

FOCUS

8th November 2016

Healthcare

Bloomberg	IPH FP
Reuters	IPH.PA
12-month High / Low (EUR)	14.5 / 9.5
Market capitalisation (EURm)	597
Enterprise Value (BG estimates EURm)	394
Avg. 6m daily volume ('000 shares)	269.4
Free Float	79.5%
3y EPS CAGR	NM
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	14.5x	5.7x	3.7x	6.5x
EV/EBITDA	NS	16.2x	7.8x	77.0x
EV/EBIT	NS	18.5x	8.3x	185.0x
P/E	NS	22.7x	11.1x	NS
ROCE	4.2	-25.3	-185.9	6.5



Innate Pharma

Liri to shine at the upcoming SITC congress

Fair Value EUR21 vs. EUR20 (price EUR11.08)

BUY

We reiterate our **BUY** recommendation and have even raised our FV to EUR21 (vs EUR20) to include a risk-adjusted success rate for lirilumab/nivolumab in treatment of head and neck cancer. Efficacy data is to be presented at the upcoming SITC congress (knowing that abstracts should be out today) and is likely to be strong in our view, otherwise it would not be involved in a late-breaking oral session (prompting us to further increase our FV if this proves to be the case).

■ **Very encouraging indicators have surfaced in the past few days.** We noted two subtle/positive factors in the BMS press release highlighting the different presentations they will make at the upcoming SITC congress (November 9-13th). Firstly, the liri/nivo combination was mentioned in the very first headline. Secondly, there will be a late-breaking oral presentation, meaning they are likely to highlight "novel and practice-changing" data (like INCY did last year with epacadostat/pembrolizumab in different solid tumours), and we were surprised that the stock did not react more positively following the announcement.

■ **A strong near-term catalyst.** So far, we were cautious on the potential of lirilumab in solid tumours as we saw some tumour microenvironments (TME) as too challenging, especially in low-inflamed ones. So strong data in head & neck cancer would make us more bullish as it would confirm the theory that NK cells could reverse an anti-inflammatory TME apart from simply augmenting adaptive immune responses. This would prompt us to revise upward our probability of success rates in solid tumours.

■ **BUY reiterated with a FV of EUR21 vs EUR20** as we now include the head & neck indication in our projections with a peak sales estimate of EUR500m in the refractory/relapsing setting along with a 20% probability of success. We see IPH as a deeply undervalued stock due to its implicit enterprise value of c.EUR300m, whereas two licensing deals have been inked involving leading big pharma (namely BMS and AZN), and might potentially yield more than EUR1bn in milestone payments as well as double-digit royalties on two blockbusters-to-be. Note also that our FV could be further revised up to EUR24 should liri/nivo yield some strong data in SCCHN in the coming days.

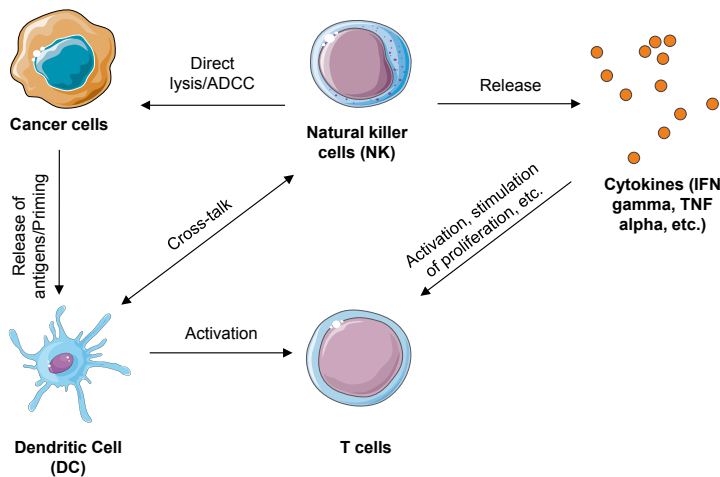


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Innate Pharma Major keys to Focus on

1. Lirilumab/Nivolumab: a strong rationale



Before going into more detail, we think it is worth explaining 1/ what lirilumab is, and 2/ why we are so optimistic about the lirilumab/nivolumab combination.

Lirilumab is a "checkpoint blocker" targeting KIR, i.e. receptors that are especially expressed at the surface of key immune soldiers belonging to our innate system, namely Natural Killer (NK) cells. By blocking the interaction between KIR and its ligand (HLA-C), "liri" releases a major brake on the capabilities of a key conductor of the anti-cancer immune response.

Strong synergies with nivolumab. Many other compounds are said to be quite synergistic with anti-PD-1, but very few of them act that significantly on NK cells... And among other factors, we believe that "liri" should be

able to enhance response to "nivo" thanks to 1/ an upregulation of PD-L1 via an increased generation of IFN- γ ; 2/ a deviation from a Th2 to a Th1 immune response; and 3/ the elimination of certain immunosuppressive items (e.g. MSDCs, cancer stem cells).

2. All eyes on the SITC congress

Very encouraging advanced indicators have surfaced in the past few days. We saw two subtle but positive elements in the BMS press release highlighting the different presentations they will make at the upcoming SITC congress (9-13th November). Firstly, the liri/nivo combination was mentioned in the very first headline. Secondly, this will be a late-breaking oral presentation, meaning they are likely to highlight "novel and practice-changing" data (like INCY did last year with epacadostat/pembrolizumab in different solid tumours), and we were quite surprised that the stock did not react more positively to this announcement.

Strong data in head & neck would surprise positively. Head & neck cancer is known to be a fairly immunosuppressive disease with lower absolute lymphocyte counts, impaired NK cell activity, poor antigen-presenting function and an increased number of anti-inflammatory immune cells (e.g. Tregs, MDSCs, TAMs). So we could expect this indication to fall out of the scope and be better addressed by options modulating the microenvironment (e.g. IDO inhibitors, anti-CSF1R, etc.).

Response rates superior to 20% and 30% in PD-L1- and PD-L1+ respectively would be very competitive (assuming patients received a median of 1 or 2 prior lines). To date, we mainly have data from PD-1/PD-L1 agents as single agents in this indication (admittedly, some preliminary data for epacadostat/pembrolizumab have been presented, but the number of evaluable patients is still very small). When looking at nivolumab as a monotherapy vs standard of care (methotrexate, docetaxel or cetuximab) in refractory/relapse patients irrespectively of their PD-L1 status, we note that the overall response rate stood at 13.3% while median PFS and OS were 2.0 and 7.5 months respectively (HR: 0.89 and 0.70). But turning to MRK's pembrolizumab in PD-L1+ patients, the ORR stood at 25% in a similar setting (with most responses being partial ones, though quite durable).

Nothing is certain, but we hope some PFS/OS data will be available...

3. How does this impact our investment case?

We were quite cautious about the potential of lirilumab in solid tumours as we saw some tumour microenvironments (TME) as too challenging, especially in low-inflamed ones. So, strong data in head & neck cancer make turn us even more bullish and might confirm the theory that NK cells' could reverse an anti-inflammatory TME (Navarro et al, 2015) apart from simply augmenting adaptive immune responses, which could prompt us to revise upward our probabilities of success in SCCHN (bearing in mind that the street has so far given no value to this indication), and eventually other solid tumours.

4. BUY reiterated with a FV of EUR21 vs EUR20

We have raised our FV from EUR20 to EUR21 as we now include the head & neck indication in our estimates. Without going into too much detail, we are assuming liri should be able to generate peak sales of c.EUR500m in the refractory/relapsing setting (cost net of rebates: USD90,000 per patient in the US, EUR70,000 in Europe, penetration rate: 20%, PoS: 20%).

An attractive risk-reward. Innate Pharma, along with Genmab (BUY – FV DKK1,650), is one of the rare must-haves within the biotech field despite the current US political context and debates on drug pricing. We foresee greater sales potential for the Danish part, but we see IPH as much more undervalued due to its implicit enterprise value of c.EUR300m (whereas two deals have been inked and might potentially yield more than EUR1bn in milestone payments, as well as double-digit royalties on two blockbusters)... And so far, the stock has not really reacted to the recent but positive news flow.

A FV of EUR24 and even more in a best-case scenario. We believe that a Phase III could be initiated anytime soon should liri/nivo yield some strong efficacy data in SCCHN; which would allow us to raise our PoS from 20% to 60% for this specific indication, all other things being equal. Obviously, our FV could go even higher, but much will depend on further results in other cancer types.

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	20%	49.4	0.9
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	35%	88.7	1.6
IPH4102	CTCL (Sézary Syndrome)	Phase Ib	0.4	14.0%	379	35%	132.5	2.5
= Enterprise Value					3,195	28%	889.9	16.5
(+) Net cash					243	100%	243.0	4.5
= Equity value					3,438	33%	1,132.9	21.0

Source: Bryan, Garnier & Co ests.

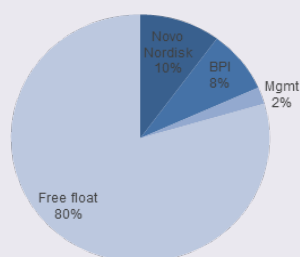
Next catalysts

Period	Product	Indication	Catalyst
12th Nov.	Lirilumab	R/R Head & neck cancer	Phase Ib results in combination with BMS' nivo
Q4 2016	Monalizumab	R/R Ovarian cancer	Preliminary Phase Ib data
Q4 2016	Lirilumab	Acute myeloid leukemia (maintenance therapy)	Phase IIb results as a monotherapy

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

Innate Pharma

Shareholders (%)



Company description

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

Simplified Profit & Loss Account (EURm)	2013	2014	2015	2016e	2017e	2018e
Revenues	16.7	7.6	25.1	69.6	113	81.4
<i>Change (%)</i>	<i>16.6%</i>	<i>-54.2%</i>	<i>230%</i>	<i>177%</i>	<i>62.1%</i>	<i>-27.9%</i>
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
<i>Change (%)</i>	<i>-17.5%</i>	<i>-617%</i>	<i>-46.2%</i>	<i>-%</i>	<i>134%</i>	<i>-94.3%</i>
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
<i>Change (%)</i>	<i>-9.6%</i>	<i>-581%</i>	<i>-66.0%</i>	<i>-%</i>	<i>105%</i>	<i>-89.1%</i>
Cash Flow Statement (EURm)						
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)						
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						
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)						
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
<i>% change</i>	<i>-25.3%</i>	<i>-488%</i>	<i>-66.5%</i>	<i>-%</i>	<i>105%</i>	<i>-89.1%</i>
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.

Price Chart and Rating History

Innate Pharma



Ratings

Date	Ratings	Price
29/09/15	BUY	EUR13.23

Target Price

Date	Target price
27/10/16	EUR20
06/04/16	EUR18
29/09/15	EUR19

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Stock rating

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NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
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 56.7%

NEUTRAL ratings 31.8%

SELL ratings 11.5%

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