



**TITAN CAPITAL MANAGEMENT**

***Investment Analyst(s):*** *Robert Cerda, Diego Franco*

*Recommendation:* ***BUY***  *Currency: USD Sector: Healthcare*

*Price:* ***$147.13*** *Consensus Target:* ***$163.56***  *Investment Style:* ***Large Cap Growth***

**BUY**

**Immuno-Oncology and Vaccine Platforms Are Long-Term Growth Drivers, Significantly Offsetting Recent Patent Losses**

**Investment Thesis**

We recommend a BUY rating for Johnson & Johnson. (JNJ). The stock represents good value with an estimated upside of 11.17% with a target price of $163.56. The upside potential is driven by **1)** Double digit EPS growth driven by their pharmaceutical sales making up roughly 51% of their income in 2019, **2)** Covid-19 being a potential positive factor reflecting in the first quarter growth of sales, and **3)** Commitment to Immunology, Infectious Diseases and Oncology Therapeutic areas. The risk to our recommendation and target price includes the ambiguity of the market right now with Covid-19 in effect. Johnson and Johnson can have a myriad of setbacks including but not limited to, decrease in supply, disruptions in their supply chain, clinical trials, etc. Through 2021, they are expecting sales growth of 16.21% that has already been shown in Q1 of 2020 thus far. That topped with strong Financial Ratio’s and ROIC will make this company a strong pick.

**Key Statistics**

***Market Overview***

Current Price:

12 Mo. Target Price:

52 Week High:

52 Week Low:

Volume:

Shares Outstanding

Market Cap:

Enterprise Value

Beta:

Dividend:

***Sector Overview***

Sector:

Industry:

% of S&P500 Market Cap:

***Financial Strength***

Current Ratio:

Quick Ratio:

LT Debt to Equity:

ROIC:

***Valuation:***

Intrinsic Value (DCF):

P/E:

P/S:

EV/EBITDA:

***Forecasted Growth:***

1Y EPS Growth:

5Y EPS Growth:

1Y Dividend Growth:

$147.13

$163.56

$157.00

$109.16

6.77M

2.63B

395.3B

409.8B

.73

2.7%

Healthcare

Pharma

24.63%

1.80

1.50

38.60

14.60

$102.44

76.8

4.5

13.30

17.23%

4.80%

9.09%

**Johnson & Johnson Sales 2011A – 2023E *(in millions)***

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***Source: Johnson & Johnson Data***

**Highlights**

* *FY2020E Earnings*: MRK has estimated an increase in Quarter 1 earnings from prior year Quarter 1 of 8.6%
* *Portfolio Growth*: MRK expects 2019 adjusted EPS 17.23%
* *Market Outlook*: Increase in Sales and ROIC over WACC despite pandemic



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**Business Description**

**BASIC OVERVIEW**

Johnson & Johnson is a holding company, which engages in the research and development, manufacture and sale of products in the health care field. It operates through the following segments: Consumer, Pharmaceutical, and Medical Devices. The Consumer segment includes products used in the baby care, oral care, beauty, over-the-counter pharmaceutical, women's health, and wound care markets.

The Pharmaceutical segment focuses on therapeutic areas such as immunology, infectious diseases ad vaccines, neuroscience, oncology, cardiovascular and metabolism, and pulmonary hypertension. The Medical Devices segment offers products used in the orthopedic, surgery, cardiovascular, diabetes care, and eye health fields. The company was founded by Robert Wood Johnson I, James Wood Johnson and Edward Mead Johnson Sr. in 1886 and is headquartered in New Brunswick, NJ.

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Global sales by subsidiaries outside the US as a percentage of Among the segments, the three main business units include:

total revenue was 48% in 2020. (~54%), Medical Devices (~29%) and Consumer Health (~17%).

**JOHNSON & JOHNSON RETURN ANALYSIS AND S&P 500 INDEX**

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The performance graph showcases a Return Analysis of Johnson & Johnson (JNJ) in comparison to the S&P 500 (SP50). The S&P 500 is an average of the top 500 companies in leading industries in the U.S. and is represented as the green line graph in the performance graph. Johnson & Johnson has been mirroring the S&P up until the market crash due to Covid-19. It has since been outperforming the benchmark and we have a strong feeling that it will continue to do so.

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***Source: Merck & Co, Inc.***

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**Valuation Analysis**

**DISCOUNTED CASH FLOW VALUATION**



We used DCF valuation to arrive at our target price of **$102.44**, a **15.5%** upside from the market’s closing price of $88.72 on December 09, 2019. **Revenue Growth Rate:** We accounted for both Bloomberg’s and JP Morgan’s estimate growth rates. **Cost of Debt + Equity:** We utilized Bloomberg’s cost of debt of 1.67% and cost of equity of 7.35%. **WACC:** Although Bloomberg showcases a WACC of 6.6%, we incorporated a higher equity risk premium due to litany of issues facing the sector over the next few years - increasing the WACC to 8.0%.

*Note: Complete DCF in Appendix*

**RELATIVE VALUATION**

*US Major Pharma*

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Criteria** | **Metric** | | **Merck & Co.** | | **Ind Avg.** | **Johnson&Johnson** | **Bristol-Myers Squibb** | **Pfizer Inc** | **Novartis AG** |
| Valuation | P/E | 22.83 | | 27.07 | | 25.01 | 15.02 | 14.12 | 28.26 |
| Valuation | F P/E | 15.26 | | - | | 14.50 | 9.03 | 13.43 | 15.45 |
| Valuation | P/S | 4.83 | | 4.60 | | 4.25 | 3.93 | 4.03 | 4.44 |
| Valuation | P/B | 7.91 | | 10.90 | | 5.94 | 6.65 | 3.58 | 3.79 |
| Valuation | PEG | 2.51 | | 3.69 | | 4.20 | 2.50 | 3.16 | 3.21 |
| Valuation | EV/EBITDA | 13.30 | | 38.86 | | 11.70 | 11.21 | 10.50 | 15.17 |
| Valuation | Div. Growth | 2.84 | | - | | 6.45 | 2.56 | 1.12 | 3.07 |

Merck & Co.’s EV/EBITDA is 65.78% under the industry average of 38.86. This confirms that Merck & Co. is undervalued and supports our DCF analysis within the 20-60% range in the market. The company’s P/S ratio displays a slightly higher value compared to its peers. P/E ratio of 22.83 is lower than the industry average of 27.07 with a slight discount of about 16%.

Our relative valuation of the EBITDA multiple 13.30x and the P/B metric of 7.91 (industry average 38.86x and 5.94x respectively) supports our DCF analysis.



*Note: Industry Average consists of most major pharma companies: MRK, JNJ, BMY, PFE, LLY, TEVA, SNY, GSK, AZN, NVS*

**ANALYST RESEARCH**

***Source: Bloomberg***

*Note: Additional Analyst Research in Appendix*

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**Financial Analysis**

Corp val corp acct corp dev corp strategies

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**Economic vs Reported Earnings**

Economic Earnings are almost always different from reported earnings. What I find particularly attractive with this model is that aside from having a downturn in 2017, Johnson and Johnson has almost always significantly surpassed the Economic Earnings.

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**Return on invested Capital (ROIC)**

ROIC measures all return on cash invested in the business. Weighted-Average Cost of Capital (WACC) is the average of debt and equity capital costs that all publicly traded companies with debt and equity stakeholders incur as a cost of operating.

Companies must earn an ROIC greater than WACC to generate positive economic earnings and create value for shareholders. The significant difference makes this very attractive for me.

**Growth Appreciation Period**

The market-implied duration of profit growth or GAP measures the number of years the company must maintain an edge over its competitors by having a strong ROIC over WACC. The consistent strong performance places (JNJ) in that category. The market is expecting revenue to grow 3.2% and generate an average Economic Margin of 7.3%.

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**Liquidity**

And just to show what the ratios are telling us, each is well above last year showing that their assets are well above their liabilities and we have a very strong indication that they have a lot of stability and that this is a very low risk investment.

***Source: Johnson and Johnson Data***

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**REVENUE AND EARNINGS ANALYSIS**

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***Source: Johnson & Johnson Data***

For Quarter 1 of 2020, although the Covid-19 Virus broke out, Johnson & Johnsons Pharmaceutical sales had sales of $11,134 (M) as opposed to prior year of $10,244 (M). An 8.7% growth in sales revenue alone. The estimated net impact of Covid-19 on the Pharmaceutical segment operational sales growth was a positive 1.0% primarily driven by increased prescriptions being filled to ensure there is access to essential medicines. This also had a smaller impact on Consumer Health assisting in a 9.2% growth due to Oral Care, Baby Care, Women’s Health, and wound care such as Neosporin and Band-Aid all related to Covid-19. Although the risks are a possibility, I believe the gains could heavily outweigh them.

**Risks**

Risks to our BUY recommendation and target price are mainly surrounded by the uncertainty of Covid-19. The length of its effect could have a negative effect on the supply chain, operations, manufacturing, sales, marketing and clinical trial operations. But based on the information provided, I feel the risks are slim.

**Recommended Trade Action**

**TRADE SIZE AND FUNDING SOURCE**

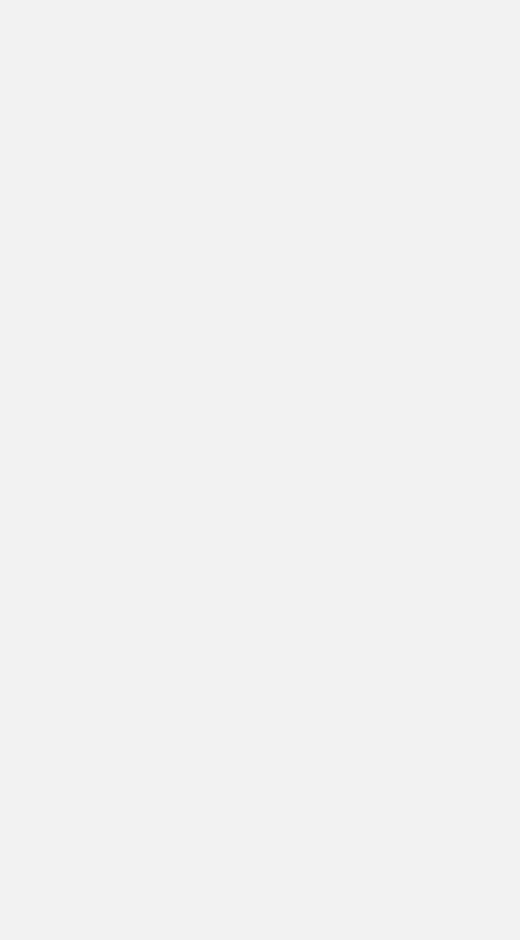
We recommend a 2% buy on Johnson & Johnson (JNJ) for the SMIF Equity Portfolio. The upside drivers double digit EPS growth, minimal risk, and strong Financials opposing the current pandemic. However, Johnson & Johnson is subject to external risks caused by the setbacks from Covid-19. But with margin upside opportunities, Johnson & Johnson has a positive outlook with strong Financial Ratio’s, revenue from quarter 1, and year over year ROIC.

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**Appendix**

**INCOME STATEMENT**

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***Source: Factset***



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**BALANCE SHEET**A screenshot of a cell phone

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***Source: Factset***

***Source: Reuters***

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**CASH FLOW STATEMENT**

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***Source: Factset***