

JOHNSON & JOHNSON
Form 10-Q
October 30, 2014

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

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended September 28, 2014
or

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

(State or other jurisdiction of
incorporation or organization)

22-1024240

(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. Yes 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). Yes 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 Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes 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 24, 2014, 2,799,110,362 shares of Common Stock, \$1.00 par value, were outstanding.

JOHNSON & JOHNSON AND SUBSIDIARIES
TABLE OF CONTENTS

	Page No.
<u>Part I — Financial Information</u>	<u>3</u>
<u>Item 1. Financial Statements (unaudited)</u>	<u>3</u>
<u>Consolidated Balance Sheets — September 28, 2014 and December 29, 2013</u>	<u>3</u>
<u>Consolidated Statements of Earnings for the Fiscal Third Quarters Ended September 28, 2014 and September 29, 2013</u>	<u>4</u>
<u>Consolidated Statements of Earnings for the Fiscal Nine Months Ended September 28, 2014 and September 29, 2013</u>	<u>5</u>
<u>Consolidated Statements of Comprehensive Income for the Fiscal Third Quarters and Fiscal Nine Months Ended September 28, 2014 and September 29, 2013</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows for the Fiscal Nine Months Ended September 28, 2014 and September 29, 2013</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>32</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>42</u>
<u>Item 4. Controls and Procedures</u>	<u>42</u>
<u>Part II — Other Information</u>	<u>43</u>
<u>Item 1 - Legal Proceedings</u>	<u>43</u>
<u>Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>43</u>
<u>Item 6 - Exhibits</u>	<u>44</u>
<u>Signatures</u>	<u>45</u>
EX-10.1	
EX-31.1	
EX-32.1	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	
EX-101 DEFINITION LINKBASE DOCUMENT	

Table of Contents

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)

	September 28, 2014	December 29, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$13,818	20,927
Marketable securities	19,187	8,279
Accounts receivable, trade, less allowances for doubtful accounts \$262 (2013, \$333)	11,615	11,713
Inventories (Note 2)	8,419	7,878
Deferred taxes on income	3,827	3,607
Prepaid expenses and other	3,107	4,003
Total current assets	59,973	56,407
Property, plant and equipment at cost	36,448	37,133
Less: accumulated depreciation	(20,644	) (20,423
Property, plant and equipment, net	15,804	16,710
Intangible assets, net (Note 3)	26,304	27,947
Goodwill (Note 3)	21,636	22,798
Deferred taxes on income	3,347	3,872
Other assets	5,033	4,949
Total assets	\$132,097	132,683
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Loans and notes payable	\$2,115	4,852
Accounts payable	6,603	6,266
Accrued liabilities	6,188	7,685
Accrued rebates, returns and promotions	4,208	3,308
Accrued compensation and employee related obligations	2,333	2,794
Accrued taxes on income	1,535	770
Total current liabilities	22,982	25,675
Long-term debt (Note 4)	13,152	13,328
Deferred taxes on income	4,063	3,989
Employee related obligations	7,551	7,784
Other liabilities	7,758	7,854
Total liabilities	55,506	58,630
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 (loss) (Note 7)	(5,382	) (2,860
Retained earnings	96,560	89,493
Less: common stock held in treasury, at cost (315,787,000 and 299,215,000 shares)	17,707	15,700

Edgar Filing: JOHNSON & JOHNSON - Form 10-Q

Total shareholders' equity	76,591	74,053
Total liabilities and shareholders' equity	\$132,097	132,683
See Notes to Consolidated Financial Statements		

3

Table of ContentsJOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited; Dollars & Shares in Millions Except Per Share Amounts)

	Fiscal Third Quarters Ended					
	September 28, 2014		September 29, 2013		Percent to Sales	
		Percent to Sales		Percent to Sales		
Sales to customers (Note 9)	\$ 18,467	100.0	%	\$ 17,575	100.0	%
Cost of products sold	5,399	29.2		5,344	30.4	
Gross profit	13,068	70.8		12,231	69.6	
Selling, marketing and administrative expenses	5,468	29.6		5,314	30.2	
Research and development expense	2,023	11.0		2,042	11.6	
In-process research and development	—	—		178	1.0	
Interest income	(18	) (0.1	)	(18	) (0.1)
Interest expense, net of portion capitalized	130	0.7		105	0.6	
Other (income) expense, net	(1,345	) (7.3	)	943	5.4	
Earnings before provision for taxes on income	6,810	36.9		3,667	20.9	
Provision for taxes on income (Note 5)	2,061	11.2		685	3.9	
NET EARNINGS	\$ 4,749	25.7	%	\$ 2,982	17.0	%
NET EARNINGS PER SHARE (Note 8)						
Basic	\$ 1.69			\$ 1.06		
Diluted	\$ 1.66			\$ 1.04		
CASH DIVIDENDS PER SHARE						
	\$ 0.70			\$ 0.66		
AVG. SHARES OUTSTANDING						
Basic	2,814.4			2,818.4		
Diluted	2,864.3			2,881.2		
See Notes to Consolidated Financial Statements						

Table of Contents

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

	Fiscal Nine Months Ended					
	September 28, 2014	Percent to Sales		September 29, 2013	Percent to Sales	
Sales to customers (Note 9)	\$ 56,077	100.0	%	\$ 52,957	100.0	%
Cost of products sold	16,893	30.1		16,387	30.9	
Gross profit	39,184	69.9		36,570	69.1	
Selling, marketing and administrative expenses	16,132	28.8		15,913	30.0	
Research and development expense	5,859	10.5		5,772	10.9	
In-process research and development	22	0.0		242	0.5	
Interest income	(50	) (0.1	)	(56	) (0.1)
Interest expense, net of portion capitalized	394	0.7		348	0.7	
Other (income) expense, net	(1,033	) (1.8	)	1,630	3.1	
Earnings before provision for taxes on income	17,860	31.8		12,721	24.0	
Provision for taxes on income (Note 5)	4,058	7.2		2,409	4.5	
NET EARNINGS	\$ 13,802	24.6	%	\$ 10,312	19.5	%
NET EARNINGS PER SHARE (Note 8)						
Basic	\$ 4.89			\$ 3.68		
Diluted	\$ 4.81			\$ 3.58		
CASH DIVIDENDS PER SHARE	\$ 2.06			\$ 1.93		
AVG. SHARES OUTSTANDING						
Basic	2,822.0			2,805.6		
Diluted	2,871.2			2,879.0		

See Notes to Consolidated Financial Statements

Table of Contents

JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited; Dollars in Millions)

	Fiscal Third Quarters Ended		Fiscal Nine Months Ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Net earnings	\$4,749	2,982	13,802	10,312
Other comprehensive income (loss), net of tax				
Foreign currency translation	(2,400	) 1,278	(2,499	) (48
Securities:				
Unrealized holding gain (loss) arising during period	(35	) 59	6	238
Reclassifications to earnings	(1	) —	(1	) (289
Net change	(36	) 59	5	(51
Employee benefit plans:				
Prior service cost amortization during period	(5	) —	(14	) 2
Gain (loss) amortization during period	101	130	301	390
Net change	96	130	287	392
Derivatives & hedges:				
Unrealized gain (loss) arising during period	14	41	(139	) 224
Reclassifications to earnings	(49	) (44	) (176	) (53
Net change	(35	) (3	) (315	) 171
Other comprehensive income (loss)	(2,375	) 1,464	(2,522	) 464
Comprehensive income	\$2,374	4,446	11,280	10,776

See Notes to Consolidated Financial Statements

The tax effects in other comprehensive income for the fiscal third quarters were as follows for 2014 and 2013, respectively: Securities: \$19 million and \$32 million; Employee Benefit Plans: \$46 million and \$68 million; Derivatives & Hedges: \$19 million and \$1 million.

The tax effects in other comprehensive income for the fiscal nine months were as follows for 2014 and 2013, respectively: Securities: \$3 million and \$28 million; Employee Benefit Plans: \$139 million and \$204 million; Derivatives & Hedges: \$170 million and \$92 million.

Table of Contents

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

	Fiscal Nine Months Ended	
	September 28, 2014	September 29, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	\$ 13,802	10,312
Adjustments to reconcile net earnings to cash flows from operating activities:		
Depreciation and amortization of property and intangibles	2,904	3,002
Stock based compensation	646	584
Venezuela adjustments	89	108
Asset write-downs	259	247
Net gain on sale of assets/businesses	(2,336)	(55)
Net gain on equity investment transactions	—	(380)
Deferred tax provision	297	(224)
Accounts receivable allowances	(54)	(32)
Changes in assets and liabilities, net of effects from acquisitions:		
Increase in accounts receivable	(399)	(971)
Increase in inventories	(1,098)	(799)
(Decrease)/increase in accounts payable and accrued liabilities	(827)	589
Decrease/(increase) in other current and non-current assets	72	(348)
Increase in other current and non-current liabilities	751	1,242
NET CASH FLOWS FROM OPERATING ACTIVITIES	14,106	13,275
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	(2,218)	(2,166)
Proceeds from the disposal of assets/businesses, net	4,481	192
Acquisitions, net of cash acquired	(291)	(819)
Purchases of investments	(25,784)	(13,583)
Sales of investments	14,576	12,891
Other	(147)	(40)
NET CASH USED BY INVESTING ACTIVITIES	(9,383)	(3,525)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends to shareholders	(5,812)	(5,424)
Repurchase of common stock	(4,381)	(3,050)
Proceeds from short-term debt	629	1,770
Retirement of short-term debt	(1,713)	(1,416)
Proceeds from long-term debt	17	51
Retirement of long-term debt	(1,787)	(1,531)
Proceeds from the exercise of stock options/excess tax benefits	1,406	2,271
Other	—	56
NET CASH USED BY FINANCING ACTIVITIES	(11,641)	(7,273)
Effect of exchange rate changes on cash and cash equivalents	(191)	(184)

Edgar Filing: JOHNSON & JOHNSON - Form 10-Q

(Decrease)/Increase in cash and cash equivalents	(7,109	) 2,293	
Cash and Cash equivalents, beginning of period	20,927	14,911	
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$13,818	17,204	
Acquisitions			
Fair value of assets acquired	\$305	1,012	
Fair value of liabilities assumed and noncontrolling interests	(14	) (193)
Net fair value of acquisitions	291	819	
See Notes to Consolidated Financial Statements			

7

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 December 29, 2013. 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 first quarter of 2014, the Company adopted the Financial Accounting Standards Board (FASB) guidance clarifying the release of accumulated Foreign Currency Translation from other comprehensive income (OCI), into current year Net Earnings. The amendment requires that when the parent company ceases to have a controlling interest in a subsidiary or a business within a foreign entity the parent is to release accumulated Foreign Currency Translation from OCI. This update became effective for all annual periods and interim reporting periods beginning after December 15, 2013. 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 2014, the Company adopted the FASB guidance on the presentation of unrecognized tax benefits when various qualifying tax credits exist. The amendment requires that unrecognized tax benefits be presented on the Consolidated Balance Sheet as a reduction to deferred tax assets created by net operating losses or other tax credits from prior periods that occur in the same taxing jurisdiction. To the extent that the unrecognized tax benefit exceeds these credits, it shall be presented as a liability. This update became effective for all annual periods and interim reporting periods beginning after December 15, 2013. The adoption of this standard did not have a material impact on the presentation of the Company's financial position.

During the fiscal second quarter of 2014, the FASB issued amended guidance on the use and presentation of discontinued operations in an entity's financial statements. The new guidance restricts the presentation of discontinued operations to business circumstances when the disposal of business operations represents a strategic shift that has or will have a major effect on an entity's operations and financial results. Examples of a strategic shift could include, but not be limited to: disposal of major geographic segments, a major line of business or other major business component of an entity. The new guidance also expands the required disclosures for entities that have assets held for sale but do not meet the new definition of discontinued operations. This amendment includes early adoption provisions allowing the Company to implement this update immediately for the first quarter of 2014. The Company elected to adopt this standard for the first quarter of 2014. The balances and updated disclosures required by the amended guidance are included in Note 10 in the Notes to the Consolidated Financial Statements.

During the fiscal second quarter of 2014, the FASB issued Accounting Standards Update 2014-09: Revenue from Contracts with Customers. This standard replaces substantially all current revenue recognition accounting guidance. This update is required to be adopted by all public companies for all annual periods and interim reporting periods beginning after December 15, 2016. Early adoption of this standard is not permitted. The Company is currently assessing the impact of the future adoption of this standard on its financial statements.

During the fiscal second quarter of 2014, the FASB issued amended guidance Accounting Standards Update No. 2014-10: Development Stage Entities: Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entity Guidance in Topic 810, Consolidation. The change in the current guidance will require the Company to determine if it should consolidate one of these entities based on the change in the consolidation analysis. This update to the consolidation analysis will become effective for all annual periods and interim reporting periods beginning after December 15, 2015. The adoption of this standard is not expected to have a material impact on the presentation of the Company's results of operations, cash flows or financial position.

During the fiscal second quarter of 2014, the FASB issued Accounting Standards Update 2014-12: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This standard clarifies the current accounting guidance for entities that issue share-based payment awards that require a specific performance target be achieved for employees to become eligible to vest in the awards, which may occur subsequent to a required service period. Current accounting guidance does not explicitly address how to account for these types of awards. The new standard provides explicit guidance and clarifies that these types of performance targets should be treated as performance conditions. The accounting for share-based awards with performance conditions is already specified in current accounting guidance. This update is required to be adopted by all public companies for all annual periods and interim reporting periods beginning after December 15, 2015. Early adoption of this standard is permitted and the Company has elected to adopt this standard for the second quarter of 2014. The adoption of this standard did not have a material impact on the Company's results of operations, cash flows or financial position.

Table of Contents

During the fiscal third quarter of 2014, the FASB issued Accounting Standards Update No. 2014-15: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This standard requires management to evaluate, for each annual and interim reporting period, whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date the financial statements are issued or are available to be issued. If substantial doubt is raised, additional disclosures around management's plan to alleviate these doubts are required. This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2016. This standard is not expected to have any impact on current disclosures in the financial statements.

Reclassification

Certain prior period amounts on the Consolidated Statements of Cash Flows have been reclassified to conform to current year presentation.

NOTE 2 — INVENTORIES

(Dollars in Millions)	September 28, 2014	December 29, 2013
Raw materials and supplies	\$1,165	1,224
Goods in process	2,303	2,612
Finished goods	4,951	4,042
Total inventories	\$8,419	7,878

NOTE 3 — INTANGIBLE ASSETS AND GOODWILL

Intangible assets that have finite useful lives are amortized over their estimated useful lives. The latest annual impairment assessment of goodwill and indefinite lived intangible assets was completed in the fiscal fourth quarter of 2013. 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)	September 28, 2014	December 29, 2013
Intangible assets with definite lives:		
Patents and trademarks — gross	\$8,991	9,164
Less accumulated amortization	4,614	4,146
Patents and trademarks — net	4,377	5,018
Customer relationships and other intangibles — gross	18,256	19,027
Less accumulated amortization	5,075	4,872
Customer relationships and other intangibles — net	13,181	14,155
Intangible assets with indefinite lives:		
Trademarks	7,425	7,619
Purchased in-process research and development	1,321	1,155
Total intangible assets with indefinite lives	8,746	8,774
Total intangible assets — net	\$26,304	27,947

Table of Contents

Goodwill as of September 28, 2014 was allocated by segment of business as follows:

(Dollars in Millions)	Consumer	Pharm	Med Dev & Diag	Total
Goodwill, net at December 29, 2013	\$8,531	2,068	12,199	22,798
Goodwill, related to acquisitions	—	92	—	92
Goodwill, related to divestitures	(101)	—	(600)	(701)
Currency translation/Other	(446)	(68)	(39)	(553)
Goodwill, net as of September 28, 2014	\$7,984	2,092	11,560	21,636

See Note 10 to the Consolidated Financial Statements for more details related to acquisitions and divestitures.

The weighted average amortization periods for patents and trademarks and customer relationships and other intangible assets are 17 years and 24 years, respectively. The amortization expense of amortizable intangible assets was \$1,033 million and \$980 million for the fiscal nine months ended September 28, 2014 and September 29, 2013, respectively. The estimated amortization expense for the five succeeding years approximates \$1,350 million, before tax, per year. Amortization expense is included in cost of products sold. Intangible asset write-downs are included in Other (income) expense, net.

NOTE 4 — FAIR VALUE MEASUREMENTS

The Company uses forward foreign 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 materials denominated in a foreign currency. The Company uses cross currency interest rate swaps to manage currency risk primarily related to borrowings. Both types of derivatives are designated as cash flow hedges.

Additionally, the Company uses interest rate swaps as an instrument to manage interest rate risk related to fixed rate borrowings. These derivatives are treated as fair value hedges. The Company also uses forward foreign 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 foreign exchange contracts to offset its exposure to certain foreign currency assets and liabilities. These forward foreign 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 September 28, 2014, the Company had notional amounts outstanding for forward foreign exchange contracts, cross currency interest rate swaps and interest rate swaps of \$32.6 billion, \$2.4 billion and \$1.0 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 and losses associated with interest rate swaps are recorded to interest expense in the period in which they occurred. Gains and 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 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 for forward foreign exchange contracts and cross currency interest rate swaps. For interest rate swaps designated as fair value hedges, hedge ineffectiveness, if any, is included in current period earnings within interest expense. For the current reporting period, hedge ineffectiveness associated with interest rate swaps are not material.

As of September 28, 2014, the balance of deferred net losses on derivatives included in accumulated other comprehensive income was \$70 million after-tax. For additional information, see the Consolidated Statements of Comprehensive Income and Note 7. The Company expects that substantially all of the amounts related to forward foreign exchange contracts will be reclassified into

Table of Contents

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 contracts. The amount ultimately realized in earnings may 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 cash flow hedges for the fiscal third quarters in 2014 and 2013:

(Dollars in Millions)	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					
Cash Flow Hedges By Income Statement Caption	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Sales to customers ⁽³⁾	\$(43)	25	(2)	17	—	—
Cost of products sold ⁽³⁾	(37)	42	37	51	(2)	—
Research and development expense ⁽³⁾	25	(20)	8	(14)	—	—
Interest (income)/Interest expense, net ⁽⁴⁾	11	7	(6)	(2)	—	—
Other (income) expense, net ⁽³⁾	58	(13)	12	(8)	—	—
Total	\$14	41	49	44	(2)	—

The following table is a summary of the activity related to derivatives designated as cash flow hedges for the first fiscal nine months in 2014 and 2013:

(Dollars in Millions)	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					
Cash Flow Hedges By Income Statement Caption	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Sales to customers ⁽³⁾	\$(73)	22	6	24	1	—
Cost of products sold ⁽³⁾	(187)	220	196	72	(4)	4
Research and development expense ⁽³⁾	28	(27)	(5)	(31)	(1)	(3)
Interest (income)/Interest expense, net ⁽⁴⁾	21	15	(12)	(6)	—	—
Other (income) expense, net ⁽³⁾	72	(6)	(9)	(6)	—	(1)
Total	\$(139)	224	176	53	(4)	—

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

- (1) Effective portion
- (2) Ineffective portion
- (3) Forward foreign exchange contracts
- (4) Cross currency interest rate swaps

For the fiscal third quarter ended September 28, 2014, a loss of \$2 million was recognized and for the fiscal third quarter ended September 29, 2013, no gain or loss was recognized in Other (income) expense, net, relating to forward foreign exchange contracts not designated as hedging instruments.

For the fiscal nine months ended September 28, 2014 and September 29, 2013, a loss of \$48 million and a gain of \$50 million, respectively, was recognized in Other (income) expense, net, relating to forward foreign exchange contracts not designated as hedging instruments.

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 determined using assumptions that market participants would use in pricing an asset or liability. The authoritative

Table of Contents

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 foreign exchange contracts, interest rate contracts) 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 differ 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.

The Company's significant financial assets and liabilities measured at fair value as of September 28, 2014 and December 29, 2013 were as follows:

(Dollars in Millions)	September 28, 2014				December 29, 2013
	Level 1	Level 2	Level 3	Total	Total ⁽¹⁾
Derivatives designated as hedging instruments:					
Assets:					
Forward foreign exchange contracts	\$—	534	—	534	537
Interest rate contracts ⁽²⁾	—	111	—	111	169
Total	—	645	—	645	706
Liabilities:					
Forward foreign exchange contracts	—	579	—	579	133
Interest rate contracts ⁽³⁾⁽⁴⁾	—	4	—	4	26
Total	—	583	—	583	159
Derivatives not designated as hedging instruments:					
Assets:					
Forward foreign exchange contracts	—	28	—	28	25
Liabilities:					
Forward foreign exchange contracts	—	40	—	40	29
Other Investments ⁽⁵⁾	\$396	—	—	396	333

(1) As of December 29, 2013, these assets and liabilities are classified as Level 2 with the exception of Other investments of \$333 million, which are classified as Level 1.

(2) Includes \$110 million and \$169 million of non-current assets for September 28, 2014 and December 29, 2013, respectively.

(3) Includes \$4 million and \$19 million of non-current liabilities for September 28, 2014 and December 29, 2013, respectively.

(4) Includes cross currency interest rate swaps and interest rate swaps.

(5) Classified as non-current other assets.

Table of Contents

Financial Instruments not measured at Fair Value:

The following financial assets and liabilities are held at carrying amount on the consolidated balance sheet as of September 28, 2014:

(Dollars in Millions)	Carrying Amount	Estimated Fair Value
Financial Assets		
Current Investments		
Cash	\$2,226	2,226
Government securities and obligations	19,247	19,249
Reverse repurchase agreements	8,138	8,138
Corporate debt securities	1,280	1,281
Money market funds	1,364	1,364
Time deposits	750	750
Total cash, cash equivalents and current marketable securities	\$33,005	33,008

Fair value of government securities and obligations and corporate debt securities was estimated using quoted broker prices and significant other observable inputs.

The Company classifies all highly liquid investments with stated maturities of three months or less from date of purchase as cash equivalents and all highly liquid investments with stated maturities of greater than three months from the date of purchase as current marketable securities.

The estimated fair value was the same as the amortized cost as of December 29, 2013.

Financial Liabilities

Current Debt	\$2,115	2,115
Non-Current Debt		
2.15% Notes due 2016	898	922
3 month LIBOR+0.07% FRN due 2016	800	801
0.70% Notes due 2016	399	398
5.55% Debentures due 2017	1,000	1,124
5.15% Debentures due 2018	898	1,026
1.65% Notes due 2018	598	598
4.75% Notes due 2019 (1B Euro 1.2726)	1,268	1,534
3% Zero Coupon Convertible Subordinated Debentures due in 2020	164	288
2.95% Debentures due 2020	542	564
3.55% Notes due 2021	446	481
6.73% Debentures due 2023	250	324
3.375% Notes due 2023	550	573
5.50% Notes due 2024 (500 MM GBP 1.6332)	812	993
6.95% Notes due 2029	296	413
4.95% Debentures due 2033	500	586
4.375% Notes due 2033	646	704
5.95% Notes due 2037	995	1,288
5.85% Debentures due 2038	700	912

Edgar Filing: JOHNSON & JOHNSON - Form 10-Q

4.50% Debentures due 2040	539	574
4.85% Notes due 2041	298	343
4.50% Notes due 2043	499	545
Other	54	54
Total Non-Current Debt	\$13,152	15,045

13

Table of Contents

The weighted average effective interest rate on non-current debt is 4.41%.

The excess of the fair value over the carrying value of debt was \$1.4 billion at December 29, 2013.

Fair value of the non-current debt was estimated using market prices, which were corroborated by quoted broker prices and significant other observable inputs.

NOTE 5 — INCOME TAXES

The worldwide effective income tax rates for the fiscal nine months of 2014 and 2013 were 22.7% and 18.9%, respectively. The higher effective tax rate in 2014 as compared to 2013 was primarily due to the divestiture of the Ortho-Clinical Diagnostics business at an approximate 41% effective tax rate, litigation accruals at low tax rates, the accrual of an additional year of the Branded Prescription Drug Fee, which is not tax deductible, and additional U.S. tax expense related to a planned increase in dividends from current year foreign earnings as compared to the prior year. Also, the mix of earnings into higher tax jurisdictions, primarily the United States, increased the tax rate. Additionally, the 2014 tax rate was adversely impacted by the expiration, at year end 2013, of the U.S. Research & Development (R&D) tax credit and the Controlled Foreign Corporation (CFC) look-through provision as compared to 2013. The 2013 fiscal nine months tax rate included both the 2012 benefit and the 2013 benefit from the R&D tax credit and the CFC look-through provisions, because those provisions were enacted into law in January 2013 and were retroactive to January 1, 2012.

These increases to the year to date 2014 tax rate were partially offset by a tax benefit of \$398 million associated with the Conor Medsystems divestiture. The tax rate was also reduced as the Company adjusted its unrecognized tax benefits as a result of (i) the federal appeals court's decision in OMJ Pharmaceuticals, Inc.'s litigation regarding credits under former Section 936 of the Internal Revenue Code (see Note 11 to the Consolidated Financial Statements for additional information), and (ii) a settlement of substantially all issues related to the Company's U.S. Internal Revenue Service audit of tax years 2006 - 2009.

As of September 28, 2014, the Company had approximately \$2.3 billion of liabilities from unrecognized tax benefits, which reflects the adjustments described above. The Company believes it is possible that audits may be completed by tax authorities in some jurisdictions over the next twelve months. The Company is not able to provide a reasonably reliable estimate of the timing of any other future tax payments relating to uncertain tax positions.

NOTE 6 — PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Components of Net Periodic Benefit Cost

Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the fiscal third quarters of 2014 and 2013 include the following components:

(Dollars in Millions)	Fiscal Third Quarters Ended			
	Retirement Plans		Other Benefit Plans	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Service cost	\$197	204	52	49
Interest cost	255	226	50	37
Expected return on plan assets	(403	) (360	) (2	) (1
Amortization of prior service cost/(credit)	1	1	(8	) (1
Recognized actuarial losses	115	169	33	29

Edgar Filing: JOHNSON & JOHNSON - Form 10-Q

Curtailments and settlements	(11) —	—	—
Net periodic benefit cost	\$154	240	125	113

14

Table of Contents

Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the fiscal nine months of 2014 and 2013 include the following components:

(Dollars in Millions)	Fiscal Nine Months Ended			
	Retirement Plans		Other Benefit Plans	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Service cost	\$594	615	158	147
Interest cost	768	681	149	112
Expected return on plan assets	(1,212	) (1,084	) (5	) (4
Amortization of prior service cost/(credit)	4	4	(25	) (2
Recognized actuarial losses	346	509	101	84
Curtailments and settlements	(11) —	—	—
Net periodic benefit cost	\$489	725	378	337

Company Contributions

For the fiscal nine months ended September 28, 2014, the Company contributed \$36 million and \$27 million to its U.S. and international retirement plans, respectively. The Company plans to continue to fund its U.S. defined benefit plans to comply with the Pension Protection Act of 2006. International plans are funded in accordance with local regulations.

NOTE 7 — ACCUMULATED OTHER COMPREHENSIVE INCOME

Components of other comprehensive income (loss) consist of the following:

(Dollars in Millions)	Foreign Currency Translation	Gain/(Loss) On Securities	Employee Benefit Plans	Gain/(Loss) On Derivatives & Hedges	Total Accumulated Other Comprehensive Income (Loss)
December 29, 2013	\$ (202	) 106	(3,009	) 245	(2,860
Net change	(2,499	) 5	287	(315	) (2,522
September 28, 2014	\$ (2,701	) 111	(2,722	) (70	) (5,382

Amounts in accumulated other comprehensive income are presented net of the related tax impact. Foreign currency translation is not adjusted for income taxes where it relates to permanent investments in international subsidiaries. For additional details on comprehensive income see the Consolidated Statements of Comprehensive Income.

Details on reclassifications out of Accumulated Other Comprehensive Income:

Gain/(Loss) On Securities - reclassifications released to Other (income) expense, net.

Employee Benefit Plans - reclassifications are included in net periodic benefit cost. See Note 6 for additional details.

Gain/(Loss) On Derivatives & Hedges - reclassifications to earnings are recorded in the same account as the hedged transaction. See Note 4 for additional details.

Table of Contents

NOTE 8 — EARNINGS PER SHARE

The following is a reconciliation of basic net earnings per share to diluted net earnings per share for the fiscal third quarters ended September 28, 2014 and September 29, 2013:

(Shares in Millions)	Fiscal Third Quarters Ended	
	September 28, 2014	September 29, 2013
Basic net earnings per share	\$1.69	1.06
Average shares outstanding — basic	2,814.4	2,818.4
Potential shares exercisable under stock option plans	148.4	154.1
Less: shares which could be repurchased under treasury stock method	(101.2	) (107.9
Convertible debt shares	2.7	3.0
Accelerated share repurchase program	—	13.6
Average shares outstanding — diluted	2,864.3	2,881.2
Diluted earnings per share	\$1.66	1.04

The diluted earnings per share calculation for both the fiscal third quarters ended September 28, 2014 and September 29, 2013 included the dilutive effect of convertible debt that was offset by the related reduction in interest expense.

The diluted earnings per share calculation for the fiscal third quarter ended September 29, 2013 included the dilutive effect of 13.6 million shares related to the accelerated share repurchase program, associated with the acquisition of Synthes, Inc.

The diluted earnings per share calculation for both the fiscal third quarters ended September 28, 2014 and September 29, 2013 included all shares related to stock options, as there were no options or other instruments which were anti-dilutive.

The following is a reconciliation of basic net earnings per share to diluted net earnings per share for the fiscal nine months ended September 28, 2014 and September 29, 2013:

(Shares in Millions)	Fiscal Nine Months Ended	
	September 28, 2014	September 29, 2013
Basic net earnings per share	\$4.89	3.68
Average shares outstanding — basic	2,822.0	2,805.6
Potential shares exercisable under stock option plans	148.8	154.7
Less: shares which could be repurchased under treasury stock method	(102.3	) (110.4
Convertible debt shares	2.7	3.0
Accelerated share repurchase program	—	26.1
Average shares outstanding — diluted	2,871.2	2,879.0
Diluted earnings per share	\$4.81	3.58

The diluted earnings per share calculation for both the fiscal nine months ended September 28, 2014 and September 29, 2013 included the dilutive effect of convertible debt that was offset by the related reduction in interest expense.

The diluted earnings per share calculation for the fiscal nine months ended September 29, 2013 included the dilutive effect of 26.1 million shares related to the accelerated share repurchase program, associated with the acquisition of

Synthes, Inc.

The diluted net earnings per share calculation for both the fiscal nine months ended September 28, 2014 and September 29, 2013 included all shares related to stock options, as there were no options or other instruments which were anti-dilutive.

16

Table of Contents

NOTE 9 — SEGMENTS OF BUSINESS AND GEOGRAPHIC AREAS

SALES BY SEGMENT OF BUSINESS

(Dollars in Millions)	Fiscal Third Quarters Ended			Percent Change
	September 28, 2014	September 29, 2013		
Consumer				
United States	\$1,173	1,225	(4.2)%
International	2,416	2,386	1.3	
Total	3,589	3,611	(0.6)
Pharmaceutical				
United States	4,723	3,549	33.1	
International				