

Analyzing impact of a news on a publicly traded company course term paper example...

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Executive Summary

Stock Recommendation: BUY

Novartis, one of leading pharmaceuticals companies of world, is considering a proposed asset exchange with another pharmaceutical company- Merck and Co., according to a news report on Bloomberg. We have chosen to analyze the impact of the deal on Novartis. And we have concluded that if this deal falls through, it will create positive synergies for the company Novartis. We have determined the net effect of this deal on the revenue and profits of the Novartis and incorporated the synergies in our valuation to determine the intrinsic value of the company. Based on the valuation, we give the stock a BUY rating based on current stock price of the company.

Summary of the News Article Regarding Novartis

A Bloomberg article Novartis is considering exchanging its animal-health division for one of Merck & Co.'s assets rather than selling the division, according to close sources. Since Novartis has little use for extra cash, it may choose to swap the division for an asset that will strengthen the company in an area in which it's already a strong player. Merck's over-the-counter business is attractive to Novartis, but although it has not been clarified that Merck is open to that exchange.

Novartis animal-health division has also received interest from German drug-maker Boehringer Ingelheim GmbH, as well as from Lilly & Co. and Bayer AG (BAYN), according to several sources.

According to Merck, its animal health unit is the second largest in the world having revenues of USD 3.40 billion in 2012, whereas Citigroup Inc. analysts calculated a value of about USD 4.0 billion for Novartis's veterinary unit.

Sources in the last month said that Novartis is weighing selling several of its units, including Over-the-counter medicines and vaccines operation.

According to Novartis CEO Joe Jimenez, the company wants its units to be industry leaders in each of its divisions or it will think of divesting them. But it hasn't made any decision on divesting any of its units or divisions.

Novartis is working with Goldman Sachs to check options for its animal-health business and the other units, people having knowledge of company's plans.

Implication of the Actual Deal for Novartis

Here, we are assuming that the news of the article actually comes true, i. e. Novartis is able to exchange its animal health unit with Merck's over-the-counter unit. Now we have to look at the impact of removal of one unit and addition of another unit in case of Novartis. The animal health unit, part of Consumer Health division, of Novartis generated a revenue of USD 0.9bn in 2012, whereas the consolidated revenue of Novartis was USD 57.6bn.

Overall sales of that division declined by 19% in 2012 from 2011, compared to a decline of sales by 3% in the whole company. Also profit margins of the division is lower than that of the whole company.

Merck's Over the Counter unit is the largest part of Consumer health division of the company. Consumer health division of Merck generated about USD 472.5mn in revenue in 2012, approximately 4% of the total company revenue; whereas the division generated about USD 63mn in EBITDA,

approximately 2% of Group EBITDA.

So if assets of both companies are swapped, based on 2012 numbers, Novartis revenue will actually fall by USD 427mn, whereas its Operating Income will increase by USD 15mn. So the deal is value adding for Novartis, thus it should have a positive effect in the stock.

About the Company- Novartis:

Founded in 1996, Novartis is one of the largest pharmaceutical companies of the world with leading positions in pharmaceuticals, eye care, generic medicines, vaccines and diagnostics, and consumer health. Its main strength lies in innovating new drugs to meet the patient needs, and growing presence in new and emerging markets. According to IMS, the company was first among top 20 global corporations of 2012 by sales with revenues of USD 50.76bn.

Key Strategies of Novartis

The company sees focused diversification of healthcare portfolio as its key strategy. This strategy is supported by three priorities of the company:

1. Innovation through research and development: The core strategy of the company is growing via scientific innovation, prioritized on high-growth components of healthcare. In details, Novartis is focused more on innovation, whereas many other companies are outsourcing their R & D. In 2012, the company spent USD 9.3bn in Research & Development - the highest among Pharmaceutical companies and other industries.
2. Increasing growth through new launches and raising presence in Emerging Growth Markets: Innovative drugs have been contributing in the group's performance; in 2012, recently launched products drew about USD 16.3

billion or 29% of total net revenue.

The Company has also continued growth by presence in emerging growth countries (According to the company definition, all markets except the United States, Canada, Western Europe, Australia, New Zealand and Japan). In 2012, these economies contributed USD 13.8 billion or 24% of total sales of Novartis.

3. Growing productivity through efficiency initiatives: The Company attempts to operate as efficiently as possible by decreasing expenses and improving profitability, to have flexibility in further investments, but innovation and R & D are still the main priorities of Novartis. Considering several income statement items' CAGR (Constant Annual Growth Rate) from 2005 to 2012, it is clear that Novartis spent more on R & D, but was able to reduce SG & A Expenses allowing the company to have a higher operating income growth than gross margin growth.

A major source of productivity growth for the company is mergers and acquisitions. For example, the company realized merger-related cost synergy of about USD 370mn through full integration of Alcon (eye-care) which has become second largest division in the group.

Valuation:

WACC: We have calculated weighted average cost of capital of Novartis based on CAPM method; calculation is shown below:

FCF Valuation: Based on FCF (Free Cash Flow) method of valuation, taking into account that the deal with Merck is successful, the intrinsic value of Novartis becomes USD 87.67 per share for Dec 31, 2013, whereas the current price of Novartis is USD 76.84 per share, providing a return of 14%

(Assumed a Perpetual Growth Rate of 2.5%).

Given the valuation and leadership prospects of the company in the healthcare industry and with probable deal with Merck in the horizon, we give a BUY rating for the company at current pricing.

Appendix:

Projected Income Statement

Projected Balance Sheet

Assumptions

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