

Shire PLC

Price 4,528p

Q3 2016: Baxalta doing less than expected... but overall growth momentum remains solid

Fair Value 6800p vs. 6900p (+50%)

BUY

Bloomberg	SHP LN
Reuters	SHP.L
12-month High / Low (p)	5,323 / 3,480
Market Cap (GBPm)	40,906
Ev (BG Estimates) (GBPm)	58,471
Avg. 6m daily volume (000)	2,643
3y EPS CAGR	14.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.4%	-8.1%	6.3%	-3.6%
Healthcare	-7.5%	-13.5%	-6.3%	-16.1%
DJ Stoxx 600	-2.2%	-1.3%	-1.8%	-8.3%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	6,100	10,953	14,821	15,765
% change		79.6%	35.3%	6.4%
EBITDA	2,924	4,609	6,695	7,371
EBIT	2,785	4,334	6,250	6,851
% change		55.6%	44.2%	9.6%
Net income	2,310	3,305	4,646	5,321
% change		43.1%	40.6%	14.5%

	2015	2016e	2017e	2018e
Operating margin	45.7	39.6	42.2	43.5
Net margin	37.9	30.2	31.4	33.8
ROE	23.5	11.0	14.0	14.3
ROCE	16.2	5.1	7.2	8.2
Gearing	14.7	71.6	55.1	37.6

(USD)	2015	2016e	2017e	2018e
EPS	3.89	4.25	5.04	5.77
% change	-	9.0%	18.7%	14.5%
P/E	14.2x	13.0x	11.0x	9.6x
FCF yield (%)	6.8%	NM	6.6%	9.0%
Dividends (USD)	0.23	0.20	0.22	0.30
Div yield (%)	0.4%	0.4%	0.4%	0.5%
EV/Sales	8.4x	6.5x	4.6x	4.1x
EV/EBITDA	17.6x	15.5x	10.2x	8.7x
EV/EBIT	18.5x	16.5x	10.9x	9.3x

Q3 2016 revenues and EBIT significantly disappointed, especially concerning BXLT's Hematology franchise... But the miss was due to the unfavourable timing of large orders rather than a decrease in demand for FVIII or bypassing therapies. We believe that Q4 should be a more dynamic quarter, and for this reason have barely reduced our EPS estimates. That said, 1/ our FV is trimmed to GBp6,800 following this publication, and 2/ we have removed the stock from our top pick list as all the major catalysts we see are likely to emerge in H1 2017.

ANALYSIS

- **Disappointing Q3 revenues... Especially concerning Baxalta.** Non-GAAP revenues and operating profit were much lower than expected (-3% and -6% respectively compared to consensus' figures); most of the mismatch being due to a poor performance by Baxalta products, and especially in Hematology (impacted by quite unfavourable timing of international large orders).

Fig. 1: Q3 16 published vs estimates

(in USDm)	Q3 2016	BG	CS	Published vs CS
Product sales	3,315	3,485	3,427	-3%
% growth y-o-y	110%	121%	117%	
Non GAAP operating income	1,254	1,337	1,335	-6%
Non GAAP net income	962	969	974	-1%
% growth y-o-y	50%	51%	52%	
Non GAAP diluted earnings per ADS	3.17	3.17	3.29	-4%
% growth y-o-y	-2%	-2%	1%	

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

- **Q4 should be more dynamic** as Hematology should hopefully be less impacted by some sort of volatility in sales from tenders; especially since underlying demand for FVIII remains strong on a global basis (and the trend has been confirmed by comments from competitors, including BAY, which incidentally also suffered from fluctuations in order volumes. This is probably why the FY revenue guidance (USD10.8-11.0Bn) was reiterated yesterday.
- **Synergies are said to be ahead of internal targets**, and explain why the company is now anticipating higher restructuring/integration costs by year end (hence the reduction in FY GAAP guidance from -0.4/0.0 to -1.1/-0.7). Obviously, this reinforces our belief that the streamlining could be faster than the latest guidance provided (USD300m in 2017, USD550m in 2018, and at least USD700m in 2019)... See our previous note [here](#) for further details.
- **Xiidra: an incredible uptake.** On 21st October, the drug had market share of 16%, bearing in mind it was launched at the end of August, thereby confirming its best-in-class profile as well as its blockbuster potential in our view. Overall sales expectations have been revised up over the past few weeks, but we believe that the last quarter could well surprise as 1/ the molecule now has a Tier2/3 coverage for more than 75% of patients; 2/ the signs and symptoms of dry eye disease are known to be exacerbated during the winter season, thus facilitating its marketing...
- **De-listing fears are overdone in our view.** At the beginning of the week, SHP's stock was under pressure because of an interview by Express Scripts' CMO (Steven Miller). No specific treatments were mentioned, but Mr Miller put a particular emphasis on 1/ the rising cost of haemophilia drugs (+22% this year, driven "almost entirely by price increases"), and 2/ how expensive it could be to treat a patient developing inhibitors against coagulation factors (whether thanks to an immune tolerance induction strategy or bypassing therapies).
- This figure of +22% is a bit surprising in our view, especially since the YTD trends reported by SHP, BAY, BIIB, NOVO and SOBI are not that aggressive. And even more when turning to SHP as Advate, Adynovate and Feiba have benefitted from very low single price increases pa over the past few years. We cannot rule out that one of these options could be downgraded / less well-reimbursed by the payors, but a complete de-listing (notably for a key product like Advate) as well as a significant price pressure sound very unlikely.



VALUATION

- **We have trimmed our FV from GBp6,900 to GBp6,800** as we have slightly reduced our EPS estimates following these disappointing Q3 2016 results. But we reiterate our BUY rating in light of an attractive valuation (P/E 2017e: 11x) along with the key catalysts we have identified (take-up of lifitegrast, Phase III results of DX2930 in Q2 17, earnings improvement in Q4, etc.).
- **While we stick to our positive stance, we have decided to remove the stock from our BG top pick list** as 1/ we believe the Capital Market Day is unlikely to add more positive momentum (no guidance/details on revenue synergies to be given, etc.) while fears over a potential price pressure are likely to remain; 2/ all the other catalysts will emerge more in H1 2017.

NEXT CATALYSTS

- 10th November: Capital Market Day.

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