

SANOFI

EQUITY RESEARCH Valuation and Outlook for 2020

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SANOFI

2020 : A Transition Period For Sanofi

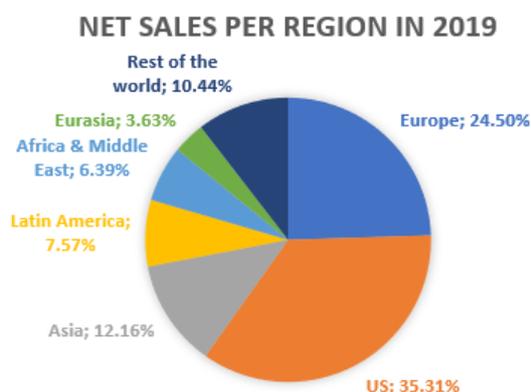
I. PRESENTATION OF SANOFI AND ITS BUSINESS ENVIRONMENT

a. Presentation of Sanofi :

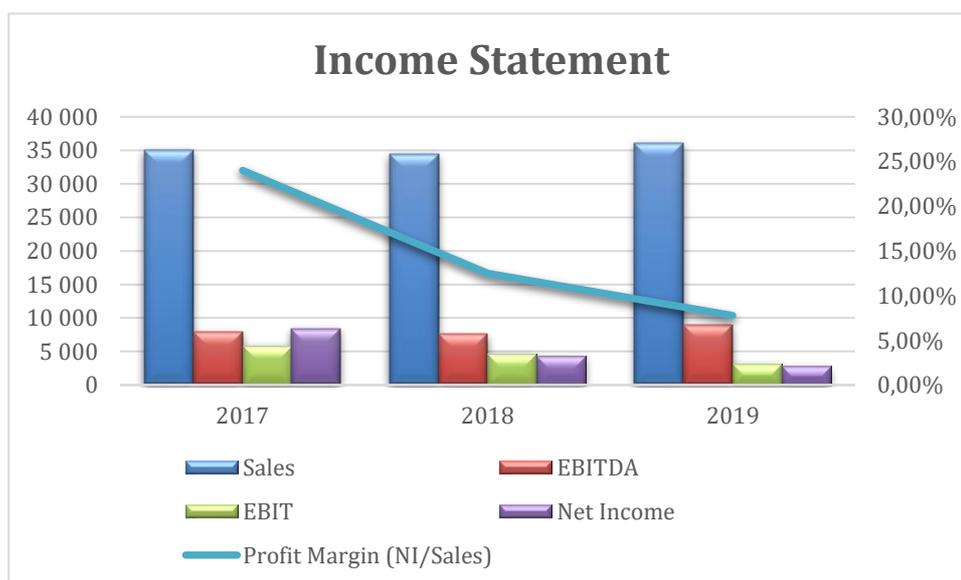
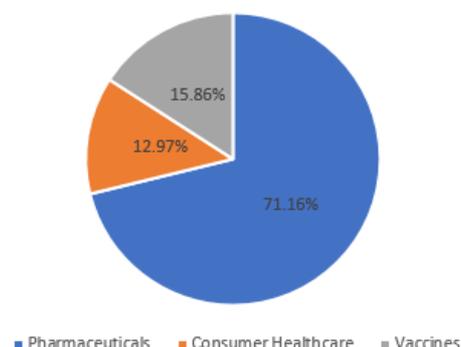
Sanofi is a leading French company which manufactures and provides healthcare solutions in more than 170 countries around the world. The company operates in 3 segments :

- Pharmaceuticals
- Consumer Healthcare
- Vaccine

Market Data	
Industry	Health Care
Share price (25/03/2020)	€76.8 (CAC 40), \$41,37 (NASDAQ)
Market Capitalization (€ in million)	95,321



Net Sales per Segment in 2019



Sanofi's revenues in 2019 were equivalent to €36Bn, which slightly exceeded 2018 and 2017. The revenues were mainly carried by the pharmaceutical activities, especially in the United States. Although the sales and the EBITDA are higher in 2019 than the two years before, EBIT and Net Income are, on the other hand, decreasing. Therefore, the profit margin is lower in 2019 (7,77%) and shows a significant decreasing trend (24% in 2018 to 7,7% in 2019). This difference can be explained by the higher amount in amortization and impairment of intangible assets as well as by the higher amount of *other operating expenses* (+120% in 2019), compensated only partially by *other operating income* (+70% in 2019). However, the SG&A and R&D expenses have been quite stable since 2017.

Finally, Sanofi seems to be in a transition period with a little and steady growth rate for 2019. This transition will continue in 2020, all the more so now with the COVID-19, which can be an opportunity for the company. Moreover, Sanofi CEO Paul Hudson unveiled on December 2019 a new strategy to drive innovation and growth implying efficiency savings and a restructuration of the company (more in the part *Strategy and SWOT of Sanofi*).

b. The healthcare sector and the top competitors

The healthcare sector consists of businesses that provide medical services, manufacture medical equipment/drugs, provide medical insurance, or otherwise facilitate the provision of healthcare to patients. The sector is important worldwide and especially in developed countries. It represents for example a fifth of overall GDP in the US. The figures show an outstanding growth in this sector for the next coming years ¹ :

- Global health care spending is projected to increase at an annual rate of 5.4% until 2022 (\$7,724Bn in 2017, \$10,059Bn in 2022)
- Per-person health care spending is expected to continue to grow widely especially in North America, Western Europe and Asia.

Although the sector needs high R&D expenses for companies like Sanofi, the market is protected by barriers to entry such as economies of scale, professional licence, regulation, intellectual property protections and specialized expertise. Moreover, the demand for healthcare and pharmaceutical products is highly price inelastic, which guarantee a high minimum level of revenues for drug manufacturers like Sanofi. Finally, the outlook in this sector are good and Sanofi as well as its competitors would certainly benefit from this growth.

€ in million (31/12/2019)	Sanofi	Novartis	Pfizer	Merck & Co	Roche Holding
Sales	36,126	43,659.69	47,568.08	43,054.86	57,861.27
EBITDA	8,875	13,706.60	20,490.58	17,935.24	23,928.28
EBIT	3,125	8,351.76	16,253.12	14,633.50	16,518.88
Net Income	2,806	6,569.45	14,957.98	9,047.59	12,705.46
Enterprise value	129,508	212,176.63	245,016.22	227,322.90	260,761.94
EV/EBITDA	14.59x	15.48x	11.96x	12.67x	10.90x
EV/EBIT	41.44x	25.41x	15.08x	15.53x	15.79x
EV/Sales	3.58x	4.86x	5.15x	5.28x	4.51x
Total Debt	24,685	25,171.10	47,935.76	24,216.98	13,520.67
Cash & cash equivalent	9,427	10,214.04	1,199.54	8,894.08	5,718.73
Equity/Total debt	2.39x	2.03x	1.22x	0.99x	2.44x

¹ <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Life-Sciences-Health-Care/gx-lshc-hc-outlook-2019.pdf>

Even if Sanofi is one of the leaders in the health care and pharmaceutical sector, there is still a gap in terms of sales, EBITDA and net income between the company and its top peers like Novartis, Pfizer, Merck & Co and Roche. When we look at the EV/EBITDA multiple, Sanofi appears to be near to average in comparison to its leading competitors. However, the EV/EBIT seems quite high and shows that the company is maybe a little overvalued.

On the contrary, the company is below the average concerning the EV/Sales. In addition, Sanofi has good results concerning the equity/total debt ratio (2nd, behind Roche) and the amount of cash, revealing the good financial health of the company.

c. Evolution of the share price



Since October 2019, Sanofi's share price has globally outperformed the market (CAC 40) and its peers. Despite the stock market crash, due to the COVID-19, the stock won 1.08% (03/25/2020) compare to one year before, which clearly outperformed the CAC 40 (-17.55%) and the sector (Novartis : -15%, Pfizer : - 28.65%, Merck & Co : -15,93%). The stock price of Sanofi is currently €76,8 (03/25/2020). The performance of the stock in 2020 could be explained by investors' trust towards the new strategy and by the implication of the company in the fight against the COVID-19, in collaboration with the American biotechnological company Regeneron.

II. VALUATION

a. Assumptions of the valuation

First of all, for the valuation, I estimated that Sanofi is a mature firm in a mature market with well-established competitors. The company has a steady growth rate. Therefore, I computed the terminal value (exit value) using a multiple ratio approach to find the theoretical value of Sanofi in 2020. In this approach, I chose the EV/EBITDA multiple with a value of 14.5x, which correspond to an admitted average in the pharmaceutical industry¹. Moreover, the valuation is based on the results of 2019 and doesn't take into account the potential impact on the COVID-19 (which could be positive for the company) or the potential benefits of the new strategy and restructuration of the company which are unknown. The valuation should be updated in the future to considerer the real impact of these factors.

b. Construction and results of the valuation

I found a **share price of €85.33** with a **Weighted Average Cost of Capital (WACC) of 5.125%** and an **exit multiple of 14.5x** while the **current share price of Sanofi is €76.8** (25/03/2020).

N.B. For simplification reasons and because it is more relevant, I will only make a comparison with Sanofi's stock price in the CAC 40.

Enterprise Value		Implied Equity Value and Share Price	
Terminal Value		Enterprise Value	122,413.37 €
EBITDA (2019)	8,875	Less: Total Debt	-24,685
Exit Multiple	14.5x	Less: Preferred Stock	0
Terminal Value	128687.5	Less: Noncontrolling Interest	-174
Discount Factor	0.95	Plus: Cash and Cash Equivalents	9,427
Present Value of Terminal Value	122413.3684		
		Implied Equity Value	106,981
Enterprise Value	122,413.37 €		
		Fully Diluted Shares Outstanding	1253.8
		Implied Share Price	85.33 €

¹<https://www.equidam.com/ebitda-multiples-trbc-industries/>

Enterprise Value						
Exit Multiple						
		13.0x	14.0x	14.5x	15.0x	16.0x
	4.125%	76.07 €	82.86 €	86.26 €	89.66 €	96.46 €
	4.625%	75.64 €	82.41 €	85.79 €	89.18 €	95.94 €
WACC	5.125%	75.23 €	81.96 €	85.33 €	88.69 €	95.43 €
	5.625%	74.81 €	81.51 €	84.86 €	88.21 €	94.92 €
	6.125%	74.40 €	81.07 €	84.41 €	87.74 €	94.41 €

The result is naturally highly dependent of the assumptions used to compute the WACC and of the choice of the exit multiple. The sensitivity analysis shows the impact of such assumptions on the share price.

Concerning the construction of the WACC, the cost of equity was computed using the CAPM model ($R_f + \beta \cdot (R_m - R_f)$) plus a country risk premium given the fact that Sanofi is present in more than 170 countries, especially in Latin America, Africa & Middle East and Eurasia. The Beta (0,867) was calculated using a regression between the evolution of Sanofi's stock price and the CAC 40 value during the last past 5 years (until the 31st December of 2019). Then I used the average over 5 years of the German 10-years bond to compute the risk-free rate while the Market Risk Premium is the difference between the average of the return of the CAC 40 minus the risk-free rate. Finally, the Country Risk Premium is the weighted average (by revenues) of the defaults spread of Sanofi's markets around the world

WACC Calculation	
Capital Structure	
Debt-to-Total Capitalization	30.0%
Equity-to-Total Capitalization	70.0%
Cost of Debt	
Cost-of-Debt	0.726%
Tax Rate	31.0%
After-tax Cost of Debt	0.5%
Cost of Equity	
Risk-free Rate	0.238%
Market Risk Premium	6.0%
Beta	0.867
Country Risk Premium	1.169%
Cost of Equity	5.44%
WACC	5.125%

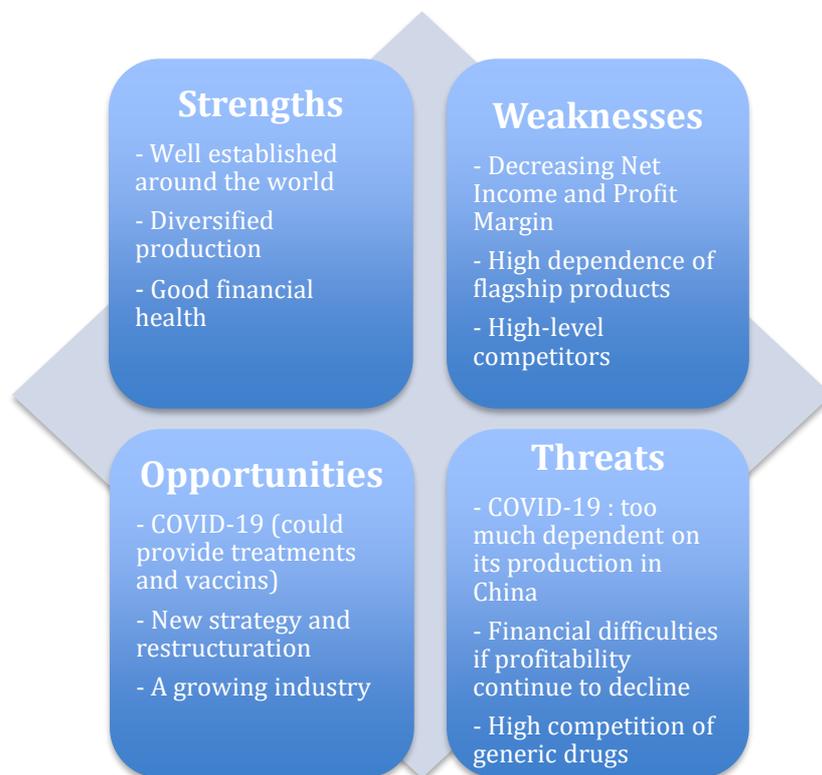
We can observe that the WACC is mainly dependant of the cost of equity. Indeed, the debt represents only 30% of the total capitalization and the cost of debt of Sanofi is low.

III. STRATEGY AND SWOT OF SANOFI

a. The new strategy

As announced by Sanofi CEO Paul Hudson, the company will implement a new strategy aiming to deliver strong growth of several drugs (for example Dupixent), vaccines and treatments (oncology, haematology, etc), but also to focus on innovations, efficiency savings (in limiting spending on de-prioritized businesses) and on a restructuration in three core global business units (Speciality Care, Vaccines and General Medicines). Therefore, 2020 will be a transition period with the implementation of this new strategy, coming to fruition between 2022 and 2025. Thanks to this plan, Sanofi should save €2 billion by 2022, obtaining a Business Operating Income (EBITDA + *Restructuring cost and similar items* + *Fair value remeasurement of contingent consideration* + *other gain/losses and litigation*) margin of 30% in 2022 and of 32% by 2025. Furthermore, the company expects to increase its annual Free Cash Flow by approximately 50% by 2022 compared with an adjusted base of €4.1Bn in 2018.

b. SWOT



IV. Conclusion

Despite the stock market crash due to the COVID-19, Sanofi's stock outperformed the market and its peers, showing the trust of the investors in the new strategy implemented by the company for the foreseeable years. The company operates in a growing sector because of population ageing and the increasing need in healthcare products of emerging countries. However, the company faces a high-level competition with other well-established companies. Moreover, the restructuring comes at just the right moment to alter the declining Net Income (-66% in 2 years). 2020 should be a transition period for Sanofi to restore its profitability in 2021. I personally believe in the company and thanks to the trust of the investors the share price could reach my valuation share price (€85.33) during 2020. This theoretical value could appear somewhat bullish but is conceivable if Sanofi implements good strategic decisions, including effective R&D, especially considering the higher market growth rate than the overall global economy.

V. ADDITIONNAL COMMENTS

I am a M1 EDHEC Business School student in Finance, passionate about asset management and equity research and not a professional equity research analyst. I don't claim this valuation and equity research rapport is perfect and must be seen without a critical view. Moreover, this publication is not in any case an investment advice.

As my goal is also to develop my skills, I am open to any argument or debate if it is relevant and if it enables me to improve future valuation/equity research rappers. This personal project aims to do an equity research and valuation about Sanofi in a concise way. Therefore, all my researches and computations are not necessarily display in this document.