Novartis AG (NVS)

Updated October 19th, 2018 by Nate Parsh

Key Metrics

Current Price:	$86	**5 Year CAGR Estimate:**	8.4%	**Volatility Percentile:**	20.1%
Fair Value Price:	$95	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	57.5%
% Fair Value:	91%	**5 Year Valuation Multiple Estimate:**	2.0%	**Growth Percentile:**	10.6%
Dividend Yield:	3.4%	**5 Year Price Target**	$110	**Valuation Percentile:**	64.6%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	41.3%

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 division 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 3rd quarter earnings on October 18th. The company earned $1.32 per share, beating estimates by $0.02 and increasing 2.3% from the third quarter 2017. Revenue grew 3% to $12.78 billion, $210 below analysts' estimates.

Novartis' Innovative Medicines had revenue growth of more than 6%. Sales for *Cosentyx*, which treats plaque psoriasis, were up 35%. This follows 43% growth last quarter and 35% growth in the first quarter. *Entresto*, used to treat chronic heart failure, saw sales grow 112%. *Entresto* has seen sales double year over year for the past three quarters. *Tafinlar + Mekinist*, which treats melanoma, saw revenues increase 33% year over year. Sales for the company's eye care division, Alcon, improved almost 3%. Alcon is being spun off sometime in the first half of 2019. Novartis' Sandoz division, which holds the company's generic drug portfolio, had a 5.2% decline in sales. Sandoz has been hurt by competition in recent quarters. Even with this decline in generic sales, Novartis now sees mid-single digit sales growth compared to its prior forecast of low single digit growth. This is due to the strength of its Innovative Medicines. Novartis also has several drugs coming to market this year, including ones that treat multiple sclerosis and breast cancer that could help grow sales. This is in addition to recently launched drugs, such as *Aimovig,* which could produce $1 billion peak sales.

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***
Shares	2265.5	2270.5	2300.8	2421.9	2472.3	2426.1	2398.6	2373.9	2374.1	2317.5	***2300***	***2220***

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.

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. Novartis generated $3.3 billion in free cash flow during the third quarter, an 8% increase from the prior year. For 2018, the company has generated almost $9 billion, 10% higher than the same period of 2017. This likely gives the company plenty of capital to maintain and increase its dividend going forward.

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	***16.3***	***18***
Avg. Yld.	3.2%	3.9%	3.7%	4.1%	4.2%	3.3%	3.1%	2.7%	3.5%	3.4%	***3.4%***	***3.1%***

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 $5 increase since our July 17th update, Novartis has a P/E of 16.3. If shares were to reach our targeted valuation, Novartis' stock would experience multiple expansion of 2% per year through 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

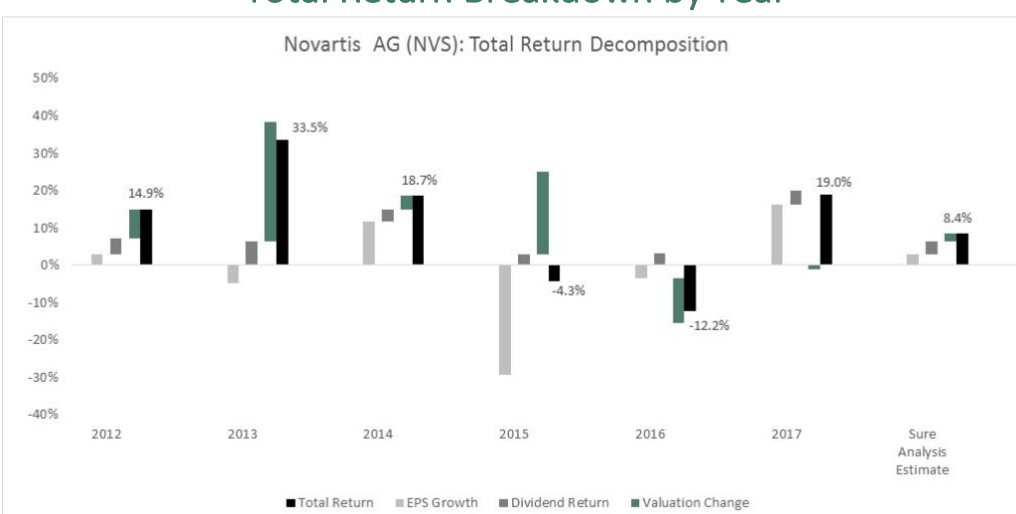
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	39.8%	34.5%	30.1%	34.4%	29.1%	28.6%	28.9%	25.1%	24.5%	24.8%	***25.8%***	***30%***
Debt/A	35.6%	39.8%	43.4%	43.9%	44.2%	41%	43.5%	41.4%	42.4%	44.2%	***43.8%***	***42%***
Int. Cov.	---	29.7	18.9	15	14.6	16.4	17.7	7.9	7.4	13.2	***13.7***	***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 ratio 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. The company's recent reduction in its USD-denominated dividend payment earns it a D rating for both Dividend Safety and Retirement Suitability.

Final Thoughts & Recommendation

After factoring in third quarter earnings, we expect shares of Novartis to have annual returns of 8.4% through 2023, down from our estimate of 9.9%. This is based off earnings growth (3%), dividends (3.4%) and multiple expansion (2.0%). Novartis offers a strong dividend yield combined with slight possible multiple expansion make shares of Novartis a buy in our opinion.

Total Return Breakdown by Year



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

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	42584	45103	51561	59375	51971	52716	53634	50387	49436	50135
Gross Profit	31145	32924	37073	40392	36105	36137	36289	32983	31916	32960
Gross Margin	73.1%	73.0%	71.9%	68.0%	69.5%	68.6%	67.7%	65.5%	64.6%	65.7%
SG&A Exp.	14097	14331	15797	18049	15117	15241	14993	14247	14192	14997
D&A Exp.	N/A	N/A	3419	5788	4442	4405	4682	5471	6043	6076
Operating Profit	8964	9982	11526	10780	11507	10983	11089	8977	8268	8629
Op. Margin	21.1%	22.1%	22.4%	18.2%	22.1%	20.8%	20.7%	17.8%	16.7%	17.2%
Net Profit	8195	8400	9794	8940	9270	9175	10210	17783	6712	7703
Net Margin	19.2%	18.6%	19.0%	15.1%	17.8%	17.4%	19.0%	35.3%	13.6%	15.4%
Free Cash Flow	7453	9458	11835	11922	11422	9796	10493	8392	8596	9875
Income Tax	1336	1468	1733	1483	1706	1498	1545	1106	1119	1296

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	78.3	95.5	123.3	117.5	124.2	126.3	125.4	131.6	130.1	133.1
Cash & Equivalents	2038	2894	5319	3709	5552	6687	13023	4674	7007	8860
Acc. Receivable	7026	8310	9873	10323	10051	9902	8275	8180	8202	8600
Inventories	5792	5830	6093	5930	6744	7267	6093	6226	6255	6867
Goodwill & Int.	11285	22370	64923	61912	61421	58867	53143	65391	62320	61747
Total Liabilities	27862	38043	53549	51556	54928	51782	54543	54434	55233	58852
Accounts Payable	3395	4012	4788	4989	5593	6148	5419	5668	4873	5169
Long-Term Debt	7364	13988	22943	20229	19726	18018	20411	21931	23802	28532
Total Equity	50288	57387	63196	65844	69137	74343	70766	77046	74832	74168
D/E Ratio	0.1464	0.2437	0.363	0.3072	0.2853	0.2424	0.2884	0.2846	0.3181	0.3847

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	10.7%	9.7%	9.0%	7.4%	7.7%	7.3%	8.1%	13.8%	5.1%	5.9%
Return on Equity	16.5%	15.6%	16.2%	13.9%	13.7%	12.8%	14.1%	24.1%	8.8%	10.3%
ROIC	14.5%	13.0%	11.9%	10.0%	10.6%	10.1%	11.1%	18.7%	6.8%	7.6%
Shares Out.	2265.5	2270.5	2300.8	2421.9	2472.3	2426.1	2398.6	2373.9	2374.1	2317.5
Revenue/Share	18.80	19.89	22.41	24.61	21.26	21.27	21.71	20.67	20.60	21.15
FCF/Share	3.29	4.17	5.14	4.94	4.67	3.95	4.25	3.44	3.58	4.16

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.