

FOCUS

21st November 2016

Healthcare

Bloomberg	IPH FP
Reuters	IPH.PA
12-month High / Low (EUR)	14.5 / 9.5
Market capitalisation (EURm)	784
Enterprise Value (BG estimates EURm)	580
Avg. 6m daily volume ('000 shares)	317.1
Free Float	79.5%
3y EPS CAGR	
Gearing (12/15)	-322%
Dividend yield (12/16e)	NM

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	25.14	69.65	112.92	81.44
EBIT (EURm)	-10.77	21.28	49.86	2.85
Basic EPS (EUR)	-0.12	0.49	1.00	0.11
Diluted EPS (EUR)	-0.12	0.49	1.00	0.11
EV/Sales	21.95x	8.33x	5.32x	8.77x
EV/EBITDA	NS	23.9x	11.3x	104.2x
EV/EBIT	NS	27.3x	12.1x	250.4x
P/E	NS	29.8x	14.6x	NS
ROCE	4.2	-25.3	-185.9	6.5



Innate Pharma

Still time to jump on the bandwagon

Fair Value EUR23 (price EUR14.54)


BUY

We welcomed Catherine Moukheibir to our Healthcare Conference; and obviously most of the discussions with her evolved around the liri/nivo data in head & neck cancer. We remain strong buyers of the stock despite the recent re-rating (+8% YTD vs -15% for the NBI) as: 1/ the recent news flow de-risked part of the equity story, be it for lirilumab or monalizumab; 2/ some strong near-term catalysts are likely to support the ongoing positive momentum; and 3/ at current levels, the company is an attractive/obvious M&A target in our view.

■ **All eyes are on lirilumab (anti-KIR).** The fact that liri/nivo generated such impressive data in first solid tumours (HNSCC or head & neck cancer in this case) is obviously good news. But we believe the Street will give an increasing probability of success for to liri/nivo in HNSCC... and might even enlarge it from lung and melanoma to other tumour types, including challenging ones for immunotherapies (e.g. liver, gastric).

■ **Monalizumab (anti-NKG2A): an increasingly significant asset for AZN.** As previously written, we see liri/nivo in HNSCC as a very positive signal for monalizumab/durvalumab in this same disease, and partially de-risk this very development as targeting NKG2A also involves a disinhibition of NK cells. And we even believe that “mona” could be a more attractive option as: 1/ its mechanism of action goes beyond the innate system and involves other key immune cells; 2/ it might benefit from a solid predictive marker of response (HLA-E) in HNSCC and other cancer types. But first, let’s wait for more clarity on KESTREL and EAGLE. The impact would be negative for AZN should these AEs prove be related to the addition of tremelimumab (anti-CTLA-4) to durvalumab (anti-PD-L1)... But, obviously, this would leave the field free to IPH’s mona, and raise further chances of a speculative scenario.

■ **We stick to our BUY rating with a FV of EUR23.** Despite the recent rally, we continue to see IPH as a deeply undervalued stock, especially since we do not capture the whole upside in our figure. Also, we plan to make a few changes to our SOTP in the coming weeks as we are now more comfortable with the potential of both liri and mona in solid tumours.

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Innate Pharma Major keys to Focus on

1. One Chart

	Lirilumab + Nivolumab	Nivolumab alone ¹
ORR, n/N (%)	7/29 (24.1)*	32/240 (13.3)
Complete response	3 (10.3)*	6 (2.5)
Partial response	4 (13.8)*	26 (10.8)
DCR, n/N (%)	15/29 (51.7)	NR
ORR by PD-L1 expression, n/N (%) [†]		
<1%	0/9 (0)	9/73 (12.3)
≥1%	7/17 (41.2)	15/88 (17.0)
≥5%	6/11 (54.5)	12/54 (22.2)
≥50%	4/7 (57.1)	7/19 (36.8)
Overall survival, % (95% CI)		
At 6 months	90 [‡]	55.6 (48.9, 61.8)
At 12 months	60 [§]	36.0 (28.5, 43.4)

* Includes unconfirmed responses.

[†] PD-L1 expression was not determined in 3 patients; none of these patients were responders.

[‡] Patients at risk, n = 15/41. [§] Patients at risk, n = 10/41.

■ As there is very promising data involving lirilumab in combination with nivolumab in heavily pre-treated patients (most of them having received at least two prior lines of systemic therapy) with head & neck squamous cell carcinoma (HNSCC), most of the discussions revolved around this.

■ **Outstanding overall survival data! 60%...** That's the percentage of patients alive at 12-months thanks to liri/nivo, irrespective of their PD-L1 status. Clearly, such a figure compares very favourably with nivo alone in the CheckMate-141 study, especially since: 1/ the patients receiving the combination probably had a worse prognosis; and 2/ some complete responses were observed (while PD-1/PD-L1 agents are known to induce little or no CR on their own)... Of note, no responses were seen in patients with a low PD-

L1 expression (< 1%) or an HPV-positive status. But we believe it is too premature to draw conclusions, all the more so as nivo and pembro as monotherapies managed to induce some responses in both HPV+ and PD-L1- patients in large trials (Ferris *et al.*, 2016. Seiwert *et al.*, 2016).

And don't forget the safety belt. As said in our feedback from our first BG Oncology Day ([here](#)), safety is also of essence... And fortunately, the cocktail was well-tolerated (Grade III/IV: 15% with events like increases in amylase or lipase). We believe this will be a key differentiating factor, especially when compared with CTLA-4/PD-1-based regimens, and eventually checkpoint blockers targeting activating receptors (e.g. OX40, CD137, GITR). Although BMS's urelumab's safety data are so far surprisingly good in our view (Masarelli *et al.*, 2016).

2. One Sentence

« *We want to enlarge our US shareholder base* »

Such a move is also motivated by the management's willingness to secure higher valuations thanks to an increased access to life-science specialists with a higher risk appetite for the sector... But the company is also likely to develop itself more aggressively.

With c.EUR240m of cash & cash equivalents on its balance sheet, the company is far from being in need... and, even with a strong increase in R&D expenses in the coming years, we believe its cash horizon is secure until 2020 should we assume an absence of milestone payments and further collaboration agreements. But let's keep in mind that: 1/ our estimates, and those of the consensus, are based on the current clinical programme; 2/ contrary to the deal with BMS, the one with AZN involves co-development/marketing... Given the increasingly positive momentum behind lirilumab and NK-cell therapies more broadly, we believe both IPH and AZN are willing to expand monalizumab's reach (and particularly to haematological malignancies overexpressing the HLA-E marker).

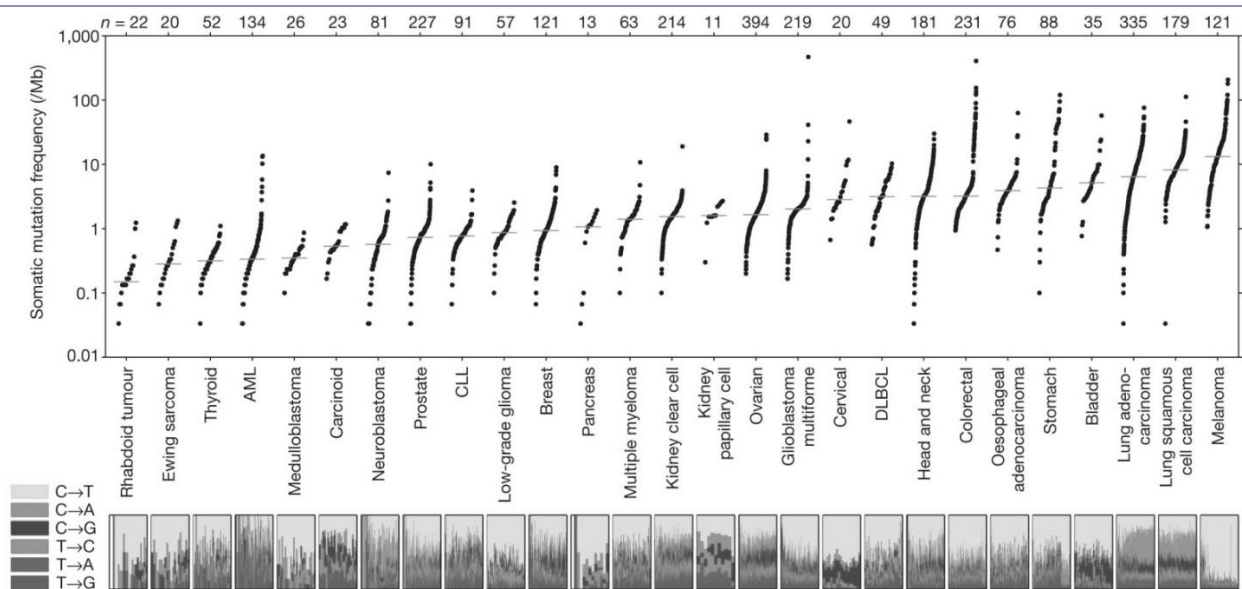
3. Seeing beyond the HNSCC indication

We believe the Street will give an increasing probability of success for to liri/nivo in HNSCC... and might even enlarge it from lung and melanoma to other tumour types, including challenging ones for anti-cancer immunotherapies.

Admittedly, we need more data on a larger population to get a better view on their respective potentials in each cancer type given their intrinsic characteristics, as well as the differences in their micro-environments (TME). Also, some might argue that having chosen HNSCC for the presentation might be due to: 1/ a more favourable competitive landscape, as we have so far little reliable data from PD-1/PD-L1 blockers in combination with another I-O agent (even for BMS’s urelumab or INCY’s epacadostat); or 2/ the limited number of late-stage trials within BMS’s portfolio involving the disease, apart from Opdivo/Yervoy.

The potential scope of indications could be larger than previously anticipated. Presenting strong data in this tumour type goes beyond these contextual elements. HNSCC is quite a challenging one for I-O agents due to its immunosuppressive TME: lower lymphocyte count, impaired NK cell activity, higher number of anti-inflammatory immune cells (e.g. MSDCs, Tregs.), poor-antigen presentation, etc. Also, the rate of somatic mutations (which correlates positively with tumour immunogenicity – Chen *et al.*, 2012) in this condition tend to be lower than the ones seen in lung cancers and melanoma. Hence, our cautious stance when we initiated coverage. But the story is quite different, and we believe the consensus will give an increasingly significant value to liri/nivo in other lower-inflamed/lightly mutated tumours (e.g. liver, colorectal, ovarian).

Fig. 1: Somatic mutations observed in tumour types



Source: Lawrence *et al.*, 2013; Bryan, Garnier & Co. *ests*

4. Lirilumab: a nice fit within BMS’s portfolio

A differentiated cocktail. Lirilumab is likely to become increasingly significant within BMS’s portfolio in the context of the race against MRK and ROG. The recent failure of nivo in monotherapy and as a first-line treatment in NSCLC obviously played a role (see our ESMO 2016 feedback [here](#)), as we believe the big pharma are more likely to rely on differentiated combinations for future growth... And liri/nivo is one of them, in our view, whereas OX40, CSF1R, LAG3, GITR, CD137 and IDO1 are also targeted by some of BMS’s competitors.

A Phase III is very likely in our view. We would be really surprised if BMS does not initiate a pivotal trial testing liri/nivo in HNSCC in light of these preliminary data. Besides: 1/ there is no significant late-stage development in this disease apart from nivo/ipi; 2/ so far, we have little data from early-stage assets in combo with Opdivo... and those we have seen were not that promising. Urelumab (CD137 agonist), for instance, induced an ORR of 5% in pre-treated patients (but PD-1 naïve), but we lack details to appreciate such figures better.

5. A positive read-across for monalizumab

Monalizumab shares some similarities with liri... and much more. As previously written, we see liri/nivo in HNSCC as a very positive signal for mona/durva in this same disease, and partially de-risk this very development as targeting NKG2A also involves a disinhibition of NK cells. And we even believe that “mona” could be a more attractive option as: 1/ its mechanism of action goes beyond the innate system and also involves some CD8+ T lymphocytes; and 2/ it might benefit from a solid predictive marker of response (HLA-E) in HNSCC and other cancer types.

But first, let's wait for more clarity on KESTREL and EAGLE. A few weeks ago, the FDA placed a partial clinical hold on AZN's trials involving patients with head & neck cancer (be it in monotherapy or in combo with other candidates) due to a high incidence of bleeding events. We can't say whether this is due to: 1/ AZN's compounds (and in this case, it is fair to say that durva/treme arms carry more risks than others), or 2/ other reasons, knowing that a such risk is a well-known complication of the condition (proximity of tumours to major blood vessels + use of prior therapies like surgery and radiation). In any case, we need more clarity on this. The impact would obviously be negative for AZN, should these AEs prove be related to the addition of treme to durva... On the other hand, this would leave the field free for mona.

6. How does the Conference impact our Investment Case

We more than ever believe that IPH will become a target for AZN at some point, especially if the valuation remains at current levels for too long. Despite the recent rally, we continue to see IPH as a deeply undervalued stock, especially since we do not capture the whole upside in our figure (as we solely include three indications for the development of lirilumab/nivolumab in solid tumours). So far, we stick to our bullish stance following this conference, and reiterate our BUY rating with a FV of EUR23... But we might make a few changes in the near future.

Fig. 2: IPH - BG valuation

Drug candidates	Indications	Clinical stage	Peak sales (EURbn)	WACC (%)	NPV (EURm)	PoS (%)	r-NPV (EURm)	Per share (EUR)
Lirilumab Monotherapy	Acute Myeloid Leukemia	Phase II	0.5	13.0%	208	35%	72.9	1.4
Lirilumab + Elotuzumab	Multiple Myeloma	Phase Ib	0.5	13.0%	186	20%	37.2	0.7
Lirilumab + Nivolumab	NSCLC	Phase Ib	0.9	13.0%	392	20%	78.5	1.5
Lirilumab + Nivolumab	Melanoma	Phase Ib	0.4	13.0%	161	20%	32.2	0.6
Lirilumab + Nivolumab	Head & Neck cancer	Phase Ib	0.6	13.0%	247	50%	123.6	2.3
IPH2201 + Ibrutinib	Chronic Lymphocytic Leukemia	Phase II	0.3	14.0%	200	35%	70.0	1.3
IPH2201 + Durvalumab	NSCLC	Phase Ib	0.8	14.0%	537	20%	107.3	2.0
IPH2201 + Durvalumab	Ovarian cancer	Phase II	0.8	14.0%	632	35%	221.2	4.1
IPH2201 + Durvalumab	Head & Neck cancer	Phase II	0.4	14.0%	254	45%	114.1	2.1
IPH4102	CTCL (Sézary Syndrome)	Phase Ib	0.4	14.0%	379	35%	132.5	2.5
= Enterprise Value					3,195	31%	989.4	18.4
(+) Q3 16 net cash					243	100%	243.0	4.5
= Equity value					3,438	36%	1,232.4	22.9

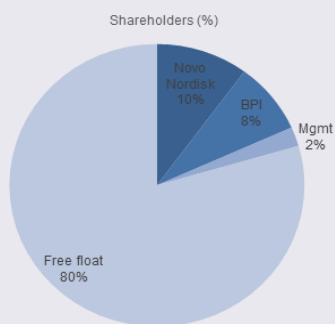
Source: Bryan, Garnier & Co ests.

Next Catalysts

Period	Product	Area	Comments
December 2 nd	Monalizumab	Ovarian cancer	Preliminary efficacy data as a single agent
Q1 17	Lirilumab	AML (maintenance)	Readout of the Phase Ib as a single agent
ASCO 17	Lirilumab	Solid and liquid tumours	Phase I/II in combination with BMS' Opdivo

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

Innate Pharma



Simplified Profit & Loss Account (EURm)	2013	2014	2015	2016e	2017e	2018e
Revenues	16.7	7.6	25.1	69.6	113	81.4
Change (%)	16.6%	-54.2%	230%	177%	62.1%	-27.9%
Adjusted EBITDA	(1.9)	(17.7)	(8.1)	24.3	53.4	6.9
EBIT	(2.8)	(20.0)	(10.8)	21.3	49.9	2.9
Change (%)	-17.5%	-617%	-46.2%	-%	134%	-94.3%
Financial results	0.33	0.49	4.1	5.0	4.0	3.0
Pre-Tax profits	(2.9)	(19.7)	(6.7)	26.3	53.9	5.9
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Profits from associates	NM	NM	NM	NM	NM	NM
Minority interests	NM	NM	NM	NM	NM	NM
Net profit	(2.9)	(19.7)	(6.7)	26.3	53.9	5.9
Restated net profit	(2.9)	(19.7)	(6.7)	26.3	53.9	5.9
Change (%)	-9.6%	-581%	-66.0%	-%	105%	-89.1%

Cash Flow Statement (EURm)	2013	2014	2015	2016e	2017e	2018e
Operating cash flows	(1.6)	(16.8)	(3.6)	29.3	57.4	9.9
Change in working capital	9.4	1.3	(211)	47.6	68.3	113
Capex, net	0.55	1.0	7.4	10.0	10.0	10.0
Financial investments, net	0.96	2.0	78.1	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Other	NM	NM	NM	NM	NM	NM
Net debt	(36.5)	(65.0)	(232)	(204)	(183)	(70.0)
Free Cash flow	(11.5)	(19.1)	201	(28.3)	(20.9)	(113)

Balance Sheet (EURm)	2013	2014	2015	2016e	2017e	2018e
Tangible fixed assets	6.5	6.0	44.1	51.1	57.6	63.6
Intangibles assets	0.0	5.4	9.7	9.7	9.7	9.7
Cash & equivalents	41.3	69.2	236	207	186	73.1
current assets	8.0	10.1	16.2	9.6	13.0	16.5
Other assets	0.0	0.0	0.0	0.0	1.0	1.0
Total assets	55.9	90.7	306	277	266	163
L & ST Debt	4.8	4.2	3.8	3.1	3.1	3.1
Others liabilities	10.0	10.8	228	174	109	0.0
Shareholders' funds	40.3	74.6	72.1	98.3	152	158
Total Liabilities	55.9	90.7	306	277	266	163
Capital employed	4.5	10.7	(158)	(104)	(29.0)	89.8

Ratios	2013	2014	2015	2016e	2017e	2018e
Operating margin	(16.77)	(263)	(42.85)	30.55	44.16	3.50
Tax rate	0.0	0.0	0.0	0.0	0.0	0.0
Net margin	(17.37)	(259)	(26.67)	37.73	47.70	7.18
ROE (after tax)	(7.18)	(26.41)	(9.31)	26.72	35.39	3.70
ROCE (after tax)	(63.63)	(184)	4.23	(25.32)	(186)	6.51
Gearing	(90.68)	(87.14)	(322)	(207)	(120)	(44.26)
Pay out ratio	0.0	0.0	0.0	0.0	0.0	0.0
Number of shares, diluted	47.16	54.39	53.84	53.92	53.92	53.92

Data per Share (EUR)	2013	2014	2015	2016e	2017e	2018e
EPS	(0.06)	(0.37)	(0.12)	0.49	1.00	0.11
Restated EPS	(0.06)	(0.37)	(0.12)	0.49	1.00	0.11
% change	-25.3%	-488%	-66.5%	-%	105%	-89.1%
EPS bef. GDW	NM	NM	NM	NM	NM	NM
BVPS	0.88	1.41	1.34	1.82	2.82	2.93
Operating cash flows	(0.03)	(0.32)	(0.07)	0.54	1.06	0.18
FCF	(0.25)	(0.36)	3.72	(0.52)	(0.39)	(2.09)
Net dividend	0.0	0.0	0.0	0.0	0.0	0.0

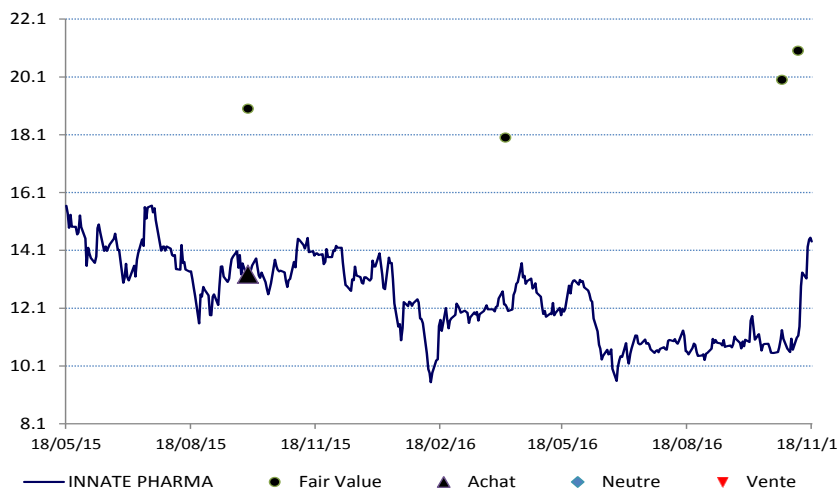
Source: Company Data; Bryan, Garnier & Co ests.

Company description

Innate Pharma is a biopharmaceutical company developing first-in-class immunotherapy drugs for cancer and inflammatory diseases.

Price Chart and Rating History

Innate Pharma



Ratings		
Date	Ratings	Price
29/09/2015	BUY	EUR13,23

Target Price	
Date	Target price
08/11/2016	EUR21
27/10/2016	EUR20
06/04/2016	EUR18
29/09/2015	EUR19
08/07/2011	EUR3
25/11/2010	EUR2,2
01/09/2010	EUR3,1
09/02/2010	EUR3,4
15/07/2009	EUR3,7
07/11/2008	EUR3,2
10/04/2007	EUR7,1

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SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56.1%

NEUTRAL ratings 32.5%

SELL ratings 11.5%

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