

Novartis

Price CHF78.90

Ready for a fresh round of refocusing on Specialty Care?

Fair Value CHF89 (+13%)

NEUTRAL

Bloomberg	NOVN VX
Reuters	NOVN.VX
12-month High / Low (CHF)	102.3 / 68.5
Market Cap (CHF)	207,279
Ev (BG Estimates) (CHF)	210,901
Avg. 6m daily volume (000)	6,094
3y EPS CAGR	5.7%

	1 M	3 M	6 M	31/12/15
Absolute perf.	5.6%	10.2%	-10.6%	-9.1%
Healthcare	1.7%	5.7%	-7.1%	-6.1%
DJ Stoxx 600	0.5%	6.7%	-8.5%	-4.7%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	49,414	50,145	52,551	55,856
% change		1.5%	4.8%	6.3%
EBITDA	13,119	12,996	13,822	15,372
EBIT	7,544	7,496	8,322	9,872
% change		-0.6%	11.0%	18.6%
Net income	6,017	6,568	7,603	9,133
% change		9.2%	15.8%	20.1%

	2015	2016e	2017e	2018e
Operating margin	15.3	14.9	15.8	17.7
Net margin	12.2	13.1	14.5	16.4
ROE	8.1	8.5	9.9	11.6
ROCE	14.4	13.4	14.6	16.9
Gearing	21.4	22.5	20.8	16.4

(USD)	2015	2016e	2017e	2018e
EPS	5.01	4.96	5.28	5.92
% change	-	-1.1%	6.5%	12.1%
P/E	15.9x	16.1x	15.1x	13.5x
FCF yield (%)	0.6%	3.1%	4.5%	5.0%
Dividends (USD)	2.75	3.00	2.64	2.96
Div yield (%)	3.5%	3.8%	3.3%	3.7%
EV/Sales	4.3x	4.2x	4.0x	3.7x
EV/EBITDA	16.2x	16.4x	15.3x	13.6x
EV/EBIT	28.1x	28.4x	25.4x	21.1x

Joe Jimenez clearly stated during yesterday's Investor Day in Basel that he was driving a specialisation strategy at the helm of Novartis. So, the focus is to turn around Alcon and later on decide whether to keep it or not although it is less of a fit. The same goes for the stake in the JV with GSK in OTC and of course with Roche's stake, which will be divested before rituximab's biosimilar is launched. The same also goes for non-specialised respiratory drugs. In the end, Novartis could get a meaningful amount of cash to strengthen core businesses. Novartis could well transform itself deeply again over the next couple of years.

ANALYSIS

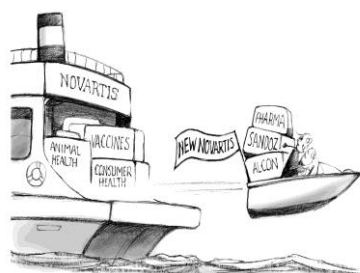
- The key take-away from the Novartis Meet-The-Management Day in Basel yesterday was that top management agreed to say that Alcon post-turnaround would be questioned within the group, that Roche's stake would be sold by the end of 2017 and the minority stake in the joint-venture with GSK in Consumer Healthcare also divested at some point. All of these assets do not fit with a strategy of specialisation. Core is Pharmaceuticals and differentiated generics. That said, Novartis is mainly considering bolt-on acquisitions (up to USD5bn), except if something bigger arises but that would need to be "clearly understood by shareholders" (unlike Bayer's move?).
- Time will tell how to reconcile the two positions i.e. a very significant amount of cash and leverage capacity with the idea of making bolt-on acquisitions. But a rough calculation would suggest that Roche's stake at the market place is worth CHF13-14bn, the stake in the Consumer JV with GSK at least CHF12bn and Alcon maybe CHF15-18bn, so Novartis can clearly position itself towards something big if needed, for instance to close the gap in immunology more quickly than by waiting for its internal developments to reach the market. Obviously, a lot will depend on the type of opportunity that arises and also on how quick and deeply Alcon's business is turned around and how quick also Entresto responds to new marketing impetus.
- On these two topics: 1- **Alcon's** new CEO gave a first good impression and is determined to pursue a customer-centric strategy with three key priorities: (i) a good customer service, with appropriate training; (ii) fix the issues around the supply chain which includes an increase in inventories in-house to prevent any disruption; (iii) interacting more with opinion leaders to improve products and procedures. Alcon also recognises that more focus has been put on IoLs and contact lenses than before when surgical equipments were given priority. 2- **Entresto**: things are definitely improving since it has gained support from bodies like NICE and IQWiG and has received class I recommendations in key guidelines by ESC, ACC and AHA. As a consequence, Novartis has decided to double the current sales force in support of Entresto in the US (700) over the coming months to have a first Primary Care sales force and increase audience and prescription base.
- We found Novartis also very confident about its NBS initiative launched in 2014. Up to then, the cost base was growing at a pace of 4.2% per year on average. And the idea over the next 5 years is to keep the base flat (ex. R&D costs), which would save no less than USD5bn.
- On the R&D front, we were less impressed. After several management changes, the new organisation is well in place with younger people in charge. But although Novartis tried to share its enthusiasm about meaningful opportunities like LEE011, ABL001, RTH258 or ofatumumab, we are not fully sure that this is enough to drive Novartis through a period that will also be characterised by several patent expiries. Hence maybe a way to close the loop with the previous chapter: BD activities are required to strengthen the portfolio and bring Novartis back on a growth trajectory. From that perspective, the division that looks well on track is Sandoz whose biosimilar opportunity is a step towards change with manufacturing and development costs already largely in the cost base, thus offering significant margin leverage.

VALUATION

- The asset swap with GSK was only a first step towards a refocusing of Novartis towards Specialty Care. This strategy could well be highly value-creative but requires some more time.

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