

Novartis

Price CHF83.65

Let's wait and see how it performs at the start of 2016

Fair Value Under Review

NEUTRAL vs. BUY

Bloomberg	NOVN VX
Reuters	NOVN.VX
12-month High / Low (CHF)	102.3 / 79.7
Market Cap (CHFm)	223,930
Ev (BG Estimates) (CHFm)	223,579
Avg. 6m daily volume (000)	5 109
3y EPS CAGR	3.2%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-1.6%	-7.6%	-15.2%	-3.6%
Healthcare	-4.3%	-4.9%	-11.1%	-5.2%
DJ Stoxx 600	-7.4%	-9.8%	-14.0%	-7.3%

YEnd Dec. (USDm)	2014	2015e	2016e	2017e
Sales	57,996	49,340	50,454	53,105
% change		-14.9%	2.3%	5.3%
EBITDA	15,487	14,737	14,643	16,021
EBIT	10,736	9,237	9,143	10,521
% change		-14.0%	-1.0%	15.1%
Net income	10,210	8,055	8,427	9,789
% change		-21.1%	4.6%	16.2%

	2014	2015e	2016e	2017e
Operating margin	18.5	18.7	18.1	19.8
Net margin	17.6	16.3	16.7	18.4
ROE	14.1	11.5	11.9	13.4
ROCE	18.4	15.7	15.6	17.9
Gearing	9.2	19.7	15.0	9.8

(USD)	2014	2015e	2016e	2017e
EPS	5.23	5.07	5.17	5.75
% change	-	-3.1%	2.1%	11.1%
P/E	15.7x	16.2x	15.9x	14.3x
FCF yield (%)	7.0%	1.0%	4.8%	5.4%
Dividends (USD)	2.60	2.75	3.00	2.87
Div yield (%)	3.2%	3.3%	3.7%	3.5%
EV/Sales	3.7x	4.5x	4.3x	4.0x
EV/EBITDA	13.7x	14.9x	14.8x	13.3x
EV/EBIT	19.8x	23.8x	23.7x	20.3x

Disappointing final 2015 numbers, weak guidance for flat performance in 2016, delay with serelaxin and questions around Alcon and Entresto point to a difficult start to the year for Novartis in our view. We put our FV under review but we cut our rating to NEUTRAL (despite theoretical upside) to reflect negative relative positioning vs other names in the European pharma space.

ANALYSIS

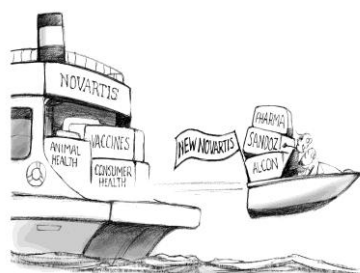
- Novartis is reporting this morning lower-than-expected numbers for its fourth-quarter of 2015 with Pharma more or less in line with expectations while Sandoz and Alcon are below estimates.
- Pharmaceuticals has had another good quarter in Q4 with sales up 9% and core operating margin expanding by 160bp to 26.8%. Note however that the reported growth includes the positive perimeter impact of the former oncology GSK drugs. This growth, among others, was driven by another very good performance of Gilenya (USD742, +18%) and the continuing strong ramp-up of Cosentyx that achieved USD121m in Q4 (vs our expected USD112m). In the respiratory field, Ultibro performed well but others suffered more, including Onbrez which was down. Note also that China posted a very strong quarter in Pharmaceuticals overall with several one-offs as a result of highly concentrated tenders. But the big disappointment comes from Entresto that posted a very low USD5m for the quarter. We knew access to the drug was still restricted in Q4 but we did not expect such low numbers. Novartis says it expects "to expand access beginning in early 2016". Ex-US markets will help too. No doubt however that Entresto will raise questions about the right level of expectations for 2016 but maybe also at peak.
- But the miss in Q4 came from Sandoz and Alcon. Sandoz did not surprise the management that much because Generics remain volatile by nature and because comparison base was not easy. However the flat growth in Q4 (which compares to +11% in Q2 and +9% in Q3) is also the reflection of forced price cuts in the US for several product ranges and notably dermatology so that price impact was negative by 8% compared to a positive impact in the previous period. As far as Alcon, the 6% decline is a significant further downward move compared to previous quarters (-2% in Q3) and the group is reporting competitive pressure in IOLs and a slowdown in equipment purchases in the surgical segment, generic competition to Patanol for pharmaceuticals. As expected, Novartis is announcing first steps in its plan to return to growth at Alcon which results in the transfer of the former pharmaceuticals segment to the Pharma division while Alcon will concentrate on surgical solutions and contact lenses. New Head is also appointed, with previous experience at Hospira and Allergan as President. To note is that another type of transfer will take place, this time between Pharma and Sandoz with the first transferring to the second about USD900m in annual sales of old, non-marketed products (like Foradil or Aclasta). All in all, those changes will have a positive influence on Sandoz's margins and negative on Alcon's.
- In the end, the full-year 2015 performance resulted in a core EPS of USD5.01 (vs CS: USD5.06).
- Note also in the R&D update section of the press release that the final read-out of the RELAX-HF2 study is delayed from mid-2016 into 2017, which removes a significant potential triggering event from 2016. There is still no update about strategy for Ultibron in the US.

VALUATION

- On top of the transfers of product segments from one division to another, Novartis also announces new wave of efficiency measures in manufacturing operations which will result in USD1.4bn in costs over 5 years and USD1bn annual cost savings by 2020.
- Guidance for 2016 is towards flat sales and core EBIT. Associates and financials should play positively but this will be offset by currencies so that core EPS can be expected flat too. This means consensus has to cut its estimates for 2016 by 4 to 5%.
- We put our FV under review. We think Novartis will underperform the sector in H1 and therefore we also reduce our rating to NEUTRAL from BUY.

NEXT CATALYSTS

- Today at 2.30pm: Conference Call - [Click here to download document](#)



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BUY ratings 60,2%

NEUTRAL ratings 30,8%

SELL ratings 9%

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