

Q2 2018 Earnings Call

Company Participants

- Alex Gorsky, Chairman & Chief Executive Officer
- Joseph J. Wolk, Executive Vice President & Chief Financial Officer
- Matthew Stuckley, Investor Relations Contact

Other Participants

- Bob Hopkins, Analyst
- Danielle Antalffy, Analyst
- David Ryan Lewis, Analyst
- Geoff Meacham, Analyst
- Glenn John Novarro, Analyst
- Jami Rubin, Analyst
- Jayson T. Bedford, Analyst
- Joanne Karen Wuensch, Analyst
- Larry Biegelsen, Analyst
- Rick Wise, Analyst
- Vamil K. Divan, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Johnson & Johnson's second quarter 2018 earnings conference call. All participants will be in listen-only mode until the question-and-answer session of the conference. This call is being recorded.

I would now like to turn the conference call over to Johnson & Johnson. You may begin.

Joseph J. Wolk {BIO 19812977 <GO>}

Hello. This is Joe Wolk, and it is my pleasure to welcome you to the investor conference call to review Johnson & Johnson's business results for the second quarter of 2018. I am pleased to be joined for a discussion by Alex Gorsky, Chairman and Chief Executive Officer. Also helping us out today is Matt Stuckley, Senior Director of Investor Relations.

As many of you know, this is my first earnings call as Chief Financial Officer. I am very honored, excited and humbled to assume the role for this great company. Dominic Caruso leaves a lasting impact on the business in many ways. I want to personally thank

him for his commitment to this transition. He has been very gracious with his time. It is great to be surrounded by the many talented and dedicated people of Johnson & Johnson who stride every day to make a positive difference in the lives of all stakeholders outlined in Our Credo.

And I want to thank you on this webcast for the support and kind words since the announcement. I look forward to our continued partnership. As far as naming a new Head of Investor Relations, we have many qualified associates to choose from and will be making that announcement in the near future.

Well, as far as the first earnings call, I would hope you agree that the business did their part to help me ease into the role. Our solid second quarter results, which reflect our highest adjusted operational sales growth since the second quarter of 2016, were driven by the strong double-digit growth in Pharmaceuticals and accelerating sales momentum in our Medical Device business.

Consumer sales were below our expectations. However, there were some onetime factors that depressed reported results. That said, we need to do better in the Consumer segment and have plans in place to accelerate growth in the back half of the year with many new product introductions.

Let me now turn the call over to Matt to cover some housekeeping matters and kickoff the sales review.

Matthew Stuckley

Thanks, Joe, and hello, everyone. Regarding today's agenda, I will start by summarizing enterprise sales and earnings per share for the quarter before turning it back to Joe for segment sales highlights. Alex will then provide his perspective on the company and the healthcare environment. Joe will conclude formal remarks, discussing our earnings results and guidance considerations as you update your models before we open the call up for your questions. We anticipate today's webcast to last approximately 75 minutes.

A few logistics before we get into the details. This review is being made available via webcast, accessible through the Investor Relations section of the Johnson & Johnson website at investor.jnj.com. There you can also find additional materials, including today's presentation and accompanying schedules.

Please note that this morning's presentation includes forward-looking statements. We encourage you to review this cautionary statement regarding commentary included in today's discussion as well as the company's Form 10-K, which identifies certain factors that could cause the company's actual results to differ materially from those projected. Our SEC filings, including our 2017 Form 10-K, along with reconciliations of non-GAAP financial measures utilized for today's discussion to the most comparable GAAP measures are all available at investor.jnj.com.

A number of the products and compounds discussed today are being developed in collaboration with strategic partners or licensed from other companies. This slide acknowledges those relationships. For your reference, here is a slide summarizing notable developments that occurred in the second quarter.

Now, on to the results. Worldwide sales were \$20.8 billion for the second quarter of 2018, a 10.6% increase versus the second quarter of 2017. On an operational basis, sales were up 8.7% as currency had a positive impact of 1.9%.

In the U.S., sales were up 9.4%. In regions outside the U.S., our operational growth was 7.9% with the effective currency exchange rates benefiting our reported OUS results by 3.9 points. Excluding the net impact of acquisitions and divestitures, operational sales growth was 6.3% worldwide, 5.7% in the U.S. and 6.8% outside the U.S. Joe will provide the same reference for each segment.

With respect to earnings for the quarter, net earnings were \$4 billion and diluted earnings per share were \$1.45 versus \$1.40 a year ago. Excluding amortization expense and special items for both periods, adjusted net earnings for the current quarter were \$5.7 billion and adjusted diluted earnings per share were \$2.10, representing increases of 14% and 14.8% respectively compared to the same period in 2017. On an operational basis, adjusted diluted earnings per share grew 11.5%.

Now, I will turn the call back to Joe to go over sales highlights by segment. Joe?

Joseph J. Wolk {BIO 19812977 <GO>}

Thank you, Matt. Beginning with Consumer, I'll now comment on quarterly sales performance by business segment, highlighting items that build upon the slides that are being presented. Unless otherwise stated, percentages referenced represent operational sales change in comparison to the second quarter of 2017 or in other words, results that exclude the impact of currency translation.

Worldwide Consumer segment sales totaled \$3.5 billion, declining operationally 0.4%. Excluding the impact of acquisitions and divestitures, mainly the divestiture of the Compeed business in the Wound Care/Other franchise outside the U.S., total adjusted operational sales growth was 0.9% worldwide.

Performance in the quarter included the onetime impacts of a transportation strike in Brazil and a retail inventory reset for the U.S. Baby relaunch. Taking those items into account, adjusted operational growth would have been consistent with Q1 at approximately 2%.

Our largest Consumer franchise, the OTC business, led the segment with above-market performance growing at 3.7%, driven by share gains across multiple brands. Analgesics, namely TYLENOL, and digestive products drove the growth.

FINAL

The Beauty franchise grew 1.8% operationally. As we referenced last quarter, growth in this quarter was expected to be negatively impacted by the Q1 seasonal inventory build of approximately \$20 million with 300 basis points in the U.S. related to sun protection products stocking. This is primarily reflected in NEUTROGENA. Growth in the quarter was driven by market expansion and share growth for OGX and Dr. Ci Labo as well as new product introductions in NEUTROGENA outside the U.S.

Oral Care performance in the U.S. saw solid growth of nearly 5% due to strong LISTERINE consumption from ongoing promotions and new products. The divestitures of the REACH and REMBRANDT brands negatively impacted worldwide growth by just over 1 point. The OUS declines are due to competitive pressures.

As I mentioned earlier, Baby Care results were negatively impacted in the quarter by the U.S. Baby relaunch as retailers reset their shelves with the new products that started shipping in July. Results outside the U.S. reflect competitive pressures, partially offset by continued expansion of AVEENO Baby.

Moving on to our Pharmaceutical segment, worldwide sales of \$10.4 billion grew 17.6%. Excluding the net impact of the Actelion acquisition, operational adjusted sales growth was 11% worldwide, representing strong above-market growth. Growth was broadly based both geographically as well as across therapeutic areas with double-digit growth in nine key products, including pro forma sales for UPTRAVI and OPSUMIT obtained in the Actelion acquisition. The segment was led by the Oncology portfolio, which grew globally 39%. DARZALEX continued its strong performance growing globally by approximately 68%.

In the U.S., market growth and the strong launch uptake of the one prior-line indication is resulting in share gains. Outside the U.S., DARZALEX is experiencing increased penetration and share gains in the 31 EMEA countries in which it is now commercially available as well as in the Asia-Pacific region where it received approval late last year.

IMBRUVICA in the U.S. gained more than 3 points of market share versus prior year across all lines of therapy based on first quarter data, largely driven by share in line one chronic lymphocytic leukemia or CLL. The CLL market is estimated to have grown approximately 13%.

ZYTIGA had another strong quarter, growing 60% due to the continued market growth of approximately 33% and strong share growth in the metastatic high-risk castration sensitive prostate cancer indication based on the LATITUDE clinical trial.

Our Immunology franchise posted 12% sales growth despite the negative impact of biosimilars on REMICADE sales. Growth was led by STELARA, up 34%, where we remain very pleased with the uptake of the Crohn's disease indication. Market share has improved 10 points in Crohn's disease compared to the second quarter of 2017. REMICADE in the U.S. declined approximately 14%, largely driven by price erosion. REMICADE has retained approximately 94% of the infliximab volume share.

Lastly in Immunology, sales for our newly launched treatment for psoriasis, TREMFYA, totaled \$126 million due to strong demand with over 15,000 patients now on therapy. TREMFYA has already achieved a 5% share of the psoriasis market.

In Neuroscience, our paliperidone palmitate long-acting injectable portfolio grew steadily in all regions, driven by new patient starts and persistency.

Results for the Actelion Pulmonary Hypertension assets acquired in June 2017 are commented to here on a pro forma basis. OPSUMIT growth accelerated globally to 16% due to increased share and market growth. UPTRAVI continues to experience a strong demand with 41% growth in the U.S. Of note, the dynamic we highlighted in recent quarters regarding an increased level of patients on assistance programs in the U.S. has improved. As expected, TRACLEER is declining as generics entered the European market during the second half of last year.

Turning our attention to the Medical Devices segment, worldwide Medical Device sales were \$7 billion, growing 1.9%. Excluding the net impact of acquisitions and divestitures, adjusted operational sales growth was 2.9% worldwide. We acknowledge there is still work to do here, but this represents our strongest growth since Q3 2016 and is a positive step toward the above-market growth we plan to achieve in 2020 highlighted during our recent Business Review Day. Operational growth was driven by continued strong performance in Interventional Solutions and Vision as well as improving growth in Surgery.

Within Interventional Solutions, our market leadership in electrophysiology coupled with our new product offerings in ablation and advanced catheters continued to propel the overall market and our own growth, which was more than 17% worldwide.

Vision delivered strong growth in both the contact lens and surgical business across key geographies totaling \$1.2 billion in sales and worldwide growth of 9.6%. The contact lens business grew a very healthy 10.5% on the strength of our ACUVUE OASYS and ACUVUE MOIST lines, most notably in our market-leading astigmatism lenses.

In Vision Surgical, worldwide growth of 7.5% was driven by the cataract business, primarily intraocular lenses.

In Orthopaedics, excluding the impact of acquisitions and divestitures, performance was flat to the second quarter of 2017. In trauma, growth is driven by our newer products like the TFNA femoral nail. In hips, we continue to be the market leader in the anterior approach and see strong demand for the primary stem ACTIS, although we estimate the market growth was only about 1% in the U.S.

Subsequent to the quarter we completed the acquisition of assets from Medical Enterprises Distribution, which includes the automated ME1000 Surgical Impactor for use in hip replacement. The new name for this technology is the KINCISE Surgical Automated System.

FINAL

In spine and knees, we are losing share. However, new product launches in spine and the launch of the ATTUNE Revision System in knees led to improved performance this quarter in both businesses.

Selling days did provide a benefit of approximately 1 point to Orthopaedics growth for the quarter, offsetting the negative impact we noted in the first quarter. We do not expect selling days to have a material impact on results for the remainder of the year. Pricing pressure continued to impact all categories in Orthopaedics. For the quarter, U.S. pure price was negative 5% in spine, negative 3% in hips, negative 2% in knees and negative 1% in trauma.

Within the Surgery Group, the Advanced Surgery category was strong, led by growth outside the U.S. On a worldwide basis, endocutters grew 7% as new products are experiencing strong demand and biosurgery grew over 8%, driven by topical absorbable hemostats and biologics. In General Surgery, wound closure grew 5% with growth in all regions as barbed and Plus Sutures are experiencing strong adoption.

As a final comment regarding the U.S. hospital setting, let me provide utilization trends. For the first quarter of 2018, we saw a slight increase in hospital admissions of 50 basis points. Surgical procedures were down approximately 1% and lab procedures were up about 2.5%. Our preliminary estimates for the second quarter indicate consistent rates for hospital admissions and surgical procedures with lab procedure growth lowering to approximately 1.5%.

That concludes the sales highlights for Johnson & Johnson's 2018 second quarter. It is now my pleasure to turn the call over to Alex Gorsky. Alex?

Alex Gorsky {BIO 16239711 <GO>}

Thank you, Joe, and thank all of you for joining our second quarter earnings call and webcast today. I'm pleased to be here today to discuss our strong performance this second quarter of 2018 and how we are well positioned for the rest of the year and for the future.

Overall, we are very pleased with our financial performance to-date, both for the first half of this year as well as in the second quarter. Our accelerating sales and EPS growth results exceeded consensus estimates. Following my remarks, Joe will provide deeper insight into how our performance and outlook will impact our full year guidance for 2018.

Before I provide some perspective by business segment, it's important to begin what I usually do, emphasizing that we are always guided by Our Credo and this year, we proudly celebrate its 75th anniversary. Our Credo is as relevant today as the day it was written, balancing opportunity and responsibility, we're united and inspired by Our Credo and we live in the responsibilities it outlines each and every day. It reminds us that our first responsibility is to our customers and patients and it compels us to deliver on our responsibilities to our employees, our communities, our environment and, last but not least, our shareholders.

And the success we achieve can be directly attributed to our more than 134,000 diverse and talented Johnson & Johnson employees in 60 countries around the world who exhibit Our Credo values every day in every way.

I am also proud to share that we released our Johnson & Johnson 2017 Health for Humanity report in June, which highlights how we are preparing for the future, meeting our enduring commitments to create long-term value, and positively contributing to society. This report shares the progress we're making toward our Health for Humanity 2020 goals and our UN Sustainable Development goals. To complement the report, we also conducted our first ever Health for Humanity webcast to engage in deeper discussion about the report's contents on environmental, social, and governance topics. This session recording is available on our company website as well.

We recognize that to lead the next frontier of health is a big commitment, but we are ready, willing, and able to take on this mission. Guided by our purpose-driven strategies and values rooted in Our Credo, we will always seek to put the needs and well-being of the people we serve first.

Additionally, I'd like to highlight that a few weeks ago, we announced Sandi Peterson, Executive Vice President and Group Worldwide Chairman, has decided to retire from Johnson & Johnson effective October 1, 2018. Sandi joined Johnson & Johnson in 2012. And over her time with our company, she has had responsibility for our Consumer and Medical Device segments in addition to other business functions. I am sure Sandi will approach the next stage of her life with the same energy that she brought to us. Please join me in wishing her all the best in this new chapter of her life.

In conjunction with Sandi's decision to retire, we implemented additional management changes that will ensure a continued focus on delivering our commitments to all of our stakeholders named in Our Credo. Joaquin Duato and Dr. Paul Stoffels have been promoted to Vice Chairman of the Executive Committee.

The role of Vice Chair has traditionally been a part of Johnson & Johnson's leadership structure and in place for most of our company's history. In the Vice Chair roles, both Joaquin and Paul will leverage their expertise in Credo-based leadership broadly across the organization and provide the enterprise with additional strategic counsel, direction, and oversight.

I'm also pleased to announce that Ashley McEvoy has been promoted to Executive Vice President, Worldwide Chairman, Medical Devices, which includes her continued leadership of our Vision business. Additionally, Jennifer Taubert will assume responsibility for the Pharmaceutical business, and both Jennifer and Ashley will be members of the Executive Committee. Ashley and Jennifer are exceptional long-tenured Johnson & Johnson leaders with proven track records of success and who both embody Credo-based leadership.

These and other changes we made in recent months recognize the deep bench of strength within our company and how we're utilizing the skills of our many talented

leaders who will ensure that we continue to create value for our patients, consumers, and our shareholders.

Now, as you've heard me say on several occasions, innovation has been and will continue to be the cornerstone of every life-saving and life-changing product and solution that we provide to people around the world, and sustaining innovation has been the basis of our success and what has driven our growth and value through the years and will for many years to come.

Increasing investment in innovation is a critical aspect of our strategy and the foundation for our future. In fact, last year we ranked number five in the U.S. and number eight globally across all industries for R&D investment. And through the first two quarters of 2018, due to the benefits of the enacted U.S. tax legislation we highlighted earlier this year, we have increased our investment in R&D by approximately 16%, with the objective of developing new products and solutions that address today's medical needs and anticipate the medical needs of the future.

We continue to invest internally at a very healthy rate, progressing the rich pipelines across our three business segments and optimizing the innovative collaboration that happens within the walls of our company.

And as you know, we recognize that good ideas come from everywhere. This is why we also seek and choose dynamic external partners to innovate with and who can help us unlock new treatments for patients and solutions for our customers. We are always on the lookout for value-creating opportunities and collaborations. And to this end, we have closed seven major acquisitions and licensing deals since the beginning of this year.

We also continue to enhance our status as a preferred partner, being agnostic to where the best science and technology resides and aggressively pursuing transformational innovation. Additionally, we regularly evaluate each of our businesses to determine if they still fit our strategy and our criteria for value creation.

And as you have seen us do consistently, when it makes sense, we undertake a process to consider if different ownership for a business might be value-enhancing or if a business might be a better fit in another company's portfolio.

Recently, we announced the acceptance of a binding offer for our LifeScan business and the receipt of a binding offer for our ASP business. We expect to complete the LifeScan transaction by the end of this year. And should the offer for our ASP business be accepted, the proposed transaction would be expected to close in early 2019, subject to customary conditions and regulatory approvals.

Our activity in both mergers and acquisitions reflects our capital allocation priorities, which have remained consistent and we believe proven. First, as I just highlighted, we prioritize investing in our business at competitive levels. Then we allocate capital to drive long-term value by placing a priority on paying dividends to our shareholders. Next, we

deploy capital for value-creating acquisitions. And finally, we evaluate further opportunities to return value to our shareholders such as through share repurchases.

Johnson & Johnson has the financial strength and cash flow to simultaneously return value to shareholders, while at the same time continuing to invest in internal and external opportunities that further strengthen our robust enterprise pipeline and drive long-term growth.

Now, I want to provide a few highlights about each of our business segments, but first, I think it's important to emphasize that we continue to think of ourselves as a 132-year-old startup, innovating and executing each and every day to win our customers' and shareholders' trust, confidence, and support.

We have a strong sense of urgency, we are not complacent and we are not looking back. We are looking forward and moving forward as fast as the change happening all around us on the global, technological, social, economic, political, and healthcare fronts. We believe Johnson & Johnson is strongly positioned for continued and future growth.

Our Pharmaceutical business has delivered outstanding and sustained performance, growing at an adjusted rate of 11%, inclusive of the impact of negative net price driven by the successful launches and growth of many blockbuster medicines. It has been an industry leader in all performance measures, including R&D productivity and commercial capabilities.

Earlier this year we launched ERLEADA, a treatment for patients with non-metastatic castration-resistant prostate cancer. This is the second of up to 10 promising new therapeutics that we plan to file or launch by 2021. Each of these new therapeutics have the potential for more than \$1 billion of peak revenue.

Throughout the rest of 2018, we have identified several other key catalysts for growth, which focus on: continued patient penetration in our Oncology areas of prostate cancer and hematology; a growing immunology portfolio, driven by the continued growth of established brands like STELARA, which is a biologic for the treatment of a number of immune-mediated inflammatory diseases, and new products like TREMFYA, which treats adults living with moderate to severe plaque psoriasis. And this growth is even more impressive when you consider the REMICADE erosion due to biosimilars; also, the Pulmonary Hypertension assets we acquired last year, which, by the way, this second quarter represents the strongest quarter we've had to date in this area, led by OPSUMIT and UPTRAVI\; and the continued solid performance in long-acting injectables in Neuroscience, XARELTO, and our HIV portfolio.

We are confident that the continued growth of our marketed products and the expected launches from our robust pipeline position us well to outgrow the market for many years to come while offering life-saving or life-changing solutions that give new hope to patients around the world.

Now, let me spend some time on our Consumer segment. As discussed in our Consumer and Medical Device business review back in May, I am confident in our strategies to move quickly to address new market needs with an omni-channel approach from the large-box retailers to the e-commerce channels to better serve our consumers.

The Consumer second quarter sales growth was disappointing. And as Joe mentioned, this was driven by the impact of some one-time events. That said, we recognize that we need to perform better here, and we believe we are positioned for a strong second half of this year based on our strong underlying consumption data.

Additionally, we are revitalizing our Baby business. In fact, beginning this month, our newly formulated JOHNSON'S Baby products have started to ship to retailers across the United States. We continue to strengthen and expand our portfolio by iconic science-based and professionally endorsed products and we have a number of planned launches in the second half of this year. We also believe that this will drive top line growth that will be met with even greater bottom line growth as we continue to improve our productivity and margins.

In Medical Devices, we have powerful opportunities for growth across our Orthopaedics, Surgery, Interventional Solutions and Vision businesses. We have businesses, which, again, displayed great strength in the second quarter, such as Vision and electrophysiology reaching double-digit growth and biosurgery and endocutters reaching high single-digit growth, but we fully recognize our progress has not been uniform across the entire portfolio. There are areas where we must and we will improve such as in our knee and spine businesses, both of which took positive steps forward in Q2.

While growth was still negative, our knee business improved performance compared to last quarter, driven by the recent launch of our ATTUNE Revision platform. Similarly, our spine business improved performance in the second quarter due to the new products we've launched in the space. We've also increased investments across our Medical Device portfolio in critical capabilities, technologies and solutions that our customers are demanding.

Additionally, we are improving our cadence of innovation and are on track to deliver 15 to 20 major product launches planned for 2018. We are driving innovation, partnering closer with customers, simplifying operations and focusing on execution, all to meet the needs of customers and patients when, where and how they want their needs to be met. We believe these drivers will deliver sustainable above-market growth across the entire breadth of our Medical Devices businesses starting today and we are committed to delivering across the portfolio in 2020.

Now, as a broader space healthcare company, when we look at the current marketplace, business landscape and external environment, we're often asked about the potential impacts to our business and industries. Let me address a few of those topics that are in the current headlines.

Regarding the recent St. Louis talcum powder lawsuit and verdict, as you know, our Baby Powder is a trusted product that we sold to families for over 100 years and Johnson & Johnson is deeply disappointed in this verdict. Now, we remain confident that our products do not contain asbestos and do not cause ovarian cancer and we intend to pursue all available appellate remedies. In fact, every verdict against Johnson & Johnson in this court that has gone through the appeals process has been reversed.

Additionally, I want to emphasize that preeminent scientific and regulatory bodies, including the National Cancer Institute, the U.S. Food and Drug Administration have fully reviewed the full body of scientific evidence on multiple occasions and found that it does not support the allegation that talc causes ovarian cancer. Like previous appeals, we are confident that there are multiple grounds for reversal of this jury verdict and that ultimately the case will be reversed.

Regarding global trade, as a global company, Johnson & Johnson relies on free trade and open markets to bring its products to patients and consumers around the world. We continue to work with government officials because fair and equitable trade is in everyone's best interest, not just for companies, but for the consumer. We will continue to monitor developments very closely on this front as we expect this to be an issue in motion for some time.

Regarding overall healthcare costs and drug pricing in the United States, I'd like to make a few key points. First, let me say that we understand why there's such a passionate dialogue on this topic. We know that people are facing higher out-of-pocket costs when they seek medical care from a hospital, a doctor's office or some other alternative healthcare provider and especially when they go to the pharmacy to get medications.

However, as a point of reference, medicines represent 14% of the total healthcare costs in the United States and Medical Devices represent 6% of the total healthcare costs in the United States. The remaining 80% is accounted for by areas outside of our industry. I'd also like to emphasize the value derived from innovative medicines has been and continues to be significant in addressing health issues today and reducing morbidity rates in the future.

Furthermore, medicines have contributed greatly to extending life expectancy. For example, cancer deaths have declined 20% due to pharmaceutical treatments since the 1990s. All these improvements actually offset healthcare costs in the U.S.

We also believe changes are needed regarding how we cover and pay for medical care and drug treatment therapies in the U.S. We are working with various partners in the healthcare system to transform the way healthcare is paid for, so everyone involved is held accountable and rewarded for the value they deliver. That said, there are a few items that we typically focus on when participating in the healthcare cost and drug pricing dialogue and they include, first, a system that rewards innovation.

Companies need to continue to fund research in science and technology and invest in new ideas and new products. We have the best healthcare system in the world here in the

FINAL

U.S. and we want a system that allows us to keep it that way. We also want to see a system that is personalized and value-based. A value-based system begins and ends with the patient at the center of every consideration and is judged on the overall outcome. Striving to provide patients with convenience and innovative capabilities for healthcare management, affordable access and coverage choices and personalized healthcare experiences remains a top priority for Johnson & Johnson.

Second, transparency, I am really proud that our Pharmaceutical business has taken a lead in transparency in the industry. We just issued our second Annual Report on transparency and as a matter of fact, this year's report shows a decrease in net prices for the products in our portfolio. Our Janssen U.S. Transparency Report shows in 2017 the net impact of price on our Pharmaceutical business was minus 4.6% after rebates and discounts of nearly \$15 billion.

And lastly, as we continue to engage in dialogue and develop proposals to contain healthcare costs, we need to be extremely careful and cognizant about avoiding unintended consequences, which may increase patients' costs further and/or decrease patients' access to affordable and quality healthcare. We're really glad that the administration has called for a fact-based dialogue. We believe a discussion based on facts is a good thing.

It's too early to predict the impact of any potential new federal regulations, but it's an important issue, we recognize that and we want to help lead the solutions. We know that it's our responsibility and we will continue to unite around efforts that address some of the most critical health and consumer needs of people around the world.

And as we consistently live up to these values, I am very proud and honored to share several industry recognitions for Johnson & Johnson that occurred over the last few months and that further underscore our commitment to make diversity and inclusion an everyday behavior, create an open, supportive and inclusive professional environment where people can bring their whole selves to work, build a global diverse workforce for the future that consistently enhances our business performance and reputation and ensure that good health is within reach for everyone everywhere.

As a global healthcare leader, we operate at the intersection of science, technology, speed and change, which enables us to reimagine tomorrow today. As leaders of this great company, we take that responsibility very seriously. We believe in a bright and successful future where virtually anything that can be imagined can be accomplished through a laser-like focus on innovation, execution and our customers, which ultimately drives superior long-term performance.

And while we're focused on all of this, we also remain committed to fulfilling Our Credo responsibilities and striving to profoundly change the trajectory of health for humanity.

Thank you for your time, interest, engagement and continued support. I look forward to addressing your questions during the upcoming Q&A, but I will now turn the call back

over to Joe who will provide more insight on our results for the second quarter as well as additional commentary about our guidance for the remainder of the year. Joe?

Joseph J. Wolk {BIO 19812977 <GO>}

Thanks, Alex. Since sales have been addressed, I'll comment on second quarter results related to cash, the P&L, and then guidance for 2018. At the end of the quarter, we had approximately \$14 billion of net debt, which consists of approximately \$18 billion of cash and marketable securities and approximately \$32 billion of debt.

Regarding our consolidated statement of earnings for the second quarter of 2018, if you direct your attention to the boxed section of the schedule, you will see we have provided our earnings adjusted to exclude intangible amortization expense and special items. As referenced in the table of non-GAAP measures, the 2018 second quarter net earnings are adjusted to exclude intangible asset amortization expense and special items of \$1.8 billion on an after-tax basis, the largest of which is intangible amortization.

Our adjusted earnings per share is, therefore, \$2.10, exceeding the mean of analyst estimates. This is an increase of 14.8% versus the second quarter of 2017. Adjusted EPS on a constant currency basis was \$2.04, up 11.5% versus the second quarter of 2017.

Highlighting a few items on the statement of earnings, gross profit for the quarter decreased by 230 basis points, primarily driven by intangible asset amortization from the Actelion acquisition, partially offset by segment mix.

Selling, marketing and administrative expenses were lower as compared to the second quarter of 2017 by 60 basis points due to leveraging in the Pharmaceutical business, partially offset by investments in Consumer and Medical Devices businesses in support of new product launches.

As you heard from Alex, we prioritize funding for innovation. Our investment in research and development as a percent of sales was 12.7%, which is higher than the second quarter 2017 as we continue to advance and enhance our pipeline.

Other income and expense was a net expense of \$364 million in the quarter compared to net expense of \$527 million in the same period last year. Excluding special items recorded in this line, other income and expense was relatively flat with a net gain of \$461 million in 2018 compared to a net gain of \$434 million in the prior-year period, primarily reflecting divestiture gains.

Excluding special items, the effective tax rate was 18.5% compared to 20.2% in the same period last year. This rate is consistent with our expectations as a component of the full year effective tax rate. The 18.5% rate for the second quarter is the result of current interpretation of certain provisions of the Tax Cuts and Jobs Act, specifically relating to new provisions taxing international income.

We anticipate the U.S. Treasury to issue regulations later this year. These anticipated regulations are reflected in our tax rate guidance, which I will provide shortly.

Let's now look at adjusted income before tax by segment. In the second quarter of 2018, our adjusted income before tax for the enterprise improved 30 basis points versus the second quarter of 2017.

Looking at the adjusted pre-tax income by segment, Medical Devices at 27.8% is lower than the previous year, primarily due to acquisitions and new product launches. Pharmaceutical margins declined by 130 basis points to 43.2%, driven by lower other income. Consumer margins improved to 25.7% due to divestiture gains, partially offset by an increase in brand marketing investments.

Let me now share some perspectives for you to consider as you refine your financial models for 2018. Our sales guidance for 2018 continues to include the impact of biosimilars and generics for REMICADE, PROCRIT and TRACLEER. However, we do not anticipate any impact from generic competition this year for ZYTIGA, RISPERDAL CONSTA, PREZISTA and INVEGA SUSTENNA.

As we've done for several years, our guidance will be based first on a constant currency basis reflecting our results from operations. This is the way we manage our business and we believe this provides a good understanding of the underlying performance of our business. We will also provide an estimate of our sales and EPS results for 2018 with the impact that current exchange rates could have on the translation of those results.

For the full year 2018, we would be comfortable with your models reflecting operational sales of 4.5% to 5.5% for the year, an increase over our previous guidance. This would result in sales for 2018 on a constant currency basis of approximately \$79.9 billion to \$80.7 billion. We expect that operational sales growth, excluding the impact of acquisitions and divestitures, will be between 3.5% and 4.5% for the year, which is also an increase to our previous guidance.

Although we are not predicting the impact of currency movements, utilizing the euro as of last week at \$1.17 for the balance of the year, the positive impact of foreign currency translation would be approximately 0.8%. This is below the rate of \$1.23, which we utilized in our previous guidance, and results in 120 basis point reduction. Thus, under this scenario, we expect reported sales to reflect a change in the range of 5.3% to 6.3% for a total expected level of reported sales of approximately \$80.5 billion to \$81.3 billion. This is lower than our previous guidance solely due to the change in currency.

Factors for you to consider for the balance of this year are the acceleration of our Consumer and Medical Devices businesses as well as the impact of generics and biosimilars that I've mentioned and tougher comparisons on the Pharmaceutical segment as this current wave of above-market growth began in the third quarter of last year.

Our pre-tax operating margin guidance remains unchanged. We continue to expect to improve our pre-tax operating margins by approximately 150 basis points. For purposes

of your models and assuming no major acquisitions or other major uses of cash, I suggest you consider modeling net interest expense of between \$500 million and \$600 million. This is lower than previous guidance as we benefit from an increase in interest income from higher rates.

Regarding other income and expense, as a reminder, this is the account where we record royalty income as well as gains and losses arising from such items as litigation, investments by our Development Corporation, divestitures, asset sales and write-offs. We would be comfortable with your models for 2018 reflecting net other income and expense, excluding special items, as a net gain ranging from approximately \$1.5 billion to \$1.7 billion, which is consistent with our previous guidance.

Moving on to taxes, our effective tax rate guidance for 2018, excluding special items, is approximately 17% to 18%, which is a tightening of the range related to our prior guidance.

Taking all of this into consideration, we would be comfortable with adjusted EPS guidance in the range of \$7.92 to \$8.02 per share on a constant currency basis, reflecting operational or constant currency growth of approximately 8.5% to 9.9%, which is higher than our previous guidance and reflects a tightening of the range due to the underlying strength of the business.

Again, we are not predicting the impact of currency movements, but to give you an idea of the potential impact on EPS, with the euro at \$1.17, our reported adjusted EPS would be positively impacted by approximately \$0.15 per share, which is lower than our previous guidance of \$0.20 per share. Therefore, our reported adjusted EPS would range from \$8.07 to \$8.17 per share, reflecting growth of approximately 11.2% at the midpoint.

So in closing, we are pleased with our second quarter results and remain confident about the strength of our business. Our underlying sales growth, excluding acquisitions and divestitures, is projected to be approximately 3.5% to 4.5%, an acceleration from 2017 and an increase of 1% over our guidance at the start of this year.

Consistent with our principle to grow earnings faster than sales, our guidance for reported adjusted EPS growth is 10.5% to 11.9% or 11.2% at the midpoint. This is an increase of the midpoint versus previous guidance, incorporating strong operational performance, partially offset by the impact of the strengthening dollar. We are confident in our performance not just for the balance of this year, but beyond.

I will now turn things back over to Matt to open up the Q&A portion of the call.

Matthew Stuckley

Great. Thank you, Joe, and thank you, Alex. We will now move on to the Q&A portion of today's discussion. Rob, can you please provide Q&A instructions for those on the line wishing to ask a question?

Q&A

Operator

Yes, thank you. Your first question comes from the line of Larry Biegelsen with Wells Fargo.

Q - Larry Biegelsen {BIO 7539249 <GO>}

Good morning, thanks for taking the question. Let me start with one on the guidance and then one on Pharma. So the first half organic growth I think was about 5.3%, excluding acquisitions, divestitures, and currency. And I think the guidance this morning implies second half organic growth of about 2.5%. So my questions are as follows. What else besides the comps is leading to the slower second half expected growth, and what are you expecting directionally for each of the three divisions in the second half versus the first half?

And then I'll fit in my second question here on Pharma now. So ZYTIGA in the U.S. has been driving a lot of your growth in Pharma. How confident are you that you can continue to drive above-market growth in Pharma in 2019 if you lose exclusivity for ZYTIGA later this year? Thanks for taking the questions.

A - Alex Gorsky {BIO 16239711 <GO>}

Good morning, Larry, good to hear from you. Let me take the second question first. With respect to ZYTIGA, if you look at the strong quarter that the Pharmaceutical unit had, let's remove that growth out, and it's still about 8%, well above any market comparator. So the portfolio is strong. You look at the uptake of TREMFYA, STELARA for Crohn's, our growth is coming from multiple sources. So while we're very pleased with ZYTIGA's performance, we're not dependent upon it.

With respect to guidance, so we have raised the operational growth to a midpoint of 5%. There are some things that I think that need to be pointed out with respect to the second half. I want to state up front though, we do expect to grow in the second half in our Pharmaceutical unit as well as accelerate, as you heard at our Analyst Day, for Medical Devices and Consumer. Matter of fact, I think you saw a positive if not modest step in this quarter with respect to Medical Devices, but the comps are pretty significant year on year. If you look at the second half of last year, where we had - really I would call it this new wave of above-market growth for the Pharmaceutical unit. It was dependent upon STELARA doing so well in Crohn's, the launch of TREMFYA, the LATITUDE data came out for ZYTIGA.

The way we looked at it was the first half growth of this year compared to the second half of last year was about 4% - 4% to 5%. We expect that business to continue to grow going forward. And again, with the other sectors kicking in as well, we think it bodes pretty well for the entire year.

I'd also say we are likely to see a little bit more pronounced effect from generics in the back half of this year, so PROCIT, CONCERTA, and obviously TRACLEER in the U.S. So those are some of the things that I would consider as you look out for the balance of this year.

Q - Larry Biegelsen {BIO 7539249 <GO>}

Thank you for taking the questions.

A - Alex Gorsky {BIO 16239711 <GO>}

Thank you, Larry.

Operator

Your next question comes from Glenn Novarro with RBC Capital Markets.

Q - Glenn John Novarro {BIO 2430199 <GO>}

Hi, good morning. Thanks for taking the questions. Alex, I have two Medical Device questions for you. First, toward the tail end of the device meeting, you made the comment about midsize to larger Medical Device acquisitions. And you commented that if the opportunity was there and it felt right, that's something that you would consider. So, Alex, I'm wondering if you can elaborate a little bit more on that comment from the Medical Device day, in light of maintaining the AAA rating, in light of over \$30 billion of debt on the balance sheet, and in light of a new head of Medical Devices. And can you quantify what midsize to large means to you?

And then lastly, on Medical Device strategy, given the fact that you do have a new head of Medical Devices, does anything change in the near term? And what I'm referring to, it seems like Sandi's strategy to accelerate growth was a function of divesting slow growth businesses and doing tuck-in deals. So, should we assume that strategy is maintained in the near term? Thank you.

A - Alex Gorsky {BIO 16239711 <GO>}

Hey, Glenn. Thank you very much for your question. And look, before I answer both of them, let me also just reiterate some of Joe's earlier comments and congratulate our business leaders, I believe, for producing results this quarter that were very strong and very consistent with a lot of the strategic goals that we had set in place and that we discussed over the past several years. It started with our Pharmaceutical sector, but even the increased performance, I think, we saw underlying in Medical Devices, particularly in Vision Care and Hospital Medical Devices.

And while we clearly have got work to do in Consumer, we believe we've got strong reasons to believe in the back end of the year, given some of the launches that we'll be focusing on as well as other areas of improved execution, that we'll see that delivering at and above-market growth rates. So I just want to thank all of our employees for making those possible.

FINAL

Now, as it relates to Medical Devices, Glenn, consistent with comments that I've frequently made in the past, we remain very interested in value-creating inorganic growth opportunities in Medical Devices. We are quite excited about the 15 to 20 launches that we have in place for this year. And over the past couple of years, I think what we've seen is an uptick in the number of bolt-on acquisitions that we've done.

In fact, just last year, we invested more than \$1 billion in our Medical Device group, giving us good new technologies really across almost all of our major platforms. And of course, with our very strong balance sheet, it also gives us the flexibility to continue to invest going forward. I won't comment specifically on exactly what size or obviously what companies, but when we think that the strategy is right, that it fits with our portfolio, that we feel that ultimately we can actually create value based upon the asset and operationalize it and execute, we're ready to do so.

Now regarding the overall strategy of the Medical Device unit, given the change in leadership, I'd like to again thank Sandi for her leadership and for what she contributed, really not only in Medical Devices, but across the other areas of our business. But also welcome Ashley who's really a seasoned Johnson & Johnson leader with extensive experience in Medical Devices really for about the past eight years, both in our Ethicon as well as our Vision Care business, where she has led a very significant turnaround.

But we believe that the underlying strategies of focusing on innovation, i.e. increasing the amount of launches and also bolt-on acquisitions that we've done, we expect that to continue, an improved focus on execution, which has been in place over the last 12 months, but we'll continue going forward, and we think that we're seeing the early signs that in fact that strategy and that plan is paying off as you saw HMD growth rate of just about 3.5% for this quarter and you saw Vision Care continue to grow at an overall rate of about 9%. So that's the way that I would look at it and thank you very much for your question.

Operator

Your next question comes from the line of Jami Rubin with Goldman Sachs.

Q - Jami Rubin {BIO 1527982 <GO>}

Hi. Thank you. Alex and, this is a question for you as well, Joe, I'd love your views on this. Corporate simplification is clearly getting rewarded on Wall Street and J&J has certainly participated in this strategy by selling underperforming businesses, but investors have actually rewarded much bigger steps to reshape portfolios.

Most recently, Novartis announced its decision to spin Alcon, GE's decision to spin its healthcare business. Obviously, we've seen massive long-term outperformance from both AbbVie and Zoetis, which were spinouts. You have been consistent in your view that your Credo, 75 years old now, embraces a conglomerate structure. We're just wondering if there is an appetite internally now with a new CFO in place and with the recent underperformance of the stock to rethink the conglomerate structure. After 75 years, is it time to tweak this Credo? Thanks.

Bloomberg Transcript

A - Alex Gorsky {BIO 16239711 <GO>}

Hey, Jami. Thank you very much for your question. And look, what I would say is we are always challenging our internal strategy and as you and I have talked about in the past that our diversified strategy is not predicated upon our 130-plus-year history, but it's really predicated upon our excitement and our outlook for overall healthcare and our performance going forward.

As it relates to some of the recent transactions across the business, what I would say here too, if you look out over a 25, a 10, a 15, a 5, a 3, even 2-year overall performance, what you see is that Johnson & Johnson has outperformed and we really manage the business with that kind of a long-term outlook.

I think you've also seen that over the past several years, we've been much more disciplined and focused on pruning our portfolio in appropriate places where frankly we didn't feel that we saw significant growth opportunities or perhaps where good companies, good product lines were better suited in someone else's hands as - we continue to invest in more promising areas. And we'll continue to evaluate those kind of strategies on our model and on our approach going forward. Thank you very much.

A - Joseph J. Wolk {BIO 19812977 <GO>}

Jami, the only other thing I might add to that and may be emphasizes Alex's point is that we're performance-based. So, while our heritage may say we were constructed a certain way, if we don't perform and we don't have the same, I would say, strategies that we're executing upon in terms of being leaders in the markets in which we play, driving earnings a little bit faster than the top line growth and then having the capital allocation priorities that you become very familiar with, we would challenge that. And so, the nice thing about the transition between Dominic and I is that there doesn't need to be in upheaval of policies or company protocol because the performance has borne out that it certainly is very strong and it works.

Q - Jami Rubin {BIO 1527982 <GO>}

Thank you very much.

Operator

Your next question comes from Vamil Divan with Credit Suisse.

Q - Vamil K. Divan {BIO 15748296 <GO>}

Hi. Great. Thanks for taking my question. So, a couple on REMICADE if I could. Just it looks like it's about a 16% decline in the first quarter if we excluded those onetime impacts and about 14% this quarter in the U.S. Is there any sort of sequential changes you're expecting either on price or otherwise as we think about the second half of the year or moving into 2019, just so we can kind of project obviously a very important product?

FINAL

Bloomberg Transcript

And then, the latest if you can share on the lawsuit that Pfizer and others have filed against you guys on some of your contracting strategy. I think we're waiting for the judge to rule on a motion for dismissal. Can you just give us a sense of when we expect to hear back from the judge and if the case goes forward, when do you think we may ultimately have a decision? Thanks.

A - Alex Gorsky {BIO 16239711 <GO>}

Yes. So, with respect to REMICADE performance, yeah, I think this quarter was 14%, 16% adjusted in the first quarter. So, we don't see any step change from this point on for the balance of the year. What I would say is maybe you might see a little bit of increased discounts as contracts come for renewal at the beginning of next year and there'll be some accrual effect obviously in the fourth quarter for that product, but nothing significant. We still maintain about 94% of the infliximab volume share.

Regarding the lawsuit, which we believe is baseless in its merits, there's really no update on that. So, we'll wait and see, but it's not something that concerns us giving the contracting practices that we employ and how that is on par with others in the industry.

Q - Vamil K. Divan {BIO 15748296 <GO>}

Okay, thanks.

A - Alex Gorsky {BIO 16239711 <GO>}

Thank you, Vamil.

Operator

Your next question comes from the line of David Lewis with Morgan Stanley.

Q - David Ryan Lewis {BIO 15161699 <GO>}

Good morning, maybe one quick one for Alex and maybe two quick ones for Joe. Alex, just coming back to the management changes if I could. So, we all know Pharma has been the historic value driver for the business. And I guess by promoting two Pharmaceutical executives to Vice Chairman, is it fair that investors would conclude your management sees Pharma as the driver or the primary driver of shareholder value creation on a go-forward basis? Why would that be an appropriate conclusion? And then, two quick ones for Joe.

A - Alex Gorsky {BIO 16239711 <GO>}

Sure, David. Thank you very much. No, I don't think that would be an appropriate conclusion to draw on. What I would say is, first of all, I'd like to recognize and congratulate the great performance and frankly the significant value that's been created under leadership of Paul and Joaquin in their leadership of our Pharmaceutical business. But I think it's also important to note that, look, these are very broad seasoned leaders with more than three decades of experience. And for the past several years, Paul whilst playing a critical role in our Pharmaceutical business is also taking an increasingly more

active role across our R&D portfolio. And so, we look forward to having him continue to accelerate the value of our future pipeline and, frankly, the level of science and innovation that we have across Johnson & Johnson.

Joaquin too is a very experienced leader, who did have some experience outside, actually in the Medical Device area, but he's somebody who has, again, a long track record of leading through complex challenging issues and significant opportunities. So, by expanding his role, we think the impact that he can have in working with Jorge in our Consumer Group as well as with our information technology, our supply chain and other areas, will be very positive.

And I think the other important issue here, David, is that with Ashley's promotion, Ashley will continue to report into me and will report into me and her new role maintaining responsibility for Vision Care. So, given her previous experience in Medical Devices, given my experience in Medical Devices, this will allow us to continue to manage our entire portfolio of businesses with very strong leaders across Johnson & Johnson.

And by the way, I'll also be remiss if I didn't recognize Jennifer Taubert, who is now leading our Pharmaceutical business. Again, a very experienced seasoned leader, who's been a big part of our Pharmaceutical growth over the past several years and we really look forward to seeing her upcoming contributions going forward.

Q - David Ryan Lewis {BIO 15161699 <GO>}

Okay. Thanks, Alex. Very clear. And then, Joe, just two quick ones from me. The first is, this is like the first time I think you called out procedure growth as a driver of the AF business in quite some time. So, I wonder you're seeing early benefit from the CABANA trial.

And then, just to follow up on Actelion, I think that business was a slight decline in the first quarter. Can you just update us on the growth rate of Actelion? I know you gave us the pieces, but the overall growth rate in the second quarter. Thanks so much.

A - Joseph J. Wolk {BIO 19812977 <GO>}

Sure. Thanks, David. So, our CABANA, I think that could have a benefit to the market. It's probably still too early to make that determination that that's driving additional procedures at this point. With respect to Actelion, I believe if you look at the entire portfolio and it gets a little tricky, because we had a minor divestiture there, but I think it was up about 2%. Where we're really focused on there, as you know, though, is OPSUMIT and UPTRAVI, where they grew very, very healthy double digits for the quarter. And, again, as I noted in some of the prepared remarks, the dynamic of the patient assistance foundations does not seem to be an overhang.

A - Alex Gorsky {BIO 16239711 <GO>}

Thanks for the questions, David.

FINAL

Bloomberg Transcript

Operator

Your next question is from the line of Joanne Wuensch with BMO Capital Markets.

Q - Joanne Karen Wuensch {BIO 2379289 <GO>}

Good morning and thank you for taking the questions. Simply, there are two. In Medical Devices, you pointed out that an extra day added percentage to growth. Is there anything else either in Devices, Pharma or Consumer that need to be called out that may have helped stocking of particular campaigns or et cetera?

A - Joseph J. Wolk {BIO 19812977 <GO>}

No. I think this was a fairly clean quarter. With respect to that, there was some selling days in Medical Devices, primarily in the Orthopaedics side of things that we called out in Q1, which was a hurt. It comes back as a help this quarter and then some of these factors in Consumer, which depressed reported results, which we should see come back to us in the back half of this year, but nothing around gross to net or anything of that nature, Joanne.

Q - Joanne Karen Wuensch {BIO 2379289 <GO>}

That's helpful. And then, as my follow-up, I appreciate the progress made in spine and in knees sequentially, but they're struggling, and those are markets that even on a good day are probably growing 1% to 2%. How do we think about them really being additive to the total organization and how long does it take to go from a negative growth rate to even the market growth rate? Thank you.

A - Alex Gorsky {BIO 16239711 <GO>}

Yeah, Joanne. Thank you very much for your question. And, look, we have been disappointed with the performance of both of those segments. However, we are confident going forward and let me just take each.

If we look at our underlying knee business, even just on a sequential basis from first quarter to second quarter, we're seeing underlying improvement. We believe that that's being driven by the launch of the ATTUNE Revision as well as the extended tibial play. We've got other launches regarding the cementless planned in the future and, look, the data around ATTUNE whether it's from UK, Australia, New Zealand or the Michigan registries remain strong. And frankly, we put a greater focus on execution with our sales force that we believe will continue to see a positive turnaround in that aspect of our business in the back-end of this year.

As you know with spine, that's been a longer-term issue. That's been, frankly, we believe a market-driven issue to a very large degree, albeit we have had some dislocation and complexity as we saw the Synthes and DePuy organizations come together that caused some challenge in our sales forces. And frankly, our innovation cadence slowed down there as well. I think we're now in a position where we put a much improved focus on stabilizing the sales organization.

Two, we have here also a strong cadence of new launches with our interbody cage, with other type of guidance systems, as well as some additional nails, plates and screws and other systems that we think are also going to contribute to positive growth as we go through the back-end of 2018 and into 2019.

Q - Joanne Karen Wuensch {BIO 2379289 <GO>}

Thank you.

Operator

Your next question comes from Bob Hopkins with Bank of America.

Q - Bob Hopkins {BIO 2150525 <GO>}

Good morning and thanks for taking the questions. Sorry if I missed this, but just the first question, I was wondering if you could just comment on the impact on pricing, peer pricing, on the Pharma business in Q2. And more importantly, has your outlook for drug pricing for 2018 would be unchanged relative to the commentary that you made earlier in the year? Just looking for an update on this important topic. Thank you.

A - Joseph J. Wolk {BIO 19812977 <GO>}

Good morning, Bob. Thanks for the questions. So, yeah, it is an important topic as Alex referred to in his comments. So, if you look at the stellar results in Pharmaceuticals, where we had 11% adjusted operational growth, that was in light of a price decline of about - let me see here, about 2% for the quarter. So, it's been 4% year to date in terms of negative price. It's 2% for this quarter.

We would expect that to be probably in the realm of about a 4% to 6% somewhere this year as we look out over the back half of this year and given the results that we've had in the first half. So, again, we continue to act responsibly in this way. As Alex referenced, our Transparency Report from last year indicated price down in the U.S. about 4.5%. You're looking at something similar this year.

A - Alex Gorsky {BIO 16239711 <GO>}

Bob, what I would also just add there is that I think it also just harkens back to the strong underlying volume increases that we're seeing across our portfolio, particularly in Oncology and Immunology, but beyond that, our Neuroscience group and Cardiovascular has remained strong as well as our Infectious Disease. So, again, on a very broad base, volume-driven which means that ultimately we're reaching more patients around the world.

Q - Bob Hopkins {BIO 2150525 <GO>}

Great. Thank you for that color. And then, just one quick follow-up on the trends in Orthopaedics. I was wondering if you could just clarify, on the selling daypart, was that a global impact for Orthopaedics or was that more of an impact in the U.S.? And then, just

curious was there any change in your view on kind of Orthopaedic market growth rates in Q2 versus Q1? Thank you very much.

A - Joseph J. Wolk {BIO 19812977 <GO>}

Matt, do you want to take this one?

A - Matthew Stuckley

Thanks, Joe. So, Bob, thanks for the question. The selling day impact that Joe quoted was global of about 1 point and that was pretty equal between both the U.S. and outside the U.S. I think as we look at overall Orthopaedic market trends in Q2, relatively stable versus what we saw in Q1. I think in trauma is one in particular where we did see that market decline a little bit versus the growth we saw in Q1, but overall relatively consistent with the first quarter.

Operator

Your next question comes from the line of Danielle Antalffy with Leerink Partners.

Q - Danielle Antalffy {BIO 16104603 <GO>}

Hey. Good morning, guys. Thanks so much for taking the question. Just a follow-up question on the spine business. It's been pretty weak and it seems like the market is actually very weak. And J&J historically has done a lot of reevaluating businesses and getting out of slower growth businesses that no longer makes sense. Can you talk about whether this is even still a good market for J&J? Is this a business just based on the recent performance that could be up for potential divestiture?

And my next question, my follow-up there is, is this a market that might be moving in the direction of stem therapy ultimately and what J&J's views are there? Thanks so much.

A - Alex Gorsky {BIO 16239711 <GO>}

Hey, Danielle. Thank you very much. And look, what I would say overall is we still believe that spine is a large attractive global market. There's a lot of unmet need because, as we all know, as we get older, a lot of the existing technologies don't deliver the same level of clinical outcomes and patient satisfaction, for example, that you might experience with a hip or even a knee replacement.

And look, while we're excited about the progress that we're making and some of the strong cadence of launches and acquisitions, we clearly know that we've got more work to do with the performance of this business. And the reason for that, frankly, is the continued slowdown in the spine category growth, especially in the U.S. We had some portfolio gaps, as I mentioned earlier, that we're now closing, and we had sales force attrition in 2017, which did have a negative impact, and we think that that is now stabilized. So while we still have got work to do, we maintain the number two position globally, we think that it's a very strong complement to the rest of our portfolio, but we are very, very focused on getting that business turned around and moving in the right direction.

Operator

Your next question comes from the line of Geoff Meacham with Barclays.

Q - Geoff Meacham {BIO 21252662 <GO>}

Hey, guys. Good morning and thanks for taking the questions. I have a few Pharma questions. I've got one for Joe and then a follow-up for Alex.

So, Joe, on PH, UPTRAVI hasn't beaten consensus really until this quarter. Was there something different in 2Q? And do you guys view this as a start of a more sustained acceleration of the franchise? And then there are several generics coming into the prostacyclin category this year. What are your guys expectations on pricing or step edit?

A - Joseph J. Wolk {BIO 19812977 <GO>}

So with regards to the performance in the quarter, beating consensus, that's probably less relevant for us. I know it's important for you guys. But what I would say it's probably the Patient Assistance Foundation. We are seeing, obviously, the impact of the broader reach that Johnson & Johnson has with respect to patient penetration.

Regarding generics coming in later this year, that's part of the guidance in which we've provided. We'll see how that plays out and we'll just go from there, but that is part of our thinking going forward, Geoff.

A - Alex Gorsky {BIO 16239711 <GO>}

Hey, Geoff. This is Alex. The other thing that I might add is, look, whenever you do this kind of an acquisition, there are certain elements in the transition that you've got to work your way through. And I think part of what we're seeing, frankly, is now that we have several quarters under our belt, that that team is really starting to come together. We're starting to realize the global selling synergies.

I've been particularly impressed with our Medical Affairs team and the way that we're looking at new opportunities to how do we identify patients earlier, how do we start combination therapy earlier to actually help potentially stop the progression of the disease. And combined with just general executional improvements that we see across the board, that's why it makes us bullish on Actelion going forward.

Q - Geoff Meacham {BIO 21252662 <GO>}

Okay, that's helpful. And then, Alex, when you look at the segments within Pharma, obviously, Oncology is a standout for growth, but you have Neuroscience and Cardio and Metabolic that are laggards. When you and the board make capital allocation decisions, does the breadth of Pharma growth really inform your strategy? I guess I'm trying to figure out how aggressive you want to be on the BD front and whether the categories within Pharma really matter.

A - Alex Gorsky {BIO 16239711 <GO>}

FINAL

Look, overall, Geoff, what I would say is that we still believe there's a lot of opportunities across the really now six different platforms that we have in our Pharmaceutical group, and it starts basically with unmet need. If you look at some of the lower penetration rates in the new categories, for example in Immunology, you still see penetration rates in things like psoriasis and psoriatic arthritis of only around 35%. And even in the novel oral anticoagulant class, you still see warfarin at about a 45% share. So there's a lot of opportunity that we focus on.

I think the other issue for us is that by taking this portfolio approach, not only does it allow us to expand into new patient opportunities and obviously do a lot of the Medical Affairs investment with new indications, but it also enables us to do that in a fairly efficient manner, so that we don't have to re-create sales or marketing or reimbursement organizations, but rather it can be another option in the portfolio.

And frankly, that's why now, for example, if you look at Immunology, STELARA is well on its way to becoming our number one product. But if you look with TREMFYA, SIMPONI, even with the REMICADE decline in the face of biosimilars, our overall portfolio approach, I think, is in fact really working.

A - Joseph J. Wolk {BIO 19812977 <GO>}

Hey, Geoff, maybe just to pick up on Alex's comment too, because you called out Neuroscience specifically, the core brands there, the long-acting injectables, are only penetrated to the tune of about 15%. We know that that's the best way to treat those types of patients, and that portfolio of assets is performing extremely well. So the reported growth for that particular therapeutic area is impeded by CONCERTA and some declines in ULTRAM and older products.

I would also point to the excitement we have around esketamine in that particular space. So we think we'll be filing that very shortly here, certainly by the end of the year. It's a novel new treatment for patients suffering from depression. We know that's the number one cause of suicide here in the United States and globally. So we think that's going to be a very healthy therapeutic area for us going forward.

A - Alex Gorsky {BIO 16239711 <GO>}

Geoff, just to tag on to that, our underlying LAI business in Neuroscience is growing at about 12%. We think that category is less than 12% penetrated. And Joe is exactly right, if you look at the unmet need in the area of treatment-resistant depression, and frankly what the data suggests with the potential for esketamine, we couldn't be more excited for patients or for our business going forward.

Operator

Your next question comes from Jayson Bedford with Raymond James.

Q - Jayson T. Bedford {BIO 5141602 <GO>}

Good morning and thanks for taking the questions. Just a couple of device-related questions and perhaps I missed this, but of the 15 to 20 new product launches in 2018, how many of those have you launched already?

And then, my second question is just on the margin profile in devices, the business is generating 30-plus percent margins over the last couple years. You've now seen two straight quarters of sub-30% margins. And realizing there are a lot of moving parts in this number, but curious as to the source of margin softness. Is it a function of increased R&D investment? Is gross margin a little softer? Any color there would be helpful. Thanks.

A - Joseph J. Wolk {BIO 19812977 <GO>}

So with respect to the new products that we've launched in Medical Devices, I would say we're probably about 60% of the way there at this point. Some of these are staggered launches. If you look at the ATTUNE Revision, we launched it fully here in the U.S. and then it's going to proceed globally, but I would say we're about 60% of the way in meeting that commitment for 2018.

With respect to margin comparisons year on-year, I would think that's going to be related to primarily other income and the lack of divestiture gains that were recognized through the first half of last year versus what we've recognized this year.

In terms of R&D investment, I would say that's up slightly. We are one of the highest investors in terms of absolute dollars in the Medical Device space and gross margin continues to improve from an operational perspective. There is a little bit of headwind with price, obviously, but in terms of our supply chain as we announced last quarter, we continue to make refinements there to keep our costs highly competitive to provide patients and hospital systems with greater affordable access.

Q - Jayson T. Bedford {BIO 5141602 <GO>}

Thanks, Joe.

A - Joseph J. Wolk {BIO 19812977 <GO>}

You're welcome, Jayson.

A - Alex Gorsky {BIO 16239711 <GO>}

Thanks for the question, Jayson. Rob, I think we have time for one more question.

Operator

Yes. Your next question is coming from the line of Rick Wise with Stifel.

Q - Rick Wise {BIO 1490589 <GO>}

Good morning. Good morning, Alex. Hi, Joe.

A - Alex Gorsky {BIO 16239711 <GO>}

Hey, Rick. Good morning.

Q - Rick Wise {BIO 1490589 <GO>}

I'll just ask one question really this morning, a lot of my others have been answered. On slide 22, it talked about the Medical Device portfolio and growth strategy. Alex, you highlight the notion that you're focused on maximizing new market growth opportunities and sites of care beyond the hospital. Not a big deal probably, but are you looking at sites of care beyond the hospital, is it simply trends shifting to ambulatory surgical centers? Is there something more substantial here that you can do or thinking about related to home health, digital health, other new initiatives? Just any color would be very interesting to hear. Thanks so much.

A - Alex Gorsky {BIO 16239711 <GO>}

Sure, Rick. Thanks for the question. And the short answer is, yes, but in particular, in a lot of our conversations and discussions with hospital systems, as they're trying to navigate their way through the challenges that they're seeing in the current marketplace, clearly, they're dealing with shifts in care from the traditional hospital operating room to the ambulatory care center trying to do a better job of managing both preoperative as well as postoperative care. And those are all areas that, frankly, we think are exciting not only in terms of the business opportunity, but also in terms of a better position overall for Johnson & Johnson and ultimately improving patient outcomes.

Q - Rick Wise {BIO 1490589 <GO>}

Thank you so much, Alex.

A - Alex Gorsky {BIO 16239711 <GO>}

Thank you.

A - Matthew Stuckley

Thank you for the question, Rick, and thanks, everyone, who asked a question today and apologies to those who we could not get to in time. However, please don't hesitate to reach out to the Investor Relations team as needed with any follow ups.

I'll now turn the call back to Alex for some closing remarks.

A - Alex Gorsky {BIO 16239711 <GO>}

Sure. Well, thank you very much for your continued confidence and support in Johnson & Johnson. I think you'll agree with me that we had a very strong quarter, that's quite consistent with the plans that we've been laying out. As expected, we have some areas that were particularly strong, others that we need to continue to focus on and improve, but overall, we're pleased with the progress that we're making. And again, we appreciate your continued support.

So, on behalf of the more than 130,000 employees of Johnson & Johnson around the world, who wake up every day trying to help patients and consumers live a longer, healthier and happier life in a Credo-based way, thank you very much and we'll look forward to catching up with you later in the year. Bye for now.

Operator

Thank you. This concludes today's Johnson & Johnson Second Quarter 2018 Earnings Conference Call. You may now disconnect.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2021, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript