10-Q 1 tenq.txt UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549 FORM 10-Q (X) Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended October 2, 2005 or ( ) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the for the transition period from to Commission file number 1-3215 JOHNSON & JOHNSON (Exact name of registrant as specified in its charter) NEW JERSEY 22-1024240 (State or other jurisdiction of (I.R.S. Employer Incorporation or organization) 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 (X) No ( ) Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes (X) No ( ) Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [x] 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 30, 2005, 2,974,929,975 shares of Common Stock, $1.00 par value, were outstanding. 1 JOHNSON & JOHNSON AND SUBSIDIARIES TABLE OF CONTENTS Part I - Financial Information Page No. Item 1. Financial Statements (unaudited) Consolidated Balance Sheets - October 2, 2005 and January 2, 2005 3 Consolidated Statements of Earnings for the Fiscal Quarters Ended October 2, 2005 and September 26, 2004 6 Consolidated Statements of Earnings for the Fiscal Nine Months Ended October 2, 2005 and September 26, 2004 7 Consolidated Statements of Cash Flows for the Fiscal Nine Months Ended October 2, 2005 and September 26, 2004 8 Notes to Consolidated Financial Statements 10 Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 31 Item 3. Quantitative and Qualitative Disclosures About Market Risk 43 Item 4. Controls and Procedures 43 Part II - Other Information Item 1 - Legal Proceedings 44 Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds 44 Item 6 - Exhibits 44 Signatures 45 2 Part I - FINANCIAL INFORMATION Item 1 - Financial Statements JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Unaudited; Dollars in Millions) ASSETS October 2, January 2, 2005 2005 Current Assets: Cash and cash equivalents $14,825 9,203 Marketable securities 354 3,681 Accounts receivable, trade, less allowances for doubtful accounts $173(2004, $206) 7,154 6,831 Inventories (Note 4) 4,015 3,744 Deferred taxes on income 1,813 1,737 Prepaid expenses and other current assets 2,415 2,124 Total current assets 30,576 27,320 Marketable securities, non-current 44 46 Property, plant and equipment, at cost 19,086 18,664 Less accumulated depreciation 8,859 8,228 Property, plant and equipment, net 10,227 10,436 Intangible assets (Note 5) 15,675 15,105 Less accumulated amortization 3,589 3,263 Intangible assets, net 12,086 11,842 Deferred taxes on income 658 551 Other assets 2,983 3,122 Total assets $56,574 53,317 See Notes to Consolidated Financial Statements 3 JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Unaudited; Dollars in Millions) LIABILITIES AND SHAREHOLDERS' EQUITY October 2, January 2, 2005 2005 Current Liabilities: Loans and notes payable $ 278 280 Accounts payable 3,684 5,227 Accrued liabilities 3,164 3,523 Accrued rebates, returns and promotions 2,120 2,297 Accrued salaries, wages and commissions 1,144 1,094 Taxes on income 1,657 1,506 Total current liabilities 12,047 13,927 Long-term debt 2,139 2,565 Deferred tax liability 409 403 Employee related obligations 3,055 2,631 Other liabilities 2,077 1,978 Total liabilities 19,727 21,504 Shareholders' equity: Preferred stock - without par value (authorized and unissued 2,000,000 shares) - - Common stock - par value $1.00 per share (authorized 4,320,000,000 shares; issued 3,119,842,000 shares) 3,120 3,120 Note receivable from employee stock ownership plan - (11) Accumulated other comprehensive income (Note 8) (751) (515) Retained earnings 40,422 35,223 4 Less common stock held in treasury, at cost (144,828,000 & 148,819,000 shares) 5,944 6,004 Total shareholders' equity 36,847 31,813 Total liabilities and shareholders' equity $56,574 53,317 See Notes to Consolidated Financial Statements 5 JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited; dollars & shares in millions except per share figures) Fiscal Third Quarter Ended October 2, Percent Sept. 26, Percent 2005 to Sales 2004 to Sales Sales to customers (Note 6) $12,310 100.0% 11,553 100.0 Cost of products sold 3,340 27.1 3,187 27.6 Gross profit 8,970 72.9 8,366 72.4 Selling, marketing and administrative expenses 4,078 33.1 3,854 33.3 Research expense 1,502 12.2 1,198 10.4 Purchased in-process research and development - - 18 .2 Interest income (123) (1.0) (49) (.4) Interest expense, net of portion capitalized 22 0.2 30 0.2 Other (income)expense, net (63) (0.5) 41 0.4 Earnings before provision for taxes on income 3,554 28.9 3,274 28.3 Provision for taxes on income (Note 3) 929 7.6 933 8.0 NET EARNINGS $2,625 21.3 2,341 20.3 NET EARNINGS PER SHARE (Note 7) Basic $ .88 .79 Diluted $ .87 .78 CASH DIVIDENDS PER SHARE $ .33 .285 AVG. SHARES OUTSTANDING Basic 2,974.6 2,968.1 Diluted 3,017.1 3,009.0 See Notes to Consolidated Financial Statements 6 JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited; dollars & shares in millions except per share figures) Fiscal Nine Months Ended October 2, Percent Sept. 26, Percent 2005 to Sales 2004 to Sales Sales to customers (Note 6) $37,904 100.0% 34,596 100.0 Cost of products sold 10,330 27.3 9,716 28.1 Gross profit 27,574 72.7 24,880 71.9 Selling, marketing and administrative expenses 12,315 32.5 11,205 32.4 Research expense 4,336 11.4 3,476 10.0 Purchased in-process research and development 353 0.9 18 0.1 Interest income (316) (0.8) (123) (0.4) Interest expense, net of portion capitalized 52 0.1 127 0.4 Other (income)expense, net (184) (0.5) (36) (0.1) Earnings before provision for taxes on income 11,018 29.1 10,213 29.5 Provision for taxes on income (Note 3) 2,790 7.4 2,921 8.4 NET EARNINGS $8,228 21.7 7,292 21.1 NET EARNINGS PER SHARE (Note 7) Basic $ 2.77 2.46 Diluted $ 2.73 2.43 CASH DIVIDENDS PER SHARE $ .945 .81 AVG. SHARES OUTSTANDING Basic 2,973.5 2,968.1 Diluted 3,019.0 3,004.4 See Notes to Consolidated Financial Statements 7 JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited; Dollars in Millions) Fiscal Nine Months Ended October 2, Sept. 26, 2005 2004 CASH FLOWS FROM OPERATIONS Net earnings $ 8,228 7,292 Adjustment to reconcile net earnings to cash flows: Depreciation and amortization of property and intangibles 1,586 1,506 Purchased in-process research and development 353 18 Deferred tax provision (410) (424) Accounts receivable allowances (24) 68 Changes in assets and liabilities, net of effects from acquisition of businesses: Increase in accounts receivable (646) (452) Increase in inventories (433) (91) Decrease in accounts payable and accrued liabilities (1,732) (787) Decrease in other current and non-current assets 860 545 Increase in other current and non-current liabilities 912 995 NET CASH FLOWS FROM OPERATING ACTIVITIES 8,694 8,670 CASH FLOWS FROM INVESTING ACTIVITIES Additions to property, plant and equipment (1,490) (1,142) Proceeds from the disposal of assets 152 235 Acquisitions, net of cash acquired (747) (330) Purchases of investments (5,095) (9,121) Sales of investments 8,324 7,508 Other (Primarily intangibles) (295) (91) NET CASH PROVIDED/(USED) BY INVESTING ACTIVITIES 849 (2,941) CASH FLOWS FROM FINANCING ACTIVITIES Dividends to shareholders (2,810) (2,404) Repurchase of common stock (1,164) (985) Proceeds from short-term debt 537 313 Retirement of short-term debt (602) (1,114)

Proceeds from long-term debt 4 16 Retirement of long-term debt (196) (1) Proceeds from the exercise of stock options 534 434 8 NET CASH USED BY FINANCING ACTIVITIES (3,697) (3,741) Effect of exchange rate changes on cash and cash equivalents (224) (17) Increase in cash and cash equivalents 5,622 1,971 Cash and cash equivalents, beginning of period 9,203 5,377 CASH AND CASH EQUIVALENTS, END OF PERIOD $14,825 7,348 ACQUISITIONS Fair value of assets acquired 883 369 Fair value of liabilities assumed (136) (39) Net cash paid for acquisitions $ 747 330 See Notes to Consolidated Financial Statements 9 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS NOTE 1 - The accompanying unaudited interim financial statements and related notes should be read in conjunction with the Consolidated Financial Statements of Johnson & Johnson and Subsidiaries (the "Company") and related notes as contained in the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2005. 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. NOTE 2 - FINANCIAL INSTRUMENTS The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) 133, SFAS 138 and SFAS 149 requiring that all derivative instruments be recorded on the balance sheet at fair value. As of October 2, 2005, the balance of deferred net losses on derivatives included in accumulated other comprehensive income was $49 million after-tax. The Company expects that substantially all of this amount will be reclassified into earnings over the next 12 months as a result of transactions that are expected to occur over that period. The amount ultimately realized in earnings will differ as foreign exchange rates change. Realized gains and losses are ultimately determined by actual exchange rates at maturity of the derivative. Transactions with third parties will cause the amount in accumulated other comprehensive income to affect net earnings. The maximum length of time over which the Company is hedging is 18 months. The Company also uses currency swaps to manage currency risk primarily related to borrowings, which may exceed 18 months. For the first fiscal nine months ended October 2, 2005, the net impact of the hedges' ineffectiveness to the Company's financial statements was insignificant. For the first fiscal nine months ended October 2, 2005, the Company has recorded a net loss of $4 million after tax in other (income) expense, representing the impact of discontinuance of cash flow hedges because it is probable that the originally forecasted transactions will not occur by the end of the originally specified time period. Refer to Note 8 for disclosures of movements in Accumulated Other Comprehensive Income. NOTE 3 - INCOME TAXES The worldwide effective income tax rates for the first fiscal nine months of 2005 and 2004 were 25.3% and 28.6%, respectively, representing a decrease of 3.3%. Of this decrease, 2.1% was attributed to increases in taxable income in lower tax jurisdictions relative to taxable income in higher tax jurisdictions. The remaining net decrease of 1.2% was attributed to a one-time tax benefit partially offset by IPR&D, as described below. The fiscal second quarter of 2005 included a benefit of $225 million, due to the reversal of a tax liability previously 10 recorded during the fiscal fourth quarter of 2004, associated with a technical correction made to the American Jobs Creation Act of 2004 (AJCA), in May 2005. Under the AJCA, approximately $8 billion, of the previously disclosed $10.8 billion, has been repatriated through the fiscal third quarter of 2005. Acquisition related In-process Research & Development (IPR&D) charges of $353 million that are non-deductible for tax purposes were recorded in the fiscal second quarter of 2005. In the fiscal third quarter of 2004, the Company recorded IPR&D charges of $18 million before tax and $12 million after tax as a result of the acquisition of U.S. commercial rights to certain patents and know how in the field of sedation and analgesia from Scott Lab, Inc. NOTE 4 - INVENTORIES (Dollars in Millions) October 2, 2005 January 2, 2005 Raw materials and supplies $ 1,246 964 Goods in process 1,021 1,113 Finished goods 1,748 1,667 $ 4,015 3,744 NOTE 5 - INTANGIBLE ASSETS Intangible assets that have finite useful lives are amortized over their estimated useful lives. Goodwill and indefinite lived intangible assets are assessed annually for impairment. The latest impairment assessment of goodwill and indefinite lived intangible assets was completed in the fiscal fourth quarter of 2004 and no impairment was determined. Future impairment tests will be performed annually in the fiscal fourth quarter, or sooner if warranted by economic conditions. (Dollars in Millions) October 2, 2005 January 2, 2005 Goodwill $ 6,732 6,597 Less accumulated amortization 713 734 Goodwill - net 6,019 5,863 Trademarks (non-amortizable) 1,207 1,232 Less accumulated amortization 134 142 Trademarks (non-amortizable)- net 1,073 1,090 Patents and trademarks 4,159 3,974 Less accumulated amortization 1,326 1,125 Patents and trademarks - net 2,833 2,849 Other amortizable intangibles 3,577 3,302 Less accumulated amortization 1,416 1,262 Other intangibles - net 2,161 2,040 Total intangible assets 15,675 15,105 Less accumulated amortization 3,589 3,263 Total intangibles - net $12,086 11,842 11 Goodwill as of October 2, 2005 as allocated by segment of business is as follows: (Dollars in Millions) Med. Dev Consumer Pharm & Diag Total Goodwill, net at January 2, 2005 $1,160 832 3,871 5,863 Acquisitions - 71 196 267 Translation & Other (62) (26) (23) (111) Goodwill, net as of October 2, 2005 $1,098 877 4,044 6,019 The weighted average amortization periods for patents and trademarks and other intangible assets are 15 years and 17 years, respectively. The amortization expense of amortizable intangible assets for the fiscal nine months ended October 2, 2005 was $379 million and the estimated amortization expense for the five succeeding years approximates $550 million, annually. NOTE 6 - SEGMENTS OF BUSINESS AND GEOGRAPHIC AREAS (Dollars in Millions) SALES BY SEGMENT OF BUSINESS (1) Fiscal Third Quarter Percent 2005 2004 Change Consumer U.S. $ 1,075 1,023 5.1% International 1,156 1,001 15.5 2,231 2,024 10.2 Pharmaceutical U.S. $ 3,527 3,694 (4.5)% International 1,930 1,791 7.8 5,457 5,485 (0.5) Med Devices and Diagnostics U.S. $ 2,365 2,073 14.1% International 2,257 1,971 14.5 4,622 4,044 14.3 U.S. $ 6,967 6,790 2.6% International 5,343 4,763 12.2 Worldwide $ 12,310 11,553 6.6% 12 Fiscal Nine Months Percent 2005 2004 Change Consumer U.S. $ 3,281 3,090 6.2% International 3,508 2,981 17.7 6,789 6,071 11.8 Pharmaceutical U.S. $ 10,905 10,980 (0.7)% International 5,935 5,308 11.8 16,840 16,288 3.4 Med Devices and Diagnostics U.S. $ 7,104 6,306 12.7% International 7,171 5,931 20.9 14,275 12,237 16.7 U.S. $ 21,290 20,376 4.5% International 16,614 14,220 16.8 Worldwide $ 37,904 34,596 9.6% (1) Export and intersegment sales are not significant. OPERATING PROFIT BY SEGMENT OF BUSINESS Fiscal Third Quarter Percent 2005 2004 Change Consumer $ 426 358 19.0% Pharmaceutical 1,796 1,922 (6.6) Med. Dev. & Diag.(1) 1,363 1,052 29.6 Segments total 3,585 3,332 7.6 Expenses not allocated to segments (31) (58) Worldwide total $ 3,554 3,274 8.6% Fiscal Nine Months Percent 2005 2004 Change Consumer $ 1,301 1,187 9.6% Pharmaceutical(2) 5,518 6,117 (9.8) Med. Dev. & Diag.(3) 4,265 3,179 34.2 Segments total 11,084 10,483 5.7 Expenses not allocated to segments (66) (270) Worldwide total $ 11,018 10,213 7.9% 13 (1) Includes $18 million of IPR&D charges related to an acquisition of rights to certain patents and know how completed in the fiscal third quarter of 2004. (2) Includes $302 million of IPR&D charges related to acquisitions completed in the fiscal second quarter of 2005. (3) Includes $51 million of IPR&D charges related to an acquisition completed in the fiscal second quarter of 2005 and $18 million for an acquisition of rights to certain patents and know how completed in the fiscal third quarter of 2004. SALES BY GEOGRAPHIC AREA Fiscal Third Quarter Percent 2005 2004 Change U.S. $ 6,967 6,790 2.6% Europe 2,860 2,638 8.4 Western Hemisphere, excluding U.S. 783 639 22.5 Asia-Pacific, Africa 1,700 1,486 14.4 Total $ 12,310 11,553 6.6% Fiscal Nine Months Percent 2005 2004 Change U.S. $ 21,290 20,376 4.5% Europe 9,222 8,124 13.5 Western Hemisphere, excluding U.S. 2,259 1,858 21.6 Asia-Pacific, Africa

5,133 4,238 21.1 Total $ 37,904 34,596 9.6% NOTE 7 - 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 October 2, 2005 and September 26, 2004. (Shares in Millions) Fiscal Third Quarter Ended October 2, Sept. 26, 2005 2004 Basic net earnings per share $ .88 .79 Average shares outstanding - basic 2,974.6 2,968.1 Potential shares exercisable under 14 stock option plans 209.7 194.9 Less: shares which could be repurchased under treasury stock method (174.3) (168.6) Convertible debt shares 7.1 14.6 Average shares outstanding - diluted 3,017.1 3,009.0 Diluted earnings per share $ .87 .78 The diluted earnings per share calculation included the dilutive effect of convertible debt that was offset by the related reduction in interest expense of $2 million for the fiscal third quarter ended October 2, 2005 and $3 million for the fiscal third quarter ended Sept. 26, 2004. The diluted earnings per share calculation excluded 46 million and 43 million shares related to options for the fiscal third quarters ended October 2, 2005 and Sept. 26, 2004, respectively, as the exercise price per share of these options was greater than the average market value. If these shares were included it would result in an anti-dilutive effect on diluted earnings per share. The following is a reconciliation of basic net earnings per share to diluted net earnings per share for the fiscal nine months ended October 2, 2005 and Sept. 26, 2004. (Shares in Millions) Fiscal Nine Months Ended October 2, Sept. 26, 2005 2004 Basic net earnings per share $ 2.77 2.46 Average shares outstanding - basic 2,973.5 2,968.1 Potential shares exercisable under stock option plans 209.9 193.4 Less: shares which could be repurchased under treasury stock method (171.5) (171.7) Convertible debt shares 7.1 14.6 Average shares outstanding - diluted 3,019.0 3,004.4 Diluted earnings per share $ 2.73 2.43 The diluted earnings per share calculation included the dilutive effect of convertible debt that was offset by the related reduction in interest expense of $9 million for the first fiscal nine months ended October 2, 2005 and $11 million for the first fiscal nine months ended Sept. 26, 2004. The diluted earnings per share calculation excluded 46 million and 44 million shares related to options for the first fiscal nine months ended October 2, 2005 and Sept. 26, 2004, respectively, as the exercise price per share of these options was greater than the average market value. If these shares were included it would result in an anti-dilutive effect on diluted earnings per share. 15 NOTE 8 - ACCUMULATED OTHER COMPREHENSIVE INCOME The total comprehensive income for the first fiscal nine months ended October 2, 2005 was $8.0 billion, compared with $7.4 billion for the same period a year ago. The total comprehensive income for the fiscal third quarter ended October 2, 2005 was $2.7 billion, compared with $2.4 billion for the same period a year ago. Total comprehensive income included net earnings, net unrealized currency gains and losses on translation, net unrealized gains and losses on available for sale securities and net gains and losses on derivative instruments qualifying and designated as cash flow hedges. The following table sets forth the components of accumulated other comprehensive income. Total Unrld Gains/ Accum For. Gains/ Pens (Losses) Other Cur. (Losses) Liab on Deriv Comp Trans. on Sec Adj. & Hedg Inc/ (Loss) January 2, 2005 $ (105) 86 (346) (150) (515) 2005 nine months changes: Net change associated with current period hedging transactions - - - 414 Net amount reclassed to net earnings - - - (313)* Net nine months changes (314) (23) - 101 (236) October 2, 2005 $ (419) 63 (346) (49) (751) Amounts in accumulated other comprehensive income are presented net of the related tax impact. Foreign currency translation adjustments are not currently adjusted for income taxes, as they relate to permanent investments in international subsidiaries. *Primarily offset in net earnings by changes in value of the underlying transactions. NOTE 9 - MERGERS, ACQUISITIONS AND DIVESTITURES On December 15, 2004, the Company announced the signing of a definitive agreement to acquire Guidant Corporation (Guidant), a world leader in the treatment of cardiac and vascular disease, for $25.4 billion in fully diluted equity value. The Boards of Directors of the Company and Guidant, as well as the shareholders of Guidant have given their respective approvals for the transaction. On November 2, 2005, the Company was notified that the Federal Trade Commission conditionally approved the proposed transaction and that such approval was conditioned upon the Company divesting certain rights and assets of its businesses in drug-eluting stents, endoscopic vessel harvesting products, and anastomotic assist devices. The Company continues to view the previously announced product recalls at Guidant and the related regulatory investigations, claims and other developments as serious matters affecting both Guidant's short-term results and 16 long-term outlook. The Company believes that these events have had a material adverse effect on Guidant, and, as a result, the Company is not required under the terms of the merger agreement to close the Guidant acquisition. The Company has had discussions with Guidant regarding a restructuring of the terms of the transaction, although those discussions have not resulted in any agreement between the companies. The Company cannot assure that the companies will resume those discussions or, if discussions do resume, whether they will be able to reach agreement on revised terms that would allow the Company to proceed with the transaction. On November 7, 2005 Guidant filed a lawsuit against the Company, which is described in Note 12 (Legal Proceedings). On April 4, 2005 the Company completed its acquisition of TransForm Pharmaceuticals, Inc., a company specializing in the discovery of superior formulations and novel crystalline forms of drug molecules, for $230 million. During the fiscal second quarter of 2005 a one-time before and after-tax charge of $50 million reflecting the expensing of IPR&D charges was incurred. On June 3, 2005 the Company completed its acquisition of Closure Medical Corporation, a company with expertise and intellectual property in the biosurgicals market, for a net purchase price of $364 million. During the fiscal second quarter of 2005 a one-time before and after-tax charge of approximately $51 million reflecting the expensing of IPR&D charges was incurred. On June 30, 2005 the Company completed its acquisition of Peninsula Pharmaceuticals, Inc., a privately held biopharmaceutical company focused on developing and commercializing antibiotics to treat life-threatening infections, for a purchase price of approximately $245 million. During the fiscal second quarter of 2005, a one-time before and after-tax charge of approximately $252 million reflecting the expensing of IPR&D charges was incurred. The Company's 2004 acquisitions included: Merck's 50% interest in the Johnson & Johnson-Merck Consumer Pharmaceuticals Co. European non-prescription pharmaceutical joint venture including all of the infrastructure and brand assets managed by the European joint venture; Egea Biosciences, Inc., which has developed a proprietary technology platform called Gene Writer, that allows for the rapid and highly accurate synthesis of DNA sequences, gene assembly, and construction of large synthetic gene libraries, through the exercise of the option to acquire the remaining outstanding stock not owned by Johnson & Johnson; Artemis Medical, Inc. a privately held company with ultrasound and x-ray visible biopsy site breast markers as well as hybrid markers; U.S. commercial rights to certain patents and know-how in the field of sedation and analgesia from Scott Lab, Inc.; Biapharm SAS, a privately held French producer and marketer of skin care products centered around the leading brand BIAFINE(r); the assets of Micomed, a privately owned manufacturer of spinal implants primarily focused on supplying the German market; and the acquisition of the AMBI(r) skin care brand for women of color. 17 NOTE 10 - PRO FORMA STOCK BASED COMPENSATION At October 2, 2005, the Company had 17 stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principle Board Opinion No. 25 "Accounting for Stock Issued to Employees" and its related Interpretations. Compensation costs were not recorded in net income for stock options, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. As required by SFAS No. 148, "Accounting for Stock-Based

Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123," the following table shows the estimated effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation. (Dollars in Millions Except Per Share Data) Fiscal Third Quarter Ended October 2, 2005 Sept. 26, 2004 Net income, as reported $ 2,625 2,341 Less: Compensation expense(1) 87 88 Net Income,pro forma $ 2,538 2,253 Earnings per share: Basic - as reported $.88 $.79 - pro forma .85 .76 Diluted - as reported $.87 $.78 - pro forma .85 .75 (1) Determined under fair value based method for all awards, net of tax. (Dollars in Millions Except Per Share Data) Fiscal Nine Months ended October 2, 2005 Sept. 26, 2004 Net income, as reported $ 8,228 7,292 Less: Compensation expense(1) 263 254 Net Income, pro forma $ 7,965 7,038 Earnings per share: Basic - as reported $2.77 $2.46 - pro forma 2.68 2.37 Diluted - as reported $2.73 $2.43 - pro forma 2.65 2.36 (1) Determined under fair value based method for all awards, net of tax. 18 NOTE 11 - 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 2005 and 2004 include the following components: (Dollars in Millions) Retirement Plans Other Benefit Plans Fiscal Third Quarter ended October 2, Sept. 26, October 2, Sept. 26, 2005 2004 2005 2004 Service cost $ 107 107 14 13 Interest cost 120 114 22 26 Expected return on plan assets (144) (129) (1) (1) Amortization of prior service cost 3 4 (3) (1) Amortization of net transition asset (1) (1) - - Recognized actuarial losses 54 52 6 10 Net periodic benefit cost $ 139 147 38 47 Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the first fiscal nine months of 2005 and 2004 include the following components: (Dollars in Millions) Retirement Plans Other Benefit Plans Fiscal Nine Months ended October 2, Sept. 26, October 2, Sept. 26, 2005 2004 2005 2004 Service cost $ 323 319 42 37 Interest cost 366 339 66 77 Expected return on plan assets (435) (387) (3) (2) Amortization of prior service cost 9 11 (6) (2) Amortization of net transition asset (2) (2) - - Recognized actuarial losses 165 155 19 32 Net periodic benefit cost $ 426 435 118 142 Company Contributions As of October 2, 2005, the Company contributed $16 million and $26 million to its U.S. and international retirement plans, respectively, in 2005. The Company does not anticipate a minimum statutory funding requirement for its U.S. retirement plans in 2005. However the Company may or may not choose to further fund 19 the plans in 2005. International plans will be funded in accordance with local regulations. NOTE 12 - LEGAL PROCEEDINGS Product Liability The Company is involved in numerous product liability cases in the United States, many of which concern adverse reactions to drugs and medical devices. The damages claimed are substantial, and while the Company is confident of the adequacy of the warnings and instructions for use that accompany such products, it is not feasible to predict the ultimate outcome of litigation. However, the Company believes that if any liability results from such cases, it will be substantially covered by existing amounts accrued in the Company's balance sheet under its self-insurance program and by third-party product liability insurance. One group of cases against the Company concerns the Janssen Pharmaceutica Inc. ("Janssen") product PROPULSID (cisapride), which was withdrawn from general sale and restricted to limited use in 2000. In the wake of publicity about those events, numerous lawsuits were filed against Janssen and the Company regarding PROPULSID in state and federal courts across the country. These actions seek substantial compensatory and punitive damages and accuse Janssen and the Company of inadequately testing for and warning about the drug's side effects, of promoting it for off-label use and over promotion. In addition, Janssen and the Company have entered into tolling agreements with various plaintiffs' counsel halting the running of the statutes of limitations with respect to the potential claims of a significant number of individuals while those attorneys evaluate whether or not to sue Janssen and the Company on their behalf. On February 5, 2004, Janssen announced that it had reached an agreement in principle with the Plaintiffs Steering Committee (PSC) of the PROPULSID Federal Multi-District Litigation (MDL), to resolve federal lawsuits related to PROPULSID. The agreement was to become effective once 85% of the death claimants, and 75% of the remainder, agreed to the terms of the settlement. In addition, 12,000 individuals who had not filed lawsuits, but whose claims were the subject of tolling agreements suspending the running of the statutes of limitations against those claims, also had to agree to participate in the settlement before it became effective. On March 24, 2005, it was confirmed that the PSC of the MDL had enrolled enough plaintiffs and claimants in the settlement program to make the agreement effective. Of the 282 death plaintiffs subject to the program, 255 (90%) are confirmed enrolled. Of the 3,538 other plaintiffs subject to the program, 3,156 (89%) are confirmed enrolled. In addition, 19,775 "tolled" claimants are confirmed as enrolled. Those participating in the settlement will submit medical records to an independent panel of physicians who will determine whether the claimed injuries were caused by PROPULSID and otherwise meet the standards for compensation. If those standards are met, a court-appointed special master will 20 determine compensatory damages. Janssen has paid into a compensation escrow account $72.3 million and could pay up to an additional $17.7 million depending on the number of plaintiffs that enroll in the program. Enrollment will remain open until December 15, 2005. Janssen has established an administrative fund of $15 million, and paid legal fees to the PSC of $22.5 million, which amount was approved by the court. Not participating in the settlement program are 2,547 plaintiffs and 7,843 tolled claimants. Of those, 453 plaintiffs are potentially subject to the MDL settlement but have not to date enrolled in it; 1,532 plaintiffs filed cases in federal court subsequent to February 1, 2004, and thus are not subject to the MDL settlement; and 562 have state court actions and thus are not subject to the settlement. Of those not participating in or subject to the MDL settlement, 159 plaintiffs are alleged to have died from use of the drug and 2,388 assert other personal injury claims. The nature of the claims of the tolled claimants are unknown. Of the remaining federal and state plaintiffs, 2,254 cases (89%) are venued in Mississippi. With respect to all the various PROPULSID actions against them, Janssen and the Company dispute the claims in those lawsuits and are vigorously defending against them except where, in their judgment, settlement is appropriate. Janssen and the Company believe they have adequate self-insurance accruals and third- party product liability insurance with respect to these cases. In communications to the Company, the excess insurance carriers have raised certain defenses to their liability under the policies and to date have declined to reimburse Janssen and the Company for PROPULSID-related costs despite demand for payment. In May 2005, hearings were held in London in the arbitration proceeding commenced by Janssen and the Company against Allianz Underwriters Insurance Company, which issued the first layer of applicable excess insurance coverage, to obtain reimbursement of PROPULSID- related costs. Final arguments in that matter were held on July 22, 2005 and a decision is expected before the end of 2005. In May 2005, the Company commenced arbitration against Lexington Insurance Company, which issued the second layer of excess insurance coverage. In the opinion of the Company, the excess carriers remain legally obligated to provide coverage for the PROPULSID-related losses at issue. Affirmative Stent Patent Litigation In patent infringement actions tried in Delaware Federal District Court in late 2000, Cordis Corporation (Cordis), a subsidiary of Johnson & Johnson, obtained verdicts of infringement and patent validity, and damage awards against Boston Scientific Corporation (Boston Scientific) and Medtronic AVE, Inc. (Medtronic) based on a number of Cordis vascular stent patents. On December 15, 2000, the jury in the damage action against Boston Scientific returned a verdict of $324 million and on December 21, 2000, the jury in the

Medtronic action returned a verdict of $271 million. These sums represent lost profit and reasonable royalty damages to compensate 21 Cordis for infringement but do not include pre or post judgment interest. In March and May 2002, the district judge issued post trial rulings that confirmed the validity and enforceability of the main Cordis stent patent claims but found certain other Cordis patents unenforceable. Further, the district judge granted Boston Scientific a new trial on liability and damages and vacated the verdict against Medtronic on legal grounds. On August 12, 2003, the Court of Appeals for the Federal Circuit found the trial judge erred in vacating the verdict against Medtronic and remanded the case to the trial judge for further proceedings. In March 2005, the remaining issues were tried in the remanded case against Medtronic and the retrial proceeded against Boston Scientific. Juries returned verdicts of infringement and patent validity in favor of Cordis in both retrials. Cordis has requested the trial court to reinstate with interest the verdicts obtained against those entities in 2000. Defendants in both cases have filed post-trial motions seeking to vacate the jury verdicts or, alternatively, grant them a new trial on damages. Cordis also has pending in Delaware Federal District Court a second action against Medtronic AVE accusing Medtronic of infringement by sale of stent products introduced by Medtronic subsequent to its GFX and MicroStent products, the subject of the earlier action referenced above. That second action was stayed in April 2005 pending the outcome of an arbitration concerning Medtronic's claim that the products at issue in that case are licensed pursuant to a 1997 license. In January 2003, Cordis filed a patent infringement action against Boston Scientific in Delaware Federal District Court accusing its Express2, TAXUS and Liberte stents of infringing the PALMAZ patent that expires in November 2005. The Liberte stent was also accused of infringing Cordis' GRAY patent that expires in 2016. In June 2005, a jury found that the Express2, Taxus and Liberte stents infringed the PALMAZ patent and that the Liberte stent also infringed the GRAY patent. Boston Scientific will ask the trial judge to vacate the verdicts and, if unsuccessful, there will be a trial on damages and willfulness in the future. Patent Litigation Against Various Johnson & Johnson Subsidiaries The products of various Johnson & Johnson subsidiaries are the subject of various patent lawsuits, the outcomes of which could potentially adversely affect the ability of those subsidiaries to sell those products, or require the payment of past damages and future royalties. With respect to all of these matters, the Johnson & Johnson subsidiary involved is vigorously defending against the claims of infringement and disputing where appropriate the validity and enforceability of the patent claims asserted against it. On July 1, 2005, a jury in Federal District Court in Delaware found that the Cordis CYPHER stent infringed Boston Scientific's Ding `536 patent and that the Cordis CYPHER and BX VELOCITY stents also infringed Boston Scientific Corporation's Jang `021 patent. 22 The jury also found both those patents valid. Cordis has asked the judge to overturn the jury verdicts or grant a new trial. If the judge does not overturn the jury verdicts, there will be a damage and willfulness trial in 2006 and Boston Scientific will seek an injunction against CYPHER. If upheld by the trial court, Cordis will appeal the jury verdicts to the Court of Appeals for the Federal Circuit. In March of 2006, Boston Scientific's case asserting infringement by the CYPHER stent of another Boston Scientific patent is scheduled for trial in Delaware Federal District Court. In that case as well, Boston Scientific seeks an injunction and substantial damages. On January 26, 2005, the Federal District Court for the Southern District of Florida granted Cordis summary judgment dismissing a breach of contract and patent infringement suit filed against Cordis by Arlaine and Gina Rockey seeking royalties on the sales of all Cordis balloon expandable stents. Plaintiffs have filed an appeal with the Court of Appeals for the Federal Circuit. On June 8, 2005, in an action brought by Boston Scientific against Cordis in the Netherlands under the Kastenhofer patent, Cordis was enjoined from manufacturing and selling in the Netherlands two-layer catheters, including those used with the CYPHER stent. The injunction was stayed by another Dutch court, but that stay was lifted on October 12, 2005. Cordis does not anticipate a disruption in the supply of CYPHER product outside the Netherlands from the injunction. In the Belgian action filed by Boston Scientific under the Kastenhofer patent, Boston Scientific is seeking a Pan-European injunction against the sale of infringing catheters, i.e., an injunction that would be effective not just in Belgium but in all of the countries served by the European Patent Office. Trial has not been scheduled but could occur during 2006. In the action against Centocor pursued by Chiron and Rockefeller University asserting infringement by REMICADE of the Cerami patent, the district court in East Texas recently issued an unfavorable claim interpretation ruling. Trial is set for February 2006 and Centocor is vigorously defending the action. The following chart summarizes various patent lawsuits concerning products of Johnson & Johnson subsidiaries. Product J&J Patents Plaintiff/Patent Court Trial Date Company Holder Date Filed Drug Cordis Ding Boston Scientific Germany TBD 02/04 Eluting Corp. Stents Drug Cordis Grainger Boston Scientific D.Del. 03/06 12/03 Eluting Corp. Stents Stents Cordis Boneau Medtronic Inc. Arbitration 11/05 4/02 23 Two-layer Cordis Kasten- Boston Scientific N.D.Cal. TBD 2/02 Catheters hofer Corp. Belgium TBD 12/03 Forman REMICADE Centocor Cerami Rockefeller E.D.Tex. 2/06 04/04 University and Chiron Corporation Stents Cordis Israel Medinol Multiple TBD 05/03 E.U. jurisdictions Contact Vision Nicolson CIBA Vision M.D. Fla. TBD 09/03 Lenses Care Litigation Against Filers of Abbreviated New Drug Applications (ANDAs) The following chart indicates lawsuits pending against generic firms that filed Abbreviated New Drug Applications seeking to market generic forms of products sold by various subsidiaries of the Company prior to expiration of the applicable patents covering those products. These ANDAs typically include allegations of non-infringement, invalidity and unenforceability of these patents. In the event the subsidiary of the Company involved is not successful in these actions, or the 30-month stay expires before a ruling from the district court is obtained, the firms involved will have the ability to introduce generic versions of the product at issue resulting in very substantial market share and revenue losses for the product of the Company's subsidiary. As previously communicated and noted from the chart below, 30- month stays are scheduled to expire during 2006 with respect to ANDA challenges regarding TRI-CYCLEN LO, RISPERDAL and TOPAMAX. Trials are not expected to occur before the expiration of the stays with respect to TRI-CYCLEN LO or RISPERDAL, but could occur in the case of TOPAMAX. Unless 30-month stays are extended or preliminary injunctions granted, outcomes which are uncertain, final FDA approval to market will occur shortly after expiration of the 30-month stays. Because a firm that launches an ANDA product before trial would be liable potentially for lost profits if found at trial to infringe a valid patent, typically ANDA products are not launched under such circumstances. Nonetheless, such "at risk" launches have occurred in cases involving drugs of Johnson & Johnson subsidiaries, and the risk of such a launch cannot be ruled out. Brand Name Patent/NDA Generic Court Trial Date 30- Product Holder Challenger Date Filed Month Stay Expires ACIPHEX 20 mg Eisai Teva S.D.N.Y. TBD 11/03 02/07 delay release tablet (for Dr. Reddy's S.D.N.Y. TBD 11/03 02/07 Janssen) Mylan S.D.N.Y. TBD 01/04 02/07 CONCERTA McNeil-PPC Impax D. Del. TBD 09/05 None 18, 27, 36 and 54 mg ALZA Andrx controlled release tablet DITROPAN XL 5, Ortho- Mylan D.W.V. 02/05 05/03 09/05 24 10, 15 mg McNeil controlled ALZA Impax N.D.Cal. 12/05 09/03 01/06 release tablet LEVAQUIN Daiichi, Mylan D.W.V. 05/04 02/02 07/04 Tablets 250, 500, 750 JJPRD mg tablets Ortho- Teva D.N.J. TBD 06/02 11/04 McNeil LEVAQUIN Daiichi, Sicor (Teva) D.N.J. TBD 12/03 05/06 Injectable JJPRD Single use Ortho- vials and 5 McNeil mg/ml premix LEVAQUIN Daiichi, American D.N.J. TBD 12/03 05/06 Injectable JJPRD Pharmaceutic al Single use Ortho- Partners vials McNeil QUIXIN Daiichi, Hi-Tech D.N.J. TBD 12/03 05/06 Ophthalmic Pharmacal Solution (Levofloxacin) Ortho- Ophthalmic McNeil solution

ORTHO TRI Ortho- Barr D.N.J. TBD 10/03 02/06 CYCLEN LO McNeil 0.18 mg/0.025 mg, 0.215 mg/0.025 mg and 0.25 mg/0.025 mg PEPCID Complete McNeil-PPC Perrigo S.D.N.Y. TBD 02/05 06/07 RAZADYNE Janssen Teva D. Del TBD 07/05 01/08 Mylan D. Del TBD 07/05 01/08 Dr. Reddy's D. Del TBD 07/05 01/08 Purepac D. Del TBD 07/05 01/08 Barr D. Del TBD 07/05 01/08 Par D. Del TBD 07/05 01/08 AlphaPharm D. Del TBD 07/05 01/08 RISPERDAL Janssen Mylan D.N.J. TBD 12/03 05/06 Tablets .25, 0.5, 1, 2, Dr. Reddy's D.N.J. TBD 12/03 06/06 3, 4 mg tablets RISPERDAL M-Tab Janssen Dr. Reddy's D.N.J. TBD 02/05 07/07 0.5, 1, 2, 3, 4 Barr D.N.J. TBD 10/05 02/08 mg TOPAMAX Ortho-Mylan D.N.J. TBD 04/04 09/06 McNeil 25, 50, 100, Cobalt D.N.J. TBD 10/05 03/08 200 mg tablet ULTRACET 37.5 Ortho- Kali (Par) D.N.J. TBD 11/02 04/05 tram/ McNeil 25 325 apap tablet Teva D.N.J. TBD 02/04 07/06 Caraco E.D. Mich. 03/06 09/04 02/07 In the action against Mylan involving Ortho-McNeil's DITROPAN XL (oxybutynin chloride), the court on September 27, 2005, found the Ditropan XL Patent invalid and not infringed by Mylan's ANDA product. Ortho-McNeil and ALZA will appeal. Mylan has not yet received final FDA approval to launch its ANDA product, but such approval could come at any point. In the action against Impax, Impax has moved for judgment of invalidity based on the decision in the Mylan suit. In the action against Mylan Pharmaceuticals USA (Mylan) involving Ortho-McNeil Pharmaceutical, Inc. (Ortho-McNeil) for LEVAQUIN (levofloxacin), the trial judge on December 23, 2004 found the patent at issue valid, enforceable and infringed by Mylan's ANDA product and issued an injunction precluding sale of the product until patent expiration in late 2010. Mylan has appealed to the Court of Appeals for the Federal Circuit. In the action against Kali involving Ortho-McNeil's ULTRACET (tramadol hydrochloride/ acetaminophen), Kali moved for summary judgment on the issues of infringement and invalidity. The briefing on that motion was completed in October 2004 and a decision is expected anytime. With respect to claims other than that at issue in the litigation against Kali, Ortho-McNeil has filed a reissue application in the U.S. Patent and Trademark Office seeking to narrow the scope of the claims. Kali received final approval of its ANDA at expiration of the 30-month stay on April 21, 2005, and launched its generic product the same day. If Ortho-McNeil ultimately prevails in its patent infringement action against Kali, Kali will be subject to an injunction and damages. In the action against Teva Pharmaceuticals USA (Teva) involving Ortho-McNeil's ULTRACET (tramadol hydrocholoride/acetaminophen), Teva has moved for summary judgment on the issues of infringement and validity. The briefing on that motion was completed in March 2005. In the action against Caraco involving Ortho-McNeil's ULTRACET (tramadol hydrocholoride/acetaminophen), Caraco has moved for summary judgment of non-infringement. The motion was argued on October 7 and granted on October 20, 2005. Ortho-McNeil will appeal. With respect to all of the above matters, the Johnson & Johnson subsidiary involved is vigorously defending the validity and enforceability and asserting the infringement of its own or its licensor's patents. 26 Average Wholesale Price (AWP) Litigation Johnson & Johnson and its pharmaceutical subsidiaries, along with numerous other pharmaceutical companies, are defendants in a series of lawsuits in state and federal courts involving allegations that the pricing and marketing of certain pharmaceutical products amounted to fraudulent and otherwise actionable conduct because, among other things, the companies allegedly reported an inflated Average Wholesale Price (AWP) for the drugs at issue. Most of these cases, both federal actions and state actions removed to federal court, have been consolidated for pre-trial purposes in a Multi-District Litigation (MDL) in federal district court in Boston, Massachusetts. The plaintiffs in these cases include classes of private persons or entities that paid for any portion of the purchase of the drugs at issue based on AWP, and state government entities that made Medicaid payments for the drugs at issue based on AWP. In the MDL proceeding in Boston, plaintiffs have moved for class certification of all or some portion of their claims. On August 16, 2005, the trial judge certified Massachusetts only classes of private insurers providing "Medi-gap" insurance coverage and private payers for physician-administered drugs where payments were based on AWP. The judge also allowed plaintiffs to file a new complaint seeking to name proper parties to represent a national class of individuals who made co-payments for physician- administered drugs covered by Medicare. Appeals of the judge's ruling will now be pursued. Other The New York State Attorney General's office (N.Y. AG) and the Federal Trade Commission issued subpoenas in January and February 2003 seeking documents relating to the marketing of sutures and endoscopic instruments by the Company's Ethicon and Ethicon Endo subsidiaries. In February 2005, the N.Y. AG advised that it had closed its investigation. The Connecticut State Attorney General's office also issued a subpoena for the same documents. These subpoenas focus on the bundling of sutures and endoscopic instruments in contracts offered to Group Purchasing Organizations and individual hospitals in which discounts are predicated on the hospital achieving specified market share targets for both categories of products. The operating companies involved have responded to the subpoenas. On June 26, 2003, the Company received a request for records and information from the U.S. House of Representatives' Committee on Energy and Commerce in connection with its investigation into pharmaceutical reimbursements and rebates under Medicaid. The Committee's request focuses on the drug REMICADE (infliximab), marketed by the Company's Centocor, Inc. (Centocor) subsidiary. On July 2, 2003, Centocor received a request that it voluntarily provide documents and information to the criminal division of the U.S. Attorney's Office, District of New Jersey, in connection with its investigation into various Centocor marketing practices. Subsequent requests for documents have been received from the U.S. Attorney's Office. Both the Company and Centocor responded, or are 27 in the process of responding, to these requests for documents and information. On August 1, 2003, the Securities and Exchange Commission (SEC) advised the Company of its informal investigation under the Foreign Corrupt Practices Act of allegations of payments to Polish governmental officials by U.S. pharmaceutical companies. On November 21, 2003, the SEC advised the Company that the investigation had become formal and issued a subpoena for the information previously requested in an informal fashion, in addition to other background documents. The Company and its operating units in Poland have responded to these requests. On December 8, 2003, Ortho-McNeil, a subsidiary of Johnson & Johnson, received a subpoena from the United States Attorney's Office in Boston, Massachusetts seeking documents relating to the marketing, including alleged off-label marketing, of the drug TOPAMAX (topiramate). Ortho-McNeil is cooperating in responding to the subpoena. In October 2004, the U.S. Attorney's Office in Boston asked attorneys for Ortho-McNeil to cooperate in facilitating the subpoenaed testimony of several present and former Ortho-McNeil employees before a grand jury in Boston. Cooperation in securing the testimony of additional witnesses before the grand jury has been requested and is being provided. On January 20, 2004, the Company's subsidiary, Janssen, received a subpoena from the Office of the Inspector General of the United States Office of Personnel Management seeking documents concerning sales and marketing of, any and all payments to physicians in connection with sales and marketing of, and clinical trials for, RISPERDAL (risperidone) from 1997 to 2002. Documents subsequent to 2002 have also been requested. Janssen is cooperating in responding to the subpoena. In April 2004, the Company's pharmaceutical companies were requested to submit information to the U.S. Senate Finance Committee on their use of the "nominal pricing exception" in calculating Best Price under the Medicaid Rebate Program. This request was sent to manufacturers for the top twenty drugs reimbursed under the Medicaid Program. The Company's pharmaceutical companies have responded to the request. In February 2005 a request for supplemental information was received from the Senate Finance Committee, which has been responded to by the Company's pharmaceutical

companies. On July 27, 2004, the Company received a letter request from the New York State Attorney General's Office for documents pertaining to marketing, off-label sales and clinical trials for TOPAMAX (topiramate), RISPERDAL (risperidone), PROCRIT (Epoetin alfa), REMINYL (galantamine HBr), REMICADE (infliximab) and ACIPHEX (rabeprazole sodium). The Company is responding to the request. On August 9, 2004, Johnson & Johnson Health Care Systems, Inc. (HCS), a Johnson & Johnson subsidiary, received a subpoena from the Dallas, Texas U. S. Attorney's Office seeking documents 28 relating to the relationships between the group purchasing organization Novation and HCS and other Johnson & Johnson subsidiaries. The Company's subsidiaries involved are responding to the subpoena. On September 30, 2004, Ortho Biotech Inc. (Ortho Biotech), a Johnson & Johnson subsidiary, received a subpoena from the U.S. Office of Inspector General's Denver, Colorado field office seeking documents directed to sales and marketing of PROCRIT (Epoetin alfa) from 1997 to the present. Ortho Biotech is responding to the subpoena. In March 2005, DePuy Orthopaedics, Inc. (DePuy), a Johnson & Johnson subsidiary, received a subpoena from the U.S. Attorney's Office, District of New Jersey, seeking records concerning contractual relationships between DePuy and surgeons or surgeons in training involved in hip and knee replacement and reconstructive surgery. Other leading orthopaedic companies are known to have received the same subpoena. DePuy is responding to the subpoena. On June 9, 2005, The United States Senate Committee on Finance requested the Company to produce information regarding its use of educational grants. A similar request was sent to other major pharmaceutical companies. On July 5, 2005, the Committee specifically requested information about educational grants in connection with the drug PROPULSID. The Company is in the process of responding to the request. On July 20, 2005, Scios, Inc. (Scios), a Johnson & Johnson subsidiary, received a subpoena from the United States Attorney's Office, District of Massachusetts, seeking documents related to the sales and marketing of NATRECOR. Scios is responding to the subpoena. In early August 2005, Scios was advised that the investigation will be handled by the United States Attorney's Office for the Northern District of California in San Francisco, rather than the United States Attorney's Office in Boston, Massachusetts. On September 26, 2005, Johnson & Johnson received a subpoena from the United States Attorney's Office, District of Massachusetts, seeking documents related to sales and marketing of eight drugs to Omnicare, Inc., a manager of pharmaceutical benefits for long- term care facilities. The Johnson & Johnson subsidiaries involved are in the process of responding to the subpoena. In September 2004, plaintiffs in an employment discrimination litigation initiated against the Company in 2001 in Federal District Court in New Jersey moved to certify a class of all African American and Hispanic salaried employees of the Company and its affiliates in the United States, who were employed at any time from November 1997 to the present. Plaintiffs seek monetary damages for the period 1997 through the present (including punitive damages) and equitable relief. The Company filed its response to plaintiffs' class certification motion in May 2005. A 29 decision by the District Court is not expected until 2006. The Company disputes the allegations in the lawsuit and is vigorously defending against them. The Company, along with its wholly owned Ethicon and Ethicon Endo subsidiaries, are defendants in three federal antitrust actions challenging suture and endo-mechanical contracts with Group Purchasing Organizations and hospitals in which discounts are predicated on a hospital achieving specified market share targets for both categories of products. In each case, plaintiffs seek substantial monetary damages and injunctive relief. In Applied Medical v. Ethicon Inc. et al (C.D.CA, filed September 5, 2003), fact discovery is complete and the defendants have moved for summary judgment on all claims. In Conmed v. Johnson & Johnson et al (S.D.N.Y., filed November 6, 2003), fact discovery is also complete and summary judgment motions have been filed by defendants on all claims. In Genico v. Ethicon, Inc. et al (E.D. TX, filed October 15, 2004) written discovery is underway. After a remand from the Federal Circuit Court of Appeals in January 2003, a partial retrial was commenced in October and concluded in November 2003 in Federal District Court in Boston, Massachusetts in the action Amgen v. Transkaryotic Therapies, Inc. (TKT) and Aventis Pharmaceutical, Inc. (Aventis). The matter is a patent infringement action brought by Amgen against TKT, the developer of a gene-activated EPO product, and Aventis, which held marketing rights to the TKT product, asserting that TKT's product infringes various Amgen, Inc. (Amgen) patent claims. TKT and Aventis dispute infringement and are seeking to invalidate the Amgen patents asserted against them. On October 15, 2004, the district court issued rulings that upheld its initial findings in 2001 that Amgen's patent claims were valid and infringed. An appeal is pending. The Amgen patents at issue in the case are exclusively licensed to Ortho Biotech Inc. in the U.S. for non- dialysis indications. Ortho Biotech Inc. is not a party to the action. On November 7, 2005, Guidant Corporation filed a civil suit in the United States District Court for the Southern District of New York alleging that the Company is required to complete the acquisition of Guidant under the merger agreement the companies entered into in December 2004. The complaint seeks an order compelling the Company to effect the purchase of Guidant at $76 a share. The Company believes it is not required under the terms of the merger agreement to close the Guidant transaction. It views the previously announced product recalls at Guidant and the related regulatory investigations, claims and other developments as serious matters affecting both the short-term results and long- term outlook for Guidant. The Company believes those events have had a material adverse effect on Guidant and, as a result, that it is not required to close the acquisition. The Company will vigorously defend itself against the allegations in Guidant's complaint. The Company is also involved in a number of other patent, trademark and other lawsuits incidental to its business. The 30 ultimate legal and financial liability of the Company in respect to all claims, lawsuits and proceedings referred to above cannot be estimated with any certainty. However, in the Company's opinion, based on its examination of these matters, its experience to date and discussions with counsel, the ultimate outcome of legal proceedings, net of liabilities already accrued in the Company's balance sheet, is not expected to have a material adverse effect on the Company's financial position, although the resolution in any reporting period of one or more of these matters could have a significant impact on the Company's results of operations and cash flows for that period. NOTE 13 - SUBSEQUENT EVENTS On October 24, 2005 the Company entered into a definitive agreement to purchase the Rembrandt Brand of oral care products from The Gillette Company. The transaction is anticipated to close in the fourth quarter of 2005, subject to regulatory approvals and the customary closing conditions. On October 26, 2005 the Company announced the conclusion of an agreement to jointly develop and market BAY 59-7939 (Factor Xa inhibitor) for the prevention and treatment of thrombosis with Bayer HealthCare. BAY 59-7939 is currently undergoing Phase II clinical trials. On October 27, 2005 the Company received a not approvable letter from the FDA on the New Drug Application for dapoxetine hydrochloride, an investigational compound for the treatment of premature ejaculation(PE). The Company continues to believe that dapoxetine provides important benefits for men who suffer from PE and plans to address questions raised in the FDA letter and continue the global development program. Item 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Results of Operations Analysis of Consolidated Sales For the first fiscal nine months of 2005, worldwide sales were $37.9 billion, an increase of 9.6% over 2004 first fiscal nine month sales of $34.6 billion. The impact of foreign currencies accounted for 1.7% of the total reported fiscal nine month increase. Sales by U.S. companies were $21.3 billion in the first fiscal nine months of 2005, which represented an increase of 4.5% over the same period last year. Sales by international companies were $16.6 billion,

which represented an increase of 16.8%, of which 4.0% was due to currency fluctuations. All international regions throughout the world posted double digit sales increases during the first fiscal nine months of 2005 as sales increased 13.5% in Europe, 21.6% in the Western Hemisphere (excluding the U.S.) and 21.1% in the Asia-Pacific, Africa region. These sales gains included the positive impact of currency fluctuations between the U.S. dollar and foreign currencies in Europe of 3.4%, in the Western Hemisphere (excluding the U.S.) of 9.4% and in the Asia-Pacific, Africa region of 2.8%. For the fiscal third quarter of 2005, worldwide sales were $12.3 billion, an increase of 6.6% over 2004 fiscal third quarter sales of $11.6 billion. The impact of foreign currencies accounted for 0.8% of the total reported fiscal third quarter 2005 increase. Sales by U.S. companies were $7.0 billion in the fiscal third quarter of 2005, which represented an increase of 2.6%. Sales by international companies were $5.3 billion, which represented an increase of 12.2%, of which 1.9% was due to positive currency fluctuations. All international regions throughout the world posted sales increases during the fiscal third quarter of 2005 as sales increased 8.4% in Europe, 22.5% in the Western Hemisphere (excluding the U.S.) and 14.4% in the Asia-Pacific, Africa region. These sales gains included the impact of currency 31 fluctuations between the U.S. dollar and foreign currencies in Europe of 0.5%, in the Western Hemisphere (excluding the U.S.) of 12.0% and in the Asia-Pacific, Africa region of 1.7%. Analysis of Sales by Business Segments Consumer Consumer segment sales in the first fiscal nine months of 2005 were $6.8 billion, an increase of 11.8% over the same period a year ago with 9.5% of operational growth and a positive currency impact of 2.3%. U.S. Consumer segment sales increased by 6.2% while international sales gains of 17.7% included a positive currency impact of 4.6%. Major Consumer Franchise Sales - First Fiscal Nine Months Total Operations Currency 2005 2004 %Change %Change %Change OTC Pharm & Nutr. $ 1,947 $ 1,662 17.1% 15.8% 1.3% Skin Care 1,804 1,580 14.2 11.8 2.4 Women's Health 1,180 1,087 8.5 5.5 3.0 Baby & Kids Care 1,168 1,064 9.7 6.8 2.9 Other 690 678 1.8 (3.5) 5.3 Total $ 6,789 $6,071 11.8% 9.5% 2.3% Consumer segment sales in the fiscal third quarter of 2005 were $2.2 billion, an increase of 10.2% over the same period a year ago with 8.5% of operational growth and a positive currency impact of 1.7%. U.S. Consumer segment sales increased by 5.1% while international sales gains of 15.5% included a positive currency impact of 3.4%. 32 Major Consumer Franchise Sales - Fiscal Third Quarter Total Operations Currency 2005 2004 %Change %Change %Change OTC Pharm & Nutr. $ 634 $ 566 12.0% 11.1% 0.9% Skin Care 582 509 14.3 13.0 1.3 Women's Health 398 371 7.3 4.7 2.6 Baby & Kids Care 396 361 9.5 7.1 2.4 Other 221 217 1.8 (0.2) 2.0 Total $ 2,231 $ 2,024 10.2% 8.5% 1.7% Consumer segment sales growth in the fiscal third quarter was attributable to strong sales performance in the major franchises in this segment including OTC Pharmaceutical & Nutritional products, Skin Care, Women's Health and Baby & Kids Care. OTC Pharmaceutical & Nutritional operational sales growth of 11.1% was primarily driven by continued growth in SPLENDA(r) No Calorie Sweetener and adult and pediatric analgesics. This sales growth was partially offset by the negative impact of restrictions implemented on products containing pseudoephedrine, which will continue to negatively impact the business during peak sales cycles for the cold and flu season in the fiscal fourth quarter of 2005 and the fiscal first quarter of 2006. In an effort to mitigate this impact, the Company is in the process of reformulating products containing pseudoephedrine. The Skin Care franchise operational sales growth of 13.0% was attributed to NEUTROGENA(r), AVEENO(r), CLEAN & CLEAR(r) and JOHNSON'S(r) adult brands. The Women's Health franchise achieved operational growth of 4.7% resulting from strong contributions from the K-Y(r) and STAYFREE(r) product lines. The Baby & Kids Care franchise operational sales growth of 7.1% resulted from continued success with JOHNSON'S(r) SOFTWASH(r) AND SOFTLOTION(r) product lines and babycenter.com. Pharmaceutical Pharmaceutical segment sales in the first fiscal nine months of 2005 were $16.8 billion, an increase of 3.4% over the same period a year ago with 2.1% of this change due to operational increases and the remaining 1.3% increase related to the positive impact of currency. The U.S. Pharmaceutical sales decrease was 0.7% and the growth in international Pharmaceutical sales was 11.8% which included 3.9% related to the positive impact of currency. Major Pharmaceutical Product Revenues - First Fiscal Nine Months Total Operations Currency 2005 2004 %Change %Change %Change RISPERDAL(r) $2,654 $2,203 20.5% 18.8% 1.7% PROCRIT(r)/EPREX(r) 2,526 2,739 (7.8) (9.0) 1.2 REMICADE(r) 1,842 1,548 19.0 19.0 - TOPAMAX(r) 1,267 1,029 23.1 21.7 1.4 DURAGESIC(r)/ Fentanyl Transdermal 1,226 1,548 (20.8) (22.5) 1.7 LEVAQUIN(r)/FLOXIN(r) 1,092 921 18.5 18.3 0.2 33 Hormonal Contraceptives 879 975 (9.8) (10.8) 1.0 ACIPHEX(r)/PARIET(tm) 859 786 9.2 7.0 2.2 Other 4,495 4,539 (1.0) (2.7) 1.7 Total $16,840 $16,288 3.4% 2.1% 1.3% Pharmaceutical segment sales in the fiscal third quarter of 2005 were $5.5 billion, a decrease of 0.5% over the same period a year ago with 1.1% of this change due to operational decreases, partially offset by a 0.6% increase related to the positive impact of currency. The U.S. Pharmaceutical sales decrease was 4.5% and the growth in international Pharmaceutical sales was 7.8% which included 1.8% related to the positive impact of currency. Major Pharmaceutical Product Revenues - Fiscal Third Quarter Total Operations Currency 2005 2004 %Change %Change %Change RISPERDAL(r) $916 $746 22.9% 22.4% 0.5% PROCRIT(r)/EPREX(r) 844 887 (4.8) (5.3) 0.5 REMICADE(r) 624 545 14.5 14.5 - TOPAMAX(r) 429 365 17.6 16.7 0.9 DURAGESIC(r)/ Fentanyl Transdermal 394 536 (26.5) (26.8) 0.3 LEVAQUIN(r)/FLOXIN(r) 332 270 22.8 22.5 0.3 Hormonal Contraceptives 281 304 (7.7) (8.5) 0.8 ACIPHEX(r)/PARIET(tm) 300 276 8.6 7.6 1.0 Other 1,337 1,556 (14.1) (15.1) 1.0 Total $5,457 $5,485 (0.5)% (1.1)% 0.6% The Pharmaceutical segment experienced an overall operational decline of 1.1% for the fiscal third quarter of 2005 versus 2004, primarily due to the significant impact of generic competition on various products, including DURAGESIC(r), ULTRACET(r), SPORANOX(r) and hormonal contraceptives. However, sales growth within the segment, during the fiscal third quarter of 2005, was led by strong performances from RISPERDAL(r), REMICADE(r), TOPAMAX(r) and LEVAQUIN(r). (The discussion to follow correlates to the sequence of the chart above.) Growth was achieved with the continued success of RISPERDAL(r) (risperidone), and RISPERDAL CONSTA(r) (risperidone), a long acting injection medication that treats the symptoms of schizophrenia, with operational growth of 22.4%. RISPERDAL(r) benefited from a Medicaid rebate adjustment due to a government approved retroactive change in the methodology used to calculate average manufacturing price for Medicaid charges. PROCRIT(r) (Epoetin alfa) and EPREX(r) (Epoetin alfa) performance continued to be adversely affected by competition. Combined these two products had an operational decline of 5.3% in the third quarter of 2005. Volume associated with share loss to competitive products was the primary driver of the decline. PROCRIT(r) pricing has stabilized in the third quarter of 2005. REMICADE(r) (infliximab), a biologic approved for the treatment of Crohn's disease, ankylosing spondylitis, and use in the treatment of rheumatoid arthritis experienced strong operational growth of 34 14.5% over prior year fiscal third quarter. REMICADE(r) received FDA approval for the treatment of ulcerative colitis and the European Commission granted approval for use in the treatment of severe plaque psoriasis during the fiscal third quarter of 2005. Sales of TOPAMAX(r) (topiramate), which has been approved for adjunctive use in epilepsy, as well as for the prophylactic treatment of migraines, achieved strong operational growth of 16.7%, over prior year fiscal third quarter. In June of 2005 TOPAMAX(r) was also approved for use as an initial monotherapy in the treatment of epilepsy. DURAGESIC(r) (fentanyl transdermal system) sales declined by 26.8% operationally, which was primarily driven by the negative impact of generic

competition in the U.S. beginning in January 2005. An authorized generic version of DURAGESIC(r), being marketed for the Company in the U.S., has captured a strong portion of the generic market. LEVAQUIN(r) (levofloxacin) achieved operational sales growth of 22.5% over prior year, benefiting from strong market growth, as well as, an additional FDA approval for short course treatment of acute bacterial sinusitis. CONCERTA(r) (methylphenidate HCL), a product for the treatment of attention deficit hyperactivity disorder, sales continued to grow despite the lack of patent exclusivity in the U.S. At present, the FDA has not approved any generic version that is substitutable for CONCERTA(r). Abbreviated New Drug Applications (ANDAs) for generic versions of CONCERTA(r) are pending and may be approved at any time. NATRECOR(r)(nesiritide), a product for the treatment of patients with acutely decompensated congestive heart failure who have dyspnea at rest or with minimal activity, has experienced a significant decline in demand due to recent negative public press regarding a meta analysis of selected historical clinical trials. The Company believes that there is no recent data supporting these medical and consumer publications and the currently approved label for NATRECOR(r) reflects all available data to date. In response, the Company has assembled an expert panel to review the available data and clinical development plans for the product and is also engaged in ongoing dialogue with the FDA. Both the panel and the FDA support the continued appropriate use of NATRECOR(r). NATRECOR(r), a Scios Inc. product, was purchased by the Company in 2003 and resulted in the recording of an intangible asset. The remaining unamortized intangible value associated with NATRECOR(r) was $1.1 billion at the end of the fiscal third quarter of 2005, and based on the current estimate of projected future cash flows, no adjustment to this intangible is required. Medical Devices and Diagnostics Medical Devices and Diagnostics segment sales in the first fiscal nine months of 2005 were $14.3 billion, an increase of 16.7% over the same period a year ago with 14.9% of this change due to operational increases and the remaining 1.8% increase related to 35 the positive impact of currency. The U.S. Medical Devices and Diagnostics sales increase was 12.7% and the growth in international Medical Devices and Diagnostics sales was 20.9% which included 3.8% related to the positive impact of currency. Major Medical Devices and Diagnostics Franchise Sales - First Fiscal Nine Months Total Operations Currency 2005 2004 %Change %Change %Change CORDIS(r) $2,977 $2,298 29.6% 27.8% 1.8% DEPUY(r) 2,870 2,468 16.3 14.9 1.4 ETHICON(r) 2,332 2,085 11.9 9.4 2.5 ETHICON ENDO-SURGERY(r) 2,273 2,047 11.0 8.8 2.2 LIFESCAN(r) 1,436 1,240 15.9 14.1 1.8 Vision Care 1,276 1,123 13.6 12.0 1.6 ORTHO-CLINICAL DIAGNOSTICS(r) 1,064 928 14.6 13.2 1.4 Other 47 48 (2.1) (14.6) 12.5 Total $14,275 $12,237 16.7% 14.9% 1.8% Medical Devices and Diagnostics segment sales in the fiscal third quarter of 2005 were $4.6 billion, an increase of 14.3% over the same period a year ago with 13.7% of this change due to operational growth and the remaining 0.6% increase related to the positive impact of currency. The U.S. Medical Devices and Diagnostics sales increase was 14.1% and the growth in international Medical Devices and Diagnostics sales was 14.5% which included 1.2% related to the positive impact of currency. Major Medical Devices and Diagnostics Franchise Sales - Fiscal Third Quarter Total Operations Currency 2005 2004 %Change %Change %Change CORDIS(r) $994 $756 31.5% 31.0% 0.5% DEPUY(r) 897 790 13.5 13.2 0.3 ETHICON(r) 745 687 8.3 7.4 0.9 ETHICON ENDO-SURGERY(r) 723 672 7.6 6.9 0.7 LIFESCAN(r) 462 420 10.0 9.4 0.6 Vision Care 443 392 12.9 12.3 0.6 ORTHO-CLINICAL DIAGNOSTICS(r) 342 309 10.8 10.4 0.4 Other 16 18 (11.1) (17.2) 6.1 Total $4,622 $4,044 14.3% 13.7% 0.6% Sales growth in the Medical Devices and Diagnostics segment was led by strong results experienced across the segment. The Cordis franchise was a major driver, with operational growth of 31.0%. The primary growth driver of the Cordis franchise was the CYPHER(r) Sirolimus-eluting Stent in both U.S. and international markets, with excellent growth in Japan, as CYPHER(r) was approved for reimbursement late in the third fiscal quarter of 2004 in Japan. In addition, the Biosense Webster business also had a strong quarter with its navigational catheter line of products and received approval for the NAVI-START(tm) steerable tip diagnostic 36 catheter and the CARTO(tm) EP navigation system, enabling the release of their first robotically steered electrophysiology catheter in the U.S. In April and July of 2004, Cordis Cardiology Division of Cordis Corporation received warning letters from the FDA regarding Good Manufacturing Practice and Good Clinical Practice regulations. These observations followed post-approval site inspections completed in 2003 and early 2004 including sites involved in the production of the CYPHER(r) Sirolimus-eluting stent. In response to the warning letters, Cordis has made improvements to their quality system. The FDA has completed inspections of the three facilities involved in the April warning letter and Cordis has provided written responses to the recent inspection observations. Cordis is working and meeting with the FDA to discuss next steps. The DePuy franchise's operational growth of 13.2% was primarily attributed to DePuy's orthopaedic joint reconstruction products including the hip and knee product lines. Strong performance was also achieved in DePuy's spine unit and Mitek sports medicine products. Ethicon worldwide sales grew operationally by 7.4% from the same period in the prior year. Contributing to the strong results was the continued penetration with several suture and mesh products, including VICRYL(r) (polyglactin 910) Plus, an anti-bacterial coated suture, PROCEED(r), tissue separating mesh, and MULTIPASS(r) Needle Coating. The Ethicon Endo-Surgery franchise achieved operational growth of 6.9% over prior year. This growth was mainly driven by endocutter sales that include products used in performing bariatric procedures for the treatment of obesity, an important focus area for the franchise. Also contributing to the franchise's growth was sales from HARMONIC SCALPEL(r), CONTOUR(r) and the advanced sterilization product line. The LifeScan franchise operational growth of 9.4% was a result of continued growth of U.S. sales, as well as strong growth in international markets. ONETOUCH(r) ULTRA blood glucose meter, has been the key growth driver in this franchise. Vision Care franchise operational sales growth of 12.3% was led by the continued success of ACUVUE(r) ADVANCE(tm) brand contact lenses with HYDRACLEAR(tm) and 1-DAY ACUVUE(r). An additional contributor was ACUVUE(r) OASYS(tm) with HYDRACLEAR(tm), for tired and dry eyes, which was launched in the fiscal third quarter of 2005. The Ortho-Clinical Diagnostics franchise reported operational growth of 10.4% over the same period in the prior year, which was driven by its continued global market penetration of the automated blood bank products and growth of the ECI equipment base. Cost of Products Sold and Selling, Marketing and Administrative Expenses Consolidated costs of products sold for the first fiscal nine months of 2005 decreased to 27.3% from 28.1% of sales over the same period a year ago. The decrease resulted from cost improvement initiatives and improved gross margins in the Medical 37 Devices & Diagnostics segment, primarily driven by lower manufacturing costs related to CYPHER(r) Sirolimus-eluting Stent, which more than offset an unfavorable product mix. The cost of products sold for the fiscal third quarter of 2005 decreased to 27.1% from 27.6% of sales over the same period a year ago. During the quarter, cost improvement initiatives and improved gross margins in the Medical Devices and Diagnostics segment were partially offset by negative mix. Consolidated selling, marketing and administrative expenses for the first fiscal nine months of 2005 increased 9.9% over the same period a year ago. Consolidated selling, marketing and administrative expenses as a percent to sales for the first fiscal nine months of 2005 were 32.5% and remained relatively flat versus 32.4% for the same period a year ago. Consolidated selling, marketing and administrative expenses for the fiscal third quarter of 2005 increased 5.8% over the same period a year ago. As a percent to sales, consolidated selling, marketing and administrative expenses were 33.1% versus 33.3% for the same period a year ago. Research

& Development Research activities represent a significant part of the Company's business. These expenditures relate to the development of new products, improvement of existing products, technical support of products and compliance with governmental regulations for the protection of the consumer. Worldwide costs of research activities, for the first fiscal nine months of 2005 were $4.3 billion, an increase of 24.7% over the same period a year ago. Research and development spending in the fiscal third quarter of 2005 was $1.5 billion, an increase of 25.4% over the fiscal third quarter of 2004. This increase is a reflection of the number of products in late stage development. In-Process Research & Development In the fiscal second quarter of 2005, the Company recorded In- process Research & Development (IPR&D) charges of $353 million before and after tax related to acquisitions in the Pharmaceutical and Medical Devices and Diagnostics segments. These acquisitions included TransForm Pharmaceuticals, Inc., Peninsula Pharmaceuticals, Inc. and CLOSURE Medical Corporation. In the fiscal third quarter of 2004, the Company recorded IPR&D charges of $18 million before tax and $12 million after tax as a result of the acquisition of U.S. commercial rights to certain patents and know how in the field of sedation and analgesia from Scott Lab, Inc. Other (Income) Expense, Net Other (income) expense is the account where the Company records gains and losses related to the sale and write-down of certain equity securities of the Johnson & Johnson Development Corporation, losses on the disposal of fixed assets, currency gains & losses, minority interests, litigation settlements, as well as royalty income. In the fiscal third quarter of 2005 the Company recorded a gain of $63 million as contrasted with a loss in the same period in 2004 of $41 million. This favorable 38 variance was the result of gains recorded on the sale of the Spectacle Lens business and other properties in 2005. During the fiscal third quarter of 2004, the Company recorded a write down of an insurance receivable and various asset write offs. OPERATING PROFIT BY SEGMENT Consumer Segment Operating profit for the Consumer segment as a percent to sales in the first fiscal nine months of 2005 was 19.2% versus 19.6% over the same period a year ago due to increased investment spending in consumer promotions and advertising for the OTC Pharmaceutical and Nutritional franchise. Operating profit as a percent to sales in the fiscal third quarter of 2005 was 19.1% versus 17.7% over the same period a year ago, due to a reduction in selling, marketing and administrative expenses, and the timing of advertising activity and promotional allowances. Pharmaceutical Segment Operating profit for the Pharmaceutical segment as a percent to sales in the first fiscal nine months of 2005 was 32.8% versus 37.6% over the same period a year ago. Operating profit as a percent to sales in the fiscal third quarter of 2005 was 32.9% versus 35.0% over the same period a year ago. For both periods operating profit was negatively impacted by increased research and development spending and generic competition. The first fiscal nine months of 2005 was also impacted by IPR&D. IPR&D of $302 million reduced operating profit as a percent to sales by 1.8% for the first fiscal nine months. Medical Devices and Diagnostics Segment Operating profit for the Medical Devices and Diagnostics segment as a percent to sales in the first fiscal nine months of 2005 was 29.9% versus 26.0% over the same period a year ago. Operating profit as a percent to sales in the fiscal third quarter of 2005 was 29.5% versus 26.0% over the same period a year ago. The increase in 2005 was due to improved gross profit, resulting from cost reduction programs, lower manufacturing costs related to CYPHERr Sirolimus-eluting Stent and favorable product mix. Interest (Income) Expense Interest income increased in both the first fiscal nine months and fiscal third quarter of 2005 as compared to the same periods a year ago. The increase is primarily due to higher rates of interest earned on cash holdings and an improved cash position. The cash balance including marketable securities at the end of the fiscal third quarter of 2005 was $15.2 billion, which was $2.1 billion higher than the end of the fiscal third quarter of 2004. Interest expense decreased in both the first fiscal nine months and fiscal third quarter of 2005 as compared to the same periods a year ago, resulting from lower average debt balances. Provision For Taxes on Income The worldwide effective income tax rates for the first fiscal nine months of 2005 and 2004 were 25.3% and 28.6%, respectively, representing a decrease of 3.3%. Of this decrease, 2.1% was 39 attributed to increases in taxable income in lower tax jurisdictions relative to taxable income in higher tax jurisdictions. The remaining net decrease of 1.2% was attributed to a one-time tax benefit partially offset by IPR&D, as described below. The fiscal second quarter of 2005 included a benefit of $225 million, due to the reversal of a tax liability previously recorded during the fiscal fourth quarter of 2004, associated with a technical correction made to the American Jobs Creation Act of 2004 (AJCA), in May 2005. Under the AJCA, approximately $8 billion, of the previously disclosed $10.8 billion, has been repatriated through the fiscal third quarter of 2005. Acquisition related IPR&D charges of $353 million that are non- deductible for tax purposes were recorded in the fiscal second quarter of 2005. In the fiscal third quarter of 2004, the Company recorded IPR&D charges of $18 million before tax and $12 million after tax as a result of the acquisition of U.S. commercial rights to certain patents and know how in the field of sedation and analgesia from Scott Lab, Inc. LIQUIDITY AND CAPITAL RESOURCES Cash Flows Cash generated from operations provided the major sources of funds for the growth of the business, including working capital, capital expenditures, acquisitions, share repurchases, dividends and debt repayments. In the first fiscal nine months of 2005, cash flow from operations was $8.7 billion, which is consistent with the same period a year ago. Higher net earnings in 2005 were offset by a decrease in accounts payable and accrued liabilities. Investing activities provided $0.8 billion in the first fiscal nine months of 2005, as compared to a usage of $2.9 billion during the same period a year ago. The increase in cash generated by investing activities was the result of reduced purchases of investment securities and an increase in the sales of investments, partially offset by an increase in acquisitions. Financing activities used $3.7 billion in the first fiscal nine months of 2005 and 2004. Dividends On July 18, 2005, the Board of Directors declared a regular cash dividend of $0.33 per share, payable on September 13, 2005 to shareholders of record as of August 23, 2005. On October 20, 2005, the Board of Directors declared a regular cash dividend of $0.33 per share, payable on December 13, 2005 to shareholders of record as of November 22, 2005. The Company expects to continue the practice of paying regular cash dividends. OTHER INFORMATION New Accounting Standards In December 2004, the FASB issued SFAS No. 123(R), Share Based Payment. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods and services. It focuses primarily on 40 accounting for transactions in which an entity obtains employee services in share-based payment transactions (such as employee stock options and restricted stock units). The statement requires the measurement of the cost of employee services received in exchange for an award of equity instruments (such as employee stock options and restricted stock units) at fair value on the grant date. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (the requisite service period). On April 14, 2005 the SEC approved a new rule that delays the effective date of SFAS No. 123(R) for annual, rather than interim, periods that begin after June 15, 2005. As a result, the Company will adopt this statement in the first fiscal quarter of 2006. Upon adoption of this standard, the Company currently intends to apply the modified retrospective transition method. Previously reported financial statements will be restated to reflect SFAS No. 123 disclosure amounts. As required by SFAS No. 148, Accounting for Stock Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123, the Company disclosed in its 2004 Annual Report, the net income and earnings per share effect had the Company applied the fair value recognition provision of SFAS No. 123. The disclosure impact in 2004 and 2003 was compensation expense net of tax

of $329 million and $349 million and diluted earnings per share of $0.10 and $0.11, respectively. The Company is currently evaluating the effect of adoption on future financial results. The Company will implement SFAS 151, Inventory Costs, an amendment of ARB No. 43 in the fiscal first quarter of 2006. The Company believes the adoption of this statement will not have a material effect on its results of operations, cash flows or financial position. The Company implemented SFAS 153, Exchanges of Non-monetary Assets, an amendment of APB 29 during the fiscal third quarter of 2005, as allowed by the Standards, which did not have a material effect on its results of operations, cash flows or financial position. The following recent accounting pronouncements became effective in 2004 and did not have a material impact on the Company's results of operations, cash flows or financial position. *EITF Issue 02-14: Whether an Investor should apply the Equity Method of Accounting to Investments other than Common Stock. *EITF Issue 04-1: Accounting for Preexisting Relationships between the Parties to a Business Combination. Economic and Market Factors Johnson & Johnson is aware that its products are used in an environment where, for more than a decade, policymakers, consumers and businesses have expressed concern about the rising cost of health care. Johnson & Johnson has a long-standing policy of pricing products responsibly. For the period 1994 through 2004 in 41 the United States, the weighted average compound annual growth rate of Johnson & Johnson price increases for health care products (prescription and over-the-counter drugs, hospital and professional products) was below the U.S. Consumer Price Index (CPI). Inflation rates, even though moderate in many parts of the world during 2004, continue to have an effect on worldwide economies and, consequently, on the way companies operate. In the face of increasing costs, the Company strives to maintain its profit margins through cost reduction programs, productivity improvements and periodic price increases. The Company faces various worldwide health care changes that may result in pricing pressures that include health care cost containment and government legislation relating to sales, promotions and reimbursement. The Company also operates in an environment increasingly hostile to intellectual property rights. Generic drug firms have filed Abbreviated New Drug Applications seeking to market generic forms of most of the Company's key pharmaceutical products, prior to expiration of the applicable patents covering those products. In the event the Company is not successful in defending a lawsuit resulting from an Abbreviated New Drug Application filing, the generic firms will then introduce generic versions of the product at issue, resulting in very substantial market share and revenue losses. For further information see the discussion on "Litigation Against Filers of Abbreviated New Drug Applications" in Note 12 to the unaudited interim consolidated financial statements. CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS This Form 10-Q contains forward-looking statements. Forward- looking statements do not relate strictly to historical or current facts and anticipate results based on management's plans that are subject to uncertainty. Forward-looking statements may be identified by the use of words like "plans," "expects," "will," "anticipates," "estimates" and other words of similar meaning in conjunction with, among other things, discussions of future operations, financial performance, the Company's strategy for growth, product development, regulatory approval, market position and expenditures. Forward-looking statements are based on current expectations of future events. The Company cannot guarantee that any forward- looking statement will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Investors should realize that if underlying assumptions prove inaccurate or that unknown risks or uncertainties materialize, actual results could vary materially from the Company's expectations and projections. Investors are therefore cautioned not to place undue reliance on any forward-looking statements. The Company assumes no obligation to update any forward-looking statements as a result of new information or future events or developments. Risks and uncertainties include general industry conditions and competition; economic conditions, such as interest rate and 42 currency exchange rate fluctuations; technological advances, new products and patents attained by competitors; challenges inherent in new product development, including obtaining regulatory approvals; challenges to patents; U.S. and foreign health care reforms and governmental laws and regulations; trends toward health care cost containment; increased scrutiny of the health care industry by government agencies; product efficacy or safety concerns resulting in product recalls or regulatory action. The Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2005 contains, as an Exhibit, a discussion of additional factors that could cause actual results to differ from expectations. The Company notes these factors as permitted by the Private Securities Litigation Reform Act of 1995. Item 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK There has been no material change in the Company's assessment of its sensitivity to market risk since its presentation set forth in Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in its Annual Report on Form 10-K for the fiscal year ended January 2, 2005. Item 4 - CONTROLS AND PROCEDURES-EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES Disclosure controls and procedures. As of the end of the period covered by this report, management evaluated the effectiveness of the Company's disclosure controls and procedures. The Company's disclosure controls and procedures are designed to ensure that the Company records, processes, summarizes and reports in a timely manner the information the Company is required to disclose in its reports filed under the Securities Exchange Act. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. William C. Weldon, Chairman and Chief Executive Officer, and Robert J. Darretta, Vice Chairman and Chief Financial Officer, reviewed and participated in this evaluation. Based on this evaluation, Messrs. Weldon and Darretta concluded that, as of the date of their evaluation, the Company's disclosure controls and procedures were effective. Internal control. During the period covered by this report, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. 43 Part II - Other Information Item 1 - Legal Proceedings The information called for by this item is incorporated herein by reference to Note 12 included in Part I, Notes to Consolidated Financial Statements. Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers. The following table provides information with respect to Common Stock purchases by the Company during the fiscal third quarter of 2005. Common Stock purchases on the open market are made as part of a systematic plan to meet the Company's compensation programs. Fiscal Month Total Number of Average Price Paid Shares Purchased Per Share July 4 - July 31, 2005 350,000 $64.15 August 1 - August 28, 2005 1,041,000 $63.69 August 29 - October 2, 2005 1,373,400 $63.99 Item 6 - Exhibits Exhibit 10.1 Form of Restricted Stock Unit Certificate under the Johnson & Johnson 2005 Long-Term Incentive Plan - Filed with this document.* Exhibit 31.1 Certifications under Rule 13a-14(a) of the Securities Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Filed with this document. Exhibit 32.1 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Furnished with this document. *Management contract or compensatory plan. 44 SIGNATURES Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized. JOHNSON & JOHNSON (Registrant) Date: November 7, 2005 By /s/ R. J. DARRETTA R.

J. DARRETTA Vice Chairman, Board of Directors; Chief Financial Officer and Director (Principal Financial Officer) Date: November 7, 2005 By /s/ S. J. COSGROVE S. J. COSGROVE Controller (Principal Accounting Officer) 45