

20th July 2016

Healthcare

Novartis

Price CHF80.25

Conference call focused on new drugs and M&A

Fair Value CHF87 vs. CHF89 (+8%)

NEUTRAL

Bloomberg	NOVN VX
Reuters	NOVN.VX
12-month High / Low (CHF)	102.3 / 68.5
Market Cap (CHFm)	210,826
Ev (BG Estimates) (CHFm)	203,831
Avg. 6m daily volume (000)	5 805
3y EPS CAGR	5.3%

There was no breaking news during the conference call held yesterday afternoon to discuss the half-year results, but it was interesting to note that most of the questions concerned M&A opportunities for the company. Novartis repeatedly said that it was not compelled to do anything big including in I.O. and would prioritize bolt-on acquisitions unless a bigger deal that makes sense for everyone arises. That said, it could be outside of oncology and, for instance, the presence in Respiratory is being reassessed by new Head of Innovative Medicines. Our impression remains that the transformation phase is not over, which makes it difficult to fully endorse a turnaround scenario.

	1 M	3 M	6 M	31/12/15
Absolute perf.	7.2%	8.2%	-1.9%	-7.5%
Healthcare	8.7%	2.9%	3.1%	-4.5%
DJ Stoxx 600	3.5%	-3.4%	1.3%	-7.8%

ANALYSIS

- We did not learn a lot from the discussion about the numbers per se and the interesting parts of the conference call were those referring to new or yet-to-come products and to BD and M&A.
- Several times, management said that its objective was to design differentiated drugs and with each meaningful opportunity, it is the intention to work on differentiation. It was in particular asked about two late-stage assets, namely LEE011 in the CDK4/6 inhibitor class where Imbruvica (Pfizer) is already marketed in the US and AMG334 in migraine with, in both cases, significant competition around. The CDK4/6 inhibitor market is one that Novartis believes can exceed USD10bn, but beyond that it is starting trials that are "pretty unique" like MONALEESA-7 in post-menopausal women in combination with different drugs including aromatase inhibitors. The company is still evaluating the opportunity to start trials in the neo-adjuvant and adjuvant settings. For AMG-334, Novartis believes it can be first-to-market and have specific mode of action (by targeting the receptor instead of the ligand), broader label and advantageous sc delivery form.
- Of course, Cosentyx and Entresto were also addressed, first with conviction that it belongs to a class that should become leader in the targeted indications including psoriasis and also with mention that 4-year data anticipated next year might bring differentiating arguments vs Taz (Lilly) in terms of duration of response. As for Entresto, Novartis argued about the logics behind an increase in the commercial and marketing support decided for H2 in the US and resulting in an extra USD200m investment in the GP sales force. This was very much the consequence of quicker and better-than-anticipated guidelines obtained by the drug from ESC, AHA and others. The recommendation to use Entresto in the US is broad and also supported by pharmaco-economic studies saying that Entresto saves lives at an affordable price.
- But the central theme of questions was M&A. Several targeted the oncology franchise and more specifically the need for Novartis to strengthen its presence in I.O. Perhaps not very convincingly, management answered that they don't feel they have to do something in I.O because it is a long run and they have enough to compete with second-generation products. But actually it was also clear that cardiology or immunology are fields of equal interest for Novartis to do deals or transactions. And new Head of Innovative Medicines Paul Hudson, who comes from AstraZeneca, made it clear that he wants to personally assess the strengths of Novartis in the Respiratory field to decide what to do here, meaning confirm a partnering route or invest, including in the US to launch Ultibro for instance, and in R&D to leverage some opportunities like the triple combination QVM or the CRTh2 antagonist in asthma.

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	49,414	48,381	50,435	53,536
% change		-2.1%	4.2%	6.1%
EBITDA	13,119	12,183	13,441	14,892
EBIT	7,544	6,683	7,941	9,392
% change		-11.4%	18.8%	18.3%
Net income	6,017	6,077	7,492	8,929
% change		1.0%	23.3%	19.2%

	2015	2016e	2017e	2018e
Operating margin	15.3	13.8	15.7	17.5
Net margin	12.2	12.6	14.9	16.7
ROE	8.1	7.9	9.8	11.5
ROCE	14.4	12.6	14.2	16.4
Gearing	21.4	23.4	21.7	17.2

(USD)	2015	2016e	2017e	2018e
EPS	5.01	4.79	5.25	5.85
% change	-	-4.4%	9.5%	11.4%
P/E	16.3x	17.0x	15.5x	13.9x
FCF yield (%)	0.6%	2.8%	4.4%	4.8%
Dividends (USD)	2.75	3.00	2.62	2.92
Div yield (%)	3.4%	3.7%	3.2%	3.6%
EV/Sales	4.2x	4.3x	4.1x	3.8x
EV/EBITDA	15.7x	17.0x	15.3x	13.6x
EV/EBIT	27.3x	31.0x	25.9x	21.6x

VALUATION

- Although we make a slight downward adjustment to numbers that drives a small cut to our FV to CHF87 (from CHF89), we believe that Novartis is coming closer to the exit door of its transition period that started a year ago. That said, some strategic decisions might have implications in terms of earnings and growth for the years to come. NEUTRAL still looks like the adequate rating.

NEXT CATALYSTS

- Early October 2016: MONALEESA-2 phase III study results presented at ESMO

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BUY ratings 55,8%

NEUTRAL ratings 34%

SELL ratings 10,2%

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