

11th March 2016

Healthcare

Roche

Price CHF244.60

Adjustment to our model after LAVOLTA results

Fair Value CHF303 vs. CHF311 (+24%)

BUY

Following mixed headline results from the LAVOLTA studies, we have cautiously decided to remove lebrizumab 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 lebrizumab 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 lebrizumab 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 lebrizumab 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 lebrizumab 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 Kadcyla 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](#)

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



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