

Q2 2020 ESG Update for Investors and Analysts

July 24, 2020

Dear investors and analysts,

I hope this letter finds you and your families continuing to be safe and well.

In our second quarterly ESG update, we outline Novartis specific developments, ESG themes and respond to the top 10 questions you have asked. During the past quarter, we had several road shows and teleconferences dedicated to ESG. In total we engaged with fifty six institutions, representing just over a quarter of our issued share capital. The discussions primarily focused on our continuing response to the COVID-19 pandemic, settlements relating to longstanding legacy legal matters and the evolution of Novartis' approach to ESG. These, together with the "Top 10 ESG Questions" received and our responses are outlined below. We will provide a more comprehensive update on our annual ESG investor event on September 1, 2020 hosted by our CEO (invitations to be sent separately).

We hope this update is of interest and value your feedback. Thank you.

Novartis' evolving response to COVID-19

Our primary concerns remain the health and safety of our associates and patients while we also continue to take strong actions to help address the pandemic

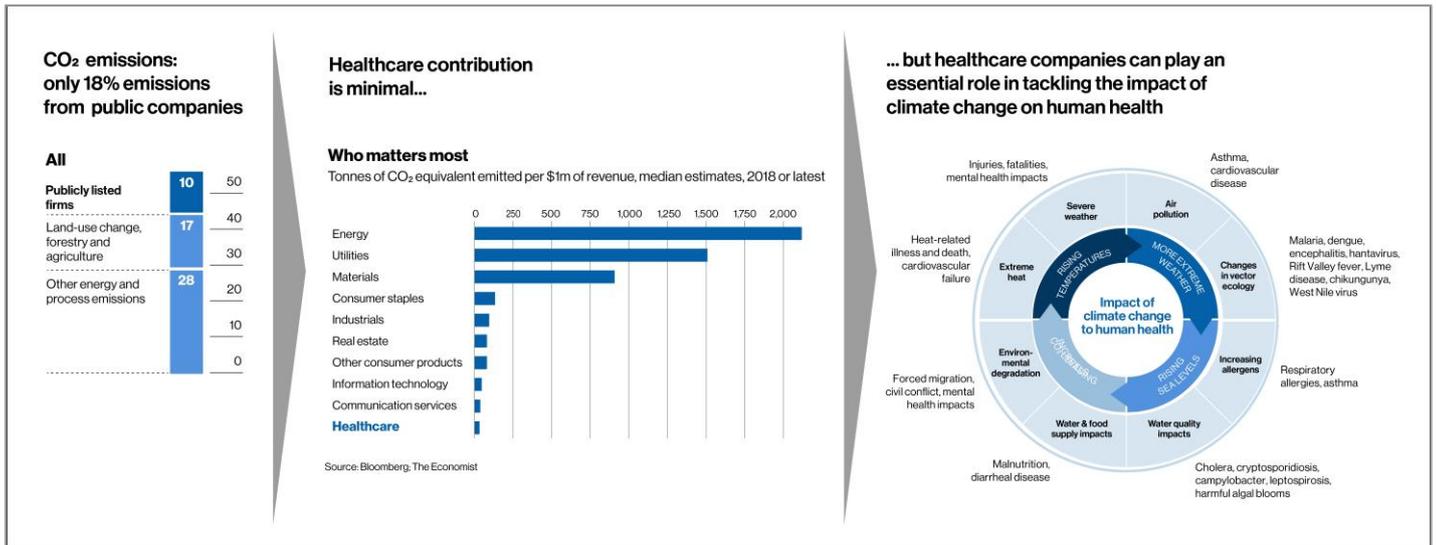
- During the second quarter, COVID-19 had an impact on our business with forward purchasing from the first quarter largely reversing. Despite this our operations remain stable with record high customer service levels. Our cash collections continue to be according to our normal trade terms, and days sales outstanding at normal levels. We implemented and embraced new ways of working, which include less travel and meeting costs. Novartis remains well positioned to meet its ongoing financial obligations and has sufficient liquidity to support our normal business activities.
- To support the global public health response, we continue to be engaged in **multiple collaborative R&D efforts, large scale clinical trials and donations to support local communities** in need (see also the information available at our COVID-19 Information Center: <https://www.novartis.com/coronavirus>): Phase III clinical trials evaluating canakinumab in patients with pneumonia as a result of SARS-CoV-2 infection, and ruxolitinib in combination with standard of care compared to SoC alone, in collaboration with Incyte, are continuing. Data readouts from these studies are expected in the second half of 2020. We continue to support 35+ ongoing investigator-initiated trials involving 10 Novartis medicines.
- In July, Novartis launched a first-of-its-kind **not-for-profit portfolio of medicines for symptomatic treatment of COVID-19**. The new portfolio of 15 medicines from the Sandoz division addresses urgent unmet needs of low- and lower middle income countries to treat patients with COVID-19 symptoms. The portfolio will be sold at no profit to governments in up to 79 eligible low- and lower middle income countries during the pandemic and until a vaccine or curative treatment is available.

Themes and comments from ESG investors on implications of COVID-19 and responses

We had very productive discussions with many of you during our ESG roadshows and summarized below are some of the key themes you raised as evolving ESG trends post COVID-19. Thank you for these insights.

- **ESG momentum growing** – not just amongst ESG specialists, but buy side analysts and portfolio managers as nearly all of you are integrating ESG analyses into investment decisions
- **Shift from shareholder primacy** to a greater focus on other stakeholders, particularly employees, customers and communities
- **"S" becoming very prominent** as focus shifting from "E" to "G" and in particular "S" for crises management

- “S” factors mentioned include employee, customer and supply chain management in general, and for **healthcare access and impact of medicines on patients**.
- Recommendation to include “S” **impact in corporate strategy**
- “R” **for resilience** of revenue, liquidity, supply chains has become the **centerpiece of good “G”**
- **Human capital management** at forefront for you the shareholder and for companies too (see above for Novartis)
- Increasing demand for the inclusion of **ESG metrics in compensation**
- Strengthening of non-financial considerations in capital allocation decisions, including closer scrutiny of dividend policy and buybacks for companies that receive financial support from governments during the pandemic
- Paying **fair share of corporate taxes** increasingly important as post COVID deficits rise sharply
- Security of supply chain more important than speed and costs. New UN guidelines on human rights in supply chains
- Technology adoption accelerated with longer term implications for “S” factors, including **cyber security**
- “E” **still relevant** for pharma, but focus **shifting to impact of climate change on human health** (see below)



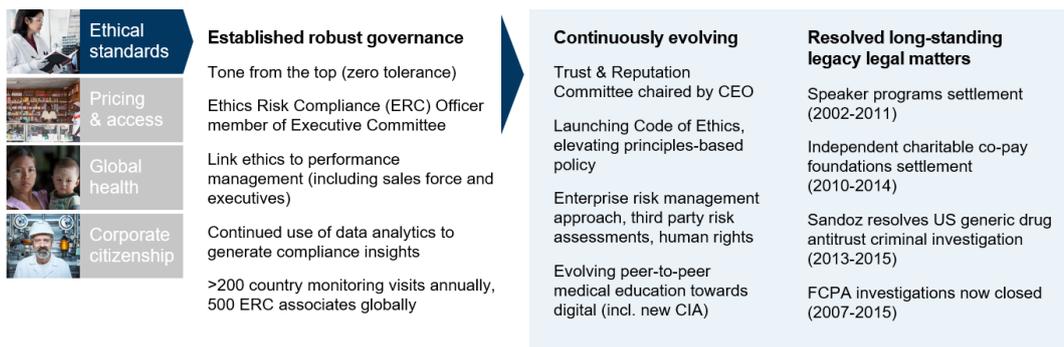
Resolving Novartis legacy legal matters

We are continuing our long term journey to build trust with society and during the second quarter we resolved our material legacy compliance issues.

- We finalized our USD 678 million settlement relating to a civil suit challenging speaker programs and other promotional events conducted in the US (2002 - 2011) as well as USD 51 million related to the company’s support of certain independent charitable co-pay foundations (2010 - 2014). Provisions for these settlements were previously made. Novartis has agreed to new corporate integrity obligations with the US Department of Health & Human Services ([link](#) to CIA) that will mean we will continue to evolve our approach to peer-to-peer medical education. Such education will transition towards a digital format in keeping with the changes that we have made and seen to be effective in recent months.
- All Foreign Corrupt Practices Act (FCPA) investigations into Novartis are now closed with the settlement that we have reached with the US Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC). As part of the settlements, Novartis and certain of its current and former subsidiaries agreed to pay USD 234 million to the DOJ and USD 113 million to the SEC.

These settlements are an important step in progressing our journey to build trust with society, a key strategic priority for Novartis as presented by the CEO at Q2 2020 earnings call July 21, 2020 (see below).

Progressing on our journey of building trust with society



Sustainalytics and ISS ESG improves Novartis ESG scores, recognizing progress on governance

As outlined in our first quarterly update, we recognize the importance of third party ESG rating agencies, who provide secondary data to our shareholders, enhancing their ability to evaluate ESG performance.

Sustainalytics has recently published its (1) Risk Report and (2) Controversies Report on Novartis. Both reports recognize progress made by Novartis including the recent settlements of legacy legal matters.

In summary:

- a. **Risk Report:** Overall risk score improved from almost 30 to just under 21. Now **Novartis ranks highest within the pharma peer group** and the pharmaceuticals subindustry (341 pharma companies), driven by strong management of material ESG issues. Also noted for strong corporate governance.
- b. **Controversy Report:** Controversy **level upgrade from 5** (severe in bribery & corruption) **to 3** (significant). Upgrade due to above, recent settlements, and the absence of no new issues.
- c. **Human Capital:** **Novartis ranked number 1 amongst pharma peer group** and in pharmaceuticals sub-industry.

Source: Novartis ESG Risk Rating Report, Controversy Report published by Sustainalytics July 9, 2020. <https://www.sustainalytics.com/esg-ratings>

ISS ESG (Oekom) published their ESG report on Novartis and continues to acknowledge our progress:

- a. Novartis is joint **sector leader** (out of 364 companies), with an improved rating from B- to grade B; outperforming industry performance for 1) access to medicines; 2) ethics in R&D; 3) business ethics, lobbying and ethical marketing.
- b. Significant improvement was acknowledged in the integration of sustainability performance objectives into the variable remuneration of the executive management team – upgraded from D+ to A+ on this indicator.

Source: Novartis ESG report published by ISS ESG on April 30, 2020. <https://www.issgovernance.com/esg/ratings/>

These improved scores are encouraging, though we recognize we can still go make further improvements in some areas. We will continue to place a relentless focus on our ESG framework and performance in the period ahead.

Top 10 ESG related questions from shareholders and our responses

Key questions on legacy issues and following the announcement of recent settlements

Question	Response
1 Are most material legacy compliance issues now resolved?	<ul style="list-style-type: none"> • Our material legacy compliance issues have now been resolved • Please refer to our Annual Report / 20-F page F-56 for other significant ongoing legal proceedings • With changes implemented, systems in place we are confident that we can avoid systemic issues (see question 4)
2 What has been reaction of ESG rating agencies to the settlements - will they incorporate into their updates?	<ul style="list-style-type: none"> • Sustainalytics has upgraded our rating from almost 30 to just under 21 which puts us highest within the pharma peer group (see details above) • We'll continue to work with the other ESG rating agencies to properly reflect the efforts Novartis is making
3 Will new CIA impact financial performance in US?	<ul style="list-style-type: none"> • We do not expect the changes required by the CIA to our speaker programs to have a material impact on our financial performance. • Over the past several years, Novartis Pharmaceuticals Corporation (NPC) has moved away from the traditional speaker program model. Specifically, since 2007: 1) We have decreased the number of Novartis speaker programs by approximately 81%; 2) The number of speakers participating in such programs has decreased by approximately 89%; 3) Our total spend on speaker programs has decreased by approximately 74% • With regard to the specifics of the CIA (link), it prohibits: a) Paying HCPs to deliver education to other HCPs, except in very limited circumstances such as the launch of a new medicine or indication, and this engagement must take place virtually and there are strict limits on payments. b) Hosting speaker programs in restaurants. c) Serving alcohol at a speaker program • Our investment in digital technologies over the past several years, combined with our recent experience engaging virtually with HCPs during the COVID-19 pandemic in many countries around the world, gives us the confidence that we will be able to execute on this digital transformation and fully support the Company's educational objectives with HCPs.
4 What guarantee exists that the company has changed and such events are unlikely to happen again?	<p>Company is different:</p> <ul style="list-style-type: none"> • Ethics and Compliance a strategic objective, endorsed and tracked by the Board and Executive Committee (2018). • Variable incentives structures changed to ensure appropriate behaviours through the organization and zero-tolerance for any misdeed. • Leadership accountability - country business reviews with senior management include ethics, risk and compliance reporting. • Overhauling our policies, cultural transformation, whistleblowing mechanism ("speak up office"). • Continuously evolving with the launch of our new Code of Ethics, integrated enterprise risk management and third party risk management covering all risk workstreams and human rights. • Evolved management report via compliance dashboard with centralized monitoring and remediation process in alignment with internal audit (integrated assurance).

Other general ESG questions

5 How have you changed your ESG strategy / priorities post COVID-19?	<ul style="list-style-type: none"> • COVID-19 validated our ESG priorities. For example, one of the key learnings from the pandemic is that healthcare systems strengthening is essential for access to innovation. COVID-19 reinforces the need to continue do more to strengthen healthcare systems across the globe as we implement the "Access Principles" throughout our portfolio. • Materiality analysis is central to our approach to ESG. Our materiality webinar series for ESG has continued with strong uptake - 2 recent sessions focused on our approach to access and COVID-19 pandemic response. For those who
---	--

	<p>could not participate, a recording is available here: https://www.novartis.com/investors/environmental-social-and-governance/materiality-assessments</p>
<p>6 What is your overall approach to pricing your medicines, in particular in low income countries (LICs)/ lower middle income countries (LMICs)?</p>	<p>We believe that responsible pricing needs to start with full transparency around four value pillars:</p> <ul style="list-style-type: none"> • Clinical value (i.e. improvement in mortality) • Patient value (i.e. improvement in quality of life) • System value (i.e. reduction in hospitalization) • Societal value (i.e. returning to more productive lives) <p>For LICs/LMICs, we are implementing a tiered pricing that considers socioeconomic factors, such as gross domestic product/national income per capita, human development index, income disparity and local affordability, which are now systematically used to guide the prices for launch brands.</p>
<p>7 Are you reporting in line with SASB, TCFD?</p>	<p>a) SASB: Yes, please refer to newly published SASB index: https://www.novartis.com/sites/www.novartis.com/files/novartis-sustainability-accounting-standards-board-sasb-index.pdf</p> <p>b) TCFD: We are currently evaluating.</p>

Progress on culture and compliance initiatives

<p>8 Can you comment on your progress on culture transformation?</p>	<p>We committed culture transformation as a key strategic priority in 2018, implementing several initiatives to catalyze the change:</p> <ul style="list-style-type: none"> • Rolled out significant campaign across the organization (tone from the top) • Linking culture to performance management; launched a pilot with >16,000 associates to evolve our performance management system • Employee survey frequency increased from every 2 years to quarterly • 100% of managers receive upward feedback on an ongoing basis; top leaders undergoing extensive leadership program • Committed significant training <p>We evolved our management reporting dashboard to measure our progress, systematically tracked at the CEO level. The metrics (from Microsoft Glint survey) have been trending positively – e.g. engagement score increased from 74 in 2019 to 80 as of May 2020 (vs. benchmark of 70), reaching an all-time high during the pandemic. These positive trends have encouraged us to continue our efforts on human capital, including a new flexibility policy to all office-based staff effective July 15, 2020.</p>
<p>9 Can you elaborate what the NEW code of ethics is? How are you rolling this out?</p>	<ul style="list-style-type: none"> • Code of Ethics is a principle-based policy co-created with >3,000 associates and external behavioral scientists • Serves as a guide for 1) decision making to help navigate situations that are complex or unclear; 2) understanding biases at play in ethical decision making • Online platform rolled out in June; policy effective September; e-training expected Q4 2020
<p>10 Klaus Moosmayer mentions enterprise risk management approach - what exactly is this? Can you provide more details?</p>	<ul style="list-style-type: none"> • Bottom-up approach of identifying and assessing risks (forms part of the strategic planning process) • Established mitigation actions for each with clear accountability • Mitigation actions monitored regularly • More details and top risks published: https://www.novartis.com/sites/www.novartis.com/files/novartis-enterprise-risk-management.pdf