

## Sector View

## Healthcare

## A more challenging 2016 for healthcare stocks? Three new names in the "Top Pick List"

	1 M	3 M	6 M	31/12/14
Healthcare	-1.7%	5.4%	-1.2%	14.6%
DJ Stoxx 600	-4.8%	5.7%	-5.5%	6.8%

\*Stoxx Sector Indices

## Companies covered

<b>ABLYNX</b>	<b>BUY</b>	<b>EUR18 vs 17</b>
<i>Last Price</i>	EUR15,905	<i>Market Cap.</i> EUR872m
<b>ACTELION</b>	<b>BUY</b>	<b>CHF159</b>
<i>Last Price</i>	CHF139,6	<i>Market Cap.</i> CHF15,932m
<b>ADOCIA</b>	<b>BUY</b>	<b>EUR113</b>
<i>Last Price</i>	EUR73,22	<i>Market Cap.</i> EUR501m
<b>ASTRAZENECA</b>	<b>BUY</b>	<b>5550p</b>
<i>Last Price</i>	4616,5p	<i>Market Cap.</i> GBP58,347m
<b>BAYER</b>	<b>NEUTRAL</b>	<b>EUR126 vs 124</b>
<i>Last Price</i>	EUR115,8	<i>Market Cap.</i> EUR95,761m
<b>BIOMERIEUX</b>	<b>BUY</b>	<b>EUR121 vs 112</b>
<i>Last Price</i>	EUR109,9	<i>Market Cap.</i> EUR4,336m
<b>BONE THERAPEUTICS</b>	<b>BUY</b>	<b>EUR29 vs 26</b>
<i>Last Price</i>	EUR19,49	<i>Market Cap.</i> EUR134m
<b>CELBYAD</b>	<b>BUY</b>	<b>EUR81</b>
<i>Last Price</i>	EUR48,4	<i>Market Cap.</i> EUR451m
<b>DBV TECHNOLOGIES</b>	<b>BUY</b>	<b>EUR92 vs 83</b>
<i>Last Price</i>	EUR66,43	<i>Market Cap.</i> EUR1,601m
<b>ERYTECH</b>	<b>BUY</b>	<b>EUR51</b>
<i>Last Price</i>	EUR25,62	<i>Market Cap.</i> EUR201m
<b>FRESENIUS MED.CARE</b>	<b>BUY</b>	<b>EUR97 vs 90</b>
<i>Last Price</i>	EUR77,73	<i>Market Cap.</i> EUR24,318m
<b>FRESENIUS SE</b>	<b>BUY</b>	<b>EUR68 vs 64</b>
<i>Last Price</i>	EUR65,97	<i>Market Cap.</i> EUR35,955m
<b>GALAPAGOS</b>	<b>BUY</b>	<b>EUR64</b>
<i>Last Price</i>	EUR56,76	<i>Market Cap.</i> EUR2,218m
<b>GENMAB</b>	<b>BUY</b>	<b>DKK1170</b>
<i>Last Price</i>	DKK917,5	<i>Market Cap.</i> DKK54,428m
<b>GENOMIC VISION</b>		
<i>Last Price</i>	EUR8,79	<i>Market Cap.</i> EUR39m
<b>GLAXOSMITHKLINE</b>	<b>NEUTRAL</b>	<b>1540p vs 1530p</b>
<i>Last Price</i>	1373p	<i>Market Cap.</i> GBP66,822m
<b>INNATE PHARMA</b>	<b>BUY</b>	<b>EUR19</b>
<i>Last Price</i>	EUR13,54	<i>Market Cap.</i> EUR728m
<b>IPSEN</b>	<b>BUY</b>	<b>EUR63</b>
<i>Last Price</i>	EUR61	<i>Market Cap.</i> EUR5,077m
<b>KORIAN</b>	<b>SELL</b>	<b>EUR38</b>
<i>Last Price</i>	EUR33,68	<i>Market Cap.</i> EUR2,676m
<b>LDR HOLDING</b>	<b>BUY</b>	<b>USD53</b>
<i>Last Price</i>	USD25,11	<i>Market Cap.</i> USD729m
<b>NICOX</b>	<b>Under review</b>	<b>U.R.</b>

## LOOKING BACK ON 2015

In 2015, Healthcare stocks outperformed the general indices for the fifth consecutive year and the outperformance was 7.3% when comparing the Stoxx Healthcare to the Stoxx Europe 600. However, it is worth mentioning that the last quarter of the year was less good as the sector then underperformed by 0.05% with a very wide range of performances in absolute terms coming from Novartis (-3%) and Sanofi (-7%) that disappointed by announcing flat EPS growth for the next three years up to 13% and 19% for Actelion and UCB respectively.

In more general terms, 2015 was another record year for the number of approvals in the US with a total of 45 new drugs approved, up from 41 the year before. This is indeed recognition of the recovered ability of the industry to bring innovative drugs on a more regular basis to the market. But the other side of the coin is that too many innovative drugs then question how to pay for them as healthcare costs are already very high. And we have seen as a consequence increasing difficulties for industry players to be paid for the innovation they are bringing.

That is why 2015 was made up of a mix of authentic successes and disappointments. It looks more difficult in Primary Care with the examples of respiratory drugs, diabetes and heart drugs in trouble to perform, contrasting with Speciality Care which still looks relatively protected as illustrated by MS and oncology medicines. From that perspective, 2015 clearly confirmed promises for the immune-oncology drugs (and in particular the anti-PD1/PD-L1) whereas ocrelizumab was the first drug to show positive phase III data in PPMS.

Altogether, the regular flow of innovation, the increasing pressures on prices but also the requirement for more combinations should confirm the trend in favour of more focused strategies and portfolios. This was again illustrated in 2015 with the listing of Covestro (a first step towards a less diversified Bayer), the asset swap between Sanofi and B.I. or the deal between AstraZeneca and Celgene in immuno-haematology.

## WHAT WE SEE FOR Q1 2016

The last part of 2015 was already more challenging for the healthcare sector and we expect 2016 to feed with the same ingredients to make this year of presidential elections in the US a more volatile one for the sector as a whole. In particular, we do expect a lot of noise around the need for a reform of the drug pricing system and we may anticipate some more pressure on this front.

That being said, several stocks trade at severe discounts to their respective highs (see Bayer, Novartis or Sanofi) and, in general, valuations are back to relatively attractive levels. Even if valuation *per se* does not make an investment case appealing because other elements are required, including a good momentum, it is difficult for us to warn about unreasonable price levels, hence the absence of any SELL rating as we start the new year.

True is however that 2016 is not expected to be a fantastic year in terms of growth as most of the companies in our European universe will face significant generic headwinds (Novartis' Gleevec, AZN's Crestor, Sanofi's Lantus, Actelion's Tracleer etc ...) while investing behind new launches or new growth platforms.

After Novartis-GSK and more recently Sanofi-B.I., we would expect more asset swaps and BD transactions as several portfolios still need to be reshuffled and refocused. This is a good reason why we will still approach our sector vertically, i.e. covering both small and large cap companies as they will increasingly interact together. Hence our interest in Adocia and Zealand or Genmab and Innate to leverage our global understanding of the diabetes and haemato-oncology businesses respectively.

Last Price EUR9,124 Market Cap. EUR209m

## CONCLUSIONS AND TOP PICKS

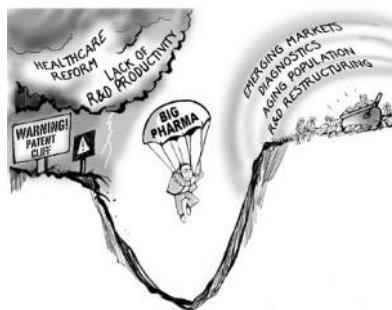
<b>NOVARTIS</b>	<b>BUY</b>	<b>CHF109</b> <b>vs 107</b>
Last Price	CHF86,8	Market Cap. CHF232,363m
<b>NOVO NORDISK</b>	<b>NEUTRAL</b>	<b>DKK425</b> <b>vs 415</b>
Last Price	DKK399,9	Market Cap. DKK824,819m
<b>ORPEA</b>	<b>BUY</b>	<b>EUR76</b>
Last Price	EUR73,78	Market Cap. EUR4,431m
<b>QIAGEN</b>	<b>Under review</b>	<b>U.R.</b>
Last Price	EUR25,115	Market Cap. EUR6,020m
<b>ROCHE HOLDING</b>	<b>BUY</b>	<b>CHF338</b> <b>vs 327</b>
Last Price	CHF276,4	Market Cap. CHF194,188m
<b>SANOFI</b>	<b>NEUTRAL</b>	<b>EUR90</b>
Last Price	EUR78,6	Market Cap. EUR102,622m
<b>TRANSGENE</b>		<b>EUR12</b>
Last Price	EUR2,53	Market Cap. EUR98m
<b>UCB</b>	<b>NEUTRAL</b>	<b>EUR75</b> <b>vs 73</b>
Last Price	EUR83,23	Market Cap. EUR16,189m
<b>ZEALAND</b>	<b>BUY</b>	<b>DKK200</b>
Last Price	DKK151,5	Market Cap. DKK3,689m

Hence we come to our selection for Q1 2016. We have tried to be balanced by segment and size when selecting the various names and here is the final list: **Bone Therapeutics** is jumping in as we see a rich first-quarter that we approach with optimism; **Genmab** is also joining because we anticipate a dense direct and indirect news-flow for the company at the start of the year; because we are strong believers in a favourable year for the UK large caps, we have opted for **AstraZeneca** that enjoys superior upside to its FV than GSK and more attractive news-flow too. Thinking about a fourth seat for a healthcare stock, we fluctuated between Roche and Actelion and finally decided not to pick either of the two for Q1 as we would like to see how their guidances for 2016 are made first and there are two other strong BUY recommendations in our coverage list.

The reason why we picked **AstraZeneca (BUY – FV GBP5,550)** in the large cap pharma universe is because we think that 2016 will be selective and transformative stories only will be able to perform strongly in a more challenging environment. In the recent two years, Bayer and Novartis benefited strongly from structural changes. 2016 will be the pivotal year in which AstraZeneca will at the same time lose a significant part of US Nexium and US Crestor but also increase the contribution from new growth engines like Brillinta, Lynparza, Farxiga or Tagrisso while new opportunities will continue to arise across the year with new phase III study read-outs, filings and approvals, including benralizumab, saxadapa or durvalumab. Moreover, we expect the two most recent strategic transactions with ZS Pharma and Actera to contribute also to the positive news-flow as early as in 2016. Lastly, from a financial perspective, and despite the loss of exclusivity of key historical drugs and their impact on profits and margins, we think that AstraZeneca can manage its bottom-line and deliver another flat year of core EPS on which it will then build an undisputed growth trajectory over the following 7-8 years until 2023. That is why we think it is worth buying now despite a couple of years of flattish core EPS ahead.

We're also adding **Genmab (BUY – FV DKK1,170)** to our list. Its lead product, Darzalex (daratumumab), has recently been approved for the treatment of double-refractory or heavily pre-treated patients with multiple myeloma. Plus, impressive novel data were presented during the ASH conference... But we do believe this is not the end of the story. We have identified several other catalysts that should materialise during this Q1 16 : 1/ the approval of ofatumumab as a maintenance therapy for CLL; 2/ a positive read-across arising from the granting of a priority review for Roche's ocrelizumab in multiple sclerosis to be filed shortly both in RRMS and PPMS; 3/ the icing on the cake, we think a deal between JNJ (which currently retains all rights on daratumumab) and another big pharma is very likely in order to explore further the potential of combining the drug with others with different mechanisms of action. By the way, Q2-16 will also be of importance as we expect positive phase III results for Darzalex as a second-line therapy.

Lastly, we are adding **Bone Therapeutics (BUY – FV EUR29)** to our Q1 top picks list. After its successful Euronext IPO in February 2015, the company delivered on its pipeline with (i) positive results from the first patients cohort in its pivotal delayed-union phase IIb/III trial, (ii) the initiation of the spine fusion phase IIa trial, and (iii) expansion of its footprint in the US with the opening of its headquarters. Moreover, the application of the company's autologous technology in the osteoporosis indication has been proven safe in the first patients infused. We expect a strong news-flow in Q1 this year, with the results from the second patient cohort in the delayed union trial (phase IIa/III). Recall that if interim results expected in H1 2016 showed a 75% (n=12) responder rate in the first 16 patients treated, the study could be prematurely stopped and phase III initiated, adding ~EUR12 to our fair value. As mentioned above, the IV route has been proved safe in patients suffering from osteoporosis (72h follow-up showing migration of osteoblastic cells to the skeleton). Although cautious (EUR3 of our fair value), should the results be positive which would add a further EUR3, we would expect the company to proceed to a development strategy update (partnership opportunity?) to maximise the value of the product in a highly capital-intensive indication.



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