

Sector View

Healthcare

Top Picks Q3 2016: Shire jumps in and takes Actelion's seat, others remain

	1 M	3 M	6 M	31/12/15
Healthcare	1.3%	9.6%	-5.0%	-5.0%
DJ Stoxx 600	-3.5%	-0.3%	-9.2%	-9.2%

*Stoxx Sector Indices

Companies covered

Company	Recommendation	Target Price
ABLYNX	BUY	EUR18
Last Price	EUR11,89	Market Cap. EUR724m
ACTELION	BUY	CHF173
Last Price	CHF165,5	Market Cap. CHF18,888m
ADOCIA	BUY	EUR100
Last Price	EUR46,16	Market Cap. EUR316m
ASTRAZENECA	BUY	5100p
Last Price	4502,5p	Market Cap. GBP56,939m
BAYER	NEUTRAL	U.R.
Last Price	EUR90,69	Market Cap. EUR74,996m
BIOMERIEUX	BUY	EUR122
Last Price	EUR122,25	Market Cap. EUR4,823m
BONE THERAPEUTICS	BUY	EUR30
Last Price	EUR16,745	Market Cap. EUR115m
CELLECTIS	BUY	EUR37
Last Price	EUR24,14	Market Cap. EUR853m
CELYAD	NEUTRAL	EUR20
Last Price	EUR21,79	Market Cap. EUR203m
DBV TECHNOLOGIES	BUY	EUR91
Last Price	EUR59,46	Market Cap. EUR1,433m
ERYTECH	BUY	EUR48
Last Price	EUR21,29	Market Cap. EUR169m
FRESENIUS MED.CARE	BUY	EUR94
Last Price	EUR78,16	Market Cap. EUR23,976m
FRESENIUS SE	BUY	EUR73
Last Price	EUR66,23	Market Cap. EUR36,170m
GALAPAGOS	BUY	EUR64
Last Price	EUR49,345	Market Cap. EUR2,275m
GENEURO	BUY	EUR18,2
Last Price	EUR8,8	Market Cap. EUR129m
GENMAB	BUY	DKK1600
Last Price	DKK1237	Market Cap. DKK74,015m
GLAXOSMITHKLINE	BUY	1740p
Last Price	1600p	Market Cap. GBP77,958m
INNATE PHARMA	BUY	EUR18
Last Price	EUR10,41	Market Cap. EUR560m
IPSEN	BUY	EUR63
Last Price	EUR56,06	Market Cap. EUR4,667m
KORIAN	NEUTRAL	EUR29
Last Price	EUR29,29	Market Cap. EUR2,328m
LDR HOLDING	Tender to the offer	
Last Price	USD36,99	Market Cap. USD1,081m
MORPHOSYS	BUY	EUR62
Last Price	EUR37,685	Market Cap. EUR1,000m

LOOKING BACK ON Q2 2016

Q2 2016 was a strange quarter actually and if Healthcare performed very well in the end, this was largely because it appeared to be the safest heaven over the few days following the Brexit vote. UK healthcare stocks in particular skyrocketed by more than 10% in a single week. Before that, healthcare stocks did not show particularly strong momentum and simply showed signs of a stabilisation after a difficult start to the year.

So, thanks to the Brexit vote, Healthcare achieved an outstanding relative performance of more than 11% compared to the Stoxx Europe 600, meaning +8.7% in absolute terms. As always, some of the large cap pharmaceutical stocks were behind the performance considering their weight in the overall index but it was also supported by stellar performances from some small to mid-cap healthcare stocks this time. In the first category are the three UK names as previously highlighted (Shire +17.2%, AZN +14.5%, GSK +13.6%) but also Novartis, up 15%. Of course, when reported in EUR, the performances are not so good but nevertheless remain strong and positive. In the second category are Galapagos, Nicox and Genmab all up by more than 30% during the quarter. However, it is also worth mentioning that some small biotech companies did not fully recover from a difficult quarter which also includes one specific large cap name, Bayer, for obvious reasons (bid over Monsanto).

To note also in our coverage the bid over LDR by Zimmer Biomet at USD37 per share (+45% in Q2). Genmab (+33%) benefited from strong daratumumab data whereas Celyad (-43%) suffered from disappointingly negative results for its lead stem cell therapy product candidate, C-CURE, in CHF (CHART-1 trial). Lastly, Novo-Nordisk did not benefit from positive data for SUSTAIN-6 (to be presented at EASD) and LEADER (presented at ADA) and stock was flat over the quarter (+0.8%).

WHAT WE SEE FOR Q3 2016

Since inception of the Top Pick List in 2012, this is one of the toughest quarters to assess in our view because macro trends are quite difficult to handle and to predict for the coming weeks and months.

In particular, we are fundamentally positive on UK names but we do question how they are going to perform in the post-Brexit environment as we might finally see some cash-out from UK funds, impacting healthcare stocks in the end. We also see moving parts if not binary events for non-UK stocks which we are not fully comfortable with like the final outcome for Bayer in Monsanto's bid, for Roche with APHINITY's phase III results or for Novartis with Entresto and Alcon at mid-year. Obviously, PDUFA dates for both lixisenatide and iGlarLixi during the quarter will be key events for Sanofi but even more substantially for Zealand.

As such, we have tried to take reasonable risks while keeping our exposure to the healthcare sector unchanged i.e. with four stocks included in the List for the quarter to come. This results in one change with the inclusion of Shire and exit of Actelion.

CONCLUSIONS AND TOP PICKS

Here is the list of healthcare stocks included in BG's Top Pick List for Q3 2016: Ablynx, Fresenius SE, Ipsen and Shire.

ACTELION (BUY – FV CHF173): we have decided not to include the stock this quarter after a strong performance over the last two quarters although we expect another strong set of quarterly numbers to be released on 21st July with another highly likely increase in guidance for core EBIT in 2016. With Opsumit still performing very well (driven by the US), the increasing likelihood of not seeing US generic bosentan this year and a strong take-off of Upravi in the US, we believe that Actelion will upgrade its guidance to low-to-mid teen's growth. And we do not see this reflected yet into CS figures as Bloomberg suggests expectations are for a modest 11.4% core operating income growth in reported terms whereas we cautiously (in our view) expect Actelion to report 13.1%. As a reminder, in Q1, currencies played positively by 6pp (+8% underlying, +14% reported) with Upravi just starting. Although we expect the positive currency impact to reduce somewhat, we believe it will remain positive by at least 3-4%. Now, we also expect investors to pay increasing attention to the mid-term over the short-term and we do not see a lot coming through in Q3 to help from that perspective.

NICOX	CORPORATE	EUR14
Last Price	EUR12,19	Market Cap. EUR279m
NOVARTIS	NEUTRAL	CHF89
Last Price	CHF80,45	Market Cap. CHF211,351m
NOVO NORDISK	NEUTRAL	DKK400
Last Price	DKK363,5	Market Cap. DKK731,567m
ORPEA	BUY	EUR79
Last Price	EUR74,49	Market Cap. EUR4,474m
QIAGEN	NEUTRAL	EUR22
Last Price	EUR19,845	Market Cap. EUR4,757m
ROCHE HOLDING	BUY	CHF293
Last Price	CHF256,7	Market Cap. CHF180,348m
SANOFI	NEUTRAL	EUR83
Last Price	EUR75,02	Market Cap. EUR96,549m
SHIRE PLC	BUY	6500p
Last Price	4672p	Market Cap. GBP41,996m
TRANSGENE	CORPORATE	EUR12
Last Price	EUR2,54	Market Cap. EUR98m
UCB	NEUTRAL	EUR80
Last Price	EUR67,2	Market Cap. EUR13,071m
ZEALAND	BUY	DKK176
Last Price	DKK122,5	Market Cap. DKK3,005m

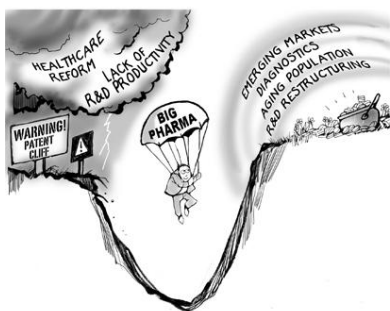
SHIRE (BUY – FV GBP6,500): We believe Shire displays an outstandingly attractive risk-reward as 1/ we expect an above-industry average EPS growth of 14% over the 2015-2020e period; 2/ nearly 85% of our 2020 sales estimate is derived from already commercialised products; 3/ at current levels, SHP trades on a 55% discount to CSL on 2017e P/E (30% compared with the European sector as a whole). In our view, this gap will be significantly reduced thanks to the very next catalysts... and namely (i) the approval of lifitegrast as a treatment for dry-eye disease on the 22nd July (impact on our FV: -GBP150 if negative / +GBP150 if positive); 2/ the (likely) increase in anticipated cost synergies with Baxalta on 2nd August (FV: +GBP200 assuming an updated guidance of USD750m vs USD500m previously).

IPSEN (BUY – FV EUR63): We still consider Ipsen well placed to take advantage of the next quarter to convince an increasing number of investors that it is worth looking at the ongoing deep change taking place within the group. Not only will second-quarter figures show an overall improvement in momentum vs the poor first-quarter impacted by tender phasing and wholesaler inventories with the exception of a solid continuing trend for Somatuline in the US but we also anticipate the quarter to result in two key triggering events: (i) CHMP positive opinion for cabozantinib in second-line renal cell carcinoma is expected in September whereas new data might be disclosed ahead of the ESMO meeting both in first and second line; (ii) arrival of new CEO by September is also likely. If Somatuline has the potential to surprise CS on the upside with its US peak sales and maybe more with its influence on profits, we think that cabozantinib is even less well captured by CS. Recently unveiled data in RCC carry strong potential for the drug and maybe stronger than initially thought although competition with IO (including Opdivo) is expected to be fierce. Last but not least, our understanding is that position of Marc de Garidel has clarified over the last few months and we expect his influence at the head of the Board, in close collaboration with Anne Beaufour and the new CEO, to help Ipsen's perspectives over the medium and long term.

ABLYNX (BUY – FV EUR18). We maintain Ablynx in our top pick list as Q2 should be a turning point with the publication results from the two trials evaluating ALX-0061 in rheumatoid arthritis' patients. While results from the first trial expected in July, should give a good trend of the product's efficacy, we would not look at statistical significance (no placebo arm). The second however should provide us with data enabling us to better assess the company's IL-6, hence its potential in the RA space. As a reminder, we have assumed EUR1.5bn in peak sales for the product candidate. We believe that interactions with AbbVie have been reinforced over the past weeks and should the latter decide to opt-in, Ablynx would be eligible for a USD75m milestone payment. Positive results would add EUR3 to our Fair Value.

FRESENIUS SE (BUY – FV EUR73). Fresenius SE also stays in. While comps should be stronger in Q2 for Fresenius SE, we see no short term threat to the company's ability to maintain 1/ top line trends and 2/ profitability, mainly for KABI in the US. Monitoring of the US drug shortages situation show us that although the number of shortages shrank in the US since June 2015 (50 to 44), KABI still benefits from more than 20 of them, which should enable the division keep up with strong growth margins in Q2. The recent appreciation in the USD against the EUR should also benefit KABI which generates 56% of its EBIT in the US compared with around 1/3rd of sales. The promotion of Stephan Sturm to CEO following Ulf Mark Schneider's departure does not change the equity story and we expect the transition to be seamless with no operative shake-up. Our numbers for the year are within the high end of the company's guidance which we view as conservative (organic topline growth BGe7.4% vs. guidance 6-8%, Net Income growth BGe 12.3% vs guidance 8-12%).

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