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 July 2, 2006 or ( ) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to Commission file number 1-3215 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. (X) Yes ( )No Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non- accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer (X) Accelerated filer ( ) Non-accelerated filer ( ) 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 July 30, 2006 2,925,021,833 shares of Common Stock, $1.00 par value, were outstanding. JOHNSON & JOHNSON AND SUBSIDIARIES TABLE OF CONTENTS Part I - Financial Information Page No. Item 1. Financial Statements (unaudited) Consolidated Balance Sheets - July 2, 2006 and January 1, 2006 3 Consolidated Statements of Earnings for the Fiscal Second Quarters Ended July 2, 2006 and July 3, 2005 5 Consolidated Statements of Earnings for the Fiscal Six Months Ended July 2, 2006 and July 3, 2005 6 Consolidated Statements of Cash Flows for the Fiscal Six Months Ended July 2, 2006 and July 3, 2005 7 Notes to Consolidated Financial Statements 9 Item 2. 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Controls and Procedures 42 Part II - Other Information Item 1 - Legal Proceedings 43 Item 1A - Risk Factors 43 Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds 43 Item 4 - Submission of Matters to a Vote of Security Holders 44 Item 6 - Exhibits 45 Signatures 46 Part I - FINANCIAL INFORMATION Item 1 - FINANCIAL STATEMENTS JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Unaudited; Dollars in Millions) ASSETS July 2, 2006 January 1, 2006* Current Assets: Cash & cash equivalents $14,647 $16,055 Marketable securities 78 83 Accounts receivable, trade, less allowances for doubtful accounts $163 (2005,$164) 8,162 7,010 Inventories (note 4) 4,313 3,959 Deferred taxes on income 2,091 1,931 Prepaid expenses and other receivables 2,223 2,442 Total current assets 31,514 31,480 Marketable securities, non-current 21 20 Property, plant and equipment at cost 20,965 19,716 Less: accumulated depreciation (9,678) (8,886) Property, plant and equipment, net 11,287 10,830 Intangible assets, net (note 5) 6,617 6,185 Goodwill, net (note 5) 6,657 5,990 Deferred taxes on income 1,683 1,138 Other assets 3,211 3,221 Total Assets $60,990 $58,864 * Restated to include the impact of share based compensation expense; see Notes 1 and 10 for additional information. See Notes to Consolidated Financial Statements JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Unaudited; Dollars in Millions) LIABILITIES AND SHAREHOLDERS' EQUITY July 2, 2006 January 1, 2006* Current Liabilities: Loans and notes payable $654 $668 Accounts payable 4,089 4,315 Accrued liabilities 3,286 3,529 Accrued rebates, returns and promotions 1,948 2,017 Accrued salaries, wages and commissions 985 1,166 Accrued taxes on income 1,227 940 Total current Liabilities 12,189 12,635 Long-term debt 1,981 2,017 Deferred taxes on income 322 211 Employee related obligations 3,456 3,065 Other liabilities 2,300 2,226 Total liabilities 20,248 20,154 Shareholders' Equity: Common stock - par value $1.00 per share (authorized 4,320,000,000 shares; issued 3,119,842,000 shares) 3,120 3,120 Accumulated other comprehensive income (note 8) (550) (755) Retained earnings 46,530 42,310 Less: common stock held in treasury, at cost (185,855,000 and 145,364,000 shares) 8,358 5,965 Total shareholders' equity 40,742 38,710 Total liabilities and shareholders' equity $60,990 $58,864 * Restated to include the impact of share based compensation expense; see Notes 1 and 10 for additional information. See Notes to Consolidated Financial Statements JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited; dollars & shares in millions except per share figures) Fiscal Quarters Ended July 2, Percent July 3, Percent 2006 to 2005* to Sales Sales Sales to customers (Note 6) $13,363 100.0% $12,762 100.0% Cost of products sold 3,788 28.3 3,522 27.6 Gross profit 9,575 71.7 9,240 72.4 Selling, marketing and administrative expenses 4,351 32.6 4,278 33.5 Research expense 1,828 13.7 1,525 11.9 In-process research & development 87 0.6 353 2.8 Interest income (209) (1.6) (109) (0.8) Interest expense, net of portion capitalized 13 0.1 15 0.1 Other income, net (98) (0.7) (88) (0.7) Earnings before provision for taxes on income 3,603 27.0 3,266 25.6 Provision for taxes on income (Note 3) 783 5.9 678 5.3 NET EARNINGS $2,820 21.1% $2,588 20.3% ` NET EARNINGS PER SHARE Basic $0.96 $0.87 Diluted $0.95 $0.86 CASH DIVIDENDS PER SHARE $0.375 $0.33 AVG. SHARES OUTSTANDING Basic 2,954.0 2,973.7 Diluted 2,974.4 3,024.7 * Restated to include the impact of share based compensation expense; see Notes 1 and 10 for additional information. See Notes to Consolidated Financial Statements JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited; dollars & shares in millions except per share figures) Fiscal Six Months Ended July 2, Percent July 3, Percent 2006 to 2005* to Sales Sales Sales to customers (Note 6) $26,355 100.0% $25,594 100.0% Cost of products sold 7,400 28.1 7,018 27.4 Gross profit 18,955 71.9 18,576 72.6 Selling, marketing and administrative expenses 8,446 32.0 8,405 32.8 Research expense 3,360 12.7 2,909 11.4 In-process research & development 124 0.5 353 1.4 Interest income (406) (1.5) (193) (0.7) Interest expense, net of portion capitalized 29 0.1 30 0.1 Other income, net (816) (3.1) (121) (0.5) Earnings before provision for taxes on income 8,218 31.2 7,193 28.1 Provision for taxes on income (Note 3) 2,093 8.0 1,766 6.9 NET EARNINGS $6,125 23.2% $5,427 21.2% ` NET EARNINGS PER SHARE Basic $2.07 $1.83 Diluted $2.05 $1.80 CASH DIVIDENDS PER SHARE $0.705 $0.615 AVG. SHARES OUTSTANDING Basic 2,963.0 2,973.0 Diluted 2,982.5 3,021.8 * Restated to include the impact of share based compensation expense; see Notes 1 and 10 for additional information. See Notes to Consolidated Financial Statements JOHNSON & JOHNSON AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited; Dollars in Millions) Fiscal Six Months Ended July 2, 2006 July 3, 2005* CASH FLOW FROM OPERATING ACTIVITIES Net earnings $6,125 $5,427 Adjustment to reconcile net earnings to cash flow: Depreciation and amortization of property and intangibles 1,067 1,063 Stock based compensation 340 271 Purchased in-process research and development 124 353 Deferred tax provision (628) (212) Accounts receivable allowances (5) (17) Changes in assets and liabilities, net of effects from acquisitions: Increase in accounts receivable (949) (876) Increase in inventories (229) (380) Decrease in accounts payable and accrued liabilities (794) (1,651) Decrease in other current and non-current assets 83 578 Increase in other current and non-current liabilities 696 93 NET CASH FLOWS FROM OPERATING ACTIVITIES 5,830 4,649 CASH FLOWS FROM INVESTING ACTIVITIES Additions to property, plant and equipment (1,034) (874) Proceeds from the disposal of assets 1 77 Acquisitions, net of

cash acquired (1,218) (693) Purchases of investments (396) (4,999) Sales of investments 322 7,611 Other (primarily intangibles) (37) (282) NET CASH (USED)/PROVIDED BY INVESTING ACTIVITIES (2,362) 840 CASH FLOWS FROM FINANCING ACTIVITIES Dividends to shareholders (2,089) (1,829) Repurchase of common stock (2,968) (988) Proceeds from short-term debt 500 351 Retirement of short-term debt (723) (314) Proceeds from long-term debt - 4 Retirement of long-term debt (10) (20) Proceeds from the exercise of stock options/excess tax benefits 332 455 (4,958) (2,341) NET CASH USED BY FINANCING ACTIVITIES Effect of exchange rate changes on cash and cash equivalents 82 (195) (Decrease)/increase in cash and cash equivalents (1,408) 2,953 Cash and Cash equivalents, beginning of period 16,055 9,203 CASH AND CASH EQUIVALENTS, END OF PERIOD $14,647 $12,156 Acquisitions Fair value of assets acquired $1,392 $854 Fair value of liabilities assumed (174) (161) Net cash paid for acquisitions $1,218 $693 * Restated to include the impact of share based compensation expense; see Notes 1 and 10 for additional information. See Notes to Consolidated Financial Statements 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 1, 2006. The unaudited interim financial statements include all adjustments (consisting only of normal recurring adjustments) and accruals necessary in the judgment of management for a fair statement of the results for the periods presented. During the fiscal first quarter of 2006, the Company elected to adopt SFAS 123(R), Share Based Payment, under the modified retrospective application method. Accordingly, financial statement amounts for the prior periods presented in this Form 10-Q have been restated to reflect the fair value method of expensing prescribed by SFAS 123(R). 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 July 2, 2006, the balance of deferred net losses on derivatives included in accumulated other comprehensive income was $2 million after-tax. For additional information, see Note 8. 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 fiscal second quarters ended July 2, 2006 and July 3, 2005, the net impact of the hedges' ineffectiveness, transactions not qualifying for hedge accounting and discontinuance of hedges, to the Company's financial statements was insignificant. 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 six months of 2006 and 2005 were 25.5% and 24.6%, respectively, an increase of 0.9% primarily due to the expiration of the U.S. research and development tax credit at the end of fiscal 2005, and the net effect of the following items. The tax rate for the first fiscal six months of 2006 benefited from a reversal of tax allowances of $134 million associated with the Tibotec business. This benefit was offset by acquisition-related IPR&D charges of $124 million, for which there was a minimal tax benefit. Additionally, the first fiscal six months of 2006 includes the gain associated with the Guidant termination fee, less associated expenses, of $622 million before tax recorded at a 40.8% tax rate. The first fiscal six months 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, in May 2005, as well as, the impact of acquisition-related IPR&D charges of $353 million that are non-deductible for tax purposes. NOTE 4 - INVENTORIES (Dollars in Millions) July 2, 2006 January 1, 2006 Raw materials and supplies $1,124 $931 Goods in process 1,067 1,073 Finished goods 2,122 1,955 $4,313 $3,959 NOTE 5 - INTANGIBLE ASSETS AND GOODWILL 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 2005 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) July 2, 2006 January 1, 2006 Trademarks (non-amortizable) $1,565 $1,400 Less accumulated amortization 134 134 Trademarks (non-amortizable)-net 1,431 1,266 Patents and trademarks 4,445 4,128 Less accumulated amortization 1,524 1,370 Patents and trademarks - net 2,921 2,758 Other amortizable intangibles 3,773 3,544 Less accumulated amortization 1,508 1,383 Other intangibles - net 2,265 2,161 Total intangible assets - gross 9,783 9,072 Less accumulated amortization 3,166 2,887 Total intangible assets - net 6,617 6,185 Goodwill - gross 7,381 6,703 Less accumulated amortization 724 713 Goodwill - net $6,657 $5,990 Goodwill as of July 2, 2006 as allocated by segment of business is as follows: (Dollars in Millions) Consumer Pharm Med Dev Total & Diag Goodwill, net of accumulated amortization at January 1, 2006 $1,090 $874 $4,026 $5,990 Acquisitions 153 - 455 608 Translation & Other 30 17 12 59 Goodwill as of July 2, 2006 $1,273 $891 $4,493 $6,657 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 six months ended July 2, 2006 was $268 million and the estimated amortization expense for the five succeeding years approximates $565 million, per year. NOTE 6 - SEGMENTS OF BUSINESS AND GEOGRAPHIC AREAS (Dollars in Millions) SALES BY SEGMENT OF BUSINESS (1) Fiscal Quarters Ended July 2, July 3, Percent 2006 2005 Change Consumer U.S. $1,103 $1,092 1.0% International 1,295 1,186 9.2 2,398 2,278 5.3 Pharmaceutical U.S. 3,682 3,595 2.4 International 2,128 2,033 4.7 5,810 5,628 3.2 Medical Devices & Diagnostics U.S. 2,590 2,378 8.9 International 2,565 2,478 3.5 5,155 4,856 6.2 U.S. 7,375 7,065 4.4 International 5,988 5,697 5.1 Worldwide $13,363 $12,762 4.7% Fiscal Six Months Ended July 2, July 3, Percent 2006 2005 Change Consumer U.S. $2,253 $2,206 2.1% International 2,500 2,352 6.3 4,753 4,558 4.3 Pharmaceutical U.S. 7,383 7,378 0.1 International 4,053 4,005 1.2 11,436 11,383 0.5 Medical Devices & Diagnostics U.S. 5,110 4,739 7.8 International 5,056 4,914 2.9 10,166 9,653 5.3 U.S. 14,746 14,323 3.0 International 11,609 11,271 3.0 Worldwide $26,355 $25,594 3.0% (1) Export and intersegment sales are not significant. OPERATING PROFIT BY SEGMENT OF BUSINESS (Dollars in Millions) Fiscal Quarters Ended July 2, July 3, Percent 2006 2005 Change Consumer $439 $399 10.0% Pharmaceutical(1) 1,697 1,524 11.4 Medical Devices & Diagnostics (2) 1,435 1,364 5.2 Segments total 3,571 3,287 8.6 Income/(expense) not allocated to segments 32 (21) Worldwide total $3,603 $3,266 10.3% Fiscal Six Months Ended July 2, July 3, Percent 2006 2005 Change Consumer $904 $837 8.0% Pharmaceutical(1) 3,624 3,600 0.7 Medical Devices & Diagnostics(3) 3,595 2,812 27.8 Segments total 8,123 7,249 12.1 Income/(expense) not allocated to segments 95 (56) Worldwide total $8,218 $7,193 14.2% (1) Includes $302 million of IPR&D charges related to acquisitions completed in the fiscal second quarter of 2005. (2) Includes $87 million and $51 million of IPR&D charges related to acquisitions completed in the fiscal second quarter of 2006 and fiscal

second quarter of 2005, respectively. (3) Includes $124 million and $51 million of IPR&D charges related to acquisitions completed in the first fiscal six months of 2006 and first fiscal six months of 2005, respectively. The first fiscal six months of 2006 also includes the gain associated with the Guidant termination fee, less associated expenses, of $622 million before tax. Excluding the Guidant termination fee operating profit growth for the first fiscal six months of 2006 versus the same period last year was 5.7%. SALES BY GEOGRAPHIC AREA (Dollars in Millions) Fiscal Quarters Ended July 2, July 3, Percent 2006 2005 Change U.S. $7,375 $7,065 4.4% Europe 3,295 3,186 3.4 Western Hemisphere, excluding U.S. 876 751 16.6 Asia-Pacific, 1,817 1,760 3.2 Africa Total $13,363 $12,762 4.7% Fiscal Six Months Ended July 2, July 3, Percent 2006 2005 Change U.S. $14,746 $14,323 3.0% Europe 6,366 6,362 0.1 Western Hemisphere, excluding U.S. 1,698 1,477 15.0 Asia-Pacific, 3,545 3,432 3.3 Africa Total $26,355 $25,594 3.0% 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 second quarters ended July 2, 2006 and July 3, 2005. (Shares in Millions) Fiscal Quarters Ended July 2, July 3, 2006 2005 Basic net earnings per share $0.96 $0.87 Average shares outstanding - basic 2,954.0 2,973.7 Potential shares exercisable under stock option plans 227.5 260.2 Less: shares which could be repurchased under treasury stock method (211.0) (216.6) Convertible debt shares 3.9 7.4 Adjusted average shares outstanding - diluted 2,974.4 3,024.7 Diluted earnings per share $0.95 $0.86 The diluted earnings per share calculation included the dilutive effect of convertible debt that was offset by the related reduction in interest expense of $1 million and $3 million for the fiscal second quarters ended July 2, 2006 and July 3, 2005, respectively. The diluted earnings per share calculation excluded 45 million and 0.4 million shares related to options for the fiscal second quarters ended July 2, 2006 and July 3, 2005, 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 six months ended July 2, 2006 and July 3, 2005. (Shares in Millions) Fiscal Six Months Ended July 2, July 3, 2006 2005 Basic net earnings per share $2.07 $1.83 Average shares outstanding - basic 2,963.0 2,973.0 Potential shares exercisable under stock option plans 227.4 214.3 Less: shares which could be repurchased under treasury stock method (211.8) (172.9) Convertible debt shares 3.9 7.4 Average shares outstanding - diluted 2,982.5 3,021.8 Diluted earnings per share $2.05 $1.80 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 and $7 million for the first fiscal six months ended July 2, 2006 and July 3, 2005, respectively. The diluted earnings per share calculation excluded 45 million and 46 million shares related to options for the first fiscal six months ended July 2, 2006 and July 3, 2005, 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. NOTE 8 - ACCUMULATED OTHER COMPREHENSIVE INCOME The total comprehensive income for the first fiscal six months ended July 2, 2006 was $6.3 billion, compared with $5.1 billion for the same period a year ago. The total comprehensive income for the fiscal second quarter ended July 2, 2006 was $2.9 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 securities available for sale 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. (Dollars in Millions) Total Unrld Gains/ Accum For. Gains/ Pens (Losses) Other Cur. (Losses) Liab on Deriv Comp Trans. on Sec Adj. & Hedg Inc/ (Loss) January 1, 2006 $(520) 70 (320) 15 (755) 2006 six months changes: Net change associated with current period hedging transactions - - - 7 Net amount reclassed to net earnings - - - (24)* Net six months changes 246 (24) - (17) 205 July 2, 2006 $(274) 46 (320) (2) (550) 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 June 25, 2006 the Company entered into a definitive agreement to acquire the Consumer Healthcare business of Pfizer Inc. for a purchase price of $16.6 billion in cash. The transaction is expected to close by the end of 2006 and is subject to customary clearances, including the Hart-Scott-Rodino Antitrust Improvements Act and European Union merger control regulation. During the fiscal second quarter of 2006, the following companies were acquired: Vascular Control Systems, Inc., a privately held company focused on developing medical devices to treat fibroids and to control bleeding in obstetric and gynecologic applications and Groupe Vendome S.A., a privately held French marketer of adult and baby skin care products. During the fiscal first quarter of 2006, the following companies were acquired: Animas Corporation, a leading maker of insulin infusion pumps and related products; Hand Innovations LLC, a privately held manufacturer of fracture fixation products for the upper extremities; and Future Medical Systems S.A., a privately held company that primarily develops, manufactures and markets arthroscopic fluid management systems. On January 25, 2006 the definitive agreement to acquire Guidant Corporation was terminated by Guidant in accordance with its terms. Pursuant to the terms of the agreement, Guidant paid the Company a fee of $705 million. The Company recorded a gain associated with the Guidant termination fee, less associated expenses, of $622 million before tax in other income during the fiscal first quarter of 2006. The 2005 acquisitions included: TransForm Pharmaceuticals, Inc., a company specializing in the discovery of superior formulations and novel crystalline forms of drug molecules; Closure Medical Corporation, a company with expertise and intellectual property in the biosurgicals market; Peninsula Pharmaceuticals, Inc., a biopharmaceutical company focused on developing and commercializing antibiotics to treat life-threatening infections; and rights to all consumer and professionally dispensed REMBRANDT(R) Brand of oral care products, such as whitening toothpastes, strips, systems and mouth rinses. NOTE 10 - SHARE BASED COMPENSATION At July 2, 2006, the Company had 16 share based compensation plans. The shares outstanding are for contracts under the Company's 1995 and 2000 Stock Option Plans, the 2005 Long Term Incentive Plan, the 1997 Non-Employee Director's Plan and the Centocor, Innovasive Devices, ALZA, Inverness and Scios Stock Option Plans. During 2006, no options were granted under any of these plans except the 2005 Long Term Incentive Plan. The compensation cost that has been charged against income for these plans was $187 million for the fiscal second quarter of 2006 and $136 million for the fiscal second quarter of 2005. The total income tax benefit recognized in the income statement for share based compensation arrangements was $65 million and $48 million for the fiscal second quarters of 2006 and 2005, respectively. The compensation cost that has been charged against income for these plans was $340 million for the first fiscal six months of 2006 and $271 million for the first fiscal six months of 2005. The total income tax benefit recognized in the income statement for share based compensation arrangements was $119 million and $95 million for the first fiscal six months of 2006 and 2005, respectively. Share based compensation costs capitalized as part of inventory were insignificant in all periods. Stock options expire 10 years from the date they are granted and vest over periods that range from one to five years. All options are granted at current market price on the date of grant. Under the 2005 Long Term Incentive Plan, the Company may issue up to 260 million shares of common stock. Shares available for future grants under

the 2005 Long Term Incentive Plan were 223.4 million at July 2, 2006. The Company settles employee stock option exercises with treasury shares. Treasury shares are replenished throughout the year for the number of shares used to settle employee stock option exercises. The fair value of each option award is estimated on the date of grant using the Black Scholes option valuation model that uses the assumptions noted in the following table. Starting in 2006, expected volatility represents a blended rate of 4-year daily historical average volatility rate, and 5-week average implied volatility rate based on at-the-money traded Johnson & Johnson options, with a life of 2 years. Prior to 2006, expected volatility was based on 5-year weekly historical volatility rate. Historical data is used to determine the expected life of the option. The risk- free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The weighted average fair value of options granted was $12.22 for fiscal year to date 2006, $15.48 in 2005, and $13.11 in 2004. The fair value was estimated based on the weighted average assumptions of: Fiscal YTD Fiscal Year Fiscal Year 2006 2005 2004 Risk Free Rate 4.60% 3.72% 3.15% Expected Volatility 19.6% 25.0% 27.0% Expected Life 6 yrs 5 yrs 5 yrs Dividend Yield 2.50% 1.93% 1.76% A summary of option activity under the Plan as of January 2, 2006, and changes during the year then ended is presented below. Weighted Weighted Avg Aggregate Average Remaining Intrinsic Shares Exercise Contractual Value (000's) Price Term (000's) Outstanding at January 2, 2006 248,542 $53.05 Options granted 28,895 $58.37 Options exercised (8,054) $41.48 Options canceled/forfeited (4,152) $58.98 Outstanding at July 2, 2006 265,231 $53.89 6.28 $1,877,175 Exercisable at July 2, 2006 148,859 $49.39 $1,567,740 The total intrinsic value of options exercised during 2006 was $148.9 million. As of July 2, 2006, the total unrecognized compensation cost was $964.5 million, which has a weighted average period of 1.41 years to be recognized. During 2006, the Company granted 7.3 million shares of Restricted Stock Units, at an average fair value of $54.15, using the fair market value at the date of grant. The fair value of Restricted Stock Units is discounted for dividends, which are not paid on Restricted Stock Units during the vesting period. The outstanding shares of Restricted Stock Units as of July 2, 2006 were 7.2 million. The fair value of Restricted Stock Units vested during the fiscal year-to-date 2006 was $1.7 million. The Company settles employee stock issuances with treasury shares. Treasury shares are replenished throughout the year for the number of shares used for employee stock issuances. As previously discussed, the Company elected to adopt SFAS 123(R) under the modified retrospective application method. The Company believes that the modified retrospective application of this standard achieves the highest level of clarity and comparability among the presented periods. Accordingly, financial statement amounts for the prior period presented in this Form 10-Q have been restated to reflect the fair value method of expensing prescribed by SFAS 123(R). The Company has filed a Current Report on Form 8-K on April 17, 2006 with restated data to reflect the modified retrospective application. The following table details the retroactive application impact of SFAS 123(R) on previously reported results. (Dollars in millions, except per share amounts) As Previously For the quarter ended July 3, 2005 Restated Reported Earnings before provision for taxes on income $ 3,266 $ 3,402 Net earnings 2,588 2,676 Basic net earnings per share 0.87 0.90 Diluted net earnings per share 0.86 0.89 For the six months ended July 3, 2005: Earnings before provision for taxes on income $ 7,193 $ 7,464 Net earnings 5,427 5,603 Basic net earnings per share 1.83 1.88 Diluted net earnings per share 1.80 1.86 Net cash flows from operating activities 4,649 4,687 Net cash used by financing activities $(2,341) $(2,379) 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 second quarters of 2006 and 2005 include the following components: (Dollars in Millions) Retirement Plans Other Benefit Plans July 2, July 3, July 2, July 3, 2006 2005 2006 2005 Service cost $ 136 $106 $19 $15 Interest cost 144 128 26 18 Expected return on plan assets (177) (159) (1) (1) Amortization of prior service cost 3 3 (1) (2) Amortization of net transition asset - - - - Recognized actuarial losses 64 54 10 2 Net periodic benefit cost $ 170 $132 $53 $32 Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the first fiscal six months of 2006 and 2005 include the following components: (Dollars in Millions) Retirement Plans Other Benefit Plans July 2, July 3, July 2, July 3, 2006 2005 2006 2005 Service cost $ 262 $216 $37 $28 Interest cost 284 246 52 44 Expected return on plan assets (350) (291) (2) (2) Amortization of prior service cost 6 6 (3) (3) Amortization of net transition asset - (1) - - Recognized actuarial losses 127 111 20 13 Net periodic benefit cost $ 329 $287 $104 $80 Company Contributions For the fiscal six months ended July 2, 2006, the Company contributed $11 million and $13 million to its U.S. and international retirement plans, respectively. The Company does not anticipate a minimum statutory funding requirement for its U.S. retirement plans in 2006. 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 and, where available, by third-party product liability insurance. One group of cases against the Company concerns a product of the Company's subsidiary, Janssen Pharmaceutica Inc. (Janssen), PROPULSID(R) (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(R) in state and federal courts across the country. In February 2004, Janssen reached an agreement with the Plaintiffs' Steering Committee (PSC) of the PROPULSID(R) Federal Multi-District Litigation (MDL), to resolve federal lawsuits related to PROPULSID(R). 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. In March 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. Those participating in the settlement submit medical records to an independent panel of physicians who determine whether the claimed injuries were caused by PROPULSID(R) and otherwise meet the standards for compensation. If those standards are met, a court- appointed special master determines compensatory damages. Janssen has paid into a compensation escrow account $77.6 million, 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. No additional funds will be contributed to the first settlement program. In December 2005, Janssen reached agreement with the MDL PSC and the plaintiffs' State Liaison Committee (SLC) to create a second settlement program for resolving the state and federal lawsuits not subject to, or not participating in, the first settlement program, as well as the remaining unfiled claims subject to tolling agreements. The new program becomes effective once 90% of the plaintiffs representing decedents, 95% of the other plaintiffs and 5,000 of the remaining tolled claims, agree to the terms of the settlement. Janssen will pay as compensation a minimum of $14.5 million and a maximum of $15 million into the second settlement program, depending upon the percentage of enrollment above the 90% and 95% thresholds. Janssen will also establish an administrative fund not to

exceed $3 million and pay legal fees not to exceed $4 million subject to court approval. Funds remaining in the compensation account, after resolution of all filed claims, will be returned to Janssen and the Company. 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 raised certain defenses to their liability under the policies and to date have declined voluntarily to reimburse Janssen and the Company for PROPULSID(R)-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(R)-related costs. That proceeding was resolved in a fashion satisfactory to Janssen and the Company in November 2005. In May 2005, the Company commenced arbitration against Lexington Insurance Company, which issued the second layer of excess insurance coverage and, in March 2006, against SR International Business Insurance Co., LTD., which issued the third. In the opinion of the Company, the excess carriers remain legally obligated to provide coverage for the PROPULSID(R)- related losses at issue. A number of other products of Johnson & Johnson subsidiaries are subject to numerous product liability claims and lawsuits, including ORTHO EVRA(R), RISPERDAL(R) and DURAGESIC(R). There are approximately 500 claimants who have filed lawsuits or made claims regarding injuries allegedly due to ORTHO EVRA(R), 300 claimants with respect to RISPERDAL(R) and 100 with respect to DURAGESIC(R). These claimants seek substantial compensatory and, where available, punitive damages. The Johnson & Johnson subsidiary responsible for marketing the product at issue is vigorously defending against these claims. 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. In December 2000, the jury in the damage action against Boston Scientific returned a verdict of $324 million and the jury in the Medtronic action returned a verdict of $271 million. These sums represent lost profit and reasonable royalty damages to compensate Cordis for infringement but do not include pre or post judgment interest. In March and May 2002, the district judge granted Boston Scientific a new trial on liability and damages and vacated the verdict against Medtronic on legal grounds. In August 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. In March 2006, the district judge entered judgment on liability for Cordis, but deferred deciding on damages pending appeal to the Court of Appeals for the Federal Circuit. Those appeals will now follow. Cordis also has an arbitration claim against Medtronic AVE accusing Medtronic of infringement by sale of stent products introduced by Medtronic subsequent to its GFX(R) and MicroStent(R) products, the subject of the earlier action referenced above. Those products were found to have been licensed pursuant to a 1997 license by an arbitration panel in March 2005. Further arbitration proceedings will determine whether royalties are owed for those products. In January 2003, Cordis filed a patent infringement action against Boston Scientific in Delaware Federal District Court accusing its Express2(TM),Taxus(R) and Liberte(R) stents of infringing the Palmaz patent that expired in November 2005. The Liberte(R) stent was also accused of infringing Cordis' Gray patent that expires in 2016. In June 2005, a jury found that the Express2(TM), Taxus(R) and Liberte(R) stents infringed the Palmaz patent and that the Liberte(R) stent also infringed the Gray patent. Motions filed by Boston Scientific seeking to vacate the verdict or obtain a new trial were denied in June 2006. Appeals to the U.S. Court of Appeals for the Federal Circuit will now proceed. 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. In July 2005, a jury in Federal District Court in Delaware found that the Cordis CYPHER(R) stent infringed Boston Scientific's Ding `536 patent and that the Cordis CYPHER(R) and BX VELOCITY(R) stents also infringed Boston Scientific's Jang `021 patent. The jury also found both of those patents valid. Boston Scientific seeks substantial damages and an injunction in that action. In June 2006, the District Court denied motions by Cordis to overturn the jury verdicts or grant a new trial. Cordis will appeal the jury verdicts to the Court of Appeals for the Federal Circuit. Trial of Boston Scientific's case asserting infringement by the CYPHER(R) stent of another Boston Scientific patent, which had been scheduled for trial in March 2006, has been adjourned without a new date. In that case as well, Boston Scientific seeks an injunction and substantial damages. In an action filed in Belgium by Boston Scientific under its Kastenhofer patent, Boston Scientific is seeking a pan-European injunction against the sale of infringing catheters, i.e., an injunction that would be effective in all of the countries served by the European Patent Office. Trial has not been scheduled but could occur during 2006. In Germany, Boston Scientific has several actions based on Ding patents pending against the Cordis CYPHER(R) stent. No trial has been scheduled in those cases. The following chart summarizes various patent lawsuits concerning products of Johnson & Johnson subsidiaries. J&J Plaintiff/ Product Company Patents Patent Holder Court Trial Date Filed Drug Eluting Cordis Grainger Boston Scientific D. Del. * 12/03 Stents Corp. Drug Eluting Cordis Ding Boston Scientific Germany * 04/04 Stents Corp. 11/04 Two-layer Cordis Kasten- Boston Scientific N.D. Cal * 02/02 Catheters hofer Corp. Belgium * 12/03 Forman Stents Cordis Israel Medinol Multiple E.U. * 05/03 jurisdictions Contact Lenses Vision Nicolson CIBA Vision M.D. Fla. * 09/03 Care * Trial date to be established. 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 following chart, 30-month stays have or are scheduled to expire during 2006 with respect to ANDA challenges regarding ORTHO TRI-CYCLEN(R) LO, RISPERDAL(R) and TOPAMAX(R). Trial did not occur before the expiration of the stays with respect to ORTHO TRI-CYCLEN(R) LO and RISPERDAL(R), but could occur in the case of TOPAMAX(R). Unless 30-month stays are extended or preliminary injunctions granted, outcomes which are uncertain, final FDA approval to market will usually 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 Trial Date 30-Month Product Holder Challenger Court Date Filed Stay Expires ACIPHEX(R) 20 Eisai Teva S.D.N.Y. * 11/03 02/07 mg delay (for Janssen) Dr. Reddy's S.D.N.Y. * 11/03 02/07 release tablet Mylan S.D.N.Y. * 01/04 02/07 AXERT(R) 6.25 Almirall Teva S.D.N.Y. * 03/06 11/08 and 12.5 mg Ortho-McNeil Neurologics CONCERTA(R) McNeil-PPC Impax D.Del. * 09/05 None 18,27,36 and 54 mg ALZA Andrx controlled release tablet DITROPAN XL(R) Ortho-McNeil Mylan D.W.V. 02/05 05/03 09/05 5, 10, 15 mg ALZA Impax N.D.Cal. 12/05 09/03 01/06 controlled release tablet LEVAQUIN(R) Injectable Daiichi,JJPRD Sicor(Teva) D.N.J. * 12/03 05/06 Single use vials Ortho-McNeil and 5 mg/ml premix LEVAQUIN(R) Injectable Daiichi,JJPRD American D.N.J. * 12/03 05/06 Single use vials Ortho-McNeil Pharmaceutical Partners QUIXIN(R) Ophthalmic Daiichi, Hi-Tech D.N.J. * 12/03 05/06 Solution (Levo- floxacin) Ortho-McNeil Pharmacal Ophthalmic solution ORTHO TRI CYCLEN(R) LO Ortho-McNeil Barr D.N.J. * 10/03 02/06 0.18 mg/ 0.025 mg 0.215 mg/ 0.025 mg and 0.25 mg/ 0.025 mg PEPCID(R) Complete McNeil-PPC Perrigo S.D.N.Y. 10/06 02/05 06/07 RAZADYNE(TM) Janssen Teva D. Del 06/07 07/05 01/08 Mylan D. Del 06/07 07/05 01/08 Dr. Reddy's D. Del 06/07 07/05 01/08 Purepac D. Del 06/07 07/05 01/08 Barr D. Del 06/07 07/05 01/08 Par D. Del 06/07 07/05 01/08 AlphaPharm D. Del 06/07 07/05 01/08 RAZADYNE(TM) ER Janssen Barr D.N.J. * 06/06 11/08 RISPERDAL(R) Tablets Janssen Mylan D.N.J. 06/06 12/03 05/06 .25, 0.5, 1, 2, 3, 4 Dr. Reddy's D.N.J. 06/06 12/03 06/06 mg tablets Apotex D.N.J. * 06/06 11/08 RISPERDAL(R) M-Tab Janssen Dr. Reddy's D.N.J. 06/06 02/05 07/07 0.5,1,2,3, 4 mg Barr D.N.J. * 10/05 02/08 RISPERDAL(R) Oral Janssen Apotex D.N.J. * 03/06 08/08 Solution, 1 mg/ml TOPAMAX(R) Ortho-McNeil Mylan D.N.J. * 04/04 09/06 25,50,100, 200 mg tablet Cobalt D.N.J. * 10/05 03/08 TOPAMAX(R) SPRINKLE Ortho-McNeil Cobalt D.N.J. * 12/05 05/08 25,50 mg capsule ULTRACET(R) Ortho-McNeil Kali (Par) D.N.J. * 11/02 04/05 37.5 tram/ Teva D.N.J. * 02/04 07/06 325 apap tablet Caraco E.D. Mich * 09/04 * * Trial date to be established In the action against Mylan and Dr. Reddy's Laboratories regarding RISPERDAL(R) tablets, trial on the merits was heard by the district court in New Jersey between June 28 and July 5, 2006. At the court's direction, defendants have agreed not to launch pending the court's decision which is expected in the fourth quarter of 2006. In the action against Mylan involving the Company's subsidiary Ortho-McNeil Pharmaceutical, Inc.'s (Ortho- McNeil) product, DITROPAN XL(R) (oxybutynin chloride), the court in September 2005 found the DITROPAN XL(R) patent invalid and not infringed by Mylan's ANDA product. Ortho-McNeil and ALZA Corporation (ALZA), a subsidiary of the Company, have appealed. In the action against Impax, Impax also received judgment of invalidity based on the decision in the Mylan suit and Ortho-McNeil and ALZA have appealed that decision. Both appeals have been consolidated. Neither Mylan nor Impax has received final FDA approval to launch its ANDA product, but such approval could come at any point. In December 2005, Mylan announced that it had entered into two agreements with Ortho-McNeil regarding oxybutynin chloride extended release tablets. One agreement relates to Ortho-McNeil's supply of certain dosages of oxybutynin chloride extended release tablets and the second relates to a patent license to ALZA intellectual property regarding DITROPAN XL(R). These agreements, which are confidential, have been submitted to the Federal Trade Commission. In the weeks following the adverse ruling in the DITROPAN XL(R) ANDA litigation against Mylan in September 2005, Ortho-McNeil and ALZA received seven antitrust class action complaints filed by purchasers of the product. The complaints were filed in various federal courts, but all claim damages based on the laws of over 25 states. They allege that Ortho-McNeil and ALZA violated the antitrust laws of the various states by knowingly pursuing baseless patent litigation, and thereby delaying entry into the market by Mylan and Impax. In the action against Mylan involving its ANDA for Ortho- McNeil's product LEVAQUIN(R) (levofloxacin), the trial judge in December 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. In December 2005, the Court of Appeals for the Federal Circuit affirmed the judgment of validity, enforceability and infringement. Mylan filed a motion for rehearing by the Court of Appeals, which has been denied. In the consolidated actions against Teva, Sicor, Hi- Tech Pharmacal, and American Pharmaceutical Partners involving the ANDAs for various levofloxacin preparations, summary judgment was granted for Ortho- McNeil and ALZA in March 2006 on the claim that the LEVAQUIN(R) patent was obtained by inequitable conduct and was therefore unenforceable. In the action against Mylan involving Ortho-McNeil's TOPAMAX(R) tablets, Ortho-McNeil has moved for a preliminary injunction to prevent launch of Mylan's generic copy upon expiration of the 30-month stay in September 2006. Mylan has agreed not to launch pending outcome of the motion. In the action against Kali involving Ortho-McNeil's ULTRACETr (tramadol hydrochloride/acetaminophen), Kali moved for summary judgment on the issues of infringement and invalidity 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. That patent issued August 1, 2006. Kali obtained final approval of its ANDA at expiration of the 30-month stay in April 2005, and launched its generic product the same day. If Ortho- McNeil ultimately prevails in its patent infringement action against Kali, Kali could be subject to an injunction and damages. In the action against Teva Pharmaceuticals USA (Teva) involving Ortho-McNeil's ULTRACET(R)(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. A ruling could issue at any point. Barr Laboratories has been joined in the suit as a codefendant as the successor to Teva's ANDA. In the action against Caraco involving Ortho-McNeil's ULTRACET(R) (tramadol hydrocholoride/acetaminophen), Caraco's motion for summary judgment of non- infringement was granted in October 2005. Ortho-McNeil has appealed that decision. Caraco launched its generic ULTRACET(R) "at risk" in December 2005. 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. 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 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. The Court of Appeals declined to allow an appeal of those issues and in January 2006, the court certified the national class as noted above. A trial of some or all of the issues in the Massachusetts or the national class actions could occur before the end of 2006. OTHER In June 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 REMICADEr (infliximab), marketed by the Company's Centocor, Inc. (Centocor) subsidiary. In July 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 in the process of responding, to these requests for documents and information. In December 2003, Ortho-McNeil received a subpoena from the U.S. Attorney's Office in Boston, Massachusetts seeking documents relating to the marketing, including alleged off-label marketing, of the drug TOPAMAX(R) (topiramate). An additional subpoena for documents was served in June 2006. Ortho-McNeil is cooperating in responding to the subpoenas. 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 federal grand jury in Boston. Cooperation in securing the testimony of additional witnesses before the grand jury has been requested and is being provided. In January 2004, Janssen received a subpoena from the Office of the Inspector General of the U.S. 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(R) (risperidone) from 1997 to 2002. Documents subsequent to 2002 have also been requested. An additional subpoena seeking information about marketing of and adverse reactions to RISPERDAL(R) was received from the U.S. Attorney's Office for the Eastern District of Pennsylvania in November 2005. Janssen is cooperating in responding to these subpoenas. 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. In August 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 relating to the relationships between the group purchasing organization Novation and HCS and other Johnson & Johnson subsidiaries. The Company's subsidiaries involved have responded to the subpoena. In September 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(R) (Epoetin alfa) from 1997 to the present, as well as to dealings with U.S. Oncology Inc., a healthcare services network for oncologists. Ortho Biotech has responded to the subpoena. In March 2005, DePuy Orthopaedics, Inc. (DePuy Orthopaedics), 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 Orthopaedics 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 Orthopaedics is responding to the subpoena. In June 2005, the U.S. Senate Committee on Finance requested the Company to produce information regarding use by its pharmaceutical subsidiaries of educational grants. A similar request was sent to other major pharmaceutical companies. In July 2005, the Committee specifically requested information about educational grants in connection with the drug PROPULSID(R). A follow up request was received from the Committee for additional information in January 2006. In July 2005, Scios Inc. (Scios), a Johnson & Johnson subsidiary, received a subpoena from the U.S. Attorney's Office, District of Massachusetts, seeking documents related to the sales and marketing of NATRECOR(R). Scios is responding to the subpoena. In early August 2005, Scios was advised that the investigation would be handled by the U.S. Attorney's Office for the Northern District of California in San Francisco. In September 2005, Johnson & Johnson received a subpoena from the U.S. 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 January 2006, Janssen received a civil investigative demand from the Texas Attorney General seeking broad categories of documents related to sales and marketing of RISPERDAL(R). Janssen is in the process of responding to the request. In February 2006, Johnson & Johnson received a subpoena from the Securities & Exchange Commission requesting documents relating to the participation by several Johnson & Johnson subsidiaries in the United Nations Iraq Oil For Food Program. The subsidiaries are cooperating with the SEC in producing responsive documents. In June 2006, DePuy, Inc. (DePuy), a Johnson & Johnson subsidiary, received a subpoena from the U.S. Department of Justice, Antitrust Division, requesting documents related to the manufacture and sale of orthopaedic devices, and had search warrants executed in connection with the investigation. DePuy is cooperating in responding to the request for documents. 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 U.S., 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. 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-Surgery 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. These actions are: Applied Medical v. Ethicon Inc. et al. (C.D.CA, filed September 5, 2003); Conmed v. Johnson & Johnson et al. (S.D.N.Y., filed November 6, 2003); and Genico v. Ethicon, Inc. et al. (E.D. TX, filed October 15, 2004). Trial in the Applied Medical case commenced July 11, 2006 and is expected to last five weeks. In December 2005, two purported class actions were filed on behalf of purchasers of endo-mechanical instruments. These actions, captioned Delaware Valley Surgical Supply Co., Inc. v. Johnson & Johnson et al. and Niagara Falls Memorial Medical Center v. Johnson & Johnson et al., were both filed in the Federal District Court for the Central District of California. 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, Inc. (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 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. The Court of Appeals for the Federal Circuit affirmed in part those rulings in August 2006, finding certain claims infringed, but reversing and remanding as to other claims. The Amgen patents at issue in the case are exclusively licensed to Ortho Biotech in the U.S. for non-dialysis indications. Ortho Biotech is not a party to the action. In November 2005, Amgen filed suit against Hoffmann- LaRoche, Inc. in the U.S. District Court for the District of Massachusetts seeking a declaration that the Roche product CERA, which Roche has indicated it will seek to introduce into the United States, infringes a number of Amgen patents concerning EPO. Ortho Biotech has sought to intervene in the case. The suit is in its preliminary stages. The Company is also involved in a number of other patent, trademark and other lawsuits incidental to its business. The 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. 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 six months of 2006, worldwide sales were $26.4 billion, a total increase of 3.0% and an operational increase of 4.2% over 2005 first fiscal six months sales of $25.6 billion. Currency fluctuations negatively impacted sales by 1.2% for the period. Sales by U.S. companies were $14.7 billion in the first fiscal six months of 2006, which represented an increase of 3.0% over the same period last year. Sales by international companies were $11.6 billion, which represented a total increase of 3.0%, an operational increase of 5.7%, and a negative impact from currency of 2.7% over the first fiscal six months of 2005. Sales by companies in Europe experienced an increase of 0.1%, with operational growth of 4.8% and a negative impact from currency of 4.7%. Sales by companies in the Western Hemisphere, excluding the U.S., experienced total growth of 15.0%, operational growth of 7.5% and a positive impact from currency of 7.5%. Sales by companies in the Asia-Pacific, Africa region posted sales growth of 3.3%, with operational growth of 6.7% and a negative impact from currency of 3.4%. For the fiscal second quarter of 2006, worldwide sales were $13.4 billion, a total increase of 4.7% and an operational increase of 4.8%, over 2005 fiscal second quarter sales of $12.8 billion. Currency fluctuations negatively impacted sales by 0.1% for the period. Sales by U.S. companies were $7.4 billion in the fiscal second quarter of 2006, which represented an increase of 4.4%. Sales by international companies were $6.0 billion, which represented a total increase of 5.1%, an operational increase of 5.2%, and a negative impact from currency of 0.1% over the fiscal second quarter of 2005. Sales by companies in Europe experienced a total increase of 3.4%, with operational growth of 4.3% and a negative impact from currency of 0.9%. Sales by companies in the Western Hemisphere, excluding the U.S., experienced total growth of 16.6%, operational growth of 9.4% and a positive impact from currency of 7.2%. Sales by companies in the Asia-Pacific, Africa region posted sales growth of 3.2%, with operational growth of 5.2% and a negative impact from currency of 2.0%. Analysis of Sales by Business Segments Consumer Consumer segment sales in the first fiscal six months of 2006 were $4.8 billion, an increase of 4.3% over the same period a year ago, with 4.5% of operational growth and a negative currency impact of 0.2%. U.S. Consumer segment sales increased by 2.1% while international sales experienced a total increase of 6.3%, an operational increase of 6.7%, with a negative currency impact of 0.4%. Major Consumer Franchise Sales (Dollars in Millions) First Fiscal Six Months July 2, July 3, Total Operations Currency 2006 2005 Change Change Change Skin Care $1,313 $1,223 7.4% 8.4% (1.0)% OTC Pharm & Nutr 1,286 1,313 (2.1) (2.1) - Baby & Kids Care 827 772 7.2 7.0 0.2 Women's Health 814 782 4.0 3.7 0.3 Other 513 468 9.6 9.8 (0.2) Total $4,753 $4,558 4.3% 4.5% (0.2)% Consumer segment sales in the fiscal second quarter of 2006 were $2.4 billion, an increase of 5.3% over the same period a year ago with 4.5% of operational growth and a positive currency impact of 0.8%. U.S. Consumer segment sales increased by 1.0% while international sales experienced a total increase of 9.2%, an operational increase of 7.7%, with a positive currency impact of 1.5%. Major Consumer Franchise Sales (Dollars in Millions) Fiscal Second Quarter July 2, July 3, Total Operations Currency 2006 2005 Change Change Change Skin Care $654 $602 8.6% 8.1% 0.5% OTC Pharm & Nutr 633 628 0.7 (0.2) 0.9 Baby & Kids Care 421 393 7.2 6.1 1.1 Women's Health 415 406 2.4 1.4 1.0 Other 275 249 10.4 10.0 0.4 Total $2,398 $2,278 5.3% 4.5% 0.8% Consumer segment sales growth in the fiscal second quarter of 2006 was attributable to strong sales performance in Skin Care and Baby & Kids Care. The Skin Care franchise operational sales growth of 8.1% was attributed to sales of products in the AVEENO(R), JOHNSON'S(R) adult, suncare, CLEAN AND CLEAR(R) lines and the newly acquired Groupe Vendome product line, partially offset by a sales decline in ROC(R) products. The OTC Pharmaceuticals and Nutritionals franchise experienced an operational decline of 0.2%, primarily due to a decline in demand for Adult TYLENOL(R) products, partially offset by strong growth from SPLENDAr No Calorie Sweeteners. The Baby & Kids Care franchise achieved operational sales growth of 6.1%, which resulted from continued success of cleanser, lotion and cream product lines in international markets, partially offset by declines in U.S. sales. BABYCENTER(R) revenue was also a growth contributor in this franchise. The Women's Health franchise achieved operational growth of 1.4% resulting from contributions from STAYFREE(R) product lines. Pharmaceutical Pharmaceutical segment sales in the first fiscal six months of 2006 were $11.4 billion, a total increase of 0.5% over the same period a year ago with 1.4% of this change due to operational increases and the remaining 0.9% decrease related to the negative impact of currency. The U.S. Pharmaceutical sales increase was 0.1% and the total growth in international Pharmaceutical sales was 1.2%, with 3.8% of this change due to operational increases and the remaining 2.6% decrease related to the negative impact of currency. Major Pharmaceutical Product Revenues (Dollars in Millions) First Fiscal Six Months July 2, July 3, Total Operations Currency 2006 2005 Change Change Change RISPERDAL(R)/ RISPERDAL(R) CONSTA(R) $2,055 $1,738 18.2% 20.3% (2.1)% PROCRIT(R)/ EPREX(R) 1,594 1,682 (5.2) (4.4) (0.8) REMICADE(R) 1,457 1,219 19.6 19.6 - TOPAMAX(R) 965 837 15.3 15.8 (0.5) LEVAQUIN(R)/ FLOXIN(R) 744 760 (2.1) (2.2) 0.1 DURAGESIC(R)/ Fentany Transdermal 661 832 (20.5) (18.6) (1.9) ACIPHEX(R)/ PARIET(TM) 614 559 9.9 11.0 (1.1) Hormonal Contraceptives 501 598 (16.2) (16.4) 0.2 Other 2,845 3,158 (9.9) (9.0) (0.9) Total $11,436 $11,383 0.5% 1.4% (0.9)% Pharmaceutical segment sales in the fiscal second quarter of 2006 were $5.8 billion, a total and operational increase of 3.2% over the same period a year ago, with a neutral year over year currency comparison. The U.S. Pharmaceutical sales increase was 2.4% and the growth in international Pharmaceutical sales was 4.7%, with no net impact from currency. Major Pharmaceutical Product Revenues (Dollars in Millions) Fiscal Second Quarter July 2, July 3, Total Operations Currency 2006 2005 Change Change Change RISPERDAL(R)/ RISPERDAL(R) CONSTRA(R) $1,036 $894 16.0% 16.6% (0.6)% PROCRIT(R)/ EPREX(R) 808 846 (4.5) (4.7) 0.2 REMICADE(R) 777 642 21.0 21.0 - TOPAMAX(R) 495 431 14.8 14.7 0.1 LEVAQUIN(R)/ FLOXIN(R) 343 320 7.2 7.2 - DURAGESIC(R)/

Fentanyl Transdermal 336 382 (12.0) (11.9) (0.1) ACIPHEX(R)/ PARIET(TM) 308 281 9.8 9.1 0.7 Hormonal Contraceptives 247 296 (16.4) (17.1) 0.7 Other 1,460 1,536 (4.9) (4.9) - Total $5,810 $5,628 3.2% 3.2% -% Sales growth within the segment was led by strong performances from RISPERDAL(R)/RISPERDAL(R) CONSTA(R) (risperidone), REMICADE(R) (infliximab) and TOPAMAX(R) (topiramate). Generic competition related to DURAGESIC(R) (fentanyl transdermal system), ULTRACET(R)(tramadol hydrochloride/acetaminophen), SPORANOX(R) (itraconazole) and hormonal contraceptives continued to negatively impact sales during the fiscal second quarter of 2006. RISPERDAL(R) (risperidone), a medication that treats the symptoms of schizophrenia and bipolar mania, and RISPERDALr CONSTAr (risperidone) long acting injection that treats the symptoms of schizophrenia, achieved operational growth of 16.6% in the fiscal second quarter of 2006. Sales growth was positively impacted by increases in the net pricing of RISPERDAL(R) and demand of RISPERDAL(R) CONSTA(R). PROCRIT(R) (Epoetin alfa) and EPREX(R) (Epoetin alfa) performance combined had an operational sales decline of 4.7%, as compared to prior year fiscal second quarter. PROCRITr experienced an operational decline of 7.4% due to competitive pressure, while EPREXr had operational growth of 0.7%. The approval of the once weekly administration for EPREX(R) in Europe contributed to stabilizing EPREX(R) sales. Although the EPREX(R) patent has expired in most major European markets, an erythropoietin biosimilar has not yet been approved. REMICADE(R) (infliximab), a biologic approved for the treatment of Crohn's disease, ankylosing spondylitis, psoriasis, psoriatic arthritis, ulcerative colitis and use in the treatment of rheumatoid arthritis, experienced strong operational growth of 21.0% over prior year fiscal second quarter. This continued growth was driven by increased demand due to expanded indications. During the fiscal second quarter of 2006, REMICADE(R) received approval for the pediatric Crohn's disease indications. TOPAMAX(R) (topiramate), which has been approved for adjunctive and monotherapy use in epilepsy, as well as, for the prophylactic treatment of migraines, experienced strong operational growth of 14.7%. LEVAQUIN(R) (levofloxacin) experienced operational sales growth of 7.2% over prior year, primarily due to increased volume. DURAGESIC(R)/Fentanyl Transdermal (fentanyl transdermal system) experienced an operational sales decline of 11.9%, primarily driven by the negative impact of generic competition in the U.S. beginning in January 2005. Additionally, generic versions of DURAGESIC(R) have been launched in Europe. The hormonal contraceptive franchise experienced an operational sales decline of 17.1% primarily resulting from generic competition in oral contraceptives. This was partially offset by strong growth in ORTHO TRI- CYCLEN(R) LO (norgestimate/ethinyl estradiol), a low dose oral contraceptive. ORTHO EVRA(R) (norelgestromin/ethinyl estradiol), the first contraceptive patch approved by the FDA, experienced a significant decline in sales as a result of labeling changes and negative media coverage concerning product safety. CONCERTA(R) (methylphenidate HCl), a product for the treatment of attention deficit hyperactivity disorder, achieved operational sales growth of 9.0% over the fiscal second quarter of 2005. 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. Recent negative publicity and FDA activities concerning attention deficit hyperactivity products may impact CONCERTA(R) sales in 2006. 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 past negative media coverage regarding a meta analysis of selected historical clinical trials. The Company believes that there is no new data supporting the conclusions of these medical and consumer publications and the currently approved label for NATRECOR(R) reflects all available data to date. On June 23, 2006 the FDA granted accelerated approval to the anti-HIV medication PREZISTAT (darunavir) tablets. PREZISTAT, co-administered with 100 mg ritonavir (PREZISTA/rtv) and with other antiretroviral agents, is indicated for the treatment of human immunodeficiency virus (HIV) infection in antiretroviral treatment-experienced adult patients, such as those with HIV-1 strains resistant to more than one protease inhibitor. Medical Devices and Diagnostics Medical Devices and Diagnostics segment sales in the first fiscal six months of 2006 were $10.2 billion, an increase of 5.3% over the same period a year ago, with 7.3% of this change due to operational increases and the remaining 2.0% decrease related to the negative impact of currency. The U.S. Medical Devices and Diagnostics sales increase was 7.8% and the growth in international Medical Devices and Diagnostics sales was 2.9%, which included operational increases of 6.8% and a decrease of 3.9% related to the negative impact of currency. Major Medical Devices and Diagnostics Franchise Sales (Dollars in Millions) First Fiscal Six Months July 2, July 3, Total Operations Currency 2006 2005 Change Change Change CORDIS(R) $2,143 $1,983 8.1% 10.4% (2.3)% DEPUY(R) 2,074 1,973 5.1 6.7 (1.6) ETHICON ENDO- SURGERY(R) 1,651 1,553 6.3 8.3 (2.0) ETHICON(R) 1,590 1,584 0.4 2.3 (1.9) LIFESCAN(R) 1,027 975 5.4 6.4 (1.0) Vision Care 915 833 9.9 13.3 (3.4) ORTHO-CLINICAL DIAGNOSTICS(R) 738 721 2.4 4.2 (1.8) Other 28 31 (9.7) (9.7) - Total $10,166 $9,653 5.3% 7.3% (2.0)% Medical Devices and Diagnostics segment sales in the fiscal second quarter of 2006 were $5.2 billion, an increase of 6.2% over the same period a year ago, with 6.7% of this change due to operational growth and the remaining 0.5% decrease related to the negative impact of currency. The U.S. Medical Devices and Diagnostics sales increase was 8.9% and the growth in international Medical Devices and Diagnostics sales was 3.5%, which included operational growth of 4.6% and a decrease of 1.1% related to the negative impact of currency. Major Medical Devices and Diagnostics Franchise SaleS (Dollars in Millions) Fiscal Second Quarter July 2, July 3, Total Operations Currency 2006 2005 Change Change Change CORDIS(R) $1,068 $1,014 5.4% 6.2% (0.8)% DEPUY(R) 1,035 980 5.6 5.9 (0.3) ETHICON ENDO- SURGERY(R) 857 786 9.0 9.5 (0.5) ETHICON(R) 816 797 2.4 2.7 (0.3) LIFESCAN(R) 522 474 10.3 10.0 0.3 Vision Care 474 426 11.5 13.4 (1.9) ORTHO-CLINICAL DIAGNOSTICS(R) 368 366 0.5 1.0 (0.5) Other 15 13 15.4 15.9 (0.5) Total $5,155 $4,856 6.2% 6.7% (0.5)% The Cordis franchise was a key contributor to the Medical Devices and Diagnostics segment results, with operational growth of 6.2% over the fiscal second quarter of 2005. The primary growth driver of the Cordis franchise was the CYPHER(R) Sirolimus-eluting Stent in both U.S. and international markets. Strong performance was also achieved by Biosense Webster and the endovascular business. In April and July of 2004, the Cordis Cardiology Division of Cordis Corporation received Warning Letters from the FDA regarding Good Manufacturing Practice regulations and Good Clinical Practice regulations. In response to the Warning Letters, Cordis has made improvements to its quality systems and has provided periodic updates to the FDA. The Clinical Warning Letter issues have been resolved to the FDA's satisfaction. With respect to the Quality System Warning Letter,in addition to the improvement updates, the Cordis Juarez and stent supplier locations were inspected with acceptable results. Cordis is preparing for third quarter re-inspections in the Miami Lakes and Puerto Rico locations and possible re-inspection of Warren. The DePuy franchise's operational growth of 5.9% was primarily due to DePuy's orthopaedic joint reconstruction products. Strong performance was reported in Mitek sports medicine products and the trauma business, with the combined impact of the Hand Innovations acquisition and strong growth in the base business. The Ethicon Endo-Surgery franchise experienced operational growth of 9.5% over prior year. A major contributor of growth continues to be endocutter sales, which include products used in performing bariatric procedures for the treatment of obesity, an important focus area for the franchise. Strong

results were achieved with the success of the HARMONIC SCALPEL(R), an ultrasonic cutting and coagulating surgical device, which received approval in January 2006 for expanded indications to include plastic surgery, as well as, continued growth in advanced sterilization products. Ethicon worldwide sales grew operationally by 2.7% from the same period in the prior year, resulting from solid growth in wound management and women's health and urology, partially offset by challenging conditions with several European health care systems. Sales of both GYNECARE products and DERMABOND(R) had strong results in the fiscal second quarter of 2006 as compared to the same period in the prior year. The LifeScan franchise experienced operational growth of 10.0%. Strong performance was achieved in the ONETOUCH(R) ULTRA(R) product line. An additional contributor was Animas Corporation, acquired in the fiscal first quarter of 2006, providing LifeScan with a platform for entry into the insulin pump segment of the diabetes market. The Vision Care franchise operational sales growth of 13.4% was led by the continued success of ACUVUE(R) ADVANCE(TM) Brand Contact Lenses with HYDRACLEAR(TM), ACUVUE(R) ADVANCE(TM) Brand Contact Lenses for ASTIGMATISM, ACUVUE(R) OASYS(TM) Brand Contact Lenses with HYDRACLEAR(TM) PLUS and 1-DAY ACUVUE(R). The Ortho-Clinical Diagnostics franchise achieved operational growth of 1.0% over prior year. Competitive pricing pressure was the major contributor to the modest results in the fiscal second quarter of 2006. Cost of Products Sold and Selling, Marketing and Administrative Expenses Consolidated costs of products sold for the first fiscal six months of 2006 increased to 28.1% from 27.4% of sales over the same period a year ago. The cost of products sold for the fiscal second quarter of 2006 increased to 28.3% from 27.6% of sales. The increase resulted from unfavorable product mix, primarily in the Pharmaceutical segment. Consolidated selling, marketing and administrative expenses for the first fiscal six months of 2006 increased 0.5% over the same period a year ago. Consolidated selling, marketing and administrative expenses as a percent to sales for the first fiscal six months of 2006 were 32.0% versus 32.8% for the same period a year ago. Consolidated selling, marketing and administrative expenses for the fiscal second quarter of 2006 increased 1.7% over the same period a year ago. As a percent to sales, consolidated selling, marketing and administrative expenses were 32.6% versus 33.5% for the same period a year ago. Decreases in the quarterly and six month periods were primarily associated with cost containment efforts across many of the Company's businesses. 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 six months of 2006 were $3.4 billion, an increase of 15.5% over the same period a year ago. Research and development spending in the fiscal second quarter of 2006 was $1.8 billion, an increase of 19.9% over the fiscal second quarter of 2005. The major factors contributing to this increase were the $165 million up front payment to Vertex Pharmaceuticals for the rights to develop and commercialize VX-950 for Hepatitis C in selected regions, as well as, higher levels of investment in research projects in the Medical Devices and Diagnostics segment and a significant number of pharmaceutical projects in late stage development. In-Process Research & Development(IPR&D) In the fiscal second quarter of 2006, the Company recorded IPR&D charges of $87 million before tax, with no tax benefit, related to the acquisition of Vascular Control Systems, Inc. In the fiscal second quarter of 2005, the Company recorded IPR&D charges of $353 million before tax, with no tax benefit, 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. Other (Income) Expense, Net Other (income) expense, net 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, gains and losses on the disposal of fixed assets, currency gains and losses, minority interests, litigation settlements, royalty income, as well as, certain miscellaneous one time events. The favorable change in other (income) expense for the first fiscal six months of 2006 of $695 million, as compared to the same period a year ago, was primarily due to the gain associated with the Guidant termination fee, less associated expenses, of $622 million before tax recorded in the fiscal first quarter of 2006. OPERATING PROFIT BY SEGMENT Consumer Segment Operating profit for the Consumer segment as a percent to sales in the first fiscal six months of 2006 was 19.0% versus 18.4% over the same period a year ago. Operating profit as a percent to sales in the fiscal second quarter of 2006 was 18.3% versus 17.5% over the same period a year ago. This increase was related to advertising and promotions spending in fiscal 2006 as compared to fiscal 2005. Pharmaceutical Segment Operating profit for the Pharmaceutical segment as a percent to sales in the first fiscal six months of 2006 was 31.7% versus 31.6% over the same period a year ago. Operating profit as a percent to sales in the fiscal second quarter of 2006 was 29.2% versus 27.1% over the same period a year ago. For both periods in 2006, operating profit was favorable, as compared to the same periods a year ago, due to the acquisition-related IPR&D charges incurred during the first fiscal six months of 2005 and the fiscal second quarter of 2005 of $302 million. However, this favorability was partially offset in both periods of 2006 by increased research and development spending, including the $165 million up front payment to Vertex Pharmaceuticals in the fiscal second quarter of 2006 for the rights to develop and commercialize VX-950 for Hepatitis C in selected regions. Medical Devices and Diagnostics Segment Operating profit for the Medical Devices and Diagnostics segment as a percent to sales in the first fiscal six months of 2006 was 35.4% versus 29.1% over the same period a year ago. Operating profit as a percent to sales in the fiscal second quarter of 2006 was 27.8% versus 28.1% over the same period a year ago. The primary driver of the improved operating profit in the Medical Devices and Diagnostics segment for the fiscal six months over the same period a year ago was the gain associated with the Guidant termination fee, less associated expenses, of $622 million before tax. Additionally, gross profit for the first fiscal six months of 2006 was enhanced by cost reduction programs, and favorable product mix, which offset increased research and development spending and IPR&D charges. Interest (Income) Expense Interest income increased in both the first fiscal six months and fiscal second quarter of 2006 as compared to the same periods a year ago. The increase reflected an improved cash position, as well as, higher rates of interest being earned on cash holdings. The cash balance including marketable securities at the end of the fiscal second quarter of 2006 was $14.7 billion, which was $1.6 billion higher than the same period a year ago. Interest expense decreased in both the first fiscal six months and fiscal second quarter of 2006 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 six months of 2006 and 2005 were 25.5% and 24.6%, respectively, an increase of 0.9% primarily due to the expiration of the U.S. research and development tax credit at the end of fiscal 2005, and the net effect of the following items. The tax rate for the first fiscal six months of 2006 benefited from a reversal of tax allowances of $134 million associated with the Tibotec business. This benefit was offset by acquisition-related IPR&D charges of $124 million, for which there was a minimal tax benefit. Additionally, the first fiscal six months of 2006 includes the gain associated with the Guidant termination fee, less associated expenses, of $622 million before tax recorded at a 40.8% tax rate. The first fiscal six months 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, in May 2005, as well as, the impact of

acquisition-related IPR&D charges of $353 million that are non-deductible for tax purposes. 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, and acquisitions. Other uses of cash included share repurchases, dividends and debt repayments. In the first fiscal six months of 2006, cash flow from operations was $5.8 billion, an increase of $1.2 billion over the same period a year ago. This was a result of growth in net income of $0.5 billion, net of the non-cash impact of IPR&D charges. This increase in net income includes the gain associated with the Guidant termination fee, less associated expenses, of $368 million after tax. A $0.9 increase in accounts payable and accrued liabilities was also a key driver of the increase in cash flow from operations. Net cash used by investing activities increased by $3.2 billion due to a $2.7 billion net decrease in sales of investments and a $0.5 billion increase in acquisition activity. Net cash used by financing activities increased by $2.6 billion due primarily to a $2.0 billion increase in the repurchase of common stock. During the first fiscal six months of 2006 $2.7 billion was utilized for the stock repurchase program. Cash and current marketable securities were $14.7 billion at the end of the fiscal second quarter of 2006 as compared with $16.1 billion at fiscal year end 2005. Dividends On April 27, 2006, the Board of Directors declared a regular cash dividend of $0.375 per share, payable on June 13, 2006 to shareholders of record as of May 30, 2006. This represented an increase of 13.6% in the quarterly dividend rate and was the 44th consecutive year of cash dividend increases. On July 17, 2006, the Board of Directors declared a regular cash dividend of $0.375 per share, payable on September 12, 2006 to shareholders of record as of August 29, 2006. The Company expects to continue the practice of paying regular cash dividends. OTHER INFORMATION New Accounting Standards In June 2006, the FASB issued FASB Interpretation 48 [FIN 48], Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification and other matters. FIN 48 is effective for the fiscal year 2007 and the Company plans to adopt the Interpretation at that time. The Company is currently evaluating the impact of the adoption of FIN 48 on its results of operations, cash flows and financial position. The Company implemented SFAS 123(R), Share Based Payment, in the fiscal first quarter of 2006. The Company applied the modified retrospective transition method to implement SFAS No. 123(R). Previously reported financial statements were restated to reflect SFAS No. 123 disclosure amounts. See Note 1 included in Item 1. Financial Statements (unaudited)- Notes to Consolidated Financial Statements. The Company implemented SFAS 151, Inventory Costs, an amendment of ARB No. 43 in the fiscal first quarter of 2006. The adoption of this statement did not have a material effect on the Company's results of operations, cash flows or financial position. 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 1995 through 2005 in 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 2005, 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 included in Item 1. Financial Statements (unaudited)- Notes to 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 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 1, 2006 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 1, 2006. Item 4 - CONTROLS AND PROCEDURES Disclosure controls and procedures. At the end of the period covered by this report, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The Company's disclosure controls and procedures are 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 recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. 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. 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, Item 1. Financial Statements (unaudited) - Notes to Consolidated Financial Statements. Item 1A - RISK FACTORS Not applicable. Item 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers. Common Stock purchases on the open market are made as part of a systematic plan to meet the Company's compensation programs. On March 8, 2006, the Company announced that its Board of Directors approved a stock repurchase program, authorizing the Company to buy back up to $5 billion of the Company's common stock. The program has no time limit and may be suspended for periods or discontinued. The following table provides information with respect to Common Stock purchases by the Company during the fiscal second quarter of 2006. Fiscal Month Total Average Total Number Remaining Number of Price of Shares Maximum Shares Paid per Purchased as Number of Purchased(1)Share Part of Shares that Publicly May Be Announced Purchased Plans or Under the Programs Plans or Programs (2) April 3, 2006 through April 30, 2006 12,209,400 $58.29 11,312,600 May 1, 2006 through May 28, 2006 14,487,200 $59.46 14,487,200 May 29, 2006 through July 2, 2006 16,368,000 $60.74 14,088,900 Total 43,064,600 39,888,700 38,723,685 (1) During the fiscal second quarter of 2006, the Company repurchased an aggregate of 39,888,700 shares of Johnson & Johnson Common Stock pursuant to the repurchase program that was publicly announced on March 8, 2006 and an aggregate of 3,175,900 shares in open- market transactions outside of the program. (2) As of July 2, 2006, based on the closing price of the Company's Common Stock on the New York Stock Exchange on June 30, 2006 of $59.92 per share. Item 4 - Submission of Matters to a Vote of Security Holders (a) The annual meeting of the shareholders of the Company was held on April 27, 2006. (b) Election of the directors is set forth in (c) below. (c) The shareholders elected all the Company's nominees for director and ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent registered accounting firm for the fiscal year 2006. The shareholders also approved of the amendments to the Restated Certificate of Incorporation, as proposed by management, and defeated the shareholder proposals on charitable contributions and majority voting requirements for director nominees. 1. Election of Directors: Shares For Shares Withheld M. S. Coleman 2,493,523,726 50,198,917 J. G. Cullen 2,472,303,251 71,419,392 R. J. Darretta 2,412,508,484 131,214,159 M. M. E. Johns 2,506,812,713 36,909,930 A. D. Jordan 2,477,391,237 66,331,406 A. G. Langbo 2,484,553,445 59,169,198 S. L. Lindquist 2,507,139,743 36,582,900 L. F. Mullin 2,490,905,545 52,817,098 C. A. Poon 2,479,441,418 64,281,225 C. Prince 2,406,966,830 136,755,813 S. S Reinemund 2,506,672,307 37,050,336 D. Satcher 2,506,540,877 37,181,766 W. C. Weldon 2,482,692,868 61,029,775 Abstain 35,576,608 Broker Non-vote - 2. Amendments to the Restated Certificate of Incorporation: For 2,496,705,505 Against 19,668,147 Abstain 27,348,991 Broker Non-vote - 3. Ratification of Appointment of PricewaterhouseCoopers LLP: For 2,465,908,496 Against 53,156,383 Abstain 24,657,764 Broker Non-vote - 4. Shareholder proposal on charitable contributions: For 113,838,488 Against 1,714,896,357 Abstain 169,068,896 5. Shareholder proposal on majority voting requirements for director nominees: For 762,845,143 Against 1,192,219,145 Abstain 42,739,453 Item 6 - EXHIBITS 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. 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: August 8, 2006 By _____ R. J. DARRETTA Vice Chairman, Board of Directors; Chief Financial Officer and Director (Principal Financial Officer) Date: August 8, 2006 By _____ S. J. COSGROVE Controller (Principal Accounting Officer)