

# BARRON'S Online

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## Value & Growth at Johnson & Johnson

By JOHANNA BENNETT

**AFTER TWENTY CONSECUTIVE YEARS** of double-digit earnings gains, healthcare giant **Johnson & Johnson** bears more than a passing resemblance to baseball's model of consistency – iron man Cal Ripken Jr who didn't miss a game for most of his career.

The company's stock price has jumped 231% since 1995 and has outperformed the Standard & Poor's 500 Index over the last one, two, five and ten years, according to Thomson Baseline.

Yet after hitting a record high on April 15, the shares have dropped more than 12% amid worries about the company's pending \$25.4 billion purchase of medical device giant Guidant and sales of several top-selling drugs.

Nevertheless, at a time when all signs point to a slowing economy, Johnson & Johnson's defensive characteristics and healthy 2.1% dividend yield should help attract investors.

**At a Glance:**  
**Johnson & Johnson (JNJ)**

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**Stock Price:** \$61.80

"When people worry about the economy they look for cheap, big and dividends. And these days that means pharmaceuticals. And relatively speaking, J&J faces far fewer problems than Pfizer or Merck," says Les Funtleyder, healthcare strategist with Miller Tabak. "As far as havens go, it is probably the safest."

J&J's stock trades at its lowest multiple in a decade. The company's sprawling business interests, growing medical device business and pipeline, which includes 17 drugs in late-stage development, should help offset revenue lost from expiring drug patents.

And pending a decision by the Federal Trade Commission's antitrust enforcers, J&J's purchase of Guidant, the second-largest maker of implantable electronic cardiac devices, will fill a major void in the company's medical device business.

"You could consider J&J a defensive stock. But we do not own it for that reason. We think it's a good growth story," says John Zielinski, portfolio manager at Neuberger Berman, arguing that J&J's profits should grow more than 10% annually over the next few years.

Founded in 1886, Johnson & Johnson sells a vast array of

<b>52-Wk High:</b>	\$69.99
<b>52-Wk Low:</b>	\$55.36
<b>Market Cap:</b>	\$183.8 billion
<b>Earnings Est. 2006</b>	\$3.77 per share
<b>Forward P/E:</b>	16.8 x
<b>Projected Long-Term EPS growth rate:</b>	11%
<b>Projected EPS growth ('06/'05):</b>	9%
<b>Sales (over last 12 months ended July 3, 2005):</b>	\$49.9 billion
<b>Div Yield:</b>	2.1%
<b>Chairman, CEO:</b>	William C. Weldon
<b>Headquarters:</b>	New Brunswick, NJ

Sources: Thomson First Call, S&P; Data by Commodity Systems Inc., Reuters.com and Thomson Financial Network provided through Yahoo! Finance.

products, including Band-Aids, cancer drugs and devices that prop open clogged arteries.

One of the most trusted companies in the world (see *Barron's*, "[Real Asset: Barron's Survey of the Most Respected Corporations](#)"<sup>1</sup>, September 14, 2005), it is also one of the most acquisitive, completing more than \$30 billion in acquisitions in the last decade.

Yet J&J doesn't simply absorb companies, like many other large drug makers. J&J has more than 100 subsidiaries operating under their own names, with their own management and a good degree of autonomy.

"It's a huge company. But they like the entrepreneurial spirit that comes with small companies and they don't want to lose it," says Jim Huguet, president of Great Companies LLC, a J&J shareholder.

Though widely associated with Tylenol and baby shampoo, J&J business depends largely on prescription drug sales.

In 2004, drug products comprised almost 47% of revenue, while medical devices were more than one-third and consumer product sales totaled about 18%.

After acquiring Guidant, sales should reach \$59 billion in 2006 up from an expected \$51.4 billion in 2005, according to Merrill Lynch, which expects 9% sales growth in 2007.

Also, the revenue mix should change, with medical devices generating 43% of sales and pharmaceuticals 40%, Merrill Lynch says.

The deal has its detractors. Earlier this year, Guidant recalled tens of thousands of devices, hurting sales and shaking investors' confidence.

But J&J will gain access to the fast-growing market for implantable cardioverter defibrillators (ICDs), which are used to calm rapid heart beats. And with J&J's help, Guidant's devices should regain the market share lost during the recall, many analysts say.

J&J declined to comment, except to reiterate that a FTC decision should arrive this month.

Like other large drug makers, J&J has struggled to find new drugs, to offset patent expirations. Drug sales are expected to grow just 2% in 2005 compared to 13% last year.

But in 2006, pharmaceutical sales should rise 6%, according to Merrill Lynch, as the company makes progress getting new drugs through the FDA, including therapies for cancer, HIV and urological problems.

"The general consensus among investors is that J&J is great at making acquisitions, but has lagged at developing new drugs. As more progress is made on the drug pipeline, investors' concerns about the generic risk will decrease," says Glenn Novarro, an analyst with Bank of America Securities.

By the end of 2007, J&J expects to receive FDA approval for or to file applications requesting FDA

approval for up to 13 new drugs, including Dapoxetine, an experimental treatment for premature ejaculation pending before the FDA.

A decision should come later this month. Merrill Lynch expects Dapoxetine sales to contribute \$1.3 billion in revenue and 8 cents per share in earnings to 2008 results.

At 16.8x projected profits over the next four quarters, Johnson & Johnson trades well below its 10-yr median of 22.8 times forward earnings, Baseline says.

However, not all investors approved of the Guidant acquisition. And given the string of product recalls earlier this year, some investors want J&J to renegotiate a cheaper price tag, which would delay the deal and hurt revenue.

Also, the FDA could decide to extend its review of Dapoxetine, which would delay approval by six months. And doctors have called on the FDA to recall the heart failure drug Natrecor.

Nevertheless, J&J's profits are growing faster than the rest of the pharmaceutical industry. And with a cheap multiple, the stock appears as if it will outperform its peers – much as Cal Ripken Jr. did during much of his career.

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#### FULL DISCLOSURE:

- Banc of America Securities rates Johnson & Johnson at Neutral, according to analyst Glenn Novarro. Novarro does not own the stock. The company has an investment banking relationship with Banc of America.
- According to a research note, Merrill Lynch rates J&J at Buy. Analyst Katherine Martinelli does not own the stock. The firm intends to receive compensation for investment-banking services in the next three months.
- As of June 30, Neuberger Berman held 3.3 million shares of Johnson & Johnson after selling over 23,000 shares, according to Streetsight.net.
- Great Companies LLC holds 444,191 shares of J&J, last buying the stock before March 31, 2005, according to Streetsight.net.
- Miller Tabak does not have a rating on J&J stock, according to strategist Les Funtleyder.

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