Equity Research



Earnings Revised — January 25, 2022

Med Tech - Diversified

Johnson & Johnson (JNJ)

JNJ: Solid 2022 Guidance; Strategic Priorities Focused on Driving Growth

Our Call

Summary. On 1/25, JNJ reported Q4 EPS just ahead of consensus despite sales miss and provided 2022 underlying sales growth and EPS guidance that were ahead of expectations. The company reported Q4 EPS of \$2.13, a penny ahead of consensus and a penny below our estimate, despite a slightly softer top-line. For 2022, JNJ guided to underlying ex-COVID vaccine sales growth of 6.5-7.5%, which we see as a very solid start for 2022. Consumer and Medical Device (MD) sales growth are expected to improve through the year as supply constraints ease and market recovers, respectively, while Pharma growth is likely to be more stable. Reported EPS guidance of \$10.40-\$10.60, including \$0.20 from COVID vaccine, represents solid 8-10% yr/yr growth. We believe this is especially encouraging given JNJ's track record of beating its original earnings guidance.

Updating our model. We are raising our 2022 total revenue by \$4.1B to \$99.4B or 7.7% adjusted operational growth. Our forecast now includes \$3.3B revenue from COVID vaccine revenue, which had been excluded from our model. Our EPS estimate increases from \$10.19 to \$10.51, the latter including nearly \$0.20 expected contribution from the COVID vaccine. For 2023, we model total revenue of \$102.2B, or 2.8% growth (+5.3% exvaccine), and EPS of \$11.13, or 5.9% yr/yr growth (+6.0% ex-vaccine).

We could see more M&A activity at JNJ. While M&A has long been part of JNJ's DNA and about half of its source of growth historically, management commentary suggest an increased focus on deals in Pharma and MD to expand into adjacent categories and new higher growth segments. While we expect JNJ to remain disciplined, we believe management is looking to take bolder steps in its evaluation of acquisition opportunities. While tuck-in deals are still favored, the company was clear that it will consider all deal sizes when it makes sense, even during the pending spin of Consumer.

Top priorities intact with a focus on growth. New CEO Joaquin Duarto reiterated his top three priorities as CEO. First, transform MD into a best-in-class business through improved execution and entry into higher growth markets; 2) deliver on Pharma targets to continue growing faster than the market and reach \$60B revenue by 2025 by maximizing the current portfolio and advancing the rich pipeline; 3) successfully spin off the Consumer business while maintaining its global leadership. Mr. Duarto was clear that JNJ is focused on delivering near- and longer term targets. Management hinted at JNJ's aspiration to become a growth company following the Consumer spin.

COVID recovery disrupted by Omicron but demand remains. JNJ noted that recovery in the MD business was going well at the start of Q4, with procedure volume similar to 2019 level. However, the trend worsened through the quarter with volume -5% vs. 2019 in December. The incremental headwind due to Omicron has continued into the early weeks of January. That being said, management sounded optimistic that the underlying demand is still there as diagnostic volume was up 6% vs. 2019 in December, suggesting there may be a procedure backlog building in the short-term. Our sense is that JNJ is looking for the MD market to grow in the solid mid-single digit or better due to a somewhat easy comp vs. 2021 that was still hurt by COVID and catch-up of the procedure backlog. Bottomline, we believe JNJ management sounded optimistic about the recovery in MD through 2022.

Signature Picks (



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Rating	Overweight
Ticker	ואו
Price Target/Prior:	\$190.00/NC
Upside/(Downside) to Target	13.3%
Price (01/25/2022)	\$167.63
52 Week Range	\$151.47 - 179.92
Shares Outstanding	2,632,596,969
Market Cap (MM)	\$441,302
Enterprise Value (MM)	\$449,479
Average Daily Volume	7,294,139
Average Daily Value (MM)	\$1,223
Dividend (NTM)	\$3.60
Dividend Yield	2.1%
Net Debt (MM) - last reported	\$8,177
ROIC - Current year est.	11%
3 Yr EPS CAGR from current year (unless otherwise noted)	5%

\$ EPS	2021A	2022E Curr.	2022E Prior	2023E Curr.	2023E Prior
Q1 (Mar)	2.59 A	2.71 E	2.43E	-	NC
Q2 (Jun)	2.48 A	2.72 E	2.61E	-	NC
Q3 (Sep)	2.60 A	2.60 E	2.58E	-	NC
Q4 (Dec)	2.13 A	2.38 E	2.57E	-	NC
FY	9.80 A	10.51 E	10.19E	11.13 E	10.94E
P/E	17.1×	15.9x		15.1x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv. NA = Not Available, Volatility = Historical trading volatility

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Q4 EPS just ahead of expectations despite softer top-line. JNJ reported Q4 sales of \$24.8B, missing consensus of \$25.3 and our \$24.9B estimate. Adjusted operational sales growth (ex-FX, acquisitions/divestitures) was +12.3% in the quarter, including 720bps of COVID vaccine contribution. By our math, ex-vaccine sales grew nearly 13% over 4Q19, an improvement from +10% in Q3. In MD, sales grew 5.6% adjusted operational yr/yr or nearly 10% adjusting for the extra week, and were up an estimated 4% vs. 2019 (the same as in Q3). Sequentially, MD sales rose 3% from Q3 reflecting both seasonality and COVID recovery. Pharma operational sales grew 18.6% yr/yr or ~8% ex-vaccine. Consumer sales grew 2.9% yr/yr, or nearly 7% adjusting for the extra week, and were up an estimated 5% vs. 2019. On the bottom-line, JNJ reported EPS of \$2.13, beating consensus of \$2.12 but just missing our \$2.14 estimate. The EPS difference vs. our model primarily reflected higher OpEx (\$11.8B vs. our \$10.5B estimate), partly offset by a higher gross margin (72.6% vs, our 69.2% estimate) and a lower tax rate (10.4% vs, our 15.5% estimate).

Q4 segment highlights—slightly softer sales in all segments. US revenue of \$12.2B (+3.1% adjusted operational growth) just missed our \$12.4B estimate while OUS revenue of \$12.6B (+22.4% adjusted operational growth) was just above our forecast of \$12.5B. Medical Device (MD) sales of \$6.86B were shy of consensus of \$6.97B and our estimate of \$6.89B. MD sales grew 5.6% adjusted operational yr/yr or nearly 10% adjusting for extra shipping week last year, compared to +7.6% in Q3. We estimate MD sales vs. 2019 approximated 4%, the same as Q3. Pharma sales of \$14.28B (including \$1.62B for COVID vaccine) were below consensus of \$14.46B and our \$14.39B estimate. Q4 Pharma adjusted operational sales growth was 18.6% yr/yr or ~8% yr/yr ex-vaccine and adjusting for extra shipping week, compared to +13.8% in Q3. Consumer sales in Q4 grew 2.9% yr/yr adjusted operational or nearly 7% adjusted for extra shipping week, compared to +5.7% in Q3. Q4 Consumer sales of \$3.66B were also below consensus of \$3.72B and our estimate of \$3.67B.

2022 underlying sales guidance better than we expected. JNJ expects 2022 ex-COVID vaccine sales to grow 6.5-7.5% adjusted operational (ex-M&A, ex-FX), which is better than our original 6.0% estimate and likely above previous consensus expectations. FX is expected to be ~150bps of growth headwind this year, more in 1H than 2H of the year. By business, JNJ expects Consumer to grow about in-line with the market in the low-single digit, MD to continue the end of 2021 growth momentum of nearly 5% and Pharma to outpace market growth. Supply and staffing constraints are expected to hurt 1H Consumer growth, especially in Q1, with growth expected to improve in 2H of the year. Omicron and COVID-related staffing shortage could depress MD sales growth in 1H with acceleration expected through the year as the market recovers. Pharma growth is expected to be relatively stable through the year.

COVID vaccine starting to be earnings accretive in 2022. JNJ guided to 2022 COVID vaccine revenue of \$3.0-\$3.5B, up from \$2.4B reported in 2021. The company expects most of the revenue to stem from OUS sales with a little over half expected in 1H vs. 2H of the year. Importantly, JNJ estimated \$0.20 EPS contribution from COVID vaccine this year, compared to the not-for-profit status in 2021. By our math, the implied pretax margin is about 20% to yield the \$0.20 EPS on ~\$3.3B of revenue. JNJ did not comment on the potential durability of the COVID vaccine beyond 2022. For now, we are assuming that this may be a recurring revenue stream of ~\$1B annually and that the EPS impact will be relatively stable ~\$0.20 a year, with the latter implying a pretax margin of close to 60%. As the world moves through the current pandemic phase, we could see continued demand for vaccine booster shots. Additionally, we would expect improved profitability of the COVID vaccine for JNJ over time.

2022 EPS guidance largely in-line excluding COVID vaccine. JNJ guided to 2022 reported EPS of \$10.40-\$10.60 including $\sim 0.20 of FX headwind, which represents ex-FX growth of 8.2-10.2% for the year. The guidance assumes $\sim 0.20 contribution from COVID vaccine. Excluding FX and the vaccine, we estimate underlying EPS growth of 6-8%, which is roughly in-line with the ex-FX, ex-vaccine sales growth guidance of 6.5-7.5%. The company anticipates pretax operating income margin expansion of ~ 50 bps yr/yr, which should help to partly offset a higher tax rate of 15.5-16.5% (vs. 14.0% in 2021). Management talked about share repurchase as part of its capital allocation strategy although we do not believe meaningful buyback is assumed in the quidance.

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Financials

Johnson & Johnson--Income Statement

In Millions, Except Per Share Data

	2017A	2018A	2019A	2020A	1Q21A	2Q21A	3Q21A	4Q21A	2021A	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E	2024E	2025E	2026E
Product Sales																		
Consumer	13,602	13,853	13,898	14,053	3,542	3,736	3,700	3,657	14,635	3,589	3,778	3,752	3,813	14,932	15,424	15,936	16,470	17,026
Base pharma					12,098	12,435	12.491	12,677	49.701	12,788	13,198	13,340	13,913	53,239	56,600	57.708	58.981	60.588
COVID vaccine					100	164	502	1,618	2,384	1,100	900	750	550	3,300	1.000	1,000	1.000	1.000
Pharmaceutical	36.256	40.734	42.199	45.571	12.198	12,599	12.994	14,295	52.085	13,888	14.098	14.090	14,463	56,539	57,600	58,708	59.981	61.588
Medical Devices	26,593	.,		22,959			,		27,060	.,	,	,	7,299	27,936				
		26,995	25,963		6,578	6,979	6,644	6,859		6,610	7,081	6,946			29,176	30,480	31,830	33,203
Total net sales	76,451	81,582	82,059	82,583	22,318	23,313	23,338	24,811	93,780	24,087	24,957	24,788	25,575	99,407	102,200	105,124	108,281	111,817
YoY Growth	6.3%	6.7%	0.6%	0.6%	7.9%	27.1%	10.7%	10.4%	13.6%	7.9%	7.0%	6.2%	3.1%	6.0%	2.8%	2.9%	3.0%	3.3%
Cost of Sales	21,714	22,521	22,916	23,628	5,804	6,345	6,077	6,799	25,025	6,811	7,035	6,880	7,052	27,779	28,333	30,446	30,825	31,556
Amortization Expense	2,963	4,357	4,490	4,651	1,215	1,202	1,133	1,111	4,661	1,200	1,200	1,200	1,200	4,800	4,750	4,750	4,750	4,750
Total Cost of Sales	24.677	26,878	27.406	28,279	7.019	7.547	7,210	7,910	29,686	8.011	8.235	8.080	8,252	32,579	33,083	35,196	35,575	36,306
Gross Profit excl amortization	54.737	59.061	59,143	58.955	16.514	16.968	17,261	18.012	68.755	17.275	17.922	17.908	18,523	71.628	73.867	74.678	77.456	80.261
Gross Margin excl amortization	71.6%	72.4%	72.1%	71.4%	74.0%	72.8%	74.0%	72.6%	73.3%	71.7%	71.8%	72.2%	72.4%	72.1%	72.3%	71.0%	71.5%	71.8%
ů	/ 1.0 /6	12.4/0	12.170	/ 1.4/0	74.070	12.0/0	74.070	12.0/0	13.370	11.170	/ 1.0 /6	12.2/0	12.4/0	12.170	12.370	7 1.0 /6	11.576	/ 1.0 /0
Operating Expenses																		
R&D	10,555	10,775	11,355	12,091	3,154	3,364	3,391	4,681	14,590	3,312	3,494	3,470	4,412	14,688	14,564	14,297	14,455	14,648
% Revenue	13.8%	13.2%	13.8%	14.6%	14.1%	14.4%	14.5%	18.9%	15.6%	13.8%	14.0%	14.0%	17.3%	14.8%	14.3%	13.6%	13.4%	13.1%
Y-Y Growth	16.0%	2.1%	5.4%	6.5%	22.2%	18.9%	19.9%	16.9%	20.7%	5.0%	3.0%	2.3%	-5.8%	0.7%	-0.8%	-1.8%	1.1%	1.3%
SG&A	21,421	22,540	22.178	22.067	5.427	6,067	5.994	7,149	24,637	5,660	6.102	6.197	6,905	24,865	25.295	25,703	26,258	26.836
% Revenue			27.0%	26.7%	24.3%	26.0%	25.7%		26.3%	23.5%	24.5%	25.0%	27.0%				24,3%	24.0%
	28.0%	27.6%						28.8%						25.0%	24.8%	24.5%		
Y-Y Growth	7.4%	5.2%	-1.6%	-0.5%	4.3%	11.8%	10.4%	10.8%	11.6%	4.3%	1.8%	3.4%	-3.4%	0.9%	1.7%	1.6%	2.2%	2.2%
Total Operating Expenses	31,975	33,315	33,534	34,158	8,581	9,431	9,385	11,830	39,227	8,972	9,596	9,667	11,317	39,553	39,858	40,000	40,714	41,484
Operating Income incl medtech tax, ex-am	22.761	25.746	25.610	24.797	7.933	7,537	7,876	6,182	29.528	8.303	8.326	8.241	7,206	32.076	34.009	34.678	36.742	38.777
Operating Margin incl medtech tax, ex-am	29.8%	31.6%	31.2%	30.0%	35.5%	32.3%	33.7%	24.9%	31.5%	34.5%	33.4%	33.2%	28.2%	32.3%	33.3%	33.0%	33.9%	34.7%
Y-Y Growth	1.2%	13.1%	-0.5%	-3.2%	00.070	02.070	00.170	21.070	19.1%	01.070	00.170	00.270	20.270	8.6%	6.0%	2.0%	6.0%	5.5%
EBITDA incl medtech tax	27.439	29.665	30.704	28.097	9.015	8.746	8.746	7.259	33.766	9.350	9.442	9.344	8.372	36.508	38.180	38.723	40.990	43.241
YoY Growth	12.6%	.,		-8.5%	15.1%	10.5%	10.5%	13.6%	20.2%	3.7%	9,442 8.0%	6.8%	15.3%	8.1%	4.6%	1.4%	40,990 5.9%	43,241 5.5%
101 Glowin	12.0%	8.1%	3.5%	-0.5%	15.176	10.5%	10.5%	13.0%	20.2%	3.176	0.076	0.0%	15.3%	0.1%	4.0%	1.476	5.9%	5.5%
Interest Income	(\$385)	(\$611)	(\$357)	(\$111)	(\$17)	(\$19)	(\$25)	(\$14)	(\$75)	(\$20)	(\$23)	(\$26)	(\$28)	(\$97)	(\$107)	(\$118)	(\$130)	(\$143)
Interest Expense	934	1.005	318	201	65	48	32	61	206	46	41	38	37	161	153	146	138	131
Other (Income) / Expense	(1,999)	(1,347)	(2.576)	(720)	(403)	(268)	(189)	(206)	(1,066)	(320)	(320)	(320)	(320)	(1,280)	(1,000)	(700)	(660)	(660)
Total Interest and Other (Inc) / Exp	(1,450)	(953)	(2,615)	(630)	(355)	(239)	(182)	(159)	(935)	(295)	(302)	(308)	(311)	(1,216)	(954)	(672)	(651)	(671)
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Pretax Income ex-amortization	24,211	26,699	28,224	25,427	8,288	7,776	8,058	6,341	30,463	8,598	8,628	8,548	7,518	33,292	34,963	35,351	37,394	39,448
Pretax Margin ex-amortization	31.7%	32.7%	34.4%	30.8%	37.1%	33.4%	34.5%	25.6%	32.5%	35.7%	34.6%	34.5%	29.4%	33.5%	34.2%	33.6%	34.5%	35.3%
Pretax Income	21,248	22,342	23,734	20,776	7,073	6,574	6,925	5,230	25,802	7,398	7,428	7,348	6,318	28,492	30,213	30,601	32,644	34,698
Pretax Margin	27.8%	27.4%	28.9%	25.2%	31.7%	28.2%	29.7%	21.1%	27.5%	30.7%	29.8%	29.6%	24.7%	28.7%	29.6%	29.1%	30.1%	31.0%
Income Tax Expense	4,172	4,383	4,916	3,995	1,367	1,151	1,090	661	4,269	1,376	1,380	1,368	1,203	5,327	5,577	5,638	5,964	6,292
Tax Rate	17.2%	16.4%	17.4%	15.7%	16.5%	14.8%	13.5%	10.4%	14.0%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%
Net Income ex-amortization	\$20,039	\$22,316	\$23,308	\$21,432	\$6.921	\$6.625	\$6.968	\$5,680	\$26,194	\$7,222	\$7.247	\$7.181	\$6,315	\$27,965	\$29,386	\$29.712	\$31,429	\$33,156
Net Margin ex-amortization	26.2%	27.4%	28.4%	26.0%	31.0%	28.4%	29.9%	22.9%	27.9%	30.0%	29.0%	29.0%	24.7%	28.1%	28.8%	28.3%	29.0%	29.7%
Cash EPS	\$ 7.30	\$ 8.18	\$ 8.68	\$ 8.03	ų 2.00	ų <u>-</u>	\$ 2.60	\$ 2.13	\$ 9.80	¥	·	·	\$ 2.38	\$ 10.51	\$ 11.13	\$ 11.34	\$ 12.09	\$ 12.85
Y-Y Growth	8.3%	12.0%	6.2%	-7.5%	12.4%	12.8%	18.5%	14.4%	22.1%	4.6%	4.5%	3.7%	11.9%	7.3%	5.9%	1.9%	6.6%	6.3%
Fully Diluted Shares Outstanding	2.744	2.729	2.684	2.669	2.673	2.672	2.675	2.670	2.672	2.666	2.662	2.658	2.653	2.660	2.640	2.620	2.600	2,581
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Source: Company reports and Wells Fargo Securities, LLC estimates

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Price Target Basis and Risk

Price Target for JNJ: \$190.00 from NC

Our price target of \$190 implies about 17x our 2023E EPS of \$11.13 and is based on a sum-of-the-parts analysis.

Risk for JNJ

Risks include uncertain impact of COVID, lower demand for COVID vaccine, uncertainty in opioid/talc litigations, significant pipeline delays, and unexpected deterioration in the industry.

Investment Thesis

IN

Our Overweight rating reflects our expectation that JNJ's underlying growth to improve over time with easing of multiple headwinds and new product launches.

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Required Disclosures

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Additional Information Available Upon Request

Johnson & Johnson Rating History as of 01-24-2022



Initiation (I); Drop Coverage (D); Overweight (BUY); Equal Weight (HOLD); Underweight (SELL); Suspended (SR); Not Rated (NR); No Estimate (NE)

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- 1=Overweight: Total return on stock expected to be 10%+ over the next 12 months. BUY
- 2=Equal Weight: Total return on stock expected to be -10% to +10% over the next 12 months. HOLD

3=Underweight: Total return on stock expected to lag the Overweight- and Equal Weight-rated stocks within the analyst's coverage universe over the next 12 months. SELL

As of January 24, 2022

56.2% of companies covered by Wells Fargo Securities, LLC Equity Research are rated Overweight. 35.7% of companies covered by Wells Fargo Securities, LLC Equity Research are rated Equal Weight.

8.1% of companies covered by Wells Fargo Securities, LLC Equity Research are rated Underweight.

Wells Fargo Securities, LLC has provided investment banking services for 51.2% of its Equity Research Overweight-rated companies.

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 $Wells \ Fargo \ Securities, LLC \ has \ provided \ investment \ banking \ services \ for \ 35.2\% \ of \ its \ Equity \ Research \ Underweight-rated \ companies.$

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