Johnson & Johnson (JNJ)

Updated July 17th, 2018 by Nate Parsh

Key Metrics

Current Price:	$129	**5 Year CAGR Estimate:**	7.6%	**Volatility Percentile:**	4.8%
Fair Value Price:	$129	**5 Year Growth Estimate:**	4.8%	**Momentum Percentile:**	33.1%
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	-0.1%	**Valuation Percentile:**	61.7%
Dividend Yield:	2.9%	**5 Year Price Target**	$162	**Total Return Percentile:**	49.4%

Overview & Current Events

Johnson & Johnson is a diversified health care company and a leader in the area of pharmaceuticals (~49% of sales), medical devices (~34% of sales) and consumer products (~17% of sales). JNJ was founded in 1886 and employs more than 125,000 people around the world. The company generated more than $76 billion in revenues in 2017.

Johnson & Johnson has spent heavily on acquiring companies that fit with its business model. One such is example is the company's $30 billion all-cash purchase of Actelion, which closed on June 16th, 2017. Actelion brings to Johnson & Johnson a line-up of high margin medicines for rare diseases that are already contributing to earnings.

On July 12th, 22 women, who claimed asbestos in JNJ's talc-based products caused ovarian cancer, were awarded punitive damages totaling more than $4 billion by a Missouri jury. This is on top of the $550 million the jury had already awarded. The company will appeal and has been successful in other such cases, though there are more than 9,000 lawsuits currently pending. The FDA has stated that there is no asbestos in JNJ's baby power and talc is safe for use.

JNJ released 2nd quarter earnings on July 17th. JNJ earned $2.10 per share, 15% above Q2 2017's results and topping expectations by $0.03. The company's revenue grew 10.6% to $20.83 billion, beating estimates by $440 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$4.57	$4.63	$4.76	$5.00	$5.10	$5.52	$5.70	$5.48	$5.93	$7.30	***$8.12***	***$10.27***
DPS	$1.80	$1.93	$2.11	$2.25	$2.40	$2.59	$2.76	$2.95	$3.15	$3.32	***$3.54***	***$5.06***

JNJ has grown earnings over the past 10 years at a rate of 4.8%. The company managed to grow earnings before, during and after the last recession, showing that JNJ's products are in demand regardless of market conditions. Because of improving business performance and tax reform, the company forecasts that earnings per share will grow by 11% in 2018. We expected earnings to grow at the historical rate going forward. JNJ raised the midpoint of its earnings forecast to $8.12, $0.02 above the prior guidance range.

The Pharmaceutical division had robust growth of nearly 20% in the quarter. The company's acquisition of Actelion contributed 6.6% of this growth. JNJ's line of immunology (+13%) and oncology (+42%) drugs performed very well during the quarter. *Stelara*, which treats immune-mediated inflammatory diseases, grew 36%. In oncology, *Simponi*, which treats skin cancer, had revenue growth of 25% while *Zytiga*, treatment for prostate cancer, had sales increase 63%. *Zytiga* is expected to see generic competition increase by the end of 2018. The Medical Device segment posted 3.7% growth, helped by 2.5% organic growth and 3.5% positive currency impact in international markets. Sales for the Consumer division grew 0.7% from Q2 2017. Growth in over-the-counter products like Tylenol and digestive health were offset by decreases in sales from baby care products.

JNJ has increased its dividend for the past 55 years and has an average raise of 7.4% over the past 10 years. JNJ gave shareholders a 7.1% increase on April 26th. Applying the average growth to the current dividend and investors could receive $5.06 in dividends by 2023. Based off our estimates, this would result in a payout ratio below 50%.

Disclosure: This analyst has a long position in the security discussed in this research report.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.3	12.5	13.1	12.7	13.1	15.6	17.7	18.2	19.1	20.9	***15.9***	***15.8***
Avg. Yld.	2.8%	3.3%	3.4%	3.5%	3.6%	3.0%	2.7%	3.0%	2.8%	2.6%	***2.9%***	***3.1%***

Based off of Monday's closing price, shares of JNJ have a current earnings per share multiple of 15.9. We feel shares are fairly valued relative to the stock's historical multiple. If shares were to return to their decade long average multiple of 15.8, the stock could see P/E reversion of just 0.1% annually through 2023. JNJ pays a generous dividend and the stock's current yield (2.9%) is well above that of the S&P 500's and just above that of the 10-year Treasury Bond.

Safety, Quality, Competitive Advantage, & Recession Resiliency

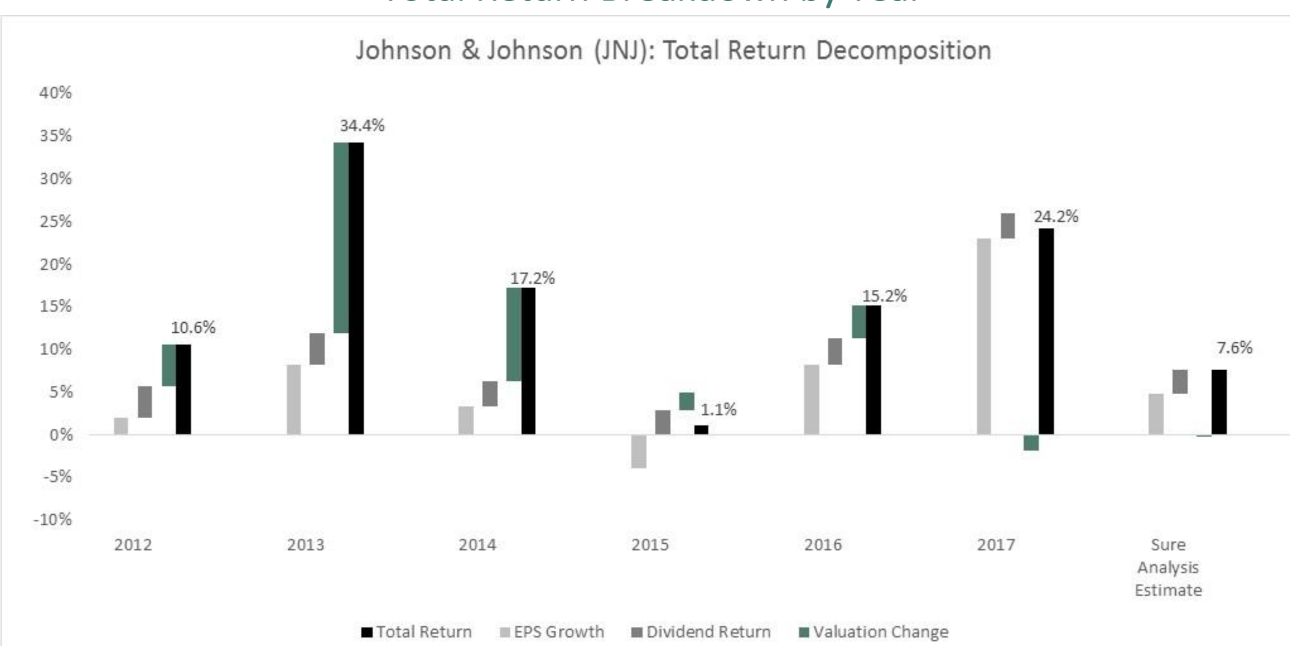
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	53.4%	45.9%	41.6%	39.3%	37.6%	36.9%	39.6%	36.4%	35.6%	32.5%	***34%***	***39.9%***
Debt/A	49.9%	46.6%	45%	49.8%	46.6%	44.2%	46.5%	46.7%	50.1%	61.8%	***59.2%***	***48.7%***
Int. Cov.	234.6	44.9	50	26.9	30.6	39.1	45.3	46.6	57.3	33.9	***39.3***	***60.9***
Payout	39.4%	41.7%	44.3%	45%	47.1%	46.9%	48.4%	53.8%	53.1%	45.5%	***43.6%***	***49.3%***
Std. Dev.	30.4%	17.8%	13%	17.5%	9.8%	12.8%	14.7%	16.4%	13.3%	11.5%	***12.3%***	***15.7%***

Based on the company's ability to improve earnings in 2008 and 2009, JNJ can be considered a recession proof company. By having a diversified business model of drugs, devices and consumer products, JNJ is insulated to a certain degree from business slowdowns in any one division. JNJ has a reasonably low dividend payout ratio. This gives JNJ ample room to raise its dividend even in a prolonged recession. If EPS grows at a faster than historical rate, the dividend could grow at a much higher rate.

Final Thoughts & Recommendation

After factoring in second quarter earnings results and $6 increase in share price since our last update, we expect shares of Johnson & Johnson to return 7.6% annually, down from our previous estimate of 8.6%. This is a combination of earnings growth (4.8%), dividend yield (2.9%) and multiple reversion (0.1%). Still, Johnson & Johnson offers one of the longest dividend growth streaks available to investors and has a AAA credit rating from Standard & Poor's (one of just two companies). While this remarkable steady and safe company has increased in price slightly, we continue to recommend investors consider purchasing Johnson & Johnson. We reaffirm our five-year price target of $162.

Total Return Breakdown by Year



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