Novartis AG (NVS)

Updated July 5th, 2018 by Nate Parsh

Key Metrics

Current Price:	$77	**5 Year CAGR Estimate:**	11.2%	**Volatility Percentile:**	14.6%
Fair Value Price:	$95	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	25.9%
% Fair Value:	81%	**5 Year Valuation Multiple Estimate:**	4.3%	**Valuation Percentile:**	89.3%
Dividend Yield:	3.9%	**5 Year Price Target**	$110	**Total Return Percentile:**	72.0%

Overview & Current Events

Novartis researches, develops and markets products to improve patients' health. The company's Pharmaceutical division offers medicines in the areas of oncology, cardiovascular, dermatology, respiratory and several others. Novartis' Sandoz divisions markets generic drugs. The Alcon division, which Novartis announced on June 29th that it would be spinning off into its own separate company, provides products related to eye care. Novartis employs more than 120,000 people worldwide, has a current market cap of nearly $175 billion and generated more than $49 billion in sales in 2017.

Novartis is incorporated in Switzerland, but U.S. investors have access to the company through an American Depositary Receipt, or ADR. There are more than 250 ADRs listed on the New York Stock Exchange. More than $800 billion worth of ADRs are held by institutional investors, so retail investors shouldn't be concerned about liquidity.

Novartis released 1st quarter earnings on April 19th. The company had EPS of $1.28, a 13% improvement from Q1 2017 and $0.03 ahead of analysts' estimates. Novartis grew revenues 10% to $12.7 billion, topping estimates by $120 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.56	$3.69	$4.26	$3.78	$3.89	$3.70	$4.13	$2.92	$2.82	$3.28	***$5.27***	***$6.11***
DPS	$1.68	$1.74	$1.94	$2.36	$2.41	$2.43	$2.76	$2.67	$2.72	$2.72	***$2.94***	***$3.42***

Novartis has increased earnings at a rate of 3.1% per year over the last decade. The company actually saw an improvement in EPS during the last recession. Healthcare companies, especially those with lifesaving or improving medicines, often perform well during a recession as people will seek out treatments for aliments regardless of the economic climate. Analysts expect that the company expects it will see earnings per share of $5.27 in 2018 with mid-single digit growth going forward. We assume 3% EPS growth through 2023.

Cosentyx, treatment for plaque psoriasis, was up 35% in constant currency, though this was still below estimates. *Entresto*, used to treat chronic heart failure, saw sales grow 126% year over year. Novartis's top selling drug *Gilenya* saw 8% growth from Q1 2017 to $821 million. This pharmaceutical is used to help slow the progress of multiple sclerosis. Sales of these drugs and others helped to offset a 2% decline in Novartis's generic business.

AbbVie's (ABBV) rheumatoid-arthritis drug *Humira* is the top selling pharmaceutical in the world. Though the company maintains a patent for selling in the U.S., AbbVie will lose this protection in Europe in October 2018. Novartis is one pharma company looking to capitalize on this development. Novartis' biosimilar *Adalimumab* was given a favorable recommendation from regulators in Europe. This could boost earnings in the future.

Novartis is unusual in that it pays an annual dividend, with the most recent being paid on March 6th, 2018. The dividend was maintained in 2016 and 2017 after being cut slightly in 2015. Still, we expect dividend growth to grow at a rate similar to our expected earnings growth rate.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.5	12.1	12.4	15.2	14.8	19.8	21.4	33.3	27.3	24.5	***14.6***	***18***
Avg. Yld.	3.2%	3.9%	3.7%	4.1%	4.2%	3.3%	3.1%	2.7%	3.5%	3.4%	***3.9%***	***3.1%***

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

Novartis saw earnings per share decline at the same time the share price accelerated in the 2013-2015 period. We assign shares a P/E multiple of 18 to help account for the wide variance in valuations over the last decade. Based off estimates for the current year, Novartis has a P/E of 14.6. If shares were to reach our targeted valuation, Novartis' stock would experience multiple expansion of 4.3% per year through 2023. Shares of Novartis trade with a dividend yield that tops both that of the S&P 500 and the 10-Year Treasury Bond, giving the stock some appeal as an income investment.

Safety, Quality, Competitive Advantage, & Recession Resiliency

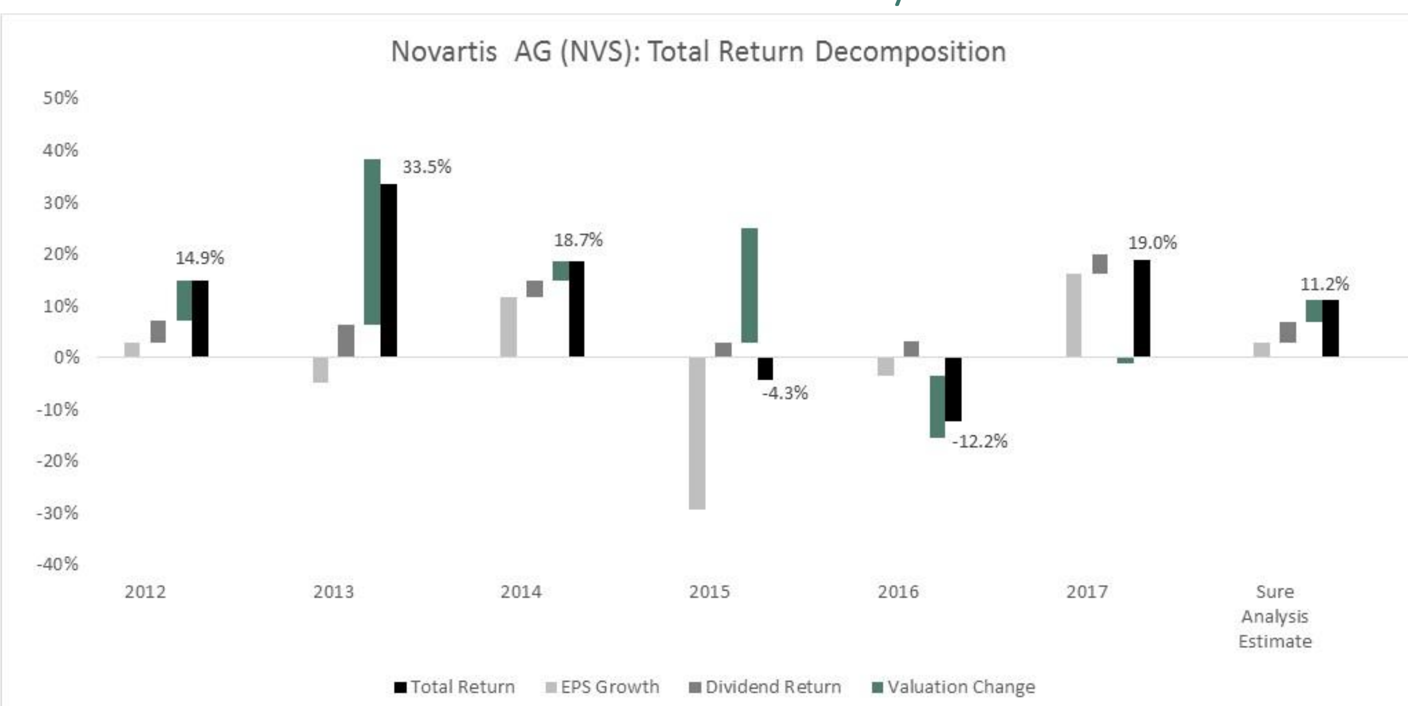
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	39.8%	34.5%	30.1%	34.4%	29.1%	28.6%	28.9%	25.1%	24.5%	24.8%	***25.8%***	***30%***
Debt/A	35.6%	39.8%	43.4%	43.9%	44.2%	41%	43.5%	41.4%	42.4%	44.2%	***43.8%***	***42%***
Int. Cov.	---	29.7	18.9	15	14.6	16.4	17.7	7.9	7.4	13.2	***13.7***	***15.6***
Payout	47.2%	47.2%	45.5%	62.4%	62%	65.7%	66.8%	91.4%	96.5%	82.9%	***55.8%***	***55.8%***
Std. Dev.	23.2%	25.4%	21.4%	18.1%	13.3%	10.5%	14.2%	14.4%	18.6%	12.2%	***13.1%***	***17.1%***

Novartis has seen its gross profits as a percentage of assets decline steadily over the last decade, while the company's debt as a percentage of assets climb higher. That being said, Novartis has plenty of capital to cover the interest on its debt. Less than 30% of the company's $34 billion in debt is due in the next 5 years. The company is not overly leveraged and should be considered safe as an ongoing concern.

Final Thoughts & Recommendation

We forecast that Novartis can offer an annual return of 11.2% per year through 2023. We arrive at this estimate based off of earnings growth (3%), dividends (3.9%) and multiple expansion (4.3%). The company has seen progress in growth in some of its biggest pharmaceuticals and while its generic business declined slightly, the addition of a *Humira* biosimilar should help return this division to growth. In addition to spinning off its eye care division, Novartis announced a $5 billion buyback, almost 3% of the current market cap. Factoring in a high yield and decent growth prospects, we think Novartis can be a positive addition to an income focused portfolio.

Total Return Breakdown by Year



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