

GMG Equity Research

NOVARTIS

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17/10/2019

Key data

Market capitalization (millions CHF)	223.976
Entreprise value (million CHF)	239.336
Share price (CH)	86,56

Stock absolute and relative performance (CHF)

In %	Absolute	Relative *
1 month	0,8%	0,6%
3 months	-6,6%	-7,7%
6 months	12,4%	6,5%
YTD	20,2%	-3,4%
1 year	14,5%	0,2%
2018	5,7%	14,3%
2017	15,2%	-4,7%

*relative to SPI

Description

Novartis is a large pharmaceutical company operating worldwide. The group has been streamlined into 2 divisions: Innovative medicines and Sandoz, its generic drugs division.

The group sold or carved out other activities such as eye care (Alcon), Consumers (Over The Counter drugs) and vaccines.

In Innovative medicine, the oncologic products are managed under a specific framework. They account for about 40% of the sales of the division.

Other important therapeutic fields are multiple sclerosis, respiratory and ophthalmology. A group of older drugs, many of which are no longer protected by patents, are reported under the label Established drugs. They account for about 20% of divisional sales.

Novartis has increased its Research & Development effort to about 17%-18% of its sales. Moreover, the group regularly takes over smaller firms with late stage promising products pipeline.

Sandoz is aiming at being a leader in difficult to make generic and biosimilar drugs. Its competitive advantage is supposed to come from the know-how shared with the specialists team from Innovative medicines.

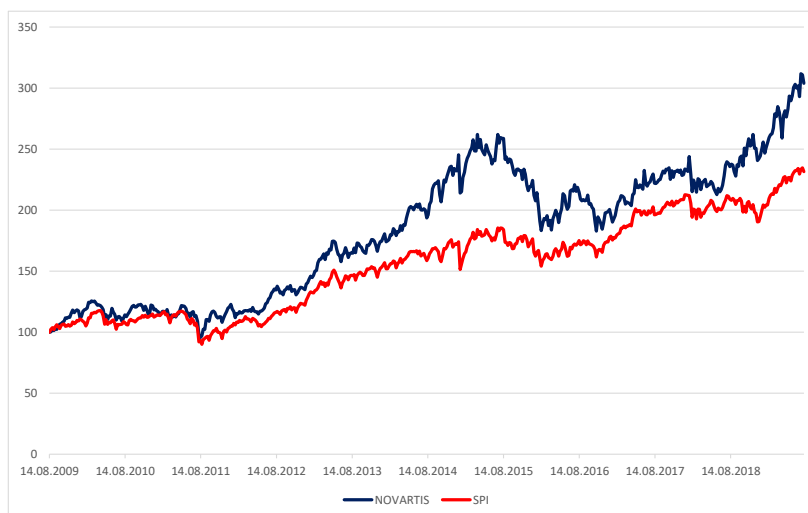
Firm's performance

Over the last 20 years, Novartis has delivered above market returns close to 6% per year in average. Over the last 10 years, total returns have been as high as 12% per year in average.

This is a remarkable achievement considering that the capital allocation of the group during this period has been questionable. More specifically, in the early 2000's, the group embarked in a strategy of diversification. Unfortunately, Novartis seems to have destroyed a lot value in this process. For example, Alcon, which was bought (from Nestlé) for 39 billion in 2010, was carved out 9 years later at a value of 28 billion. At Vaccines, profitability remained elusive; at Consumers, profits plummeted. Sandoz has recently posted lackluster sales growth. This is the result of a healthy progression of volumes and of intense price pressure. As a result, profitability is suffering.

Novartis seems to have an interesting R&D pipeline which, depending on clinical tests outcomes, should enable the group to further grow its sales and profits.

Share price (10 years)



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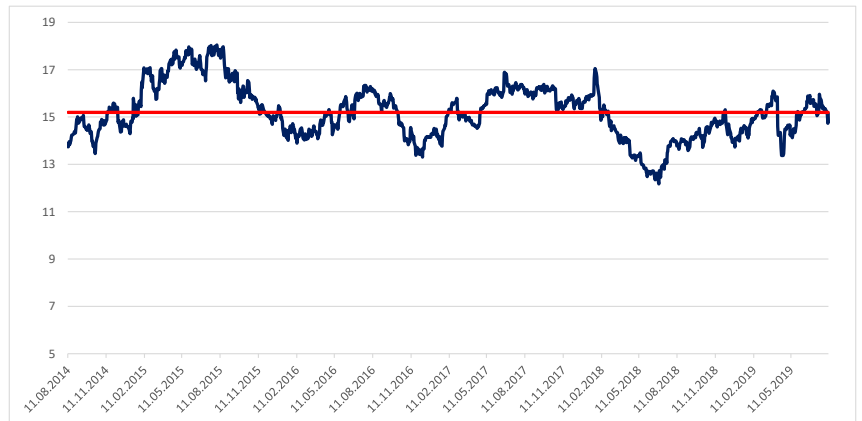
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Valuation ratios

	12/16	12/17	12/18	12/19e	12/20e
EV/EBITDA	14,3	16,1	11,3	15,5	14,2
PER	13,8	15,0	14,4	22,6	21,4
Free Cash Flow Yield	6,2%	6,8%	7,7%		
Dividend Yield	4,1%	4,1%	3,9%	3,3%	3,5%
P/BV	2,6	3,0	2,8	2,9	2,9

Bloomberg ESG ranking

Global ESG	59,5
Environment	59,7
Social	49,1
Governance	69,6

EV / EBITDA

Environment, Social & Governance comments
Environment

- Committed to becoming carbon neutral by 2025 in its own operations.
- The group aims to achieve water sustainability and reduce consumption by half from 2016 to 2020.

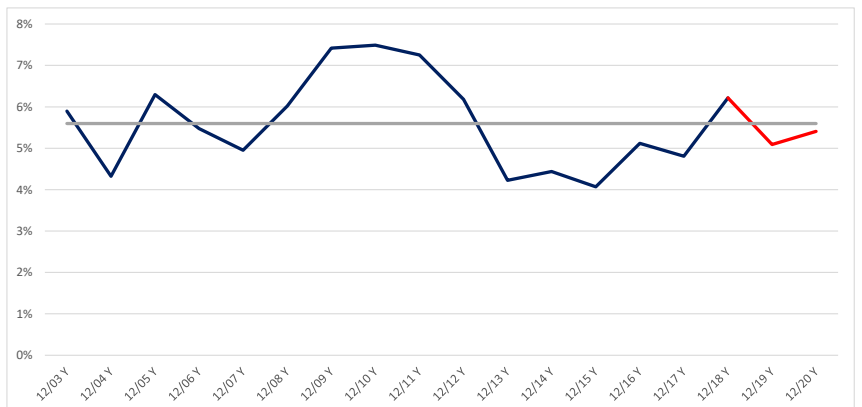
Social

- Committed to gender balanced representation in management by 2023 (42% of women in management in 2018).
- Continuing efforts to reduce the impact of malaria and leprosy through the Novartis Foundation.

Governance

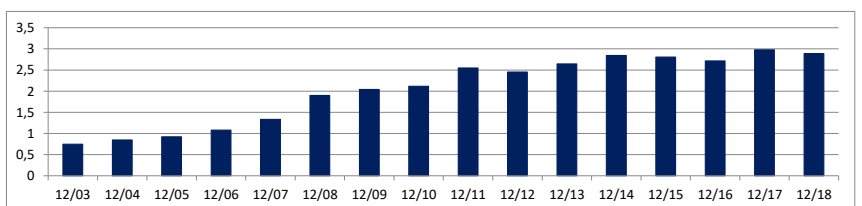
- The firm has been involved or is involved in a number of legal actions regarding commercial and marketing malpractices. Over the last 3 years, the firm payed close to 1 billion in fines.

- Although the group claims it is acting to improve its behaviour, one can not assert that new cases will not appear in the future. The position of Chief Ethics and Compliance Officer was created in 2018.

Free Cash Flow Yield

ESG affiliations and codes of conduct

UN Global Compact	✓
UN PRI (responsible investment)*	✓
Anti bribery policy	✓
Employee CSR training	✗
Fair remuneration policy	✓

* Applicable to financial institutions

Dividend per share (CHF)




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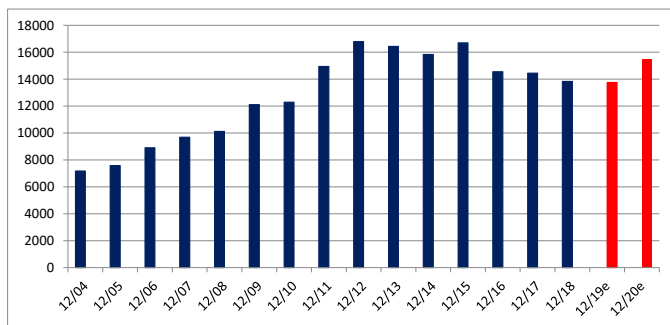
Performance ratios

	12/16	12/17	12/18	12/19e	12/20e
Operating Margin	17,0%	17,6%	15,7%	29,4%	30,7%
ROIC	6,8%	7,0%	6,6%		
ROE	10,4%	10,9%	12,6%	16,0%	17,6%
WC / Sales	5,6%	9,8%	11,5%	12,7%	12,1%
Net Debt / EBITDA	110,2%	126,6%	78,5%	99,0%	74,0%
Net Debt / Equity	21,2%	25,5%	20,7%	19,5%	15,7%
Capex / D&A	34,8%	32,6%	31,8%		

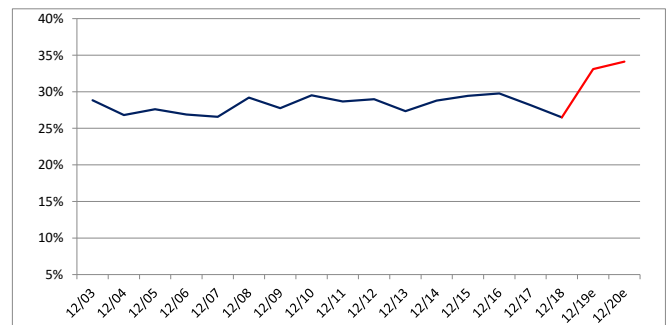
Financial statements (million USD)

		12/16	12/17	12/18	12/19e	12/20e
Chairman:	Joerg Reinhardt					
Tenure (years):	6,3					
CEO:	Vasant Narasimhan "Vas"					
Tenure (years):	1,8					
CFO:	Harry Kirsch					
Tenure (years):	5,7					
Sales		48.518	49.109	51.900	46.851	49.075
variation			1,2%	5,7%	-9,7%	4,7%
D&A costs		5.350	5.198	5.584		
EBITDA		14.443	14.961	20.704	15.512	16.744
variation			3,6%	38,4%	-25,1%	7,9%
Net earnings		11.314	11.391	11.938	8.345	9.613
Total current assets		24.931	28.208	35.563	35.563	35.563
Total fixed assets		105.193	104.871	110.000	110.000	110.000
Shareholders equity		74.891	74.227	78.692	78.692	78.692
Working capital		2.722	4.805	5.956	5.956	5.956
Net debt		15.909	18.940	16.256	15.360	12.389
Operating cash flow		11.475	12.621	14.272	13.366	13.996
Capex		-1.862	-1.696	-1.773	-2.151	-2.082
Free cash flow		9.613	10.925	12.499	11.216	11.914

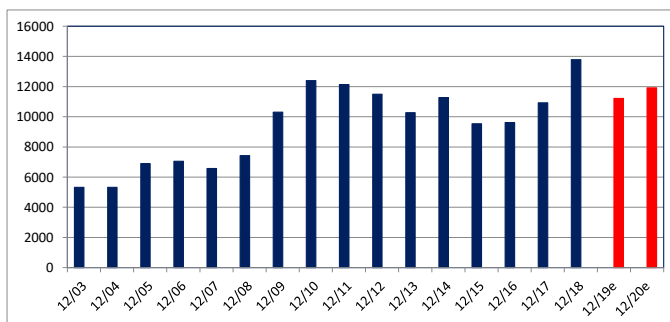
EBITDA



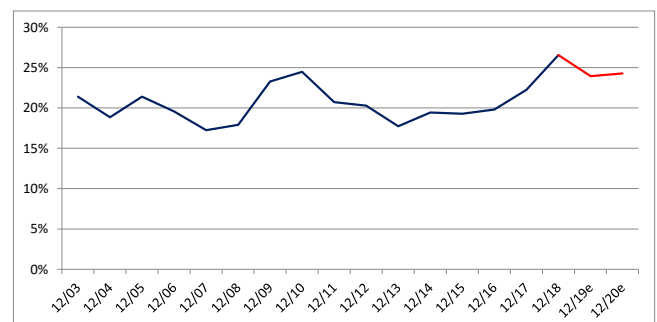
EBITDA margin



Free cash flow



Free cash flow & Free cash flow / sales





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SWOT

Strengths

- Growth is based on a relatively large number of products in different therapeutic areas. Momentum is good for the time being

Weaknesses

- New wave of patents expiries in the next coming years (Gilenya, Afinitor, Exjade)
- Improving profitability at Sandoz seems to be a lasting issue

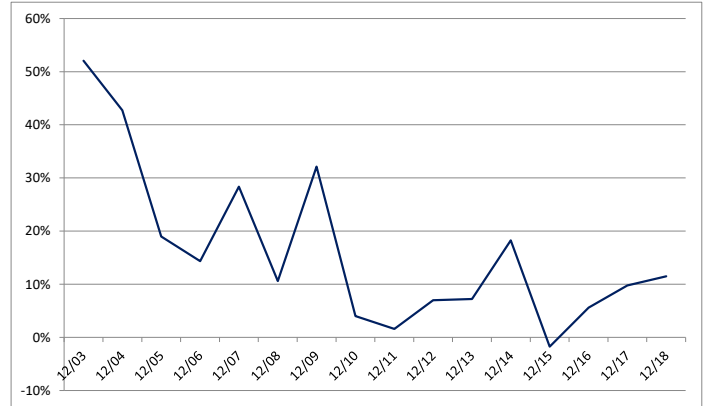
Opportunities

- Several launches of new products are taking place or are expected

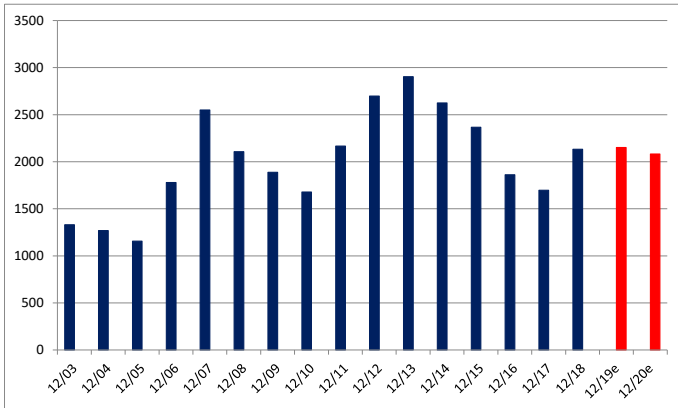
Threats

- The firm relies quite a lot on M&A to fill up its late stage R&D pipeline (Lutathera, Zolgensam); these transactions substantially reduce Free Cash Flow, but all of them do not turn out to be value accretive over time

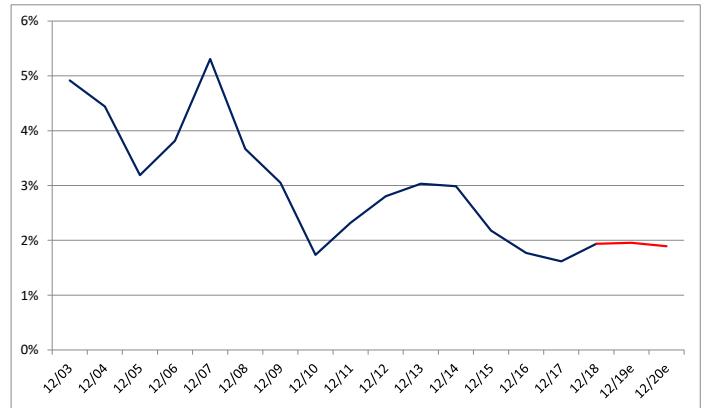
Working capital / sales



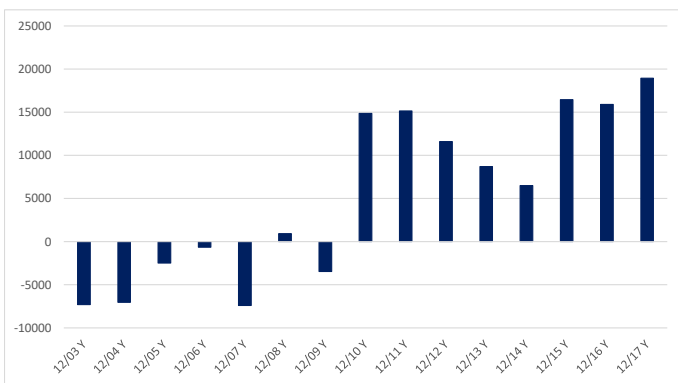
CAPEX



CAPEX / non current assets



NET DEBT



NET DEBT / EBITDA

