NOVARTIS

Enrico Vanni
Vice Chairman of the
Board of the Directors

Chairman of the
Compensation Committee

Novartis International AG
Postfach
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February 8, 2017

Concerning: Response to the report issued by proxy advisor, Institutional Shareholder Services (ISS)

Dear shareholder,

The purpose of this letter is to set out the Novartis position in respect of the report issued by proxy advisor ISS on February 7, 2017 in advance of the upcoming Novartis Annual General Meeting (AGM).

All proposals by the Board of Directors on the agenda items of the AGM have been carefully considered and taken in the best interests of the company and its shareholders.

ISS has recommended to vote FOR the proposals by the Board with regard to Resolutions 5.1 and 5.2, respectively, the total maximum amount of Board compensation from the 2017 AGM to the 2018 AGM and the Executive Committee compensation for financial year 2018. **ISS' quantitative pay-for-performance evaluation also suggests the CEO pay-for-performance alignment is reasonable**, i.e. **'Low Concern' rating** (rating scale: Low, Medium and High Concern) according to ISS.

However, ISS has recommended to vote AGAINST the proposal of the Board with regard to Resolution 5.3, i.e. the Advisory Vote on the 2016 Compensation Report based on: (1) a one-time performance share grant worth USD 3.9 million made to F. Michael Ball, new CEO of Alcon, and (2) concerns on Novartis benchmarking practices given the base salary increases for the CEO and other Executive Committee members.

Given that ISS notes in its report that the Novartis compensation system is in line with market practice in many respects, and certain aspects of the company disclosures in the Compensation Report exceed market standards, the Board finds ISS' recommendation to vote AGAINST the 2016 Compensation Report difficult to understand.

The Board respects all shareholder votes on our Compensation Report, and is committed to continued engagement with shareholders to ensure a full understanding of diverse viewpoints. Before you cast your vote on Resolution 5.3, i.e. the Advisory Vote on the 2016 Compensation Report, please consider the following:

1. Compensation of F. Michael Ball, CEO of Alcon
ISS is concerned that, as a result of the one-time performance share grant, F. Michael Ball received a total, at grant value, compensation of USD 8.7 million for 2016, which represents an 80 percent increase in comparison to his predecessor.

Novartis success requires a strong culture of performance, a long-term orientation, and consistency of purpose among senior executives, all of which are reinforced by the design of our compensation program. The Board is convinced that the recruitment and compensation structure and level for Mr. Ball is in the best interests of delivering maximum shareholder returns, closely aligned with the achievements of the Alcon turnaround plan.

- The success of the **Alcon turnaround is an important factor in returning value to shareholders**. The Board and the CEO of Novartis decided to make a change in leadership and believe that Mr. Ball, new CEO of Alcon, is the right candidate to guide Alcon to recovery.
- **Mr. Ball has held various senior executive and CEO positions in the US ophthalmology and medical devices industry** and has demonstrated a track record of turning around and growing companies from his previous roles at Hospira and Allergan. He also has a strong focus on product and quality improvements with high ethical standards that will ensure a sustainable future for the Alcon business.
- In reaching the terms of the offer for Mr. Ball, **consistent with market practice** and compensation levels given his background and experience as a former CEO of a US-listed company, the Board decided to award him a **one-time target performance share unit grant of 50 000 shares subject to performance criteria over a three-year performance period (2016-2018)**, vesting in 2019 subject to the extent the performance conditions are met.
- The long-term award was made **on an exceptional basis and outside of our normal company's practices**. The **performance conditions directly relate to where the Alcon business needs to be within the next three years relative to peers**. The stretch targets include returning sales to significant growth and ahead of peers, returning the business to the market's operating income margin, successful product launches over and above market consensus, improving customer service and supply chain performance. This additional one-time award is appropriate and in the best interests of shareholders as there is **no overlap with the performance conditions of the three-year performance-period plans LTPP and LTRPP,** both of which have primarily Group focused performance conditions, **or with the short-term Annual Incentive**, which provides rewards based on, among others, achievement of absolute financial measures.
- We do not consider ISS' reported 80% increase in total at grant value compensation versus Mr. Ball's predecessor a meaningful comparison, given that this performance award is a one-off and not a recurrent annual grant. **Excluding the one-time performance share grant, Mr. Ball's at grant value annual compensation is comparable with market practice given his profile and experience**.

2. Salary increases for the CEO and other Executive Committee members

ISS notes in its report that several Executive Committee members received substantial increases in base salaries. ISS' concern is that these increases are solely based on benchmarking and the rationale not fully disclosed in the 2016 Compensation Report. Also, ISS challenges the company's benchmarking practices.

Our Executive Committee compensation system reflects our need to offer **competitive compensation packages at the median level of comparable roles at our direct competitors in the global healthcare industry**. While benchmarking information regarding executive pay is considered, **any decisions on compensation are ultimately based on careful consideration by the Board and Compensation Committee** of the specific business needs of Novartis and each executive's experience, responsibilities, skill sets and performance. The Board and the Compensation Committee decided that these increases in base salary were justified and reflective of our philosophy of attracting, rewarding and retaining top executive talent.

- After three consecutive years of no increase and close monitoring of the CEO compensation, the Board decided to increase the CEO target total compensation, including a base salary increase of 1.9% effective March 1, 2016, as disclosed on page 123 of the 2016 Compensation Report. Even with this increase, **CEO target total compensation continues to be below the 25th percentile level** of our global healthcare peer group based on an analysis from the Compensation Committee's independent external compensation advisor (Frederic W. Cook & Co., Inc). See analysis in Appendix A to this letter.

- ISS focuses solely on one aspect of the compensation system, i.e. base compensation, without consideration for the variable compensation. More meaningfully, Novartis disclosed, on a voluntary basis, CEO realized compensation in its 2016 Compensation Report. **CEO's total realized compensation excluding dividend equivalents is 14% lower than his target total compensation for 2016**. It was also lower than last year's CEO realized compensation.
- The increases received by certain Executive Committee members are consistent with the Compensation Committee's decision to bring their **compensation closer to the median level over a period of 3 or 4 years** following their appointment to the Executive Committee, **which was warranted by performance**. In addition, **certain Executive Committee members received additional responsibilities**. The Compensation Committee is fully aware that these gradual adjustments require annual base salary increases over and above the market merit increase/inflation for a period of time. **Like for the CEO, a number of Executive Committee members are tracking below the median market benchmark based on an analysis of our specialist external provider** (Willis Towers Watson), and reviewed by the Compensation Committee independent external compensation advisor. See analysis in Appendix B to this letter.
- The Novartis global healthcare peer group, which is the only peer group used to benchmark CEO and other Executive Committee members' target compensation, includes both European and US companies accurately reflecting the competitive pharmaceutical and biotechnology landscape of Novartis. As disclosed on page 114 of the 2016 Compensation Report, the global healthcare peer group is the most relevant benchmark given the fierce competition within the pharmaceutical and biotechnology industries for top executive talent.

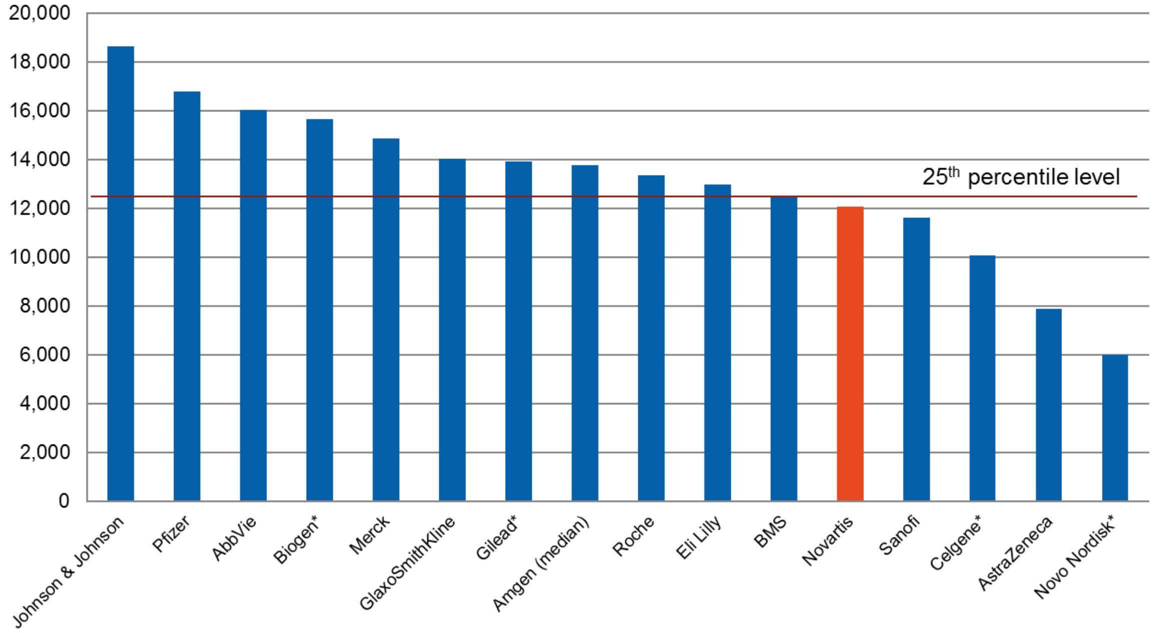
Novartis is committed to the highest standards of corporate governance on all matters including compensation, transparency and disclosure. During the last years, we have taken steps to further strengthen our corporate governance by implementing the rules of the Ordinance against Excessive Compensation in Stock Exchange Listed Companies, introducing annual elections of the Chairman of the Board, of all Board members, and of Compensation Committee members. In addition, in 2014, we conducted an extensive review of our compensation systems and related disclosure. As a result of the review, we enhanced our compensation structure and disclosure to better align with our shareholders' interests. We continue to critically review our compensation system each year to ensure it remains the most appropriate approach for Novartis and our shareholders.

We will endeavour to address any issues or suggestions shareholders may have regarding our compensation system in the coming months, and will seek to incorporate changes that our shareholders consistently register. Engagement with our shareholders on governance and compensation is an important component and critical to our company long-term success. We are happy to speak with you on this or any related matters at your convenience.

Yours respectfully,

Enrico Vanni
Vice Chairman of the Board of the Directors
Chairman of the Compensation Committee

APPENDIX A – 2016 CEO Target Total Compensation (in CHF thousands)



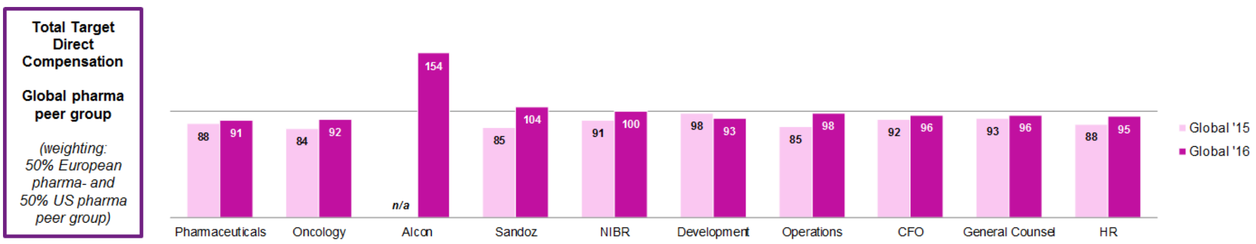
* Represents new peer company

Data source: Frederic W. Cook & Co. Inc., independent external compensation advisor for the Novartis Compensation Committee. All incentive plans are at target value, based on 100% achievement of target

APPENDIX B – 2016 Other Executive Committee members Target Total Compensation vs. benchmark median

With the exception of Alcon's specific situation already explained in this letter, all Executive Committee members are below the median level of the external benchmark, i.e. the global healthcare peer group. The graphs below illustrate the ratio (Novartis' levels as % of median market levels) of Novartis' Executive Committee positions versus the global healthcare peer group. Please note that:

- A ratio below/above 100 indicates a below/above median market positioning, and
- The composition of both the European and US pharmaceutical peer group changed compared to last year, from 12 to 15 healthcare companies.



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