JOHNSON & JOHNSON
Form 10-Q
November 08, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the quarterly period ended October 2, 2011
or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the transition period from to
Commission file number 1-3215
(Exact name of registrant as specified in its charter)

NEW JERSEY	22-1024240
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Johnson & Johnson Plaza
New Brunswick, New Jersey 08933
(Address of principal executive offices)
Registrant s telephone number, including area code (732) 524-0400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. þ Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes þ No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

On October 28, 2011 2,730,849,018 shares of Common Stock, $1.00 par value, were outstanding.

JOHNSON & JOHNSON AND SUBSIDIARIES

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Part I FINANCIAL INFORMATION

Item 1 FINANCIAL STATEMENTS

JOHNSON & JOHNSON AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited; Dollars in Millions Except Share and Per Share Data)

	October 2, 2011	January 2, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,617	$ 19,355
Marketable securities	15,310	8,303
Accounts receivable, trade, less allowances for doubtful accounts $315 (2010, $340)	10,552	9,774
Inventories (Note 2)	6,428	5,378
Deferred taxes on income	2,480	2,224
Prepaid expenses and other receivables	3,056	2,273
Total current assets	53,443	47,307
Property, plant and equipment at cost	31,736	30,426
Less: accumulated depreciation	(17,101)	(15,873)
Property, plant and equipment, net	14,635	14,553
Intangible assets, net (Note 3)	18,225	16,716
Goodwill, net (Note 3)	16,049	15,294
Deferred taxes on income	5,564	5,096
Other assets	3,905	3,942
Total assets	$ 111,821	$ 102,908
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Loans and notes payable	$ 5,326	$ 7,617
Accounts payable	5,730	5,623
Accrued liabilities	4,136	4,100
Accrued rebates, returns and promotions	2,895	2,512
Accrued compensation and employee related obligations	2,263	2,642
Accrued taxes on income	1,336	578
Total current liabilities	21,686	23,072
Long-term debt (Note 4)	13,031	9,156
Deferred taxes on income	1,889	1,447
Employee related obligations	6,215	6,087
Other liabilities	7,473	6,567
Total liabilities	50,294	46,329
Shareholders equity:		
Common stock par value $1.00 per share (authorized 4,320,000,000 shares; issued 3,119,843,000 shares)	$ 3,120	$ 3,120
Accumulated other comprehensive income (Note 7)	(3,068)	(3,531)
Retained earnings	82,634	77,773
Less: common stock held in treasury, at cost (387,592,000 and 381,746,000 shares)	21,159	20,783
Total shareholders equity	61,527	56,579
Total liabilities and shareholders equity	$ 111,821	$ 102,908

See Notes to Consolidated Financial Statements

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JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited; Dollars & Shares in Millions Except Per Share Amounts)

	Fiscal Third Quarters Ended			
	October 2, 2011	Percent to Sales	October 3, 2010	Percent to Sales
Sales to customers (Note 9)	$ 16,005	100.0%	$ 14,982	100.0%
Cost of products sold	5,072	31.7	4,594	30.7
Gross profit	10,933	68.3	10,388	69.3
Selling, marketing and administrative expenses	5,240	32.7	4,709	31.4
Research and development expense	1,773	11.1	1,657	11.1
Interest income	(17)	(0.1)	(13)	(0.1)
Interest expense, net of portion capitalized	134	0.8	108	0.7
Other (income) expense, net	(308)	(1.9)	(292)	(2.0)
Earnings before provision for taxes on income	4,111	25.7	4,219	28.2
Provision for taxes on income (Note 5)	909	5.7	802	5.4
NET EARNINGS	$ 3,202	20.0%	$ 3,417	22.8%
NET EARNINGS PER SHARE (Note 8)				
Basic	$ 1.17		$ 1.24	
Diluted	$ 1.15		$ 1.23	
CASH DIVIDENDS PER SHARE	$ 0.57		$ 0.54	
AVG. SHARES OUTSTANDING				
Basic	2,737.0		2,751.6	
Diluted	2,778.2		2,786.4	

See Notes to Consolidated Financial Statements

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JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited; Dollars & Shares in Millions Except Per Share Amounts)

	Fiscal Nine Months Ended			
	October 2, 2011	Percent to Sales	October 3, 2010	Percent to Sales
Sales to customers (Note 9)	$ 48,775	100.0%	$ 45,943	100.0%
Cost of products sold	15,022	30.8	13,752	29.9
Gross profit	33,753	69.2	32,191	70.1
Selling, marketing and administrative expenses	15,511	31.8	14,244	31.0
Research and development expense	5,393	11.0	4,862	10.6
Interest income	(56)	(0.1)	(83)	(0.2)
Interest expense, net of portion capitalized	388	0.8	317	0.7
Other (income) expense, net	(115)	(0.2)	(1,868)	(4.0)
Restructuring expense	589	1.2		
Earnings before provision for taxes on income	12,043	24.7	14,719	32.0
Provision for taxes on income (Note 5)	2,589	5.3	3,327	7.2
NET EARNINGS	$ 9,454	19.4%	$ 11,392	24.8%
NET EARNINGS PER SHARE (Note 8)				
Basic	$ 3.45		$ 4.14	
Diluted	$ 3.40		$ 4.08	
CASH DIVIDENDS PER SHARE	$ 1.68		$ 1.57	
AVG. SHARES OUTSTANDING				
Basic	2,738.5		2,754.2	
Diluted	2,777.6		2,792.0	

See Notes to Consolidated Financial Statements

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JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; Dollars in Millions)

	Fiscal Nine Months Ended October 2, 2011	October 3, 2010
CASH FLOW FROM OPERATING ACTIVITIES		
Net earnings	$ 9,454	$ 11,392
Adjustments to reconcile net earnings to cash flows from operating activities:		
Depreciation and amortization of property and intangibles	2,315	2,170
Stock based compensation	484	474
Deferred tax provision	(849)	644
Accounts receivable allowances	(21)	30
Changes in assets and liabilities, net of effects from acquisitions:		
Increase in accounts receivable	(489)	(585)
Increase in inventories	(787)	(197)
Decrease in accounts payable and accrued liabilities	(100)	(1,552)
Increase in other current and non-current assets	(906)	(310)
Increase in other current and non-current liabilities	1,746	495
NET CASH FLOWS FROM OPERATING ACTIVITIES	10,847	12,561
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	(1,765)	(1,425)
Proceeds from the disposal of assets	721	324
Acquisitions, net of cash acquired	(2,469)	(1,269)
Purchases of investments	(25,444)	(10,679)
Sales of investments	18,438	6,669
Other	(331)	(70)
NET CASH USED BY INVESTING ACTIVITIES	(10,850)	(6,450)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends to shareholders	(4,601)	(4,323)
Repurchase of common stock	(1,672)	(1,512)
Proceeds from short-term debt	7,216	1,896
Retirement of short-term debt	(10,044)	(5,390)
Proceeds from long-term debt	4,471	1,079
Retirement of long-term debt	(12)	(21)
Proceeds from the exercise of stock options/excess tax benefits	946	685
NET CASH USED BY FINANCING ACTIVITIES	(3,696)	(7,586)
Effect of exchange rate changes on cash and cash equivalents	(39)	3
Decrease in cash and cash equivalents	(3,738)	(1,472)
Cash and Cash equivalents, beginning of period	19,355	15,810
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 15,617	$ 14,338
Acquisitions		
Fair value of assets acquired	$ 2,689	$ 1,321
Fair value of liabilities assumed and non-controlling interests	(220)	(52)
Net cash paid for acquisitions	$ 2,469	$ 1,269

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NOTE 1 The accompanying unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited Consolidated Financial Statements of Johnson & Johnson and its subsidiaries (the Company) and related notes as contained in the Company s Annual Report on Form 10-K for the fiscal year ended January 2, 2011. The unaudited interim financial statements include all adjustments (consisting only of normal recurring adjustments) and accruals necessary in the judgment of management for a fair statement of the results for the periods presented.

During the fiscal third quarter of 2011, the Financial Accounting Standards Board (FASB) issued amendments to goodwill impairment testing. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard is not expected to have a material impact on the Company s results of operations, cash flows or financial position.

During the fiscal second quarter of 2011, the FASB issued an amendment to the disclosure requirements for presentation of comprehensive income. The amendment requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance is effective retrospectively for the interim periods and annual periods beginning after December 15, 2011. The adoption of this standard is not expected to have a material impact on the Company s results of operations, cash flows or financial position.

During the fiscal second quarter of 2011, the FASB issued amendments to disclosure requirements for common fair value measurement. These amendments result in convergence of fair value measurement and disclosure requirements between U.S. GAAP and IFRS. This guidance is effective prospectively for the interim periods and annual periods beginning after December 15, 2011. Early adoption is prohibited. The adoption of this standard is not expected to have a material impact on the Company s results of operations, cash flows or financial position.

During the fiscal first quarter of 2011, the Company adopted the FASB guidance and amendments issued related to revenue recognition under the milestone method. The objective of the accounting standard update is to provide guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. This update became effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. The adoption of this standard did not have a material impact on the Company s results of operations, cash flows or financial position.

During the fiscal first quarter of 2011, the Company adopted the FASB guidance on how pharmaceutical companies should recognize and classify in the Company s financial statements, the non-deductible annual fee paid to the Government in accordance with the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act. This fee is based on an allocation of a company s market share of total branded prescription drug sales from the prior year. The estimated fee was recorded as a selling, marketing and administrative expense in the Company s financial statement and will be amortized on a straight-line basis for the year as per the FASB guidance. The adoption of this standard did not have a material impact on the Company s results of operations, cash flows or financial position.

NOTE 2 INVENTORIES

(Dollars in Millions)	October 2, 2011	January 2, 2011
Raw materials and supplies	$ 1,348	1,073

Goods in process	1,853	1,460
Finished goods	3,227	2,845
Total inventories	$ 6,428	5,378

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NOTE 3 INTANGIBLE ASSETS AND GOODWILL

Intangible assets that have finite useful lives are amortized over their estimated useful lives. The latest impairment assessment of goodwill and indefinite lived intangible assets was completed in the fiscal fourth quarter of 2010. Future impairment tests for goodwill and indefinite lived intangible assets will be performed annually in the fiscal fourth quarter, or sooner if warranted.

(Dollars in Millions)	October 2, 2011	January 2, 2011
Intangible assets with definite lives:		
Patents and trademarks gross	$ 7,789	6,660
Less accumulated amortization	2,883	2,629
Patents and trademarks net	4,906	4,031
Other intangibles gross	8,787	7,674
Less accumulated amortization	3,369	2,880
Other intangibles net	5,418	4,794
Intangible assets with indefinite lives:		
Trademarks	5,951	5,954
Purchased in-process research and development	1,950	1,937
Total intangible assets with indefinite lives	7,901	7,891
Total intangible assets net	$ 18,225	16,716

The acquisition of Crucell N.V. during the fiscal first quarter of 2011, increased purchased in-process research and development by $1.0 billion. During the fiscal second quarter of 2011, the Company reclassified $971 million from purchased in-process research and development to amortizable other intangibles to reflect the commercialization of ZYTIGA®.

Goodwill as of October 2, 2011 was allocated by segment of business as follows:

(Dollars in Millions)	Consumer	Pharm	Med Dev & Diag	Total
Goodwill, net at January 2, 2011	$ 8,144	1,225	5,925	15,294
Acquisitions	251	538		789
Currency translation/Other	(60)	5	21	(34)
Goodwill, net as of October 2, 2011	$ 8,335	1,768	5,946	16,049

The weighted average amortization periods for patents and trademarks and other intangible assets are 17 years and 27 years, respectively. The amortization expense of amortizable intangible assets for the fiscal nine months ended October 2, 2011 was $611 million, and the estimated amortization expense for the five succeeding years approximates $840 million, per year.

NOTE 4 FAIR VALUE MEASUREMENTS

The Company uses forward exchange contracts to manage its exposure to the variability of cash flows, primarily related to the foreign exchange rate changes of future intercompany product and third- party purchases of raw materials denominated in foreign currency. The Company also uses cross currency interest rate swaps to manage currency risk primarily related to borrowings. Both types of derivatives are designated as cash flow hedges. The Company also uses forward exchange contracts to manage its exposure to the variability of cash flows for repatriation of foreign dividends. These contracts are designated as net investment hedges. Additionally, the Company uses forward exchange contracts to offset its exposure to certain foreign currency assets and liabilities. These forward exchange contracts are not designated as hedges, and therefore, changes in the fair values of these derivatives are recognized in earnings, thereby offsetting the current earnings effect of the related foreign currency assets and liabilities. The Company does not enter into derivative financial instruments for trading or speculative purposes, or that contain credit risk related contingent features or requirements to post collateral. On an ongoing basis, the Company monitors counterparty credit ratings. The Company considers credit non-performance risk to be low, because the Company enters into agreements with commercial institutions that have at least an A (or equivalent) credit rating. As of

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October 2, 2011, the Company had notional amounts outstanding for forward foreign exchange contracts and cross currency interest rate swaps of $25 billion and $3 billion, respectively.

All derivative instruments are recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether the derivative is designated as part of a hedge transaction, and if so, the type of hedge transaction.

The designation as a cash flow hedge is made at the entrance date of the derivative contract. At inception, all derivatives are expected to be highly effective. Changes in the fair value of a derivative that is designated as a cash flow hedge and is highly effective are recorded in accumulated other comprehensive income until the underlying transaction affects earnings, and are then reclassified to earnings in the same account as the hedged transaction. Gains/losses on net investment hedges are accounted for through the currency translation account and are insignificant. On an ongoing basis, the Company assesses whether each derivative continues to be highly effective in offsetting changes in the cash flows of hedged items. If and when a derivative is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current period earnings in other (income)/expense, net, and was not material for the fiscal quarters ended October 2, 2011 and October 3, 2010. Refer to Note 7 for disclosures of movements in Accumulated Other Comprehensive Income.

As of October 2, 2011, the balance of deferred net gains on derivatives included in accumulated other comprehensive income was $180 million after-tax. For additional information, see Note 7. The Company expects that substantially all of the amounts related to foreign exchange contracts will be reclassified into earnings over the next 12 months as a result of transactions that are expected to occur over that period. The maximum length of time over which the Company is hedging transaction exposure is 18 months excluding interest rate swaps. The amount ultimately realized in earnings will differ as foreign exchange rates change. Realized gains and losses are ultimately determined by actual exchange rates at maturity of the derivative.

The following table is a summary of the activity related to derivatives designated as hedges for the fiscal third quarters in 2011 and 2010:

	Gain/ (Loss) recognized in Accumulated OCI(1)		**Gain/(Loss) reclassified from Accumulated OCI into income(1)**		**Gain/ (Loss) recognized in other income/expense(2)**	
			Fiscal Third Quarters Ended			
(Dollars in Millions)	2011	2010	2011	2010	2011	2010
Cash Flow Hedges						
Foreign exchange contracts	$ (57)	45	4	(12) (A)	1	18
Foreign exchange contracts	(58)	(7)	(21)	(106) (B)	(1)	121
Foreign exchange contracts	6	(46)	(40)	20 (C)	1	(11)
Cross currency interest rate swaps	(67)	(24)	(6)	(1) (D)		
Foreign exchange contracts	59	(63)	(4)	9 (E)	(1)	(17)
Total	$ (117)	(95)	(67)	(90)		111

All amounts shown in the table above are net of tax.

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The following table is a summary of the activity related to derivatives designated as hedges for the fiscal nine months in 2011 and 2010:

	Gain/ (Loss) recognized in Accumulated OCI[1]		**Gain/ (Loss) reclassified from Accumulated OCI into income[1]**		**Gain/ (Loss) recognized in other income/expense[2]**	
			Fiscal Nine Months Ended			
(Dollars in Millions)	2011	2010	2011	2010	2011	2010
Cash Flow Hedges						
Foreign exchange contracts	$ (30)	(39)	(6)	(41) (A)	(1)	(3)
Foreign exchange contracts	34	(213)	(127)	(204) (B)	2	(33)
Foreign exchange contracts	(2)	27	(21)	41 (C)	(1)	5
Cross currency interest rate swaps	(107)	(73)	(24)	10 (D)		
Foreign exchange contracts		18	(7)	8 (E)	1	3
Total	$ (105)	(280)	(185)	(186)	1	(28)

All amounts shown in the table above are net of tax.

(1) Effective portion

(2) Ineffective portion

(A) Included in Sales to customers

(B) Included in Cost of products sold

(C) Included in Research and development expense

(D) Included in Interest (income)/Interest expense, net

(E) Included in Other (income)/expense, net

For the fiscal third quarters ended October 2, 2011 and October 3, 2010, a loss of $10 million and a gain of $119 million, respectively, were recognized in Other (income)/expense, net, relating to foreign exchange contracts not designated as hedging instruments .

For the fiscal nine months ended October 2, 2011 and October 3, 2010, a loss of $2 million and a gain of $50 million, respectively, were recognized in Other (income)/expense, net, relating to foreign exchange contracts not designated as hedging instruments.

In addition, during the fiscal second quarter of 2011, the Company entered into an option to hedge the currency risk associated with the cash portion of the payment for the planned acquisition of Synthes, Inc. The option was not designated as a hedge, and therefore, changes in the fair value of the option are recognized as other (income)/expense, net. During the fiscal third quarter and the fiscal nine months ended October 2, 2011, the mark to market adjustment to reduce the value of the currency option was $304 million and $202 million, respectively.

Fair value is the exit price that would be received to sell an asset or paid to transfer a liability. Fair value is a market-based measurement that is determined using assumptions that market participants would use in pricing an asset or liability. The authoritative literature establishes a three-level hierarchy to prioritize the inputs used in measuring fair value. The levels within the hierarchy are described below with Level 1 having the highest priority and Level 3 having the lowest.

The fair value of a derivative financial instrument (i.e., forward exchange contract or currency swap) is the aggregation by currency of all future cash flows discounted to its present value at the prevailing market interest rates and subsequently converted to the U.S. dollar at the current spot foreign exchange rate. The Company does not believe that fair values of these derivative instruments materially differs from the amounts that could be realized upon settlement or maturity, or that the changes in fair value will have a material effect on the Company s results of operations, cash flows or financial position. The Company also holds equity investments which are classified as Level 1 because they are traded in an active exchange market. The Company did not have any other significant financial assets or liabilities which would require revised valuations under this standard that are recognized at fair value.

The following three levels of inputs are used to measure fair value:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Significant other observable inputs.

Level 3 Significant unobservable inputs.

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The Company s significant financial assets and liabilities measured at fair value as of October 2, 2011 and January 2, 2011 were as follows:

	October 2, 2011				January 2, 2011
(Dollars in Millions)	**Level 1**	**Level 2**	**Level 3**	**Total**	**Total[1]**
Derivatives designated as hedging instruments:					
Assets:					
Foreign exchange contracts	$	$ 604	$	$ 604	$ 321
Cross currency interest rate swaps[2]		7		7	17
Total		611		611	338
Liabilities:					
Foreign exchange contracts		425		425	586
Cross currency interest rate swaps[3]		599		599	502
Total		1,024		1,024	