

The Financial Statement Analysis of Johnson and Johnson

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Abstract. Johnson & Johnson is a group of companies that manufactures healthcare products, medical devices, and pharmaceuticals, and has a 100-year history of being a leader in the pharmaceutical industry. Johnson & Johnson has always had a good reputation, but the previous year Johnson & Johnson suffered a large amount of product recalls. The original company's products did not meet the quality requirements and the hygiene conditions of the manufacturing process were not up to scratch. As a result, Johnson & Johnson's reputation has suffered greatly and the company's overall earnings have been affected, in recent years, a global pandemic of Covid-19 has led to the announcement of another halt to Johnson & Johnson's vaccine production. This essay will therefore examine whether these turmoils that have hit Johnson & Johnson have had a negative impact on Johnson & Johnson's financial situation over the last five years by calculating and analyzing the company's financial ratio. Through the analysis of the data and financial ratios obtained, Johnson & Johnson's overall profits have been on the rise in recent years due to its excellent marketing and management strategies. It is a worthwhile company for investors to invest in. However, in the long run, if Johnson & Johnson does not find a way to address the damage to its reputation and improve the quality of its products to increase consumer trust in the brand, then the value of Johnson & Johnson will still be on a downward slope.

Keywords: Johnson & Johnson; Financial ratio; Fundamental analysis.

1. Introduction

1.1. Background

Against the backdrop of the Covid-19 epidemic, many companies suffered production shutdowns. The worldwide economic downturn was caused by a drop in consumer demand. The economic volatility has hurt all sectors, but the pharmaceutical industry is unique in that it has received relatively little damage from the epidemic. This is because there is currently a high global demand for medical supplies. Therefore, companies such as Johnson & Johnson, which manufacture medical devices and carry out research and development of drugs, will gain some profit from this crisis. This essay will focus on the financial situation of Johnson & Johnson in the context of the epidemic. However, in 2021 Johnson & Johnson's vaccine production is discontinued, so this paper will also look at the discontinuation of vaccine production as a major factor affecting the company's financial situation. As a result of this particular and unstable context, the quality of the information in various industries may deteriorate. The data used in this thesis will be obtained not only from company annual reports but also from third parties (e.g. financial institutions), mainly since many companies face bankruptcy and therefore some companies hide important financial information through fraud and misrepresentation, thus making the financial statements provided by companies risky.

1.2. Related research

Alshehhi conducted the financial ratio of Johnson & Johnson, which is including liquidity ratio, activity ratio, debt ratio, and profitability ratio, and the has been used are collected from the financial statement of Johnson & Johnson. By the financial ratio, the company's performance can be observed and will also indicate whether the company is making a profit. It is also an important indicator for investors to judge the future business value of the company [1]. Khalifa et al. examined the impact of the shutdown of New Crown vaccine production on Johnson & Johnson's financial position, including the impact on Johnson & Johnson of the scandals that have erupted in the company in recent years.

It is argued that the company has focused on the development of the New Crown vaccine due to the impact of the New Crown epidemic, and therefore the financial ratios of the company are examined with particular focus on the financial statements of recent years. Based on the above analysis, (Khalifa et al.) concluded that investors should pay particular attention to the company's production lines and their production performance [2]. MBA School Team included the strategy that Johnson & Johnson has implied. The pricing strategy indicated that Johnson has an affordable rate. As the market, Johnson is mostly occupied by consumer products, which means it is important to measure the purchasing ability of the consumers. The distribution strategy, Johnson & Johnson has subsidiaries in many parts of the world, so the company has set up local windows in each location, which helps Johnson & Johnson to understand the needs of local buyers and allows the company to better integrate into the culture of other countries or regions. Johnson & Johnson has a good marketing strategy and they are very good at using different media to promote their company and products to increase awareness of the company [3].

Lefebvre pointed out that it is difficult to determine the factors that make the US healthcare industry competitive because there is so little data to use. The competitiveness of the US healthcare industry is related to availability and appeal, and to the number of students willing to choose a healthcare career. Therefore, it was concluded that if you want to be more competitive, you need to improve the salary and treatment of the industry [4]. Wisdom believed that Johnson & Johnson has increased its competitiveness in the market through its differentiation strategy, thus attracting more appealing consumers. Johnson & Johnson has dominated the industry and due to its irreplaceability, consumers are happy to buy Johnson & Johnson's products because not only are they reasonably priced but they can also be guaranteed quality and the products are unique. In contrast, Eiliy has adopted a price leadership strategy, where prices are low but the company has become a market follower due to a lack of variety and uniqueness [5]. Taylor states the challenges and solutions that Johnson & Johnson will face through an analysis of the value chain to determine which are the most important parts of the company, what are the main activities of the company, and which aspects of the company need to be improved. It also analyses Johnson & Johnson's competitive advantages [6].

Adamkasi analyzes Porter's five forces to identify Johnson & Johnson's strengths and reveals the reasons why Johnson & Johnson can dominate the market. However, due to some scandals and the development of other companies in the industry, it is consumers have become less loyal to the company's brand and therefore there is less pressure for new companies to enter the industry [7]. Amrith reveals the opportunities, weaknesses, strengths, and ways to improve the company. Summarises the need for the company to improve its innovation to become more competitive [8]. Yunpeng et al. focus on the impact or otherwise of the New Crown epidemic on investor sentiment, with examples from China, the US, Japan, and India. Finally, it is argued that institutional investment has had a greater impact on the investment sentiment generated by the New Crown epidemic [9]. Nearly one hundred executives of Johnson & Johnson were surveyed, randomly selected based on personality and gender, to investigate the effectiveness and performance of Johnson & Johnson's executives [10].

1.3. Objective

The second part of the paper will use quantitative methods to determine Johnson & Johnson's liabilities, profitability, earnings per share, net worth, and the value of the company's investments by calculating important financial ratios. These are very important indicators for investors. The third section will analyze the calculations obtained in the second section and discuss the reasons for the changes. What are the strengths and weaknesses of the company compared to other industries in the same sector? The fourth section will give a summary of Johnson & Johnson's current financial situation, whether it is worth investing in, what risks it faces, and suggest what other areas are worth looking at.

2. Method and data

The Methodology this paper will use is to calculate the financial ratio. The data will be gathered from the financial statements and the yahoo finance of Johnson & Johnson between 2017-2021. There are four categories of financial ratios, Profitability ratio, investment ratio, liquidity ratio, and efficiency ratio. Profitability ratios are including four types of ratios.

$$\text{Gross profit margin} = (\text{Gross Profit} / \text{Revenue}) \times 100\% \quad (1)$$

This will show whether Jonson & Jonson can control their goods quantity, selling prices, and the cost of materials.

$$\text{Net profits margins} = (\text{Net Profit} / \text{Revenue}) \times 100\% \quad (2)$$

Net profit margins can reflect the profits level of Johnson & Johnson. A Higher NPM will represent the company has a better financial performance. It is also an important indicator for investors.

$$\text{Return on Equity (ROE)} = (\text{Net income} / \text{Equity (Shareholders' Funds)}) \times 100\% \quad (3)$$

This ratio could measure the ratio available to shareholders, a higher value means the shareholders have valuable income.

$$\text{Return on Capital Employed (ROCE)} = (\text{PBIT} / \text{Capital Employed}) \times 100\% \quad (4)$$

Where it reflects the net income of shareholders. Normally, an increase in ROCE is expected by the company.

In terms of liquidity ratio, liquidity contains the current ratio and quick aid assets ratio.

$$\text{Current ratio} = \text{Current Assets} / \text{Current Liabilities} \quad (5)$$

Where it measures the ability to pay loans. A long period means a short-term cash cycle. In most cases, companies want to have a long loan period to ensure that they do not run short of cash flow.

For investment ratio.

$$\text{EPS} = \text{Profit after tax and preference dividends} / \text{Equity shares in issue} \quad (6)$$

And the last indicator is an efficiency ratio

$$\text{Receivables collection period (in days)} = (\text{Trade Receivables} / \text{Revenue}) \times 365 \quad (7)$$

where it shows the ability that the company can pay the loan.

3. Results and Discussion

All Financial Data were collected from the financial statement of Johnson & Johnson. From Table 1 and Table 2, a positive trend can be found. The revenue of Johnson & Johnson was increasing over the past five years. The Gross profits also had an upward trend. And the Long-Term Debt declined. Compared to one of its competitors, Pfizer, Johnson & Johnson occupies a large market and has a better base. And Johnson & Johnson is more diversified than Pfizer. Johnson & Johnson's main businesses include health care, medical devices, skincare and beauty, and pharmaceuticals.

And then, through analyzing the financial ratio from 2017-2021 of Johnson & Johnson, the current financial situation of Johnson & Johnson can be observed and the financial problems that the company is currently facing can be determined, which will help managers to develop better solutions. Secondly, it is convenient to compare with other companies in the same industry, which can give a better understanding of Johnson & Johnson's situation in the whole industry.

Table 1. Data from the income statement (Million\$)

Year	2021	2020	2019	2018	2017
Revenue	93,775	82,584	82,059	81,581	76,450
Gross Profit	63,920	54,157	54,503	54,490	51,011
Net Income	20,878	14,714	15,119	15,297	1,300
Interest Expense / Income	183	201	318	1,005	934

Table 2. Data from the balance sheet (Million\$)

Year	2021	2020	2019	2018	2017
Total Assets	182,018	174,894	157,728	152,954	157,303
Long-Term Debt	29,985	32,635	26,494	27,684	30,675
Shareholders' Equity	74,023	63,278	59,471	59,752	60,160
Total Current Assets	60,979	51,237	45,274	46,033	43,088
Total Current Liabilities	45,226	42,493	35,964	31,230	30,537
Shares Outstanding (Basic)	2,632	2,633	2,645	2,682	2,692

For the profitability ratio (Table 3), the gross profit margin changes over the last five years have been very small, with no more than two percentage points up or down. But for the Gross profits margin, a significant increase can be observed, increasing from 1.7% to 18.75%. As the table is shown above (extracted from the annual report 2018 of JNJ). As shown in Table 4, in 2018, the sector of beauty, OTC, and Oral Care has a remarkable increase. In addition, Johnson & Johnson's Pharmaceuticals division sales rose 12.4% in 2018 compared to 2017, with sales of \$4.07 billion. The rise in sales in these divisions above contributed significantly to the rise in the Company's net profit. In 2021, there was another significant increase in net profit margin from 17.82% to 22.26%. The main reason for the improvement in net profit margin is the increase in sales of the medical device. Sales of medical devices are up 17.9% compared to 2020. Sales of medical devices are up 17.9% compared to 2020.

Table 3. Profitability ratio

Profitability ratio	2017	2018	2019	2020	2021
Gross profit margin	66.72%	66.79%	66.42%	65.58%	68.16%
Net profit margin	1.7%	18.75%	18.42%	17.82%	22.26%
Return on equity	1.88%	24.42%	25.47%	27.37%	26.59%

Table 4. Major consumer franchise Sales (Dollars in Millions)

Major consumer Franchise Sales	2018	2017	2016	'18 vs. '17	17 vs. '16
Beauty	4382	4200	3897	4.30%	7.8
OTC	4334	4216	3977	5.9	3.7
Baby care	1858	1916	2001	-3	-4.2
Oral Care	1555	1531	1568	1.6	-2.4
Women's Health	1049	1050	1076	-0.1	-1.6
Wound Care/Other	675	779	797	-13.4	-2.3
Total consumer sales	13853	13307	13307	1.8	2.2

Meanwhile, the pharmaceutical industry continues its upward trend. Over the years, the rise in sales in the medical devices and manufacturing sector has been driven by the New Crown epidemic, which has seen a significant rise in net profit for Johnson & Johnson as a medical device supplier through 2021, as the epidemic continues to expand and the world needs a large number of medical resources and medical devices. In addition to this, Johnson & Johnson has started to develop and produce the Covid-19 vaccine in recent years, which has created an objective increase in the company's annual revenue, and the popularity of the New Crown vaccine has led to a significant increase in demand for the vaccine in recent years. And the pharmaceutical, as well as medical device

industry, has always been a highly profitable industry. The rise in net profit has also led to an objective increase in return on equity. By 2021, the return on equity will have risen by 24.71% compared to 2017. This is a positive indicator for investors and the continued rise in return on equity will attract more and more investors.

In comparison, Pfizer, one of Johnson & Johnson's competitors, has also seen an objective increase in total revenue, as Pfizer's Pfizer vaccines have contributed significantly to the company's revenue growth. However, Johnson & Johnson remains the leading company within the industry due to Pfizer's lack of product diversity and a significant gap between its industrial base and Johnson & Johnson's.

For the Liquidity ratio (Table 5) in 2019, the current ratio has decreased to 1.26. The decline was due to a decrease in liquidity, with Johnson & Johnson expanding its investments in 2019, partly for the purchase of assets, devices, and land, and partly for investment in the development of Covid-19 vaccine as well as other drugs.

Table 5. Liquidity ratio

Liquidity ratio	2017	2018	2019	2020	2021
Current ratio	1.41	1.47	1.26	1.21	1.35

For investment ratio (Table 6). Johnson & Johnson's stock price has been on the rise, with the biggest increase in 2018, up almost 5%. We know from the company's 2018 annual report that Johnson & Johnson has increased its investment in development and research, and the company's revenue in healthcare is up a significant amount compared to 2017, and the rise in the company's total profit has increased the stock price. This proves that Johnson & Johnson's profitability is improving.

Table 6. Investment ratio

Investment ratio	2017	2018	2019	2020	2021
EPS	0.47	5.61	5.63	5.51	7.81

For the efficiency ratio (Table 7) Johnson & Johnson's collectible collection period is around 60 days, and generally, the company prefers a shorter collectible collection period but would prefer a longer payable period, as this would ensure that the company has sufficient funds to carry out its normal operations. From Table 5, it can see that Johnson & Johnson's average collection period is relatively stable, which indicates that the company's revenue is relatively stable and it will not easily run out of funds in the short term.

Table 7. Efficiency ratio

Efficiency ratio	2017	2018	2019	2020	2021
Receivable collection period (in days)	64	63	64	60	58

4. Conclusion

Overall, Johnson & Johnson's growth is positive and sustainable, thanks to the diversity of Johnson & Johnson's products, with steady growth in all of Johnson & Johnson's industries, particularly in the pharmaceuticals and medical devices sectors. And due to the new crown epidemic in recent years, Johnson & Johnson's growth in the pharmaceutical industry will continue. For investors, Johnson & Johnson is a good investment target, as the continued growth of return on equity represents a company that has generated abundant profits in recent years.

However, due to the announced discontinuation of production of the Covid-19 vaccine offered by Johnson & Johnson in 2020, the official explanation was that production had increased due to an oversupply and that the company intended to focus on producing other, more profitable vaccines. However, the company's reputation in the US has been affected by reports that a small number of users of the vaccine have experienced serious side effects. This included the Johnson & Johnson scandal some years ago. Therefore, Johnson & Johnson should invest more in development and

research, and obtaining a patent on a disease or vaccine could restore the company's reputation and generate high profits. Johnson & Johnson should also pay attention to the quality of its products to ensure customer loyalty to the brand. In addition to this, product innovation should be enhanced to attract more investors and consumers.

For future research, researchers can continue to explore which other sectors Johnson & Johnson can expand into and which industries can restore the company's reputation by investing in them.

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