UBS

Novo Nordisk

Denmark/Pharmaceuticals
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UBS Research
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12-month rating	**Buy**
12-month price target	**DKK350.00**
Price	**DKK241.70**

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Margin quality and ROIC robustness

- Don't forget the other half – ex-US not margin or ROIC dilutive
- Segmentation of the insulin market is still key
- Worries about GLP-1 pricing are premature
- Valuation: Buy, Price Target DKr350

Understandably much of the current focus on Novo is on US pricing. This however has, in our view, led to a mistaken perception that a tougher US pricing environment equates to non-sustainability of Novo's ROIC. This is the reason for Novo's trading on a short term P/E and not a long-term cash valuation. Underlying this is a significant misunderstanding of Novo's ex-US operating margin perceived to be dilutive. Our analysis of US and ex-US growth vs the ex-R&D CER margin overtime shows that it is not dilutive. CFO comments at Q4 substantiate the analysis. In the '17 transition period, the ex-US business is increasingly important from a growth and margin perspective - we remind investors the sales split is roughly equal. Coupled with improved OPEX discipline and the 'expected future cost drivers', the company's 5% 5yr EBIT CAGR target is realistic despite a toughening US pricing environment. We reiterate our Buy rating/DKK 350 price target.

Segmentation of the insulin market is still key
We believe the market is not differentiating between the different pockets of Novo's diabetes top-line and is wrongly applying a risk of Lantus's 20-30% pricing headwinds to the whole diabetes top-line. Dynamics between the different types of insulin vary significantly. Analysing the relative contributions of different insulin franchises and regional split reveal a top-line that is more dynamic than the current valuation implies.

Worries about GLP-1 pricing are premature
Our client interaction has revealed concern about the sustainability of GLP-1 growth and margin contribution. This shows investors are unaware of the pricing strategy that competitors have already deployed without apparent impact. Our analysis shows this market remains a two-player one (Novo and Lilly) with both players aiming for product differentiation. Payer dynamics have already happened and remain moderate.

Valuation: Buy, Price Target DKr350
We focus on DCF (WACC 6.8%, terminal growth 2%) in setting price targets, but sense-check vs. PE multiples, considering EPS growth profile. This is 20x '18e 'core' and IFRS earnings. Our sector 'core' '18e target multiple is 14.2x, but we think Novo has superior growth. Our '20 EPS estimate is in line with sell-side consensus, but valuations suggest buyside consensus discounting these estimates heavily.

Trading data and key metrics

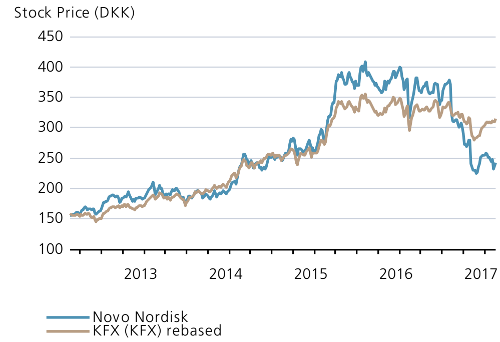
52-wk range	DKr387.00-220.70
Market cap.	DKr611bn/US$86.9bn
Shares o/s	2,530m (ORD)
Free float	75%
Avg. daily volume ('000)	4,016
Avg. daily value (m)	DKr973.6
Common s/h equity (12/17E)	DKr47.6bn
P/BV (12/17E)	12.4x
Net debt / EBITDA (12/17E)	NM
RIC	NOVOb.CO
BBG	NOVOB DC

Sources: UBS, Bloomberg

EPS (UBS, diluted) (DKr)

	From	To	% ch	Cons.
12/17E	15.33	15.49	1	15.34
12/18E	17.65	17.92	2	16.92
12/19E	19.45	20.00	3	18.31

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

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Investment Thesis

Investment Case

Novo has de-rated from a 40% premium to a sector multiple as the market seems to have lost confidence in the company's ability to deliver premium growth and the business model. Insulin pricing pressure and rare erosion of non-diabetes franchises have triggered the fall. Our view is that after a tough (and trough) 2017, Novo will return to an 11% EPS CAGR (v 9% cons) as the pricing headwinds are less pronounced than feared and as the non-insulin diabetes portfolio (Victoza and semaglutide) outweigh pressure. As payer formularies are published in 2017 and Novo results that reflect low negative price/mix effects, we expect the stock to re-rate and benefit from positive earnings momentum.

Company Profile: Novo Nordisk

Novo Nordisk is a Danish pharmaceutical company specialising in diabetes (79% of 2015 sales), with a focus on insulins and other proteins, such as GLP-1 analogues. Other key disease areas are obesity, haemophilia and growth disorders. Novo's sales are weighted towards the US (51% of 2015 sales), Europe (19%) and China (9%). In January 2016, Novo launched Tresiba, a next-generation long-acting insulin. It also has semaglutide, a once-weekly subcutaneous GLP-1 analogue, in late-stage development. A Phase IIIa programme, PIONEER, has recently been launched to determine the safety and efficacy of oral semaglutide.

Statement of Risk

Risks for the pharma industry in general relate to: continued lowered levels of R&D productivity, unexpected generic competition, government pressures on pricing, and various forms of litigation risk. Volume prescription growth in the US market has slowed in recent years, and newly approved drugs can show sluggish uptake. Key risks for Novo include: (1) progress on market share and particularly US pricing, for Novo's premium-priced insulin analogues such as Levemir/Tresiba, and in GLP1 (Victoza) in the face of increasing competition from brands and biosimilars; and (2) (unlikely) regulatory failure of Tresiba, (3) failure of semaglutide to meet high expectations.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.

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Highlights (DKrm)	12/14	12/15	12/16	12/17E	12/18E	12/19E	12/20E	12/21E
Revenues	88,806	107,927	111,780	118,015	124,477	131,981	138,539	143,450
EBIT (UBS)	34,492	49,444	48,432	50,763	54,547	59,206	63,018	65,393
Net earnings (UBS)	26,481	34,860	37,925	37,723	42,430	46,064	49,037	50,889
EPS (UBS, diluted) (DKr)	10.07	13.52	14.96	15.49	17.92	20.00	21.91	23.42
DPS (DKr)	5.00	6.40	7.60	8.00	9.00	10.00	10.50	11.00
Net (debt) / cash	15,185	19,392	20,470	21,279	19,627	19,996	23,065	29,449

Profitability/valuation	12/14	12/15	12/16	12/17E	12/18E	12/19E	12/20E	12/21E
EBIT margin %	38.8	45.8	43.3	43.0	43.8	44.9	45.5	45.6
ROIC (EBIT) %	125.1	182.8	181.4	193.9	177.0	153.4	136.4	123.9
EV/EBITDA (core) x	17.3	17.9	16.0	11.0	10.2	9.4	8.8	8.4
P/E (UBS, diluted) x	24.8	26.6	21.7	15.6	13.5	12.1	11.0	10.3
Equity FCF (UBS) yield %	4.2	3.4	4.8	5.9	5.7	6.3	6.8	7.4
Net dividend yield %	2.0	1.8	2.3	3.3	3.7	4.1	4.3	4.6

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 DKr241.70 on 14 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.

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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).

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