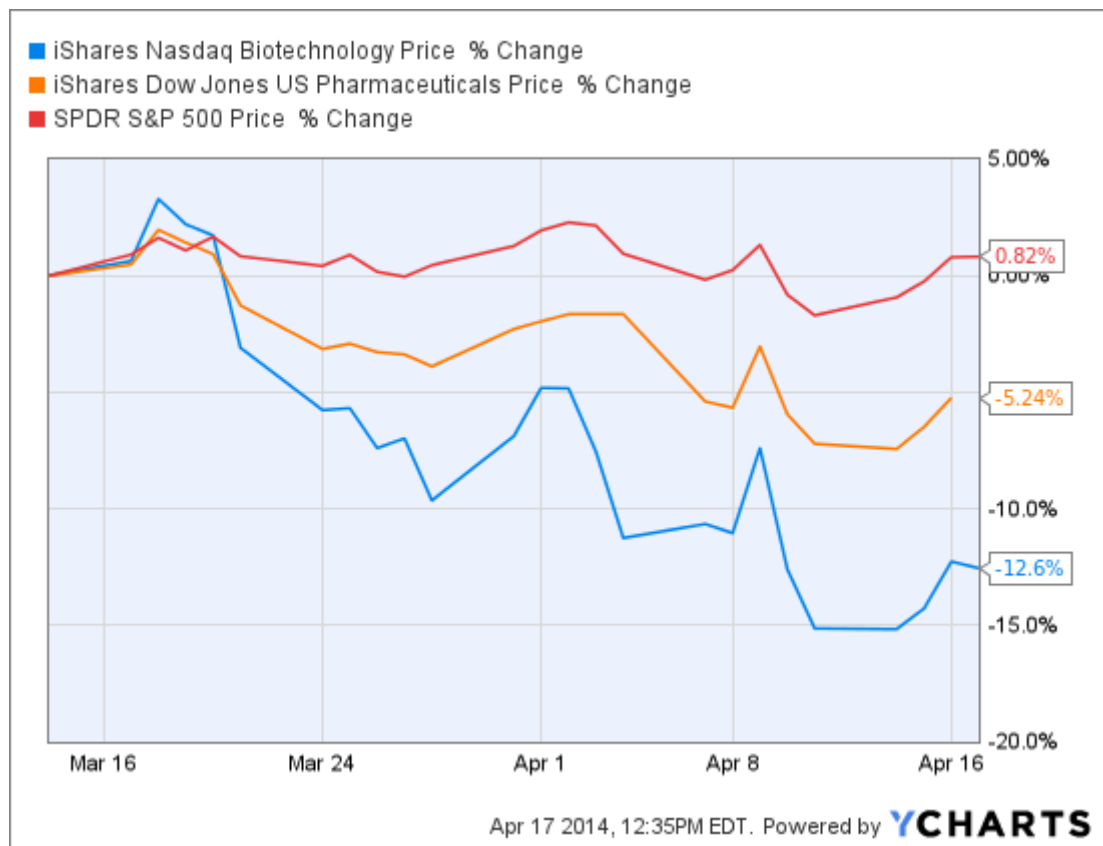


Johnson & Johnson: Why Top Funds Are Buying

BY CARLA FRIED APRIL 22, 2014

The recent profit-taking sell-off in biotech stocks, including Biogen Idec ([BIIB](#)) and Gilead Sciences ([GILD](#)), has claimed more staid pharmaceutical stocks as collateral damage, as seen by the [YCharts Stock Screener](#).

Over the past month, the iShares Dow Jones U.S. Pharmaceutical ETF ([IHE](#)) has fallen less than half as much as the iShares NASDAQ Biotechnology ETF ([IBB](#)) but that's way off the performance of the broad market, represented by the SPDR S&P 500 ETF ([SPY](#)):



IBB data by YCharts

Despite the recent profit taking, both health-care related ETFs beat the [S&P 500](#)'s total return over the past [one-year](#), [three-year](#) and [five-year](#) periods. And to be clear, biotech has clearly delivered on its high-growth promise, leading in all three periods.

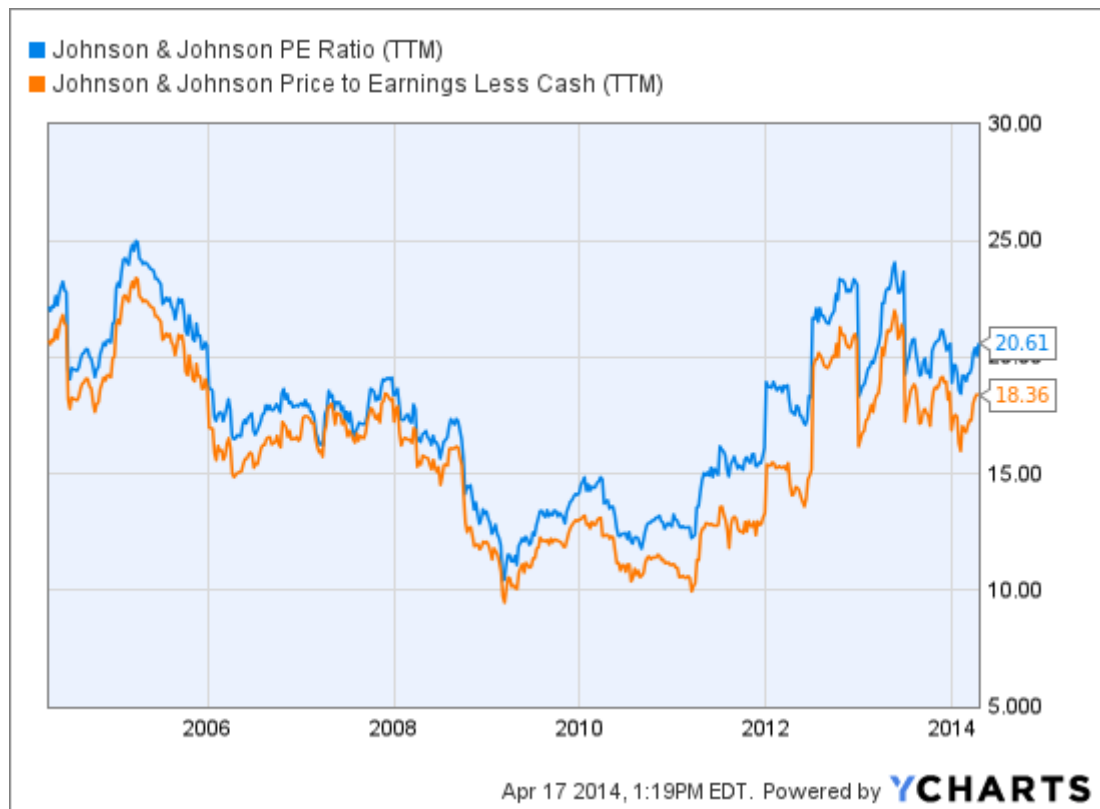
But if you're looking to rein in volatility a tad at this juncture, a "boring" big pharma stock has its potential charms. In terms of global wide-moat-i-ness, Johnson & Johnson ([JNJ](#)) is at the top of any short list. Now of course, there was the 2010-2012 stretch where Johnson & Johnson couldn't seem to do much right, juggling product recalls, the Risperdal litigation and a defensive C-Suite change. Investors were not amused:



JNJ Total Return Price data by YCharts

With all those troubles baked into the stock price and management finally regaining its footing, Johnson & Johnson has (re)found its mojo. Since the start of 2013 its total return is more than 10 points ahead of the S&P 500 (as is the iShares pharma ETF).

Not surprisingly valuation, using [PE ratio less cash](#), has risen as well. But Johnson & Johnson is still trading well below its pre-crisis levels:



JNJ PE Ratio (TTM) data by YCharts

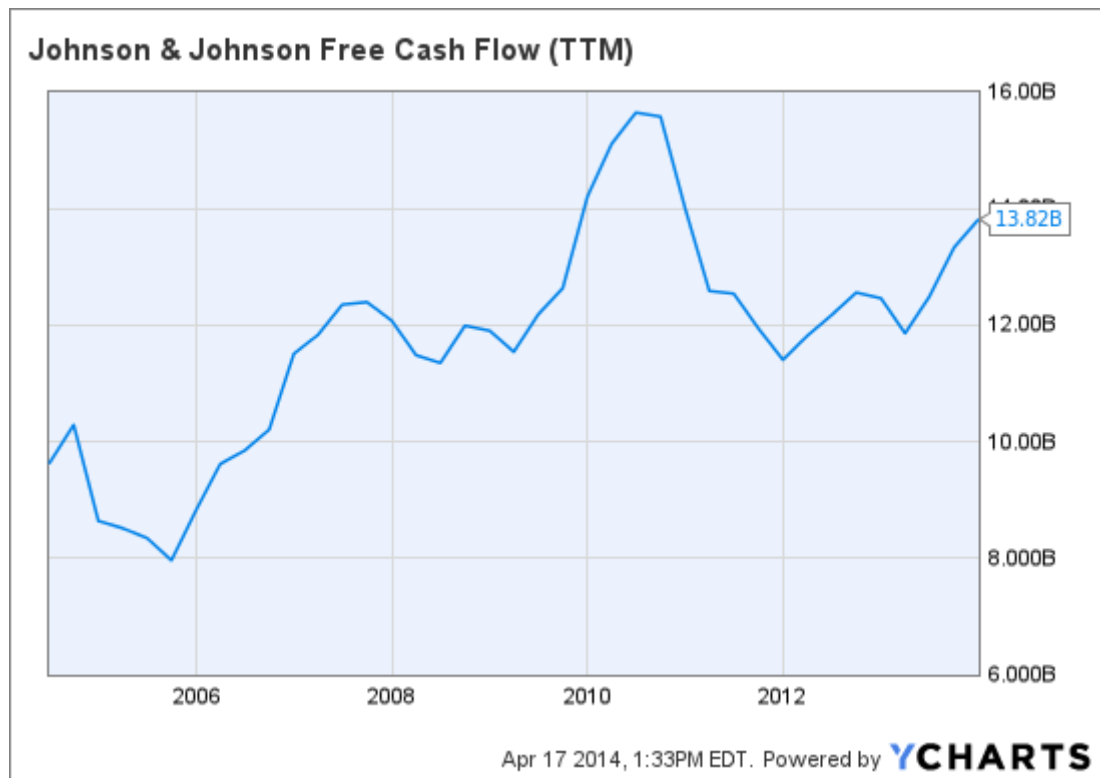
In the first quarter, the FPA Crescent fund added to its position in Johnson & Johnson. (See here for the [bona fides](#) on what is one of the finest track records in the fund industry over the past 15 years.

What makes that noteworthy is that FPA Crescent is an absolute deep-value-to-the-point-of-contrarian type of fund. When the managers can't find appropriate value they sit it out in cash; currently more than 40% of the \$17 billion fund is on the sidelines.

So if FPA Crescent is willing to add to its position, that's a pretty good signal Johnson & Johnson is not overvalued. Some back history: The managers first bought the stock in the third quarter of 2010 but had not added to the position since the second quarter of 2012. The recent purchase simply restored the stock to around 2% of the FPA Crescent portfolio; given fund inflows and market performance it had fallen to about 1.5% of fund assets at the end of 2013.

(Microsoft ([MSFT](#)) and Oracle ([ORCL](#)) are the fund's largest positions at 7.3% and 7.0% respectively. In the first quarter, the Microsoft position was given a slight trim, and the Oracle holding was added to.)

While Johnson & Johnson is not selling at a bargain valuation, it's not necessarily expensive for one of the most impressive cash machines around:

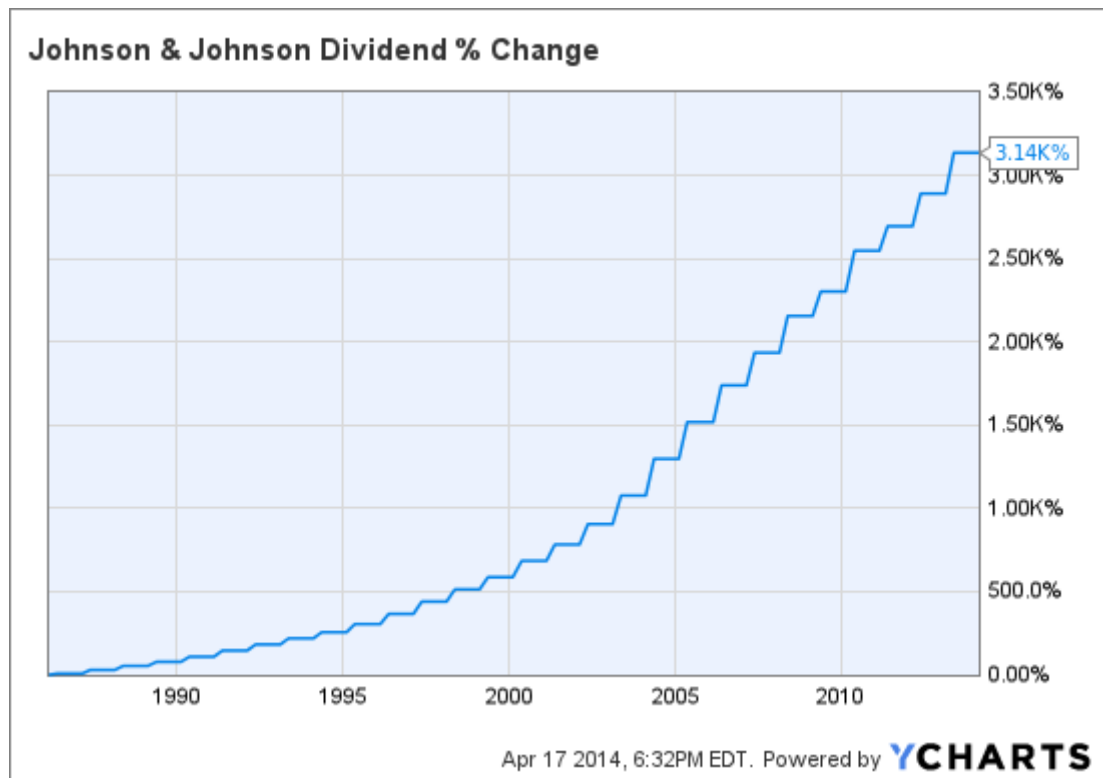


JNJ Free Cash Flow (TTM) data by YCharts

In its just reported first quarter results, revenue grew 3.5% adjusted for currency headwinds, and EPS grew 6.9%, excluding special one-time items. Management raised its full-year 2014 guidance a smidge. Revenues are now targeted at between 5%-6% growth, compared to a 3.7%-4.7% range given in January. And adjusted EPS guidance rose to 4%-6% growth from 3%-5% in January.

Moreover, there's nearly \$30 billion of cash and short-term investments on the books, giving Johnson & Johnson plenty of dry powder for both acquisitions and shareholder returns. In 2012 Johnson & Johnson financed a \$19.7 billion buyout of Swiss medical device maker Synthes using a combo of stock and cash. That deal solidified Johnson and Johnson's position in the growing medical device field. In fact, devices and diagnostics now account for about 40% of Johnson & Johnson's sales, in line with the revenue generated from the drug manufacturing arm of the company. Consumer products are now just 20% or so of the revenue stream.

And there's a pretty nice dividend story as well. The quality-conscious Vanguard Dividend Appreciation index ETF (**VIG**) took a fresh 3.6% position in Johnson & Johnson in the fourth quarter. That ETF demands at least 10 years of consistent dividend growth. As the chart below shows, Johnson & Johnson has been delivering on that front for far longer.



JNJ Dividend data by YCharts

Over the past five years dividend growth has clocked in at 35%. The payout has grown more than 130% over the past 10 years, a stretch where inflation was just 25%, giving shareholders a nice inflation-beating income stream. Johnson & Johnson's current [dividend yield](#) near 2.7% is right in line with the payout on the 10-year Treasury note. But, of course, the bond's yield is fixed, and Johnson & Johnson shareholders have every reason to expect their payout will keep rising, as the current [payout ratio](#) based on earnings is below 35% and the cash payout ratio is right around 40%.

*Carla Fried, a senior contributing editor at [ycharts.com](#), has covered investing for more than 25 years. Her work appears in *The New York Times*, *Bloomberg.com* and *Money Magazine*. She can be reached at editor@ycharts.com. Read the [RIABiz profile of YCharts](#). You can also request a [demonstration](#) of YCharts Platinum.*

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