Disnat GPS Report

Johnson & Johnson (JNJ, U$132.27)

Desjardins
Online Brokerage

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General Comments

Johnson & Johnson is the largest and most significant healthcare company in the world.

The company has three divisions: pharmaceuticals (45% of revenues), medical devices (35% of revenues), and consumer healthcare products (20%).

This partition into three distinctive sectors provides an interesting diversification of business activities, but above all it ensures that no product in any division is large enough to singularly affect the performance of the business (as did Lipitor for Pfizer, for example).

In addition to its considerable and effective diversification, Johnson & Johnson distinguishes itself from other multinationals by knowing and respecting its *credo*. Written more than 70 years ago, this statement of principles is so important to the culture of the company that we have found it useful to provide you with a brief summary (we invite you to read the full original text in the latest annual report or on the Johnson & Johnson website).

The Johnson & Johnson *Credo*

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services...

We are responsible to our employees, the men and women who work with us throughout the world...

We are responsible to the communities in which we live and work and to the world community as well...

Our final responsibility is to our stockholders… When we operate according to these principles, the stockholders should realize a fair return.

At Disnat GPS, we believe that the knowledge and respect of this *credo*, both by management and by employees, did more than help the company make the right decisions during the 1982 Tylenol crisis: These principles form the very foundation of what makes Johnson & Johnson a superior company!

This report is the first Disnat GPS report published on Johnson & Johnson.

Financial Health

Fiscal Year	2014	2015	2016
Long term debt (in billions of dollars)	15	13	22
Debt/equity ratio	0.22	0.18	0.32

Johnson & Johnson's financial health is among the strongest.

The company is so well positioned that it is one of only two US companies to achieve a AAA credit rating, the other being Microsoft.

To understand the significance of this credit rating, it is important to keep in mind that the US government, despite its power of taxation, has a lower credit rating (AA+) than Johnson & Johnson!

Johnson & Johnson's low debt and ease of borrowing offer the company some flexibility. It could potentially increase this debt to increase its dividend, improve its share repurchase program or make some useful acquisitions as it did recently (Synthes, Actélion, etc.) without having to take excessive financial risks in terms of funding.

The financial health of the company is a particularly important factor for our investment in Johnson & Johnson.

In Disnat GPS's investment philosophy, financial health is a key factor, and virtually no other business is as financially sound as Johnson & Johnson!

Growth

Compound Yield	1 year	3 years	5 years	10 years
Earnings	2.6%	0.3%	2.0%	3.0%
Earnings per share	8.2%	7.2%	11%	4.8%

The growth in Johnson & Johnson's earnings per share is exceptionally stable. Sustained growth of more than 2-3% in revenues and 11% in earnings per share for five years represent good performance for a multinational of this size.

Looking ahead, we see that the most recent acquisitions have been concentrated in the pharmaceutical and medical device sectors. These sectors normally offer better profit margins and complement the company's activities, which increases synergy.

In addition, we believe healthcare and beauty products will be a riskier sector due to the continued growth of private brands such as Kirkland (Costco), Equate (Walmart) and Personelle (Jean Coutu). However, while the Beauty and Healthcare division contributes to Johnson & Johnson's healthy diversification, a slight decline in the space it occupies in the business is likely to beneficial future results.

Population aging and the rapid development of a middle class in emerging economies should provide support for the demand of health products, which bodes well for the health sector and its main advocate: Johnson & Johnson.

Valuation

Key Ratios	JNJ	JNJ (5 yr avg)	S&P 500
Price/earnings	22.4	19.8	21.4
Forward price/earnings	18.6	n.a.	19.9
Dividend yield	2.5%	2.9%	2.1%

In terms of price/earnings ratios and future price/earnings, Johnson & Johnson stock is currently trading relatively in line with the S&P 500 ratio and with its own average of the last five years.

Johnson & Johnson's valuation is therefore a relatively attractive entry point for acquiring a superior business at a fair price.

The dividend yield, which currently stands at around 2.5%, is relatively lower than its historical average, but is still 0.4% higher than the index.

On the other hand, while a stock can not replace a fixed income product (bonds, GICs, etc.), Johnson & Johnson's dividend compares favorably to current interest rates, which is an additional factor contributing to the strength of this stock.

At Disnat GPS, we usually prefer securities with a clearly discounted price/earnings ratio relative to the S&P 500 and their own five-year average. In the case of Johnson & Johnson, the superior quality of the business is reason enough for us to pay a "quality premium"!

Governance

Fiscal Year	2012	2013	2014	2015	2016
Earnings per share ($)	3.86	4.81	5.70	5.48	5.93
Dividend ($)	2.40	2.59	2.76	2.95	3.15
Number of shares (mil)	2,821	2,783	2,767	2,721	2,694

Johnson & Johnson has paid out and increased its dividend in each of the past 54 years.

Over the past five years, Johnson & Johnson's dividend has increased by an average of more than 8% per year.

In addition, the company regularly buys back its shares. Over the past five years, Johnson & Johnson has repurchased more than 4% of its outstanding shares. In 2016, it used about two-thirds of its $10 billion buyout budget!

With regard to internal development, in addition to the approximately nine billion dollars earmarked for research and development and the proposed acquisition of Actalion for approximately $30 billion, the company also made 14 smaller acquisitions in 2016.

A steady increase in dividend, share buybacks, a large research and development budget and targeted acquisitions are the basis for good governance. Johnson & Johnson is therefore the perfect example of the kind of company we want to include in our Disnat GPS portfolios.

Explanatory Notes

Disnat GPS reports contain five separate sections, each followed by comments from the Disnat GPS Portfolio Strategist regarding the following:

1. Company Description

2. Financial Health

3. Growth

4. Valuation

5. Governance

At Disnat GPS, we believe that the topics, ratios and other financial figures presented here are particularly important.

However, for reasons of space, we can not publish all available data. We therefore invite you to read the additional financial information on the Disnat website.

Furthermore, this report is an analysis of the condition of a company today, with a medium to long term view. It is in no way an adequate tracking of daily activities of the stock market in general or of this particular company.

For a more regular monitoring of this and other securities held in one of our portfolios, please to subscribe to Disnat GPS now.

Warning

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