

Credit ratings and conservative leverage

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Roche and Novartis have long belonged to the small group of European industrial companies with credit ratings in the double-A range. According to their published investor information, Roche has been rated in the AA category by Standard & Poor's and at a comparable level by Moody's, while Novartis has carried ratings of about AA- and Aa3. Such ratings are higher than those of many sovereign states and comparable to those of the strongest corporate issuers in the world. They reflect the scale and stability of the groups' cash flows, the diversification of their product portfolios and a financial policy that has traditionally favoured low leverage.¹

Conservative leverage has a history in Basel that goes back to the family-controlled companies of the twentieth century. Roche in particular was known for decades as a company that held very large liquid reserves and avoided debt almost entirely. Analysts sometimes described the company of the 1980s and 1990s as a bank with a pharmaceutical laboratory attached, since its financial assets were considerable and its income from investments occasionally attracted as much attention as its operating results. That reputation was partly myth, although it captured a real preference for financial independence that the controlling families shared with the management.²

Novartis, formed in 1996 from the merger of Ciba-Geigy and Sandoz, inherited a different tradition, since both predecessor companies had been listed public companies with dispersed shareholdings. The new group nevertheless adopted a financial policy that aimed at a strong rating, partly because a high rating lowers the cost of acquisition finance and partly because it gives the company access to the commercial paper markets in the United States and Europe on attractive terms. Both groups have publicly stated that they intend to maintain strong ratings, while accepting that a large acquisition may temporarily raise leverage. The rating agencies

accept such a temporary increase if they are persuaded that the company will reduce its debt again within a few years.³

The measure most often used to describe this policy is the ratio of net debt to earnings before interest, taxes, depreciation and amortisation. For both groups this ratio has usually remained low, often below one and a half times, except in the period immediately following a major acquisition. At times, especially when large disposals generated cash, one or the other group has even been in a net cash position. The flexibility that results from this policy allows the companies to act quickly when an acquisition opportunity appears, which is a competitive advantage in an industry in which promising biotechnology companies are frequently sold through auctions with short deadlines.⁴

1 Notes

1. On the credit ratings of Roche and Novartis, see the investor relations pages of both companies and the rating reports of S&P Global Ratings and Moody's Investors Service. Current rating levels and outlooks to be verified. ↩
2. On Roche's historically large liquid reserves and conservative financial policy, see the company histories of Roche, among them the centenary publication of 1996, and contemporary press reports. The characterisation as a "bank with a laboratory" is a commonly reported description and to be verified. ↩
3. On the formation of Novartis in 1996 from Ciba-Geigy and Sandoz, see Part D, Chapter II, and Part G, Chapter I. On the financial policy of maintaining strong credit ratings, see the capital allocation sections of the Novartis and Roche annual reports and investor presentations. To be verified. ↩
4. On the ratio of net debt to EBITDA and the net debt or net cash positions of Roche and Novartis, see the financial reviews in their annual reports. Figures vary considerably between years and are to be verified. ↩

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