



# NOVARTIS

NOVN SW | 14 Pages | 25 January 2018

Pharmaceuticals  
Switzerland

## OUTPERFORM

Price Target: CHF 93.0 (from CHF 90.0)

### Accelerating at the margin

We believe that Novartis is set for a period of sustained sales growth and improving margins.

Sandoz may be weak this year owing to US price pressure but underlying dynamics remain strong and biosimilars should start to deliver material profitability in 2019.

Novartis now has a sharp focus on rising innovation, tight cost control, and clear goals for operating performance. We lift our TP from CHF 90 to CHF 93. Outperform.

#### WHERE ARE WE DIFFERENT? / WHAT HAS CHANGED?

We now include the USD3.9bn purchase of Advanced Accelerator Applications (forecasts based on AAA management's long range projections as published in SEC filings) and incorporate mid-January FX rates. Although our group sales estimates rise by c 4%, this masks a cut of c.3% to underlying Sandoz forecasts. We have also taken a slightly more cautious approach to the unpredictable line of 'other operating income and expense'. We remain around two percentage points ahead of pre-FY consensus core operating margin for the group in 2020E, driven by our more positive view for Innovative Medicines (core OM of 35.5% vs consensus of 33.3%). The net effect of these cost changes is to trim our 2018E EPS forecasts by 2%. We are now 5%, 8%, 12% & 14% ahead of pre-FY 17 consensus EPS '18-21E, although we expect consensus to move by c.3% following the FY results. Note that we continue to expect two further share buybacks of USD 5bn each before the end of 2021E.

#### INVESTMENT CASE

Our investment case is straightforward: we expect Novartis to continue to focus on delivering innovation-driven sales from a tightly controlled cost base and with R&D gently deflating to a more sustainable c.20% of sales. We see biosimilars as a material profit driver for Sandoz and longer term we envisage Novartis exiting retail generics (assuming a buyer could ever be found). Alcon's destiny should be clear within 18 months (likely to be outside Novartis) and we see increasing potential for significantly greater value to be realised.

#### VALUATION AND CATALYSTS

We lift our target price to CHF 93, based on our DCF (WACC 7.62%, TG 1.2%) and keep our Outperform recommendation. Novartis currently trades on 14.2x 2019E core EPS in line with the sector average – we see this as unwarranted given a Novartis 11% CAGR in EPS 2017-'21E vs 7% for the sector. At our new TP the stock would trade on a modest 10% 2019 PE premium, although at our TP, the rich (c.40%) 2019 EV/EBITDA premium could cap further performance.

LAST CLOSE (CHF)	85.9
MKTCAP (USD bn)	193.5
UPSIDE (%)	8.3
DAILY T/O (CHF m)	350

CHANGES TO ESTIMATES	2018E	2019E
Revenues (%)	+4.0	+3.9
EPS (%)	(2.0)	(0.1)

YEAR TO DEC (USD M)	2017	2018E	2019E	2020E
Group revenue	49,109	52,451	54,297	56,062
EBITDA (adj.)	14,357	16,185	17,521	18,954
EBIT (adj.)	9,252	10,752	11,857	13,052
EPS (adj.) (USD)	4.86	5.57	6.14	6.69
EPS (Cons.) (USD)	4.84	5.30	5.66	5.98
DPS (CHF)	2.80	3.00	3.15	3.30
P/E (adj.)	17.3	16.3	14.8	13.6
EPS y/y (%)	2.3	14.5	10.2	9.0
EV/EBITDA (adj.)	15.2	14.1	12.8	11.6
Dividend yield (%)	3.3	3.3	3.5	3.6
Free CF yield (%)	5.1	5.5	5.7	6.3
EV/IC	2.02	2.19	2.11	2.07
RoIC (%)	8.5	10.3	11.1	12.3
Net debt (cash)	19,047	18,116	12,994	11,846
Other EV items	5,967	5,967	5,967	5,967
EV (USD bn)	218.9	228.9	224.7	219.7

Next event: AGM (05 Mar 2018)

#### ANALYSTS

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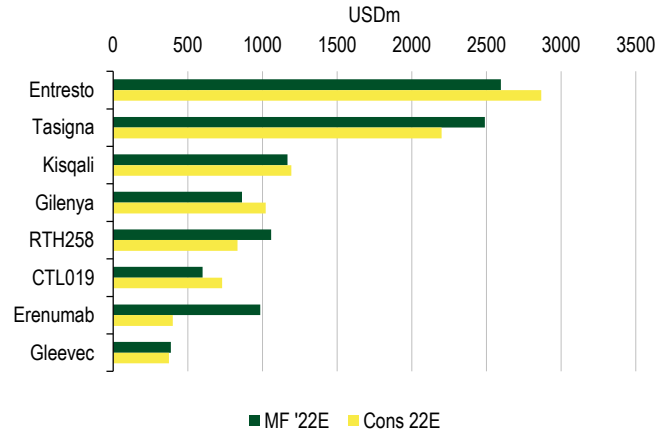
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**KEY FINANCIALS**

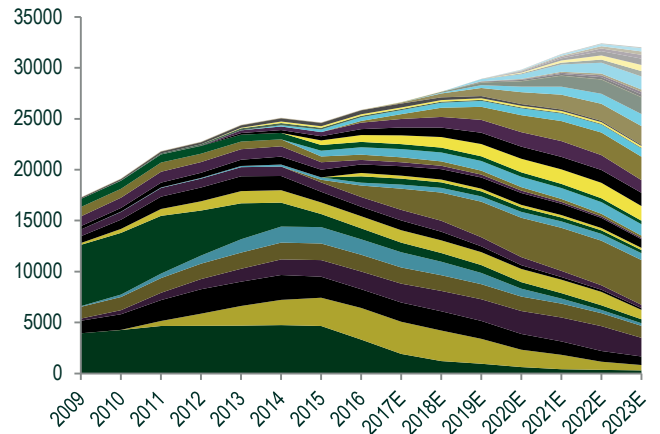
YEAR TO DECEMBER (USD M)	2017	2018E	2019E	2020E
<b>PROFIT &amp; LOSS ACCOUNT</b>				
Group revenue (as reported)	49,109	52,451	54,297	56,062
EBITDA	14,023	15,475	16,765	18,111
<b>EBIT</b>	<b>8,629</b>	<b>9,705</b>	<b>10,810</b>	<b>11,955</b>
t/o: At-equity result	1,108	1,170	1,239	1,298
Pre-tax result	8,999	10,048	11,350	12,589
Income tax, other items	(1,296)	(1,486)	(1,679)	(1,862)
Net result group	7,703	8,562	9,671	10,727
Minorities, other	0	0	0	0
<b>Net result shareholders</b>	<b>7,703</b>	<b>8,562</b>	<b>9,671</b>	<b>10,727</b>
<b>EPS, fully diluted (USD)</b>	<b>3.28</b>	<b>3.75</b>	<b>4.28</b>	<b>4.79</b>
<b>MainFirst adjustments</b>				
Exceptionals in EBIT	(623)	(1,047)	(1,047)	(1,097)
<b>Profit &amp; Loss Account (adj.)</b>				
EBITDA	14,357	16,185	17,521	18,954
<b>EBIT</b>	<b>9,252</b>	<b>10,752</b>	<b>11,857</b>	<b>13,052</b>
Net result, shareholders	11,413	12,701	13,856	14,992
<b>EPS, fully diluted (USD)</b>	<b>4.86</b>	<b>5.57</b>	<b>6.14</b>	<b>6.69</b>
<b>CASH FLOW STATEMENT</b>				
EBITDA	14,023	15,475	16,765	18,111
Cash interest and tax	(3,312)	(3,688)	(3,947)	(4,275)
Changes in working capital	244	542	(180)	(267)
Other operating CF items	1,665	1,729	1,831	1,877
<b>Net operating cash flow</b>	<b>12,621</b>	<b>14,057</b>	<b>14,469</b>	<b>15,446</b>
Capital expenditure (intangibles, tangibles)	2,746	2,832	2,823	2,803
<b>Free cash flow</b>	<b>9,875</b>	<b>11,225</b>	<b>11,646</b>	<b>12,643</b>
Acquisitions, Disposals, Financial assets	(784)	(3,300)	600	600
Dividends, minority payouts	(6,495)	(6,994)	(7,124)	(6,831)
Capital measures, other	(5,618)	0	0	(5,263)
<b>Change in net cash (debt)</b>	<b>(3,022)</b>	<b>931</b>	<b>5,122</b>	<b>1,149</b>
Net cash (debt)	(19,047)	(18,116)	(12,994)	(11,846)
<b>BALANCE SHEET</b>				
Fixed assets (USD bn)	104.9	103.3	100.8	98.2
t/o Goodwill	31,349	32,349	32,349	32,349
Current assets	28,208	25,714	30,263	31,864
t/o Inventories	6,867	6,556	6,678	6,896
t/o Trade receivables	8,600	8,654	8,959	9,194
t/o Cash and equivalents	9,485	7,248	11,370	12,518
Group equity	74,227	73,443	76,698	76,051
t/o Shareholders equity	74,168	73,384	76,639	75,992
Interest-bearing liabilities	28,532	25,364	24,364	24,364
Other liabilities and provisions	30,320	30,236	30,036	29,629
t/o Pension provisions	5,495	5,495	5,495	5,495
t/o Trade liabilities	5,169	5,455	5,701	5,886
<b>Balance sheet total (USD bn)</b>	<b>133.1</b>	<b>129.0</b>	<b>131.1</b>	<b>130.0</b>
Net working capital	10,298	9,756	9,936	10,203
Capital employed (incl. Goodwill) (USD bn)	115.2	113.1	110.8	108.4
<b>RATIOS</b>				
Revenue y/y	1.2%	6.8%	3.5%	3.3%
EBITDA margin (adj.)	29.2%	30.9%	32.3%	33.8%
EBIT margin (adj.)	18.8%	20.5%	21.8%	23.3%
EPS (adj.) y/y	2.3%	14.5%	10.2%	9.0%
Net working capital intensity (as a % of sales)	21.0%	18.6%	18.3%	18.2%
DSOs (trade receivables as days of revs)	63.9	60.2	60.2	59.9
Inventory turnover (Days)	51.0	45.6	44.9	44.9
Net debt (cash) / EBITDA (adj.)	1.33	1.12	0.74	0.62
EBITDA (adj.) / Capex	5.23	5.71	6.21	6.76
Free CF yield (FCF / market cap)	5.1%	5.5%	5.7%	6.3%
Oper. FCF yield ((FCF - net int. taxed) / EV)	4.5%	4.9%	5.2%	5.8%

**SALES FORECASTS MF VS CONSENSUS '22E (USDm)**



Source: MainFirst Research

**RISING DIVERSITY IN IM PORTFOLIO (USDm)**



Source: MainFirst, Company data. Each area represents a modelled IM product

**Figure 1: MFe SALES AND CORE OP GROWTH 17-22e VS. CONSENSUS**



Source: MainFirst Research



## Main changes to our model

We continue to believe that Novartis is on track for longer term sustained mid-single digit growth in sales. We welcome the clear goals of mid-30s core operating margin in IM around 2020. On a group basis core operating margin should be boosted as biosimilars grow in scale and start to deliver a positive contribution to profits, probably from 2019 onwards. We see 9% CAGR in core operating income 2016-21E (vs 6% for consensus). When coupled with our expectation of a further two share buy backs, each of USD5bn, over this period we see EPS growth of 11% on a compound basis 2017-21E vs 7% for the European large cap pharma sector.

Our model now reflects FY 17 results. We have also included the acquisition of AAA in our model.

Figure 2: New key divisional forecasts (USDm)

	2016	2017	2018E	2019E	2020E	2021E	2022E
<b>Sales</b>							
Innovative Medicines	32,562	33,025	35,707	36,773	37,709	39,218	41,317
Sandoz	10,144	10,060	10,479	11,017	11,615	12,310	13,048
Alcon	5,812	6,024	6,265	6,506	6,738	6,969	7,212
<b>Group sales cont. bus.</b>	<b>48,518</b>	<b>49,109</b>	<b>52,451</b>	<b>54,297</b>	<b>56,062</b>	<b>58,496</b>	<b>61,577</b>
Other revenues	918	1,026	1,043	1,063	1,084	1,105	1,127
Group revenues	49,436	50,135	53,494	55,359	57,145	59,601	62,704
<b>Operating profit (IFRS)</b>							
Innovative Medicines	7,426	7,782	8,435	9,207	9,936	10,494	11,577
Sandoz	1,445	1,368	1,577	1,813	2,094	2,429	2,914
Alcon	-132	-190	-6	117	229	341	526
Corporate	-471	-331	-301	-327	-304	-299	-306
Group operating profit	8,268	8,629	9,705	10,810	11,955	12,965	14,711
<b>Core operating profit</b>							
Innovative Medicines	10,354	10,330	11,710	12,555	13,397	14,058	15,140
Sandoz	2,071	2,080	2,128	2,364	2,645	2,980	3,465
Alcon	850	857	945	1,068	1,180	1,292	1,477
Corporate	-288	-417	-251	-277	-254	-249	-256
<b>Group core operating profit (cont)</b>	<b>12,987</b>	<b>12,850</b>	<b>14,532</b>	<b>15,709</b>	<b>16,968</b>	<b>18,080</b>	<b>19,826</b>
<b>Sales growth CER</b>							
Innovative Medicines	10%	2%	8%	3%	3%	4%	5%
Sandoz	2%	4%	4%	5%	5%	6%	6%
Alcon	-2%	3%	4%	4%	4%	3%	3%
<b>Core operating profit growth CER</b>							
Innovative Medicines	-1%	3%	13%	7%	7%	5%	20%
Sandoz	4%	0%	2%	11%	12%	13%	20%
Alcon	-27%	1%	10%	13%	10%	10%	14%
Group	-2%	2%	13%	8%	8%	7%	10%
<b>EPS cont. ops basic (USD)</b>	<b>2.82</b>	<b>3.28</b>	<b>3.75</b>	<b>4.28</b>	<b>4.79</b>	<b>5.36</b>	<b>6.30</b>
<b>Core EPS basic (USD)</b>	<b>4.75</b>	<b>4.86</b>	<b>5.57</b>	<b>6.14</b>	<b>6.69</b>	<b>7.36</b>	<b>8.35</b>
<b>Ave SII basic</b>	<b>2378</b>	<b>2346</b>	<b>2280</b>	<b>2258</b>	<b>2243</b>	<b>2172</b>	<b>2103</b>

Source: MainFirst Research



The table below shows the main changes to our model.

**Figure 3: Main changes to estimates 2018-22E**

METRIC	DIVISION	2018E	2019E	2020E	2021E	2022E	COMMENT ON CHANGE
Sales	IM	6.1%	6.1%	5.6%	4.8%	4.1%	Mainly driven by forex and AAA inclusion US price pressure
	Sandoz	-0.4%	-0.8%	-1.3%	-1.5%	-1.5%	
	Alcon	1.3%	1.7%	1.8%	1.8%	1.8%	
	Group	4.2%	4.1%	3.6%	3.0%	2.6%	
Core OP	IM	2.5%	3.7%	2.9%	-0.1%	-1.8%	Higher retail generic erosion assumed Improving performance following FY17
	Sandoz	-9.5%	-6.7%	-8.1%	-5.7%	2.3%	
	Alcon	2.0%	6.6%	2.1%	-3.1%	2.1%	
	Corporate	-12.4%	-12.7%	-15.3%	-17.3%	-19.0%	
Rep OP	IM	-0.7%	1.0%	-0.2%	-3.8%	-5.4%	
	Sandoz	-11.9%	-8.0%	-9.6%	-6.5%	3.1%	
	Alcon	-74.7%	128.7%	11.6%	-11.0%	6.1%	
	Corporate	-10.5%	-10.9%	-13.1%	-14.9%	-16.4%	
Other operating inc/exp.	Group	-237	-207	-202	-196	-188	More cautious view of OOI/E
Change as proportion of Core OP		-1.6%	-1.4%	-1.2%	-1.1%	-0.9%	
Reported EPS	Group	-1.3%	1.6%	-0.2%	-3.0%	-2.2%	
Core EPS	Group	-1.8%	0.1%	-0.9%	-3.0%	-2.5%	

Source: MainFirst Research

We have also made some changes to our sales forecasts for some key innovative medicines and show below our revised expectations. These include marginally raised forecasts for Cosentyx (+USD 200m in 2022E), Promacta (+USD 260m) and Tafinlar/Mekinist (+USD 180m). We have lowered Kisqali sales forecasts by USD 400m in 2020 and now expect USD 812m.

**Figure 4: Major product sales forecasts (USDm) 2017-22E**

PRODUCT	2017	2018E	2019E	2020E	2021E	2022E
Gleevec	1,943	1,336	1,048	688	455	387
Cosentyx	2,071	2,955	3,695	4,065	4,414	4,573
Entresto	507	1,057	1,501	1,952	2,300	2,598
Tasigna	1,841	2,042	2,173	2,301	2,400	2,490
Kymriah/ CTL019	0	40	120	240	480	600
Kisqali	76	248	555	812	1,015	1,167
Tafinlar/Mekinist	873	1,135	1,355	1,517	1,652	1,757
AAA (Lutathera etc)		249	493	718	970	1,171
Jakavi/ INC 424	777	973	1,168	1,249	1,287	1,325
Promacta/Revolade	867	1,215	1,488	1,675	1,826	1,736
AMG 334	0	68	272	544	789	986
Sandostatin	1,612	1,604	1,540	1,479	1,420	1,329
Votrient	808	897	969	1,037	1,094	1,170
Galvus/Eucreas	1,233	1,362	1,403	1,445	1,474	1,474
Xolair	920	1,060	1,145	1,214	1,153	1,038
Lucentis	1,888	2,043	1,900	1,672	1,421	1,137
Ultibro Breezhaler	411	567	681	783	861	904
Ilaris	402	474	536	595	648	687
Gilenya (FTY 720)	3,185	3,167	2,594	1,826	1,526	862
Diovan	957	946	848	705	586	498
Voltarol	465	452	425	404	375	349
Exjade/Jadenu	1,059	1,125	933	826	632	455
Travoprost	589	572	528	466	411	370
ACZ885	0	0	68	117	170	218
Afinitor Votubia	1,525	1,457	1,240	868	554	356
Sandimmun	488	483	442	388	330	281
Topical Olopatadine Group	284	270	256	243	231	220
Exforge	960	1,031	702	456	319	256
Seebri Breezhaler	151	160	165	170	175	180
Exelon	381	346	298	249	196	167
RYDAPT /PKC 412	0	20	43	61	74	84
Zortress/Certican	414	290	232	185	158	134
Onbrez Breezhaler/Arcapta Neohaler	112	108	97	87	78	71
Total change - named drugs						
Other drugs	6,226	5,886	5,192	4,514	3,911	3,397
Pipeline drugs	0	68	668	2,158	3,828	6,890
Total IM	33,025	35,707	36,773	37,709	39,218	41,317

Source: Company accounts, MainFirst Research



# Financial Estimates

## Profit & Loss Account

**Figure 5: Profit and loss account forecasts 2016-2022E**

	2016	2017	2018E	2019E	2020E	2021E	2022E
<b>Group Sales</b>	<b>48,518</b>	<b>49,109</b>	<b>52,451</b>	<b>54,297</b>	<b>56,062</b>	<b>58,496</b>	<b>61,577</b>
Other revenues	918	1,026	1,043	1,063	1,084	1,105	1,127
Group revenues	49,436	50,135	53,494	55,359	57,145	59,601	62,704
Cost of goods sold	-17,520	-17,175	-17,935	-18,221	-18,609	-19,598	-20,273
Gross Profit	31,916	32,960	35,559	37,139	38,537	40,003	42,431
Sales Costs	-11,998	-12,861	-13,751	-14,118	-14,323	-14,514	-14,813
Pharma R&D	-7,709	-7,630	-8,106	-8,127	-8,107	-8,275	-8,511
Pharma R&D as % sales	-24%	-23%	-23%	-22%	-22%	-21%	-21%
Other R&D	-1,330	-1,342	-1,383	-1,423	-1,457	-1,503	-1,579
Total R&D costs	-9,039	-8,972	-9,489	-9,550	-9,565	-9,778	-10,090
Administration Costs	-2,194	-2,136	-2,159	-2,199	-2,255	-2,310	-2,373
Other operating income/expense	-417	-362	-455	-462	-439	-436	-444
Operating Profit	8,268	8,629	9,705	10,810	11,955	12,965	14,711
Total amortisation, impairments and restr.	4,719	4,221	4,827	4,900	5,013	5,116	5,116
<b>Core operating income continuing ops</b>	<b>12,987</b>	<b>12,850</b>	<b>14,532</b>	<b>15,709</b>	<b>16,968</b>	<b>18,080</b>	<b>19,826</b>
EBITA	12,129	12,516	13,822	14,954	16,125	17,164	18,943
EBITDA pre exc	14,311	14,023	15,475	16,765	18,111	19,341	21,330
Financial Items	-1,154	-738	-827	-699	-664	-645	-591
Pre-tax Profit	7,817	8,999	10,048	11,350	12,589	13,679	15,542
Group income tax - cont. ops	-1,119	-1,296	-1,486	-1,679	-1,862	-2,024	-2,299
Net Profit continuing ops	6,698	7,703	8,562	9,671	10,727	11,655	13,243
Net Income	6,712	7,703	8,562	9,671	10,727	11,655	13,243
EPS basic from continuing ops	2.82	3.28	3.75	4.28	4.79	5.36	6.30
Diluted EPS from continuing ops	2.80	3.25	3.71	4.24	4.73	5.30	6.22
<b>Core EPS basic continuing ops</b>	<b>4.75</b>	<b>4.86</b>	<b>5.57</b>	<b>6.14</b>	<b>6.69</b>	<b>7.36</b>	<b>8.35</b>
Core net income attr. to shareholders	11,307	11,413	12,701	13,856	14,992	15,993	17,558
Core EPS basic (USD)	4.75	4.86	5.57	6.14	6.69	7.36	8.35
Change in core EPS basic	-3%	2%	14%	10%	9%	10%	13%
DPS (CHF)	2.75	2.80	3.00	3.15	3.30	3.45	3.60
Change in dividend	2%	2%	7%	5%	5%	5%	4%
Average SII (basic)	2378	2346	2280	2258	2241	2172	2103

Source: MainFirst Research, company



## Cash-Flow

**Figure 6: Cash flow statement**

YEAR TO DECEMBER (USD M)	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
<b>EBITDA (as reported)</b>	<b>14,202</b>	<b>13,618</b>	<b>14,023</b>	<b>15,475</b>	<b>16,765</b>	<b>18,111</b>	<b>19,341</b>	<b>21,330</b>	<b>22,604</b>
Cash interest and tax payments	(3,089)	(2,946)	(3,312)	(3,688)	(3,947)	(4,275)	(4,576)	(5,092)	(5,407)
Change in working capital	(863)	(77)	244	542	(180)	(267)	(385)	(496)	(314)
Inventories	(482)	(235)	(612)	311	(122)	(217)	(299)	(379)	(214)
Trade receivables	(513)	(229)	(398)	(54)	(304)	(235)	(341)	(441)	(282)
Trade liabilities & prepayments	132	387	1,254	286	246	185	256	323	183
Other operating CF items	1,647	880	1,665	1,729	1,831	1,877	1,852	1,832	1,975
<b>Operating cash flow</b>	<b>11,897</b>	<b>11,475</b>	<b>12,621</b>	<b>14,057</b>	<b>14,469</b>	<b>15,446</b>	<b>16,232</b>	<b>17,573</b>	<b>18,858</b>
<b>Capex</b>	<b>3,505</b>	<b>2,879</b>	<b>2,746</b>	<b>2,832</b>	<b>2,823</b>	<b>2,803</b>	<b>2,925</b>	<b>3,079</b>	<b>3,166</b>
Intangible fixed assets	(1,138)	(1,017)	(1,050)	(985)	(982)	(975)	(1,017)	(1,070)	(1,101)
Tangible fixed assets	(2,367)	(1,862)	(1,696)	(1,848)	(1,842)	(1,829)	(1,908)	(2,008)	(2,065)
<b>Free cash flow</b>	<b>8,392</b>	<b>8,596</b>	<b>9,875</b>	<b>11,225</b>	<b>11,646</b>	<b>12,643</b>	<b>13,308</b>	<b>14,494</b>	<b>15,692</b>
Acquisitions/Disposals/Financial assets	(15,747)	243	(784)	(3,300)	600	600	600	600	600
Dividends, minority payouts	(6,643)	(6,475)	(6,495)	(6,994)	(7,124)	(6,831)	(7,105)	(7,202)	(7,279)
Equity measures	773	671	729	724	708	721	718	716	718
Other changes in net cash	3,290	(2,576)	(6,347)	(724)	(708)	(5,984)	(5,981)	(716)	(718)
<b>Change in net cash</b>	<b>(9,935)</b>	<b>459</b>	<b>(3,022)</b>	<b>931</b>	<b>5,122</b>	<b>1,149</b>	<b>1,539</b>	<b>7,892</b>	<b>9,013</b>
<b>Net cash (debt)</b>	<b>(16,484)</b>	<b>(16,025)</b>	<b>(19,047)</b>	<b>(18,116)</b>	<b>(12,994)</b>	<b>(11,846)</b>	<b>(10,306)</b>	<b>(2,414)</b>	<b>6,598</b>
<b>CASH FLOW RATIOS</b>									
Operating cash flow/Sales	24.1%	23.7%	25.7%	26.8%	26.6%	27.6%	27.7%	28.5%	29.8%
Free cash flow/Sales	17.0%	17.7%	20.1%	21.4%	21.4%	22.6%	22.7%	23.5%	24.8%
Dividend payout ratio	94.5%	96.7%	84.3%	81.7%	73.7%	63.7%	61.0%	54.4%	51.2%
Capex/Sales	7.1%	5.9%	5.6%	5.4%	5.2%	5.0%	5.0%	5.0%	5.0%
Capex/D&A	67.1%	53.8%	50.9%	49.1%	47.4%	45.5%	45.9%	46.5%	46.0%
D&A/Sales	10.6%	11.0%	11.0%	11.0%	11.0%	11.0%	10.9%	10.7%	10.9%

Source: Company reports, MainFirst estimates



## Balance Sheet

Figure 7: Balance Sheet

YEAR TO DECEMBER (USD M)	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
<b>Fixed assets (USD bn)</b>	<b>108.7</b>	<b>105.2</b>	<b>104.9</b>	<b>103.3</b>	<b>100.8</b>	<b>98.2</b>	<b>95.5</b>	<b>92.8</b>	<b>89.9</b>
Intangibles	65,391	62,320	61,747	59,343	55,580	51,785	48,002	44,241	40,474
t/o Goodwill	31,174	30,980	31,349	32,349	32,349	32,349	32,349	32,349	32,349
Tangibles	15,982	15,641	16,464	16,155	16,186	16,028	15,759	15,381	14,830
Financial fixed assets	15,314	14,304	13,732	14,902	16,142	17,439	18,798	20,221	21,709
Other fixed assets	12,024	12,928	12,928	12,928	12,928	12,928	12,928	12,928	12,928
<b>Current assets</b>	<b>22,845</b>	<b>24,931</b>	<b>28,208</b>	<b>25,714</b>	<b>30,263</b>	<b>31,864</b>	<b>34,043</b>	<b>42,755</b>	<b>52,264</b>
Inventories	6,226	6,255	6,867	6,556	6,678	6,896	7,195	7,574	7,788
Trade receivables	8,180	8,202	8,600	8,654	8,959	9,194	9,535	9,975	10,258
Other current assets	2,992	2,697	3,256	3,256	3,256	3,256	3,256	3,256	3,256
Cash & equivalents	5,447	7,777	9,485	7,248	11,370	12,518	14,058	21,950	30,962
<b>Group equity</b>	<b>77,122</b>	<b>74,891</b>	<b>74,227</b>	<b>73,443</b>	<b>76,698</b>	<b>76,051</b>	<b>76,056</b>	<b>82,813</b>	<b>90,463</b>
Minorities	76	59	59	59	59	59	59	59	59
Shareholders' equity	77,046	74,832	74,168	73,384	76,639	75,992	75,997	82,754	90,404
<b>Provisions</b>	<b>8,044</b>	<b>8,470</b>	<b>10,060</b>	<b>10,986</b>	<b>12,003</b>	<b>13,034</b>	<b>14,025</b>	<b>14,943</b>	<b>15,941</b>
Pension	5,419	5,495	5,495	5,495	5,495	5,495	5,495	5,495	5,495
Other	2,625	2,975	4,565	5,491	6,508	7,539	8,530	9,448	10,446
<b>Liabilities</b>	<b>46,390</b>	<b>46,763</b>	<b>48,792</b>	<b>44,614</b>	<b>42,397</b>	<b>40,959</b>	<b>39,451</b>	<b>37,770</b>	<b>35,802</b>
Interest-bearing liabilities	21,931	23,802	28,532	25,364	24,364	24,364	24,364	24,364	24,364
Interest-free liabilities	24,459	22,961	20,260	19,250	18,033	16,595	15,087	13,406	11,438
Trade liabilities	5,668	4,873	5,169	5,455	5,701	5,886	6,142	6,466	6,649
Other interest-free liabilities	18,791	18,088	15,091	13,795	12,332	10,708	8,944	6,940	4,790
<b>Balance sheet total (USD bn)</b>	<b>131.6</b>	<b>130.1</b>	<b>133.1</b>	<b>129.0</b>	<b>131.1</b>	<b>130.0</b>	<b>129.5</b>	<b>135.5</b>	<b>142.2</b>
<b>CAPITAL AND LIQUIDITY RATIOS</b>									
Net working capital	8,738	9,584	10,298	9,756	9,936	10,203	10,588	11,084	11,398
Capital employed (USD bn)	117.4	114.8	115.2	113.1	110.8	108.4	106.1	103.9	101.3
Tangible group equity	45,948	43,911	42,878	41,094	44,349	43,702	43,707	50,464	58,114
Number of shares, fully diluted (m)	4,876	4,800	4,742	4,611	4,565	4,533	4,395	4,257	4,224
Fixed asset intensity (as a % of revenue)	156.8%	153.0%	149.7%	135.3%	126.1%	117.4%	107.9%	98.1%	91.0%
Net working capital intensity	17.7%	19.8%	21.0%	18.6%	18.3%	18.2%	18.1%	18.0%	18.0%
Fixed assets as a % of total assets	82.6%	80.8%	78.8%	80.1%	76.9%	75.5%	73.7%	68.5%	63.2%
Net debt (cash) as a % of BS total	12.5%	12.3%	14.3%	14.0%	9.9%	9.1%	8.0%	1.8%	-4.6%
Equity ratio (Group equity/BS total)	58.6%	57.6%	55.8%	56.9%	58.5%	58.5%	58.7%	61.1%	63.6%
Net gearing (Net debt/Group equity)	0.21	0.21	0.26	0.25	0.17	0.16	0.14	0.03	(0.07)
Net debt/EBITDA (adj.)	1.06	1.06	1.33	1.12	0.74	0.62	0.51	0.11	n/m
DSOs (trade receivables as days of revs)	60.4	61.7	63.9	60.2	60.2	59.9	59.5	59.1	59.1
Inventory turnover (Days)	46.0	47.1	51.0	45.6	44.9	44.9	44.9	44.9	44.9
<b>RETURN RATIOS</b>									
Price/NAV	2.63	2.67	2.61	2.79	2.68	2.66	2.54	2.29	2.10
Price/Tangible NAV	4.41	4.54	4.52	4.98	4.64	4.62	4.42	3.75	3.27
RoE (Net result/Shareholders' equity)	15.3%	15.1%	15.4%	17.3%	18.1%	19.7%	21.0%	21.2%	20.4%
RoCE (EBIT)	8.6%	8.0%	8.0%	9.5%	10.7%	12.0%	13.3%	15.2%	16.5%
RoCE (NOPAT)	6.9%	6.6%	6.4%	7.6%	8.5%	9.5%	10.4%	11.8%	12.7%
Return on total assets (NOPAT)	6.2%	5.8%	5.6%	6.7%	7.2%	7.9%	8.5%	9.0%	9.1%
<b>ENTERPRISE VALUE COMPONENTS</b>									
Enterprise value	225.3	221.6	218.9	228.9	224.7	219.7	209.5	197.7	189.6
Market Cap (USD bn)	202.8	199.5	193.9	204.8	205.7	201.8	193.2	189.3	190.2
Net debt (cash)	16,484	16,025	19,047	18,116	12,994	11,846	10,306	2,414	(6,598)
Pension provisions	5,419	5,495	5,495	5,495	5,495	5,495	5,495	5,495	5,495
Market value of minorities	624	608	472	472	472	472	472	472	472
Other items	0	0	0	0	0	0	0	0	0

Source: Company reports, MainFirst estimates





## Valuation

Our target price is primarily driven by our DCF. Using a WACC of 7.62% and a terminal growth rate of 1.4% for the group suggests fair value CHF93 per share.

### DCF valuation

Figure 8: DCF valuation of Novartis

YEAR TO DECEMBER (USD M)	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Core model assumptions										
Group revenue	48,518	49,109	52,451	54,297	56,062	58,496	61,577	63,320	65,112	67,429
EBITA (adj.) *	12,226	12,616	13,925	15,060	16,234	17,276	19,058	20,106	20,917	22,032
NOPLAT	10,115	10,124	11,143	11,917	12,749	13,489	14,755	15,488	16,047	16,827
Capex, net	(1,871)	(2,106)	(2,232)	(2,223)	(2,203)	(2,325)	(2,479)	(2,566)	(2,656)	(2,771)
Depreciation & Impairment	2,182	1,507	1,652	1,811	1,986	2,177	2,387	2,616	2,868	3,144
Change in working capital	(846)	(714)	542	(180)	(267)	(385)	(496)	(314)	(323)	(417)
Other operating items	(602)	1,965	744	922	963	919	845	927	933	996
Free operating CF (FoCF)	8,978	10,777	11,849	12,247	13,227	13,876	15,011	16,151	16,871	17,779
Group revenue, y/y (%)	(1.81)	1.22	6.81	3.52	3.25	4.34	5.27	2.83	2.83	3.56
EBITA margin (%)	25.20	25.69	26.55	27.74	28.96	29.53	30.95	31.75	32.13	32.67
Working-capital intensity (%)	19.75	19.10	18.60	18.30	18.20	18.10	18.00	18.00	18.00	18.00
Fixed-asset intensity (%)	216.81	213.55	197.00	185.71	175.13	163.24	150.66	142.04	133.60	124.45
Capex as a % of revenue	3.86	4.29	4.26	4.09	3.93	3.97	4.03	4.05	4.08	4.11
Capex as a % of Depreciation	85.75	139.73	135.11	122.75	110.94	106.79	103.87	98.08	92.59	88.14
Normalised tax rate	-17.3%	-17.3%	-17.3%	-17.3%	-17.3%	-17.3%	-17.3%	-17.3%	-17.3%	-17.3%
RoCE (NOPLAT) (%)		8.8	9.8	10.6	11.6	12.6	14.1	15.1	16.0	17.3
Free CF/CE (%)		9.4	10.4	10.9	12.1	12.9	14.3	15.7	16.9	18.3
DCF Parameters										
Interest-bearing liabilities as a % of (D+E)		Current	Target							
WACC		8.82%	10.00%	Common parameters						
NPV of FoCF '2018+		243,255	244,974	Terminal FCF growth						
+ Net cash (debt), current	YE'17	(19,047)	Risk-free rate							
- Tax adjusted Pension liabilities		(4,720)	Market risk premium							
- Minorities (Market value)		(472)	Beta							
+/- Other items			Cost of debt (pre-tax)							
= Equity value		219,016	220,735							
/ Number of shares (m)		2,371								
<b>= NPV per share (CHF)</b>		<b>92.7</b>	<b>93.5</b>							
Sensitivity analysis										
WACC	0.4%	0.9%	1.4%	1.9%	2.4%	2.9%	Terminal growth rate			
6.1%	110	118	128	141	157	177				
6.6%	100	107	115	124	136	152				
7.1%	91	97	103	111	121	132				
7.6%	84	88	94	100	108	117				
8.1%	77	81	86	91	97	104				
8.6%	72	75	79	83	88	94				
9.1%	67	69	73	76	81	85				

\*EBIT adjusted for interest charges on pension obligations

Source: MainFirst Research

### Peer group comparison

A peer group comparison suggests that a fair value for Novartis, assuming a 10% premium to the sector on 2019 PE multiples would be CHF 93 per share. This is clearly driven by Novartis’s low tax rate. At our new TP, the stock would trade at a 40% premium to the sector average for 2019/20 EV/EBITDA. Whilst we believe this would be warranted given the sustainable and competitive position that Novartis is building, relative to the sector it may act as a cap on share price growth from our price target, assuming today’s model remains valid.

Figure 9: Peer group valuation comparison

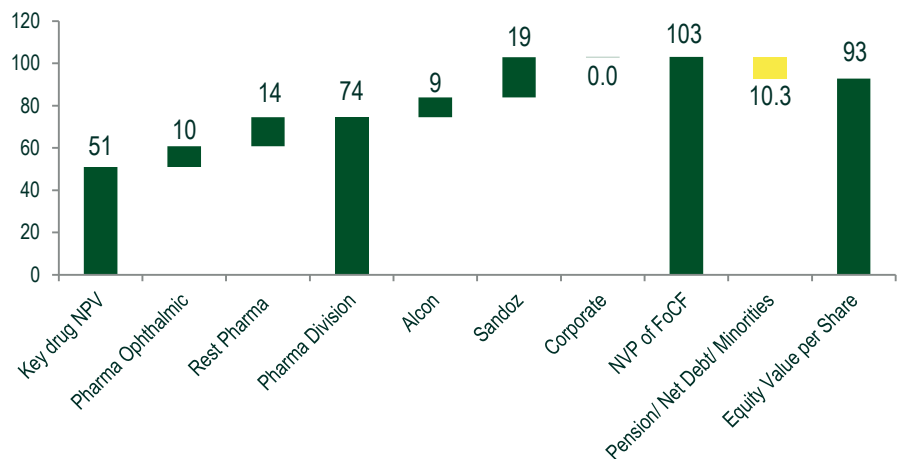
	Rating	Ticker	Price 1c	EV / EBITDA			P/E			CAGR EPS 17-21E
				2018E	2019E	2020E	2018E	2019E	2020E	
Roche Holding AG	Neutral	ROG VX	235	9.8x	9.3x	8.8x	14.4x	13.7x	12.9x	5.1%
AstraZeneca PLC*	N/R	AZN US	4,988	14.9x	13.2x	10.6x	19.5x	17.5x	14.6x	10.5%
Bayer AG	Outperform	BAYN GR	108	11.0x	10.2x	9.4x	16.6x	14.4x	13.1x	10.0%
GlaxoSmithKline PLC*	N/R	GSK LN	1,347	8.3x	8.1x	7.2x	12.7x	12.1x	11.5x	3.0%
Merck KGaA		MRK GY	91	12.0x	11.2x	10.4x	14.8x	13.6x	12.6x	5.2%
Novo Nordisk A/S*	N/R	NOVOB DC	348	12.3x	11.6x	10.8x	21.2x	19.8x	18.2x	8.1%
Sanofi	Neutral	SAN FP	72	9.1x	8.4x	8.0x	12.1x	11.0x	10.2x	6.3%
Novartis AG	Outperform	NOVN VX	86	15.6x	14.1x	12.8x	16.2x	14.7x	13.5x	10.9%
Sector median				11.5x	10.7x	9.9x	15.5x	14.1x	13.0x	7.2%
Novartis - our targeted premium							10%	10%	10%	
Implied multiple				11.5x	10.7x	9.9x	17.1x	15.5x	14.3x	
Implied share price				63.4	65.1	66.6	95.2	95.0	95.7	

Source: MainFirst Research, \* Bloomberg

### SoTP calculation

We have also constructed a divisional DCF. The components of our CHF93 price target can be seen in the chart below.

Figure 10: SOTP CHF



Source: MainFirst Research



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### COMPANY

Novartis

Source: MainFirst

### KEY

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Expected to underperform the STOXX Europe 600 by at least 5%  
Expected to perform broadly in line (+/- 5%) with the STOXX Europe 600

Source: MainFirst

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COMPANY	DATE	REC	PRICE
Novartis	02 Feb 17	Outperform	CHF 72.5
	24 Apr 16	Neutral	CHF 74.5
	27 Oct 15	Underperform	CHF 90.5
	14 Apr 15	Neutral	CHF 100.6

Source: MainFirst, Bloomberg (\*) O – Outperform, U – Underperform, N – Neutral, NR – Not rated

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Company Name	BLOOMBERG	EXCHANGE		Last close	Date	Rating	Price Target
	Code	Code	FX				
Roche Holding AG	ROG	SW	CHF	234.5	24/01/2018	Neutral	250.0
AstraZeneca PLC	AZN	AZN US	GBP	4987.5	24/01/2018	N/R	
Bayer AG	BAYN	BAYN GR	EUR	108.36	24/01/2018	Outperform	144.0
GlaxoSmithKline PLC	GSK	GSK LN	GBP	1347	24/01/2018	N/R	
Merck KGaA	MRK	MRK GY	EUR	90.52	24/01/2018	Outperform	120.0
Novo Nordisk A/S	NOVOB	NOVOB DC	DKK	347.65	24/01/2018	N/R	
Sanofi	SAN	SAN FP	EUR	72.31	24/01/2018	Neutral	75.0
Novartis AG		NOVN VX	CHF	85.90	24/01/2018	Outperform	93.0

Source: MainFirst Research



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