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This health-care giant delivers the right medicine for my dividend portfolio

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Health-care giant Johnson & Johnson has been a solid addition to my Strategy Lab model dividend portfolio.

Since I "bought" the shares in January, 2015, they've posted a total return – including dividends – of 29.7 per cent, beating the S&P 500's total return of 24.6 per cent over the same period. Thanks to the falling loonie, my total return in Canadian dollars is an even juicier 32.2 per cent – or 13.2 per cent on an annualized basis.

As pleased as I am with that performance, I believe J&J has more good news in its medicine cabinet. Here's why I remain fan of the stock (which I also hold personally):

Dividends continue to grow

You might say my love affair with J&J was a case of destiny. I was conceived in 1963, the same year that J&J began an uninterrupted string of annual dividend increases that now stretches to 55 years – one of the longest records for a publicly traded U.S. company. The most recent hike came in April, when J&J boosted its dividend by 5 per cent, to 84 cents (U.S.) a quarter from 80 cents. And I'll bet you a bottle of Extra-Strength Tylenol that J&J will increase its dividend again next year, and the year after that. Given the company's solid free cash-flow generation ($15.5-billion last year), strong financial position (it's one of the few companies with a triple-A credit rating) and conservative payout ratio (about 47 per cent of earnings), "we expect Johnson & Johnson to grow the dividend at a rate of 6 per cent a year, in line with earnings growth," Edward Jones analyst Ashtyn Evans said in a note. The current yield of 2.7 per cent isn't huge, but it's the future growth of the dividend that gets me excited.

Three health-care stocks in one

With J&J, you get diversified exposure to the global health-care industry in one convenient package. The company operates in three segments: pharmaceuticals (47 per cent of sales), medical devices (35 per cent) and consumer products (18 per cent), with nearly half of last year's total revenue of $71.9-billion generated outside the United States. Each division, in turn, offers a diversified product lineup. Pharmaceuticals, for instance, covers five broad areas: immunology, infectious diseases and vaccines, psychiatric disorders, oncology and cardiovascular diseases.

Diversification is an advantage, because if one product category or geographic region experiences a downturn, the others can pick up the slack. J&J also pours huge amounts of money into research and development – $9.1-billion in 2016 – to keep its product pipeline full.

Growth through acquisitions

Thanks to J&J's strong cash flow and bulletproof balance sheet, the company is able to take advantage of acquisition opportunities that arise. J&J is currently in the midst of its biggest acquisition yet – the $30-billion takeover of Switzerland's Actelion, Europe's biggest biotech company.

The deal, which was announced in January and is expected to close in the second quarter, will give J&J access to Actelion's portfolio of high-margin drugs for rare diseases and help to counter revenue losses as J&J's biggest product, inflammatory-disease treatment Remicade, faces competition from a cheaper "biosimilar" drug. "We believe JNJ has a solid new drug pipeline, which, along with the Actelion acquisition, should support long-term growth," said Ms. Evans, who rates J&J a "buy."

Reasonable valuation

J&J trades at about 17 times estimated 2017 earnings – higher than its peers but reasonable given its broad product lineup, strong balance sheet and steadily growing earnings. In fact, the company has posted higher adjusted earnings for 32 consecutive years. "J&J has one of the most consistent long-term, value-creation track records in the business world … a gratifying trend we expect to continue," Odlum Brown analyst Steven Zicherman said in a note, in which he reiterated his "buy" rating. According to Thomson Reuters, of the 21 analysts who follow the company, there are eight "buys" and 13 "holds." The average 12-month price target of $128.82. The shares closed on Tuesday at $123.70, up 36 cents.

A conservative investment

J&J is not without risks. Product recalls, patent expirations and quality control issues could all affect the stock. "The good news is that these headwinds have largely dissipated and the company's valuation is expanding to reflect this improved outlook," said Mr. Zicherman, who has a price target of $135 on the shares. The global health-care industry is worth an estimated $8.4-trillion and growing at 3 per cent to 5 per cent annually, and as the most diversified player in the space J&J's breadth and depth is unmatched, he 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," he said.

Be sure to do your own due diligence before investing in any security and always maintain a properly diversified portfolio.

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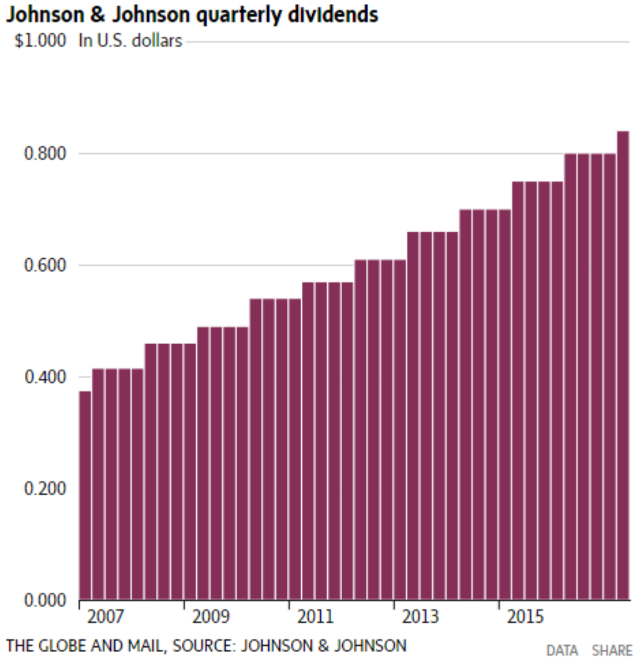
Johnson & Johnson quarterly dividends



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