11th March 2016

Healthcare

Roche

Price CHF244.60

Adjustment to our model after LAVOLTA results

Fair Value CHF303 vs. CHF311 (+24%) **BUY**

Bloomberg	ROG VX
Reuters	ROG.VX
12-month High / Low (CHF)	282.5 / 240.7
Market Cap (CHF)	171,847
Ev (BG Estimates) (CHF)	184,417
Avg. 6m daily volume (000)	1 482
3y EPS CAGR	6.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.4%	-9.1%	-5.6%	-11.5%
Healthcare	3.7%	-9.4%	-10.5%	-11.7%
DJ Stoxx 600	5.8%	-8.2%	-7.2%	-8.8%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	48,145	50,836	52,235	53,773
% change		*5.6%*	*2.8%*	*2.9%*
EBITDA	19,430	20,029	21,475	21,844
EBIT	13,821	16,798	18,675	19,644
% change		*21.5%*	*11.2%*	*5.2%*
Net income	11,626	12,341	13,854	14,055
% change		*6.2%*	*12.3%*	*1.4%*

	2015	2016e	2017e	2018e
Operating margin	28.7	33.0	35.8	36.5
Net margin	24.1	24.3	26.5	26.1
ROE	43.7	49.3	46.3	41.1
ROCE	28.1	27.3	28.7	28.7
Gearing	60.4	45.1	28.1	14.3

(CHF)	2015	2016e	2017e	2018e
EPS	13.49	14.32	16.07	16.31
% change	-	*6.2%*	*12.3%*	*1.4%*
P/E	18.1x	17.1x	15.2x	15.0x
FCF yield (%)	5.6%	4.6%	5.5%	6.2%
Dividends (CHF)	8.10	8.60	9.65	9.79
Div yield (%)	3.3%	3.5%	3.9%	4.0%
EV/Sales	3.9x	3.6x	3.5x	3.3x
EV/EBITDA	9.6x	9.2x	8.4x	8.1x
EV/EBIT	13.5x	11.0x	9.7x	9.0x

Following mixed headline results from the LAVOLTA studies, we have cautiously decided to remove lebrikizumab from our sales model. Together with a few other changes to sales estimates, including figures for Gazyva and Kadcyla, we have reduced our FV by CHF8 to CHF303. Roche remains a BUY.

ANALYSIS

- After the earnings season, we are reviewing the stocks we cover to make adjustments, like we did yesterday with AstraZeneca. With Roche, the idea is to factor in product ramp-ups that are slightly different compared to our expectations, as well as to take in to account the first lessons from last week's headline results from the two LAVOLTA phase III studies.
- The products for which we have made the most significant changes are Gazyva and Kadcyla on the downside, and Esbriet and the HER2 family on the upside. For the first two, our statement as of today is that they are running behind expectations (i) Gazyva because the indication scope is too limited so far, whereas competition to broaden it is already intense, making it fair to notch down our estimates for the next few years while waiting for the key GOYA and GALLIUM studies; (ii) Kadcyla because it is limited to the advanced stages of HER2+ BC (EMILIA) without clear upside potential from ongoing studies (KRISTINE is a small opportunity, the combo with atezo is unlikely to beat a similar combo with Herceptin/Perjeta) and so penetration already looks high in certain geographies (+4% in the US in 2015) and upside limited except for new territories. In the opposite direction, Esbriet is outstripping expectations in the US and we simply have to be cautious about potential competition emerging because we know that Esbriet is not the ideal drug for IPF. The HER2 franchise is also surprisingly robust with Herceptin and Perjeta both strong, although the second will depend increasingly on the results of APHINITY (expected in Q4) to bring its success to another stage which is adjuvant BC, with the aim being to triple sales at least.
- That said, the reason for this short update today is also and mainly to take account of the first lessons provided by the recently-presented headline data for the two LAVOLTA studies that were investigating the IL-13-targeting antibody lebrikizumab in severe asthma. Last week Roche said that only one of these two identical phase III trials had met its primary endpoint of reducing exacerbations compared to placebo. Detailed results will be presented in an upcoming scientific meeting and Roche is waiting for the full data analysis in order to decide what steps to take next. Before we know more, what reasonable assessment of the situation can we make relative to our sales model? The most reasonable assumption before seeing any data would be that lebrikizumab is unlikely to have a strong enough effect to support full endorsement by payers and prescribers. Considering the partial overlap with IL-5-targeting agents that are more advanced in their journey (Nucala is already approved and is being launched by GSK), the bar has been set at a higher level for IL-13 agents. As such, the LAVOLTA results do not bode very well for the "filability" of lebrikizumab at least in asthma (it is also being developed in COPD, in AD and in IPF). However, it could also be that the final results show a clear enough benefit in a subset of patients (underlying medication, eosinophil count, high dose vs low dose, etc …), thus offering a path forward from a regulatory perspective. We had so far assumed a penetration rate of 60% of that of Xolair (if only because AZN's "tralo" is just behind) which, together with a PoS of 60% translated into a sales contribution of just CHF330m in 2022. Actually, what could be worse than the financial impact of "lebri"'s failure *per se* is the fact that the Respiratory franchise would have one less contributor to drive its growth.

VALUATION

- To stay on the safe side, we have decided to remove lebrikizumab from our model until we have more data (-CHF4). The other above-mentioned changes to products have an additional net impact of -CHF4 (Gazyva and Kedcyla both now with PS of CHF1.6bn vs CHF2bn previously) on our FV thereby leading to a new FV of CHF303. Roche remains a BUY given that it still looks attractive after taking into account the coming wave of new products. However, momentum for 2016 is not as good as for UK companies in our view.

NEXT CATALYSTS

19th April 2016: Q1 sales *Click here to download document*

Analyst :
Eric Le Berrigaud
33(0) 1 56 68 75 33
eleberrigaud@bryangarnier.com

Sector Team :
Mickael Chane Du
Hugo Solvet

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 64,4% NEUTRAL ratings 28,1% SELL ratings 7,4%

Research Disclosure Legend

1	Bryan Garnier shareholding in Issuer	Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer").	No
2	Issuer shareholding in Bryan Garnier	The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group.	No
3	Financial interest	A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report	No
4	Market maker or liquidity provider	A member of the Bryan Garnier Group is a market maker or liquidity provider in the securities of the Issuer or in any related derivatives.	No
5	Lead/co-lead manager	In the past twelve months, a member of the Bryan Garnier Group has been lead manager or co-lead manager of one or more publicly disclosed offers of securities of the Issuer or in any related derivatives.	No
6	Investment banking agreement	A member of the Bryan Garnier Group is or has in the past twelve months been party to an agreement with the Issuer relating to the provision of investment banking services, or has in that period received payment or been promised payment in respect of such services.	No
7	Research agreement	A member of the Bryan Garnier Group is party to an agreement with the Issuer relating to the production of this Report.	No
8	Analyst receipt or purchase of shares in Issuer	The investment analyst or another person involved in the preparation of this Report has received or purchased shares of the Issuer prior to a public offering of those shares.	No
9	Remuneration of analyst	The remuneration of the investment analyst or other persons involved in the preparation of this Report is tied to investment banking transactions performed by the Bryan Garnier Group.	No
10	Corporate finance client	In the past twelve months a member of the Bryan Garnier Group has been remunerated for providing corporate finance services to the issuer or may expect to receive or intend to seek remuneration for corporate finance services from the Issuer in the next six months.	No
11	Analyst has short position	The investment analyst or another person involved in the preparation of this Report has a short position in the securities or derivatives of the Issuer.	No
12	Analyst has long position	The investment analyst or another person involved in the preparation of this Report has a long position in the securities or derivatives of the Issuer.	No
13	Bryan Garnier executive is an officer	A partner, director, officer, employee or agent of the Bryan Garnier Group, or a member of such person's household, is a partner, director, officer or an employee of, or adviser to, the Issuer or one of its parents or subsidiaries. The name of such person or persons is disclosed above.	No
14	Analyst disclosure	The analyst hereby certifies that neither the views expressed in the research, nor the timing of the publication of the research has been influenced by any knowledge of clients positions and that the views expressed in the report accurately reflect his/her personal views about the investment and issuer to which the report relates and that no part of his/her remuneration was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.	Yes
15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

A copy of the Bryan Garnier & Co Limited conflicts policy in relation to the production of research is available at www.bryangarnier.com

London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the Financial Conduct Authority (FCA) and the Autorité de Contrôle prudential et de resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA

New Delhi
The Imperial Hotel
Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062