21st October 2016

Healthcare

Roche

Price CHF232.50

APHINITY more than ever needed

Fair Value CHF285 vs. CHF293 (+23%) **BUY**

Bloomberg	ROG VX
Reuters	ROG.VX
12-month High / Low (CHF)	279.3 / 232.5
Market Cap (CHF)	163,346
Ev (BG Estimates) (CHF)	176,125
Avg. 6m daily volume (000)	1 194
3y EPS CAGR	6.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-4.9%	-8.1%	-8.3%	-15.9%
Healthcare	-4.0%	-7.5%	-2.9%	-10.4%
DJ Stoxx 600	1.0%	1.0%	-1.8%	-5.9%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	48,145	50,188	51,143	52,070
% change		*4.2%*	*1.9%*	*1.8%*
EBITDA	19,430	19,685	21,937	22,014
EBIT	13,821	16,454	17,937	18,614
% change		*19.1%*	*9.0%*	*3.8%*
Net income	11,626	13,459	14,073	14,166
% change		*15.8%*	*4.6%*	*0.7%*

	2015	2016e	2017e	2018e
Operating margin	28.7	32.8	35.1	35.7
Net margin	24.1	26.8	27.5	27.2
ROE	43.7	48.8	45.6	41.1
ROCE	28.1	29.4	29.4	29.0
Gearing	60.4	46.1	33.7	21.0

(CHF)	2015	2016e	2017e	2018e
EPS	13.49	15.61	16.33	16.43
% change	-	*15.8%*	*4.6%*	*0.7%*
P/E	17.2x	14.9x	14.2x	14.1x
FCF yield (%)	5.9%	4.8%	5.5%	6.2%
Dividends (CHF)	8.10	9.38	9.80	9.87
Div yield (%)	3.5%	4.0%	4.2%	4.2%
EV/Sales	3.7x	3.5x	3.4x	3.3x
EV/EBITDA	9.1x	8.9x	7.9x	7.8x
EV/EBIT	12.8x	10.7x	9.7x	9.2x

It came out very clearly from the conference call discussing Q3 sales numbers that APHINITY would make a major difference to investor mindsets about Roche's ability to stay on a growth trajectory although it has other innovative drugs to launch. But pricing pressure on oncology drugs is also increasing and competition is getting fiercer even before the entry of biosimilars. This is why it is still difficult to see Roche performing until we see the data, now sometime in Q1 2017.

ANALYSIS

- As could have been expected, Roche addressed the slowdown in the oncology franchise's growth in the US by mentioning two key factors: firstly, there was a catch-up impact on the 340B programme in the US that resulted in a more significant impact on the single third quarter, which should then be partially a one-off. Roche is expecting the impact to level off in Q4. That said, the group agreed to say that more institutions are claiming for 340B inclusion and so it now represents about 18% of Genentech volumes, a level that is increasing steadily. Put in the context of the overall pricing issue for oncology drugs in the US, discounts are also on the rise in specialty care, as also illustrated by ongoing discussions around Medicare Part B for which a new pilot draft is expected in early 2017. Now, when comparing growth rates of HER2+ franchise with Avastin or Rituxan, the difference is probably for the last couple of drugs that they are also feeling some competitive pressure, Rituxan from Imbruvica and Avastin from IO drugs especially in lung cancer (about 15% of Avastin total sales).
- Because IO is becoming an issue for players in oncology as they feel increased pressure on their old products, the discussion then shifted towards Roche's own IO pipeline to get an update. Obviously, the two indications Tecentriq obtained until the beginning of 2016 are good news but 1L bladder and 2L/3L lung do not appear as the more attractive settings for PD1-PDL1 agents. But it was more difficult for Roche here to make definitive statements and claims because key data is still expected in 2017 and 2018 from the whole industry that will help understand where and how IO could play a role, in particular in 1L lung cancer. The first trial IMpower150 is due to report in H2 2017 for PFS and if positive (this is a co-primary endpoint) could be able to file whereas all others are expected in 2018 (including OS data). Some OS data should be available from the follow-up of phase I with IO/CT combo in early 2017. Beyond lung, we note that Roche is expecting the phase II trial in combination with Avastin in mRCC to report by year-end 2016 and to be presented at GI-ASCO 2017. This is several months ahead of schedule and will be interesting to read and compare with the CABOSUN data reported at ESMO, both efficacy and safety-wise.
- Lastly, we would note that during the course of the call Daniel O'Day reported that the McCave phase II trial failed to reach its primary endpoint. The study was comparing Roche's bispecific antibody (Ang2+VEGF-A) to Avastin in 1L colorectal cancer and although the bar was high, the rationale expecting it to succeed was strong. If anything, the consensus was not expecting much but we highlighted recently that if successful it could be a decent upside to numbers because it would have been a next-gen Avastin. So it won't be.

VALUATION

- There was not so much to change in our numbers after Q3 although we reduced expected growth for Avastin and Rituxan in the US for the upcoming quarters but the magnitude is limited and so the impact on the FV is only CHF8 (less than 4%).
- Bear in mind that we have PS for Perjeta of CHF3.8bn in 2022 of which less than CHF1.5bn is in adjuvant. This offers more upside than downside. However, if negative, valuation would be attractive but the growth profile would likely not.

NEXT CATALYSTS

- By year-end: ASH congress, mRCC phase II data, US approval for Ocrevus (MS)

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BUY ratings 56,7% NEUTRAL ratings 31,2% SELL ratings 12,1%

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