How to Read a Value Line Report

In order to get the greatest use out of our products, you’ll need to be able to understand our research reports and put them in context. This guide was designed to help you do just that. Referring to this guide will assist you in using our services as forecasters of relative stock price performance as well as a source of interpretive analysis and historical information that will assist you in spotting trends.

I: GETTING STARTED

As a subscriber, you will receive three parts of *The Value Line Investment Survey* each week. Part 1 is the *Summary & Index*, Part 2 is *Selection & Opinion* and Part 3 is *Ratings & Reports*. Below we will describe each section and discuss some of the ways to use them.

**Part 1 — Summary & Index**

Start with the *Summary & Index*. The front cover contains a Table of Contents, three important market statistics, and a list of all the industries we follow in alphabetical order with their current industry rank shown next to the name of the industry. The page number is to the right. The market statistics are found in three boxes. The first box (A) has the median of estimated price/earnings ratios of all stocks with earnings covered in *The Value Line Investment Survey* (approximately 1,700). The second box (B) shows the median of estimated dividend yields (total dividends expected to be paid in the next 12 months divided by the recent price) of all dividend-paying stocks in *The Value Line Investment Survey*. The third box (C) contains the estimated median price appreciation potential 3 to 5 years into the future for the approximately 1,700 stocks in *The Value Line Investment Survey*, based on Value Line’s hypothesized economic environment 3 to 5 years hence. By studying these statistics, a fairly good picture emerges of how the universe of Value Line stocks — which comprises approximately 90% of the market capitalization of all stocks traded in U.S. markets and is therefore quite representative of the stock market as a whole — is currently being evaluated.
Beginning on page 2, the Summary & Index also includes an alphabetical listing of all stocks in the publication with references to their location in Part 3, Ratings & Reports. If you are looking for a particular stock, look inside the Summary & Index section, which is updated each week to provide the most current data on all companies included in The Value Line Investment Survey.

To locate a report on an individual company, look for the page number just to the left of the company name. Then turn to that page in Part 3, Ratings & Reports, where the page number is shown in the right hand corner.

In the far left column of the Summary & Index is a page number that refers to recent Supplementary Reports, if any, which are included on the back pages of Ratings & Reports. If two stars (★★) appear in that column, it means that there is a Supplementary Report in the current Issue.

There are many columns in the Summary & Index with more information on each of the approximately 1,700 stocks we cover.

There is also a wealth of information in the stock screens toward the back of the Summary & Index, beginning on page 24.

These screens are a good place to start for anyone looking for investment ideas or help in forming a strategy. The screens are also useful for investors who want a list of stocks relevant to specific strategies they may have in mind.

Part 2—Selection & Opinion

Selection & Opinion (S&O) contains Value Line’s latest economic and stock market commentary and investment ideas, along with one or more pages of research on interesting stocks or industries, and a variety of pertinent economic and stock market statistics. It also includes four model stock portfolios (Stocks with Above-Average Year-Ahead Price Potential, Stocks for Income and Potential Price Appreciation, Stocks with Long-Term Price- Growth Potential, and Stocks with Above-Average Dividend Yields). If you spend time with Selection & Opinion each week, you should be able to get some valuable investment ideas and a good understanding of Value Line’s outlook for the economy.

Part 3—Ratings & Reports

Ratings & Reports is the core of The Value Line Investment Survey with one-page reports on approximately 1,700 companies and one-page reports on approximately 100 industries. The company reports contain Timeliness™, Safety™ and Technical ranks, our 3- to 5-year forecasts for stock prices, income and balance sheet data, as much as 17 years of historical data, and our analysts’ commentaries. They also contain stock price charts; quarterly sales, earnings, and dividend information; and a variety of other very useful data. Each page in this section is updated every 13 weeks. When important, and often unforeseen, news occurs during these 13 week intervals, a Supplementary Report (appearing in the back section of Ratings & Reports) is published. If there is a Supplementary Report, its location will be shown in the far left hand column of the Summary & Index, near the company name. (Two stars—★★—indicate that the Supplementary Report is in the current week’s Issue.)

Every week subscribers receive a new Issue of Ratings & Reports containing approximately 130 company reports grouped by industry and a smaller number of industry reports. The industry reports precede the reports on the companies in that same industry. Over the course of three months, revised reports are issued on all approximately 1,700 companies and nearly 100 industries.
II: PLANNING AN INVESTMENT STRATEGY

When planning an investment strategy, it is important to consider a large number of factors, including such things as your age, current financial situation, and risk tolerance. Of course, there are many other factors to think about, but the point is that you should not simply sit down and start picking securities.

We have created a guide called Planning an Investment Strategy that you may wish to read before taking any portfolio action. As a quick summary, you should diversify your portfolio across both asset classes (e.g., stocks, bonds, and foreign securities) and within asset classes (i.e., owning a variety of stocks and bonds).

In addition, you do not have to handle every portion of your portfolio. Instead, you might hire someone else to handle the components that you do not have the desire or experience to oversee. An example of this would be to buy a diversified fixed-income mutual fund for the bond portion of your portfolio, while maintaining a collection of stocks yourself. The right mix of “outsourcing” and personal direction is an individual decision, but in the end you should create a portfolio that offers good returns at a level of risk you can tolerate.

Again, we encourage you to take the time to read through the Planning an Investment Strategy guide so that you can start your portfolio on a solid foundation.

III: CREATING A LIST OF STOCKS FOR FURTHER RESEARCH

Once you have decided on your portfolio approach, you will need to select securities. There are many ways to use The Value Line Investment Survey to find the equities that are most appropriate for your needs.

There are approximately 1,700 stocks in our coverage universe, so opening the first issue and starting to examine each stock report in search of the few you want to own would be a time consuming and, frankly, nearly impossible task. To assist our readers in creating “short lists” of stocks for further consideration, we included a number of stock screens in the back of each Summary & Index.

The screens are updated weekly and cover a broad range of investment options, including Timely Stocks in Timely Industries, Conservative Stocks, Highest Yielding Stocks, and Stocks with Highest 3- to 5-Year Appreciation Potential. A description of the screens is provided if the title of a screen is not self-explanatory. There are, of course, many more screens than the ones listed here, so you should take a look at the pages in the back of the Summary & Index to get a feel for which ones will best fit your specific needs. Regardless of which screens you choose to use, this approach will provide you with a short list of companies to research.

For those who want more advice than a static screen, we have also created four model portfolios: Portfolio I (Stocks with Above-Average Year-Ahead Price Potential), Portfolio II (Stocks for Income and Potential Price Appreciation), Portfolio III (Stocks with Long-Term Price Growth Potential), and Portfolio IV (Stocks with Above-Average Dividend Yields). These portfolios are overseen by Value Line analysts and are updated weekly in the Selection & Opinion section. Periodically, a more in-depth review is provided detailing the most recent performance of each portfolio. These portfolios offer another convenient starting point for selecting stocks for inclusion in your own portfolio.

On an ongoing basis, we also provide stock screens and Stock Highlights in the Selection & Opinion section. The screens go beyond those included on a weekly basis in the Summary & Index and often provide a different and unique view of an investment approach. The Stock Highlights are a more in-depth review of a company that we believe merits a second look. Although these two options may not be the best starting point for you, they can play an important role in providing new and interesting investment ideas down the road.

IV: RESEARCHING A STOCK USING THE VALUE LINE PAGE

A sample Value Line report is included at the back of this guide. The numbers below reference back to the sample page.

To start studying a stock, we suggest that you concentrate on various features found on every company page of Ratings & Reports. Begin by using the Timeliness™, Safety™ and Technical ranks that appear in the upper left corner of each page (1). Next, look at the analyst’s commentary in the bottom half of each report (17). Then look at our various forecasts for financial data. Estimated financial data...
is shown on the right side (bold italic print) of the Statistical Array (15). Growth rates are in the Annual Rates box (23). A stock’s Target Price Range is on the right-hand side of the graph (11), and 3- to 5-year stock price Projections are in the projections box (29). Finally, go to the historical financial data appearing in the left side of the Statistical Array (26). Illustrations and more detail follow.

**Value Line Ranks**

(see (1) on the sample page)

**Timeliness**

The Timeliness rank is Value Line’s measure of the expected price performance of a stock for the coming six to 12 months relative to our approximately 1,700 stock universe. Stocks ranked 1 (Highest) or 2 (Above Average) are likely to perform best relative to the approximately 1,700 stocks we follow. Stocks ranked 3 are likely to be average performers. Stocks ranked 4 (Below Average) or 5 (Lowest) are likely to underperform stocks ranked 1 through 3 in Value Line’s universe.

At any one time, there are 100 stocks ranked 1; 300 ranked 2; approximately 900 ranked 3; 300 ranked 4; and 100 ranked 5.

One of the most important factors in determining the Timeliness rank is earnings growth. Companies whose earnings growth over the past 10 years has been greater than their stocks’ price appreciation tend to have favorable ranks. In addition, the ranks take into account a stock’s recent price performance relative to all approximately 1,700 stocks in the Value Line universe. A company’s recent quarterly earnings performance and any recent earnings surprises caused because a company reported results that were significantly better or worse than expected are also factors. These are all combined to determine the Timeliness rank.

Just one word of caution. Stocks ranked 1 for Timeliness are often more volatile than the overall market and tend to have smaller capitalizations (the total value of a company’s outstanding shares, calculated by multiplying the number of shares outstanding by the stock’s price per share). Conservative investors may want to select stocks that also have high Safety ranks because they are more stable issues.

**Safety**

The Safety rank is a measure of the total risk of one stock compared to all others in our approximately 1,700 stock universe. As with Timeliness rank, Value Line ranks each stock from 1 (Highest) to 5 (Lowest). However, unlike the Timeliness rank, the number of stocks in each category from 1 to 5 may vary. The Safety rank is derived from two measurements (weighted equally) found in the lower right hand corner of each page 19: a Company’s Financial Strength and a Stock’s Price Stability. Financial Strength is a measure of a company’s financial condition, and is reported on a scale of A++ (Highest) to C (Lowest). The largest companies with the strongest balance sheets get the highest scores. Price Stability is based on a ranking of the standard deviation (a measure of volatility) of weekly percent changes in the price of a company’s own stock over the last five years, and is reported on a scale of 100 (Highest) to 5 (Lowest) in increments of 5. Generally speaking, stocks with Safety ranks of 1 or 2 are most suitable for conservative investors.

A stock’s Price Growth Persistence and a company’s Earnings Predictability are also included in the box above, but do not factor into the Safety rank. However, they are useful statistics. Price Growth Persistence is a measure of the consistency of relative stock price growth over the past 10 years. Earnings Predictability is a measure of the reliability of an earnings forecast.

**Technical**

The Technical rank is primarily a predictor of a stock’s short term (three to six months) relative price change. It is based on a proprietary model which examines 10 relative price trends for a particular stock over different periods in the past year. It also takes into account the price volatility of each stock. The Technical ranks also range from 1 (High-
est) to 5 (Lowest). At any one time, about 100 stocks are ranked 1; 300 ranked 2; 900 ranked 3; 300 ranked 4; and 100 ranked 5.

**Beta**

Beta is a measure of the volatility of a stock relative to the overall stock market and is calculated by Value Line. A Beta of 1.00 suggests that a stock will move up and down in roughly lock-step with the market, so that a 3% increase or fall in the broader market would likely be accompanied by a similar percentage move in the stock. A Beta higher than 1.00 means a stock tends to move more than the market, while a Beta lower than 1.00 suggest that the stock in question will move in a muted relationship to a move in the market.

**Industry Timeliness**

Value Line also publishes Industry ranks which show the Timeliness of each industry. The Industry ranks indicate how Value Line believes the prices of stocks within 90 or more industries will perform relative to each other. These ranks are updated weekly and published on the front cover and on page 24 of the Summary & Index. They also appear at the top of each Industry Report in Ratings & Reports. The Industry rank is calculated by averaging the Timeliness ranks of each of the stocks assigned a Timeliness rank in a particular industry.

**Analyst’s Commentary**

(see 17 on the sample page)

Next, look at the analyst’s written commentary in the lower half of the page. Many readers think this is the most important section of the page. In the commentary, the analyst discusses his/her expectations for the future. There are times when the raw numbers don’t tell the full story. The analyst uses the commentary to explain why the forecast is what it is. The commentary is also particularly useful when a change in trend is occurring or about to occur. As an example, a stock may have a poor Timeliness rank but the analyst thinks earnings could turn around in the future. In this case, the analyst may use the commentary to explain why he/she thinks conditions are likely to get better, thus giving the subscriber insight into what is happening and why.

**Value Line’s Financial Data**

(see 15 and 26 on the sample page)

In the Statistical Array in the center of the report (where most of the numbers are), Value Line provides both historical data and financial projections.

**Financial Estimates**

(see 15 and 22 on the sample page)

The estimates of sales, earnings, net profit margins, income tax rates, and so forth are all derived from spreadsheets maintained on every company and printed in **bold italics**. The numbers are based on an analyst’s latest thinking about where a company may be in the future. Our analysts regularly review their projections and discuss them with a company’s management. Afterwards, they make whatever adjustments they believe are warranted.

**Historical Financial Data**

(see 26 on the sample page)

Many investors like to use the Statistical Array to do their own analysis. They, in particular, use the historical data in the center of each report to see how a company has been...
doing over a long time frame. It’s worth pointing out that while all of the data are important, different readers find different data items to be most useful.

The numbers are probably most helpful in identifying trends. For example, look at sales per share to see if they have been rising for an extended period of time. Look at operating margins and net profit margins to see if they have been expanding, narrowing or staying flat. Also check the percentages near the bottom to see if the Return on Total Capital or the Return on Shareholders’ Equity have been rising, falling or remaining about the same.

**Annual Rates Of Change**

(see 23 on the sample page)

At this point, it may be helpful to look at the Annual Rates box in the left-hand column. This box shows the compound annual growth percentages for sales, cash flow, and other items for the past 5 and 10 years and also Value Line’s projections of growth for each item for the coming 3 to 5 years. Trends are also important here. Check whether growth has been increasing or slowing to see if Value Line’s analyst thinks it will pick up or fall off in the future. (Specific estimates for various data items for three to five years in the future can be found in bold italicized type in the far right hand column of the Statistical Array.)

<table>
<thead>
<tr>
<th>ANNUAL RATES</th>
<th>Past</th>
<th>Past</th>
<th>Est’d ‘11-’13</th>
</tr>
</thead>
<tbody>
<tr>
<td>of change (per sh)</td>
<td>10 Yrs.</td>
<td>5 Yrs.</td>
<td>to ‘18-20</td>
</tr>
<tr>
<td>Sales</td>
<td>7.0%</td>
<td>3.0%</td>
<td>5.5%</td>
</tr>
<tr>
<td>“Cash Flow”</td>
<td>8.5%</td>
<td>5.0%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Earnings</td>
<td>8.5%</td>
<td>4.5%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Dividends</td>
<td>11.5%</td>
<td>8.5%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Book Value</td>
<td>11.0%</td>
<td>10.0%</td>
<td>9.5%</td>
</tr>
</tbody>
</table>

**Target Price Range and 3- to 5-year Projections**

(see 11 and 29 on the sample page)

In the upper right-hand section of each report is a Target Price Range for each stock. This is the range in which the price is likely to fall during the period 3 to 5 years hence. The range is based on the analyst’s projections in the period 3-5 years out for earnings per share multiplied by the estimated price/earnings ratio in the Statistical Array for the same period. The width of the high-low range depends on the stock’s Safety rank. A stock with a high Safety rank has a narrower range, one with a low rank, a wider one.

In the left hand column of each report, there is also a box which contains 3- to 5-year Projections for a stock price. There you can see the potential high and low average prices we forecast, the % price changes we project, and the expected compound annual total returns (price appreciation plus dividends). To make these calculations, analysts compare the expected prices out 3 to 5 years into the future (as shown in the Target Price Range and Projections box) with the recent price shown at the top of the report.

Investors whose primary goal is long-term price appreciation should study the 3- to 5-year projections carefully and choose stocks with above-average appreciation potential. For comparative purposes, you can find the Estimated Median Price Appreciation Potential for all approximately 1,700 stocks on the front page of the *Summary & Index*.
V: EXAMINING A VALUE LINE PAGE IN MORE DETAIL

In the following section, we are going to examine an actual Value Line page, with the objectives of interpreting the array of statistical data presented and weighing the data and the accompanying comment against your needs. We have chosen for examination a report on Johnson & Johnson, a large and well-known manufacturer of health care products and member of the Dow Jones Industrial Average.

Putting Data in Perspective

Looking at the top of the page, we can see that Johnson & Johnson's stock price in February 2015 was $100.35 a share (item 5 on the sample page). By itself, the stock price means very little. In the line below the price, annual high and low prices for each year from 2003 through early 2015 are indicated. Below the high and low annual prices is a price chart (graph) that shows monthly price ranges for essentially the same period, along with other useful information that we will discuss below. We note here, though, that while Johnson & Johnson stock had traded in a relatively narrow range, it has climbed about 105% from its low of $49.30 in 2004.

At the current quotation, is the stock undervalued or overvalued? The fact that the “cash flow” line is slightly below the price of the stock indicates that it appears to be overvalued. Also, sales per share, cash flow per share, earnings per share, and book value per share are all at historical highs, as can be seen in the Statistical Array (items 15 and 26 on the sample page).

Price Earnings Ratio—This is probably the most widely used measure of stock valuation. Value Line shows a variety of P/E ratios on every company page, as discussed below:

The P/E ratio on the very top of the Value Line page (item 6 on the sample page). This is calculated by dividing the recent price of the stock by the total of the last three months of earnings and the next nine months of estimated earnings.

The Relative P/E ratio (item 8). This compares the P/E of one stock with the median of estimated P/E ratios of all stocks under Value Line review. A relative P/E of more than 1 indicates that a stock’s P/E ratio is currently higher than that of the Value Line universe; a P/E of less than 1 indicates that this stock’s P/E is less than the Value Line average.

The Trailing P/E ratio (item 7). This is calculated by dividing the recent price of the stock by the past 12 months of actual (reported) earnings. This is the figure shown in most newspapers and on financial web sites.

The Median P/E ratio (item 7). This is the average annual P/E ratio of a stock over the past 10 years, with certain statistical adjustments made for unusually low or high ratios.

The Average Annual P/E ratio (items 15 and 26). This figure is calculated by dividing the average price for each year by the actual reported earnings for the same year and is shown in the Statistical Array.

The Relative (Annual) P/E ratio (items 15 and 26). This figure is calculated by dividing the Average Annual P/E of a stock with the Average Annual P/E of all stocks under Value Line review in the same year.

To gauge the significance of the recent price of a stock, the reader must look at the price in relation to a variety of data. As far as P/Es are concerned, the current P/E ratio and relative P/E ratio for Johnson & Johnson's stock, are below those of most stocks in the Value Line universe. In addition, we expect Johnson & Johnson to continue to trade at a valuation that is below the market average.

Low P/E ratios may mean that the stock is underpriced, unless there are factors indicating that there will be a significant decline in the company’s fundamentals. Is this the case with Johnson & Johnson? Probably not, since management has been very vigilant in its efforts to maximize returns from its businesses, and the Value Line analyst is expecting continued profit growth over the three to five years subsequent to 2014. Johnson & Johnson's relative P/E ratio of 0.90 (item 8), a lower valuation than found in the average stock followed by Value Line, likely reflects the fact that the company's upward earnings trend over the past 15 years has recently moderated.

The Dividend Yield (item 10 in the right top corner of the sample page) shows the expected return from cash dividends on the stock over the next 12 months, as a percentage of the recent price. Johnson & Johnson's yield of 2.8% is above the median of all dividend-paying stocks in the Value Line universe. (The median is shown each week on the cover of the Summary & Index section.) We also see that the company has increased the dividend in every year.
since 1998, as shown in line four of the Statistical Array in the center of our report, and Value Line's analyst thinks additional increases are forthcoming. Many investors view regular increases in a dividend very positively.

The Price Chart

Next, look at Johnson & Johnson's price chart (or graph) at the top of the report. The first thing to look at is the price history, shown by the small vertical bars in the center of the graph. Those bars show the high and low monthly prices for the stock (adjusted for any subsequent stock splits or dividends). Looking at the bars, you can see that the stock price marched in place from 2002 through 2012. More recently, the stock price has climbed to new highs, thanks to a strong bull market and strong sales and earnings growth.

Now look at the “cash flow” line, the solid line running from 2001 through the middle of 2013, which is more fully described below. The dashed line from mid-2013 to mid-2016, which is an extension of the “cash flow” line, is Value Line’s projection of the line for those years. For most of the past 12 years, Johnson & Johnson’s stock has traded very close to the “cash flow” line.

Finally, look at the Relative Price Strength line, the faint small dotted line, usually toward the bottom of the chart. This shows the relative performance of Johnson & Johnson stock versus the entire universe of Value Line stocks; when the Relative Price Strength line is rising, it means a stock is acting better than the universe. When it is falling, a stock is doing worse than the Value Line universe.

At the very bottom of the chart, we show volume of trading each month (item 14) as a percent of total shares outstanding. The Legends box (item 2) in the upper left of the price chart contains, among other things, information on the “cash flow” line, a record of stock splits, and whether or not there are options traded.

The Target Price Range (item 11) in the upper right corner of the price chart indicates where Value Line’s analyst believes the stock is most likely to be selling in the 3- to 5-year period. This box should be viewed in conjunction with the Projections box (item 29) near the top left-hand corner of the page, which also gives our 3- to 5-year projections. For Johnson & Johnson, we expect the average price to hover between 110 and 130, which would be between 10% and 30% above the current level.

Just above the Projections box is a section containing the Value Line Timeliness, Safety, and Technical ranks, plus a Beta calculation. Johnson & Johnson’s Beta of .75 reveals that this stock is likely to move up and down much more slowly than the typical stock on the New York Stock Exchange. If you are looking for stability, a stock like Johnson & Johnson, with a low Beta, is a good option.

The “Cash Flow” Line

The price chart at the top of the Johnson & Johnson page contains, among other things, a monthly price history for the stock (the vertical bars) overlaid by a solid line that we call the “cash flow” line (sometimes also called the “Value Line”). To plot the line, we multiply cash flow per share (net income plus depreciation and amortization less preferred dividends divided by the number of shares outstanding at the end of the year) by a number (multiple) determined by our analyst. The goal is to create a “line” that most closely matches a company’s stock price history and also “fits” the projected 3- to 5-year Target Price Range. In the case of Johnson & Johnson, the “cash flow” multiple is now 12.0. (The multiple can, and often does, change over time.)

The concept of a “cash flow” multiple is not too different from that for a Price/Earnings multiple (or ratio). The difference here is that instead of dividing the recent price of a stock by 12 months of earnings to create a P/E multiple, we divide the recent price by the total of 12 months of earnings plus 12 months of depreciation (and amortization, if there is any).

There is evidence that some stocks will generally trade at a price close to the “cash flow” line. In those cases when a stock is trading above the “cash flow” line, it will often move back down toward the “cash flow” line. When it is trading below, it will often do the opposite. In some cases, a stock may trade above or below the “cash flow” line for considerable periods of time.

Historical Results and Estimates

For each of the approximately 1,700 companies Value Line follows, we usually present per-share data going back up to 17 years in the Statistical Array in the center of each report.
The historical data (item 26) appear on the left side and are presented in regular type. We also project statistical data (item 15) for the current fiscal year, next fiscal year, as well as three to five years into the future. These projections are presented in bold italics.

Now look at a list of items in the Statistical Array (items 15 and 26).

**Sales per share**, in the top line, is an important series. When earnings per share are depressed because of poor net profit margins, a high level of sales per share can suggest the potential for an earnings recovery. It would be disconcerting, however, if sales per share declined in tandem with earnings per share.

**“Cash flow” per share** (second line), as commonly used by analysts, is the sum of reported earnings plus depreciation, less any preferred dividends, calculated on a per-share basis. It is an indicator of a company’s internal cash-generating ability—the amount of cash it earns to expand or replace plant and equipment, to provide working capital, to pay dividends, or to repurchase stock. Johnson & Johnson’s “cash flow” per share has expanded significantly since 1999.

**Earnings per share** (third line) are shown by Value Line as they were reported to stockholders, excluding nonrecurring items and adjusted for any subsequent stock splits or stock dividends. According to current accounting guidelines, companies now report earnings two ways. The first is basic earnings per share, which is the earnings available to common shareholders divided by the weighted average number of shares outstanding for the period. The second is diluted earnings per share, which reflects the potential dilution that could occur if securities or other contracts to issue common stock (like options and warrants) were exercised or converted into common stock. Value Line shows only one earnings figure in our statistical presentation; that figure is clearly identified in the footnotes (item 20), and it is almost always the diluted earnings figure.

For Johnson & Johnson, earnings per share have expanded consistently between 1999 and 2014. As indicated in footnote (B) (item 20) near the bottom edge of the report page, its earnings per share are now based on diluted shares outstanding.

**Dividends Declared per share** (fourth line) are usually the highest, in proportion to earnings, at older and larger companies, which tend to have slower-than-average growth. Directors of growth-oriented companies more often than not prefer to pay small or “token” dividends, or none at all, so they can reinvest earnings in the business. Johnson & Johnson has paid out between 36% and 46% of its earnings in dividends and invested the remainder in the business during the past five years and the percentage is likely to be about 46% over the next few years. A payout of 25%-30% is generally typical of larger capitalization stocks followed by Value Line.

**Capital Spending per share** (fifth line) is the amount that a company spends on new plant and equipment. It doesn’t include funds used for acquisitions of other companies.

**Book Value per share** (sixth line) is common shareholders’ equity determined on a per-share basis. It includes both tangible assets, like plant and receivables and inventories, as well as intangibles, like the value of patents or brand names, known as “goodwill.” Any significant intangibles will normally be indicated in a footnote. If all assets could be liquidated at the value stated on the company’s books, all liabilities such as accounts payable, taxes, and long-term debt paid, and all preferred stockholders compensated, the book value is what would be left for the common stockholders.

The number of **Common Shares Outstanding** (seventh line) is also listed in the Statistical Array. Sometimes net income rises, but earnings per share do not, because the number of shares outstanding has increased. This may happen because a company is issuing stock to pay for acquisitions or to fund internal growth. As a result, sales and profits may soar, while per-share sales and earnings lag. On the other hand, when cash-rich companies buy their own shares, earnings per share can rise even if net income is stable.

The **Average Annual P/E Ratio** (eighth line) shows what multiple of earnings investors have been willing to pay for a stock in the past and the P/E ratio the analyst expects out 3 to 5 years. Johnson & Johnson’s average annual P/E was at unusually high levels between 1999 and 2002 when drug and medical stocks were in favor; it has narrowed considerably over the past 13 years.
The Relative P/E Ratio (ninth line) shows how the stock's price-earnings ratio relates to those of all stocks in the Value Line universe. Johnson & Johnson's relative P/E of 0.90 in February 2015 was below that of the typical stock. The Value Line analyst thinks it will continue to be below average in the 2018–20 period.

The Average Annual Dividend Yield (10th line) is of special interest to conservative investors, many of whom are more concerned with income than with a stock's appreciation potential. Income-oriented investors should look for stocks with yields that are higher than the average shown each week in the center box of the front cover of the Summary & Index, but they should also look at the trend of dividends over time. Johnson & Johnson's dividend has been increased in each year shown on our page, and the analyst thinks it will continue to rise. Steady increases are very attractive for many investors. Investors should also look carefully at a company's Financial Strength to make certain that the company will be able to continue to pay the dividend. A good rule of thumb for conservative investors is to invest only in companies with Financial Strength ratings of at least B++, which is average.

Company Financial Data

The Sales figure (11th line) is the most common measure given when referring to a company's size. Johnson & Johnson's sales in 2014 were about 1.5 times the amount recorded in 2005, a very strong performance.

The Operating Margin (12th line) indicates what percentage of sales is being converted into operating income. (Operating income is total sales minus the cost of goods sold and selling, general and administrative expenses. It is also referred to as EBITDA, or earnings before interest, taxes, depreciation, and amortization.) At Johnson & Johnson, this figure peaked in 2012, but it appears poised to surpass those levels by 2018–20.

Depreciation (13th line) shows the amount charged against operating profits to reflect the aging of a company's plant and equipment. That number has risen quite steadily, but it declined in 2009 and it resumed the uptrend in 2010.

Net Profit (14th line) is the amount the company earned after all expenses including taxes, but excluding nonrecurring gains or losses and the results of discontinued operations. Usually, the higher the net, the higher the per-share earnings. Johnson & Johnson's net profit has grown considerably since 2004, and has risen in every year but in 2009, when it was little changed.

Johnson & Johnson's Income Tax Rate (15th line) has steadily declined from 24.8% in 2005 and the Value Line analyst thinks it will be 22% in the foreseeable future. Income tax rates will normally remain steady unless the federal tax rate changes in the U.S. or unless a company increases or decreases the percentage of business it does overseas, where tax rates are different.

Net Profit Margin (16th line) shows net income after taxes as a percentage of sales (or revenues). Here, the trend is the most important thing, with rising margins usually being favorable. It is often worthwhile to compare the net margin with the operating margin. Usually the two series move together, though not always. Depreciation charges, interest expense, income taxes, and other costs are deducted from (and other income added to) operating income in the determination of net profit. Where there is a disparity in the trends of the net and operating margins, it may be worth taking a second look. (If depreciation, interest charges, or tax rates move sharply in any direction, there will be an impact on net profits, and it would be worthwhile to try to determine why the change occurred.)

Johnson & Johnson's Net Profit Margin reached a record level in 2014, and we expect that mark to be bested in the near future.

Working Capital (17th line), the company's current assets less current liabilities, indicate the liquid assets available for running the business on a day-to-day basis. The higher a company's sales, the more working capital it typically has and needs. But we caution that a number of large companies with steady revenue streams no longer believe large amounts of working capital are necessary. In those cases, a negative working capital may be perfectly acceptable because a company can meet normal operating expenses from consistent cash receipts.

Long-term Debt (18th line) is the total debt due more than one year in the future. In the case of Johnson & Johnson, the amount is quite low relative to shareholders' equity.
Shareholders’ Equity (19th line), also known as net worth, is the total stockholders’ interest (preferred and common) in the company after all liabilities have been deducted from the company’s total assets. All intangible assets such as goodwill, patents, and, sometimes, deferred charges are included in shareholders’ equity. Johnson & Johnson’s equity has grown appreciably over the years, primarily from retained earnings.

Return on Total Capital (20th line) measures the percentage a company earns on its shareholders’ equity and long-term debt obligations. When a company’s return on total capital goes up, there should also be an increase in the return on shareholders’ equity (see below). If not, it simply means that the company is borrowing more and paying interest, but not earning more for the stockholders on their equity in the company’s assets. Unless a company can earn more than the interest cost of its debt over time, the risk of borrowing is not worthwhile.

Return on Shareholders’ Equity (21st line) reveals how much has been earned (in percentage terms) every year for the stockholders (common and preferred). Higher figures are usually desirable, often indicating greater productivity and efficiency. Johnson & Johnson’s percent earned on net worth reached a peak in 2008 and has declined steadily since then.

Trends in both this ratio and the return on total capital—two key gauges of corporate performance—say a great deal about the skill of management.

Retained to Common Equity (22nd line) also known as the “plowback ratio,” is net income less all dividends (common and preferred), divided by common shareholders’ equity and is expressed as a percentage. It measures the extent to which a company has internally generated resources to invest for future growth. A high plowback ratio and rapidly growing book value are positive investment characteristics.

All Dividends to Net Profit, or “payout ratio,” (23rd line) measures the proportion of a company’s profits that is distributed as dividends to all shareholders—both common and preferred. Young, fast-growing firms reinvest most of their profits internally. Mature firms are better able to pay out a large share of earnings. Johnson & Johnson paid out 46% of its profits in the form of cash dividends in 2013. By way of comparison, the typical large company in the Value Line universe usually pays out about 25%-30% of its profits in dividends.
John & Johnson rounded out on a decent note. December-quarter sales dived 1.3%, to $28.6 billion, as operations grew 3.8%, far more than the expected 0.7% consolidating the impact of currency translation. The full-year picture was brighter, as the top line advanced 4%, to $74.3 billion, thanks to internal growth of 6%. The main story in 2014 was the performance of the healthcare conglomerate’s Pharmaceutical business, which delivered tremendous top- and bottom-line growth throughout the year. The company’s growth drivers continued to fuel the group’s results, and most of the credit goes to a 1.6% new hepatitis C drug OLYSIO. On the other hand, the Consumer and Medical Devices segments struggled to generate growth over the last 12 months, and both reported top-line declines in 2014. Share earnings inch forward in the December quarter, which was in line with reduced expectations; full-year share-profit growth was much better, at 9%. We are now looking for a Q4 to report a year-over-year decrease in Q1. We have lowered our sales target to $72.7 billion, owing mostly to extremely stiff currency headwinds (in particular, currency management, orthopedic port reconstruction, etc.), and expects earnings per share to be above $71. Our model also includes intangibles. In 2013, net income was $12.5 billion, or $4.35 per share, excluding acquisition-related items. We believe the company’s management continues to focus on generating strong cash flow, and is expected to increase the dividend in the future. Moreover, we are encouraged by the company’s commitment to innovation and research & development. We recommend the stock for investors with a long-term perspective.