

Novartis

Price CHF72.55

If Novartis is a call for 2018-2020, then call me back in 2017!

Fair Value CHF81 vs. CHF87 (+12%)

NEUTRAL

Bloomberg	NOVN VX
Reuters	NOVN.VX
12-month High / Low (CHF)	90.6 / 68.5
Market Cap (CHF)	190,597
Ev (BG Estimates) (CHF)	182,706
Avg. 6m daily volume (000)	4,336
3y EPS CAGR	41.5%

Asked to comment on a very first look into 2017, CEO answered that Novartis was not so much about next year as about 2018 onwards, as the group will then exit the Gleevec patent cliff period. Although it makes sense, it also suggests that CS is likely too high on 2017 numbers and needs to be adjusted. As we do so, our FV comes down from CHF87 to CHF81. NEUTRAL reiterated.

ANALYSIS

- Obviously, we are here to anticipate upcoming trends and to try to move before the turnaround takes place, but in saying that Novartis was not a call for 2017 (as Gleevec is likely to weigh even more than previously thought, because competition in the US has been less intense so far, thus creating a higher-than-expected comparison base), but more a 2018-2020 call. The CEO has thus offered an easy argument to “wait and watchers”.
- Beyond Gleevec, which will have about USD3bn of sales exposed to generics next year, arguments in favour of a wait-and-see strategy very much relate to the yet-to-come turnaround in Alcon and Entresto cases, both of which performed poorly again in Q3. However, on these two fronts, Novartis comments have been encouraging, suggesting progress: (i) for Alcon, it comes faster in Consumer than in Surgical obviously but in Europe, where initial DTC campaigns have taken place, some market share gains have started to be seen, whereas new PanOptix IOL and new Daily Total1 are expected to drive growth further out. Last but not least, Alcon’s management is very happy about its global level of service and supply, which has not been as good for two years; (ii) as long as Entresto, TRx and NRx are starting to reflect progress on coverage and inclusion in guidelines.
- Of course, Novartis did not commit to any form of guidance for 2017, but our understanding is that 2017 might pretty much look like 2016 initially i.e. “flat to slightly declining year” overall. However, comparing that to consensus numbers, this could come as a disappointment as the market expects core EPS to jump from CHF4.74 to CHF5.05 (+6.5%). As there is no forex impact to anticipate, this could prove optimistic.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-8.3%	-11.7%	-2.9%	-16.4%
Healthcare	-6.4%	-9.9%	-5.6%	-12.9%
DJ Stoxx 600	-0.7%	0.6%	-1.0%	-6.2%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	49,414	48,572	49,355	52,335
% change		-1.7%	1.6%	6.0%
EBITDA	6,634	13,813	14,271	15,513
EBIT	1,059	8,313	8,771	10,013
% change			5.5%	14.2%
Net income	-463.4	7,123	7,794	9,023
% change		NS	9.4%	15.8%

	2015	2016e	2017e	2018e
Operating margin	2.1	17.1	17.8	19.1
Net margin	-0.9	14.7	15.8	17.2
ROE	-0.6	9.2	10.0	11.4
ROCE	-5.5	13.8	14.5	16.4
Gearing	21.4	21.5	18.4	12.4

(USD)	2015	2016e	2017e	2018e
EPS	1.92	4.78	4.92	5.44
% change		- 149.0%	3.0%	10.4%
P/E	37.9x	15.2x	14.8x	13.4x
FCF yield (%)	0.6%	3.8%	5.5%	5.8%
Dividends (USD)	2.75	3.00	2.46	2.72
Div yield (%)	3.8%	4.1%	3.4%	3.7%
EV/Sales	3.7x	3.8x	3.7x	3.4x
EV/EBITDA	27.6x	13.3x	12.7x	11.4x
EV/EBIT	173.0x	22.1x	20.6x	17.6x

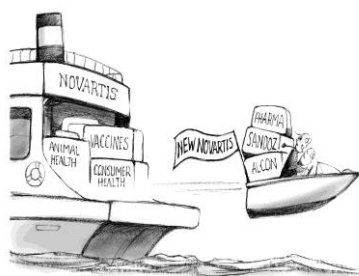
VALUATION

- We have cut our estimates for 2017 significantly from CHF5.25 to CHF4.93 in light of the above-mentioned comments from management, but also because it is now clear that we were too high with Alcon (we have cut our operating margin by 100bp) and also with several products in Pharmaceuticals including Entresto (from CHF900m down to CHF700m) and in oncology (Zykadia, Tafinlar US, Tasigna US). We have also slightly reduced our expectations on LEE011 on the back of cautious comments about requirements for cv and hepatic monitoring and until new data emerge.
- Obviously, we have also noticed some interesting comments about M&A strategy that largely contradict recent press rumours. It looks like there is no change in terms of prioritizing bolt-on acquisitions (USD2-5bn) over large-scale deals, except if “attractive opportunities” arise. The Roche stake is also still very much for sale, simply waiting for the right time (and price). Together with Alcon (once restructured) and the minority stake in JV with GSK, they represent cash pockets to be reallocated and redeployed, if necessary, into more strategic opportunities. Commenting on Lilly’s and GSK’s transactions, the CEO said that one lesson is that “focus is good!”.

NEXT CATALYSTS

- 25 January 2017: Full-year results and R&D update (Basel)

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