



## Business Description:

Johnson & Johnson (J&J) is a leading diversified multi-national healthcare corporation which provides high quality products that enhance the health and well-being of human beings. With more than 265 operating companies located in 60 countries, its diversified portfolio consists of some of the world's most well-known brands across multiple sectors including consumer products, medical devices and pharmaceuticals. Through approximately 126,500 employees worldwide, the company is engaged in the research and development, manufacture and sales of a broad range of products in the health care field. Since its incorporation in 1887, the company's expansion was based on the success of its premium quality brands and products. J&J has been recognized as a market leader with 24 brands and platforms that generate over \$1 billion in sales each. J&J is headquartered in New Brunswick, New Jersey, United States, with annual sales of more than \$74 billion.

## Overview and Investment Thesis:

- **Diversified portfolio with leading brands.** J&J is the largest and most diversified healthcare company in the world. Within its diversified product portfolio, approximately 389,000 products and product variations touch more than one billion people on a daily basis. In the consumer segment, J&J possesses some of the world's most well-known brands including Johnson's, Aveeno, BAND-AID, Listerine, Tylenol, Splenda and Visine. In the medical devices segment, the company produces a broad range of innovative products and solutions in the fields of orthopaedics, neurological disease, vision care, diabetes care, infection prevention, diagnostics, cardiovascular disease and aesthetics. In the pharmaceutical segment, J&J is dedicated to address and solve the unmet medical needs in oncology, immunology, neuroscience, infectious disease and cardiovascular and metabolic diseases.
- **Global platform with broad footprint.** J&J has 265 operating companies, employing approximately 126,500 employees in 60 countries, who engage in the research and development, manufacture, and sale of a broad range of products in the healthcare field. The company utilizes more than 78,000 suppliers and approximately 500 external manufacturers to support the development and manufacturing of its products worldwide. As of May 2015, approximately 70% of J&J's sales were generated through product lines ranking first or second in global market share.
- **Focused and prioritized R&D.** J&J has grown its business by emphasizing innovation and new product development. This strategy approach has helped J&J to become one of the most productive and fastest growing businesses over the past few years. To generate sustainable growth, J&J invested about \$194 billion in innovation from 1994 to 2014. As a result, its sales and adjusted earnings per share for that period had CAGR (compounded annual growth rate) of approximately 8% and 11% respectively. According to IDEA Pharma Productive Innovation Index 2015, its Janssen Pharmaceutical business has a robust innovation engine and is ranked number one in research and development productivity.
- **Growth potential fuelled with deep innovative pipelines.** J&J's developing pipeline is vital to the business since approximately 25% of its sales came from products launched in the past five years. The firm expects its strong pipeline to yield 20 key consumer product launches globally in 2015, 30 new major medical device product filings between 2014 and 2016, and 10 major new pharmaceutical filings and 25 line extensions between 2013 and 2017.
- **Pharmaceutical business as a crown jewel.** J&J's pharmaceutical business has been the growth engine over the past few years as the company benefitted from various new drug launches. With 14 new products launched since 2009, its

pharmaceutical business is ranked the fastest growing of the top 10 pharmaceutical firms in U.S., Europe and Japan. This segment also comprises some of J&J's largest brands that produce annual sales of more than \$1 billion, which includes Remicade, Stelara, Simponi, Olysio, Prezista, Invega Sustenna, Zytiga, Velcade and Xarelto. The pharmaceutical business continues to improve with over 10 products in its robust near-term pipeline and more than 25 selected NME (New Molecular Entity) filings beyond 2019 to drive sustainable long-term growth.

- **Robust shareholder return.** The success of J&J's capital allocation strategic framework is highlighted by the 31 consecutive years of adjusted earnings increases and the 53 consecutive years of dividend increases. Over the past 10 years, approximately 70% of J&J's free cash flow was returned to shareholders, while about 30% invested in industry segments with significant value creation opportunities. In comparison to Standard & Poor 500, J&J's cumulative total return to shareholders over the past 20 years yielded a CAGR of 13.2%, which outperformed the benchmark's 9.8%.
- **Outstanding credit quality.** The company's solid financial condition is rewarded with triple A credit ratings from S&P, Moodys and Fitch. It is one of the only three industrial companies to hold an AAA credit rating. The top rated credit rating has allowed the firm operational and investment flexibility.
- **Experienced management team with unique structure.** The structure of J&J is based on the principle of decentralized management, which enables the firm to operate with flexibility. The current management team is filled with leaders who have decades of experience within the industry. Alex Gorsky, the Chairman of the Board and CEO, joined the company in 1988 and has been named as one of the "100 Most Inspiring Leaders" by Pharma Voice. Other key executives include Chief Financial Officer Dominic J. Caruso, Pharmaceuticals Worldwide Chairman Joaquin Duato, Medical Devices Worldwide Chairman Gary Pruden and Consumer Worldwide Chairman Jorge Mesquita. They all have more than 25 years of experience within the industry.

## Industry Growth Drivers/Trends: (Industry: HealthCare):

- **Significant opportunities for growth.** According to the IMS Institute for Healthcare Informatics, global pharmaceuticals market has reached \$1 trillion in 2014, which is expected to continue growing at 3% CAGR for branded products from 2014 to 2019. In addition, global spending growth will be expanding at 4% to 7% CAGR between 2014 and 2018 and spending per capita is anticipated to be higher in most countries where J&J operates.
- **Robust US market outlook.** United States, representing nearly half of J&J's sales, currently benefits from a favorable outlook with declining unemployment rates and rising GDP. Under the provisions of the Patient Protection and Affordable Care Act and the Health Care and Educational Reconciliation Act of 2010, J&J began to benefit from tax deduction on the sale of certain medical products. We believe the strong economic recovery in U.S. and earlier healthcare reform had a positive impact on the use of medicines and will continue to contribute to the company's sales for the foreseeable future.
- **Opportunities in oncology.** As indicated by the IMS Institute for Healthcare Informatics, spending in oncology will continue to be the most significant component in developed markets. Total annual sales in 2018 are expected to reach approximately \$90 billion and the market is anticipated to experience a CAGR of nearly 10% between 2014 and 2018. Within its developing pipeline, daratumumab is considered as one of the most promising drugs, currently in phase 3 studies and having received breakthrough designation from the FDA



(Food and Drug Administration). Other prospects including imetelstat and JNJ-493 are expected to be filed with the FDA in 2017 and 2018 respectively. We believe J&J's is well positioned to receive significant benefits from the rising opportunities in oncology sector via its pipeline drugs.

- **Industry has defensive characteristics.** Nearly 20% of J&J's sales come from consumer segment. The defensive nature of the consumer sector has often lead to stable sales, consistent earnings and higher dividends. This is particularly true in a weakening economy, as consumers' demand for general household items remains resilient.
- **Benefits of brand reputation.** When it comes to purchasing pharmaceutical, medical and consumer goods, brand reputation tend to serve as one of the most important factors. Through decades of operations in North America, Europe, Asia, Middle East and Africa, J&J has already established a high level of brand recognition, building trust worthy brands such as Listerine, Tylenol, BAND-AID, Aveeno and Visine.

## Competitive Advantages:

- **Leading brands:** J&J owns some of the world's most well-known brands used by over a billion people on a daily basis.
- **Leading market share:** Approximately 70% of J&J's sales comes from products ranked either number one or number two by their global market share position.
- **Robust operating results:** J&J has outperformed its competitors in delivering better growth in terms of both of its top and bottom lines. As of May 2015, the company's 5-year sales CAGR and net income has exceeded its Competitor Composite (Composite include competitors deemed appropriate by J&J) by 200 bps (basis points) and 420 bps respectively.
- **Deep innovation pipeline:** The company expects 20 key consumer products to be launched globally in 2015, 30 new major medical device product filings between 2014 and 2016 and 10 major new pharmaceutical filings and 25 line extensions between 2013 and 2017.

## Competitors:

- **Consumer:** Procter & Gamble Co., Colgate-Palmolive Co.
- **Pharmaceutical:** Novartis AG, Pfizer Inc., Merck & Co Inc.
- **Medical devices:** Boston Scientific Corp., Stryker Corp., Baxter International Inc.

## Customers:

- Given the breadth and depth of the company's diversified portfolios of businesses, there is no significant exposure to a single customer. In addition, the majority of J&J's customers are considered retail clients, who have been using its products on daily basis.

## Barriers to Entry:

- **Innovation capability:** Industry leading firms have the ability to consistently produce new products that satisfy the dynamic needs of consumers. New entrants with less financial resources tend to be less active in response to changing customer demand.
- **Brand recognition:** Existing firms in consumer, pharmaceutical and medical devices sector benefit from their decades of operating experience in marketing their products locally. Consumers may have an established brand loyalty to those firms, which is likely to provide a barrier to new entrants.
- **Large capital outlay:** Entry in the consumer, pharmaceutical and medical devices market requires significant up-front outlays for laying out the foundation of the supply and distribution chain. Given the global exposure of many existing firms, economies of scale can be achieved, whereas it is much harder for start-up firms to follow suit.

## Officers and Directors:

- Chairman of the board, President, Chief Executive Officer, Alex Gorsky; Chief Financial Officer, Vice President Finance, Dominic Caruso; Group Worldwide Chairman, Sandra Peterson; Chief Scientific Officer, Worldwide Chairman – Pharmaceutical Group, Paulus Stoffels; Vice President, General Counsel, Michael Ullmann.

## Corporate Governance:

- **13 member board** – of which 12 are considered independent directors. Alex Gorsky is the current Chairman and Chief Executive Officer of J&J.
- There are six standing committees of the J & J Board of Directors including Audit Committee, Compensation & Benefits Committee, Nominating & Corporate Governance Committee, Finance Committee, Regulatory, Compliance & Government Affairs Committee and Science, Technology & Sustainability Committee.
- Since early 1990s, improving the sustainability profiles of J&J's products and packaging has been an integral part of the company's goal-setting efforts. In 2014, 73 products from J & J were recognized by Earthwards, an award given to those products that focus on improving the social and environmental impacts.
- J & J has made substantial progress in reducing water usage over the past 10 years, realizing an absolute reduction of more than 9% from 2005 to 2010.
- In 2014, J&J committed to accelerate and significantly expand the Ebola vaccine program in development at its Janssen Pharmaceutical Companies. The vaccine regimen was discovered in a collaborative research program with the U.S. National Institute of Health.
- J&J's key management personnel remuneration is equivalent to 0.3% of the company's operating income.

## Ownership:

- The Vanguard Group, Inc. 6.09%, State Street Global Advisors 5.60%, BlackRock Institutional Trust Company, N.A. 4.03%, Fidelity Management & Research Company 2.15%, and Wellington Management Company, LLP 1.4%.

## Capital Allocation/Uses:

- During its fiscal year 2014, J&J generated \$18.5 billion in cash flow from operations. Compared to fiscal year 2013, the company's operating cash flow increased by 6%, from \$17.4 billion. The increase in operating cash flow was primarily driven by the 18% increase in net earnings.
- On July 21, 2014, J&J announced that its Board of Directors approved a share repurchase program, authorizing the company to purchase up to \$5 billion of J&J's common stock. As of December 28, 2014, \$3.5 billion has been repurchased under the program.
- Cash spent on business acquisitions was roughly \$2 billion for 2014. These acquisitions include Covagen AG, a privately-held, biopharmaceutical company specializing in the development of multispecific protein therapeutics; Alios BioPharma, Inc., a privately-held, clinical stage biopharmaceutical company focused on developing therapies for viral diseases; and the ORSL electrolyte ready-to-drink brand.
- In September 2014, J&J secured a new 364-day Credit Facility. Total credit available to the company approximates \$10 billion, which expires on September 17, 2015.
- J&J currently has a corporate rating of AAA from Moody's, Standard & Poor's and Fitch.
- J&J's total borrowing at the end of 2014 was \$18.8 billion, an increase of 3% from \$18.2 billion in 2013. The increase between 2013 and 2014 was a result of financing for general corporate purposes. Total debt represented 21.2% of total capital in 2014 and 19.7% of total capital in 2013.
- The company increased its dividend in 2015 for the 53rd consecutive year. Total annual cash dividends paid were \$2.76 per share in 2014 compared with dividends of \$2.59 per share in 2013, and \$2.40 per share in 2012.



Financial Statement Summary					
<i>US\$ MM except per share items which is in US\$, years ended Dec 31</i>	2014	2013	2012	2011	2010
<b>Income Statement</b>					
Total Revenue	74,331	71,312	67,224	65,030	61,587
EBITDA	26,305	24,386	20,810	16,568	20,126
Earnings per Share (Diluted)	6.43	6.37	4.85	3.70	4.81
Dividend per Share	2.76	2.59	2.40	2.25	2.11
<b>Balance Sheet</b>					
Total Debt	18,760	18,180	16,165	19,627	16,773
Total Equity	69,752	74,053	64,826	57,080	56,579
Total Debt: Total Equity	26.90%	24.55%	24.94%	34.39%	29.65%
<b>Cash Flow Statement</b>					
Operating Cash Flow	18,471	17,414	15,396	14,298	16,385

Key Ratios and Figures:					
Y/E December 31	2014	2013	2012	2011	2010
EBITDA Margin	70.40%	69.60%	67.80%	68.70%	69.50%
Current Ratio	2.36	2.20	1.90	2.38	2.05
Return on Invested Capital	15.30%	13.60%	11.20%	11.30%	17.50%
Fixed Asset Turnover	4.53	4.35	4.36	4.44	4.20

Business Segments (Years ended December 31):						
Business Sectors Mix	Sales (%)		Pre-Tax Profit (%)		Identifiable Asset (%)	
	2014	2013	2014	2013	2014	2013
Consumer	19.50%	20.61%	8.99%	12.02%	24.49%	25.75%
Pharmaceutical	43.47%	39.44%	54.17%	55.92%	28.97%	25.83%
Medical Devices	37.03%	39.95%	36.84%	32.06%	46.54%	48.42%

Geographic Segments (Years ended December 31):				
Geographic Mix	Sales (%)		Long-Lived Assets (%)	
	2014	2013	2014	2013
United States	46.79%	44.75%	57.52%	53.98%
Europe	25.49%	26.08%	33.66%	37.42%
Western Hemisphere excluding U.S.	9.63%	10.41%	5.01%	4.94%
Asia-Pacific, Africa	18.08%	18.77%	3.81%	3.66%



Sourced from Thomson Reuters and Company Reports

Certain statements included in this document constitute forward-looking statements, including those identified by the expressions "anticipate," "believe," "plan," "estimate," "expect," "intend" and similar expressions to the extent they relate to the business. The forward-looking statements are not historical facts, but reflect the Portfolio Management team's current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. The Portfolio Management team has no specific intention of updating any forward-looking statements whether as a result of new information, future events or otherwise. Any opinions expressed are those of Portland Investment Counsel Inc. and do not necessarily state or reflect the views of Johnson & Johnson Co. Publication in this document should not be considered an endorsement by Johnson & Johnson Co.

This research and information, including any opinion, is based on various sources believed to be reliable but it cannot be guaranteed to be current, accurate or complete. It is for information only, and is subject to change without notice. The financial highlights reflect the different assumptions, views and analytical methods of the analysts who prepared them. This Business Brief is not an offer to sell or a solicitation of an offer to buy the security. The security discussed in the Business Brief may not be eligible for sale in some jurisdictions. If you are not a Canadian resident, this material should not have been delivered to you. The information presented in the Business Brief should not be considered personal investment advice. As each individual's situation is different, you should consult with your own professional investment, accounting, legal and/or tax advisers prior to acting on the basis of the material in the Business Brief. Information presented in this material should be considered for background information only and should not be construed as investment or financial advice. Please consult a Financial Advisor. Every effort has been made to ensure the utmost accuracy of the information provided. Information provided is believed to be reliable when posted. All information is subject to modification from time to time without notice. Consent is required for any reproduction, in whole or in part, of this piece and/or of its images and concepts. PORTLAND, PORTLAND INVESTMENT COUNSEL and the Clock Tower Design are registered trademarks of Portland Holdings Inc. Used under license by Portland Investment Counsel Inc.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel: 1-888-710-4242 • Fax: 1-866-722-4242 • www.portlandic.com • info@portlandic.com