

AstraZeneca

Price 4,143p

Billions of market cap for a 10-cent difference in 2016 core EPS?

Fair Value 5550p (+34%)

BUY-Top Picks

Bloomberg	AZN LN
Reuters	AZN.L
12-month High / Low (p)	4,863 / 3,904
Market Cap (GBP)	52,374
Ev (BG Estimates) (GBP)	61,566
Avg. 6m daily volume (000)	2,305
3y EPS CAGR	-0.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.5%	0.4%	-5.5%	-10.3%
Healthcare	-10.4%	-12.8%	-18.6%	-12.0%
DJ Stoxx 600	-7.8%	-13.5%	-17.6%	-10.1%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	23,641	21,778	21,175	22,591
% change		-7.9%	-2.8%	6.7%
EBITDA	5,937	7,053	6,613	7,321
EBIT	4,114	5,523	5,381	5,786
% change		34.2%	-2.6%	7.5%
Net income	5,390	5,055	4,961	5,304
% change		-6.2%	-1.9%	6.9%

	2015	2016e	2017e	2018e
Operating margin	17.4	25.4	25.4	25.6
Net margin	6.8	12.0	11.2	13.2
ROE	8.6	14.6	14.0	18.6
ROCE	16.2	14.6	12.5	13.1
Gearing	47.7	76.1	86.8	99.7

(USD)	2015	2016e	2017e	2018e
EPS	4.26	4.00	3.93	4.20
% change	-	-6.2%	-1.9%	6.9%
P/E	14.2x	15.1x	15.4x	14.4x
FCF yield (%)	NM	NM	4.4%	3.6%
Dividends (USD)	2.80	2.80	2.80	2.80
Div yield (%)	4.6%	4.6%	4.6%	4.6%
EV/Sales	3.6x	4.1x	4.3x	4.1x
EV/EBITDA	14.3x	12.7x	13.7x	12.6x
EV/EBIT	20.7x	16.3x	16.8x	15.9x

The debate concerning core EPS at AstraZeneca over the 2015-2017 timeframe is overdone in our view although it says a lot about the current market psychology. It does place somewhat more pressure on AstraZeneca to deliver on R&D promises but since it is the basis of our call, we are sticking very much to it and firmly confirm our BUY recommendation with an unchanged FV.

ANALYSIS

- I don't want to be wrong in the way I interpret what the market told us yesterday when it brought the AstraZeneca share price down by about 6%. But my understanding is that what matters is guidance for 2016 as it was more or less clear that AstraZeneca would keep its core EPS relatively flat over the transition period of 2015-2017 at around USD4.20 in CER terms. Last year landed at USD4.26 but guidance (low-to-mid-single digit decline at CER + 3% negative currency impact) suggests a reported 2016 number of about USD4.00-4.05. This was very much in line with what the consensus was expecting although some CS makers were slightly more bullish at around USD4.10-4.15. Moreover, some seem surprised to hear that the guidance factors in higher externalisation revenues than in 2015. This is not new. And why would we consider this line in a different way than others?
- So, what does a USD0.10-0.15 difference in 2016 core EPS means for the investment case? In our view, nothing, but this view is not shared by the market. A couple of years ago, as Pascal Soriot was implementing his strategy, the question that became a leitmotiv was: "what's the floor for 2015-2017?" (on top of the one about dividends, which no longer persists). We think the company has now embarked on its journey to return to growth and has delivered the first drugs (Lynparza, Tagrisso), good data (durva/treme, anifrolumab), has progressed with others and made well-perceived acquisitions (ZS Pharma, Acerta). By the way, it was clearly stated that some of the acquisitions would be EPS dilutive in year 1 i.e. in 2016. So, are we still at the point where a USD0.10 change in 2016 core EPS matters? With PT003 and ZS-9 approvals on the way, phase III data read-outs for durva in H&N or selumetinib in lung, the filings of benralizumab, acalabrutinib and SOCRATES all in 2016? Again our answer is "no".
- If AstraZeneca is successful in its bid to offset the negative currency impact on EPS (quote from P. Soriot during the call), then the final 2016 figure could be USD4.10 rather than USD4.00. Before yesterday, we were even lower than that, so the least we can say is that we are not worried at all. What does it mean for 2017 now? Four more months of Crestor in the US, some more in Europe and most of the profitable Seroquel XR will fly away but also much more of Tagrisso, Lynparza, but also hopefully of PT003, ZS-9, saxa-dapa and benralizumab if we are right with the use of the voucher will be in. So, again, we see it more or less flat vs 2016. Should more of the pipeline come through then more S&M costs would be incurred in 2017 and 2018, but this would also mean that the strategy is working and is a success.

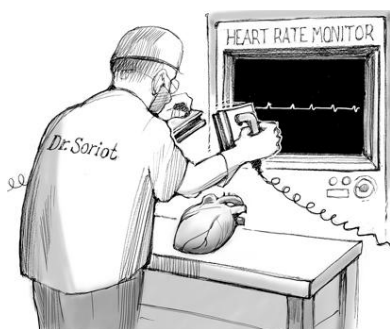
VALUATION

- What happened yesterday is very illustrative of current market conditions, the nervousness around each publication and the interpretation of any specifics in it (see also how deep the reaction was for Novo-Nordisk!).
- Because AstraZeneca is very dependent on its pipeline delivery, the market is requiring a solid floor on which the growth phase can be built. Our belief is that keeping EPS in the USD4.00-4.20 range by 2017 is fine. But it reminds us that AstraZeneca has always committed itself to revenue targets and never to earnings guidance. And so probably, yesterday's small difference in 2016 EPS raised this question again ... what is the profitability attached to the targeted revenues? Clearly this will also depend on how externalisation deals are structured.

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