6th April 2016

Sector View

Healthcare

Top Picks Q2. FRESENIUS, IPSEN and ABLYNX join ACTELION while ASTRAZENECA, GENMAB and BONE THERAPEUTICS are out

	1 M	3 M	6 M	31/12/15
Healthcare	-2.0%	-12.4%	-10.1%	-12.7%
DJ Stoxx 600	-4.0%	-8.6%	-8.4%	-10.3%

*Stoxx Sector Indices

Companies covered

ABLYNX		**BUY**	**EUR17 vs. 18**
Last Price	EUR13,02	*Market Cap.*	EUR720m
ACTELION		**BUY**	**CHF163 vs.166**
Last Price	CHF143,9	*Market Cap.*	*CHF16,423m*
ADOCIA		**BUY**	**EUR93 vs. 100**
Last Price	EUR62,56	*Market Cap.*	*EUR428m*
ASTRAZENECA		**BUY**	**5360p vs 5520p**
Last Price	3951p	*Market Cap.*	*GBP49,960m*
BAYER		**NEUTRAL**	**EUR108 vs. 113**
Last Price	EUR100	*Market Cap.*	*EUR82,695m*
BIOMERIEUX		**BUY**	**EUR115 vs. 118**
Last Price	EUR102,45	*Market Cap.*	*EUR4,042m*
BONE THERAPEUTICS		**BUY**	**EUR30**
Last Price	EUR18,2	*Market Cap.*	*EUR125m*
CELLECTIS		**BUY**	**EUR37**
Last Price	EUR25,64	*Market Cap.*	*EUR902m*
CELYAD		**BUY**	**EUR77**
Last Price	EUR38,76	*Market Cap.*	*EUR361m*
DBV TECHNOLOGIES		**BUY**	**EUR89 vs. 92**
Last Price	EUR59,7	*Market Cap.*	*EUR1,439m*
ERYTECH		**BUY**	**EUR48 vs. 51**
Last Price	EUR26,58	*Market Cap.*	*EUR211m*
FRESENIUS MED.CARE		**BUY**	**EUR94 vs. 97**
Last Price	EUR76,91	*Market Cap.*	*EUR23,562m*
FRESENIUS SE		**BUY**	**EUR70 vs. 68**
Last Price	EUR63,21	*Market Cap.*	*EUR34,501m*
GALAPAGOS		**BUY**	**EUR62 vs. 63**
Last Price	EUR37,25	*Market Cap.*	*EUR1,460m*
GENMAB		**BUY**	**DKK1225**
Last Price	DKK913	*Market Cap.*	*DKK54,486m*
GLAXOSMITHKLINE		**BUY**	**1670p**
Last Price	1419p	*Market Cap.*	*GBP69,116m*
INNATE PHARMA		**BUY**	**EUR18 vs. 19**
Last Price	EUR12,23	*Market Cap.*	*EUR658m*
IPSEN		**BUY**	**EUR60**
Last Price	EUR50,92	*Market Cap.*	*EUR4,239m*
LDR HOLDING		**BUY**	**USD38 vs. 41**
Last Price	USD26,84	*Market Cap.*	*USD784m*
NOVARTIS		**NEUTRAL**	**CHF95**
Last Price	CHF69,4	*Market Cap.*	*CHF185,783m*
NOVO NORDISK		**NEUTRAL**	**DKK400 vs. 416**
Last Price	DKK362,7	*Market Cap.*	*DKK748,092m*
QIAGEN		**NEUTRAL**	**EUR22**
Last Price	EUR19,93	*Market Cap.*	*EUR4,777m*

LOOKING BACK AT Q1 2016

The Healthcare sector significantly derated in Q1 amid concerns over the pricing power of innovation from pharmaceutical companies while entering an election year in the US. Several consecutive years with a dense flow of drug approvals have raised concern about adoption rates and coverage of healthcare costs going forward with a variety of new initiatives being implemented as a consequence. The increasing incidence of pay-for-performance pricing models, the rising level of rebates, increasing use of exclusive contracting etc… is raising the bar to reach commercial success with innovative drugs.

Fundamentals remain strong as long as innovation drives performance but we are simply at a point in the cycle when pressure is exacerbated by the aim of public representatives whoever they are to please patients/voters. And with the Supreme election coming in the US, we do not see this pressure slowing-down by any means. Beyond environment issues, we also see more competition.

As such, the STOXX600 Healthcare dropped 13% in Q1, underperforming the EUROSTOXX 50 index by 500bp (-8% in Q1), the worst relative quarterly performance since 2011. This was particularly well reflected by one of the worst performers in the quarter i.e. heavy weight Novartis that plummeted 20% amid concerns over the take-off of its highly advertised CHF drug Entresto.

WHAT WE EXPECT FOR Q2 2016

Entering Q2 2016, we see some signs of stabilization in the biotech segment if only because valuations have come down a lot, creating some M&A opportunities. The same should apply to pharmaceuticals where price-to-growth ratios like PEG have fallen significantly. That said, momentum continues to appear uncertain because these tough times for drug launches are likely to be reflected in disappointing quarterly sales reports for Q1. Moving closer to the US elections is unlikely to help and debate around the need for new healthcare reform that would favour generic/biosimilar use and limit price increases is very likely to strengthen. Mainly because of this adverse environment, we have decided not to include any large cap pharmaceutical stock in our Top Pick list for the ongoing quarter.

In order to drive through the quarter safely, we have also decided to exclude names with a low free float and too small market capitalisation.

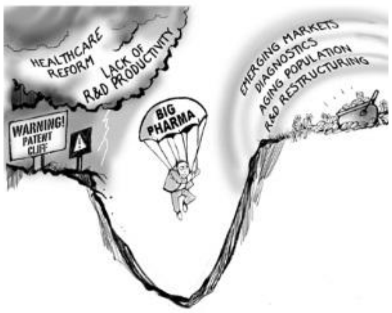
Our selection nevertheless comprises four names as in the previous quarter with one that is reiterated (Actelion) and three new ideas. Self-help stories should outperform. However, it is also fair to remind that Q2 is specific given that it includes very popular medical congresses like ASCO and ADA that may drive stock performances to some extent. That said, we won't play any recovery idea until the second half of the year. Please note also that our FVs have been affected by the new risk-free rate and equity risk premium implemented for all our covered stocks, these now standing at 7.0% and 1.6% respectively vs. 7.4% and 2.0% previously.

CONCLUSIONS AND TOP PICKS

Actelion (BUY – FV CHF163 vs CHF166) stays in. The group was the best performer in the universe during Q1 (+3% in absolute terms) and clearly outperformed the healthcare sector mainly because the company delivered full-year guidance above expectations. Although for obvious reasons it was not easy for Actelion to comment, the origin of the beat concerned the delayed launch of generic bosentan in the US. Precise timings remain uncertain as the agenda is managed by an independent party that is entitled by the FDA to act as a rapporteur between all involved players but it seems fair to assume that the first half of 2016 should be risk-free. Tracleer still represents about USD100m in quarterly sales and margin is estimated close to 90%. So each month that remains generic-free provides significant upside to earnings for Actelion (about 10% on core EBIT for each quarter saved).

The reason why we are maintaining the stock for Q2 is because we are quite confident in the numbers to be reported for Q1 on 21st April 2016 and we see a reasonable chance of a guidance upgrade. This is all the more likely in that Actelion is suggesting a nice start for Uptravi in the US although it is too early to call for a surprise because it could simply be the reflection of the easiest patients being captured. However, we see good feedbacks to report in any case at this stage during the conference call. Last but not least, Actelion looks more secured than many other names re environmental issues in the sector.

ROCHE HOLDING		**BUY**	**CHF294 vs. 303**
Last Price	CHF235,8	*Market Cap.*	*CHF165,664m*
SANOFI		**NEUTRAL**	**EUR87**
Last Price	EUR72,26	*Market Cap.*	*EUR94,350m*
UCB		**NEUTRAL**	**EUR80 vs. 82**
Last Price	EUR68,19	*Market Cap.*	*EUR13,263m*
ZEALAND		**BUY**	**DKK180 vs. 200**
Last Price	DKK129,5	*Market Cap.*	*DKK3,160m*



Removing AstraZeneca and Genmab

AstraZeneca (BUY – GBp vs. GBp5,520): clearly the group did not perform well in Q1 and because our thesis is intact, it could well have stayed in the list in Q2, all the more so that PT003 and ZS-9 should be approved during the quarter. But we are too uncomfortable with the environment to make a call on AZN for a short period of time. We would like to see how things stabilize before we return more aggressively in the second part of the year. From a longer-term view, it remains a clear BUY however.

Genmab (BUY – DKK1,225) performed well thanks to 1/ encouraging guidance for the very first year of sales of daratumumab (250-300 MUSD); 2/ the publication of positive Phase III results in combination with ibrutinib and dexamethasone (CASTOR study); 3/ the announcement of a collaboration between JNJ and Roche to test "dara" along with a PD-L1 checkpoint blocker in myeloma but also in a solid tumor. Besides, we remain positive on the outcome of the POLLUX study (which involves a combo with lenalidomide)… But we have to admit that short–term momentum is less engaging following the announcement that Morphosys is suing them and their partner for patent infringement.

We remove Bone Therapeutics (BUY – FV EUR30) from the list as we do not want to overweight healthcare. That said, one of the two expected catalysts occurred in Q1, namely interim results from the osteoporosis phase II trial. In Q2, we remain convinced that value creation should be triggered by the efficacy readout from the 2nd cohort enrolled in the Delayed-Union study. It should be followed by a DSMB review which would have the authority to prematurely stop the trial.

Adding Fresenius SE, Ipsen and Ablynx

Fresenius SE (BUY – FV EUR70 vs EUR68) enters our Top Pick list. Kabi should continue to drive the share price. Management has guided for low single-digit growth for the division in 2016, which we view as a floor in the light of 1/ our estimates pointing to 5% growth and 2/ management being conservative at the beginning of the year (meet and beat strategy). Following the approval of two new IV Gx with an upcoming launch as well as the launch of one approved in 2015. ANDA's backlog suggests that in 2016, Fresenius SE should have no difficulty in reaching the high range of its launch guidance (6-10). By playing the parent company, investors could also benefit from both strong topline at FMC and to a lesser extent, increased profitability from EPO and higher than communicated GEP gains while cushioning the risk of any major dilutive acquisition in the Care Coordination field.

Ablynx (BUY – FV EUR17 vs EUR18) jumps into our Top Pick list, ahead of key milestones for the biotech. Firstly, the phase I/IIa results expected in Q2 should provide additional insight as to the rationale of administration via nebulization in RSV infants. We would point out that Ablynx' platform may have the potential to be administrated in uncommon ways (nebulization, cream, ocular) thanks to its robustness). Secondly, we believe that the current share price significantly undervalues the deal with AbbVie for which phase IIb results and potential opt-in are expected in Q3 and H2 2016 respectively.

Ipsen (BUY – FV EUR60) is included in the list for Q2 because we highlighted in our recent note on the stock that the recent correction was a clear opportunity to play mid-term double-digit growth at a reasonable price but also interesting short-term catalysts that should reassure re the recent acquisition.

In March, Ipsen announced it had acquired the European rights for cabozantinib from Exelixis for an upfront payment of USD200m and potential other regulatory and commercial milestones + royalties. This is a transforming deal for Ipsen, one that has negative implications in the short-term because the company needs to build an oncology sales force (cost of about EUR50m), but positive ones in the medium-term. Starting in 2018-2019, it has an accretive impact on earnings and extends the growth trajectory well into the next decade. So we see it as possible provided clinical data supports the price paid. And precisely, we see upcoming catalysts that should help increase confidence in the deal with (i) final phase III data in 2L RCC to be presented either at ASCO or ESMO; (ii) FDA action date on 2L RCC expected by the end of June; (iii) EU opinion expected sometime in September.

With underlying operations still very robust, driven by Somatuline in the US, we see also Q1 numbers as reassuring for historical business. Altogether we therefore believe that Ipsen is and remains a very attractive growth story. With a PEG ratio of about 1x-1.1x, this is a strong BUY at the current price hence our decision to enter Ipsen into our Top Pick list for the ongoing quarter.

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