21st July 2016

Healthcare

Roche

Price CHF253.00

Half-year results ahead of estimates but includes one-time non-cash gain

Fair Value CHF293 (+16%) **BUY**

Bloomberg	ROG VX
Reuters	ROG.VX
12-month High / Low (CHF)	281.0 / 233.2
Market Cap (CHFm)	177,748
Ev (BG Estimates) (CHFm)	190,191
Avg. 6m daily volume (000)	1 477
3y EPS CAGR	6.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.9%	-0.2%	-0.1%	-8.5%
Healthcare	7.8%	5.0%	7.3%	-3.1%
DJ Stoxx 600	0.9%	-2.8%	5.7%	-6.8%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	48,145	50,762	51,908	53,128
% change		*5.4%*	*2.3%*	*2.4%*
EBITDA	19,430	20,345	21,444	21,699
EBIT	13,821	17,114	18,644	19,499
% change		*23.8%*	*8.9%*	*4.6%*
Net income	11,626	12,677	13,722	13,947
% change		*9.0%*	*8.2%*	*1.6%*

	2015	2016e	2017e	2018e
Operating margin	28.7	33.7	35.9	36.7
Net margin	24.1	25.0	26.4	26.3
ROE	43.7	50.4	45.8	40.7
ROCE	28.1	27.9	28.7	28.6
Gearing	60.4	44.1	27.6	13.8

(CHF)	2015	2016e	2017e	2018e
EPS	13.49	14.71	15.92	16.18
% change	-	*9.0%*	*8.2%*	*1.6%*
P/E	18.8x	17.2x	15.9x	15.6x
FCF yield (%)	5.4%	4.5%	5.4%	6.0%
Dividends (CHF)	8.10	8.83	9.56	9.72
Div yield (%)	3.2%	3.5%	3.8%	3.8%
EV/Sales	4.0x	3.7x	3.6x	3.4x
EV/EBITDA	9.9x	9.3x	8.7x	8.4x
EV/EBIT	13.9x	11.1x	10.0x	9.4x

Both divisions participated in the second-quarter to beat analysts' estimates for the period with sales 1% higher than expected. Within Pharmaceuticals, the performance of Rituxan, of the HER2 franchise and of new products like Tecentriq and Alecensa deserves a mention. Diagnostics, up 8%, delivered strongest growth over a 2-year period. This results also in higher-than-expected earnings in absolute terms although the leverage may disappoint as the difference between sales and EPS growth is only 1%. This is even more the case considering the CHF426m one-time gain from changes in pension plans. However, Roche confirms objectives for full-year, suggesting higher leverage in H2.

ANALYSIS

- There are two ways of reading half-year numbers released by Roche this morning. The first one consists of comparing the numbers to what consensus was expecting and it cannot be anything but positive here as revenues are 1% ahead of estimates (so about 2% when considering that only Q2 numbers were missing) while core EPS came out at CHF7.74 when CHF7.47 were anticipated.
- Indeed, sales performance during the quarter was good with sales up 5% in Pharma and 8% in Diagnostics, the strongest quarter since Q2 2014. Consensus beat in the second quarter was evenly split between the two divisions. Diagnostics performed very well in Professional Diags (+9% vs +7% in Q1) but also less bad in Diabetes Care were the decline was 4% (vs -11% in Q1). In Pharmaceuticals, there are always ups and downs but it is worth mentioning Rituxan, the HER2 franchise, Actemra and Tecentriq as the good surprises in the quarter while Esbriet and Avastin were slightly disappointing. All in all, the performance at the top-line was good.
- Here comes the second reading of the numbers because if core operating income is also ahead of estimates by the same magnitude than sales, numbers include a CHF426m one-time non-cash gain from Swiss pension plans changes. Stripping this gain out of the half-year figures would make core operating income appear fully in line with consensus estimates. However, considering the level of revenues, this would appear like a disappointing leverage and margin level, that corresponds to higher investments in manufacturing reflecting higher COGS and lower royalties received. That said, Roche reiterates its full-year guidance of growing eanings ahead of sales which clearly states that leverage in H2 will be higher than in H1. In order to be fully balanced as long as one-offs are concerned, we note that H1 included CHF94m one-off charge for the early redemption of a bond.

VALUATION

- In the end, with higher-than-expected sales figures and lower-than-expected restated leverage on margins, we do anticipated a mixed and fairly neutral share price reaction. Note that core EPS came out at CHF7.74 when consensus was expecting CHF7.47 but the 5% difference is entirely the reflection of the net positive impact of the two above-mentioned one-offs.
- That said, we know that this is not where the investment case currently stands. Roche's share price performance will be highly dependent on what the APHINITY phase III study says. This is likely several months ahead of us and by then , the stock is unlikely to perform one way or the other in a meaningful way.

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