Novartis AG (NVS)

Updated February 10th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$89	**5 Year CAGR Estimate:**	9.4%	**Volatility Percentile:**	9.3%
Fair Value Price:	$99	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	64.1%
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.1%	**Growth Percentile:**	22.3%
Dividend Yield:	3.3%	**5 Year Price Target**	$114	**Valuation Percentile:**	66.8%
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Total Return Percentile:**	49.0%

Overview & Current Events

Novartis researches, develops and markets products to improve patients' health. The company's Innovative Medicines 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 $205 billion and annual sales of more than $53 billion.

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 fourth quarter and full year 2018 results on January 30th. All figures are in U.S dollars. The company earned $1.25 per share in the fourth quarter, missing expectations by $0.02, but growing 3.3% year-over-year. Revenue increased 2.7% to $13.3 billion, but missed consensus estimates by $230 million. For the year, earnings-per-share increased 6% to $5.14, which was $0.13 below estimates. Revenue grew 5.7% to $51.9 billion for 2018. Currency exchange was a 3% headwind in the fourth quarter, but added 1% to sales for the year.

Novartis' Innovative Medicines had another strong quarter, with revenues growing 5.4%. Revenues for *Cosentyx*, which treats plaque psoriasis and the company's top selling product, were higher by 31%. *Cosentyx* had growth of 36% for the full year. Sales for *Entresto*, which is used to treat chronic heart failure, grew 72% in the quarter and more than doubled in 2018. *Tafinlar + Mekinist*, which treats melanoma, grew 27% in the fourth quarter and 31% for the year. Revenues for *Promacta*, which helps lower the risk of bleeding, during the quarter and year were higher by 29% and 35%, respectively. The company's top six selling products all had at least double-digit revenue growth during the year, with five of these products growing at least 24%. Alcon had sales growth of 1.5% during the quarter and 5% for the year and is on track to be a standalone company by the end of the first half of 2019. Sandoz, which holds the company's generic drug portfolio, experienced a 5.2% decline in quarterly revenues and a drop of 3% for 2018. The majority of this decline came from the U.S. as competition has caused the company to reduce prices on products. Outside of the U.S., Sandoz grew net sales by 4%. Novartis expects to bring as many as 14 potential blockbuster products to market by 2020. Novartis is expected to earn $5.48 per ADR share in 2019 and produce $53.5 billion in revenue. Achieving these estimates would represent 6.6% earnings-per-share growth and a 3.1% increase in revenue from 2018's results.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.69	$4.26	$3.78	$3.89	$3.70	$4.13	$2.92	$2.82	$3.28	$5.14	***$5.48***	***$6.35***
DPS	$1.74	$1.94	$2.36	$2.41	$2.43	$2.76	$2.67	$2.72	$2.72	$2.94	***$2.94***	***$3.42***
Shares	2,271	2,301	2,422	2,472	2,426	2,399	2,374	2,374	2,318	2,300	***2,300***	***2,220***

Novartis has increased earnings at a rate of 3.1% per year over the last decade. Earnings actually 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. Due to continued strength of the company's top selling products, we are raising our expect earnings-per-share annual growth rate to 4% from 3%.

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Novartis pays an annual dividend, with the most recent paid on March 6th, 2018. The dividend for U.S. investors was maintained in 2016 and 2017 after being cut slightly in 2015 due to currency exchange. The company has increased its dividend 22 consecutive years in local currency. Novartis generated $11.7 billion in free cash flow during 2018, a 12% increase from the prior year.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	12.1	12.4	15.2	14.8	19.8	21.4	33.3	27.3	24.5	16.3	***16.2***	***18.0***
Avg. Yld.	3.9%	3.7%	4.1%	4.2%	3.3%	3.1%	2.7%	3.5%	3.4%	3.4%	***3.3%***	***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 $3 increase since our October 19th update, Novartis has a P/E of 16.2. If shares were to reach our targeted valuation, shareholders would see an additional 2.1% added to annual returns through 2024.

Safety, Quality, Competitive Advantage, & Recession Resiliency

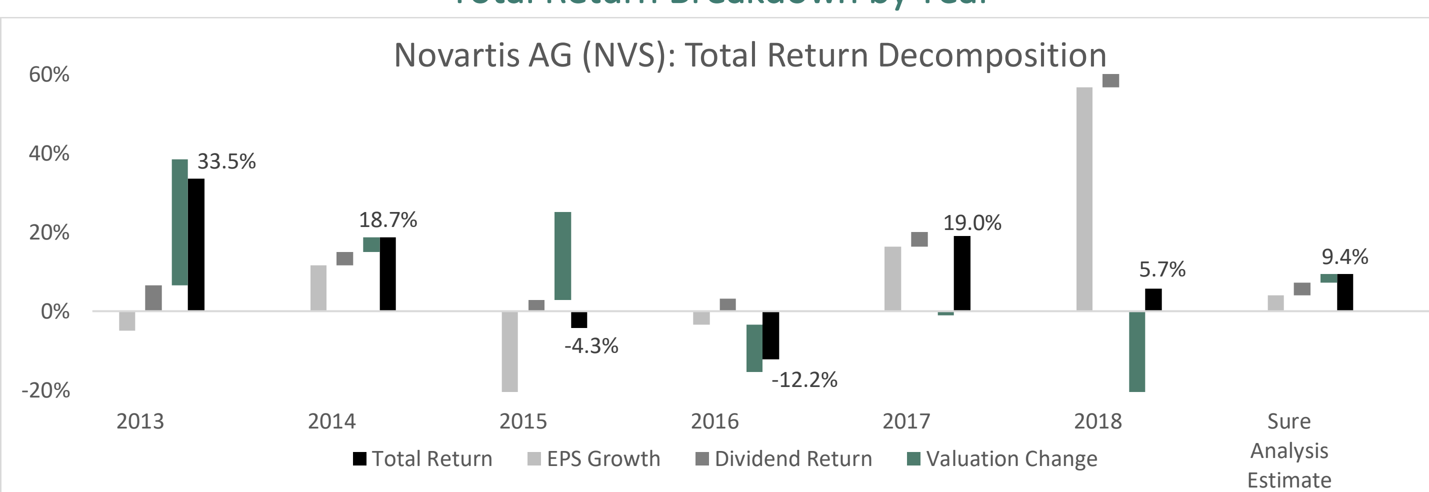
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	47%	46%	62%	62%	66%	67%	91%	97%	83%	57%	***54%***	***54%***

The chief competitive advantage for Novartis is its Innovative Medicines division, which has shown impressive growth over the last year. Four different products reached the $1 billion in annual sales mark during 2018. In addition, Novartis expects to bring to market 14 different products over the next two years with the potential for at least a billion dollars in peak sales. The company's recent reduction in its USD-denominated dividend payment, however, earns it a C rating for both Dividend Safety and Retirement Suitability.

Final Thoughts & Recommendation

After fourth quarter and full year earnings, we now believe that Novartis can offer an annual return of 9.4% through 2024. The company's top selling products will be the driver of growth going forward. Novartis's pipeline remains strong and should reward investors in the coming years. Investors looking for exposure to international pharmaceutical companies should consider adding Novartis, as the stock offers a strong dividend yield, combined with possible multiple expansion; this makes the stock a buy in our view. We have raised our 2024 price target $4 to $114 due to increased earnings estimates for the current year.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	45103	51561	59375	51971	52716	53634	50387	49436	50135	53166
Gross Profit	32924	37073	40392	36105	36137	36289	32983	31916	32960	34759
Gross Margin	73.0%	71.9%	68.0%	69.5%	68.6%	67.7%	65.5%	64.6%	65.7%	65.4%
SG&A Exp.	14331	15797	18049	15117	15241	14993	14247	14192	14997	16471
D&A Exp.	N/A	3419	5788	4442	4405	4682	5471	6043	6076	6892
Operating Profit	9982	11526	10780	11507	10983	11089	8977	8268	8629	8169
Op. Margin	22.1%	22.4%	18.2%	22.1%	20.8%	20.7%	17.8%	16.7%	17.2%	15.4%
Net Profit	8400	9794	8940	9270	9175	10210	17783	6712	7703	12611
Net Margin	18.6%	19.0%	15.1%	17.8%	17.4%	19.0%	35.3%	13.6%	15.4%	23.7%
Free Cash Flow	9458	11835	11922	11422	9796	10493	8392	8596	9875	10917
Income Tax	1468	1733	1483	1706	1498	1545	1106	1119	1296	1221

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	95.51	123.32	117.50	124.19	126.25	125.39	131.56	130.12	133.08	145.56
Cash & Equivalents	2894	5319	3709	5552	6687	13023	4674	7007	8860	13271
Acc. Receivable	8310	9873	10323	10051	9902	8275	8180	8202	8600	8727
Inventories	5830	6093	5930	6744	7267	6093	6226	6255	6867	6956
Goodwill & Int.	22370	64923	61912	61421	58867	53143	65391	62320	61747	74013
Total Liabilities	38043	53549	51556	54928	51782	54543	54434	55233	58852	66871
Accounts Payable	4012	4788	4989	5593	6148	5419	5668	4873	5169	5556
Long-Term Debt	13988	22943	20229	19726	18018	20411	21931	23802	28532	32148
Total Equity	57387	63196	65844	69137	74343	70766	77046	74832	74168	78614
D/E Ratio	0.24	0.36	0.31	0.29	0.24	0.29	0.28	0.32	0.38	0.41

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	9.7%	9.0%	7.4%	7.7%	7.3%	8.1%	13.8%	5.1%	5.9%	9.1%
Return on Equity	15.6%	16.2%	13.9%	13.7%	12.8%	14.1%	24.1%	8.8%	10.3%	16.5%
ROIC	13.0%	11.9%	10.0%	10.6%	10.1%	11.1%	18.7%	6.8%	7.6%	11.8%
Shares Out.	2,271	2,301	2,422	2,472	2,426	2,399	2,374	2,374	2,318	2,300
Revenue/Share	19.89	22.41	24.61	21.26	21.27	21.71	20.67	20.60	21.15	22.68
FCF/Share	4.17	5.14	4.94	4.67	3.95	4.25	3.44	3.58	4.16	4.66

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