diseases. The company also sells several cardiovascular medicines.

Pharmaceuticals

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Eli Lilly & Company

LLY – NYSE – Long-term Buy – 1

Model Update after Baricitinib and Semaglutide News

- **The News:** Lilly and partner Incyte announced plans to resubmit the New Drug Application for baricitinib for the treatment of rheumatoid arthritis before the end of January 2018. The decision comes after additional discussions with the FDA in recent weeks. The companies expect the resubmission package, which will include new safety and efficacy data, will be considered a Class II resubmission, which starts a new six month review process. Although this news is still not a guarantee for approval, we now believe approval is highly likely. We doubt Lilly's experienced regulatory team would take this risk without solid positive feedback from the FDA.

Two weeks ago, diabetes rival Novo Nordisk unveiled data from SUSTAIN 7, a Phase 3 trial of semaglutide pitted against Lilly's Trulicity. Semaglutide lowered HbA1c (a measure of average blood sugar levels) more and showed more weight loss than Trulicity with a similar safety profile. The safety profile was a surprise, as earlier trials displayed an uptick in diabetic retinopathy. Thus, while we had previously expected increased competition, we were far less concerned. However, the safety surprise leads us to lower our estimates for Trulicity.

- **Estimates Update:** Due to the Trulicity competitive issues, our FY18 estimates are modestly lower. However, the baricitinib news more than offsets the Trulicity adjustments in FY19 and beyond. Our FY17 estimates are unchanged. For FY18, we decreased our revenue estimate to \$23.16 billion from \$23.22 billion and lowered our non-GAAP EPS estimate to \$4.51 from \$4.54.
- **Valuation and Rating:** LLY closed yesterday at 18.3X our next 12 months non-GAAP EPS estimate. Given an attractive growth profile and well diversified portfolio, we believe this is a P/E set for expansion. Using both a P/E and DCF valuation methodology (see the next page), we are increasing our two year price target to \$94 from \$93 and maintaining our Long-term Buy rating.

Note Important Disclosures on pages 5 and 6
Note Analyst Certification on page 5

ADDITIONAL COMMENTARY

We are pleased to see the FDA seemingly reverse its position on baricitinib. As we wrote in previous reports and our August *Investment Perspectives* healthcare piece, we believe the FDA erred in its initial decision. European and Japanese regulatory authorities approved baricitinib with precautions for patients with cardiovascular risk factors, and we believe a similar label is now likely in the U.S. We think we will be below the Street consensus estimates for baricitinib given our outlook for the competitive landscape in multiple rheumatology categories, but it is still a huge market and therefore we consider this news to be a clear positive for Lilly.

VALUATION & RATING

LLY closed yesterday trading at 18.3X our next 12 months non-GAAP EPS estimate. Based on our expectations for the company's growth profile and a risk profile that we view as low relative to the industry, we believe this is a P/E set for expansion. Our two year price target is derived through two methodologies: 50% discounted free cash flow and 50% forward P/E. Our forward P/E portion is derived through a proprietary method that assesses the biopharmaceutical industry on the basis of risk and growth. Risk is measured by product concentration while growth is determined through either our estimates or market assumptions about long-term growth. For LLY, this results in a 22.5X multiple applied to FY18/FY19 GAAP EPS estimates for a \$92 price target. We note our use of GAAP estimates given weaker earnings quality, although we do project earnings quality to increase over the next few years. Our discounted free cash flow assumptions include an unchanged WACC of 7.8%. Our terminal growth rate estimate is 2.0%, and we added back net cash. The DCF model results in a \$95 price target. Thus, we assign shares a two year price target of \$94, a slight increase from our previous price target of \$93. We maintain our Long-term Buy rating.

SUITABILITY

Eli Lilly & Co. is a large and well-established biopharmaceutical company with a diversified portfolio and robust pipeline. Additionally, at this time, we believe Lilly is better positioned than peers to deal with any potential pricing regulation. However, we strongly note this favorable relative position does not equate to immunity from pricing regulation or market pressures. Based on these considerations, we assign LLY shares a suitability rating of 1.

RISKS & CONSIDERATIONS

- **Competition and innovation** – The biopharmaceutical business requires complex operations with many unique and uncertain aspects. A competitor or new company could produce new therapies that could displace LLY drugs.
- **Regulatory** – The biopharmaceutical industry is subject to an intense regulatory environment throughout a product life cycle. Regulatory actions against the company or an individual product may harm financial results.
- **Legal** – Product lawsuits are extremely common in the biopharmaceutical sector. An unfavorable court decision could hamper the ability to market a product or subject the company to earlier generic competition.

Prices of other stocks mentioned: Incyte Corporation (INCY - \$124.97)
Novo Nordisk (NVO - \$46.51)

Revenue Build											
<i>In millions</i>	<u>2015 A</u>	<u>2016 A</u>	<u>1Q17 A</u>	<u>2Q17 A</u>	<u>3Q17 E</u>	<u>4Q17 E</u>	<u>2017 E</u>	<u>2018 E</u>	<u>2019 E</u>	<u>2020 E</u>	<u>2021 E</u>
Strattera	784	855	196	187	107	97	587	366	323	288	257
Other Neuroscience	2,151	1,866	383	400	316	332	1,431	1,163	1,006	875	756
Humalog	2,842	2,769	708	678	635	724	2,746	2,653	2,581	2,525	2,471
Humulin	1,307	1,366	315	358	329	358	1,359	1,372	1,384	1,388	1,392
Forteo	1,348	1,500	348	447	410	437	1,641	1,693	1,578	1,356	1,301
Tradjenta	357	437	113	142	132	131	518	549	583	618	649
Jardiance	60	202	74	103	143	183	504	1,018	1,358	1,494	1,583
Trulicity	249	926	373	480	512	538	1,904	2,317	2,641	2,852	3,037
Basaglar	11	86	46	87	112	137	381	687	820	908	974
Other Endocrinology	862	798	147	197	157	155	655	557	539	519	502
Taltz	0	113	97	139	171	203	609	1,039	1,299	1,475	1,600
Olumiant	0	0	2	5	10	16	33	150	487	1,127	1,480
Alimta	2,493	2,283	490	533	531	506	2,060	1,940	1,834	1,764	1,300
Cyramza	384	614	171	186	185	184	726	812	864	922	946
Lartruvo	0	12	42	47	51	55	196	260	324	385	434
Abemaciclib	0	0	0	0	0	5	5	150	420	690	900
Other Oncology	633	813	184	189	194	166	734	707	666	634	604
Cialis	2,311	2,472	534	627	566	616	2,343	1,708	807	542	464
Other Cardiovascular	757	754	164	185	132	100	581	330	296	273	249
Other Pharmaceutical*	228	200	74	50	45	40	209	320	857	1,457	1,951
Animal Health	3,181	3,158	769	785	803	864	3,221	3,373	3,618	3,835	4,016
Total	<u>19,959</u>	<u>21,222</u>	<u>5,228</u>	<u>5,824</u>	<u>5,542</u>	<u>5,846</u>	<u>22,441</u>	<u>23,165</u>	<u>24,285</u>	<u>25,927</u>	<u>26,868</u>
% of Total											
Neuroscience	14.7%	12.8%	11.1%	10.1%	7.6%	7.3%	9.0%	6.6%	5.5%	4.5%	3.8%
Endocrinology	35.3%	38.1%	40.6%	42.8%	43.8%	45.5%	43.3%	46.8%	47.3%	45.0%	44.3%
Immunology	0.0%	0.5%	1.9%	2.5%	3.3%	3.7%	2.9%	5.1%	7.4%	10.0%	11.5%
Oncology	17.6%	17.4%	17.0%	16.4%	17.3%	15.7%	16.6%	16.7%	16.9%	17.0%	15.6%
Cardiovascular	15.4%	15.2%	13.3%	13.9%	12.6%	12.2%	13.0%	8.8%	4.5%	3.1%	2.7%
Other Pharmaceutical*	1.1%	0.9%	1.4%	0.9%	0.8%	0.7%	0.9%	1.4%	3.5%	5.6%	7.3%
Animal Health	15.9%	14.9%	14.7%	13.5%	14.5%	14.8%	14.4%	14.6%	14.9%	14.8%	14.9%

* Includes our estimate of risk-adjusted revenues from the pipeline

Source: Company Reports and Hilliard Lyons Estimates

Eli Lilly & Co. <i>In billions (except share data)</i> <i>Fiscal Period End</i>	LLY: Long-term Buy										
	2015 A 12/31/2015	2015 A 12/31/2016	1Q17 A 3/31/2017	2Q17 A 6/30/2017	3Q17 E 9/30/2017	4Q17 E 12/31/2017	2017 E 12/31/2017	2018 E 12/31/2018	2019 E 12/31/2019	2020 E 12/31/2020	2021 E 12/31/2021
	Income Statement										
Net Revenue	19.96	21.22	5.23	5.82	5.54	5.85	22.44	23.16	24.28	25.93	26.87
Gross Margin %	74.8%	73.4%	74.6%	73.4%	70.8%	71.6%	72.5%	72.2%	73.4%	74.9%	75.6%
Core Operating Expenses	11.3	11.7	2.8	3.0	2.7	3.0	11.5	11.4	11.9	12.5	12.9
GAAP Core Operating Income	3.6	3.9	1.1	1.3	1.2	1.1	4.7	5.4	5.9	6.9	7.4
GAAP Operating Margin %	18.0%	18.2%	21.4%	22.6%	21.2%	19.5%	21.1%	23.1%	24.5%	26.8%	27.5%
Non-Core Expenses	0.8	0.5	1.1	0.1	0.2	(0.0)	1.3	0.1	0.1	0.1	0.1
Non-GAAP Adjustments	1.8	1.3	1.3	0.2	0.4	0.2	2.1	0.9	0.8	0.7	0.5
Non-GAAP Pre-Tax Profit	4.6	4.7	1.3	1.5	1.4	1.3	5.6	6.1	6.6	7.5	7.7
Margin %	23.2%	22.0%	25.2%	25.8%	25.0%	23.0%	24.8%	26.3%	27.3%	28.8%	28.8%
Non-GAAP Effective Tax Rate	12.7%	20.1%	21.2%	21.7%	21.3%	22.3%	21.6%	22.3%	22.3%	22.4%	22.4%
Non-GAAP Net Income	3.7	3.7	1.0	1.2	1.1	1.0	4.4	4.7	5.2	5.8	6.0
Diluted Shares Outstanding	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0
GAAP Diluted EPS	\$2.26	\$2.58	-\$0.10	\$0.95	\$0.77	\$0.90	\$2.52	\$3.86	\$4.30	\$5.06	\$5.43
Non-GAAP Diluted EPS	\$3.43	\$3.52	\$0.98	\$1.11	\$1.04	\$1.00	\$4.13	\$4.51	\$4.94	\$5.56	\$5.79
	Balance Sheet										
Cash and Equivalents	3.7	4.6	2.6	3.1	3.7	3.9	3.9	4.9	7.1	10.1	13.1
Other Current Assets	8.9	10.5	10.4	12.7	11.4	11.8	11.8	11.7	11.6	11.7	11.8
Total Current Assets	12.6	15.1	13.0	15.7	15.2	15.7	15.7	16.7	18.7	21.8	24.9
Net PP&E	8.1	8.3	8.4	8.6	8.5	8.4	8.4	8.0	7.7	7.5	7.4
Other Assets	14.9	15.5	16.2	16.6	16.6	16.6	16.6	16.6	16.6	16.6	16.6
Total Assets	35.6	38.8	37.6	40.9	40.3	40.8	40.8	41.3	43.1	45.9	48.9
Current Liabilities	8.2	11.0	10.4	11.3	10.9	11.2	11.2	10.8	11.0	11.3	11.5
Non-Current Liabilities	12.7	13.7	13.1	15.5	14.7	14.7	14.7	14.3	14.1	14.1	14.1
Total Liabilities	21.0	24.7	23.5	26.8	25.6	25.8	25.8	25.1	25.0	25.4	25.5
Total Shareholders' Equity	14.6	14.1	14.1	14.2	14.8	14.9	14.9	16.2	18.0	20.6	23.4
	Cash Flow Statement										
Cash Flow from Operations	3.0	4.9	0.3	1.7	2.0	1.3	3.4	6.0	6.6	7.2	7.3
Cash Flow from Investing	0.0	(3.1)	(1.4)	(2.2)	(0.5)	(0.3)	(4.5)	(1.4)	(1.4)	(1.5)	(1.5)
Cash Flow from Financing	(3.1)	(0.6)	(0.9)	1.1	(0.8)	(0.8)	(1.4)	(3.5)	(3.0)	(2.7)	(2.8)
Free Cash Flow to Equity	-3.8	4.0	-2.1	2.5	1.5	1.0	2.8	3.7	4.9	5.8	5.9

Source: Company Reports and Hilliard Lyons estimates

Additional information is available upon request.

Analyst Certification

I, Kurt A. Kemper, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings:

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Definitions of Suitabilities:

1. A large cap, core holding with a solid history.
2. A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks.
3. An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage.
4. Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	38	30%	11%	89%
Hold/Neutral	77	61%	8%	92%
Sell	11	9%	0%	100%

As of 9 August 2017

Other Disclosures

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