

Shire PLC

Price 5,045p

Q2 2016 above expectations and increased 3-year cost synergies target... What else?

Fair Value 6900p vs. 6750p (+37%)

BUY-Top Picks

Bloomberg	SHP LN
Reuters	SHP.L
12-month High / Low (p)	5,730 / 3,480
Market Cap (GBP)	45,415
Ev (BG Estimates) (GBP)	57,424
Avg. 6m daily volume (000)	2,661
3y EPS CAGR	16.2%

	1 M	3 M	6 M	31/12/15
Absolute perf.	8.0%	18.4%	29.9%	7.4%
Healthcare	1.1%	7.3%	3.8%	-3.9%
DJ Stoxx 600	1.0%	-1.7%	0.3%	-8.3%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	6,100	11,275	15,389	16,652
% change		84.8%	36.5%	8.2%
EBITDA	2,924	4,780	6,691	7,732
EBIT	2,785	4,483	6,229	7,149
% change		61.0%	38.9%	14.8%
Net income	2,310	3,383	4,546	5,541
% change		46.5%	34.4%	21.9%

	2015	2016e	2017e	2018e
Operating margin	45.7	39.8	40.5	42.9
Net margin	37.9	30.0	29.5	33.3
ROE	23.5	11.8	13.5	13.9
ROCE	16.3	5.9	7.8	9.3
Gearing	13.8	55.8	35.2	16.7

(USD)	2015	2016e	2017e	2018e
EPS	3.89	4.35	5.01	6.11
% change	-	11.6%	15.3%	21.9%
P/E	17.2x	15.4x	13.4x	11.0x
FCF yield (%)	5.6%	NM	7.1%	9.0%
Dividends (USD)	0.23	0.20	0.22	0.30
Div yield (%)	0.3%	0.3%	0.3%	0.4%
EV/Sales	10.1x	6.8x	4.7x	4.0x
EV/EBITDA	21.1x	16.0x	10.8x	8.7x
EV/EBIT	22.2x	17.1x	11.6x	9.4x

In a nutshell, yesterday's publication provided three very positive newsitems: 1) Q2 2016 diluted earning per ADS was way above expectations; 2) updated full year guidance was a bit higher than previous estimates... and we wonder if the company is not too cautious regarding its future gross margin; and 3) three-year operating cost synergy expectations were raised by c. 40% to "at least USD700m", thereby prompting us to raise our FV to GBP6,900.

ANALYSIS

- Q2 2016 non-GAAP earnings per ADS grew by +29% to USD3.38m, and were way above expectations (BG: 3.07 and consensus: 3.12) thanks to a much higher-than-anticipated product sales (+57% vs +49%e both BG and the consensus)... Knowing that Shire ex-Baxalta's sales performance was stellar (+19% vs +12%e), while BXL's was broadly in line (USD559m vs BG: 547m – and which by the way grew by +12% on a pro-forma basis). Vyvanse (c.20% of sales) remained a strong contributor with 22% growth over the period (vs +21%e), but the outperformance was more due to the HAE franchise along with Lialda... for which we clearly underestimated the capacity to grab new patients along with the impact of recent price increases.

Fig. 1: Q2 2016 results – Published vs BG & consensus estimates

(in USDm)	Q2 16	BG	BG vs published	Cons.	Cons. vs published
Product sales	2,322	2,201	-5%	2,195	-5%
% growth y-o-y	57%	49%	8 pts	49%	8 pts
- Vyvanse	518	512	-1%	498	-4%
- Firazyr	137	125	-8%	129	-6%
- Cinryze	173	160	-7%	162	-6%
- Lialda	194	175	-10%	172	-11%
- Baxalta (one month)	559	546	-2%	573	2%
Non GAAP net income	773	696	-10%	703	-9%
% growth y-o-y	48%	34%	14 pts	35%	13 pts
Non GAAP diluted earnings per ADS	3.38	3.07	-9%	3.12	-8%
% growth y-o-y	29%	17%	12 pts	19%	10 pts

Source : Company Data; Bryan Garnier & Co. ests.

- Non-GAAP earnings per ADS are now expected to be in a range of 12.7-13.1, which is slightly better than what we and the consensus anticipated before the publication. Still, this new guidance might be quite conservative in our view... Especially when it comes to the expected 77-79% gross margin for the whole year. Even assuming Shire stand-alone's COGS over sales increases to 16-18% (e.g. because of the launch of lifitegrast or some more significant changes in the product mix we haven't captured), this expectation would imply a ratio of roughly 40-42% for BXL ex-Shire based on our estimates (which would be at the very high-end of BXL's previous publications). Nevertheless, we stick to a 80% assumption pending further details...

Fig. 2: Shire's new FY 2016 guidance

Full year 2016	Non GAAP outlook	BG new est.
Total product sales	USD10.8-11.0Bn	USD11.3Bn
Gross margin	77%-79%	80%
Combined R&D and SG&A	USD4.1-4.4Bn	USD4.2Bn
Net interest / other	USD400-450m	USD413m
Effective tax rate	16%-18%	17%
Diluted earnings per ADS	USD12.70-13.10	13.05

Source : Company Data; Bryan Garnier & Co. ests.

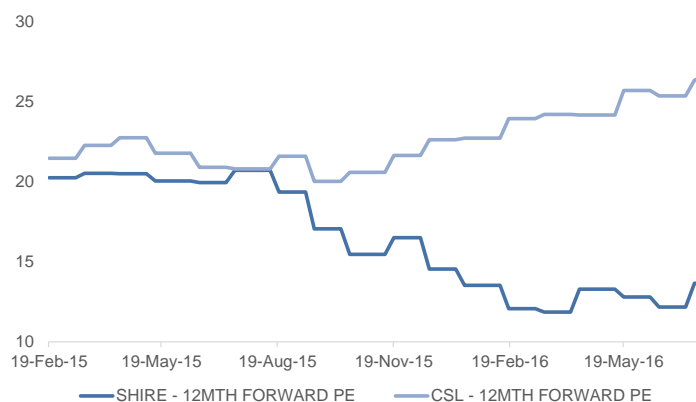
- Lastly, three-year operating cost synergy are set to rise by c.40% to "at least USD700m" (vs BG: USD500m previously)... which by the way 1/ is slightly above pre-publication consensus estimates (c. USD600-650m), and 2/ looks largely attainable in our view, especially since SHP's management expects to cut the overall SG&A line by USD350m, while BXL's G&A expenses roughly amount to USD500m. Apart from that, we have the feeling that some savings could quickly be extracted, especially regarding the R&D part.



- **The company has already completed a “major pipeline prioritisation”** and therefore decided to discontinue the development of eight programmes, of which BAX335, a gene therapy for the treatment of haemophilia B, as Shire’s management was not satisfied with its efficacy profile and would prefer to place the emphasis on a preclinical candidate. Note that this decision has no impact on our valuation as we (cautiously) did not include it in our estimates. Admittedly, the therapeutic option would be a complete breakthrough as it could virtually cure patients with the disease contrary to current therapies (i.e. plasma-derived and recombinant FVIII) and even more innovative ones (e.g. Roche’s ACE910 and Alnylam’s fitusiran)... However, we think there is still a long way to go as numerous issues need to be addressed: pre-existing/appearance of neutralising antibodies, delayed cellular immune response reducing FVIII expression, genotoxicity, risks of liver cancer following mutation of the genome, lack of sustainability of the effect, etc.
- **Surprisingly, the company has decided to keep BXLT’s oncology assets (at least for now)**, though some of them do not target rare diseases (e.g. Onivyde). While this might not be a bad thing, we still see this franchise is far from matching that of major labs in the field. And given the speed with which rivals are developing their pipelines, we believe that some licensing deals will have to be made if they really want to be competitive.

VALUATION

- **We have lifted our FV from GBP6,750 to GBP6,900** notably after having taken into account higher than previously discounted cost synergies with Baxalta (USD700m vs USD500m).
- **Buy rating reiterated. We still believe that Shire displays a very attractive risk-reward** as 1/ we anticipate a +15% EPS CAGR over the 2015-2020 period; 2/ the stock is trading on a 30% discount vs European peers (and even 45-50% should we compare it to CSL limited...).



NEXT CATALYSTS

- 28th October: Q3 2016 results.
- 10th November: Investor day.

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