

## Novartis

Price CHF80.55

2016 likely to be a transition year but the mid-term still looks promising

Fair Value CHF100 vs. CHF109 (+24%)

NEUTRAL

Bloomberg	NOVN VX
Reuters	NOVN.VX
12-month High / Low (CHF)	102.3 / 79.7
Market Cap (CHF)	215,632
Ev (BG Estimates) (CHF)	217,422
Avg. 6m daily volume (000)	5,192
3y EPS CAGR	6.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-5.3%	-9.6%	-17.7%	-7.2%
Healthcare	-4.6%	-4.7%	-9.6%	-5.5%
DJ Stoxx 600	-7.1%	-8.5%	-11.8%	-7.0%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	49,414	49,404	51,489	55,233
% change		0.0%	4.2%	7.3%
EBITDA	14,552	14,672	15,428	17,237
EBIT	8,977	9,172	9,928	11,737
% change		2.2%	8.2%	18.2%
Net income	7,450	8,393	9,227	10,960
% change		12.6%	9.9%	18.8%

	2015	2016e	2017e	2018e
Operating margin	18.2	18.6	19.3	21.3
Net margin	15.1	17.0	17.9	19.8
ROE	10.1	10.8	11.5	13.2
ROCE	14.8	13.9	15.3	17.7
Gearing	21.4	20.1	15.7	9.4

(USD)	2015	2016e	2017e	2018e
EPS	5.01	5.02	5.37	6.11
% change	-	0.1%	7.1%	13.7%
P/E	15.8x	15.8x	14.7x	13.0x
FCF yield (%)	0.6%	3.8%	5.4%	5.8%
Dividends (USD)	2.75	3.00	2.69	3.05
Div yield (%)	3.5%	3.8%	3.4%	3.9%
EV/Sales	4.3x	4.3x	4.1x	3.7x
EV/EBITDA	14.7x	14.6x	13.6x	11.9x
EV/EBIT	23.9x	23.3x	21.2x	17.5x

The conference call aimed to bring some reassuring messages to the financial community about Novartis' preparation for the future and to some extent it was well done and presented by management. While 2016 is likely to be a tough year as Gleevec will have to be absorbed, Alcon revived (including through additional investments) and launches further supported, but we think Novartis should return to growth in 2017 and maybe to a double-digit rate in 2018 onwards. Some late-stage R&D assets highlighted during the call are minimally (PKC412) or not reflected (QAW039, ABL001) in our numbers as of yet and therefore represent upside. We think it is fair to wait and see how things develop as we go into 2016 while favouring certain peers before considering a comeback later in the year.

## ANALYSIS

- Very much as expected, the conference call focused sharply on Alcon and Entresto with a lot of details provided to support the fact that long-term perspectives are unchanged.
- For Alcon, we think it is fair to remain cautious on whether or not Novartis will succeed in returning the business to growth although the new scope will help a lot as the generic impact on pharmaceuticals will no longer hit Alcon. In contact lenses, however, the company will have to quickly show that it can stop market share erosion. Management said clearly that it would take some time but that it expects to see the first fruits in Q4 2016 with a clear return to growth. Before that, the comparison base will remain high in H1 and the plan will require about USD200m in additional investments behind products and for increasing training and education for physicians in the surgical segment.
- With Entresto also, the overall message was that things should improve as the year progresses, with the group also stating that consensus numbers might be too high for the year (albeit offset by overly-low numbers for Cosentyx). Meanwhile, Novartis showed encouraging charts on the coverage side with significant progress achieved over the last three/four months. Our understanding is also that rebates have been recently agreed upon to open some doors, which could help too (including with the Veteran Affairs' channel). The sales force has been re-trained in January, with new marketing support. Since it took 12-18 months for some products before these kind of issues were solved in the US, we think it is worth waiting an additional few quarters to see what happens. Lastly, as expected, things look simpler in Europe such that an ex-US ramp-up could be faster.

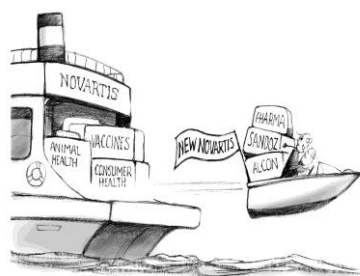
## VALUATION

- After factoring the final 2015 numbers into our model and making a few changes (mostly on the downside), we have cut our FV from CHF109 to CHF100. The main elements behind the cut are the following: (i) a sales cut for Onbrez/Seebri, Afinitor, Entresto and Alcon, partly offset by an increase for Cosentyx; (ii) USD200m incremental investments to boost Alcon; (iii) a higher-than-expected net debt level at the end of the year and also a forecast for higher financial costs by USD150-200m; (iv) we have reduced Alcon's long-term growth from 2.5% to 2%, bringing down the rate for the group in our DCF and EVA methods from 1.91% to 1.81%.
- Clearly the stock has become an issue for some time now, not because of fundamentals that remain very strong, as reflected in our FV, but because of the momentum due to a weakened Alcon, an uncertain Entresto concerning its ramp-up in 2016 and the Gleevec patent expiry.

## NEXT CATALYSTS

- 21st April 2016: First-quarter results

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