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## This health-care dividend giant has crushed the S&P 500

By JOHN HEINZL

*Thanks to its growing pharmaceuticals division, the company is posting solid results and is poised to continue raising its dividend*

*John Heinzl is the dividend investor for Globe Investor's Strategy Lab<sup>1</sup>. Follow his contributions here<sup>2</sup>. You can see his model portfolio here<sup>3</sup>.*

It's been nearly 18 months since I purchased shares of Johnson & Johnson for my Strategy Lab model dividend portfolio. Today, I'll review how the stock has performed and provide an update on the company's recent results.

I "bought" my 40 J&J shares on Jan. 28, 2015, for \$101.48 (U.S.) each. After going sideways for most of 2015, the shares have been on a roll in 2016, thanks to the company's solid results and a surging stock market.

Through July 25, my total return was 28.5 per cent, handily beating the S&P 500's total return of 11.8 per cent over the same period (all total return figures assume dividends had been reinvested in additional shares).

One of the main reasons I bought J&J (which I also own personally) was for its rising dividend, and the company has delivered on that as well: In April, the health-care giant hiked its dividend by 6.7 per cent – its 54th consecutive annual increase – citing its "2015 results, strong financial position and confidence in the future of Johnson & Johnson."

At the new dividend rate of 80 cents a quarter – or \$3.20 annually – the shares yield about 2.6 per cent. That may not be the highest yield on the block, but I have every expectation that the dividend will continue to grow for many years to come.

J&J is really three health companies in one, with separate divisions focused on prescription pharmaceuticals (45 per cent of 2015 revenue), medical devices (36 per cent) and over-the-counter consumer products (19 per cent). Such diversification is a benefit, because if one division is struggling, the others can pick up the slack.

In the second quarter, J&J's revenue and profit topped analyst estimates as all three segments posted better-than-expected sales. The strong results prompted the company to raise its 2016 earnings guidance to a range of \$6.63 to \$6.73 a share, up from \$6.53 to \$6.58 previously. When a company boosts its earnings outlook a few months after raising its dividend, it sends a very positive signal to shareholders.

The pharmaceuticals division, in particular, turned in a strong quarter, with sales rising 8.9 per cent. Results were boosted by key drugs such as Remicade (for rheumatoid arthritis) and Stelara (psoriasis) and new products including Imbruvica (blood cancer) and Xarelto (blood clots), Edward Jones analyst Linda Bannister said in a note.

"We believe [Johnson & Johnson's] earnings growth will accelerate over the next few years, driven primarily by newly launched biopharmaceutical products and a decreasing impact from patent losses," Ms. Bannister said. "In our view, shares do not fully reflect the potential of the company's new products, and we believe shares are attractively valued."

Based on 2017 estimates, the shares trade at a forward price-to-earnings multiple of about 17.5 – roughly in line with peers, she said. Over the next several years, she expects J&J's sales to grow in the low- to mid-single-digits annually, driven by new drugs and acquisitions.

Given the company's solid balance sheet (it's one of only a few companies with a triple-A credit rating), solid cash-flow generation and conservative payout ratio of about 50 per cent of earnings, the dividend should continue to grow at roughly a 7-per-cent annual pace, she said.

J&J isn't without risks. Efforts by governments and insurance companies to rein in health-care costs will likely continue to put pressure on prices for drugs and medical devices. Product-liability issues, potential patent losses or the failure of new drugs to live up to expectations could also hurt the stock. But those risks seems manageable in light of J&J's diversified business, entrenched market position and ability to develop or acquire new products.

"J&J has one of the most consistent long-term value-creation track records in the business world," Odlum Brown analyst Steven Zicherman said in a recent note. The company's adjusted earnings have grown for 32 consecutive years, through recessions, wars and geopolitical crises – a testament to J&J's ability to navigate through even the most challenging times.

"The company has deep and durable competitive advantages across multiple business units, including its trusted brand and reputation, a deep patent portfolio, economies of scale, and strong distribution capabilities," Mr. Zicherman said.

"We believe the stock will appeal to many conservative investors due to the company's low risk profile, super strong balance sheet, reasonable valuation, growing dividend, and lower-than-average stock price volatility."

In light of J&J's strong second-quarter results, Mr. Zicherman raised his price target on the shares to \$135 from \$123, reflecting Odlum Brown's belief that the stock's multiple will expand to about 19 times forward earnings in light of the company's positive outlook.

It's anyone's guess what J&J's stock price will do in the short term. But over the long term, with demand for health care rising around the world, the company's earnings and dividends will almost certainly continue to grow, which should ultimately push the share price even higher. That's why I'm happy to hold on to my J&J shares. Remember to do your own due diligence before investing in any security.

## References

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