UBS

Daiichi Sankyo

Japan/Pharmaceuticals
17 February 2017

UBS Research
Atsushi Seki, IB Analyst

12-month rating	**Sell**
12-month price target	**¥1,900.00**
Price	**¥2,570.00**

Tivantinib Phase 3 failed; expectations were low

- We only assumed ¥9/share for tivantinib
- Failed to replicate MAEQUEE trial's post-hoc analysis
- This event does not change the view
- Valuation: Price target ¥1,900

Daiichi Sankyo and ArQule announced on 17 February (JST) that the Phase 3 METIV-HCC trial for hepatocellular carcinoma treatment Tivantinib did not show improvement of overall survival as a primary endpoint. We estimated ¥9/share (30% probability of success assumed) and did not include any contribution in our earnings model. We believe expectations were low and do not expect a significant share price adjustment. We estimate that any impairment incurred would be very limited.

Failed to replicate MAEQUEE trial's post-hoc analysis

The Phase 3 MARQUEE trial on Tivantinib for non-small cell lung cancer was discontinued in October 2012 for lack of efficacy (overall survival was 8.5 months versus 7.8 months, for a hazard ratio of 0.98). In analysis after the trial, patients with high MET expression in the Tivantinib group showed statistically significant overall survival relative to placebo (9.3 months vs. 5.9 months) for a hazard ratio of 0.70. However, this result was not replicated.

This event does not change the view

Daiichi Sankyo has been boosting its oncology pipeline steadily. However, filing for its flagship asset DS-8201 is expected in 2020, and it will likely take time for investor expectations to materialize.

Valuation: Price target ¥1,900

Our PT for Daiichi Sankyo is based on DCF analysis using our 10-year earnings forecasts.

Trading data and key metrics

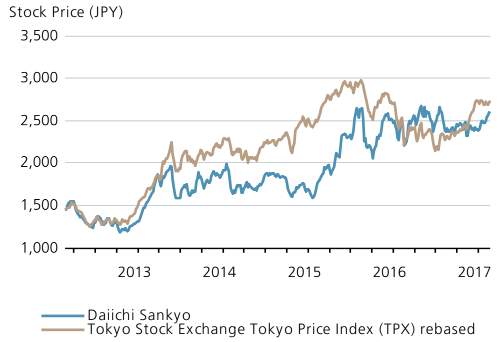
52-wk range	¥2,739-2,217
Market cap.	¥1,822bn/US$16.0bn
Shares o/s	709m (ORD)
Free float	82%
Avg. daily volume ('000)	2,388
Avg. daily value (m)	¥5,873.9
Common s/h equity (03/17E)	¥1,211bn
P/BV (03/17E)	1.4x
Net debt / EBITDA (03/17E)	NM
RIC	4568.T
BBG	4568 JP

Sources: UBS, Bloomberg

EPS (reported, basic)

	UBS	Cons.
03/17E	114.0	108.5
03/18E	105.4	99.2
03/19E	108.7	91.9

Performance



Sources: Bloomberg, UBS

Definitions of terms and abbreviations are available in the appendix section of this report, and more extensively on internet at www.ubs.com/glossary

Company Profile: Daiichi Sankyo
Daiichi Sankyo was first set up as a joint holding company at the end of September 2005. Sankyo and Daiichi Pharmaceutical became wholly-owned subsidiaries of the holding company. Following a transition period to integrate their operations, the two subsidiaries merged, converting the holding company into an operating company, Daiichi Sankyo Ltd., in April 2007.

Statement of Risk
We value Daiichi Sankyo based on a DCF model because it incorporates a long term (10-year) forecast and thus better reflects pipeline contributions and the impact of patent expirations. Risks include: 1) Better-than-expected sales of edoxaban. Its potential market is vast and revenue expansion from potential restriction removal and/or aggressive discounts could result in upside. 2) Pipeline development failure. Daiichi Sankyo has some late-stage development products, such as mirogabalin, pexidartinib and quizartinib, and the probability of success is not 100%. In addition, if the company fails to develop in-licensed products, there would be risk of recognizing impairment loss. 3) Price cut frequency, rate cuts and unexpected price cuts. The industry avoided an April 2017 price cut; however, the risk of an October 2019 price cut and an annual price cut persists. 4) Product recall due to adverse events. Regulators have become aggressive in accelerating drugs for severe diseases and products can be approved without extensive patient experience in clinical trials. A pharmaceutical product has the risk of an unexpected adverse event due to its nature, with risks of recall and economic loss. 5) Intellectual property risk. The pharmaceutical business is an intellectual property business in essence. There is risk of invalid patents and infringing on other parties' patents unexpectedly. 6) Risks of international sales. About 45% of Daiichi Sankyo's revenue comes from international markets, with exposure to FX fluctuations.

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Highlights (¥bn)	03/14	03/15	03/16	03/17E	03/18E	03/19E	03/20E	03/21E
Revenues	899	919	986	948	926	910	929	907
Operating profit	112.9	74.4	130.3	113.6	101.6	103.2	99.9	69.2
Pre-tax profit	113.0	79.9	122.3	114.6	98.8	100.4	97.1	66.4
Net profit (reported)	73.4	46.8	82.2	76.8	69.9	71.1	68.7	47.3
EPS (reported, ¥)	104.2	66.4	119.2	114.0	105.4	108.7	106.8	74.6

Profitability/valuation	03/14	03/15	03/16	03/17E	03/18E	03/19E	03/20E	03/21E
EBIT margin %	12.6	8.1	13.2	12.0	11.0	11.3	10.7	7.6
ROIC (EBIT) %	15.0	11.0	23.0	19.5	16.2	15.4	14.2	9.6
EV/EBITDA x	5.4	3.2	6.7	8.8	9.3	9.1	9.1	11.4
PE (reported) x	17.0	26.8	19.7	22.5	24.4	23.6	24.1	34.4
Net dividend yield %	3.4	3.4	3.0	2.7	2.7	2.7	2.7	2.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied.
Valuations: based on an average share price that year, (E): based on a share price of ¥2,570.0 on 17 Feb 2017 18:34 JST

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UBS 12-Month Rating	Rating Category	Coverage [1]	IB Services [2]
Buy	**Buy**	45%	28%
Neutral	**Hold/Neutral**	39%	25%
Sell	**Sell**	15%	17%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2016.

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.

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