Novartis AG (NVS)

Updated July 19th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$94	**5 Year CAGR Estimate:**	4.4%	**Volatility Percentile:**	23.3%
Fair Value Price:	$82	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	78.3%
% Fair Value:	115%	**5 Year Valuation Multiple Estimate:**	-2.7%	**Growth Percentile:**	25.0%
Dividend Yield:	3.1%	**5 Year Price Target**	$100	**Valuation Percentile:**	34.2%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	23.6%

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. Novartis employs more than 120,000 people worldwide, has a current market capitalization of $213 billion and annual sales of about $46 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.

The company's spinoff of the Alcon division, which focuses on products related to eye care, was completed on 4/9/2019.

Novartis reported second quarter financial results on 7/18/2019. All figures are in U.S dollars. The company earned $1.34 per share, beating estimates by $0.11. Revenue declined 10.6% to $11.8 billion, which was $310 million above expectations. In terms of continuing operations, earnings-per-share grew 14% year-over-year and revenue was higher by 4%. Currency translation had a negative impact of 3% on results.

Innovative Medicines grew 5%. The Pharmacy and Oncology businesses continue to be strong. *Cosentyx*, which treats plaque psoriasis and is the company's top selling product, grew 22% during the quarter. Sales growth was stronger in the U.S. (31%) than in the rest of the world (18%). Revenues for *Entresto*, which is used to treat chronic heart failure, improved 76% as demand from hospitals and ambulatory settings across all geographies increased. The Heart Failure Association of the European Society of Cardiology published a report in which *Entresto* is recommended as a first line treatment option for patients with systolic heart failure. *Tafinlar + Mekinist*, which treats melanoma, saw higher sales by 20% due to stronger uptake in the U.S. and Europe. *Promacta/Revolade*, which helps lower the risk of bleeding, experienced growth of 20%. Higher uptake rates in the U.S. and Japan were the primary drivers of growth for this product. Sales for the Sandoz segment improved 3%. This marks a return to growth for this segment as competition in the U.S. has been a drag on results for Sandoz. This past quarter saw stronger demand for generic pharmaceuticals outside of the U.S., leading to higher sales. Novartis repurchased 32.8 million shares at an average price of $85 over the first half of 2019. The company is expected to complete its $5 billion share buyback by the end of 2019.

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	***$5.14***	***$6.25***
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	2271	2301	2422	2472	2426	2399	2374	2374	2318	2300	***2270***	***2220***

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%.

Novartis pays an annual dividend, with the most recent paid on March 13th, 2019, which was 1.8% higher than the previous year. 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 23 consecutive years in local currency. Novartis generated $3.6 billion in free cash flow during the second quarter, an 11% 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	***18.3***	***16.0***
Avg. Yld.	3.9%	3.7%	4.1%	4.2%	3.3%	3.1%	2.7%	3.5%	3.4%	3.4%	***3.1%***	***3.4%***

Novartis saw earnings per share decline at the same time the share price accelerated in the 2013-2015 period. We assign shares a fair value price-to-earnings multiple of 16 to help account for the wide variance in valuations over the last decade. This valuation is a premium to most peers, but we feel that the growth in the company's key products, as well as the expectation for new products to produce strong results, warrants the slight premium. Based off estimates for the current year, Novartis has a valuation of 18.3 times earnings. If shares were to reach our target by 2024, then valuation could be a headwind of 2.7% to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

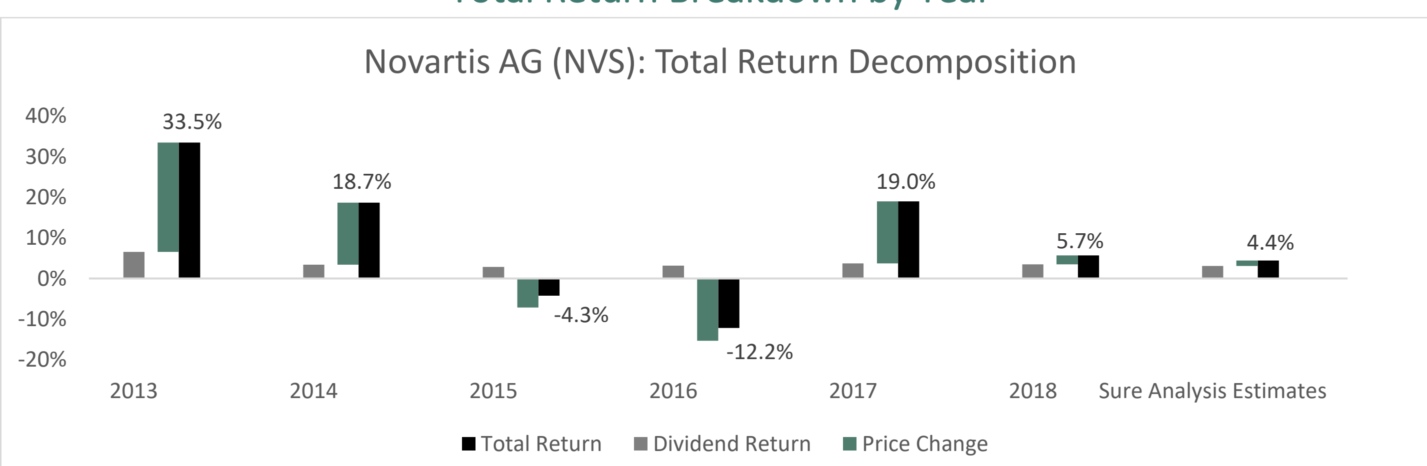
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	47%	46%	62%	62%	66%	67%	91%	97%	83%	57%	***57%***	***55%***

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. Another key advantage for the company is Novartis' willingness to spend on research and development. The company spent nearly $1.8 billion on R&D in the first quarter. This level of R&D spending should pay off as 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.

Final Thoughts & Recommendation

We forecast that Novartis AG can offer a total annual return of 4.4% through 2024, down from 7.8% previously. Shares of the company have increased 16% since our 4/28/2019 report. This has removed much of our expected total return. Novartis' business performed very well during the quarter. Top products are showing continued strength and the company's generic division even showed growth during the quarter. The company's free cash flow improved at a double-digit rate. Despite this, Novartis earns a hold recommendation from Sure Dividend due to low projected returns. We encourage investors interested in owing shares of the company to wait for a pullback before purchasing.

Total Return Breakdown by Year



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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.