Novartis AG (NVS)

Updated July 17th, 2018 by Nate Parsh

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	9.9%	**Volatility Percentile:**	14.7%
Fair Value Price:	$95	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	29.8%
% Fair Value:	85%	**5 Year Valuation Multiple Estimate:**	3.2%	**Valuation Percentile:**	82.9%
Dividend Yield:	3.7%	**5 Year Price Target**	$110	**Total Return Percentile:**	65.0%

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, with NVS being one example.

Novartis reported 2nd quarter earnings on July 18th. The company earned $1.29 per share, coming in ahead of estimates by $0.02 and increasing 5.7% from Q2 2017. Revenue grew 7.5% to $13.2 billion, $220 above analysts' estimates.

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. Earnings grew during the last recession. Healthcare companies often perform well during recessions as people will seek out treatments for aliments regardless of the economic climate. We expect earnings-per-share of $5.27 in 2018 and 3% growth through 2023.

All divisions of Novartis generated growth last quarter, led by Pharmaceutical's nearly 10% growth. *Gilenya*, which treats multiple sclerosis and remains Novartis's top selling pharmaceutical, grew 8% year over year. Generic competition is expected to put pressure on the drug's sales starting in August of 2019, though the company recently won a patent case that should uphold a dosing patent until the end of 2027. Sales for *Cosentyx*, which treats plaque psoriasis, was up 43% after being up 35% in Q1. *Entresto*, used to treat chronic heart failure, saw sales grow 117% after increasing 126% last quarter. Novartis's migraine drug *Aimovig* was approved in the U.S. on May 18th and is estimated to have peak sales of $1 billion. This increase in pharma sales helped offset a 2% decline in generic revenues, the same as the prior quarter. Novartis completed its sale of its portion of a consumer healthcare joint venture with GlaxoSmithKline (GSK) for $13 billion during the second quarter. Novartis will reinvest this capital into the business.

Novartis' *Adalimumab*, the company's biosimilar for *Humira*, was given a favorable recommendation from regulators in Europe. *Humira* is the bestselling pharmaceutical in the world, so *Adalimumab* could boost earnings in the future as AbbVie (ABBV) loses patent protections in Europe starting this October.

Novartis pays an annual dividend, with the most recent paid on March 6th, 2018. The dividend was maintained in 2016 and 2017 after being cut slightly in 2015. Still, we expect dividend growth 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	***15.4***	***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 and a $4 increase since our last update, Novartis has a P/E of 15.4. 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

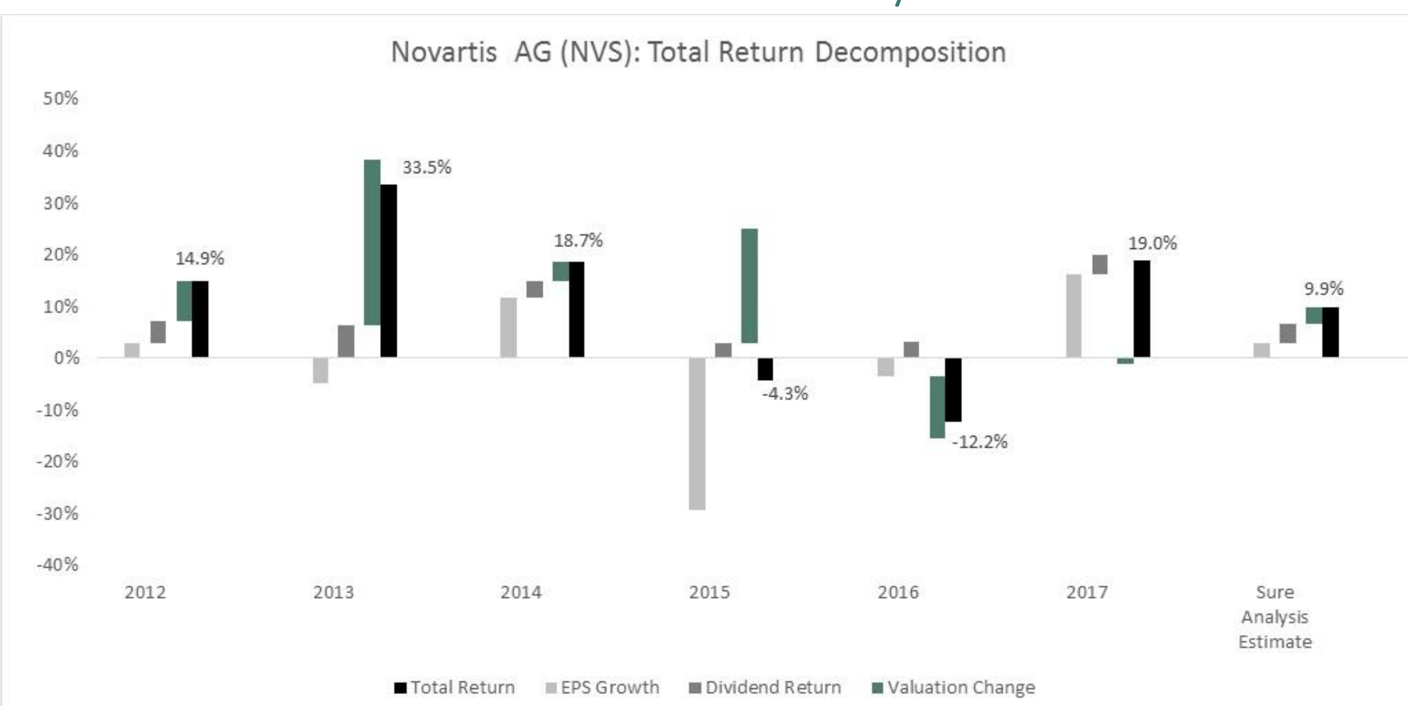
Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2023**
GP/A	39.8%	34.5%	30.1%	34.4%	29.1%	28.6%	28.9%	25.1%	24.5%	24.8%	***25.8%***	***30%***
Debt/A	35.6%	39.8%	43.4%	43.9%	44.2%	41%	43.5%	41.4%	42.4%	44.2%	***43.8%***	***42%***
Int. Cov.	---	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. In addition, less than 30% of the company's $34 billion in debt is due in the next 5 years.

Final Thoughts & Recommendation

After factoring in second quarter earnings, we expect shares of Novartis to have annual returns of 9.9% through 2023, down from our estimate of 11.2%. This is based off earnings growth (3%), dividends (3.7%) and multiple expansion (3.2%). The company's pharmaceutical business is showing strong growth even as sales for generics decline. Growth in *Cosentyx* and *Entresto* have proven to be especially impressive. News regarding the patent for *Gilenya* is good news and should allow Novartis to see growth for this drug for some time. The company also has a strong pipeline, highlighted by the recently approved *Aimovig*, that should help to grow earnings in the future. A strong dividend yield combined with possible multiple expansion make shares of Novartis a buy in our opinion. We maintain our 2023 price target of $110.

Total Return Breakdown by Year



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