



Johnson & Johnson (JNJ)

Updated July 16th, 2019 by Nathan Parsh

Key Metrics

Current Price:	\$133	5 Year CAGR Estimate:	9.2%	Volatility Percentile:	11.0%
Fair Value Price:	\$136	5 Year Growth Estimate:	6.0%	Momentum Percentile:	50.9%
% Fair Value:	98%	5 Year Valuation Multiple Estimate:	0.4%	Growth Percentile:	52.7%
Dividend Yield:	2.8%	5 Year Price Target	\$181	Valuation Percentile:	63.0%
Dividend Risk Score:	A	Retirement Suitability Score:	A	Total Return Percentile:	58.1%

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). Johnson & Johnson was founded in 1886 and employs more than 125,000 people around the world. The company has a market cap of \$351 billion, with annual sales in excess of \$81 billion. Johnson & Johnson has spent heavily on acquiring companies that fit with its business model. One such example is the company's \$30 billion all-cash purchase of Actelion, which is already contributing to earnings.

On December 14th, *Reuters* released research that stated Johnson & Johnson knew its baby powder could be contaminated with asbestos. After examining documents, the report stated that the company discussed ways to address the issue between 1971 and the early 2000s. Johnson & Johnson has denied this report, but the company has more than 12,000 product liability lawsuits related to its baby powder. The stock was down 10% the day of the *Reuters* report.

On July 12th, it was announced that the U.S. Department of Justice is pursuing a criminal investigation against Johnson & Johnson for allegedly misleading the public about the possible cancer risks of its talcum powder products.

Johnson & Johnson released financial results for the second quarter on July 16th. The company's adjusted earnings-per-share was \$2.58 for the quarter. This was \$0.14 higher than analysts had expected and a 23% increase from the prior year. Revenue declined 1.3% to \$20.6 billion, though this was \$170 million above consensus estimates.

Pharmaceutical sales improved 1.7% to \$10.6 billion. Sales for Oncology, the strongest performer in the group, were up nearly 10% in the quarter. *Darzalex*, which treats multiple myeloma, improved 52% worldwide, with nearly 90% growth in international markets. Immunology sales grew 4%, mostly due to a 16% increase in sales for *Stelara*. *Stelara* treats immune-mediated inflammatory diseases and is Johnson & Johnson's highest grossing product. Sales for the Consumer segment increased 1.1% to \$3.5 billion. The Beauty division improved 8.4% as Neutrogena and Aveeno made market share gains in the quarter. Currency headwinds negatively impacted the Consumer segment, reducing reported sales by 3.4%. Medical Devices was the lone segment to produce a decline, with revenues falling 6.9% to \$6.5 billion. One bright spot was Interventional Solutions, which grew 12.6% due to double-digit increases in Atrial Fibrillation business. Most of the other businesses within this segment posted year-over-year declines. Surgery performed the worst, declining 6.5%. This was primarily due to a recall of a temporary stapler. Orthopedics was down just 1.6%, which is an improvement over previous quarters. Johnson & Johnson maintained its earnings-per-share expectations of \$8.58 for 2019, but increased its range for expected revenue to \$80.8 billion to \$81.6 billion from \$80.4 billion to \$81.2 billion previously.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$4.63	\$4.76	\$5.00	\$5.10	\$5.52	\$5.70	\$5.48	\$5.93	\$7.30	\$8.18	\$8.58	\$11.48
DPS	\$1.93	\$2.11	\$2.25	\$2.40	\$2.59	\$2.76	\$2.95	\$3.15	\$3.32	\$3.54	\$3.70	\$4.95
Shares	2754	2738	2724	2779	2821	2783	2755	2707	2683	2650	2700	2500

Johnson & Johnson 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 the company's products are in demand regardless of market conditions. We expect earnings-per-share to grow at a rate of 6% per year through 2024 due to gains in revenue and share repurchases. This is consistent with Johnson & Johnson's earnings growth composition in the past, however,

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most growth will come from revenue expansion as the buyback is good for a low single-digit gain annually. The company increased its dividend 5.6% for the June 11th payment, and has now increased its dividend for the past 57 years.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Avg. P/E	12.5	13.1	12.7	13.1	15.6	17.7	18.2	19.1	20.9	16.7	15.5	15.8
Avg. Yld.	3.3%	3.4%	3.5%	3.6%	3.0%	2.7%	3.0%	2.8%	2.6%	2.6%	2.8%	2.7%

Shares of Johnson & Johnson have decreased \$6, or 4.3%, since our April 17th update, mostly due to announced DOJ investigation. Using the current share price and midpoint for earnings-per-share for the year, Johnson & Johnson trades with a price-to-earnings ratio of 15.5. The stock has a 10-year average P/E of 15.8. If shares were to reach our target P/E by 2024, then valuation could add 0.4% to annual returns over this time frame.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	42%	44%	45%	47%	47%	48%	54%	53%	46%	43%	43%	43%

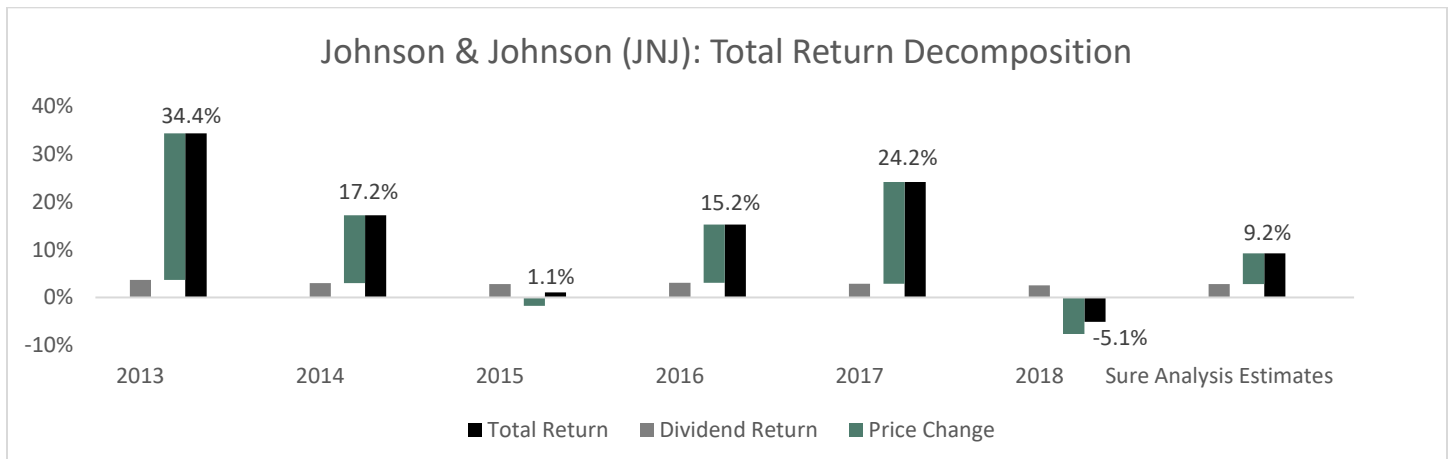
Johnson & Johnson has a reasonably low dividend payout ratio. This gives the company ample room to raise its dividend, even in a prolonged recession.

One of Johnson & Johnson's key competitive advantages is the size and scale of its business. The company is a worldwide leader in a number of healthcare categories. Johnson & Johnson's diversification allows it to continue to grow even if one of the segments is underperforming. This can be seen in the last quarterly report where declines in Medical Devices and Consumer were offset by Pharmaceuticals.

Final Thoughts & Recommendation

After reviewing second quarter results, Johnson & Johnson is now expected to offer a total annual return of 9.2% over the next five years, up from our previous forecast of 8.1%. While the Pharmaceutical division's growth wasn't as robust as previous quarters, the company continues to see strong gains in most of its top-selling products. Medical Devices remains a headwind, but losses in the Orthopedics business were less than in prior quarters. Johnson & Johnson continues to face lawsuits regarding its talcum powder products. Still, we find that the stock trades below our fair value estimate. Given the company's dividend growth history, shares of Johnson & Johnson receive a buy recommendation from Sure Dividend at this time.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	61897	61587	65030	67224	71312	74331	70074	71890	76450	81581
Gross Profit	43450	42795	44670	45566	48970	51585	48538	50101	51011	54490
Gross Margin	70.2%	69.5%	68.7%	67.8%	68.7%	69.4%	69.3%	69.7%	66.7%	66.8%
SG&A Exp.	19801	19424	20969	20869	21830	21954	21203	20067	21520	22540
D&A Exp.	2774	2939	3158	3666	4104	3895	3746	3754	5642	6929
Operating Profit	16663	16527	16153	15869	18377	20959	18065	20862	18489	20049
Op. Margin	26.9%	26.8%	24.8%	23.6%	25.8%	28.2%	25.8%	29.0%	24.2%	24.6%
Net Profit	12266	13334	9672	10853	13831	16323	15409	16540	1300	15297
Net Margin	19.8%	21.7%	14.9%	16.1%	19.4%	22.0%	22.0%	23.0%	1.7%	18.8%
Free Cash Flow	14206	14001	11405	12462	13819	14996	16106	15541	17777	18531
Income Tax	3489	3613	2689	3261	1640	4240	3787	3263	16373	2702

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	94.7	102.9	113.6	121.3	132.7	130.4	133.4	141.2	157.3	153.0
Cash & Equivalents	15810	19355	24542	14911	20927	14523	13732	18972	17824	18107
Acc. Receivable	9646	9774	10581	11309	11713	10985	10734	11699	13490	14098
Inventories	5180	5378	6285	7495	7878	8184	8053	8144	8765	8599
Goodwill & Int.	31185	32010	34276	51176	50745	49054	47393	49681	85134	78064
Total Liabilities	44094	46329	56564	56521	58630	60606	62261	70790	97143	93202
Accounts Payable	5541	5623	5725	5831	6266	7633	6668	6918	7310	7537
Long-Term Debt	14541	16773	19627	16165	18180	18760	19861	27126	34581	30480
Total Equity	50588	56579	57080	64826	74053	69752	71150	70418	60160	59752
D/E Ratio	0.29	0.30	0.34	0.25	0.25	0.27	0.28	0.39	0.57	0.51

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	13.7%	13.5%	8.9%	9.2%	10.9%	12.4%	11.7%	12.0%	0.9%	9.9%
Return on Equity	26.4%	24.9%	17.0%	17.8%	19.9%	22.7%	21.9%	23.4%	2.0%	25.5%
ROIC	20.5%	19.3%	12.9%	13.8%	16.0%	18.1%	17.2%	17.5%	1.4%	16.5%
Shares Out.	2754	2738	2724	2779	2821	2783	2755	2707	2683	2650
Revenue/Share	22.19	22.08	23.43	23.90	24.79	25.95	24.91	25.78	27.85	29.90
FCF/Share	5.09	5.02	4.11	4.43	4.80	5.24	5.73	5.57	6.48	6.79

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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