

2nd February 2016

Healthcare

Roche

Price CHF264.30

Preparing for 2017

Fair Value CHF311 vs. CHF338 (+18%)

BUY

Bloomberg	ROG VX
Reuters	ROG.VX
12-month High / Low (CHF)	282.5 / 241.7
Market Cap (CHF)	185,687
Ev (BG Estimates) (CHF)	198,110
Avg. 6m daily volume (000)	1,425
3y EPS CAGR	7.4%

FY 2015 numbers (below expectations, mainly as a result of fx, financial expenses and taxes) and comments on them have led us to slash our 2016 estimates. This year will essentially prepare for coming years for meaningful product launches, which require significant extra investments in manufacturing and commercial infrastructures. We have cut core EPS by 9% for 2016 (also due to the unexpected negative fx impact) and 4% for 2017, and our FV by 8% to CHF311.

ANALYSIS

- We have now digested the full-year 2015 numbers and the comments provided during the conference that was held last Thursday in London and we have updated our figures. The message in short is that 2016 will prepare extensively for 2017 and beyond as Roche is about to launch eight new drugs over the next two years, including some in areas where the group has to build commercial and marketing infrastructure. As such, together with additional investments in manufacturing to obtain the right level of capacity for the upcoming biologicals and the required expense in the late-stage pipeline, operational leverage is set to be very limited in 2016.
- Starting with the top line, low-to-mid single digit growth guidance for 2016 takes into account a fairly similar picture to 2015 when sales grew 5% with a slowdown in Perjeta's growth now that it has penetrated a large share of its target market in the US and in Esbriet which was in its first year. Caution on Tamiflu is also reasonable considering the current season in the US. On the other side, the decline in Xeloda and Lucentis sales is not expected to be as sharp as in 2015. New products Cotellic and Alecensa will have a limited contribution this year. We have also removed the USD50m contribution we had from ocrelizumab in the US as Roche suggested the first launches would take place in 2017 after a very careful preparation for launch.
- With this picture of limited top-line growth in mind and the required investments described above, operating margin leverage is expected to be very minimal in 2016. Actually, if core earnings are expected to grow by more than sales, this is mainly as a result of a better outlook for the bottom part of the P&L, unlike 2015. Roche restructured its gross debt last year and this came at a cost. However, this should transform into a profit in the future as the effective interest rate has been reduced from 4.4% to 3.7% while it is fair to think that the CHF324m in losses incurred due to the devaluations of the Venezuelan and Argentinean currencies are one-offs. Together with a flat tax rate, the bottom part of the P&L should offer the majority of leverage in 2016 as far as core EPS is concerned. Asked about the impact currencies could have this year, Roche said that current rates would have no impact on sales and EBIT, but a further 3% negative impact on core EPS as most of its debt is denominated in USD. This was not at all our scenario so far.

VALUATION

- We have made no major changes to our top-line estimates, but have significantly increased the cost of goods in 2016 (vs our previous estimate not vs 2015) due to new facilities with sub-optimal capacity as they are ramping up. Including final 2015 numbers, this has had a negative impact on 2016 financials and the tax rate. We have also made changes to our model to reflect Roche's guidance for the impact currencies would have on core EPS. In the end, the revision is hefty with core EPS reduced from CHF15.80 to CHF14.39 for 2016 and from CHF16.98 to CHF16.34 for 2017.
- What looks clearer now however is that 2016 is set to be a year of preparation for stronger growth in 2017 and beyond. In 2017, leverage could be maximum as biosimilars should have a limited impact while ocrelizumab and atezo will participate over the full-year. In addition, APHINITY and GOYA could also play a significant (but as yet unknown) role for Perjeta and Gazyva respectively. As such, 2016 is likely to be quiet in our view, especially in H1, thereby favouring UK peers. However, we are maintaining our BUY recommendation for the long-term perspectives harboured in the renewed pipeline.

NEXT CATALYSTS

- Q1 2016 : Completion of filing for atezo in 3L lung cancer

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NEUTRAL ratings 31.3%

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