

JOHNSON & JOHNSON

(as at May 31, 2020)

Business Description:

Johnson & Johnson, together with its subsidiaries, researches and develops, manufactures, and sells various products in the health care field worldwide. It operates in three segments: Consumer, Pharmaceutical and Medical Devices. The Consumer segment offers baby care, oral care, beauty, over-the-counter medicine products under well-known brands such as Johnson's, Listerine, Aveeno, Neutrogena, Benadryl and Tylenol. The Pharmaceutical segment offers products in various therapeutic areas, including immunology, infectious diseases, neuroscience, oncology, pulmonary hypertension and cardiovascular diseases. The Medical Devices segment provides orthopedic products, general surgery, biosurgical, endomechanical, diabetes care and vision care products. The company was incorporated in 1887 and is based in New Brunswick, New Jersey.

Investment Thesis:

- **Global market leader position in three key segments with broad offerings of products and services.** Johnson & Johnson has established a strong global reputation with well-known consumer brands and some of the most popular over-the-counter medicines such as Tylenol and Benadryl. The company has also demonstrated strong clinical results within the Pharmaceutical division across multiple therapeutic areas.
- **The company has shown strong and consistent cash flows and growth historically.** Johnson & Johnson has provided an 11.8% per annum 10-year total return as in 2019 to shareholders which demonstrates its commitment to returning value to shareholders. In addition, the company has seen 36 consecutive years of operational earnings growth.
- **The company has demonstrated robust value creation through appropriate capital allocation and research and development (R&D) investment.** In 2019, over \$11 billion was invested in R&D, which has allowed the company to grow its strong pharmaceutical and medical devices pipeline. The company positions itself well as a leader within the pharmaceutical industry to serve the increasingly aging population demographic.

Industry Drivers/Trends

Pharmaceutical, Consumer Packed Goods and Medical Devices:

- The largest driver of growth within the healthcare industry is the changing population demographic in the world. As the global population ages, the demand for innovative disease treatment and medical devices will develop rapidly.
- Another driver of growth is within emerging markets like Asia, Africa and Latin America. Many of these emerging markets are growing rapidly and expanding healthcare coverage. Johnson & Johnson has established themselves globally and the company is strategically positioned well to grow their presence in these countries as well.
- With changing healthcare and drug access legislation, more emphasis will be placed on lower drug prices and

generic medicines. Johnson & Johnson is positioned well to counter these healthcare reforms, with much of their revenue generated from a wide variety of generic brands.

Competitive Advantages:

- Accessibility to growth opportunities
- Strategic partner of choice with governments and public health organizations
- Robust portfolio of products and solutions
- Economies of scale and other size based efficiencies

Competitors:

- **Consumer Packed Goods:** Unilever PLC, Reckitt Benckiser Group PLC, The Procter & Gamble Company
- **Pharmaceutical:** Abbott Laboratories, Bristol-Myers Squibb Company, Merck & Co., Inc., Novartis AG, Pfizer Inc., Bayer AG
- **Medical Devices:** Medtronic plc, PLC, Philips Healthcare, Boston Scientific Corporation, Abbott Laboratories

Customers:

- **Consumer Packed Goods:** Consumer Packed Goods: Wholesalers, distributors, end consumers
- **Pharmaceutical:** Surgeons, pharmacies, hospital purchasers & GPOs (group purchasing organizations)
- **Medical Devices:** Nurses, hospital purchasers, clinical specialists

Barriers to Entry:

- **Regulatory Requirements:** The pharmaceutical industry is regulated very heavily by regulatory bodies such as the FDA in the U.S. These regulatory requirements serve as a barrier to entry for new companies attempting to enter the market with a novel drug.
- **Intangible Assets:** Many of the drugs in the pipeline as well as the patented drugs required heavy upfront R&D costs which generally deters new entrants into the industry.
- **Economies of Scale:** The "Big Pharma" companies are able to leverage their size to reach economies of scale and decrease costs, making it more operationally profitable for them. New companies attempting to enter the market may find it difficult to operate without possessing economies of scale.

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Officers and Directors:

Alex Gorsky, Chairman & Chief Executive Officer; **Peter Fasolo**, EVP & Chief Human Resources Officer; **Paul Stoffels**, Vice Chairman & Chief Scientific Officer; **Joseph J. Wolk**, EVP & Chief Financial Officer; **Jennifer Taubert**, EVP & Worldwide Chairman of Pharmaceuticals.

Capital Allocation/Uses:

Johnson & Johnson has demonstrated a strong capital allocation strategy, investing in organic growth needs and splitting free cash

flow between investment in M&A (mergers and acquisitions) and capital returned to shareholders.

The capital allocation strategy in fiscal year 2019 is as follows:

- \$11.4 billion invested in R&D
- \$9.9 billion paid in dividends to shareholders
- \$4.1 billion in share repurchases
- Acquired Auris Health, Inc. for \$3.4 billion on Feb. 13, 2019
- Acquired Ci:z Holdings Co., Ltd. for \$2.1 billion on Oct. 23, 2018

Financial Summary:**Income Statement (USD millions, years ended December 31st)**

	2015	2016	2017	2018	2019
Revenue	70,074.0	71,890.0	76,450.0	81,581.0	82,059.0
R&D Costs	(8,999.0)	(9,143.0)	(10,594.0)	(10,775.0)	(11,355.0)
EBIT	51,302.0	52,445.0	59,326.0	63,976.0	64,692.0
Profit before Tax	50,878.0	52,087.0	58,777.0	63,582.0	64,731.0
Net Profit	15,409.0	16,540.0	1,300.0	15,297.0	15,119.0
EPS (Diluted)	5.48	5.93	0.47	5.61	5.63
Dividends per Share	2.95	3.15	3.32	3.54	3.75

Balance Sheet

Total Assets	133,411.0	141,208.0	157,303.0	152,954.0	157,728.0
Long-Term Debt	12,857.0	22,442.0	30,675.0	27,684.0	25,494.0
Total Equity	71,150.0	70,418.0	60,160.0	59,752.0	59,471.0

Statement of Cash Flow

Cash Flows from Operations	19,569.0	18,767.0	21,056.0	22,201.0	23,416.0
Cash Flows from Investing	(77,353.0)	(4,761.0)	(14,868.0)	(3,167.0)	(6,194.0)
Cash Flows from Financing	(11,136.0)	(8,551.0)	(7,673.0)	(18,510.0)	(18,015.0)

Key Ratios and Figures (%)

Operating Margin, EBIT	73.2%	73.0%	77.6%	78.4%	78.8%
Return on Equity	21.9%	23.4%	2.0%	25.5%	25.4%

Source: Johnson & Johnson 2019 Annual Report; Wall Street Journal

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