

Research of Golden Investment Opportunity of the Blue-Chip Dividend King

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Abstract: Johnson & Johnson (JNJ) stands as a titan in the healthcare conglomerate sector, having long played a significant role in the global market. This paper undertakes a literature review methodology to delve deeply into JNJ's historical context, diverse business arms, and financial prowess. A Discounted Cash Flow (DCF) and comparative valuation method are applied to assess JNJ's investment potential, supported by a rigorous risk evaluation encompassing various facets from market dynamics to legal challenges. Concurrently, the study gauges the alignment of JNJ's strategies with prevailing pharmaceutical and healthcare trends. Conclusively, the analysis suggests tailored investment recommendations, encapsulating both immediate and future outlooks. The primary objective is to furnish prospective investors with a well-rounded assessment of JNJ's investment promise.

Keywords: Johnson & Johnson (JNJ), Discounted Cash Flow (DCF), Risk Analysis, Investment recommendations, Healthcare trends

1. Introduction

Johnson & Johnson, established in 1886, has historically been a beacon in the global healthcare industry. With its diversified portfolio spanning pharmaceuticals, medical devices, and consumer health products, J&J has consistently been a favored investment choice. Its unwavering commitment to medical innovation and its longstanding dominance in the healthcare market have made it a cornerstone in numerous investment portfolios, especially for those seeking reliable dividends.

However, in recent years, the investment aura around Johnson & Johnson has been clouded by various challenges, not least of which include political pressures and a series of legal confrontations. From 2018 until the present day, Johnson & Johnson has faced numerous potential lawsuits concerning the presence of talc in its formerly popular product -Johnson's Baby powder. These lawsuits allege that the powder caused ovarian cancer, asbestos poisoning, and other illnesses among thousands of users. Consequently, J&J shares have experienced a decline of approximately 15% over the past year alone; thereby reducing its market value from \$480 billion to around \$400 billion. These challenges have led to significant fluctuations in J&J's market value, raising questions about its continued stature as the "king of blue-chip dividends".

Set against this backdrop, this paper seeks to navigate the complex investment landscape surrounding Johnson & Johnson. The core objective is to holistically evaluate J&J's current investment viability, considering its financials, the inherent risks, and the overarching trends in a

dynamic healthcare industry characterized by regulatory shifts, patent intricacies, and technological innovations [1].

Subsequent sections will delve deeply into J&J's financial position, challenges, and strategic trajectory. Our comprehensive analysis aims to arm investors, financial analysts, and other stakeholders with insights, culminating in a decisive evaluation: Does Johnson & Johnson still merit its golden reputation among both short-term and long-term investors?

2. Company Overview

Johnson & Johnson, originating from humble beginnings in 1886 as a modest pharmacy, has risen to stand among the giants of the global healthcare sector. With a reputation built on consistent innovation and adaptability, the company has manifested its expertise across three pivotal segments: Pharmaceuticals, Medical Devices, and Consumer Health Products. This broad-spectrum approach underpins its dominant foothold in the healthcare realm [2].

Johnson & Johnson's pharmaceutical arm has shown resilience and growth. In 2022, it boasted sales figures of \$52.6 billion, reflecting a 1.7% growth from the previous year. The first quarter of 2023 maintained this momentum, recording a revenue growth of 4.2%. Driving this growth are blockbuster products, with Stelara and Darzalex taking the forefront. Particularly, Darzalex, a therapeutic for multiple myeloma, registered a striking 22% quarterly revenue spike.

The Consumer Health segment is on the precipice of transformation. Set to branch out as the independently listed "Kenvue" by the end of 2023, it recorded a robust Q1 2023 revenue of \$3.85 billion, a 7.4% surge from prior figures. The segment's success has been fueled by over-the-counter sales, anchored by household names like Tylenol. These sales accounted for a notable 43% of the segment's total figures [3].

This segment is a testament to Johnson & Johnson's adaptability, especially in the wake of global challenges like the pandemic. Reporting a sales figure of \$27.4 billion in 2022, marking a 1.4% uptick from the preceding year. U.S. sales were particularly strong, seeing a 5.4% rise. The first quarter of 2023 brought in revenues of \$7.48 billion. The Surgery and Orthopedics sub-sectors remain foundational pillars, contributing \$2.4 billion and \$2.24 billion respectively in Q1 revenues [4].

In the ensuing sections, we'll embark on a more granular analysis of these segments, aiming to decode their impact on Johnson & Johnson's overarching financial blueprint. Coupled with this, a critical risk assessment based on recent performances will be presented, alongside a detailed examination of the firm's strategic alignments in an ever-fluctuating healthcare environment. Our ultimate objective remains to offer stakeholders an in-depth insight into the investment caliber of Johnson & Johnson.

3. Valuation Analysis

In valuation analysis of J&J, the paper aims to derive a clear picture of the company's intrinsic worth using established metrics and methodologies. Through these methods, we intend to ascertain the fair value of J&J's stock, which will inform potential investment decisions.

3.1. Valuation Metrics

Price-to-Earnings (P/E) Ratio: As of July 23, 2023, JNJ's P/E ratio is 46.08, notably higher than the sector average of 29.4, suggesting that investors anticipate strong growth or stability in the company.

Price-to-Book (P/B) Ratio: JNJ's P/B ratio stands at 5.23, signifying the market values J&J much higher than its book value, indicating confidence in its prospects and intangible assets [5].

Dividend Yield: J&J offers a dividend yield of 3.09%, making it an appealing option for income-oriented investors.

3.2. Discounted Cash Flow (DCF) Analysis

The DCF analysis is a robust methodology for estimating the intrinsic value of a stock. By projecting future cash flows and discounting them to present value, we can assess whether a stock is undervalued or overvalued. Key inputs for the DCF analysis of Johnson & Johnson (J&J) include:

Table 1: JNJ Revenue & Expenses Forecast [1]

(USD in millions)	Projections					
	01-2023	01-2024	01-2025	01-2026	01-2027	01-2028
Revenue	94,943	101,171	103,195	109,965	113,279	115,607
%growth	1%	7%	2%	7%	3%	2%
Cost of goods sold	(30,989)	(32,361)	(32,349)	(33,781)	(34,103)	(34,108)
% of Revenue	33%	32%	31%	31%	30%	30%
Selling, G&A expenses	(24,765)	(26,390)	(26,917)	(28,683)	(29,548)	(30,155)
% of Revenue	26%	26%	26%	26%	26%	26%
Research & Development	(14,603)	(15,561)	(15,872)	(16,913)	(17,423)	(17,781)
% of Revenue	15%	15%	15%	15%	15%	15%
Net interest & other expenses	(2,861)	(3,049)	(3,110)	(3,314)	(3,414)	(3,484)
% of Revenue	3%	3%	3%	3%	3%	3%
Tax expense	(3,784)	(3,035)	(3,180)	(3,477)	(3,670)	(3,834)
Tax rate	17%	13%	13%	13%	13%	13%
Net Profit	17,941	20,775	21,767	23,796	25,121	26,244
% Margin	19%	21%	21%	22%	22%	23%

3.2.1. Revenue & Expenses Forecast

JNJ's future projections indicate varying revenue growth, peaking at 7% in 2024 and 2026, and stabilizing around 2% towards 2028. Despite these variations in revenue growth, the company's cost structures remain relatively consistent, hinting at steady operating efficiency. A notable observation is that the net profit margin shows an improving trend, rising from 19% in 2023 to an anticipated 23% in 2028.

Table 2: Capital Expenditure Plan [5]

USD in millions	Projections					
	01-2024	01-2025	01-2026	01-2027	01-2028	
Capex	4,235	4,320	4,603	4,742	4,840	
%of Revenue	4%	4%	4%	4%	4%	
	Historical					
	01-2019	01-2020	01-2021	01-2022	01-2023	5y Avg
Capex	3,670	3,498	3,347	3,652	4,009	3,635
% of Revenue	4%	4%	4%	4%	4%	4.2%

3.2.2. Capital Expenditure Plan

Capital expenditure (Capex) remains stable at 4% of revenue throughout the projected years. Looking back, the 5-year historical average Capex is 4.2%, closely aligning with future forecasts. This

consistent allocation for Capex suggests that JNJ is planning for sustained reinvestment in its operations.

Table 3: Depreciation & Amortization Schedule [5]

Average useful life(years)	5				
(USD in millions)	Projections				
	01-2024	01-2025	01-2026	01-2027	01-2028
For Capex in					
2020	700				
2021	669	669			
2022	730	730	730		
2023	802	802	802	802	
2024	847	847	847	847	847
2025		864	864	864	864
2026			921	921	921
2027				948	948
2028					968
Total Depreciation & amortization	3,748	3,913	4,164	4,382	4,548

3.2.3. Depreciation & Amortization

The anticipated depreciation & amortization values are mapped based on a 5-year average useful life of assets. As the Capex is expected to grow, so does the total depreciation & amortization, gradually increasing from \$3,748 million in 2024 to \$4,548 million in 2028.

Table 4: Changing in Working Capital Forecast [5]

(USD in millions except days)			Projections				
	Historical Avg	01-2023	01-2024	01-2025	01-2026	01-2027	01-2028
Days receivables	61		61	61	61	61	61
Trade receivables		16,160	16,780	17,166	18,416	18,868	19,282
Days payables	132		132	135	135	134	135
Trade payables		(11,703)	(11,688)	(11,959)	(12,482)	(12,509)	(12,574)
Days inventory	131		131	135	138	135	136
Inventory		12,483	11,657	11,979	12,762	12,599	12,705
Net working capital		16,940	16,749	17,186	18,695	18,958	19,413
Change in NWC			(191)	437	1,509	262	256

3.2.4. Working Capital Management

JNJ's net working capital is forecasted to ascend over the period. The primary factors contributing to this rise are the anticipated increases in trade receivables and inventories, counterbalanced by trade payables. This progression underscores the company's expected growth in operations and potential expansion.

Table 5: DCF Terminal Value [5]

(USD in millions)		6M/2024	2025	2026	2027	2028	Terminal
Profit before tax		11,905	24,947	27,273	28,791	30,079	
(-)Net interest income/expense		(434)	(885)	(943)	(971)	(991)	(968)
(+)Depreciation & Amortization		1,874	3,913	4,164	4,382	4,548	4,365
EBITDA		14,213	29,744	32,380	34,144	35,618	34,047
(-)Tax		1,518	3,180	3,477	3,670	3,834	3,661
(-)Capex		2,118	4,320	4,603	4,742	4,840	4,728
(-)Change in NWC		(96)	437	1,509	262	456	742
Free Cash Flow		10,673	21,807	22,790	25,469	26,488	24,916
Terminal Value							527,237
WACC/Discounted rate	6.8%						
Long-term growth rate	2.0%						
Timing of FCF(midyear)		0.25	1	2	3	4	4.5
Present Value of FCF		10,499	20,415	19,973	20,896	20,344	391,800
Enterprise Value	483,926						
Projection period	92,126	19.0%					
Terminal Value	391,800	81.0%					
(-) Current net debt	37,172						
Equity Value	446,754						
(/)Outstanding shares	2,408						
Fair Price	186						

3.2.5.DCF Terminal Value and Fair Price Estimation

JNJ's EBITDA is projected to experience steady growth, which after deductions for tax, Capex, and changes in working capital, yields the Free Cash Flow (FCF). Using the calculated FCFs and considering a terminal value of \$527,237 million (which assumes a 2% perpetual growth rate), the present values of these cash flows are derived using a discount rate of 6.8%.

Post adjustments for current net debt, JNJ's equity value stands at \$446,754 million. Distributing this value over the existing 2,408 million shares, the stock's fair price is approximated at \$186.

4. Discussion

The comprehensive DCF valuation of JNJ presents a fair stock value of \$186. With revenue and EBITDA showing signs of steady growth and considering the company's operational forecasts and capital expenditure plans, this valuation emphasizes a potentially undervalued stance for JNJ (assuming the market price is below \$186). This suggests potential growth and value realization for shareholders in the future.

4.1. Risk Analysis

Johnson & Johnson (JNJ) operates in the highly dynamic healthcare sector, where its business is exposed to various external and internal factors that may pose potential risks. In this risk analysis, we will classify these risks into three main categories: Market and Industry Risks, Financial and Operational Risks, and Legal and Ethical Risks.

4.2. Market and Industry Risks

Regulatory Changes: Johnson & Johnson faces significant risks associated with changes in regulations within the healthcare industry. Being a global player, it is subject to different regulations across various markets. Recent shifts in regulatory stances concerning intellectual property rights and pricing have raised concerns. Public policies both domestically in the U.S. as well as internationally have become increasingly unfavorable toward protecting intellectual property rights, which presents a considerable challenge for JNJ. The company's ability to obtain sufficient patent protection for new products and technologies remains uncertain while existing patents face continuous challenges through litigation processes such as Inter Parties Review (IPR) proceedings. Additionally, the introduction of biosimilar alternatives under the Biologics Price Competition and Innovation Act (BPCIA) adds another layer of complexity as competitors can contest patents on innovator biologics. If JNJ fails to defend its patents successfully, there could be a sudden decline in revenue when generic or biosimilar products enter the market "at risk."

Market Dynamics: Market dynamics and competition are fundamental risks for JNJ's operations. Approximately 25% of their projected sales for 2022 come from new products introduced within the past five years, highlighting their reliance on innovation for growth. However, the success of new products relies on various factors, such as accurately predicting future healthcare demands, achieving positive results in clinical trials, obtaining intellectual property protection, and securing timely regulatory approvals. The competitive environment and evolving customer preferences can influence the acceptance and triumph of novel offerings. Furthermore, real-world safety and effectiveness findings as well as the introduction of competing products may impact JNJ's market positioning [6].

4.3. Financial and Operational Risks

Financial Stability: Johnson & Johnson maintains investment-grade credit ratings that are crucial for ensuring its financial stability. Any potential downgrade by credit agencies could lead to increased borrowing costs, restricted market capacity for commercial paper issuance, or necessitate additional collateral for derivative contracts. Maintaining a strong creditworthiness is essential to ensure liquidity, capital position, and access to capital markets.

Operational Challenges: Operating across diverse global markets exposes JNJ to various financial, economic, and operational risks. Approximately 49% of its sales occur outside the United States which makes it vulnerable to fluctuations in foreign currency exchange rates. Currency devaluation and high inflation rates in certain economies like Argentina, Turkey, and Venezuela pose operational challenges that could potentially result in operating losses. Moreover, despite legal restrictions on importation from countries with lower prices for pharmaceutical products into the US and other markets; illegal imports can still negatively impact sales volume and profitability [7].

4.4. Legal and Ethical Risks

Recent Lawsuits and Regulatory Scrutiny: Johnson & Johnson has faced legal hurdles including lawsuits related to their pharmaceutical products as well as talcum powder usage claims. Competitors have also initiated legal proceedings challenging the company's patent rights. Regulatory scrutiny, especially concerning interactions with government officials in various countries, poses significant legal and ethical risks. Compliance with anti-bribery laws like the U.S. Foreign Corrupt Practices Act (FCPA) is vital, given the heavily regulated nature of the healthcare industry [7].

Ethical Considerations: Ethical considerations are paramount in JNJ's operations, given its role in healthcare. Ensuring that its products meet high ethical standards is essential to maintain public trust and protect its reputation. These considerations extend to interactions with healthcare providers, pricing strategies, and ensuring patient safety.

In conclusion, Johnson & Johnson operates in a complex and highly regulated industry, facing multifaceted risks. These risks span from regulatory changes and patent challenges to financial stability and ethical considerations. To mitigate these risks effectively, JNJ must maintain rigorous compliance, adapt to evolving market dynamics, and prioritize innovation while remaining vigilant about ethical practices. Continuously monitoring and adapting to changes in the healthcare landscape is crucial for safeguarding its long-term success and reputation.

5. Conclusion

The research into Johnson & Johnson (JNJ) paints a comprehensive portrait of a company with a longstanding legacy of stability and trust, particularly in the realm of dividends. Its AAA credit rating and an uninterrupted track record of dividend growth over six decades attest to its robust financial health and dependable operational model. However, the company's recent travails, specifically related to the talc baby powder debacle, have introduced an element of uncertainty and volatility.

The pivotal moment of an \$8.9 billion settlement proposition brings both a sigh of relief and a sense of apprehension. While on one hand, it has the potential to restore the dented investor confidence, on the other, its repercussions on JNJ's immediate financials and cash flows remain a concern. The fluctuating market response, as observed by the transient surge in stock prices post-settlement news, further exemplifies the precarious position of JNJ in the current scenario [8].

This study, however, is not without its limitations. Our research predominantly focused on financial projections and the company's past performance. A deeper dive into the company's product pipelines, patent expirations, and other potential litigation threats might yield insights that can further inform investment decisions. Furthermore, a comparative analysis with its peers in the pharmaceutical and consumer goods sectors might have provided a broader industry perspective.

Given the dual nature of JNJ's present circumstances - its historical resilience versus its current challenges - potential investors are advised to adopt a bifocal approach. In the immediate term, JNJ's dividend offerings serve as a beacon for those seeking stable returns amidst economic unpredictability. However, it is imperative to keep abreast of evolving patent scenarios and any regulatory mandates that might come into play.

JNJ's intrinsic value might currently be veiled by the shadows of its legal challenges. Observing the proceedings related to the talc issue is crucial. A positive resolution could usher in a wave of renewed trust and potentially unlock the company's suppressed value. Yet, prudence is the keyword here. The magnitude of the settlement, both in financial and reputational terms, cannot be overlooked.

In the future landscape, deeper investigations into JNJ's product diversifications, its research and development trajectory, and a holistic industry analysis might reveal avenues of growth and potential risks. It is essential to not just focus on the present quandary but also envision the company's potential to innovate and lead in the healthcare domain.

For the world of pharmaceuticals and consumer goods, where trust and consistency are paramount, JNJ's journey post this challenge will be a case study in crisis management, resilience, and strategic foresight.

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