Novartis AG (NVS)

Updated February 3rd, 2020 by Nathan Parsh

Key Metrics

Current Price:	$95	**5 Year CAGR Estimate:**	5.5%	**Market Cap:**	$239 billion
Fair Value Price:	$91	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date**	3/4/2020[1]
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.8%	**Dividend Payment Date:**	3/13/2020[2]
Dividend Yield:	2.7%	**5 Year Price Target**	$111	**Years Of Dividend Growth:**	23[3]
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	4%[4]

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 109,000 people and has annual sales of more than $50 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.

On 1/29/2020, Novartis reported earnings results for the fourth quarter and full-year. All figures are in U.S dollars. Earnings-per-share was $1.32 for the quarter, which was $0.01 above estimates and a 5.6% improvement from the previous year. Revenue dropped 6.5% to $12.4 billion, though this was $101 million higher than expected. For 2019, earnings-per-share improved 2.7% to $5.28 while revenue declined more than 8% to $47.4 billion. In terms of continuing operations, operating income grew 12% and revenue was up 10% for the year.

Innovative Medicines grew 11% in the fourth quarter. *Cosentyx*, which treats plaque psoriasis and is the company's top selling product, had sales growth of 21% due to strength across indications and regions. U.S. sales were up 25%. *Entresto*, which is used to treat chronic heart failure, had sales growth of 65% in the quarter due to increasing demand in both hospital and ambulatory settings. The Heart Failure Association of the European Society of Cardiology published a report in early 2019 in which *Entresto* is recommended as a first line treatment option for patients with systolic heart failure. *Tafinlar + Mekinist*, which treats melanoma, grew 15% due to increases in demand for metastatic and adjuvant melanoma. Sales for *Promacta/Revolade*, which helps lower the risk of bleeding, improved 16% due to higher uptake rates. Sandoz sales were up 2% as a 5% increase in volumes more than offset a 3% decrease in pricing. Novartis had 12% growth in emerging markets, driven by a 21% increase in sales in China. The company repurchased 60.3 million shares in 2019 at a total cost of $5.4 billion. Novartis is expected to earn $5.71 per ADR share in 2020 on revenue growth of mid- to high-single-digits.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$4.26	$3.78	$3.89	$3.70	$4.13	$2.92	$2.82	$3.28	$5.14	$5.28	***$5.71***	***$6.95***
DPS	$1.94	$2.36	$2.41	$2.43	$2.76	$2.67	$2.72	$2.72	$2.94	$2.57	***$2.57***	***$2.87***
Shares[5]	2301	2422	2472	2426	2399	2374	2374	2318	2300	2230	***2230***	***2220***

Novartis has increased earnings at a rate of 2.1% 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

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[1] Estimated date
[2] Estimated dividend payment date
[3] In local currency
[4] In local currency
[5] Share count in millions

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.

regardless of the economic climate. Due to continued strength of the company's top selling products, we are reiterating our expect earnings-per-share annual growth rate of 4%.

Novartis pays an annual dividend, with the most recent paid on 3/13/2019, 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. Free cash flow increased 15% to $12.9 billion in 2019.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	12.4	15.2	14.8	19.8	21.4	33.3	27.3	24.5	16.3	17.9	***16.6***	***16.0***
Avg. Yld.	3.7%	4.1%	4.2%	3.3%	3.1%	2.7%	3.5%	3.4%	3.4%	2.7%	***2.7%***	***2.6%***

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 2020, Novartis has a valuation of 16.6 times earnings. If shares were to reach our target by 2025, then valuation could be a headwind of 0.8% to total returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

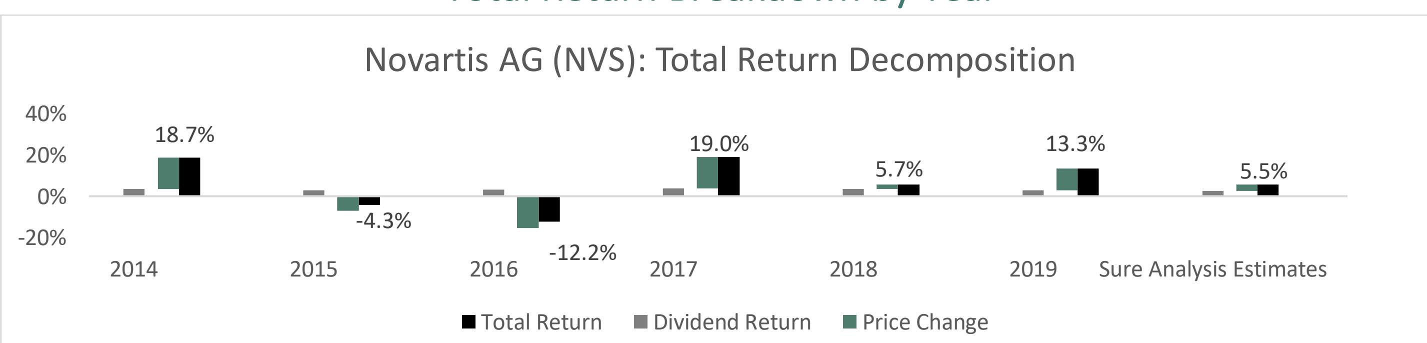
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	46%	62%	62%	66%	67%	91%	97%	83%	57%	49%	***45%***	***41%***

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 more than $9 billion on R&D over the last year. 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

After reviewing fourth quarter and full-year results, Novartis AG is expected to return 5.5% annually through 2025, down from our prior estimate of 5.9%. The company had a solid fourth quarter and full year, with both earnings-per-share and revenue from continuing operations at a double-digit rate. The company's leading products, such as *Cosentyx* and *Entresto*, continue to perform well. Shares are increased more than 9% since our last update. While we have raised our 2025 price target $11 to $111, we reiterate our hold rating on Novartis due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	51561	59375	51971	52716	53634	50387	49436	50135	53166	48,677
Gross Profit	37073	40392	36105	36137	36289	32983	31916	32960	34759	34,252
Gross Margin	71.9%	68.0%	69.5%	68.6%	67.7%	65.5%	64.6%	65.7%	65.4%	70.4%
SG&A Exp.	15797	18049	15117	15241	14993	14247	14192	14997	16471	14,369
D&A Exp.	3419	5788	4442	4405	4682	5471	6043	6076	6892	5,826
Operating Profit	11526	10780	11507	10983	11089	8977	8268	8629	8169	9,086
Op. Margin	22.4%	18.2%	22.1%	20.8%	20.7%	17.8%	16.7%	17.2%	15.4%	18.7%
Net Profit	9794	8940	9270	9175	10210	17783	6712	7703	12611	11,732
Net Margin	19.0%	15.1%	17.8%	17.4%	19.0%	35.3%	13.6%	15.4%	23.7%	24.1%
Free Cash Flow	11835	11922	11422	9796	10493	8392	8596	9875	10917	11,368
Income Tax	1733	1483	1706	1498	1545	1106	1119	1296	1221	1,793

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	123.32	117.50	124.19	126.25	125.39	131.56	130.12	133.08	145.56	118.37
Cash & Equivalents	5319	3709	5552	6687	13023	4674	7007	8860	13271	11,112
Acc. Receivable	9873	10323	10051	9902	8275	8180	8202	8600	8727	8,301
Inventories	6093	5930	6744	7267	6093	6226	6255	6867	6956	5,982
Goodwill & Int.	64923	61912	61421	58867	53143	65391	62320	61747	74013	55,311
Total Liabilities	53549	51556	54928	51782	54543	54434	55233	58852	66871	62,819
Accounts Payable	4788	4989	5593	6148	5419	5668	4873	5169	5556	5,424
Long-Term Debt	22943	20229	19726	18018	20411	21931	23802	28532	32148	27,199
Total Equity	63196	65844	69137	74343	70766	77046	74832	74168	78614	55,474
D/E Ratio	0.36	0.31	0.29	0.24	0.29	0.28	0.32	0.38	0.41	0.49

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	9.0%	7.4%	7.7%	7.3%	8.1%	13.8%	5.1%	5.9%	9.1%	8.9%
Return on Equity	16.2%	13.9%	13.7%	12.8%	14.1%	24.1%	8.8%	10.3%	16.5%	17.5%
ROIC	11.9%	10.0%	10.6%	10.1%	11.1%	18.7%	6.8%	7.6%	11.8%	12.1%
Shares Out.	2,301	2,422	2,472	2,426	2,399	2,374	2,374	2,318	2,300	2,230
Revenue/Share	22.41	24.61	21.26	21.27	21.71	20.67	20.60	21.15	22.68	20.99
FCF/Share	5.14	4.94	4.67	3.95	4.25	3.44	3.58	4.16	4.66	4.90

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