

Rating	Buy
Price (28 Aug 2020, \$)	153.64
Price Target (\$)	168.50
Market Cap (\$ B)	402.769
Enterprise value (\$ B)	411.61

Target price is an estimate based on past data

Research Analysts

Joshua Bissell
Josh@edralexponential.co.uk

Jay Hughes
Jay@edralexponential.co.uk

Johnson & Johnson (JNJ)

COMMENT

‘JNJ ink \$6.5B on Momenta buyout to bag autoimmune drug’

Johnson & Johnson has struck a deal to buy Momenta Pharmaceuticals for \$6.5 billion. The takeover will give J&J control of an anti-FcRn antibody that completed a phase 2 trial in myasthenia gravis earlier this year. This works out at \$52.50 a share in cash when the Momenta stock closed just above \$30 the day previous. When news broke of the deal, investors drove up the share price by around 70% to a value of \$6.1B (Just shy of the \$6.5B offer made). J&J’s willingness to pay that much reflects its belief that Momenta can give it multiple blockbuster launches. Nipocalimab is in clinical development in myasthenia gravis, warm autoimmune hemolytic anemia (wAIHA) and hemolytic disease of fetus and newborn.

Share Price Performance



Financial and valuation metrics

Year	30/06/20	31/03/20	31/12/19
Market Cap (\$B)	370.19	345.19	384.00
EV (\$B)	379.75	353.59	395.28
EV/Rev	20.71	17.09	19.05
EV/EBITDA	66.49	42.70	64.60
Trailing P/E	21.94	23.29	27.78
Forward P/E	18.15	14.64	6.05
Price/Sales	4.55	4.29	4.82
Price/Book	6.04	5.80	6.60

Performance	JNJ	SPX	PFE	Year	28/08/20
TTM (%)	+0.79	+1.26	+0.66	Trailing annual dividend rate	4.04
1W (%)	+0.09	+1.15	+0.94	Trailing annual dividend yield	2.52%
2W (%)	+1.25	+4.16	+2.90	5 Year average dividend yield	2.66
1M (%)	-0.90	+0.47	+1.63	Debt/Equity	48.26
3M (%)	+4.45	+11.10	+6.06	BV/Share	23.92
1Y (%)	+0.94	+0.43	+2.15	Float (\$B)	2.63

Performance comparisons:

- Pfizer (PFE) is the main US competitor of JNJ. This company has performed similarly over the recent Covid-19 crisis (this is due to an increase in need for pharmaceutical companies – e.g. vaccine creation). Due to the size of this company it is strong competition and it is also currently testing a vaccine called Pfizer-BioNTech in Canada. Although PFE is a slightly different concept it is mainly included to show the difference between a same-industry competitor and the research subject.
- JNJ used to gain a large proportion of their revenue through “pharmaceutical sales”. However, after the Covid-19 fall all sectors were faced with times of uncertainty (hence the significant drop). JNJ released news of testing and an approval case with the FDA where if accepted could lead to FDA trials (involving 60,000 living anatomies – inking placebo’s). The recovery is likely to be caused by this, but the market is likely to react strongly if positive news is released.
- SPX is the top 500 US companies on a market cap basis. Both the NYSE and NASDAQ float this and it is included to show the JNJ dip and quick recovery isn’t a market norm. This dip was largely a result of COVID-19 and had little to do with market trends or company performance hence the fall in competitors such as Pfizer. The other companies in the index are performing well as shown using the figures above. As shown JNJ is performing poorly in comparison with SPX and PFE and in the rest of this report we will analyse if the current valuation is fair, if the price may increase due to a potential acquisition, what synergies the acquisition may allow, the effect Covid-19 had on this company and what JNJ are doing currently to rectify this situation.

Johnson & Johnson (JNJ)

Price (28 Aug 2020): **\$153.64**; Rating: **Weak Buy**; Target Price: **\$168.50**; Analyst: **Joshua Bissell**

Overview

Johnson & Johnson (JNJ) is a multi-billion-dollar US healthcare company. They also consumer products. Although JNJ traditionally comprises of pharmaceuticals there are three main revenue streams. These are: pharmaceuticals, medical devices and consumer products as mentioned above.

Revenue Streams

Pharmaceuticals: This comprises around 50% of JNJ's total revenue (however, this fluctuates depending on trends in demand – e.g. now in Covid-19 if the vaccine proves tested by the FDA this figure could rise dramatically – while other sectors such as consumer products fall). JNJ's current pharmaceutical division is mostly focused on therapeutic areas of immunology, infectious diseases, neuroscience, oncology, and metabolic diseases. However, immunology roughly accounts for 32% of all pharmaceutical sales (around 16% of all revenue [\$9.8 billion in 2019]). This could cause an issue if competitors R&D pays off to produce more effective products as majority of JNJ's customer base is institution based and not recreational consumers.

Medical Devices: 40% of JNJ's current revenue is linked to this stream of revenue. Although the orthopaedic sector generates the largest percentage of this sectors products, they also provide surgical care, diabetes solutions, vision care and speciality surgical devices. 50% of these sectors sales were international.

Consumer Products: This accounts for 10% of JNJ's overall revenue, roughly. However, revenue from this sector has fell for JNJ over Covid-19. There may be many reasons for a lockdown causing a decrease in demand but here are a few:

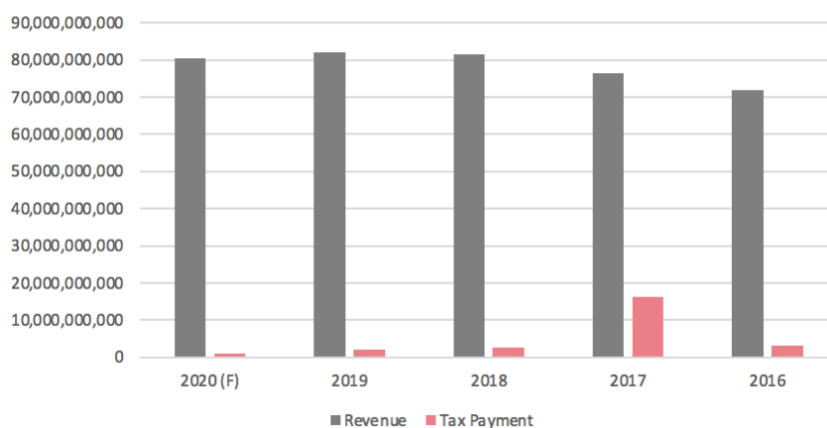
1. Lower levels of household income (due to the limits being placed on working the average household discretionary income is lower). This is especially bad because only necessities are likely to be purchased if households are living primarily off government payment schemes.
2. Lower need for certain products (e.g. facial product sales have fell significantly during Covid-19). It is also possible, due to JNJ being a well-known brand and charging small premiums, that during economic downfall consumers are switching to cheaper alternatives.

Income Statement (\$,000)	31/12/19 A	31/12/18 A
Revenue	82,059,000	81,581,000
Cost of Revenue	27,556,000	27,091,000
Gross Profit	54,503,000	54,490,000
Operating Expenses	34,423,000	34,441,000
Operating profit	20,080,000	20,049,000
Pretax profit	17,328,000	17,999,000
Tax provision	2,209,000	2,702,000
Net Income	15,185,000	15,297,000

Balance Sheet (\$,000)	31/12/19 A	31/12/18 A
Current Assets	45,274,000	46,033,000
Non-current Assets	112,454,000	106,921,000
Total Assets	157,728,000	152,954,000
Current Liabilities	35,964,000	31,230,000
Non-current Liabilities	62,293,000	61,972,000
Total Liabilities	98,257,000	93,202,000
Total Equity	59,471,000	59,752,000
Total Equity + Liabilities	157,728,000	152,954,000

Cash Flow (\$,000)	31/12/19 A	31/12/18 A
Operating Cash Flow	23,416,000	22,201,000
Investing Cash Flow	(6,194,000)	(3,167,000)
Financing Cash Flow	(18,015,000)	(18,510,000)
End Cash Position	17,305,000	18,107,000
Capital Expenditure	(3,498,000)	(3,670,000)
Issuance of Debt	42,000	85,000
Repayment of debt	(2,923,000)	(4,034,000)
Free Cash Flow	19,918,000	18,531,000

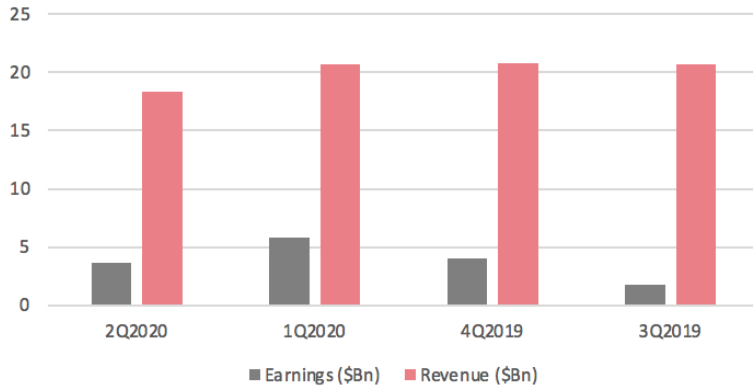
Tax Provisions



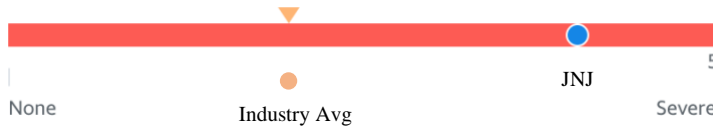
After reviewing the income statement, it was obvious that there is a pretty clear anomaly in the tax payments by JNJ. In 2017 the tax provision paid deviates from the average tax provision by over 500%. This increase was caused by a \$13.6bn charge from changes in US tax law (however, due to its previous takeover of Actelion, it managed to still beat analyst's earnings estimates. This may be an indication of increased legal department intake for JNJ which and thus a situation like this is unlikely.

INVESTMENT RATIONALE

Financials



This graph represents the short-term, however, after reviewing the other financial details the hypothesis is the same. In short, the margins produced by JNJ are not negatively affected by a pandemic that forced other companies into liquidation. This is mainly due to the size and nature of this company.



ESG RISK TOTAL: 27 (Medium – 44th percentile)

Environmental risk score: 1.3

This is likely low due to nature of the service being provided by JNJ. Further due to their strong focus on CSR there is little environmental damage or risk associated with the products sold.

Social risk score: 20.1

The sectors JNJ operate in help mitigate some of the social risk, however, poor public relations lead to a high social risk score. Some of these litigation cases include; faulty hip implants, cancer-causing asbestos, tax charges etc.

Governance risk score: 11.4

We weighted this section as 50% with social risk and environmental score lagging behind. Within this accounting practices are a large weighting, and this pulls JNJ down due to the tax charges (however, due to the time passed this is a lower factor now).

Controversy Rating: 4/5 severe

This should come as no surprise. The industry average is 1.9 to put this in perspective. The diagram to the left shows this.

DEVILS ADVOCATE

Covid-19 Consumer Demand

Although this sector accounts for only 10% of JNJ revenue the sector slipped 7% in terms of sales – these included products such as shampoo and baby care. However, medical device sales, which account for 40% of total revenue, fell by over 33%. This caused total revenue to fall over 10%. Although this decrease beat all analyst’s expectations in terms of market recovery estimates it still would not satisfy a short/mid-term investor.

Financial Trends

In 2018 the sales grew 7%, in 2019 tis figure dropped dramatically to a 1% sales increase. Not only is this low but it proves the markets, without the fault of Covid-19, are volatile.

Litigation & Negative PR

JNJ like mentioned before has many litigation suits with one main suit being “asbestos found in a baby powder bottle”. This news release caused JNJ to fall 6% in the day following the press release. This top-selling, long-term product could see JNJ receiving more litigation costs and thus negative relations in the future – leading to a volatile investment.

Even though testing occurred and now asbestos was found inside the bottle, these claims cause JNJ’s stock price to move considerably more in relation with their competitors.

MARKET OVERVIEW

Industry: Healthcare

Location: Worldwide (50% US)

Market Size: \$8.90 Trillion (Global Healthcare)

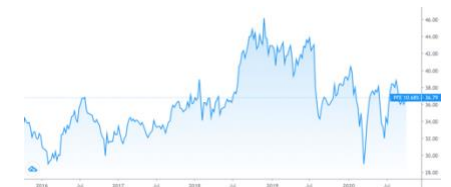
Predicted CAGR: 8.9% per annum (until 2022)

Taking into account JNJ and these three competitors – JNJ is the most overvalued and Pfizer is the most undervalued (using EV/EBITDA). However, it is not accurate to only use one so we can provide a full valuation graph if requested via the email on our website.

Key Competitors

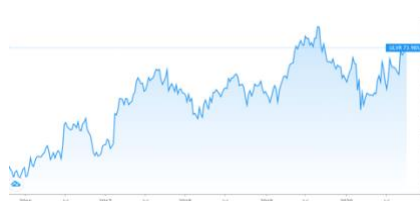
Pfizer

Price: \$36.79
EV: \$256.67 Billion
EV / EBITDA: 10.67
P/E: 14.56
Debt / equity: 98.53
Float: 5.55 Billion
Beta: 0.66



Unilever

Price: \$63.12
EV: \$191 Billion
EV / EBITDA: 17.06
P/E: 24.98
Debt / equity: 158.06
Float: 2.62 Billion
Beta: 0.32



Proctor & Gamble

Price: \$142.92
EV: \$375.90 Billion
EV / EBITDA: 19.46
P/E: 28.81
Float: 2.48 Billion
Beta: 0.41

