

# Johnson & Johnson

United States of America/Pharmaceuticals  
**19 April 2017**

UBS Research  
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## Q&A Tidbits and Post-Call Take-Aways: Optics Obscure Attractive Asset - We Remain Buyers

- Unfavorable optics obscure solid fundamentals and improving returns
- Pharma up 4.7% excluding acq/div and gross to net adjustments
- Device trends stable, Consumer margins improving despite slow start to year
- Valuation: \$136 target, 12.5x EV/EBITDA on 2018E EBITDA of \$31.2 bil

Management delivered a solid bottom line beat on in-line sales, but prior-period adjustments impacted Pharma growth, making the as-reported results look less robust. However, we see a solid fundamental Q1 print, with encouraging underlying device utilization trends. Despite the lower than expected Q1 Pharma performance on a reported basis, we continue to see key areas of strength across the JNJ Pharma franchise, including Imbruvica (up >50%) and Darzalex (up >100%), both driven by new indications, and together under-estimated in Street estimates by over \$1 bil in 2018 and beyond, by our estimates. We are raising our estimates to reflect the inclusion of the Actelion deal, and reiterate our Buy rating and \$136 on top large-cap diversified pick JNJ. We view the initial pullback in the stock as a particularly attractive entry point for investors.

**Pharma up 4.7% excluding acq/div and gross to net adjustments**  
 Excluding negative impact of 2.5% from gross to net price adjustments in 1Q16 (~\$200 mil), WW Pharma grew 4.7% in the quarter vs. our 6.0% estimate. Remicade volume has not been significantly impacted by the U.S. biosimilar launch late last year. Management raised 2017 sales guidance by \$1.3 bil to \$75.4-76.1 bil (+5.8-6.8% CC) and EPS guidance by 7c to \$7.00-7.15 (+6-8% CC) due to the inclusion of the Actelion deal, roughly in line with our \$1.4 bil and 9c estimates (see our interactive model published on February 22). Management expects FX headwinds to negatively impact revenues by 1% and EPS by 12c in 2017.

**Device trends stable, Consumer margins improving despite slow start to year**

Solid device growth was driven by priority platforms (afib, endocutters, energy, knees, and trauma), which together were up 6.5%. Consumer was roughly in line with our estimate but below consensus on slower end markets, but Consumer margins improved nicely to 20.2%, up from 18.7% a year ago.

**Valuation: \$136 target, 12.5x EV/EBITDA on 2018E EBITDA of \$31.2 bil**  
 Our price target now includes projected accretion and the impact of the \$30 bil cash outlay for the Actelion deal.

12-month rating	<b>Buy</b>
12-month price target	<b>\$136.00</b>
Price	<b>\$121.82</b>

Contributing authors: Yi Cheng

### Trading data and key metrics

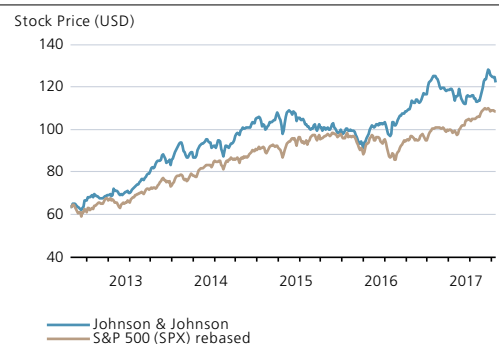
52-wk range	US\$128.96-110.99
Market cap.	US\$337bn
Shares o/s	2,765m (COM)
Free float	100%
Avg. daily volume ('000)	2,222
Avg. daily value (m)	US\$269.1
Common s/h equity (12/17E)	US\$72.7bn
P/BV (12/17E)	4.6x
Net debt / EBITDA (12/17E)	0.6x
RIC	JNJ.N
BBG	JNJ US

Sources: UBS, Bloomberg

### EPS (UBS, diluted) (US\$)

	12/17E			Cons.
	From	To	% ch	
Q1	1.80	1.83	1	1.77
Q2E	1.88	1.86	-2	1.80
Q3E	1.78	1.79	1	1.78
Q4E	1.53	1.59	4	1.67
12/17E	7.00	7.07	1	7.04
12/18E	7.49	7.86	5	7.42
12/19E	7.92	8.30	5	7.85

### Performance



Sources: Bloomberg, UBS

Definitions of terms and abbreviations are available in the appendix section of this report, and more extensively on internet at [www.ubs.com/glossary](http://www.ubs.com/glossary)

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# Johnson & Johnson

## Investment Thesis

### Investment Case

Our Buy rating is based on our expectation that potential biosimilar competition for Remicade is discounted in the stock and should be more than offset by the value of the company's pipeline. Pharma, Medical Devices, and Consumer each represents 45%, 36%, and 19% of total revenues in 2015, growing at a CAGR of 8%, 3%, and 2% through 2020. Our thesis for JNJ is largely focused on pharma.

### Company Profile: Johnson & Johnson

Johnson & Johnson is a global manufacturer and provider of diversified health care and pharmaceutical products, medical devices and equipment.

### Statement of Risk

Our \$136 price target is based on 12.5x EV/EBITDA multiple on our projected 2018E EBITDA. Risks to our price target include

greater than expected competitive impact on Remicade, major delays or drop-outs in the pipeline or an unexpected slowdown in utilization reversing recent trends.

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Highlights (US\$m)	12/14	12/15	12/16	12/17E	12/18E	12/19E	12/20E	12/21E
Revenues	74,331	70,074	71,890	75,680	80,558	84,850	89,101	93,455
EBIT (UBS)	22,741	18,342	22,301	21,805	24,242	25,839	27,445	29,067
Net earnings (UBS)	18,318	17,445	18,764	19,484	21,485	22,705	23,971	25,325
EPS (UBS, diluted) (US\$)	6.39	6.20	6.73	7.07	7.86	8.30	8.77	9.26
DPS (US\$)	2.76	2.95	3.15	3.36	3.59	3.84	4.10	4.37
Net (debt) / cash	14,329	18,515	14,781	(16,520)	(9,850)	(2,914)	4,350	4,350
Profitability/valuation	12/14	12/15	12/16	12/17E	12/18E	12/19E	12/20E	12/21E
EBIT margin %	30.6	26.2	31.0	28.8	30.1	30.5	30.8	31.1
ROIC (EBIT) %	38.4	33.9	41.2	30.1	27.4	29.7	32.2	34.5
EV/EBITDA (core) x	10.4	12.2	11.8	12.0	10.5	9.9	9.6	8.9
P/E (UBS, diluted) x	15.8	16.1	16.9	17.2	15.5	14.7	13.9	13.2
Equity FCF (UBS) yield %	5.2	5.7	4.9	5.7	7.1	7.5	8.0	8.5
Net dividend yield %	2.7	3.0	2.8	2.8	2.9	3.1	3.4	3.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied.

Valuations: based on an average share price that year, (E): based on a share price of US\$121.82 on 18 Apr 2017 18:44 EDT

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UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	45%	29%
Neutral	Hold/Neutral	39%	27%
Sell	Sell	15%	16%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2016.

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.

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**Buy:** FSR is > 6% above the MRA. **Neutral:** FSR is between -6% and 6% of the MRA. **Sell:** FSR is > 6% below the MRA.

#### **Key Definitions**

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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#### **Company Disclosures**

Company Name	Reuters	12-mo rating	Price	Price date
Johnson & Johnson	JNJ US	Buy	US\$121.82	18 Apr 2017

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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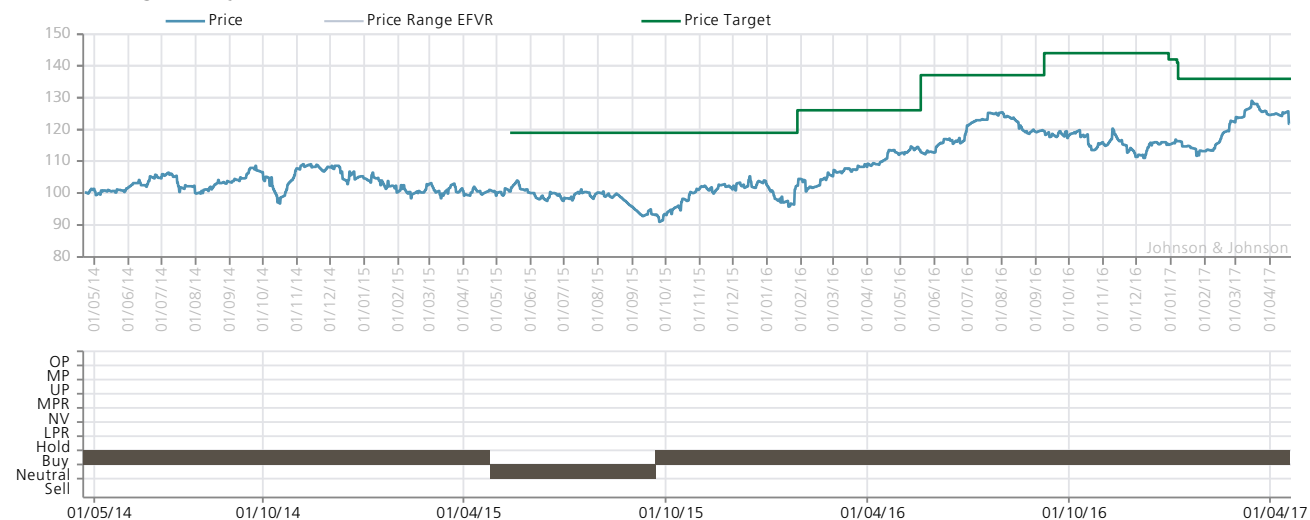
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## Global rating history -- Johnson & Johnson, JNJ US



Source: UBS CIO as of 19 April 2017

### Terms and Abbreviations

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
1H, 2H, etc. or 1H11, 2H11, etc.	First half, second half, etc. or first half 2011, second half 2011, etc.	1Q, 2Q, etc. or 1Q11, 2Q11, etc.	First quarter, second quarter, etc. or first quarter 2011, second quarter 2011, etc.
2011E, 2012E, etc.	2011 estimate, 2012 estimate, etc.	A	actual i.e. 2010A
ADR	American depositary receipt	ARPU	Average Revenue Per User
AUM	Assets under management = total value of own and third-party assets managed	Avg.	average
bn	Billion	bp or bps	Basis point or basis points (100 bps = 1 percentage point)
BVPS	Book value per share = shareholders' equity divided by the number of shares	CAGR	Compound annual growth rate
Cant Inc/Capita	Cantonal income per capita (Switzerland only)	Capex	Capital expenditures
CF	Cash flow	CFO	1) Cash flow from operations, 2) Chief financial officer
COGS	Cost of goods sold	COM	Common shares
Cons.	Consensus	Core Tier 1 Ratio	Tier 1 capital minus tier 1 hybrid securities
Cost/Inc Ratio (%)	Costs as a percentage of income	CPI	Consumer price index
CR	Combined ratio = ratio of claims and expenses as a percentage of premiums (for insurance companies)	CY	Calendar year
DCF	Discounted cash flow	DDM	Dividend discount model
Dividend Yield (%)	Dividend per share divided by price per share	DPS	Dividend per share
E	expected i.e. 2011E	EBIT	Earnings before interest and taxes
EBIT Margin (%)	EBIT divided by revenues	EBITDA	Earnings before interest, taxes, depreciation and amortization
EBITDA Margin (%)	EBITDA divided by revenues	EBITDA/Net Interest	EBITDA divided by net interest expense
EBITDAR	Earnings before interest, taxes, depreciation, amortization and rental expense	EFVR	Estimated fair value range
EmV	Embedded value = net asset value + present value of forecasted future profits (for life insurers)	EPS	Earnings per share
Equity Ratio (%)	Shareholders' equity divided by total assets	EV	Enterprise value = market value of equity, preferred equity, outstanding net debt and minorities
FCF	Free cash flow = cash a company generates above outlays required to maintain/expand its asset base	FCF Yield (%)	Free cash flow divided by market capitalization
FFO	Funds from operations	FY	Fiscal year / financial year
GDP	Gross domestic product	Gross Margin (%)	Gross profit divided by revenues
H	half year	h/h	Half-year over half-year; half on half
hist av.	Historical average	Interbank Ratio	Interbank deposits due from banks divided by interbank deposits due to banks
Interest Coverage	Ratio that expresses the number of times interest expenses are covered by earnings	Interest exp	Interest expense
ISIN	International securities identification number	K	One thousand
LLP/Net Int Inc (%)	Loan loss provisions divided by net interest income	LLR/Gross Loans (%)	Loan loss reserves divided by gross loans

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Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
LPR	Least Preferred: The stock is expected to both underperform the relevant benchmark and depreciate in absolute terms.	Market cap	Number of all shares of a company (at the end of the quarter) times closing price
m/m	Month-over-month; month on month	mn or m	Million
M and A	Merger and Acquisition	MP	Marketperform: The stocks expected performance is in line with the sector benchmark
MPR	Most Preferred: The stock is expected to both outperform the relevant benchmark and appreciate in absolute terms.	n.a.	Not available or not applicable
NAV	Net asset value	Net Debt	Short- and long-term interest-bearing debt minus cash and cash equivalents
Net DPS	Net dividends per share	NIM or Net Int Margin (%)	Net interest income divided by average interest-bearing assets
Net Margin (%)	Net income dividend by revenues	NV	Neutral View: The stock is expected to neither outperform nor underperform the relevant benchmark nor significantly appreciate or depreciate in absolute terms.
n.m. or NM	Not meaningful	NPL	Non-performing loans
OP	Outperform: The stocks is expected to outperform the sector benchmark	Op Margin (%)	Operating income divided by revenues
p.a.	Per annum (per year)	P/BV	Price to book value
P/E or PE	Price to earnings / Price Earnings Ratio	P/E Relative	P/E relative to the market
P/EmV	Price to embedded value	PEG Ratio	P/E ratio divided by earnings growth
PPI	Producer price index	Prim Bal/Cur Rev (%)	Primary balance divided by current revenue (total revenue minus capital revenue)
Profit Margin (%)	Net income divided by revenues	q/q or QQQ	Quarter-over-quarter; quarter on quarter
R and D	Research and development	ROA (%)	Return on assets
ROAE (%)	Return on average equity	ROCE (%)	Return on capital employed = EBIT divided by difference between total assets & current liabilities
ROE (%)	Return on equity	ROIC (%) or ROI	Return on invested capital
Shares o/s	Shares outstanding	Solvency Ratio (%)	Ratio of shareholders' equity to net premiums written (for insurance companies)
sotp or SOTP	Sum of the parts	Tax Burden Index	Swiss tax index; 100 = average tax burden of all cantons
tgt	Target	Tier 1 Ratio (%)	Tier 1 capital divided by risk-weighted assets; describes a bank's capital adequacy
tn	Trillion	UP	Underperform: The stock is expected to underperform the sector benchmark
Valor	Swiss company identifier	WACC	Weighted average cost of capital
CIO	UBS WM Chief Investment Office	x	multiple / multiplier
y/y or YOY	Year-over-year; year on year	yr	Year
YTD	Year-to-date		

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