UBS

GlaxoSmithKline

United Kingdom/Pharmaceuticals
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UBS Research
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12-month rating	**Neutral**
12-month price target	**1,600.00p**
Price	**1,580.00GBp**

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Gilead's GS-9883 a credible risk to GSK's HIV franchise following PhII data

In our GSK note 'Earnings see-saw leaves us at Neutral' (link) we argue that there is near term risk to GSK's HIV Triumeq/ Tivicay franchise due to market share loss if next-generation regimens are approved (Gilead's GS-9883). However we also argued that two-drug regimens (oral or injectable) could be a credible alternative eventually creating an offset for GSK. At this year's CROI conference GSK's pIII trials (SWORD 1/2) in such a dual setting (oral dolutegravir +rilpirivine) showed that switching patients from conventional triple of four-drug therapy resulted in viral suppression no different to prior therapy (95% viral suppression and no difference in serious adverse events). Given the previous pII LATTE trial (with cabotegravir) and the head-line announcement earlier this year this result is not overly surprising. The recently started pIII trials (FLAIR and ATLAS) for the depot version of cabotegravir remain our main focal point for the dual strategy – we regard the depot version as a potential revolution in HIV (data due 2018).

However at the same conference we saw the pII data for Gilead's GS-9883/ bictegravir. In its head to head trial (albeit small) against GSK's Tivicay, GS-9883 showed non-inferiority in viral suppression at 24 weeks and 48 weeks (97% v 94% and 97% v 91%), no viral resistance and no treatment related serious adverse events. As such GS-9883 appears to be a comparable product to Tivicay (which we know from the preclinical data already) leaving it as a likely credible competitor.

It is unclear at this point which strategies – incremental triple HAART (GS-9883) or a

disruptive 2-drug regimen – will ramp up from 2018 to dominate the HIV market. Our

base case assumption (based on LATTE-1/2 and SWORD-1/2) is that dual therapy is a

valid option but we don't assume rapid uptake yet. Nevertheless we believe there is

option value in GSK's strategy. We do remind investors though that consensus does not

appreciate the pending Gilead GS-9883 disruption (pIII data and filing in 2017). The key debate remains whether Gilead will gain the upper hand again or whether a disruptive two-drug regimen becomes standard of care (favouring GSK). It is possible it will get tougher for ViiV before it gets better.

Trading data and key metrics

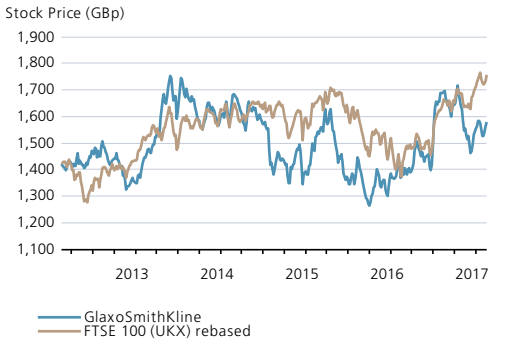
52-wk range	1,723p-1,361
Market cap.	£76.9bn/US$96.4bn
Shares o/s	4,868m (ORD)
Free float	100%
Avg. daily volume ('000)	8,293
Avg. daily value (m)	£126.9
Common s/h equity (12/16E)	£2.08bn
P/BV (12/16E)	36.9x
Net debt / EBITDA (12/16E)	1.5x
RIC	GSK.L
BBG	GSK LN

Sources: UBS, Bloomberg

EPS (UBS, diluted) (p)

	UBS	Cons.
12/16E	100.53	102.40
12/17E	110.21	110.06
12/18E	108.40	114.07

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: GlaxoSmithKline
GlaxoSmithKline is a UK large-cap pharmaceutical company. GSK's pharma business consists mainly of its HIV franchise, ViiV (a joint venture with Pfizer and Shionogi as minority shareholders), respiratory and a few smaller therapeutic areas, e.g. cardiometabolic and immune-inflammation. GSK completed an asset-swap with Novartis in March 2015 in which GSK divested its oncology business, took on Novartis' vaccines and created a world-leading consumer healthcare/OTC joint venture (Novartis is a minority shareholder with a 36.5% stake).

Statement of Risk
(1) Company-specific risks include business integration (Novartis asset swap), and the ongoing and upcoming respiratory launches. In addition the HIV JV ViiV faces competitive risk with Gilead returning with a new product (GS-9883). (2) Risks generally applicable to the pharmaceutical sector include: development risk – uncertainty regarding the timing, efficacy, and market potential of new products and technologies; commercial risk – threats from new/existing competition and pricing pressure; regulatory risk – timing/status of approvals and changes in labelling or new warnings on existing products and technologies; patent risk – products losing patent protection may face significant market share/price erosion and potential litigation; and currency risk – because of the mismatch between geographical location of cost base and sales.Valuation: We consider several methods when we set our price targets. We are most heavily influenced by DCF analysis. Our explicit forecasts run to 2025. From 2025, we assume 2% annual growth in (operating income x (1 – tax rate)) and a straight-line ROIC fade. ROIC fades to WACC over a 20 year period. This approach means that our DCF valuations are particularly sensitive to 2 parameters; WACC and our estimate of ROIC around 2025. Given these sensitivities, we sense-check our DCF valuation against PE multiples calculated on the basis of both adjusted ("core" or "non-GAAP" numbers) and IFRS or GAAP numbers, calibrated against the rest of the sector and considering the EPS growth profile. For GSK our WACC is 5.7%, terminal growth 2%.

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Highlights (£m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	25,602	23,006	23,923	27,711	30,329	31,468	32,394	33,929
EBIT (UBS)	7,771	6,594	5,729	7,623	8,547	8,528	8,529	8,890
Net earnings (UBS)	5,237	4,584	3,658	4,885	5,371	5,293	5,281	5,560
EPS (UBS, diluted) (p)	106.46	94.22	74.84	100.53	110.21	108.40	107.94	113.43
DPS (p)	0.78	0.80	0.80	0.80	0.84	0.88	0.93	0.97
Net (debt) / cash	(12,645)	(14,377)	(10,727)	(14,144)	(14,043)	(13,693)	(13,546)	(13,400)

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	30.4	28.7	23.9	27.5	28.2	27.1	26.3	26.2
ROIC (EBIT) %	35.6	31.3	27.0	35.2	38.0	36.2	34.8	34.9
EV/EBITDA (core) x	10.2	11.3	11.7	10.4	9.7	9.7	9.8	9.5
P/E (UBS, diluted) x	15.0	16.2	18.9	15.7	14.3	14.6	14.6	13.9
Equity FCF (UBS) yield %	7.3	5.1	1.4	1.2	5.3	5.9	5.9	6.2
Net dividend yield %	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1

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 1,580p on 13 Feb 2017 21:38 GMT

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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.

UBS Investment Research: Global Equity Ratings Definitions

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Global Equity 12-Month Rating Definitions

Buy: FSR is > 6% above the MRA. **Neutral:** FSR is between -6% and 6% of the MRA. **Sell:** FSR is > 6% below the MRA.

Key Definitions

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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