

Grifols

Price EUR18.81

Q3 2016 preview: further risks of earnings downgrades

Fair Value EUR20 (+6%)

NEUTRAL

Bloomberg	GRF.SM
Reuters	GRF.MC
12-month High / Low (EUR)	22.7 / 18.0
Market Cap (EUR)	11,634
Ev (BG Estimates) (EUR)	15,227
Avg. 6m daily volume (000)	771.8
3y EPS CAGR	8.5%

We reiterate our cautious stance a few days before the publication of Q3 2016 results (8th November). Consensus estimates are quite high in our view, especially looking at EBIT and EBITDA margins for the period and thus for the whole year. Given how demanding the valuation is in our view (P/E 2017e: 20.8x), we stick to our Neutral rating. Our preference goes to SHP within the Pharma/Biotech segment. But for those seeing GFS as a medtech company, we would recommend a switch towards FRE SE.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-2.3%	-6.1%	-5.0%	-11.8%
Healthcare	-4.0%	-7.3%	-3.8%	-10.8%
DJ Stoxx 600	0.5%	1.1%	-1.5%	-5.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	3,935	4,032	4,249	4,445
% change		2.5%	5.4%	4.6%
EBITDA	1,163	1,157	1,258	1,356
EBIT	970.3	955.7	1,041	1,125
% change		-1.5%	8.9%	8.0%
Net income	532.1	572.3	622.9	681.3
% change		7.5%	8.8%	9.4%

	2015	2016e	2017e	2018e
Operating margin	24.7	23.7	24.5	25.3
Net margin	13.5	14.2	14.7	15.3
ROE	16.1	15.6	15.4	15.2
ROCE	6.9	7.2	7.8	8.4
Gearing	112.6	98.2	82.0	67.1

(EUR)	2015	2016e	2017e	2018e
EPS	0.78	0.83	0.91	0.99
% change	-	7.2%	8.9%	9.4%
P/E	24.2x	22.6x	20.8x	19.0x
FCF yield (%)	3.7%	4.8%	4.1%	4.6%
Dividends (EUR)	0.32	0.31	0.33	0.36
Div yield (%)	1.7%	1.6%	1.8%	1.9%
EV/Sales	3.9x	3.8x	3.5x	3.3x
EV/EBITDA	13.2x	13.2x	11.9x	10.8x
EV/EBIT	15.8x	15.9x	14.4x	13.0x

ANALYSIS

- **The consensus currently anticipates a slight decrease in the FY 2016 EBITDA margin (-20 bps to 29.2% vs BG: 28.7%), which is too optimistic in our view.** As a reminder, the H1 margin narrowed by -110 bps to 28.4% following the accumulation of unfavourable factors (declining royalties within the transfusion diagnostics unit, higher plasma costs due to the recent opening of collection centers, etc.)... And these very same elements are likely to maintain pressure on GFS' profitability for a couple of quarters.
- **Our Q3 estimates stand below those of the consensus regarding EBITDA and EBIT (-3% and -5% respectively).** Admittedly, our net income figure is not so different from the consensus (probably because our financial result for the period is less impacted by adverse FX variations), but we believe the market is paying closer attention to operating margins (Q2 2016 EPS was notably above expectations while the EBITDA was well below... And this led to a sharp fall in the share price).
- **Where could we be wrong?** We believe the main risks on our investment case are 1/ a faster than anticipated recovery in the Diagnostics franchise (which is quite unlikely given our recent discussions with the company); 2/ an acceleration on immunoglobulins side (c.40% of total sales).

(in EURm)	Q3 15	Q3 16e (BG)	Q3 16e (CS)	BG vs CS
Sales	971	997	1,002	-1%
% growth y-o-y		2.6%	3.2%	
EBITDA	296	288	296	-3%
in % of sales	30.5%	28.9%	29.5%	
% growth y-o-y		-3%	0%	
EBIT	247	236	248	-5%
in % of sales	25.5%	23.7%	24.7%	
% growth y-o-y		-4%	0%	
Net income	140	138	140	-2%
% growth y-o-y		-1%	0%	

VALUATION

- **NEUTRAL reiterated with a FV of EUR20.**
- With a 2017e P/E of 20.8x, the stock is trading on a premium of c.10% relative to the European Pharma segment (hence our preference for SHP within this category)... which leaves little room for an eventual disappointment in our view.
- For those comparing it with medtech companies, we would note that Grifols is trading in line with FRE SE (P/E 2017e: 20.7x) while exhibiting a less attractive growth profile (EPS CAGR 2015-18: +13%). Hence our recommendation to switch into the German name.

NEXT CATALYSTS

- 8th November: Q3 2016 results.

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