

GMG Equity Research

ROCHE

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18/10/2019

Key data

Market capitalization (millions CHF)	229.023
Entreprise value (million CHF)	231.772
Share price (CH)	288,4

Stock absolute and relative performance (CHF)

In %	Absolute	Relative *
1 month	2,4%	2,7%
3 months	9,0%	8,2%
6 months	9,5%	3,9%
YTD	22,3%	-1,0%
1 year	21,4%	7,5%
2018	2,5%	11,0%
2017	9,4%	-10,5%

*relative to SPI

Description

Roche is a leading healthcare company that operates worldwide under two divisions: Pharmaceuticals and Diagnostics. The former generates close to 80% of the consolidated turnover and an even higher share of the profit.

In contrast to many healthcare groups, which aimed at diversifying when the horizon in new drugs development seemed clogged, Roche remained firmly committed to its core business. The group has consistently increased its R&D expenditures, both in absolute and relative terms. The R&D budget has been over 10 billion CHF since 2016 and absorbs more than 20% of sales. This ratio used to remain under 15% in the early 2000's.

Roche enjoyed a golden decade from the early 2000's thanks to the success of the oncologic drugs of its American subsidiary Genentech (fully owned since 2009). The 3 Genentech blockbusters are in the process of losing their respective patents. Being among the first bio drugs to do so, the impact on Roche is still difficult to assess.

Moreover, several of the drugs designed to sustain the oncologic franchises beyond the older drugs patent expiries, have not met the necessary clinical hurdles. Roche's first immuno oncologic drug, a new technology, has proven less efficient than a competitor from Merck.

While the group is losing market share in oncology, it is gaining ground in other therapeutic fields such as multiple sclerosis and haemophilia thanks to new drugs.

Roche's rich R&D pipeline should enable the group to sustain its profit growth, although one has little visibility on the outcomes of clinical research.

Firm's performance

Roche's total returns for the investors have been close to those of the market for the last two decades.

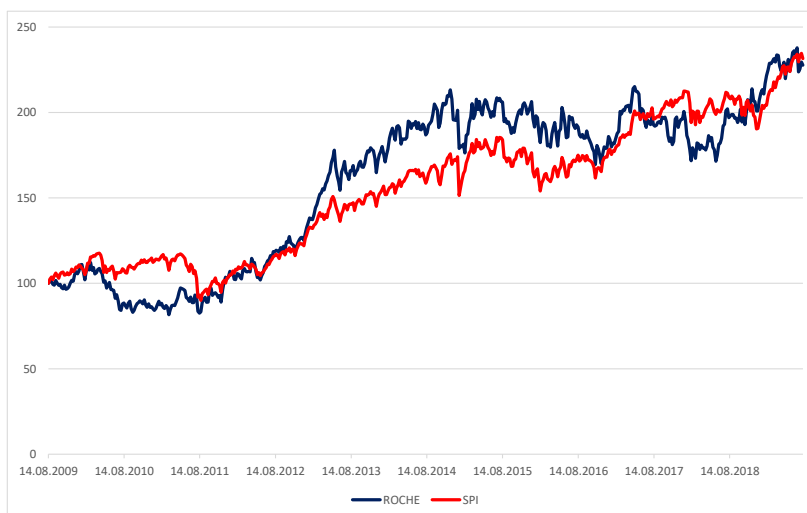
These last years, the group had to mitigate the negative effects of several patents expiries and some key negative outcomes in its R&D.

Despite these, the group has been able to keep its sales, profits and dividends growing.

However, free cash flows have struggled from 2013 to 2016. One consequence was a slowdown in dividend growth, a prominent source of the stock return, and a rise in the payout ratio. In 2017 and 2018, an increase in free cash flows has eased this concern.

We believe Roche should be able to further grow its cash flows, and dividends, in the coming years.

Share price (10 years)





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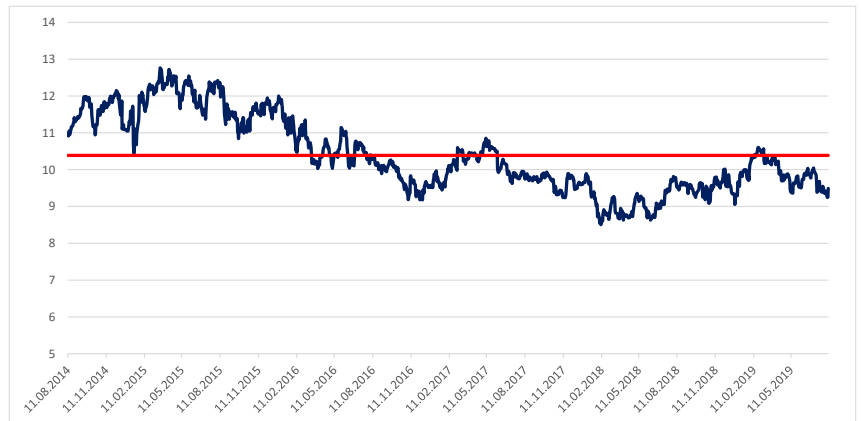
Valuation ratios

	12/16	12/17	12/18	12/19e	12/20e
EV/EBITDA	10,5	10,4	10,1	9,7	9,1
PER	16,0	16,1	13,4	15,8	15,2
Free Cash Flow Yield	4,4%	5,1%	7,4%		
Dividend Yield	3,5%	3,4%	3,6%	3,4%	3,5%
P/BV	7,6	7,3	6,9	7,5	7,5

Bloomberg ESG ranking

Global ESG	55,4
Environment	51,9
Social	63,2
Governance	55,4

EV / EBITDA



Environment, Social & Governance comments

Environment

- The firm publishes data for its environmental impact and aims to reduce it year after year.

Social

- Roche is exposed to controversies on the subject of access to life saving drugs in poor(er) countries. Roche went as far as threatening to sue South Africa for lifting some of its patents on anti-HIV drugs. The case was dropped in 2001.

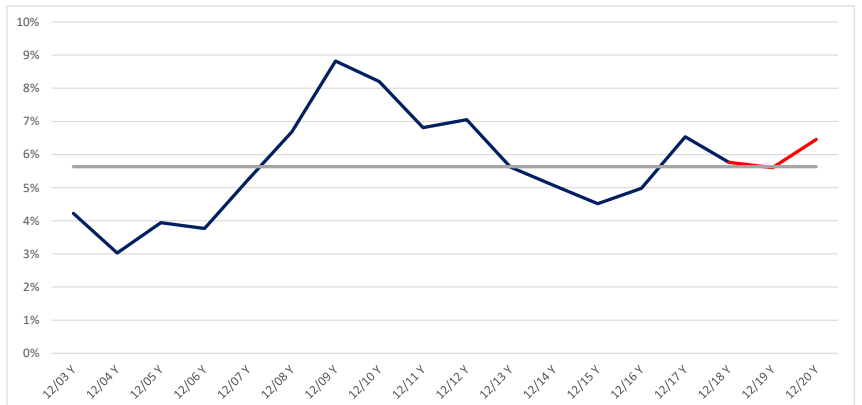
- The firm has been a pioneer in differentiating its selling prices from country to country in order to improve access to treatments. In some occurrences, the firm is experimenting contracts in which the selling price is dependent on therapeutic results.

Governance

- The stocks with voting right are owned at 45% by the shareholders group formed by the Hoffman and Oeri families and at 33% by Novartis. The latter commented several times that it would sell its stocks if a sufficient premium was offered.

- The minority shareholders, who mostly hold non voting stocks, would most probably not benefit from a transaction including a control premium.

Free Cash Flow Yield

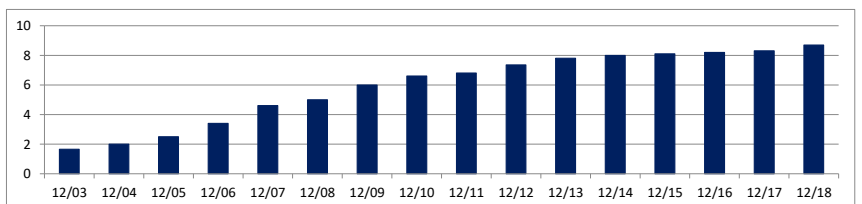


ESG affiliations and codes of conduct

UN Global Compact	✗
UN PRI (responsible investment)*	✗
Anti bribery policy	✓
Employee CSR training	✗
Fair remuneration policy	✗

* Applicable to financial institutions

Dividend per share (CHF)





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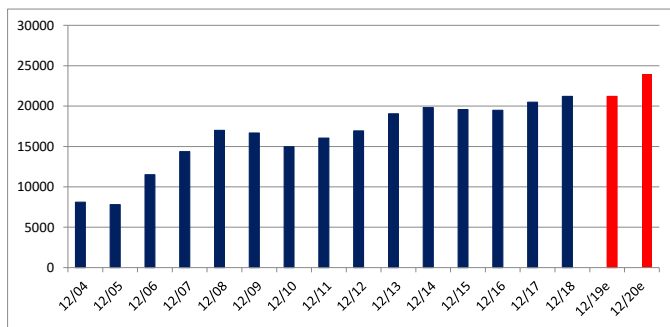
Performance ratios

	12/16	12/17	12/18	12/19e	12/20e
Operating Margin	27,8%	24,4%	26,0%	35,8%	36,0%
ROIC	20,9%	18,9%	22,6%		
ROE	51,8%	47,7%	53,2%	50,2%	42,9%
WC / Sales	12,0%	17,7%	16,2%	14,9%	14,5%
Net Debt / EBITDA	64,7%	32,8%	26,7%	11,4%	-14,0%
Net Debt / Equity	50,2%	24,0%	18,6%	9,1%	-11,4%
Capex / D&A	105,2%	90,3%	112,7%		

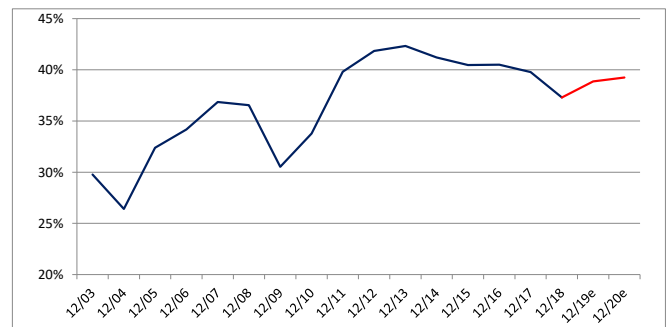
Financial statements (million CHF)

		12/16	12/17	12/18	12/19e	12/20e
Chairman:	Christoph Franz					
Tenure (years):	5,5					
CEO:	Severin Schwan					
Tenure (years):	11,7					
CFO:	Alan Hippe					
Tenure (years):	7,8					
Sales		50.576	53.299	56.846	61.769	63.436
variation			5,4%	6,7%	8,7%	2,7%
D&A costs		3.941	3.887	3.586		
EBITDA		20.483	21.201	21.201	24.011	24.898
variation			3,5%	0,0%	13,3%	3,7%
Net earnings		12.507	13.192	15.593	14.583	15.071
Total current assets		28.670	31.572	32.244	32.244	32.244
Total fixed assets		48.149	45.104	46.273	46.273	46.273
Shareholders equity		26.402	29.007	30.366	30.366	30.366
Working capital		6.070	9.412	9.211	9.211	9.211
Net debt		13.248	6.963	5.652	2.748	-3.474
Operating cash flow		14.176	17.406	19.410	17.732	19.860
Capex		-4.144	-3.509	-4.043	-3.821	-3.830
Free cash flow		10.032	13.897	15.367	13.911	16.030

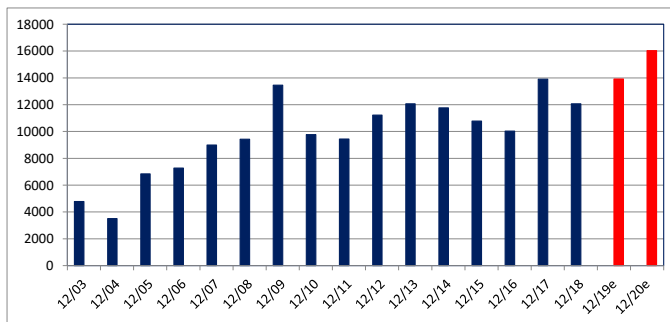
EBITDA



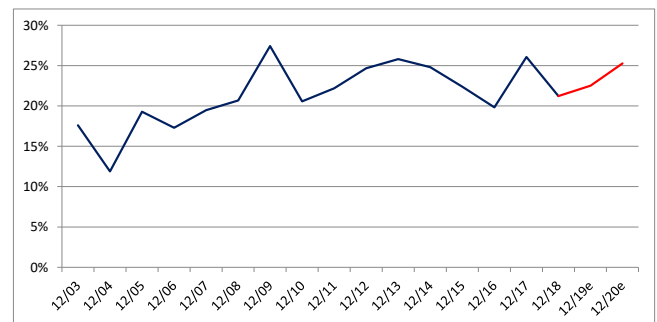
EBITDA margin



Free cash flow



Free cash flow & Free cash flow / sales





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SWOT

Strengths

- The products portfolio is relatively well diversified
- Despite its operational ups and downs, the firm has recently generated large cash flows and is committed to growing dividends

Weaknesses

- Roche experienced several failures in clinical tests in the last few years, which casted a doubt on its ability to defend some of its main oncological franchises. Its first immuno oncologic product (Tecentriq) is proving less efficient than the competitor from Merck (Keytruda)
- The market share of the group in oncology is coming down

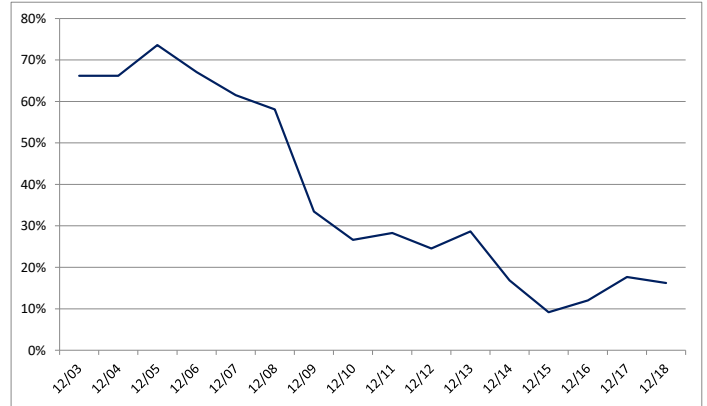
Opportunities

- Roche R&D pipeline seems promising. One can hope some of the projects will be the engines of the future growth

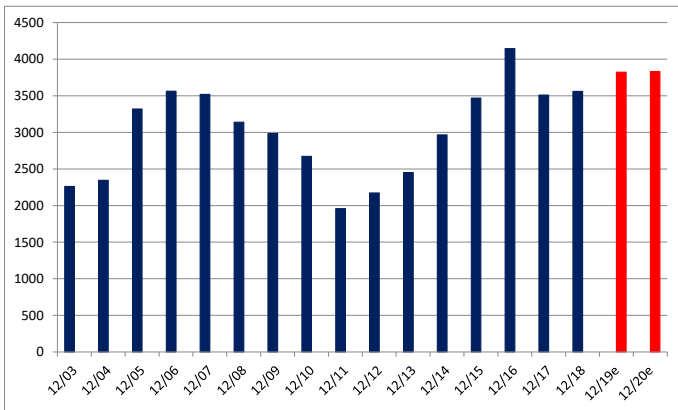
Threats

- Increasing competition from biosimilars

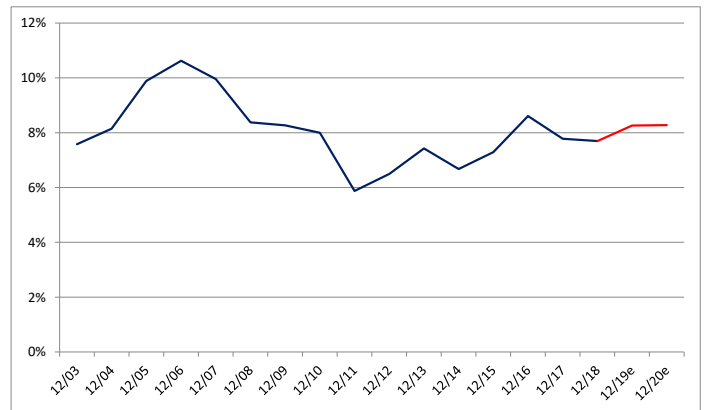
Working capital / sales



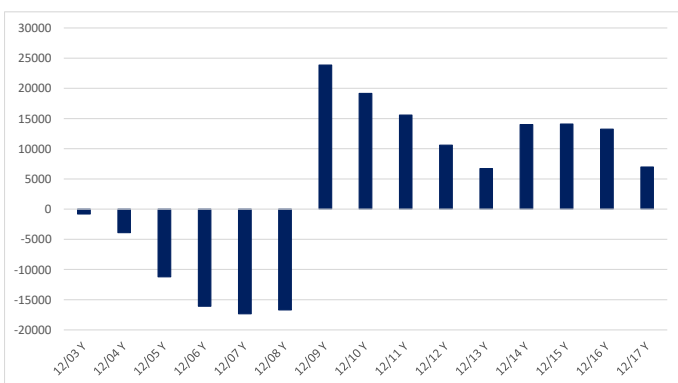
CAPEX



CAPEX / non current assets



NET DEBT



NET DEBT / EBITDA

