Equity Report [11/7/2020]

Johnson & Johnson

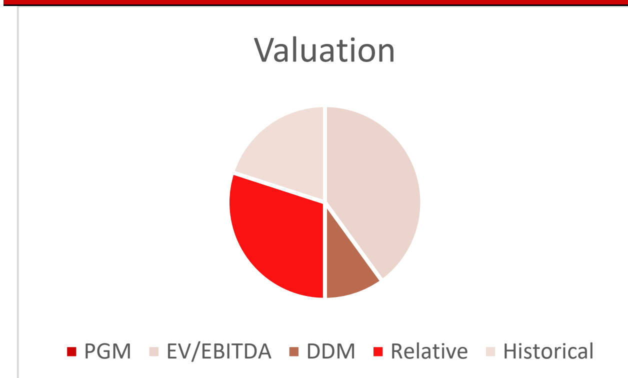
Healthcare

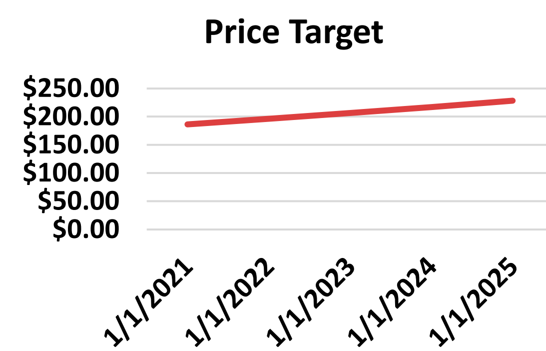
NASDAQ Symbol: JNJ

Recommendation: HOLD

Covering Analyst: Dana Welty

Intrinsic Value:





Capital Structure	
Equity	88.3%
Debt	11.7%
CAPM Presumptions	
Beta	0.69
Risk Premium	5.2%
Risk-Free Rate	1.6%
Terminal Growth Rate	3.00%
WACC Presumptions	
Cost of Equity	5.2%
Cost of Debt	3.2
Cost of Capital	5.0%

Intrinsic Value	Margin of safety
$177.23	**24.2%**

Source: Company Data, Group Estimates

Executive Summary

This equity report provides an analysis and evaluation of the current and future performance of **Johnson & Johnson** over a future period of five years. My methods of analysis include the **discounted cash flows model (DCF)**, **historical model**, **DDM, and relative model**, as well as various ratios including but not limited to ROA, ROE, ROIC, liquidity ratios, capital structure ratios, and profitability ratios.

My report finds that the prospects of the company in its current position are **positive**. The primary catalysts for long-term growth include:

- Frequent and continued acquisitions leading to an increasingly extensive brand portfolio.
- Positive outlook on their vaccine research. Especially amid a global pandemic, JNJ's continued research into vaccines including COVID-19 provide positive potential long-term growth even though a vaccine is anticipated in less than a year.
- Consistent and growing dividends, indicating that they can stay healthy
- Research and development with medical devices has continued to lead the pack with new, innovative procedures

I conclude that this company's stock is attractively **undervalued**, resulting in a margin of safety of **24.2%**. Reasons that the market has placed this stock at value include:

- Litigations resulting in multi-million (or billion) dollar lawsuits. These expenses continue to threaten Johnson & Johnson's credibility.
- Generic brand names threaten Johnson & Johnson's profitability in their largest revenue-earning segment of pharmaceuticals.
- Under new administration, tax threats could loom over JNJ's head and threated to encroach on their earnings.

Based on JNJ's current position in our large cap portfolio, we should maintain our position for the foreseeable future to ride out the expected growth of the next few years.

Key Stock Statistics:

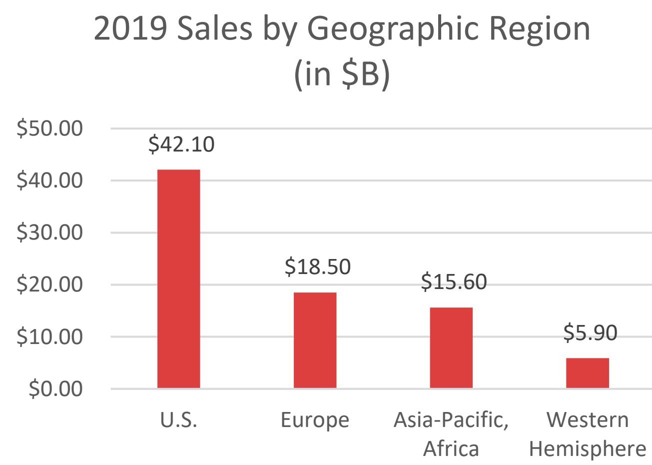
52-Wk Range ($)	109.16-157	Dividend Yield	2.9%	Book Value/Share (mrq)	24.49
Beta	0.69	Diluted EPS (ttm)	6.36	Operating Margin (ttm)	24.93%
Market Capitalization ($BN)	374.48B	P/E (ttm)	21.6x	S&P Credit Rating	Aaa
Forward Annual Dividend	4.04	P/B (mrq)	5.6x	Institutional Ownership	68.65%

Source: Yahoo! Finance

Business Description

Johnson & Johnson operates in various sub-segments of the healthcare industry. Their three primary segments are pharmaceuticals, medical devices, and consumer health, with the consumer health segment including segments in vision, skin care, and consumer goods. They are headquartered in the United States but have about 260 companies in more than 60 countries. Just over half of their sales are attributed to the US market, followed by the European market at just under 25% of sales. The Asia-Pacific region and African regions combined account for about 20% of sales, and the rest of the world accounts for the remaining 5% of sales.

In addition to these various products, JNJ specializes in research and development. In the most recent year, they have solidified themselves as a lead COVID-19 vaccine candidate and are currently in the third phase of vaccine trials following a brief pause due to an unexplained illness in one of the study's participants.



Products and Services

Johnson & Johnson segments their operations into three key areas:

- Pharmaceuticals
- Medical Devices
- Consumer Health

JNJ's largest healthcare sub-sector is pharmaceuticals, with brands such as Janssen, Actelion, Cilag, Crucell, and Novaria. They focus on developing treatment in six therapeutic areas including cardiovascular and metabolism, immunology, infectious diseases and vaccines, neuroscience, oncology, and pulmonary hypertension. They are listed on the World Health Organization's list of Essential Medications with 18 of their current prescription medications, and are continuing to put research and development towards new medications with the intention to help treat and cure patients around the world. Their products range from biological and oral therapies, as well as other types of novel therapies.

They are currently in phase III of a COVID-19 vaccine, marking them as a lead candidate with a promise to distribute the vaccine once approved by the FDA at a not-for-profit level. The vaccine has moved through trials at an unprecedented rate, making it to phase III in just over 6 months, compared to other vaccines where the research alone to get to and through phase I can take up to 10 years. From there, moving from phase II to phase III can take 2-3 years, with another 2-4 years before the vaccine is registered to the general public. There are currently 36 vaccines in phase I, 14 in phase II, and 11 in phase III, including JNJ. Once approved, JNJ has an agreement with the U.S Government for 100 million doses of the Investigational COVID-19 Vaccine, and an agreement with the European Commission Approval of Agreement to supply 200 million doses of Janssen's Vaccine Candidate. There are six vaccines from other companies currently approved for limited use, but each of these six are in either China or Russia. Thus far, there has been no approval in the United States where JNJ's vaccine research is primarily focused.

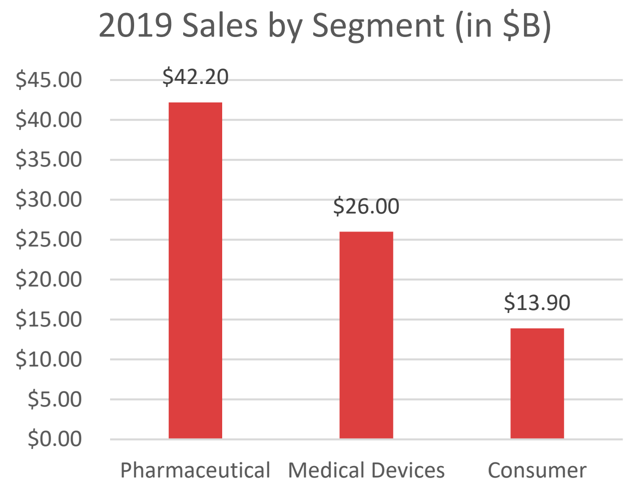
JNJ also operates in the medical device industry in four main disciplines: orthopedics, surgery, interventional solutions, and vision. They own brands such as Acclarent, Biosense Webster, and Ethicon. They have recently improved many of their surgery procedures with Ethicon by making revolutionary changes in the addition to new, minimally invasive procedures. They also specialize in biosurgery and wound closure. JNJ has sold these devices to hospitals, physicians, and other professionals for over 130 years.

JNJ's smallest healthcare sub-sector is their consumer health products sector. This sector contains essential health products with many well-known brands including Listerine and Band-Aid, self-care products with brands such as Tylenol and Benadryl, and skin health products such as Neutrogena and Aveeno. These brands are sold over the counter at various retail drugstores and outlets.

Revenue Drivers

Pharmaceuticals

Johnson & Johnson's main source of revenue is from pharmaceuticals, with 51.4% of their total sales in 2019 stemming from this sector. STELARA drove the 5.8% worldwide pharmaceutical growth in 2019, a biologic for the treatment of various inflammatory diseases. They had some generic competition with the introduction of a new biologic approved for various inflammatory diseases, leading to a decline in REMICADE revenue. During the COVID-19 pandemic, their sales remained high, listing 3.9% growth during the second quarter of 2020 and 4.7% growth in the third quarter. Although JNJ was partially impacted by the pandemic, their largest revenue driver remained strong despite the circumstances. Particularly noteworthy to their pharmaceutical sector is the acquisition of Momenta Pharmaceuticals, Inc, a company focused on autoantibody-driven diseases.



Medical Devices

JNJ's medical devices revenues grew 3.9% in 2019 and covered 31.6% of 2019 total sales. This growth was driven by electrophysiology products, international energy, and ACUVUE contact lenses. In 2020, these sales sharply declined in the second quarter amid holds on non-essential medical procedures. Sales dropped by 32.5%, but only dropped by 3.3% in the third quarter, a smaller drop than anticipated, as it was partially offset by International Solutions business growth. During good years, this revenue is driven by acquisitions and continuous new product developments. In 2019, they acquired Auris Health, a robotic technology company with the purpose of developing techniques and robots for safer and faster surgeries.

Consumer Health

Following pharmaceuticals is their consumer health products at about 17% of sales. Despite a decline in sales of 3.4% in the second quarter of 2020 due to COVID-19, their sales grew 3.1% in the third quarter even with the ongoing pandemic. Their top performers in this category are their over-the-counter medical brands such as Tylenol and Motrin, Listerine, and Band-Aid.

Acquisitions

It should also be noted that JNJ often acquires new companies, especially in the pharmaceutical sector of their business. In 2019, JNJ acquired companies such as Bermekimab and TARIS Biomedical, with agreements to acquire Verb Surgical. In 2020, they continued the acquisition trend and acquired Momenta Pharmaceuticals, one of their larger acquisitions to date. The purpose of this acquisition is to increase their leadership in immune-mediated diseases, as well as to expand further into the autoantibody-driven diseases field. Through this acquisition, they will be able to expand their customer base even further since Johnson & Johnson has not previously had expertise in this area. It is a great spot for potential growth and will greatly add to JNJ's already extensive portfolio. This trend is continuous for JNJ and they plan to keep this up for the foreseeable future.

Cost Drivers

JNJ's largest expense comes from SG&A followed by research and development. This is very typical of healthcare stocks, as overhead expenses and selling expenses rack up quickly, especially in companies comparable to JNJ's size. However, SG&A expenses have continued to hover around 27-28% of revenue while research and development expenses have slowly increased over time. JNJ's primary focus of research and development is currently on COVID-19 and the development of a vaccine, but they have continued to develop new products and gain new patents for other areas of research. In September 2020, their patent assets totaled over $22.2 billion, a drop from2019’s $23.4 billion. Despite the drop due to patents expiring, they have continued to add new patents each year, reducing the amount that this number typically drops.

Selling, General and Administrative Expenses (SG&A)

Healthcare stocks commonly have high SG&A expenses, and JNJ is no exception. While these numbers have hung around 27-28% of sales, JNJ has managed to reduce these numbers in 2020 to about 25-26% of sales because of a favorable segment mix and expense leveraging in their pharmaceuticals business. This is likely due to their reduced sales in the medical devices business, but regardless, the expense as a percent of sales has decreased. This number should return to normal levels in 2021, when the medical devices segment is expected to return to normal growth.

Research, Development, and Engineering Expenses (RD&E)

Johnson & Johnson heavily invests in research and development along with most other similar firms. They invested $11.4 billion in 2019 and have maintained their investment of 13-14% of sales in 2020. Their research has been primarily driven by portfolio progression with the COVID-19 vaccine, as well as by increased investment in robotic and digital platforms. Their vaccine is based on Ad26. According to Mathai Mammen, the Global Head of Janssen Research and Development, “This is a human adenovirus and contains a variant of the SARS-CoV-2's spike protein.” While they paused their COVID-19 vaccine phase III trials due to an unexplained illness in one of the study’s participants, this is not an unusual occurrence in vaccine research. It is common for vaccine trials to be paused and should not be a cause of alarm. They were able to resume trials a few weeks later without complications, and still do not have an expected release date of the vaccine beyond hopefully “sometime in 2021.”

Litigation Expenses

In 2019 JNJ incurred a $4 billion litigation expense in principle to settle opioid litigation. These lawsuits are not uncommon for JNJ, as they’ve been hit with sizable lawsuits in the past. They recorded an additional $1 billion in litigation expenses this year to conclude the opioid settlement. These expenses have continued to rise since 2015 from $141 million to the $4 billion in 2019. Additionally, they will pay over $100 million to end over 1,000 lawsuits blaming their baby powder for causing cancer. They also have roughly 20,000 lawsuits still pending. JNJ claims that their baby powder is safe but they are choosing to settle the lawsuits “without an admission of liability and in no way changes our position regarding the safety of our products,” according to Kim Montagnino, a JNJ spokeswoman. On November 6th 2020, JNJ and other drug wholesaler agreed to around $26 billion to settle various opioid lawsuits. With societal tensions on the rise with the opioid epidemic, this does not signal good news for JNJ in the public eye. It is not clear when this lawsuit will be settled.

Taxes

A final notable expense of JNJ is their 2017 tax cut. They paid $13 billion in relation to a U.S. tax overhaul from accumulated foreign earnings. They accumulated roughly $66 billion in foreign earnings, and after taxes, this resulted in a 4th quarter loss for JNJ in 2017. Please see the Forecasts and DCF tab of the workbook for more details.

Business Strategy

Johnson & Johnson’s goal is to expand their position as a worldwide pharmaceuticals, medical devices, and cosumer health brand through continuous innovation and a diverse supplier base that provides reliable products and services. They make high standards a priority and strive to invest in the future of health by tracking market development and seeking suppliers who can help reach this goal. They’re rooted in global diveristy, and accept that their role as an industry leader forces them to hold the highest standards for corporate citizenship. Their vast and continually growing supplier base is committed to inclusion, and they have developed programs to maintain and improve their levels of diversity. As they sell name-brand products, they charge higher prices than their competitors with the expectation of being the first brand to sell a new product, especially on their pharmaceutical end. They've continued to acquire companies each year, with 2020 including the addition of Momenta Pharmaceuticals. They've also continued to develop new patents, increasing their intellectual property. They've focused not only on increasing their supplier base, but their consumer base as well. They have began to put efforts into targeting more environemtnally conscious consumers, with a pledge of $800 million through 2030 to develop more sustainable products, especially in its consumer health sector. By beginning to target more environemental issues, JNJ begins to appeal to buyers who may have been turned off by the brand's insensitivity to other growing issues, such as drug use and drug profits.

Industry Overview

Johnson & Johnson is nested under the healthcare sector with its pharmaceutical focus, as well as for its medical devices and for most products in their consumer health segment. This industry is constantly changing and has worldwide attention with the ongoing COVID-19 pandemic. This industry is known for growth, and known to hit a few controversial areas including opioids, drug prices, vaccines, and more. There's constant room for innovation, a feat that is required for a well-valued healthcare company. Without innovation, there would not be new medicine, medical procedures, or additional research of any kind. The consumer for healthcare will likely increase in 2020 as the need for hospital beds has been rapidly increasing, and hospitals and emergency centers will be the ones likely to distribute an upcoming vaccine. Consumers are also pushing for more transparent pricing, but do not have much flexibility in the pharmaceuticals industry. This could change as society's expectations change, but for the foreseeable future, drug prices will likely continue in increase. However, consumers' pricing expectations could play a role in over-the-counter drugs such as acetaminophen (Tylenol). These prices, as other health companies continue to manufacture them at lower prices, will drive companies like Johnson & Johnson to decrease their prices. This would force JNJ to adapt to gain profits in other areas of their business, but this is something JNJ has continued to recognize. They have actively taken steps to reduce this risk in their industry. This topic is covered more heavily in other areas of this report.

Industry Growth

The healthcare industry has increasingly promising long-term growth. Amid a global pandemic, healthcare stocks have a positive outlook for the long term. The expected CAGR for the healthcare industry is anticipated to rise around 5% in 2019-2023, a number consistent with JNJ's expected growth of 3.75-5.5% over the next five years. Healthcare is currently nested in the spotlight as COVID-19 threats continue to increase with no near end in sight. The healthcare industry will likely have increased demands as people begin to take health matters more seriously than they already do, as we can see with the increased percentage of the population who got the influenza vaccine this year. Overall, vaccine rates increased for children in the United States 1.2% up to 63.8%, and adults 3.1% up to 48.4%. Johnson & Johnson's continuous work in various healthcare segments puts them in an ideal place to ride the growth of the next few years.

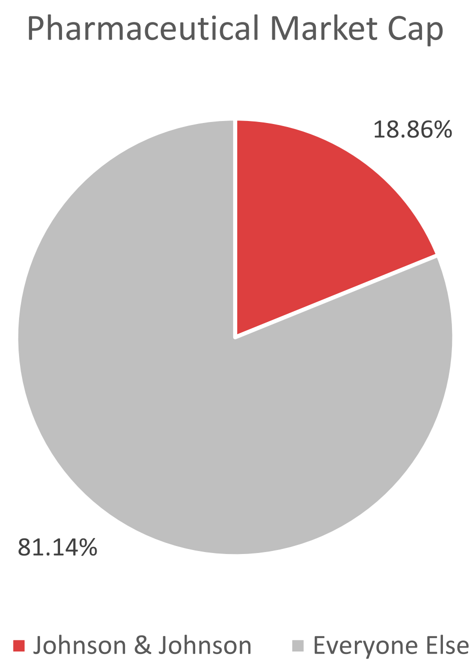
Industry Disruptors

The threats to the healthcare industry largely include public scrutiny. As the ethics behind drug production and profits continue to be questioned, this could threaten the image of healthcare companies who sell their products on a for-profit basis like JNJ. However, JNJ is combatting this disruption with their COVID-19 vaccine efforts, as they have already promised to administer the vaccine at a not-for-profit basis.

Another industry disruptor is political ideation. Typically, when a conservative president is elected to power in the United States, we see big pharma stock prices on the rise. On the other hand, when a more progressive candidate is elected, we see big pharma prices decline. This is not because one political party takes healthcare more seriously than the other. In fact, the most recent administration has demonstrated a lower priority in healthcare with the disbandment of the pandemic response team, for example. However, in either case JNJ is prepared to make shifts to keep them profitable and likeable to the public.

Market Share

Johnson & Johnson is the largest player in the healthcare industry with a market cap of nearly $375 billion. They are followed by Pfizer with a market share of $246 billion, then UnitedHealth Group at $232 billion. Most of JNJ's revenue comes from the United States, but a significant portion comes from Europe. In terms of market cap for the pharmaceuticals business, they hold roughly 18.86% of the market cap, followed by Roche, Merck & Co., Novartis, and Pfizer, but the gap is quite large. Johnson & Johnson is the clear industry leader in their largest sector. In the coming year, healthcare's defensive nature is also projected to keep them profitable. Additionally, as COVID-19 continues to vary by region around the world, JNJ's large size gives them the flexibility to pivot to more profitable markets that they are already partially invested in. For the sector overall, revenue is projected to grow around 2.7% this year and up to 5.3% next year. Johnson & Johnson's expectations are slightly lower than these as mentioned in other sections of this report. Additionally, EBIT margin growth is expected to grow about 2.4% this year and 2.9% in 2021. Again, JNJ's projections are slightly more conservative than these.



Competitive Analysis

I analyzed Johnson & Johnson's competitive positioning by constructing a SWOT analysis and a Porters' Five Forces model. These allowed me to evaluate the company's potential for future growth.

SWOT Analysis

Strengths

- Strong, well-known brand name paint an industry leader that provides familiarity among buyers
- A large market cap makes potential monetary threats seem smaller and more manageable
- A huge brand portfolio paves way for increased revenue and opportunities in their various segments
- Continued and reliable dividends

Weaknesses

- Litigation history with potential cancer-causing substances provide a strongly negative brand image in certain cases
- Dependence on pharmaceutical segment causes vulnerabilities which can lead to large losses

Opportunities

- Continued acquisitions with the potential to further expand into the global market
- COVID-19 vaccine trials have put them as a frontrunner for the first vaccine, which could help repair some branding issues, but other companies are hot on their tail

Threats

- Generic brands threaten to take business as the alternatives become cheaper and more familiar to buyers
- Fight against "Big Pharma" and drug abuse could lead JNJ to a tougher position ethically than the one they already have

- Certain brands like “Band-Aid” could lose their trademark if the brand name becomes synonymous with the product, as has happened with “Scotch Tape,” “trampoline,” or “escalator.”

Porter’s Five Forces

Porter’s five forces, which provide a framework for industry analysis, were formulated by Michael E. Porter of Harvard Business School in 1979. Following are the five parameters on which I analyzed Johnson & Johnson, and their position within the healthcare industry.

Rivalry Amongst Sellers | Medium-High

I listed the rivalry amongst sellers as medium-high. Currently, there are upwards of 20 companies who have reached at least phase I with the COVID-19 vaccine. This will lead to a strong rivalry between sellers, but fortunately for JNJ, their large amounts of financial resources help them survive. This threat also exists for their medical devices segment, but fortunately this threat can be reduced with their patents. However, when their patents expire, this threat will become larger.

Threat of Substitutes | Medium-Low

The threat of substitutes is medium low. This threat is generally low for pharmaceuticals and medical devices and larger for their consumer health products as consumers can instead choose generic brands for their consumer health products such as Tylenol and Benadryl. Fortunately, this segment accounts for the smallest portion of JNJ’s revenue at 17% of sales.

Pressure from Supplier Bargaining Power | Low

JNJ’s supply chain size makes this threat low. With such a huge network of suppliers, it is easy for them to shift to other companies if one decides to raise prices unexpectedly. This is also the case for their pharmaceuticals. Drug manufacturers get their materials from multiple suppliers, so the pressure is spread out over their entire supply chain making it hard for one supplier to place too much pressure on JNJ.

Threat of New Entrants | Low

The threat of new entrants is low in pharmaceuticals, JNJ’s most important segment. Drug manufacturing requires a ton of cash, something that JNJ – and not many other people – have access to. JNJ can afford the research and development prices that come with their industry, but it’s extremely difficult for other firms to get into the business, especially with how many new products they are able to bring out each year.

Pressure from Buyer Bargaining Power | Medium

Pressure from buyer power is listed as medium. While buyers do have the power to purchase substitutes or avoid purchasing many of their consumer health products, hospitals and other retailers do not have that luxury. Johnson & Johnson’s pharmaceutical customers almost *need* their products, greatly reducing their bargaining power. However, with increasing societal pressure to lower drug prices of essential (and many non-essential) drugs, this threat could be increasing. JNJ mitigates these threats as much as they can with their large customer base.

Financial Analysis

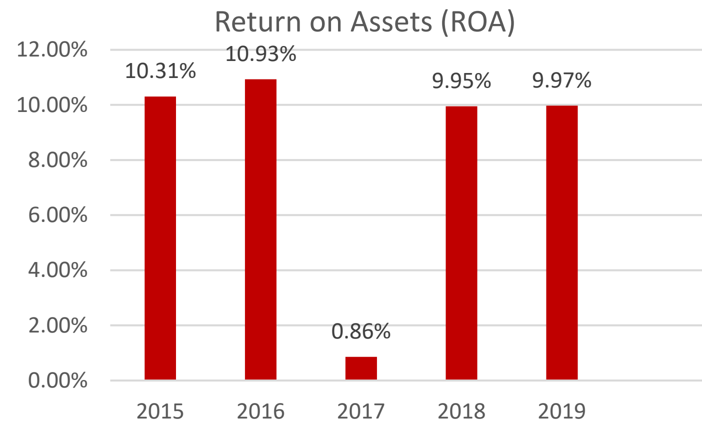
My financial analysis involves the use of a DuPont method and other financial ratios. These are especially useful in evaluating a company’s ability to deploy, retain, and generate income. JNJ has promising fundamentals that lend the company capacity to expand safely to maintain a competitive advantage in the healthcare industry.

DuPont Analysis

A DuPont analysis involves breaking down ROA, ROE, and ROIC into granular components for detailed analysis.

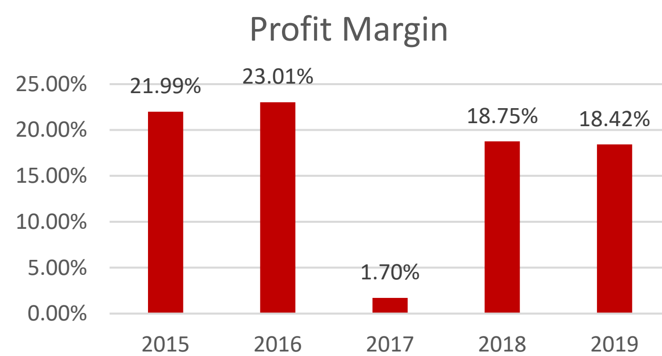
Return on Assets (ROA)

Return on assets is calculated using the DuPont method, breaking down the calculation into two separate ratios. Profit margin and asset turnover are calculated, and the product is ROA. Overall, Johnson & Johnson performed well in 2015, 2016, 2018, and 2019. However, in 2017, as mentioned above, JNJ was hit with a hefty international tax on capital gains, resulting in a $13 billion hit to their assets. This resulted in a significantly lower ROA compared to other years.



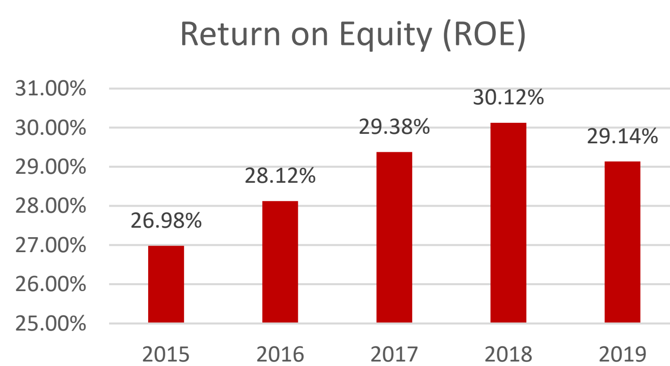
- Profit Margin

Profit margin is calculated as net income divided by total revenues. This indicates the percent of cash remaining after incurring all expenses. JNJ's profit margin tells a similar story to their ROA. Their profit margins hovered around 22-23% in 2015 and 2016 but fell sharply in 2017 with their international gains tax. In 2018 and 2019, levels did not return to their pre-2017 levels. This can be attributed to increased cost of products sold and increased research and development expenses.



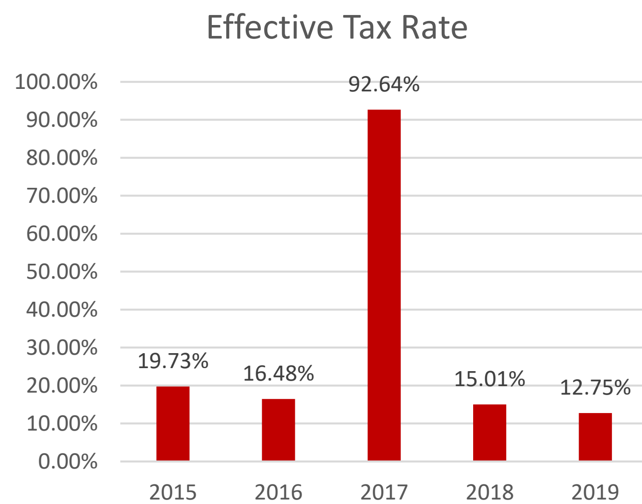
Return on Equity (ROE)

Return on equity (ROE) is calculated utilizing the DuPont method, breaking down the calculation into five separate ratios: tax burden, interest burden, operating margin, asset turnover, and leverage ratio—the product of these ratios results in ROE. JNJ's ROE had consistent gains from 2015-2018 with a slight decline in 2019. This is a positive sign for JNJ, as other competitor firms have ROE's averaging around 13%-20%. This sets JNJ apart in their industry and provides promise for future growth, although it's important to consider other factors.



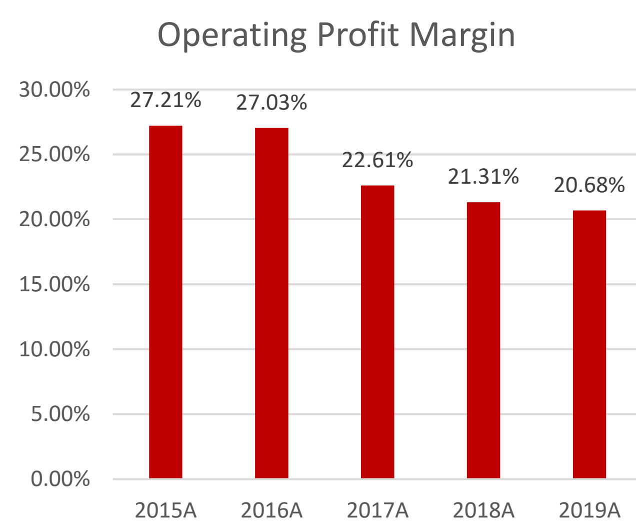
- Effective Tax Rate

The effective tax rate is calcualted as provisions for taxes on income over earnings (EBT). Companies want a smaller tax rate, as it would indicate that the company can retain more cash after taxes. JNJ has been able to maintain a relatively low corporate tax rate hovering around 20% in 2015 and down to 13% in 2019. However, 2017 told the story of international gains tax, resulting in a huge tax rate of 92.64%. Although this resulted in a significant Q4 loss for JNJ, they do not anticipate running into these situations as heavily in the future despite future litigations expected. Since this tax rate stemmed from international gains, JNJ has made sure to keep these risks at bay in the coming years.



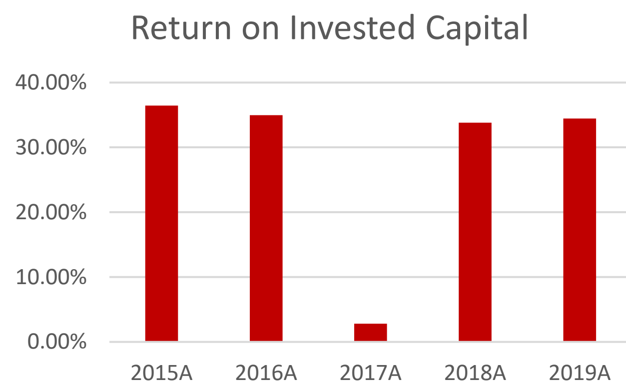
- Operating Profit Margin

Operating profit margin is calculated by dividing earnings before interest and tax (EBIT) also called operating profit by total revenues. Operating profit margin is used to analyze what percentage of total revenues remains after both cost of goods sold and operating expenses such as RD&E and SG&A are deducted from total revenues. This is a very common first indicator of a company's financial health. It allows investors to determine if the company is experiencing operational inefficiencies. Common causes of reductions in operating margin include M&A activities, which can inflict administrative cost if the merger is non-coherent, and unexpected litigation. Johnson & Johnson's operating profit margin has maintained high levels but has started to decrease in recent years due to litigation expenses. However, it is still above a healthy level and should not be cause for too much concern.



Return on Invested Capital (ROIC)

Return on invested capital (ROIC) is calculated utilizing the DuPont method, breaking down the calculation into two separate ratios: NOPAT to total revenues and total revenues to invested capital. The product of these two ratios produces ROIC. ROIC is of particular importance in determining a healthcare company's health and ability to use invested capital to generate future cash flows wisely, especially since so much of JNJ's expenses are allocated to research and development. As mentioned before, this number significantly dropped in 2017 for JNJ because of the international gains tax, but quickly recovered the following year.



Other Financial Ratios

Other financial ratios include ratios not used in the traditional DuPont calculations. These ratios are supplemental in analyzing the company's current and potential ability to handle both macroeconomic and microeconomic events. The most relevant ratios for Johnson & Johnson are the P/E ratio and EV/EBITDA ratio, which give the healthcare industry a fair valuation, and provide good insight for companies of JNJ's size.

Valuation

My valuation is the result of a combination of four methods. These methods offer value-added exposure to multiple levels of analysis. These models included a discounted cash flow model, DDM, historical model, and the relative model. To come to a final intrinsic value, each model was given a weighting based on my analysis of each methods applicability to Johnson & Johnson's past, present, and future.

Discounted Cash Flow (DCF)

I employed a discounted cash flows analysis as one of my methods to derive a price target for Johnson & Johnson. In the model, I forecasted future free cash flows through the FY 2024E. This time horizon appropriately captures several expected growth trends in Johnson & Johnson's operating results while maintaining a reasonable level of predictability. In my final valuation, I put 40% of my weighting to EV/EBITDA because it reflects the highest level of detail out of any other model used in my valuation.

Revenue

Revenue was projected using a projected growth of around 3.75-5.5%. I used an expected revenue growth of 0% for 2020, as COVID-19 has put expected revenue right at or right below 2019 levels according to management guidance. 2021 has a slightly higher projected growth rate than the following years, as JNJ expects to experience higher growth following their decreased sales in the previous year. They also expect sales to increase following the expected release of the COVID-19 vaccine; however, JNJ has already promised to distribute this vaccine at a not-for-profit level. However, despite losing profit on the vaccine post-distribution, they will likely regain some brand recognition and still experience a growth in sales. Following 2021, revenues are expected to grow around 3.75% based on past experiences with revenue growth as JNJ expects to continue their trend of various acquisitions as well as additional patents.

Cost of Goods Sold (COGS)

I projected Cost of Goods Sold as a percent of revenue as it's remained relatively stable over the past 5 years, and especially over the past three years hovering around 33.2-33.6% of revenue. Management guidance suggests that this number is not expected to change, so I maintained this rate for the future.

Selling, General, and Administrative Expenses (SG&A)

I forecasted SG&A expenses as a percent of revenue as well. JNJ has maintained consistent levels of SG&A expenses so I maintained the average rate of 27.6% over the next five years. Management guidance suggests that 2020 will be no exception to this trend even with increased COVID-19 work, which although surprising, tells that they are just reallocating their SG&A funds to different areas of their business, such as marketing for COVID-19.

Beta

Beta was estimated by performing a regression of Johnson & Johnson's historical returns against the S&P 500. Three periods were used for the regression: 5-year monthly returns, five-year weekly returns, and five years' daily returns. Of the three-time regressions, I selected the one that resulted in the highest R-Squared value - the one-year daily regression with an R-Squared of .6 and an adjusted R-squared of 0.936, an extremely high adjusted R-squared value. The value of beta from this regression was .68. Given the high adjusted R-squared value and the fact that this beta is extremely close to the .69 beta provided by various financial resources, I opted to use this beta instead of the bottom-up beta of .55.

Terminal Value Calculations

I calculated the terminal value based on the Perpetual Growth Method (PGM). I used the standard terminal growth rate of 3% to reflect Johnson & Johnson's mature business position while still acknowledging that they have some growth potential.

Capital Asset Pricing Model (CAPM) & Weighted Average Cost of Capital (WACC) Presumptions

In calculating Johnson & Johnson's cost of equity, I used the capital asset pricing model (CAPM). I used the NYU Stern's equity risk premium of 5.23% with risk-free rate data from the 30-year Treasury Bond at 1.6% giving me a cost of equity of 5.2%. I also used 3.19% as my long-term credit yield because based on JNJ's 10K, that is the rate of their longest outstanding debt due in 2048. This gave me a cost of capital of 5%.

Historical P/E Model

The historical P/E model is essentially an analysis of past market premiums to company earnings at the highest and lowest price for the period FY 2005-16. I weighted this model 20% for Johnson & Johnson due to the longevity of the company as well as the importance of EV/EBITDA and EV/Sales and P/E ratio for healthcare companies. I decided to use a five-year average period to reduce some of the outlier effects that the 2017 international gains tax had on JNJ's income. From there, I weighed the P/E ratio and EV/EBITDA.

P/E Ratio

I placed 30% of the weight of the historical model on P/E ratio. Especially for healthcare companies, P/E ratio is a great way to measure the health of the company. This ratio is especially useful given JNJ's size, and given its relative consistency, it is a good way to evaluate Johnson & Johnson. However, it does have an outlier in 2017 of 280.1x. For this reason, I placed less weight on the P/E ratio and used the 5-year average which helped bring down the ratio to a more acceptable number. Even though P/S is more consistent, P/E does a better job of evaluating JNJ as a company.

EV/EBITDA

I placed 70% of the weight of the historical model on EV/EBITDA. Although this number might be considered a little high, it is a good valuation for JNJ as they have been a longstanding company in a growing industry. It also allows for JNJ's high 2017 tax rate to not factor in, which, although is important, puts too much emphasis on their tax rate from 2017. Using EV/EBITDA, the numbers stayed more consistent than the P/E ratio, hence the heavier weighting.

Relative Model

I weighted the relative model at 30%. I compared JNJ to nine different companies; three from each of their main segments: pharmaceuticals, medical devices, and consumer health. From here, I looked at four different companies: Amgen, Medtronic PLC, Pfizer, and Proctor & Gamble. Amgen and Pfizer both fall into the pharmaceutical sector, Medtronic falls into the medical devices sector, and Pfizer (again) and P&G fall into the consumer goods sector. PG had the most similarities to JNJ with market caps above $350 billion, ROA around 9-10%, and ROE around 29%. I chose these companies by comparing relative figures such as ROE, ROA, and Market Cap, as well as P/E ratio, P/S ratio, and EV/EBITDA. Each of these companies helps me to evaluate JNJ on all three of their business segments, as well as evaluate companies of similar size and with simular numerics. I put 50% of the weight on P/S and 50% on EV/EBITDA, giving me an intrinsic value per share of $155.07.

P/S

I weighted P/S at 50% instead of P/E to give me another relevant metric to evaluate JNJ on. I also noticed that the P/E ratios of the other companies were fairly inconsistent compares to the P/S ratio. Additionally, using a P/S ratio shows the illingness of investers to pay per dollar of sales. With a stock as large as JNJ, P/S is a valuable measure because their sales are so large.

EV/EBITDA

Although mentioned earlier, I also weighted EV/EBITDA in the relative model in addition to the historical model. EV/EBITDA is increasingly relevant for companies like JNJ, so the model is important. Additionally, the EV/EBITDA was consistent for the companies I weighted, giving it a more fair valuation compared to other metrics.

Dividend Discount Model

I weighted the dividend discount model at 10%. This model provides great valuation for JNJ since they're known to be a "dividend giant" so to speak, and has consistently given out dividends at a growing rate. This is an excellent indication of a healthy company, as the market can be unforgiving to companies who decrease their dividends. JNJ's dividends are realiable and are an important part of their company and something that shareholders can expect from this consistent company. I maintained a growth rate of around 4-5.5%. Although the payout ratio may seem high, it falls in line with the expected dividend growth rate of about $.05 growth every 4^{th} quarter, and is even a bit conservative based on the growth rate especially of the past few years. Even this year, when expected revenue is not projected to grow from 2019, they've still maintained a consistent dividend, and even raised it at normal rates. Given this information and the expected earnings per share, this gives me an intrinsic value per share at $195.99. While I believe this is a fair value based on their consistent dividends, I understand that dividends aren't a perfect indicator of company health, hence the limited 10% weighting in the overall valuation.

Catalysts for Long-Term Growth

In my research of Johnson & Johnson, I have identified several catalysts for long-term growth. These are covered in more detail in previous sections of the report and in the Investor Presentation.

- Johnson & Johnson has maintained frequent and continued acquisitions leading to an increasingly extensive brand portfolio. They have recently acquired brands such as Momenta Pharmaceuticals, AURIS health, and Bermekimab. With an increasingly large portfolio, JNJ continues to prove why they are the healthcare industry leader.
- Johnson & Johnson has a positive outlook on their vaccine research. Especially amid a global pandemic, JNJ's continued research into vaccines including COVID-19 provide positive potential long-term growth even though a vaccine is anticipated in less than a year.
- Johnson & Johnson provides consistent and growing dividends, indicating that they can stay healthy
- Johnson & Johnson's research and development with medical devices has continued to lead the pack with new, innovative procedures

Risks to Projections and Expectations

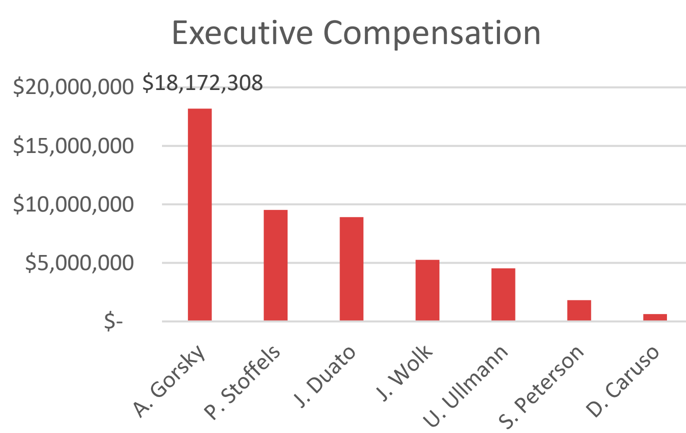
While I have identified catalysts for the long-term growth of Johnson & Johnson, there are risks to my assumptions that could affect their ability to provide returns in line with my projections and market expectations.

- Johnson & Johnson has continued to face litigations resulting in multi-million (or billion) dollar lawsuits. These expenses continue to threaten Johnson & Johnson's credibility.
- Generic brand names threaten Johnson & Johnson's profitability in their largest revenue-earning segment of pharmaceuticals
- Under new administration, tax threats could loom over JNJ's head and threated to encroach on their earnings.
- Other companies could reach a COVID vaccine first, which would significantly reduce the value of JNJ's holdings, but likely only for a short time.

I am confident that Johnson & Johnson's cash reserves significantly reduces these risks, and they have taken steps in to reduce these risks as well.

Corporate Governance

The executive committee at Johnson & Johnson consists of 11 members. The graph to the right shows the top executive compensations. The Board of Directors currently consists of 12 board members.



Executive Members

- Alex Gorsky, Chairman, Board of Directors of Chief Executive Officer
- Joaquin Duato, Vice Chairman of the Executive Committee
- Peter Fasolo, Ph.D., Executive Vice President, Chief Human Resources Officer
- Ashely McEvoy, Executive Vice President, Worldwise Chairman, Medical Devices
- Thibaut Mongon, Executive Vice President, Worldwide Chairman, Consumer Health
- Michael Sneed, Executive Vice President, Global Corporate Affairs and Chief Communication Officer
- Paul Stoffels, M.D., Vice Chairman of the Executive Committee and chief Scientific Officer
- Jennifer Taubert, Executive Vice President, Worldwide Chairman, Pharmaceuticals
- Michael Ullmann, Executive Vice President, Gneral Counsel
- Kathy Wengel, Executive Vice President and Chief Global Supply Chain Officer
- Joseph J. Wolk, Executive Vice President, Chief Financial Officer

The top seven executive members received a total of $48,867,811 in salaried compensation. The CEO Alex Gorsky received the largest salary of $18,172,308. This is broken down by salary ($1,642,308), annual performance bonus ($3,030,000), and long-term incentives ($13,500,000).

Independent Members

- Mary C Beckerle, Ph.D., Chief Executive Officer, Huntsman Cancer Institute at the University of Utah; Distinguished Professor of Biology and Oncological Sciences, University of Utah
- D. Scott Davis, Former Chairman and Chief Executive Officer, United Parcel Service, Inc.
- Ian E. L. Davis, Non-Executive Chairman, Rolls-Royce Holdings plc; Former Chairman and Worldwide Managing Director, McKinsey & Company
- Jennifer A. Doudna, Ph.D., Professor of Biochemistry & Molecular Biology; Li Ka Shing Chancellor's Professorship in Biomedical and Health, University of California, Berkeley
- Marillyn A. Hewson, Chairman, President and Chief Executive Officer, Lockheed Martin Corporation
- Hubert Joly, Executive Chairman, Best Buy Co., Inc.
- Mark B. McClellan, Director, Duke-Robert J. Margolis, MD, Center for Health Policy; Margolis Professor of Business Medicine and Policy, Duke University
- Anne M. Mulcahy, Former Chairman and Chief Executive Officer, Xerox Corporation
- Charles Price, Former Chairman and Chief Executive Officer, Citigroup Inc.
- A. Eugene Washington, M.D., M.Sc., Duke University's Chancellor for Health Affairs; President and Chief Executive Officer, Duke University Health System
- Mark A. Weinberger, Former Chairman and Chief Executive Officer, EY (Ernst & Young)
- Ronald A. Williams, Former Chairman and Chief Executive Officer, Aetna Inc.

Environmental, Social, and Governance (ESG) Observations

Johnson & Johnson has an interesting stance with ESG investments as they play a key role in certain ethically-conscious industries. For example, their statement on pricing of medicines states, "We recognize our dual responsibility to patients today and patients tomorrow. Patients today need access to our medicines. Patients tomorrow count on us to deliver cures and treatments for challenging diseases." This statement seems to be an attempt to justify high (and increasing) drug prices, but doesn't seem to hit the target head on. Additionally, they take stances on political policies, animal welfare, sustainable sourcing, and dozens of others.

In their Health for Humanity Report, they list several sustainability priorities, and take input form their stakeholders on the issues that are important to them. From there, they can better prioritize issues that are meaningful. They conduct these surveys every two to three years with the focus on three main issues: better health for all, responsible business practices, and environmental health. Some of the top sustainability issues on both the consumer and JNJ end include product quality, consumer and patient safety, and access.

Investment Summary

Overall, Johnson & Johnson delivers strong potential for growth despite being near the maturity of their business life cycle. With growing global healthcare threats, the healthcare industry will continue to thrive as people begin to take their health and the health of those around them more seriously. Additionally, they have taken steps to put themselves in the public eye for the not-for-profit work they are doing for the COVID-19 vaccine which will continue to help their brand image improve after threatening litigations. Although they may not be the first company to reach a COVID-19 vaccine, they are continuing other types of research and exploring more opportunities other than COVID-19 research. This analysis leads me to the conclusion that JNJ is well positioned for growth and to continue to serve the demands of their customers. Given our current position in the global portfolio, Johnson & Johnson is at a great point to ride the growth that the healthcare industry expects over the next few years.

***Disclosure**: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.*

I wrote this report myself, and it expresses my own opinions. I am not receiving compensation for it. I have no business relationship with any company whose stock is mentioned in this equity report. This report is written explicitly for the Oregon State Investment Group; however, I hold the right to distribute this document to potential employers or for other educational purposes as a sample of my work.

Signed:

Dana Welty

[11/10/2020]

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Appendix

Valuation

JNJ	
Johnson & Johnson	

Valuation

Valuation Method	Value	MoS	Weight	Current Price	Intrinsic Value	Price Target	
PGM	440.94	209.1 %	0.0 %	112.67	177.44	11/13/2021	186.42
EV/EBITDA	189.26	32.7 %	40.0 %	122.67	177.64	11/13/2022	196.10
EV/Sales	190.95	33.8 %	0.0 %	132.67	177.77	11/13/2023	206.28
RIM	211.09	48.0 %	0.0 %	**142.67**	**177.77**	11/13/2024	216.98
DDM	195.99	37.4 %	10.0 %	152.67	177.64	11/13/2025	228.24
GGM	176.39	23.6 %	0.0 %	162.67	177.44		
Relative	155.07	8.7 %	30.0 %	172.67	177.23		
Historical	177.02	24.1 %	20.0 %				
Intrinsic Value Per Share	**177.23**	**24.2 %**	100.0 %				
Market Price	**142.67**						
Cost of Capital	**4.88 %**						

Recommendation	
Porfolio	Large-Cap
Date of Pitch	11/13/2020
Analyst	Dana Welty
Coverage Type	Update
Buy/Hold/Sell	Hold
Update Frequency	
Next Earnings Date (Q?)	

Summary

With a price target of $177.23 per share, I am recommending a Hold

Forecasts & DCF

JNJ

Johnson & Johnson

Forecasts

# of Years Discounted						0.25	1.25	2.25	3.25	4.25
Period Ending:	2015A	2016A	2017A	2018A	2019A	2020E	2021E	2022E	2023E	2024E
Income Statement:										
Sales to customers	70,074	71,890	76,450	81,581	82,059	82,059	86,572	89,819	93,187	96,681
Cost of products sold	21,536	21,685	25,439	27,091	27,556	27,326	28,829	29,910	31,031	32,195
Gross profit	**48,538**	**50,205**	**51,011**	**54,490**	**54,503**	**54,733**	**57,744**	**59,909**	**62,156**	**64,487**
Selling, marketing and administrative expenses	21,203	19,945	21,520	22,540	22,178	22,648	23,894	24,790	25,720	26,684
Research and development expense	9,046	9,095	10,594	10,775	11,355	11,488	12,120	12,844	13,326	13,825
In-process research and development (Note 5)	224	29	408	1,126	890	903	952	988	1,025	1,063
EBIT	**19,068**	**19,435**	**17,288**	**17,388**	**16,971**	**17,068**	**18,007**	**18,413**	**19,103**	**19,820**
Interest income	(128)	(368)	(385)	(611)	(357)	(410)	(433)	(449)	(466)	(483)
Interest expense, net of portion capitalized (Note 4)	552	726	934	1,005	318	739	779	808	839	870
Other (income) expense, net	(2,064)	484	(42)	1,405	2,525	1,395	1,472	1,527	1,584	1,644
Restructuring (Note 22)	509	491	309	251	266	492	519	539	559	580
Earnings before provision for taxes on income	**19,196**	**19,803**	**17,673**	**17,999**	**17,328**	**17,479**	**18,440**	**18,862**	**19,569**	**20,303**
Effective Tax Rate	19.73 %	16.48 %	92.64 %	15.01 %	12.75 %	**21.0 %**	**21.0 %**	**21.0 %**	**21.0 %**	**21.0 %**
Provision for taxes on income (Note 8)	3,787	3,263	16,373	2,702	2,209	**3,670**	**3,872**	**3,961**	**4,110**	**4,264**
Net earnings	**15,409**	**16,540**	**1,300**	**15,297**	**15,119**	**13,808**	**14,568**	**14,901**	**15,460**	**16,039**
Net earnings per share (Notes 1 and 15)										
Basic (in dollars per share)	5.56	6.04	0.48	5.7	5.72					
Diluted (in dollars per share)	5.48	5.93	0.47	5.61	5.63	5.14	5.48	5.66	5.94	6.22
Cash dividends per share (in dollars per share)	2.95	3.15	3.32	3.54	3.75					
Average shares outstanding (Notes 1 and 15)										
Basic (in shares)	2,772	2,737	2,692	2,682	2,645					
Diluted (in shares)	2,813	2,789	2,745	2,729	2,684	2684.30	2657.46	2630.88	2604.57	2578.53
Balance Sheet:										
Cash and cash equivalents (Notes 1 and 2)	13,732	18,972	17,824	18,107	17,305	17,602	18,570	19,266	19,989	20,738
Marketable securities (Notes 1 and 2)	24,644	22,935	472	1,580	1,982	20,310	11,904	14,820	15,376	15,952
Total current assets	60,210	65,032	43,088	46,033	45,274	45,132	47,615	49,400	51,253	53,175
Loans and notes payable (Note 7)	7,004	4,684	3,906	2,796	1,202	1,641	1,731	1,796	1,864	1,934
Total current liabilities	27,747	26,287	30,537	31,230	35,964	33,644	35,495	36,826	38,207	39,639

	Underlying Assumptions				
Growth	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 4**	**Stage 5**
Revenue Growth	0.00 %	5.50 %	3.75 %	3.75 %	3.75 %
% of Revenue	33.30 %	33.30 %	33.30 %	33.30 %	33.30 %
% of Revenue	27.60 %	27.60 %	27.60 %	27.60 %	27.60 %
% of Revenue	14.00 %	14.00 %	14.30 %	14.30 %	14.30 %
% of Revenue	1.10 %	1.10 %	1.10 %	1.10 %	1.10 %
% of Revenue	(0.50)%	(0.50)%	(0.50)%	(0.50)%	(0.50)%
% of Revenue	0.90 %	0.90 %	0.90 %	0.90 %	0.90 %
% of Revenue	1.70 %	1.70 %	1.70 %	1.70 %	1.70 %
% of Revenue	0.60 %	0.60 %	0.60 %	0.60 %	0.60 %
% Growth	0.00 %	(1.00)%	(1.00)%	(1.00)%	(1.00)%
% Total Current Assets	39.00 %	39.00 %	39.00 %	39.00 %	39.00 %
% Total Current Assets	45.00 %	25.00 %	30.00 %	30.00 %	30.00 %
% of Revenue	55.00 %	55.00 %	55.00 %	55.00 %	55.00 %
% of Revenue	2.00 %	2.00 %	2.00 %	2.00 %	2.00 %
% of Revenue	41.00 %	41.00 %	41.00 %	41.00 %	41.00 %

# of Years Discounted		
Period Ending:	2015A	2016A
Capital Structure		
MV of Equity	*88.3 %*	382,969
Preferred Shares	*0.0 %*	
BV of Debt	*11.7 %*	50,546
Operating Leases	*5.5 %*	24,052
Long-term debt	*6.1 %*	26,494
CAPM Assumptions	*mrkt*	
Beta	0.68	
Equity Risk Premium	5.2 %	
Risk Free Rate for Local Currency	1.6 %	
WACC Assumptions	*CAPM*	
Cost of Equity	5.2 %	
Cost of Preferred Shares		
Cost of Debt	3.2 %	
Credit Rating	Aaa	
Default Spread	1.6 %	
LT Credit Yield	3.2 %	
Cost of Capital	***4.9 %***	

2017A	2018A	2019A	2020E	2021E
			0.25	1.25
Valuation		**PGM**	**EV/EBITDA**	**EV/Sales**
∑ of PV of Future Cash Flows		111,860	111,860	111,860
Terminal Tax Rate		21.0 %	21.0 %	21.0 %
Terminal Growth Rate		3.0 %	*0.2 %*	*0.2 %*
Exit Multiple		n/a	18.7 x	5.5 x
PV of Terminal Value		1,103,591	427,990	432,523
Enterprise Value		1,215,451	539,850	544,383
+ C&CE		17,305	17,305	17,305
+ Investments & Other			-	-
- Debt		50,546	50,546	50,546
- Minority Interests		(1,418)	(1,418)	(1,418)
- Preferred Shares		-	-	-
Equity Value		1,183,628	508,027	512,560
Shares Outstanding (Diluted)		2,684	2,684	2,684
Intrinsic Value Per Share		**440.94**	**189.26**	**190.95**

Relative Model

JNJ

Johnson & Johnson

Relative

Relative Model Inputs	
Discount Period	0.25
Sales (ntm)	82,059.00
EPS (ntm)	5.14
Book Value (ntm)	64,523.88
EPS Growth (5 yr exp.)	2.006 %
EBITDA (ntm)	24,043
Cost of Equity	5.2 %
Cost of Capital	4.9 %
C&CE (mrq)	17,305
Investments & Other (mrq)	-
LT Debt (mrq)	26,494
Minority Interest (mrq)	(1,418)
Preferred shares (mrq)	-
Diluted Shares (mrq)	2,684

Relative Model																
Ticker	JNJ	ABBV	AMGN	NVS	MDT	ISRG	ABT	CL	PFE	PG	Multiple	Value		Discounted	MoS	Weight
P/E (ttm)	21.6 x	19.8 x	17.6 x	27.1 x	31.9 x	83.0 x	56.6 x	26.5 x	23.5 x	27.2 x	25.0 x		128.79	127.17	(10.86)%	
P/S (ttm)	4.5 x	3.8 x	5.2 x	3.9 x	5.0 x	20.3 x	5.9 x	4.4 x	4.2 x	5.2 x	4.9 x		149.49	147.61	3.46 %	50.0 %
P/BV (mrq)	5.6 x	10.6 x	11.6 x	3.5 x	2.8 x	9.3 x	6.2 x	109.0 x	3.1 x	7.4 x	6.2 x		149.99	148.11	3.81 %	
PEG (5 yr expected)	2.55	85.61	1.41	2.60	3.16	5.07	3.35	3.80	2.28	4.65	2.9 x		29.66	29.29	(79.47)%	
EV/EBITDA (ttm)	14.0 x	23.3 x	15.7 x	13.1 x	22.2 x	62.6 x	31.4 x	17.9 x	18.4 x	18.4 x	18.7 x		164.51	162.53	13.92 %	50.0 %
EV/Sales (ttm)	4.6 x	5.8 x	6.0 x	4.4 x	5.6 x	18.8 x	6.3 x	4.8 x	5.2 x	5.1 x	5.5 x		164.55	162.57	13.95 %	
Weight			25.0 %		25.0 %				25.0 %	25.0 %	**Intrinsic Value Per Share**			**155.07**	**8.69 %**	***100.0 %***

Additional Information										
Ticker	JNJ	ABBV	AMGN	NVS	MDT	ISRG	ABT	CL	PFE	PG
Beta	0.68	0.69	0.81	0.43	0.65	0.98	0.89	0.6	0.6	0.4
Debt/Equity (mrq)	165.2 %	569.7 %	312.9 %	70.0 %	56.9 %		63.9 %	674.7 %	98.5 %	65.2 %
Return on Equity	29.1 %	209.1 %	67.2 %	13.3 %	876.0 %	12.5 %	10.6 %	457.1 %	13.5 %	28.9 %
Return on Assets	10.0 %	8.1 %	9.5 %	6.8 %	2.8 %	6.6 %	4.2 %	15.7 %	5.1 %	9.1 %
Market Cap ($BN):	382.97	155.75	127.21	192.41	139.83	85.61	188.42	71.15	202.21	353.05

Historical Model

JNJ

Johnson & Johnson

Historical

Year	2015A	2016A	2017A	2018A	2019A	2020E
Sales	70,074	71,890	76,450	81,581	82,059	82,059
EBIT	19,068	19,435	17,288	17,388	16,971	17,068
D&A	3,746	3,754	5,642	6,929	7,009	6,975
EBITDA	22,814	23,189	22,930	24,317	23,980	24,043
Minority Interests						
Net Income	15,409	16,540	1,300	15,297	15,119	13,808
LT Debt	12,857	22,442	30,675	27,684	26,494	36,000
C&CE	13,732	18,972	17,824	18,107	17,305	17,602
Book Value	71,150	70,418	60,160	59,752	59,471	64,524
Preferred Shares						
Diluted Shares	2,813	2,789	2,745	2,729	2,684	2,684
Sales/Share	24.91	25.78	27.85	29.90	30.57	30.57
EBITDA/Share	8.11	8.31	8.35	8.91	8.93	8.96
Minority Interest/Share	-	-	-	-	-	-
EPS	5.48	5.93	0.47	5.61	5.63	5.14
LT Debt/Share	4.57	8.05	11.17	10.15	9.87	13.41
C&CE/Share	4.88	6.80	6.49	6.64	6.45	6.56
BV/Share	25.29	25.25	21.91	21.90	22.16	24.04
Preferred/Share	-	-	-	-	-	-
High Price	92.61	111.93	132.64	140.95	143.55	
P/S	3.7 x	4.3 x	4.8 x	4.7 x	4.7 x	
P/E	16.9 x	18.9 x	280.1 x	25.1 x	25.5 x	
P/B	3.7 x	4.4 x	6.1 x	6.4 x	6.5 x	
EV/Share	92.30	113.17	137.32	144.46	146.98	
EV/EBITDA	11.4 x	13.6 x	16.4 x	16.2 x	16.5 x	
EV/Sales	3.7 x	4.4 x	4.9 x	4.8 x	4.8 x	
Low Price	79.25	84.25	101.11	112.37	119.86	
P/S	3.2 x	3.3 x	3.6 x	3.8 x	3.9 x	
P/E	14.5 x	14.2 x	213.5 x	20.0 x	21.3 x	
P/B	3.1 x	3.3 x	4.6 x	5.1 x	5.4 x	
EV/Share	78.94	85.49	105.79	115.88	123.29	
EV/EBITDA	9.7 x	10.3 x	12.7 x	13.0 x	13.8 x	
EV/Sales	3.2 x	3.3 x	3.8 x	3.9 x	4.0 x	

Used in Average?		Yes				
Average Period	3 Years	5 Years	Value	Discounted	MoS	Weight
P/S	4.25	4.00	122.26	120.72	(15.38)%	
P/E	97.60	65.00	334.38	330.18	131.43 %	30.0 %
P/B	5.69	4.87	117.04	115.56	(19.00)%	
EV/EBITDA	14.76	13.36	112.79	111.38	(21.94)%	70.0 %
EV/Sales	4.38	4.09	118.05	116.57	(18.29)%	
			Intrinsic Value Per Share	177.02	24.07 %	100.0 %

DuPont

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DuPont

	DuPont Analysis					
Period Ending	2015A	2016A	2017A	2018A	2019A	
NOPAT Margin	21.84 %	22.58 %	1.66 %	18.11 %	18.04 %	(EBIT*(1-effective tax rate))/Sales
Asset Turnover	0.5 x	0.5 x	0.5 x	0.5 x	0.6 x	Sales/Average Total Assets
Return on Assets	**10.3 %**	**10.9 %**	**0.9 %**	**9.9 %**	**10.0 %**	
Debt Burden	1.0 x	1.0 x	1.0 x	1.0 x	1.0 x	Net Income/(EBIT*(1-effective tax rate))
NOPAT Margin	27.2 %	27.0 %	22.6 %	21.3 %	20.7 %	(EBIT*(1-effective tax rate))/Sales
Asset Turnover	0.5 x	0.5 x	0.5 x	0.5 x	0.6 x	Sales/Average Total Assets
Leverage Ratio	2.1 x	2.1 x	2.5 x	2.5 x	2.5 x	Average Total Assets/Equity
Return on Equity	**27.0 %**	**28.1 %**	**29.4 %**	**30.1 %**	**29.1 %**	
NOPAT	15,306	16,233	1,272	14,778	14,808	EBIT*(1-effective tax rate)
Average Total Capitalization	42,004	46,430	45,418	43,718	42,983	Average(Long-Term Debt+Equity)
Return on Capital	**36.4 %**	**35.0 %**	**2.8 %**	**33.8 %**	**34.5 %**	

	Profitability Ratios					
Period Ending	2015A	2016A	2017A	2018A	2019A	
Gross Margin	69.3 %	69.8 %	66.7 %	66.8 %	66.4 %	Gross Profit/Sales
Operating Margin	27.2 %	27.0 %	22.6 %	21.3 %	20.7 %	Operating Income/Sales
Profit Margin	22.0 %	23.0 %	1.7 %	18.8 %	18.4 %	Net Income/ Sales
Operating Costs to Sales	43.5 %	40.4 %	42.5 %	42.2 %	41.9 %	Operating Costs/Sales
Effective Tax Rate	19.7 %	16.5 %	92.6 %	15.0 %	12.7 %	Provision for Income Tax/EBT

	Leverage Ratios					
Period Ending	2015A	2016A	2017A	2018A	2019A	
Debt to Total Assets	0.5 x	0.5 x	0.6 x	0.6 x	0.6 x	Total Liabilities/Total Assets
Total Debt to Equity	0.9 x	1.0 x	1.6 x	1.6 x	1.7 x	Total Debt/Equity
LT Debt to Equity	0.2 x	0.3 x	0.5 x	0.5 x	0.4 x	LT Debt/Equity
Times Interest Earned (TIE)	34.5 x	26.8 x	18.5 x	17.3 x	53.4 x	Operating Income/Interest Expense
Degree of Operating Leverage		2.8 x	(14.5)x	160.4 x	(2.0)x	% change in profits/% change in sales

	Liquidity Ratios					
Period Ending	2015A	2016A	2017A	2018A	2019A	
Current Ratio	2.2 x	2.5 x	1.4 x	1.5 x	1.3 x	Current Assets/Current Liabilities
Acid Test/Quick Ratio	2.0 x	1.9 x	1.5 x	1.5 x	1.5 x	(Current Assets-Inventory)/Current Liabiliites
Net Working Capital to Sales	1.0 x	1.0 x	0.8 x	0.7 x	0.7 x	(Current Assets-Current Liabilities)/Sales
Payout Ratio	53.8 %	53.1 %	706.4 %	63.1 %	66.6 %	DPS/EPS
Plowback/Retention Ratio	46.2 %	46.9 %	(606.4)%	36.9 %	33.4 %	1-Payout Ratio
Sustainable Growth Rate	12.5 %	13.2 %	(178.1)%	11.1 %	9.7 %	ROE * Plowback Ratio
EVA	13,257	16,233	1,272	14,778	14,808	NOPAT - (Cost of Capital * Total Capitalization)
Accounts Receivable Turnover	5.4 x	5.6 x	5.9 x	6.3 x	6.4 x	Sales/Average Accounts Recivable
Average Daily Sales	192.0 x	197.0 x	209.5 x	223.5 x	224.8 x	Sales/365
Days' Sales Outstanding (DSO)	0.2 x	0.2 x	0.2 x	0.2 x	0.2 x	Average Accounts Receivable/ Average Daily Sales
Inventory Turnover	8.2 x	8.4 x	9.0 x	9.6 x	9.6 x	Sales/Average Total Inventory
Days' Inventory Outstanding (DIO)	44.4 x	43.2 x	40.7 x	38.1 x	37.9 x	365/Inventory Turnover
Accounts Payable Turnover	2.9 x	2.9 x	3.4 x	3.7 x	3.7 x	COGS/Average Accounts Payable
Days' Payable Outstanding (DPO)	125.3 x	124.5 x	106.1 x	99.6 x	98.0 x	365/Accounts Payable Turnover
Cash Conversion Cycle	(80.81)	(81.07)	(65.28)	(61.37)	(59.91)	DIO+DSO-DPO

Income Statement

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Statement of Operations

											Next Fiscal Year	
Period Ending:	**2015A**	**2016A**	**2017A**	**2018A**	**2019A**	**FY2019 Q1**	**FY2019 Q2**	**FY2019 Q3**	**FY2019 Q4**	**Q1**	**Q2**	**Q3**
Income Statement [Abstract] In Millions												
Sales to customers	$ 70,074	$ 71,890	$ 76,450	$ 81,581	$ 82,059					$ 20,691	$ 18,336	$ 21,082
Cost of products sold	21,536	21,685	25,439	27,091	27,556					7,062	6,579	6,972
Gross profit	48,538	50,205	51,011	54,490	54,503					13,629	11,757	14,110
Selling, marketing and administrative expenses	21,203	19,945	21,520	22,540	22,178					5,203	4,993	5,431
Research and development expense	9,046	9,095	10,594	10,775	11,355					2,580	2,707	2,840
In-process research and development (Note 5)	224	29	408	1,126	890					0	6	138
Interest income	(128)	(368)	(385)	(611)	(357)					(67)	(19)	(12)
Interest expense, net of portion capitalized (Note 4)	552	726	934	1,005	318					25	45	44
Other (income) expense, net	(2,064)	484	(42)	1,405	2,525					(679)	24	1,200
Restructuring (Note 22)	509	491	309	251	266					58	61	68
Earnings before provision for taxes on income	19,196	19,803	17,673	17,999	17,328					6,509	3,940	4,401
Provision for taxes on income (Note 8)	3,787	3,263	16,373	2,702	2,209					713	314	847
Net earnings	$ 15,409	$ 16,540	$ 1,300	$ 15,297	$ 15,119					$ 5,796	$ 3,626	$ 3,554
Net earnings per share (Notes 1 and 15)												
Basic (in dollars per share)	$ 5.56	$ 6.04	$ 0.48	$ 5.70	$ 5.72					$ 2.20	$ 1.38	$ 1.35
Diluted (in dollars per share)	5.48	5.93	$ 0.47	$ 5.61	$ 5.63					$ 2.17	$ 1.36	$ 1.33
Cash dividends per share (in dollars per share)	$ 2.95	$ 3.15	$ 3.32	$ 3.54	$ 3.75							
Average shares outstanding (Notes 1 and 15)												
Basic (in shares)	2,771.8	2,737.3	2,692	2,681.5	2,645.1					2,633.7	2,632.9	2,632.5
Diluted (in shares)	2,812.9	2,788.9	2,745.3	2,728.7	2,684.3					2,671.0	2,665.5	2,669.3
Antidilutive Securities Excluded from Computation of Earnings Per Share, Amount											20000	20000

Balance Sheet

Balance Sheet

											Next Fiscal Year	
Period Ending:	2015A	2016A	2017A	2018A	2019A	FY2019 Q1	FY2019 Q2	FY2019 Q3	FY2019 Q4	Q1	Q2	Q3
Cash and cash equivalents (Notes 1 and 2)	$ 13,732	$ 18,972	$ 17,824	$ 18,107	$ 17,305					$ 15,530	$ 11,174	$ 18,965
Marketable securities (Notes 1 and 2)	24,644	22,935	472	1,580	1,982					2,494	7,961	11,816
Accounts receivable trade, less allowances for doubtful accounts $226 (2018, $248	10,734	11,699	13,490	14,098	14,481					14,874	14,645	14,579
Inventories (Notes 1 and 3)	8,053	8,144	8,765	8,599	9,020					8,868	9,424	9,599
Prepaid expenses and other receivables	3,047	3,282	2,537	2,699	2,392					2,358	2,588	2,528
Assets held for sale (Note 20)	0	0	0	950	94					102	100	91
Total current assets	60,210	65,032	43,088	46,033	45,274					44,226	45,892	57,578
Property, plant and equipment, net (Notes 1 and 4)	15,905	15,912	17,005	17,035	17,658					43,247	44,056	17,855
Less: accumulated depreciation					(25,674)					(25,846)	(26,458)	(27,307)
Property, plant, and equipment at cost					43,332					17,401	17,598	45,162
Intangible assets, net (Notes 1 and 5)	25,764	26,876	53,228	47,611	47,643					47,338	47,413	47,006
Goodwill (Notes 1 and 5)	21,629	22,805	31,906	30,453	33,639					33,471	33,890	34,307
Deferred taxes on income (Note 8)	5,490	6,148	7,105	7,640	7,819					7,539	7,805	7,816
Other assets	4,413	4,435	4,971	4,182	5,695					5,042	5,782	6,131
Total assets	133,411	141,208	157,303	152,954	157,728					155,017	158,380	170,693
Current liabilities:												
Loans and notes payable (Note 7)	7,004	4,684	3,906	2,796	1,202					2,190	5,332	5,078
Accounts payable	6,668	6,918	7,310	7,537	8,544					7,411	6,765	7,044
Accrued liabilities	5,411	5,635	7,304	7,601	9,715					8,384	8,940	9,629
Accrued rebates, returns and promotions	5,440	5,403	7,210	9,380	10,883					11,608	11,790	12,418
Accrued compensation and employee related obligations	2,474	2,676	2,953	3,098	3,354					2,166	2,313	3,012
Accrued taxes on income (Note 8)	750	971	1,854	818	2,266					1,930	1,632	1,666
Total current liabilities	27,747	26,287	30,537	31,230	35,964					33,689	36,772	38,847
Long-term debt (Note 7)	12,857	22,442	30,675	27,684	26,494					25,393	25,062	32,680
Deferred taxes on income (Note 8)	2,562	2,910	8,368	7,506	5,958					5,766	5,532	5,615
Employee related obligations (Notes 9 and 10)	8,854	9,615	10,074	9,951	10,663					10,529	10,411	10,184
Long-term taxes payable (Note 8)	0	0	8,472	8,242	7,444					7,402	6,591	6,745
Other liabilities	10,241	9,536	9,017	8,589	11,734					10,944	11,034	12,149
Total liabilities	62,261	70,790	97,143	93,202	98,257					93,723	95,402	106,220
Shareholders' equity:												
Preferred stock — without par value (authorized and unissued 2,000,000 shares)	0	0	0	0	0							0
Common stock — par value $1.00 per share (Note 12) (authorized 4,320,000,000 shares; issued 3,119,843,000 shares)	3,120	3,120	3,120	3,120	3,120					3,120	3,120	3,120
Accumulated other comprehensive income (loss) (Note 13)	(13,165)	(14,901)	(13,199)	(15,222)	(15,891)					(16,243)	(15,533)	(14,938)
Retained earnings	103,879	110,551	101,793	106,216	110,659					112,901	113,898	114,831
Stockholders' Equity before Treasury Stock	93,834	98,770	91,714	94,114	97,888					38,484	38,507	
Less: common stock held in treasury, at cost (Note 12) (487,336,000 shares and 457,519,000 shares)	22,684	28,352	31,554	34,362	38,417					61,294	62,978	38,540
Total shareholders' equity	71,150	70,418	60,160	59,752	59,471					$ 155,017	$ 158,380	64,473
Total liabilities and shareholders' equity	$ 133,411	$ 141,208	$ 157,303	$ 152,954	$ 157,728							$ 170,693
Common Stock, Shares Authorized					4,320,000,000							4,320,000,000
Common Stock, Shares, Issued					3,119,843,000							3,119,843,000

Statement of Cash Flows

Statement of Cash Flows					
Period Ending:	**2015A**	**2016A**	**2017A**	**2018A**	**2019A**
Cash flows from operating activities					
Net earnings	$ 15,409	$ 16,540	$ 1,300	$ 15,297	$ 15,119
Adjustments to reconcile net earnings to cash flows from operating activities:					
Depreciation and amortization of property and intangibles	3,746	3,754	5,642	6,929	7,009
Stock based compensation	874	878	962	978	977
Venezuela adjustments	122	0	0	0	0
Asset write-downs	624	283	795	1,258	1,096
Gain on sale of assets/businesses	(2,583)	(563)	(1,307)	(1,217)	(2,154)
Deferred tax provision	(270)	(341)	2,406	(1,016)	(2,476)
Accounts receivable allowances	18	(11)	17	(31)	(20)
Changes in assets and liabilities, net of effects from acquisitions and divestitures:					
Increase in accounts receivable	(433)	(1,065)	(633)	(1,185)	(289)
(Increase)/Decrease in inventories	(449)	(249)	581	(644)	(277)
Increase in accounts payable and accrued liabilities	287	656	2,725	3,951	4,060
Increase in other current and non-current assets	(103)	(529)	(411)	(275)	(1,054)
Increase/(Decrease) in other current and non-current liabilities	2,327	(586)	8,979	(1,844)	1,425
Net cash flows from operating activities	19,569	18,767	21,056	22,201	23,416
Cash flows from investing activities					
Additions to property, plant and equipment	(3,463)	(3,226)	(3,279)	(3,670)	(3,498)
Proceeds from the disposal of assets/businesses, net	3,464	1,267	1,832	3,203	3,265
Acquisitions, net of cash acquired (Note 20)	(954)	(4,509)	(35,151)	(899)	(5,810)
Purchases of investments	(40,828)	(33,950)	(6,153)	(5,626)	(3,920)
Sales of investments	34,149	35,780	28,117	4,289	3,387
Proceeds from credit support agreements	0	0	0	0	338
Other	(103)	(123)	(234)	(464)	44
Net cash used by investing activities	(7,735)	(4,761)	(14,868)	(3,167)	(6,194)
Cash flows from financing activities					
Dividends to shareholders	(8,173)	(8,621)	(8,943)	(9,494)	(9,917)
Repurchase of common stock	(5,290)	(8,979)	(6,358)	(5,868)	(6,746)
Proceeds from short-term debt	2,416	111	869	80	39
Repayment of short-term debt	(1,044)	(2,017)	(1,330)	(2,479)	(100)
Proceeds from long-term debt, net of issuance costs	75	12,004	8,992	5	3
Repayment of long-term debt	(68)	(2,223)	(1,777)	(1,555)	(2,823)
Proceeds from the exercise of stock options/employee withholding tax on stock awards, net	1,005	1,189	1,062	949	954
Other	(57)	(15)	(188)	(148)	575
Net cash used by financing activities	(11,136)	(8,551)	(7,673)	(18,510)	(18,015)
Effect of exchange rate changes on cash and cash equivalents	(1,489)	(215)	337	(241)	(9)
(Decrease)/Increase in cash and cash equivalents	(791)	5,240	(1,148)	283	(802)
Cash and cash equivalents, beginning of year (Note 1)	14,523	13,732	18,972	17,824	18,107
Cash and cash equivalents, end of year (Note 1)	13,732	18,972	17,824	18,107	17,305
Cash paid during the year for:					
Interest	617	730	960	1,049	995
Interest, net of amount capitalized	515	628	866	963	925
Income taxes	2,865	2,843	3,312	4,570	4,191
Supplemental schedule of non-cash investing and financing activities					
Treasury stock issued for employee compensation and stock option plans, net of cash proceeds/ employee withholding tax on stock awards	1,486	2,043	2,062	2,095	1,736
Conversion of debt	16	35	16	6	1
Acquisitions					
Fair value of assets acquired	1,174	4,586	36,937	1,047	7,228
Fair value of liabilities assumed and noncontrolling interests	(220)	(77)	(1,786)	(148)	(1,418)
Net cash paid for acquisitions (Note 20)	$ 954	$ 4,509	$ 35,151	$ 899	$ 5,810

Dividend Discount Model

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DDM & GGM

# of Years Discounted						0.25	1.25	2.25	3.25	4.25
Period Ending:	**2015A**	**2016A**	**2017A**	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**
Earnings Per Share	5.48	5.93	0.47	5.61	5.63	5.14	5.48	5.66	5.94	6.22
Dividend Per Share	2.95	3.15	3.32	3.54	3.75	3.90945	4.05649	4.24789	4.4517	4.66529
Growth Rate		*6.780 %*	*5.397 %*	*6.627 %*	*5.932 %*	*4.3 %*	*3.8 %*	*4.7 %*	*4.8 %*	*4.8 %*
Payout Ratio	*53.9 %*	*53.1 %*	*701.1 %*	*63.1 %*	*66.6 %*	76.0 %	74.0 %	75.0 %	75.0 %	75.0 %
PV of Dividends						3.86	3.81	3.79	3.78	3.76
EPS CAGR						(8.671)%	(1.346)%	0.186 %	1.320 %	2.006 %

Terminal Growth Rate Assumption	DCF
Terminal Growth Rate	3.0 %

Dividend Discount Model	
∑ of PV of Dividends	19.00
PV of Terminal Value	176.99
Intrinsic Value Per Share	**195.99**

Gordon Growth Model	
Projected Dividend	3.86
Cost of Equity	5.2 %
Dividend Growth Rate	3.0 %
Intrinsic Value Per Share	**176.39**