JOHNSON & JOHNSON
Form 10-Q
November 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(X) Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended October 1, 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 incorporation or organization)	(I.R.S. Employer Identification No.)

One Johnson & Johnson Plaza
New Brunswick, New Jersey 08933
(Address of principal executive offices)

Registrant's telephone number, including area code
(732) 524-0400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. (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 October 29, 2006 2,899,355,180 shares of Common Stock, $1.00 par value, were outstanding.

JOHNSON & JOHNSON AND SUBSIDIARIES

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JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited; Dollars in Millions)

ASSETS

	October 1, 2006	January 1, 2006*
Current Assets:		
Cash & cash equivalents	$14,491	$16,055
Marketable securities	201	83
Accounts receivable, trade, less allowances for doubtful accounts $154 (2005,$164)	7,978	7,010
Inventories (note 4)	4,449	3,959
Deferred taxes on income	2,001	1,931
Prepaid expenses and other receivables	2,166	2,442
Total current assets	31,286	31,480
Marketable securities, non-current	16	20
Property, plant and equipment at cost	21,490	19,716
Less: accumulated depreciation	(10,028)	(8,886)
Property, plant and equipment, net	11,462	10,830
Intangible assets, net (note 5)	6,562	6,185
Goodwill, net (note 5)	6,769	5,990
Deferred taxes on income	1,865	1,138
Other assets	3,278	3,221
Total Assets	$61,238	$58,864

* Adjusted 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

	October 1, 2006	January 1, 2006*
Current Liabilities:		
Loans and notes payable	$362	$668
Accounts payable	3,964	4,315
Accrued liabilities	3,330	3,529
Accrued rebates, returns and promotions	2,183	2,017
Accrued salaries, wages and commissions	1,268	1,166
Accrued taxes on income	956	940
Total current liabilities	12,063	12,635
Long-term debt	2,007	2,017
Deferred taxes on income	352	211
Employee related obligations	3,570	3,065
Other liabilities	2,673	2,226
Total liabilities	20,665	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)	(539)	(755)
Retained earnings	48,210	42,310
Less: common stock held in treasury, at cost (215,519,000 and 145,364,000 shares)	10,218	5,965
Total shareholders' equity	40,573	38,710
Total liabilities and shareholders' equity	$61,238	$58,864

* Adjusted 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			
	Oct. 1, 2006	Percent to Sales	Oct. 2, 2005*	Percent to Sales
Sales to customers (Note 6)	$13,287	100.0%	$12,310	100.0%
Cost of products sold	3,650	27.5	3,354	27.2
Gross profit	9,637	72.5	8,956	72.8
Selling, marketing and administrative expenses	4,291	32.3	4,161	33.8
Research expense	1,719	12.9	1,539	12.5
In-process research & development	115	0.9	-	-
Interest income	(207)	(1.6)	(123)	(1.0)
Interest expense, net				

of portion capitalized	13	0.1	22	0.2
Other expense (income), net	45	0.3	(63)	(0.5)
Earnings before provision for taxes on income	3,661	27.6	3,420	27.8
Provision for taxes on income (Note 3)	901	6.8	882	7.2
NET EARNINGS	$2,760	20.8%	$2,538	20.6%
NET EARNINGS PER SHARE				
Basic	$0.95		$0.85	
Diluted	$0.94		$0.85	
CASH DIVIDENDS PER SHARE	$0.375		$0.33	
AVG. SHARES OUTSTANDING				
Basic	2,920.0		2,974.6	
Diluted	2,948.1		3,006.2	

* Adjusted 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 Nine Months Ended			
	Oct. 1, 2006	Percent to Sales	Oct. 2, 2005*	Percent to Sales
Sales to customers (Note 6)	$39,642	100.0%	$37,904	100.0%
Cost of products sold	11,050	27.9	10,372	27.4
Gross profit	28,592	72.1	27,532	72.6
Selling, marketing and administrative				

expenses	12,737	32.1	12,566	33.2
Research expense	5,079	12.8	4,448	11.7
In-process research & development	239	0.6	353	0.9
Interest income	(613)	(1.5)	(316)	(0.8)
Interest expense, net of portion capitalized	42	0.1	52	0.1
Other income, net	(771)	(2.0)	(184)	(0.5)
Earnings before provision for taxes on income	11,879	30.0	10,613	28.0
Provision for taxes on income (Note 3)	2,994	7.6	2,648	7.0
NET EARNINGS	$8,885	22.4%	$7,965	21.0%
NET EARNINGS PER SHARE				
Basic	$3.01		$2.68	
Diluted	$2.99		$2.65	
CASH DIVIDENDS PER SHARE	$1.08		$0.945	
AVG. SHARES OUTSTANDING				
Basic	2,948.7		2,973.5	
Diluted	2,971.3		3,008.4	

* Adjusted 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 Nine Months Ended	
	October 1, 2006	October 2, 2005*
CASH FLOW FROM OPERATING ACTIVITIES		

Net earnings	$8,885	$7,965
Adjustment to reconcile net earnings to cash flow:		
Depreciation and amortization of property and intangibles	1,606	1,586
Stock based compensation	511	405
Purchased in-process research and development	239	353
Deferred tax provision	(681)	(552)
Accounts receivable allowances	(16)	(24)
Changes in assets and liabilities, net of effects from acquisitions:		
Increase in accounts receivable	(714)	(646)
Increase in inventories	(339)	(433)
Decrease in accounts payable and accrued liabilities	(398)	(1,732)
Decrease in other current and non-current assets	79	860
Increase in other current and non-current liabilities	793	854
NET CASH FLOWS FROM OPERATING ACTIVITIES	9,965	8,636
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	(1,607)	(1,490)
Proceeds from the disposal of assets	2	152
Acquisitions, net of cash acquired	(1,377)	(747)
Purchases of investments	(452)	(5,095)
Sales of investments	324	8,324
Other (primarily intangibles)	(124)	(295)
NET CASH (USED)/PROVIDED BY INVESTING ACTIVITIES	(3,234)	849
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends to shareholders	(3,182)	(2,810)

Repurchase of common stock	(5,371)	(1,164)
Proceeds from short-term debt	599	537
Retirement of short-term debt	(1,139)	(602)
Proceeds from long-term debt	1	4
Retirement of long-term debt	(12)	(196)
Proceeds from the exercise of stock options/excess tax benefits	692	592
NET CASH USED BY FINANCING ACTIVITIES	(8,412)	(3,639)
Effect of exchange rate changes on cash and cash equivalents	117	(224)
(Decrease)/increase in cash and cash equivalents	(1,564)	5,622
Cash and Cash equivalents, beginning of period	16,055	9,203
CASH AND CASH EQUIVALENTS, END OF PERIOD	$14,491	$14,825
Acquisitions		
Fair value of assets acquired	$1,627	$883
Fair value of liabilities assumed	(250)	(136)
Net cash paid for acquisitions	$1,377	$747

* Adjusted 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 and the related Current Report on Form 8-K filed with the SEC on October 31, 2006 containing the Company's previously

reported consolidated financial statements for the fiscal years 2003, 2004 and 2005, and the notes thereto, as adjusted to reflect the impact of SFAS No. 123 (R), Share Based Payment, adopted during the fiscal first quarter of 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 adjusted 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 October 1, 2006, the balance of deferred net gains on derivatives included in accumulated other comprehensive income was $29 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 third quarters ended October 1, 2006 and October 2, 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 nine months of 2006 and 2005

were 25.2% and 25.0%, respectively, an increase of 0.2% primarily due to the expiration of the U.S. research and development tax credit at the end of fiscal 2005, and the Guidant termination fee recorded at a 40.8% rate. The tax rate for the first fiscal nine months of 2006 benefited from a reversal of tax allowances of $134 million associated with the Tibotec business. The first fiscal nine 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. The tax rate in the first fiscal nine months of 2006 also benefited from additional earnings in lower tax jurisdictions relative to higher tax jurisdictions.

NOTE 4 - INVENTORIES
(Dollars in Millions)

	October 1, 2006	January 1, 2006
Raw materials and supplies	$1,143	$931
Goods in process	1,161	1,073
Finished goods	2,145	1,955
	$4,449	$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)

	October 1, 2006	January 1, 2006
Trademarks (non-amortizable)	$1,561	$1,400
Less accumulated amortization	132	134
Trademarks (non-amortizable)- net	1,429	1,266
Patents and trademarks	4,452	4,128
Less accumulated amortization	1,605	1,370
Patents and trademarks - net	2,847	2,758

Other amortizable intangibles	3,860	3,544
Less accumulated amortization	1,574	1,383
Other intangibles - net	2,286	2,161
Total intangible assets - gross	9,873	9,072
Less accumulated amortization	3,311	2,887
Total intangible assets - net	6,562	6,185
Goodwill - gross	7,497	6,703
Less accumulated amortization	728	713
Goodwill - net	$6,769	$5,990

Goodwill as of October 1, 2006 as allocated by segment of business is as follows:

(Dollars in Millions)

	Consumer	Pharm	Med Dev & Diag	Total
Goodwill, net of accumulated amortization at January 1, 2006	$1,090	$874	$4,026	$5,990
Acquisitions	153	-	543	696
Translation & Other	46	19	18	83
Goodwill as of October 1, 2006	$1,289	$893	$4,587	$6,769

The weighted average amortization periods for patents and trademarks and other intangible assets are 15 years and 17 years, respectively. The amortization expense of amortizable intangible assets for the fiscal nine months ended October 1, 2006 was $405 million and the estimated amortization expense for the five succeeding years approximates $565 million, per year.

NOTE 6 - SEGMENTS OF BUSINESS AND GEOGRAPHIC AREAS

SALES BY SEGMENT OF BUSINESS (1)
(Dollars in Millions)

	Fiscal Quarters Ended		
	Oct. 1, 2006	Oct. 2, 2005	Percent Change
Consumer			
U.S.	$1,138	$1,075	5.9%

International	1,318	1,156	14.0
	2,456	2,231	10.1
Pharmaceutical			
U.S.	3,841	3,527	8.9
International	2,040	1,930	5.7
	5,881	5,457	7.8
Medical Devices & Diagnostics			
U.S.	2,509	2,365	6.1
International	2,441	2,257	8.2
	4,950	4,622	7.1
U.S.	7,488	6,967	7.5
International	5,799	5,343	8.5
Worldwide	$13,287	$12,310	7.9%

	Fiscal Nine Months Ended		
	Oct. 1, 2006	Oct. 2, 2005	Percent Change
Consumer			
U.S.	$3,391	$3,281	3.4%
International	3,818	3,508	8.8
	7,209	6,789	6.2
Pharmaceutical			
U.S.	11,224	10,905	2.9
International	6,093	5,935	2.7
	17,317	16,840	2.8
Medical Devices & Diagnostics			
U.S.	7,619	7,104	7.2
International	7,497	7,171	4.5
	15,116	14,275	5.9
U.S.	22,234	21,290	4.4
International	17,408	16,614	4.8
Worldwide	$39,642	$37,904	4.6%

(1) Export and intersegment sales are not significant.

OPERATING PROFIT BY SEGMENT OF BUSINESS

(Dollars in Millions)	Fiscal Quarters Ended		
	Oct. 1, 2006	Oct. 2, 2005	Percent Change
Consumer	$455	$408	11.5%
Pharmaceutical	1,814	1,734	4.6
Medical Devices & Diagnostics (1)	1,339	1,319	1.5
Segments total	3,608	3,461	4.2
Income/(expense) not allocated to segments	53	(41)	
Worldwide total	$3,661	$3,420	7.0%

	Fiscal Nine Months Ended		
	Oct. 1, 2006	Oct. 2, 2005	Percent Change
Consumer	$1,359	$1,245	9.2%
Pharmaceutical(2)	5,438	5,334	1.9
Medical Devices & Diagnostics(3)	4,934	4,131	19.4
Segments total	11,731	10,710	9.5
Income/(expense) not allocated to segments	148	(97)	
Worldwide total	$11,879	$10,613	11.9%

(1) Includes $115 million of IPR&D charges related to acquisitions completed in the fiscal third quarter of 2006.
(2) Includes $302 million of IPR&D charges related to acquisitions completed in the first fiscal nine months of 2005.
(3) Includes $239 million and $51 million of IPR&D charges related to acquisitions completed in the first fiscal nine months of 2006 and 2005, respectively. The first fiscal nine 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 nine months of 2006 versus the same period last year was 4.4%.

SALES BY GEOGRAPHIC AREA
(Dollars in Millions)

	Fiscal Quarters Ended		
	Oct. 1, 2006	Oct. 2, 2005	Percent Change
U.S.	$7,488	$6,967	7.5%
Europe	3,098	2,860	8.3
Western Hemisphere, excluding U.S.	901	783	15.1
Asia-Pacific, Africa	1,800	1,700	5.9
Total	$13,287	$12,310	7.9%

	Fiscal Nine Months Ended		
	Oct. 1, 2006	Oct. 2, 2005	Percent Change
U.S.	$22,234	$21,290	4.4%
Europe	9,464	9,222	2.6

Western Hemisphere, excluding U.S.	2,599	2,259	15.1
Asia-Pacific, Africa	5,345	5,133	4.1
Total	$39,642	$37,904	4.6%

NOTE 7 - EARNINGS PER SHARE

The following is a reconciliation of basic net earnings per share to diluted net earnings per share for the fiscal third quarters ended October 1, 2006 and October 2, 2005.

(Shares in Millions)	Fiscal Quarters Ended	
	Oct. 1, 2006	Oct. 2, 2005
Basic net earnings per share	$0.95	$0.85
Average shares outstanding - basic	2,920.0	2,974.6
Potential shares exercisable under stock option plans	218.0	209.7
Less: shares which could be repurchased under treasury stock method	(193.8)	(185.2)
Convertible debt shares	3.9	7.1
Adjusted average shares outstanding - diluted	2,948.1	3,006.2
Diluted earnings per share	$0.94	$0.85

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 $2 million for the fiscal third quarters ended October 1, 2006 and October 2, 2005, respectively.

The diluted earnings per share calculation excluded 43 million and 46 million shares related to options for the fiscal third quarters ended October 1, 2006 and October 2, 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 nine months ended October 1, 2006 and October 2, 2005.

(Shares in Millions)

	Fiscal Nine Months Ended	
	Oct. 1, 2006	Oct. 2, 2005
Basic net earnings per share	$3.01	$2.68
Average shares outstanding - basic	2,948.7	2,973.5
Potential shares exercisable under stock option plans	217.6	209.9
Less: shares which could be repurchased under treasury stock method	(198.9)	(182.1)
Convertible debt shares	3.9	7.1
Average shares outstanding - diluted	2,971.3	3,008.4
Diluted earnings per share	$2.99	$2.65

The diluted earnings per share calculation included the dilutive effect of convertible debt that was offset by the related reduction in interest expense of $3 million and $9 million for the first fiscal nine months ended October 1, 2006 and October 2, 2005, respectively.

The diluted earnings per share calculation excluded 44 million and 46 million shares related to options for the first fiscal nine months ended October 1, 2006 and October 2, 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 nine months ended October 1, 2006 was $9.1 billion, compared with $7.7 billion for the same period a year ago. The total comprehensive income for the fiscal third quarter ended October 1, 2006 was $2.8 billion, compared with $2.6 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)

	For. Cur. Trans.	Unrld Gains/ (Losses) on Sec	Pens Liab Adj.	Gains/ (Losses) on Deriv & Hedg	Total Accum Other Comp Inc/ (Loss)

January 1, 2006	$ (520)	70	(320)	15	(755)
2006 nine months changes:					
Net change associated with current period hedging transactions	-	-	-	29	
Net amount reclassed to net earnings	-	-	-	(15)*	
Net nine months changes	216	(14)	-	14	216
October 1, 2006	$ (304)	56	(320)	29	(539)

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. The Company estimates that approximately $1.0 billion in proceeds will be received from the divestiture of businesses resulting from regulatory reviews.

During the fiscal third quarter of 2006, the following companies were acquired: Colbar LifeScience Ltd., a privately held company specializing in reconstructive medicine and tissue engineering and Ensure Medical, Inc., a privately held company that develops devices for post-catheterization closure of the femoral artery.

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 October 1, 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 $171 million for the fiscal third quarter of 2006 and $134 million for the fiscal third quarter of 2005. The total income tax benefit recognized in the income statement for share based compensation arrangements was $60 million and $47 million for the fiscal third quarters of 2006 and 2005, respectively. The compensation cost that has been charged against income for these plans was $511 million for the first fiscal nine months of 2006 and $405 million for the first fiscal nine months of 2005. The total income tax benefit recognized in the income statement for share based compensation arrangements was $179 million and $142 million for the first fiscal nine months of 2006 and 2005, respectively. Share based compensation costs capitalized as part of inventory were insignificant in all periods.

The total intrinsic value of options exercised

during 2006 was $319.5 million. As of October 1, 2006, the total unrecognized compensation cost was $795.1 million, which will be charged against income over a weighted average period of 1.22 years.

The following table details the retroactive application impact of SFAS 123(R) on previously reported results.

(Dollars in Millions, Except Per Share Amounts)

For the quarter ended October 2, 2005	Restated	As Previously Reported
Earnings before provision for taxes on income	$ 3,420	$ 3,554
Net earnings	2,538	2,625
Basic net earnings per share	0.85	0.88
Diluted net earnings per share	0.85	0.87
For the nine months ended October 2, 2005:		
Earnings before provision for taxes on income	$ 10,613	$ 11,018
Net earnings	7,965	8,228
Basic net earnings per share	2.68	2.77
Diluted net earnings per share	2.65	2.73
Net cash flows from operating activities	8,636	8,694
Net cash used by financing activities	$(3,639)	$(3,697)

NOTE 11 - PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Components of Net Periodic Benefit Cost
Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the fiscal third quarters of 2006 and 2005 include the following components:

(Dollars in Millions)

	Retirement Plans		Other Benefit Plans	
	Fiscal Quarters Ended			
	Oct. 1, 2006	Oct. 2, 2005	Oct. 1, 2006	Oct. 2, 2005

Service cost	$131	$107	$16	$14
Interest cost	142	120	26	22
Expected return on plan assets	(174)	(144)	-	(1)
Amortization of prior service cost	1	3	(2)	(3)
Amortization of net transition asset	(1)	(1)	-	-
Recognized actuarial losses	61	54	9	6
Net periodic benefit cost	$160	$139	$49	$38

Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the first fiscal nine months of 2006 and 2005 include the following components:

(Dollars in Millions)

	Retirement Plans		Other Benefit Plans	
	Fiscal Nine Months Ended			
	Oct. 1, 2006	Oct. 2, 2005	Oct. 1, 2006	Oct. 2, 2005
Service cost	$393	$323	$53	$42
Interest cost	426	366	78	66
Expected return on plan assets	(524)	(435)	(2)	(3)
Amortization of prior service cost	7	9	(5)	(6)
Amortization of net transition asset	(1)	(2)	-	-
Recognized actuarial losses	188	165	29	19
Net periodic benefit cost	$489	$426	$153	$118

Company Contributions

For the fiscal nine months ended October 1, 2006, the Company contributed $18 million and $22 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 March 2005, it was confirmed that the PSC of the MDL had enrolled enough plaintiffs and claimants in the proposed settlement program to make the agreement effective. 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 this 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, several of 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. The claim against SR International has been resolved satisfactorily. A decision on the claim against Lexington Insurance Company, which was heard by an arbitration panel in October, is expected in the first quarter of 2007. 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 1,000 claimants who have filed lawsuits or made claims regarding injuries allegedly due to ORTHO EVRA(R), 700 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 except where settlement is deemed appropriate.

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.

Cordis also has an arbitration claim against Medtronic 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 to Medtronic 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. Cordis expects Boston Scientific will appeal to the U.S. Court of Appeals for the Federal Circuit.

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 has moved for re-consideration of those decisions. If reconsideration is denied, Cordis will appeal to the Court of Appeals for the Federal Circuit. The District Court indicated it will consider damages, wilfullness and injunctive relief after the appeals have been decided.

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 trial date. In that case as well, Boston Scientific seeks an injunction and substantial damages.

Boston Scientific has brought actions in Belgium and the Netherlands under its Kastenhofer patent to enjoin the manufacture and sale of allegedly infringing catheters in those countries, and to recover damages. The Belgian case is pending and no hearing date has been set. A decision by the lower court in the Netherlands in Boston Scientific's favor is on appeal.

In Germany, Boston Scientific has several actions based on Ding patents pending against the Cordis CYPHER(R) stent. Cordis was successful in these actions at the trial level, but Boston Scientific has appealed.

The following chart summarizes various patent lawsuits concerning products of Johnson & Johnson subsidiaries that have yet to proceed to trial:

J&J	Plaintiff/

Product	Company	Patents	Patent Holder	Court	Trial Date	Filed
Catheters and stent delivery systems	Cordis	Fitzmaurice	Medtronic AVE	E.D. Tex	09/07	06/03
Drug Eluting Stents	Cordis	Grainger	Boston Scientific Corp.	D. Del.	*	12/03
Drug Eluting Stents	Cordis	Ding	Boston Scientific Corp.	Germany	*	04/04 11/04
Two-layer Catheters	Cordis	Kasten-hofer Forman	Boston Scientific Corp.	N.D. Cal Belgium	* *	02/02 12/03
Stents	Cordis	Israel	Medinol	Multiple E.U. jurisdictions	*	05/03
Contact Lenses	Vision Care	Nicolson	CIBA Vision	M.D. Fla.	*	09/03

* 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 statutory 30-month stay expires before a ruling from the district court is obtained, the firms involved will have the ability, upon FDA approval, 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 noted in the following chart, 30-month stays expired during 2006 and will expire in 2007 and 2008 with respect to ANDA challenges regarding various products.

Brand Name Product	Patent/NDA Holder	Generic Challenger	Court	Trial Date	Date Filed	30-Month Stay Expires
ACIPHEX(R) 20 mg delay release tablet	Eisai (for Janssen)	Teva	S.D.N.Y.	*	11/03	02/07
		Dr.Reddy's	S.D.N.Y.	*	11/03	02/07
		Mylan	S.D.N.Y.	*	01/04	02/07
AXERT(R) 6.25 and 12.5 mg	Almirall Ortho-McNeil Neurologics	Teva	S.D.N.Y.	*	03/06	11/08

CONCERTA(R) 18,27,36 and 54 mg controlled release tablet	McNeil-PPC ALZA	Andrx	D.Del.	*	09/05	None
DITROPAN XL(R) 5, 10, 15 mg controlled release tablet	Ortho-McNeil ALZA	Mylan Impax	D.W.V. N.D.Cal.	02/05 12/05	05/03 09/03	09/05 01/06
LEVAQUIN(R) Injectable Single use vials and 5 mg/ml premix	Daiichi,JJPRD Ortho-McNeil	Sicor (Teva)	D.N.J.	*	12/03	05/06
LEVAQUIN(R) Injectable Single use vials	Daiichi,JJPRD Ortho-McNeil	American Pharmaceutical Partners	D.N.J.	*	12/03	05/06
QUIXIN(R) Ophthalmic Solution (Levo-floxacin) Ophthalmic solution	Daiichi, Ortho-McNeil	Hi-Tech Pharmacal	D.N.J.	*	12/03	05/06
ORTHO TRI CYCLEN(R) LO 0.18 mg/0.025 mg 0.215 mg/0.025 mg and 0.25 mg/0.025 mg	Ortho-McNeil	Barr	D.N.J.	*	10/03	02/06
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 ..25, 0.5, 1, 2, 3, 4 mg tablets	Janssen	Mylan Dr. Reddy's Apotex	D.N.J. D.N.J. D.N.J.	06/06 06/06 *	12/03 12/03 06/06	05/06 06/06 11/08
RISPERDAL(R) M-Tab 0.5,1,2,3, 4 mg	Janssen	Dr. Reddy's Barr	D.N.J. D.N.J.	06/06 *	02/05 10/05	07/07 02/08
RISPERDAL(R)						

Oral Solution, 1 mg/ml	Janssen	Apotex	D.N.J.	*	03/06	08/08
TOPAMAX(R) 25,50,100, 200 mg tablet	Ortho-McNeil	Mylan	D.N.J.	*	04/04	09/06
		Cobalt	D.N.J.	*	10/05	03/08
TOPAMAX(R) SPRINKLE 15, 25 mg capsule	Ortho-McNeil	Cobalt	D.N.J.	*	12/05	05/08

* Trial date to be established

In the action against Mylan and Dr. Reddy's Laboratories regarding RISPERDAL(R) (risperidone) tablets and M-Tabs, the District Court in New Jersey ruled, on October 13, 2006, that the RISPERDAL(R) patent was valid, enforceable, and infringed by the generic products at issue, and entered an injunction prohibiting Mylan and Dr. Reddy's from marketing their generic risperidone products until a date no earlier than patent expiration in December 2007.

In the action against Mylan with respect to the patent on TOPAMAX(R), the District Court in New Jersey, on October 24, 2006, granted Ortho-McNeil's motion for a preliminary injunction barring launch by Mylan of its generic version of TOPAMAX(R).

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 generic product. Those rulings were affirmed by the Court of Appeals for the Federal Circuit on September 6, 2006. Neither Mylan nor Impax has received final FDA approval to launch its generic product, but such approval could come at any time.

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. 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 generic 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 was 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 Impax involving its ANDA referencing McNeil-PPC's product CONCERTA(R), McNeil and ALZA Corporation, both subsidiaries of the Company, dismissed with prejudice their claim of infringement against Impax with respect to its ANDA.

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 several of 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 the two Massachusetts-only class actions began before the Massachusetts District Court on November 6, 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 REMICADE(R) (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, several of 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 a similar subpoena. DePuy Orthopaedics is responding to the subpoena as well as a follow-on subpoena for documents. A number of

employees of DePuy have been subpoenaed to testify before a grand jury in connection with this investigation.

In June 2005, the U.S. Senate Committee on Finance requested the Company to produce information regarding use by several of 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 responding to the subpoena. Several employees of the Company's pharmaceutical subsidiaries have been subpoenaed to testify before a grand jury in connection with this investigation.

In January 2006, Janssen received a civil investigative demand from the Texas Attorney General seeking broad categories of documents related to the sales and marketing of RISPERDAL(R). Janssen is 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, marketing and sale of orthopaedic devices, and had search warrants executed in connection with the investigation. DePuy is responding to the request for documents. In

the wake of publicity about the subpoena, DePuy was served with five civil antitrust class actions.

In September 2006, Janssen received a subpoena from the Attorney General of the State of California seeking documents regarding sales and marketing and side-effects of RISPERDAL(R), as well as interactions with State officials regarding the State's formulary for Medicaid-reimbursed drugs. Janssen is in the process of responding to the subpoena.

In September 2004, plaintiffs in an employment discrimination litigation initiated against the Company in 2001 in Federal District Court in New Jersey moved to certify a class of all African American and Hispanic salaried employees of the Company and its affiliates in the 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 expects the Court to decide that motion in 2007. The Company disputes the allegations in the lawsuit and is vigorously defending against them.

The Company, along with its wholly-owned subsidiaries, Ethicon, Inc. and Ethicon Endo-Surgery, Inc., 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). In August 2006, a jury in Los Angeles returned a verdict in favor of all defendants rejecting Applied Medical's claims of antitrust violations. The Conmed case is currently scheduled for trial in April 2007. Conmed alleges damages up to $1.8 billion, which damages would be trebled under the antitrust laws if such damages, and liability, are successfully established at trial. In late December 2005 and early 2006, three purported class actions were filed on behalf of purchasers of endo-mechanical instruments. These actions have been filed in the Federal District Court for the Central District of California.

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. Amgen licenses and manufactures EPO for sale in the United States by the Company's Ortho Biotech Inc. subsidiary for non-dialysis indications. The suit is in its preliminary stages.

In October 2006, Wyeth, Inc. initiated litigation in Delaware against Cordis, a subsidiary of the Company, alleging that Cordis breached the license and supply agreement pursuant to which Wyeth supplies Cordis the drug Rapamycin which is used in connection with Cordis' CYPHER(R) Sirolimus-eluting Stent. Cordis has commenced its own action in Delaware seeking a declaration that no breach has occurred.

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 nine months of 2006, worldwide sales were $39.6 billion, a total increase of 4.6% and an operational increase of 5.0% over 2005 first fiscal nine months sales of $37.9 billion. Currency fluctuations negatively impacted sales by 0.4% for the period.

Sales by U.S. companies were $22.2 billion in the first fiscal nine months of 2006, which represented an increase of 4.4% over the same period last year. Sales by international companies were $17.4 billion, which represented a total increase of 4.8%, an operational

increase of 5.7%, and a negative impact from currency of 0.9% over the first fiscal nine months of 2005.

Sales by companies in Europe increased by 2.6%, with operational growth of 4.5% and a negative impact from currency of 1.9%. Sales by companies in the Western Hemisphere, excluding the U.S., increased by 15.1%, with operational growth of 8.6% and a positive impact from currency of 6.5%. Sales by companies in the Asia-Pacific, Africa region posted sales growth of 4.1%, with operational growth of 6.6% and a negative impact from currency of 2.5%.

For the fiscal third quarter of 2006, worldwide sales were $13.3 billion, a total increase of 7.9% and an operational increase of 6.7%, over 2005 fiscal third quarter sales of $12.3 billion. Currency fluctuations positively impacted sales by 1.2% for the period.

Sales by U.S. companies were $7.5 billion in the fiscal third quarter of 2006, which represented an increase of 7.5% over the same period last year. Sales by international companies were $5.8 billion, which represented a total increase of 8.5%, an operational increase of 5.7%, and a positive impact from currency of 2.8% over the fiscal third quarter of 2005.

Sales by companies in Europe increased by 8.3%, with operational growth of 3.8% and a positive impact from currency of 4.5%. Sales by companies in the Western Hemisphere, excluding the U.S., increased by 15.1%, with operational growth of 10.6% and a positive impact from currency of 4.5%. Sales by companies in the Asia-Pacific, Africa region posted sales growth of 5.9%, with operational growth of 6.7% and a negative impact from currency of 0.8%.

Analysis of Sales by Business Segments

Consumer

Consumer segment sales in the first fiscal nine months of 2006 were $7.2 billion, an increase of 6.2% over the same period a year ago, with 5.7% of operational growth and a positive currency impact of 0.5%. U.S. Consumer segment sales increased by 3.4% while international sales experienced a total increase of 8.8%, an operational increase of 7.8%, with a positive currency impact of 1.0%.

Major Consumer Franchise Sales

	First Fiscal Nine Months				
	Oct. 1, 2006	Oct. 2, 2005	Total Change	Operations Change	Currency Change

(Dollars in Millions)					
OTC Pharm & Nutr	$1,985	$1,947	2.0%	1.5%	0.5%
Skin Care	1,948	1,804	8.0	7.8	0.2
Baby & Kids Care	1,279	1,168	9.5	8.7	0.8
Women's Health	1,246	1,180	5.6	4.7	0.9
Other	751	690	8.8	8.7	0.1
Total	$7,209	$6,789	6.2%	5.7%	0.5%

Consumer segment sales in the fiscal third quarter of 2006 were $2.5 billion, an increase of 10.1% over the same period a year ago with 8.1% of operational growth and a positive currency impact of 2.0%. U.S. Consumer segment sales increased by 5.9% while international sales experienced a total increase of 14.0%, an operational increase of 10.2%, with a positive currency impact of 3.8%.

Major Consumer Franchise Sales - Fiscal Third Quarter

(Dollars in Millions)	Oct. 1, 2006	Oct. 2, 2005	Total Change	Operations Change	Currency Change
OTC Pharm & Nutr	$699	$634	10.2%	8.7%	1.5%
Skin Care	635	582	9.2	6.4	2.8
Baby & Kids Care	451	396	14.1	12.2	1.9
Women's Health	432	398	8.6	6.5	2.1
Other	239	221	8.1	6.8	1.3
Total	$2,456	$2,231	10.1%	8.1%	2.0%

Consumer segment sales growth in the fiscal third quarter of 2006 was attributable to solid performance across the franchises. The OTC Pharmaceutical and Nutritionals franchise experienced an operational increase of 8.7% primarily due to the re-launch of the TYLENOL(R) Upper Respiratory product line with products containing phenylephrine instead of pseudoephedrine. The Skin Care franchise's operational sales growth of 6.4% was driven by international sales of suncare products and the newly acquired Groupe Vendome product line. The Baby and Kids Care franchise experienced strong operational growth of 12.2%. This was driven by the continued strength of JOHNSON'S(R) Baby Lotion and Bath in the U.S., and in the haircare, cleanser and cream product lines in international markets. The Women's Health franchise achieved operational growth of 6.5% resulting from strong sales in the CAREFREE(R) and K-Y(R) product lines.

Pharmaceutical

Pharmaceutical segment sales in the first fiscal nine months of 2006 were $17.3 billion, a total increase of 2.8% over the same period a year ago with 3.1% of this change due to operational increases and a 0.3% decrease related to the negative impact of currency. The U.S. Pharmaceutical sales increase was 2.9% and the total growth in international Pharmaceutical sales was 2.7%, with 3.5% of this change due to operational increases and the remaining 0.8% decrease related to the negative impact of currency.

Major Pharmaceutical Product Revenues - First Fiscal Nine Months

(Dollars in Millions)

	Oct. 1, 2006	Oct. 2, 2005	Total Change	Operations Change	Currency Change
RISPERDAL(R)/ RISPERDAL(R) CONSTA(R)	$3,122	$2,654	17.6%	18.6%	(1.0)%
PROCRIT(R)/ EPREX(R)	2,392	2,526	(5.3)	(5.2)	(0.1)
REMICADE(R)	2,233	1,842	21.2	21.2	-
TOPAMAX(R)	1,498	1,267	18.3	18.4	(0.1)
LEVAQUIN(R)/ FLOXIN(R)	1,091	1,092	(0.1)	(0.1)	-
DURAGESIC(R)/ Fentany Transdermal	1,002	1,226	(18.2)	(17.4)	(0.8)
ACIPHEX(R)/ PARIET(TM)	921	856	7.2	7.2	-
Hormonal Contraceptives	772	879	(12.2)	(12.6)	0.4
Other	4,286	4,495	(4.6)	(4.4)	(0.2)
Total	$17,317	$16,840	2.8%	3.1%	(0.3)%

Pharmaceutical segment sales in the fiscal third quarter of 2006 were $5.9 billion, a total increase of 7.8% over the same period a year ago with 6.7% of this change due to operational increases and the remaining 1.1% increase related to the positive impact of currency. The U.S. Pharmaceutical sales increase was 8.9% and the growth in international Pharmaceutical sales was 5.7%, with 2.7% of this change due to operational increases and the remaining 3.0% increase related to the positive impact of currency.

Major Pharmaceutical Product Revenues - Fiscal Third Quarter

(Dollars in Millions)

	Oct. 1, 2006	Oct. 2, 2005	Total Change	Operations Change	Currency Change

RISPERDAL(R)/ RISPERDAL(R) CONSTA(R)	$1,068	$916	16.5%	15.4%	1.1%
PROCRIT(R)/ EPREX(R)	798	844	(5.5)	(6.8)	1.3
REMICADE(R)	776	624	24.3	24.3	-
TOPAMAX(R)	533	429	24.1	23.3	0.8
LEVAQUIN(R)/ FLOXIN(R)	347	332	4.7	4.8	(0.1)
DURAGESIC(R)/ Fentany Transdermal	342	394	(13.4)	(15.1)	1.7
ACIPHEX(R)/ PARIET(TM)	307	300	2.2	0.1	2.1
Hormonal Contraceptives	270	281	(3.7)	(4.7)	1.0
Other	1,440	1,337	7.7	6.4	1.3
Total	$5,881	$5,457	7.8%	6.7%	1.1%

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 third quarter of 2006. Sales results in both the fiscal third quarter of 2006 and 2005 benefited from one-time adjustments. The reserve for sales rebates was reduced by approximately $130 million in the fiscal third quarter of 2006. Sales in the fiscal third quarter of 2005 were positively impacted by a refund of approximately $80 million due to a retroactive change in the methodology used to calculate average manufacturers price from Medicaid charges. The net effect of these one-time gains contributed less than 1.0% to fiscal third quarter 2006 pharmaceutical sales growth.

RISPERDAL(R) (risperidone), a medication that treats the symptoms of schizophrenia and bipolar mania, and RISPERDAL(R) CONSTA(R) (risperidone) long acting injection that treats the symptoms of schizophrenia, achieved operational growth of 15.4% in the fiscal third quarter of 2006. Sales growth was positively impacted by increases in the net pricing of RISPERDAL(R) and demand for RISPERDAL(R) CONSTA(R). In October of 2006, the Company received approval from the FDA to market RISPERDAL(R) for the treatment of irritability associated with autistic disorder in children and adolescents.

PROCRIT(R) (Epoetin alfa) and EPREX(R) (Epoetin alfa) combined had an operational sales decline

of 6.8%, as compared to prior year fiscal third quarter. PROCRIT(R) experienced an operational decline of 9.3% due to a competitor's anticompetitive contracting strategy, both in oncology clinics and the hospital setting, while EPREX(R) had an operational decline of 1.4%. The approval of the once weekly administration for EPREX(R) in Europe resulted in volume gains, which were offset by price declines. 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 24.3% over prior year fiscal third quarter. This continued growth was driven by increased demand due to expanded indications. During the fiscal third quarter of 2006, REMICADE(R) received FDA approval for the treatment of adults with chronic severe plaque psoriasis.

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 23.3% over prior year fiscal third quarter. The net impact of the previously discussed one-time adjustments added approximately 7.0% to the operational growth in the fiscal third quarter.

DURAGESIC(R)/Fentanyl Transdermal (fentanyl transdermal system) experienced an operational sales decline of 15.1% compared to prior year fiscal third quarter, primarily driven by the negative impact of generic competition in Europe, as well as in the U.S.

The hormonal contraceptive franchise experienced an operational sales decline of 4.7% compared to prior year fiscal third quarter primarily resulting from continued generic competition in oral contraceptives. This was partially offset by 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 29.4% over the fiscal third quarter of 2005, due in part to price. At present, the FDA has not approved any generic version that is substitutable for CONCERTA(R). Abbreviated New Drug Applications (ANDAs) for generic versions of CONCERTA(R) are pending and may be approved at any time.

NATRECOR(R) (nesiritide), a product for the treatment of patients with acutely decompensated congestive heart failure who have dyspnea at rest or with minimal activity, has experienced a significant decline in demand due to 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.

Medical Devices and Diagnostics

Medical Devices and Diagnostics segment sales in the first fiscal nine months of 2006 were $15.1 billion, an increase of 5.9% over the same period a year ago, with 6.9% of this change due to operational increases and the remaining 1.0% decrease related to the negative impact of currency. The U.S. Medical Devices and Diagnostics sales increase was 7.2% and the growth in international Medical Devices and Diagnostics sales was 4.5%, which included operational increases of 6.5% and a decrease of 2.0% related to the negative impact of currency.

Major Medical Devices and Diagnostics Franchise Sales - First Fiscal Nine Months

(Dollars in Millions)

	Oct. 1, 2006	Oct. 2, 2005	Total Change	Operations Change	Currency Change
CORDIS(R)	$3,126	$2,977	5.0%	6.3%	(1.3)%
DEPUY(R)	3,045	2,870	6.1	6.8	(0.7)
ETHICON ENDO-SURGERY(R)	2,476	2,278	8.7	9.6	(0.9)
ETHICON(R)	2,386	2,327	2.6	3.4	(0.8)
LIFESCAN(R)	1,532	1,436	6.6	6.7	(0.1)
Vision Care	1,408	1,276	10.3	12.7	(2.4)
ORTHO-CLINICAL DIAGNOSTICS(R)	1,098	1,064	3.2	4.1	(0.9)
Other	45	47	(4.3)	(4.3)	-
Total	$15,116	$14,275	5.9%	6.9%	(1.0)%

Medical Devices and Diagnostics segment sales in the fiscal third quarter of 2006 were $4.9 billion, an increase of 7.1% over the same period a year ago, with 6.1% of this change due

to operational growth and the remaining 1.0% increase related to the positive impact of currency. The U.S. Medical Devices and Diagnostics sales increase was 6.1% and the growth in international Medical Devices and Diagnostics sales was 8.2%, which included operational growth of 6.1% and an increase of 2.1% related to the positive impact of currency.

Major Medical Devices and Diagnostics Franchise Sales - Fiscal Third Quarter

(Dollars in Millions)

	Oct. 1, 2006	Oct. 2, 2005	Total Change	Operations Change	Currency Change
CORDIS(R)	$983	$994	(1.1)	(1.7)%	0.6%
DEPUY(R)	971	897	8.3	7.1	1.2
ETHICON ENDO-SURGERY(R)	825	725	13.8	12.5	1.3
ETHICON(R)	796	743	7.3	5.7	1.6
LIFESCAN(R)	505	462	9.4	7.6	1.8
Vision Care	493	443	11.2	11.8	(0.6)
ORTHO-CLINICAL DIAGNOSTICS(R)	360	342	5.3	4.3	1.0
Other	17	16	6.3	6.3	-
Total	$4,950	$4,622	7.1%	6.1%	1.0%

The Cordis franchise experienced an operational sales decline of 1.7% over the fiscal third quarter of 2005. This decline was caused by lower sales of the CYPHER(R) Sirolimus-eluting Stent, partially offset by strong performance by the Biosense Webster business. The decline in CYPHER(R) Sirolimus-eluting Stent sales was caused by lower average selling prices, negative media coverage concerning drug eluting stents and the corresponding lack of market growth. During the fiscal third quarter, the Company received FDA approval to market the PRECISE(R) Nitinol Stent and the ANGIOGUARD(TM) Emboli Capture Guidewire to treat carotid artery disease. In addition, the Company received CE Mark approval in Europe for CYPHER SELECT(TM) Sirolimus-eluting Stent for use in the treatment of severe arterial disease in the leg.

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. The FDA inspected the Miami site and the Global Quality System, including Design Control system, in August 2006, with acceptable results; Cordis received no observations from the FDA during this inspection. Cordis continues to update the FDA on the status of improvements quarterly. Cordis is awaiting notification of re-inspection at the San German, Puerto Rico location and possible re-inspection of the Warren, New Jersey location.

The DePuy franchise's operational growth of 7.1% was primarily due to DePuy's orthopaedic joint reconstruction products, Mitek sports medicine products and the trauma business. The acquisitions of Future Medical Systems and Hand Innovations contributed to this growth.

The Ethicon Endo-Surgery franchise experienced operational growth of 12.5% over prior year fiscal third quarter. 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. There was also continued growth in advanced sterilization products.

Ethicon worldwide sales grew operationally by 5.7% 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 within several European health care systems. Sales of both GYNECARE products and DERMABOND(R) had strong results in the fiscal third quarter of 2006 as compared to the same period in the prior year.

The LifeScan franchise experienced operational growth of 7.6% over prior year fiscal third quarter. Animas Corporation, which was acquired in the fiscal first quarter of 2006, providing LifeScan with a platform for entry into the insulin pump segment of the diabetes market, was a key contributor to this growth. Strong performance was also achieved in the ONETOUCH(R) ULTRA(R) product line internationally.

The Vision Care franchise operational sales growth of 11.8% was led by the global success of ACUVUE(R) OASYS(TM) Brand Contact Lenses with HYDRACLEAR(TM) PLUS and ACUVUE(R) ADVANCE(TM) Brand Contact Lenses for ASTIGMATISM and the

international success of 1-DAY ACUVUE(R) MOIST(TM) and ACUVUE(R) DEFINE.

The Ortho-Clinical Diagnostics franchise achieved operational growth of 4.3% over prior year fiscal third quarter. Growth was achieved in clinical laboratory sales in both the U.S. and international markets.

Cost of Products Sold and Selling, Marketing and Administrative Expenses

Consolidated costs of products sold for the first fiscal nine months of 2006 increased to 27.9% from 27.4% of sales over the same period a year ago. The cost of products sold for the fiscal third quarter of 2006 increased to 27.5% from 27.2% of sales in the fiscal third quarter of 2005. The increase resulted from unfavorable product mix, primarily in the Pharmaceutical segment, partially offset by reductions in the manufacturing costs in the Medical Devices and Diagnostics segment.

Consolidated selling, marketing and administrative expenses for the first fiscal nine months of 2006 increased 1.4% over the same period a year ago. Consolidated selling, marketing and administrative expenses as a percent to sales for the first fiscal nine months of 2006 were 32.1% versus 33.2% for the same period a year ago. Consolidated selling, marketing and administrative expenses for the fiscal third quarter of 2006 increased 3.1% over the same period a year ago. As a percent to sales, consolidated selling, marketing and administrative expenses were 32.3% versus 33.8% for the same period a year ago. Decreases in the quarterly and nine month periods were primarily associated with cost containment efforts across many of the Company's businesses as well as reductions in advertising and promotion spending.

Research & Development

Research activities represent a significant part of the Company's business. These expenditures relate to the development of new products, improvement of existing products, technical support of products and compliance with governmental regulations for the protection of the consumer. Worldwide costs of research activities, for the first fiscal nine months of 2006 were $5.1 billion, an increase of 14.2% over the same period a year ago. Research and development spending in the fiscal third quarter of 2006 was $1.7 billion, an increase of 11.7% over the fiscal third quarter of 2005. The major factors contributing to this increase were 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 third quarter of 2006, the Company recorded IPR&D charges of $115 million before tax, with no tax benefit, related to the acquisitions of Ensure Medical, Inc. and Colbar LifeScience Ltd. IPR&D charges of $239 million before tax and $231 million after tax were recorded during the first fiscal nine months of 2006 related to the acquisitions of Vascular Control Systems, Inc., Hand Innovations LLC, Future Medical Systems S.A. and the third quarter acquisitions mentioned above.

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 includes 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 nine months of 2006 was primarily due to the gain associated with the Guidant termination fee, less associated expenses, recorded in the fiscal first quarter of 2006. This was partially offset by additional product liability reserves recorded in the fiscal third quarter of 2006.

OPERATING PROFIT BY SEGMENT
Consumer Segment
Operating profit for the Consumer segment as a percent to sales in the first fiscal nine months of 2006 was 18.9% versus 18.3% over the same period a year ago. Operating profit as a percent to sales in the fiscal third quarter of 2006 was 18.5% versus 18.3% over the same period a year ago. This increase was related to better leveraging of advertising spending in the OTC Pharmaceutical and Nutritionals franchise.

Pharmaceutical Segment
Operating profit for the Pharmaceutical segment as a percent to sales in the first fiscal nine months of 2006 was 31.4% versus 31.7% over the

same period a year ago. Operating profit as a percent to sales in the fiscal third quarter of 2006 was 30.8% versus 31.8% over the same period a year ago. For both periods in 2006, operating profit was unfavorable, as compared to the same periods a year ago, due to increased research and development spending, the recording of additional product liability reserves, as well as, lower gross profit margins.

Medical Devices and Diagnostics Segment

Operating profit for the Medical Devices and Diagnostics segment as a percent to sales in the first fiscal nine months of 2006 was 32.6% versus 28.9% over the same period a year ago. Operating profit as a percent to sales in the fiscal third quarter of 2006 was 27.1% versus 28.5% 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 nine 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 nine months of 2006 was enhanced by cost reduction programs, and favorable product mix, which offset increased research and development spending and IPR&D charges. The unfavorability in the operating profit in the fiscal third quarter of 2006 over the same period a year ago was driven by the IPR&D charges recorded during the fiscal third quarter of 2006.

Interest (Income) Expense

Interest income increased in both the first fiscal nine months and fiscal third quarter of 2006 as compared to the same periods a year ago. The increase reflected higher rates of interest being earned on cash and cash equivalents, as well as, an improved average cash position.

Interest expense decreased in both the first fiscal nine months and fiscal third quarter of 2006 as compared to the same periods a year ago, resulting from lower average interest rates and a lower debt balance.

Provision For Taxes on Income

The worldwide effective income tax rates for the first fiscal nine months of 2006 and 2005 were 25.2% and 25.0%, respectively, an increase of 0.2% primarily due to the expiration of the U.S. research and development tax credit at the end of fiscal 2005, and the Guidant termination fee recorded at a 40.8% rate. The tax rate for the first fiscal nine months of 2006 benefited from a reversal of tax allowances of $134 million associated with the Tibotec business. The first fiscal nine 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. The tax rate in the first fiscal nine months of 2006 also benefited from additional earnings in lower tax jurisdictions relative to higher tax jurisdictions.

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 nine months of 2006, cash flow from operations was $10.0 billion, an increase of $1.3 billion over the same period a year ago. This was a result of growth in net income of $0.9 billion. This increase in net income includes a reduction in the non-cash impact of IPR&D charges of $0.1 billion and the gain associated with the Guidant termination fee, less associated expenses, of $368 million after tax. A $1.3 billion increase in accounts payable and accrued liabilities, partially offset by a $0.8 billion increase in other current and non-current assets, was also a key driver of the increase in cash flow from operations. Net cash used by investing activities increased by $4.1 billion due to a $3.4 billion net decrease in sales of investments and a $0.6 billion increase in acquisition activity. Net cash used by financing activities increased by $4.8 billion due primarily to a $4.2 billion increase in the repurchase of common stock. During the first fiscal nine months of 2006, $4.8 billion was utilized for the stock repurchase program. There was also a $0.4 billion increase in dividends to shareholders. Cash and current marketable securities were $14.7 billion at the end of the fiscal third quarter of 2006 as compared with $16.1 billion at fiscal year end 2005. The Company's net cash position will be impacted in the fiscal fourth quarter of 2006 as a result of the acquisition of the Consumer Healthcare business of Pfizer Inc., which is expected to close by the end of 2006. This acquisition will be funded through a combination of cash and debt.

Dividends

On July 17, 2006, the Board of Directors declared a regular cash dividend of $0.375 per share, which was paid on September 12, 2006 to shareholders of record as of August 29, 2006.

On October 18, 2006, the Board of Directors

declared a regular cash dividend of $0.375 per share, payable on December 12, 2006 to shareholders of record as of November 28, 2006. The Company expects to continue the practice of paying regular cash dividends.

OTHER INFORMATION

New Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards No 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The statement is effective in the first fiscal quarter of 2008 and the Company will adopt the statement at that time. The Company believes that the adoption of SFAS No 157 will not have a material effect on its results of operations, cash flows or financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No 158, Employer's Accounting for Defined Pension and Other Postretirement Plans - an amendment of FASB Statements No 87, 88, 106 and 132(R). This statement requires the recognition of the funded status of a benefit plan in the statement of financial position. It also requires the recognition as a component of other comprehensive income (OCI), net of tax, of the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to statements 87 or 106. The statement has also new provisions regarding the measurement date as well as certain disclosure requirements. The statement is effective at fiscal year end 2006 and the Company will adopt the statement at that time. Based on fiscal year end 2005 financial data, the impact would be a decrease in OCI of approximately $1.7 billion and a corresponding decrease in net assets of approximately $1.7 billion. At adoption, the impact will be computed in a similar manner using then current information.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) 108, which expresses the Staff's views regarding the process of quantifying financial statement misstatements. The bulletin is effective at fiscal year end 2006. The Company believes the implementation of this bulletin will have no effect on its results of operations, cash flows or financial position.

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 does not undertake 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 was completed in the fiscal fourth quarter of 2006.

The following table provides information with respect to Common Stock purchases by the Company during the fiscal third quarter of 2006.

Fiscal Month	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Remaining Maximum Number of Shares that May Be Purchased Under the Plans or Programs (2)
July 3, 2006 through July 30, 2006	10,599,000	$60.49	10,599,000	
July 31, 2006 through August 27, 2006	13,356,400	$63.45	9,598,000	
August 28, 2006 through October 1, 2006	14,262,100	$64.14	12,945,200	
Total	38,217,500		33,142,200	3,694,656

(1) During the fiscal third quarter of 2006,

the Company repurchased an aggregate of 33,142,200 shares of Johnson & Johnson Common Stock pursuant to the repurchase program that was publicly announced on March 8, 2006 and an aggregate of 5,075,300 shares in open-market transactions outside of the program.

(2) As of October 1, 2006, based on the closing price of the Company's Common Stock on the New York Stock Exchange on September 29, 2006 of $64.94 per share.

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 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: November 8, 2006 By /s/ R. J. DARRETTA
R. J. DARRETTA
Vice Chairman, Board of Directors; Chief Financial Officer and Director
(Principal Financial Officer)

Date: November 8, 2006 By /s/ S. J. COSGROVE
S. J. COSGROVE
Controller
(Principal Accounting Officer)