

June 26, 2014



Equity Research

Johnson & Johnson

JNJ: Zytiga Holding Its Own Despite Increased Competition

Outperform

Sector: Diversified

Market Weight

Company Note

• **Summary:** We reviewed data from Symphony Health survey and IMS for JNJ's Zytiga and competing prostate cancer drugs. Zytiga's overall share among sample oncologists was 40% in May, up slightly from 39% in April and consistent with last 12 months share. Zytiga share among sample urologists decreased to 25% from 28% on a rolling three-month basis through May. Increasing penetration among urologists--which has been between 20-35% over the past year in the survey--remains a growth driver in our view for Zytiga, in addition to increased uptake in the pre-chemo market segment and in OUS markets. Zytiga TRx volume continues to grow albeit at a slower rate of mid- to high-teens vs. 20-30% growth earlier in the year. With pre-chemo use now contributing 80%+ of Zytiga use, we expect JNJ to generate somewhat higher revenue per patient as the duration of use should be longer in the pre-chemo population. JNJ reported U.S. Zytiga sales of \$229MM or 42% growth in Q1 (full-year 2013 was \$750MM sales and 62% growth). We estimate Zytiga sales of \$964MM (+29%) in the U.S. and \$2.2B (+31%) global in 2014, growing to \$1.3B and \$2.9B, respectively, in 2016. We continue to expect a new Zytiga patent with 2026 expiration to issue in the coming weeks/months.

• **Symphony survey showed Zytiga with 40% overall market share.** We reviewed May 2014 data that showed Zytiga share at 40% share among sample oncologists in the overall CRPC (castration resistant prostate cancer) market (Figure 1). Among sample urologists, Zytiga averaged 25% share on a rolling three-month basis through May, down from 30% share for rolling three-month through December 2013 (Figure 6). These share figures appear directionally consistent with JNJ's comment on its Q1 earnings call that Zytiga had 34% of the overall U.S. CRPC market. Zytiga's pre-chemo share retreated slightly to 50% in May from 51% in April while its post-chemo share rebounded to 24% in May from a 12-month low of 20% in April (Figures 2-3). Xtandi's overall share grew to 22% in May from 20% in April. The share increase reflected higher pre-chemo share at 21%, up from 20%, and slightly higher post-chemo share of 23% from 24%. DNDN's Provenge's overall share rose to 4% in May from 3% in April but remained below 5-6% share in Q4 2013, while share for Bayer/Algeta's Xofigo, approved for CRPC patients with symptomatic bone metastases, is at 4% vs. 2-3% in Q4 2013. Zytiga's pre-chemo usage fell to 75% in May (vs. 80% in April) while 58% of Xtandi usage was in pre-chemo (Figure 4). About 64% of Zytiga use was in first-line (Figure 5) vs. 22% first-line use for Xtandi in the past six months through May. With nearly 60% of Xtandi use in pre-chemo vs. less than one-quarter the drug used in first-line, the data suggests that Xtandi is likely often being used following therapies like Zytiga prior to chemo.

• Continued on the following page.

Valuation Range: \$114.00 to \$115.00

Our forward valuation range of \$114-115 equals about 18x our 2015 EPS estimate and is mainly based on a sum-of-the-parts analysis. Risks include delays to pipeline products, additional product recalls and unexpected deterioration in the industry.

Investment Thesis:

We believe that JNJ is positioned for solid growth, driven by strength of its pharmaceuticals business, recovery in the consumer segment and market stabilization coupled with share gain in MD&D unit.

Please see page 8 for rating definitions, important disclosures and required analyst certifications
All estimates/forecasts are as of 06/26/14 unless otherwise stated.

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	2013A		2014E		2015E	
			Curr.	Prior	Curr.	Prior
EPS						
Q1 (Mar.)	\$1.44	\$1.54	A	NC	NC	NE
Q2 (June)	1.48	1.55		NC	NC	NE
Q3 (Sep.)	1.36	1.46		NC	NC	NE
Q4 (Dec.)	1.24	1.35		NC	NC	NE
FY	\$5.32	\$5.91		NC	\$6.27	NC
CY	\$5.52	\$5.91			\$6.27	
FY P/EPS	19.1x	17.9x			16.9x	
Rev.(MM)	\$71,312	\$75,336			\$77,648	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
P = Volatile, * = Company is on the Priority Stock List

Ticker	JNJ
Price (06/26/2014)	\$105.65
52-Week Range:	\$85-106
Shares Outstanding: (MM)	2,875.0
Market Cap.: (MM)	\$303,744.0
S&P 500:	1,957.22
Avg. Daily Vol.:	5,590,210
Dividend/Yield:	\$2.28/2.2%
LT Debt: (MM)	\$16,000.0
LT Debt/Total Cap.:	17.5%
ROE:	27.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2014 Est. P/EPS-to-Growth:	3.0x
Last Reporting Date:	04/15/2014
	Before Open

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Together we'll go far



EXHIBIT 2257
Deponent: McSorley

EXHIBIT 10

Company Description:

New Brunswick-based Johnson & Johnson, through its more than 250 operating companies, is the world's most comprehensive and broadly based manufacturer of health care products, as well as a provider of related services, for the consumer, pharmaceutical, and medical devices and diagnostics markets. The medical devices and diagnostics segment consists of a range of products including Cardiovascular Care, DePuy Synthes orthopedics, surgical and infection prevention products, LifeScan blood glucose monitoring and insulin delivery products, Ortho-Clinical Diagnostics products, and Vistakon disposable contact lenses. The company reported 2013 sales of \$71.3B, up 8% year-over-year.

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Urologist data showed Zytiga with 25% share of the market. Urologists are key prescribers in the pre-chemo segment of the market. On a rolling 3-month basis through May, Zytiga held 25% market share vs. 3-month average of 27% in May 2013 (12-month range of 22-35%) (Figure 6). Over the same time period, Xtandi share has increased from 2% to 14%. However, hormone therapy (ADT or androgen deprivation therapy) remains the market leader among the sample urologists with Lupron Depot holding 58% rolling 3-month share (vs. 65% average share a year ago). Casodex's rolling 3-month share also declined from 28% a year ago to 17% share most recently. The key caveat we highlight here is the small sample size of 45-50 urologists each month compared to about 150 oncologists in the survey. As such, Symphony provides the urologist share data on a rolling 3-months basis while the oncologist data is shown monthly.

IMS prescription (Rx) data shows continued Zytiga uptake albeit at slower rate. Weekly Rx data showed continued uptick in Zytiga uptake in the U.S. in terms of Rx volume (Figure 7-8). For the 4-week period ended 6/13/14, Zytiga TRx totaled 9,283, up 15% yr/yr, while 4-week NRx totaled 2,793, up 4% yr/yr. While IMS data does not break out pre- vs. post-chemo usage, we note that urologists now account for 8-9% of Zytiga NRx, up from 2% a year ago. As we discussed above, continued uptick in urologist Rx should help Zytiga to further penetrate the pre-chemo segment.

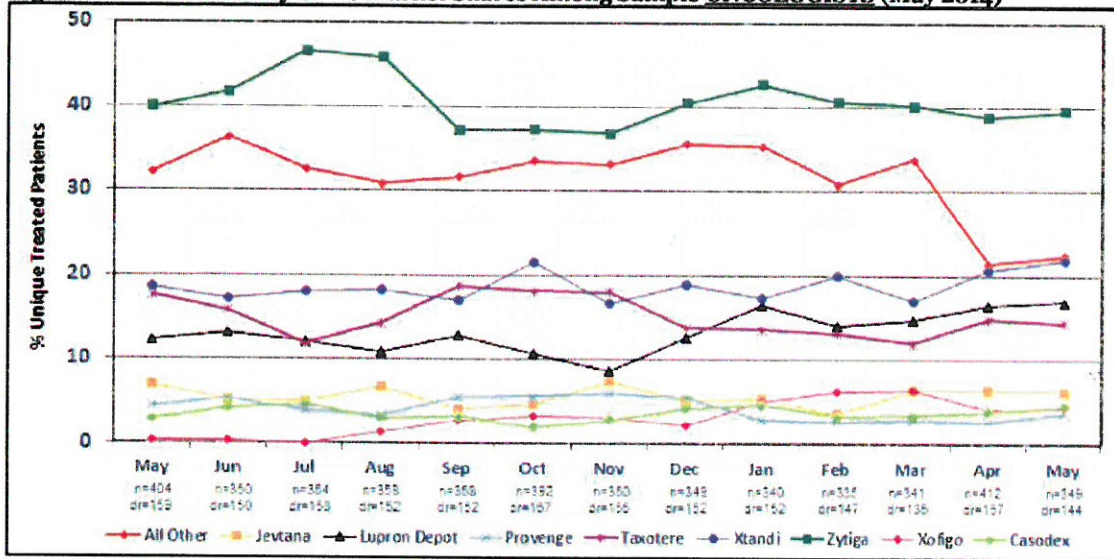
Expect JNJ's prostate cancer franchise to continue to grow in 2014 – Q1 market growth appeared robust. Zytiga has been one of JNJ's best new drug launches with global sales totaling \$1.7B in its third year on the market. Q1 U.S. Zytiga sales were \$229M (+42% yr/yr) while OUS sales totaled \$283MM (+55% ex-FX yr/yr) (Figure 9). According to JNJ, the U.S. prostate cancer market grew 10% in Q1, a deceleration from +18% in Q4 and +25% in Q3 2013, and Zytiga continued to gain share. OUS growth was driven by continued label expansion in new countries and progress on reimbursement. We expect that overall market expansion, further pre-chemo penetration and additional country roll-outs will drive 2014 Zytiga growth of +32% to \$2.2B WW and +30% to \$976MM in the U.S. Competitor MDVN/Astellas' Xtandi is expected to be approved for pre-chemo use by mid-Sept (9/18/14 PDUFA date), if not sooner, in the U.S. and in 2015 in the EU.

Aggregating reported sales for several new prostate cancer agents, we estimate Q1 global sales totaled \$893MM or 61% yr/yr growth (Figure 9). In the U.S., sales rose 51% to nearly \$500MM while OUS sales increased 75% to nearly \$400MM. While we anticipate solid global growth to continue, we expect OUS growth to continue to outpace U.S. growth in the coming quarters. Note that this market model includes primarily newer agents approved for CRPC and thus excludes hormone therapy such as Lupron Depot, chemo agent like Taxotere and supportive care products like Zometa and prednisone.

New Zytiga patent may be coming soon. On June 2, the US Patent & Trademark Office (PTO) allowed JNJ's Zytiga patent application 13/034340, suggesting that the patent could officially issue in the coming weeks or months. Once issued, we expect JNJ to list the method of use patent in the FDA Orange Book, which would force generic filers to go through the patent challenge in court and at a minimum delay generic competition beyond current Dec. 2016 composition of matter patent expiration and provide a bridge to ARN-509 which is in Phase 3 development. If the new patent is listed and upheld in a patent challenge, Zytiga would be protected until 2026. While there is increasing competition in the prostate cancer therapy market, we expect Zytiga sales to continue to grow in the near- to medium-term and to remain a solid profit contributor longer-term even on flat to declining U.S. sales. Although the patent allowance is not new (same application was previously allowed in July 2013), the new allowance suggests that the process is moving ahead as JNJ works to strengthen the patent claims. As such, while the exact timing of the patent issuance is unclear, our patent consultant felt confident that the patent will ultimately issue (well ahead of the 2016 COM patent expiration) and that the patent will provide strong protection for Zytiga against generic competition. See our JNJ note "New Zytiga Patent With 2026 Expiration Could Issue Soon" dated 6/11/14 for additional details.

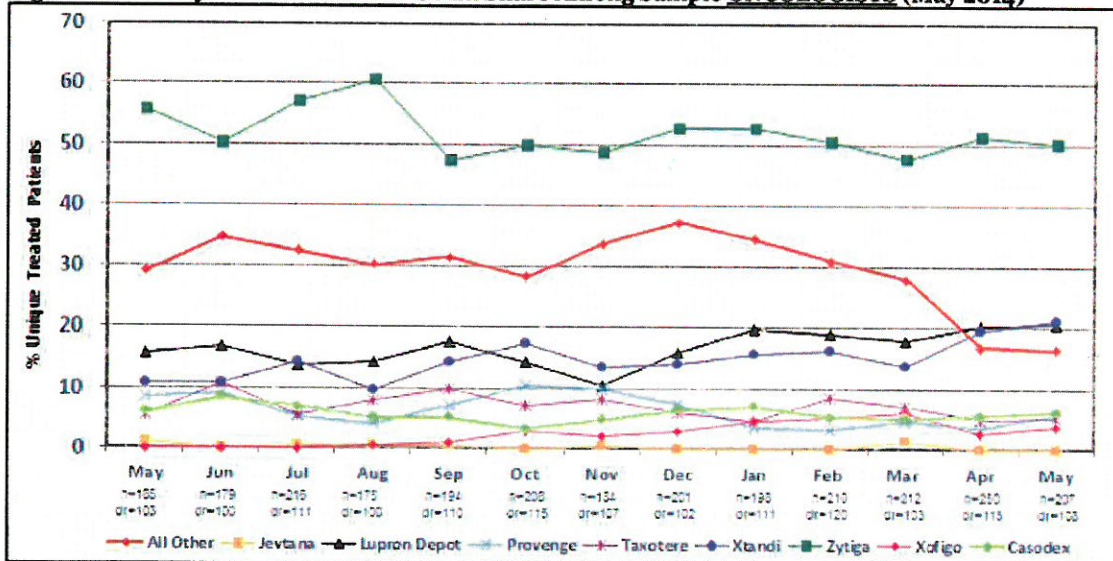
Caveats about Symphony survey: 1) small physician sample size; 2) post-chemo represents 50%+ of the survey market even though there are 2-3x as many pre-chemo patients--likely due to concentration of oncologists in the survey, who prescribe more for post-chemo; 3) inclusion of supportive care products likely understates brand share; 4) overall share trend may show small discrepancy (+/- 1%) to the pre- and post-chemo share trends due to inclusion of "unknown" chemo status patients in the overall population.

Figure 1. Overall Monthly CRPC Market Shares Among Sample ONCOLOGISTS (May 2014)



Source: Symphony Health Solutions

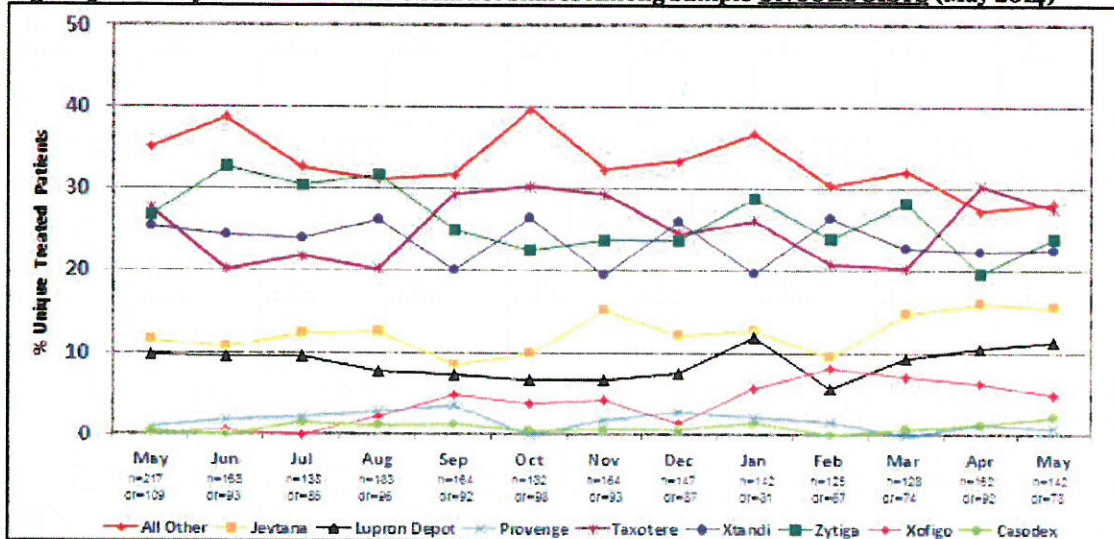
Figure 2. Monthly Chemo-Naïve CRPC Mkt Share Among Sample ONCOLOGISTS (May 2014)



Source: Symphony Health Solutions

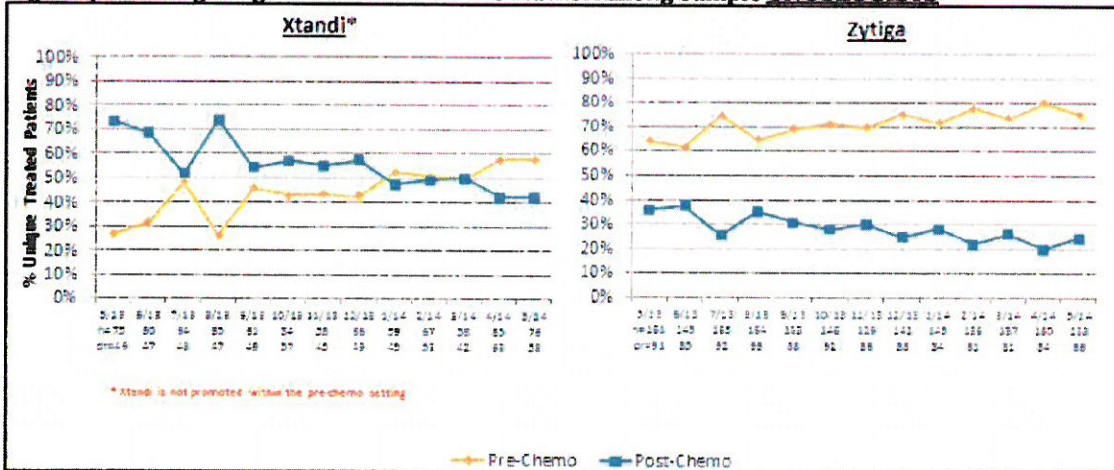
Note: In Q1 2013, Xtandi received NCCN (National Comprehensive Cancer Network) compendium listing for pre-chemo setting, which facilitates reimbursement for off-label use in pre-chemo.

Figure 3. Monthly Post-Chemo CRPC Market Shares Among Sample ONCOLOGISTS (May 2014)



Source: Symphony Health Solutions

Figure 4. Growing Usage in Pre-Chemo CRPC Market Among Sample ONCOLOGISTS



Source: Symphony Health Solutions

* Although note promoted in pre-chemo setting, Xtandi received NCCN (National Comprehensive Cancer Network) compendium listing for pre-chemo setting in Q1 2014, which facilitated reimbursement for off-label use.

Figure 5. CRPC Line of Therapy By Brand Among Sample ONCOLOGISTS

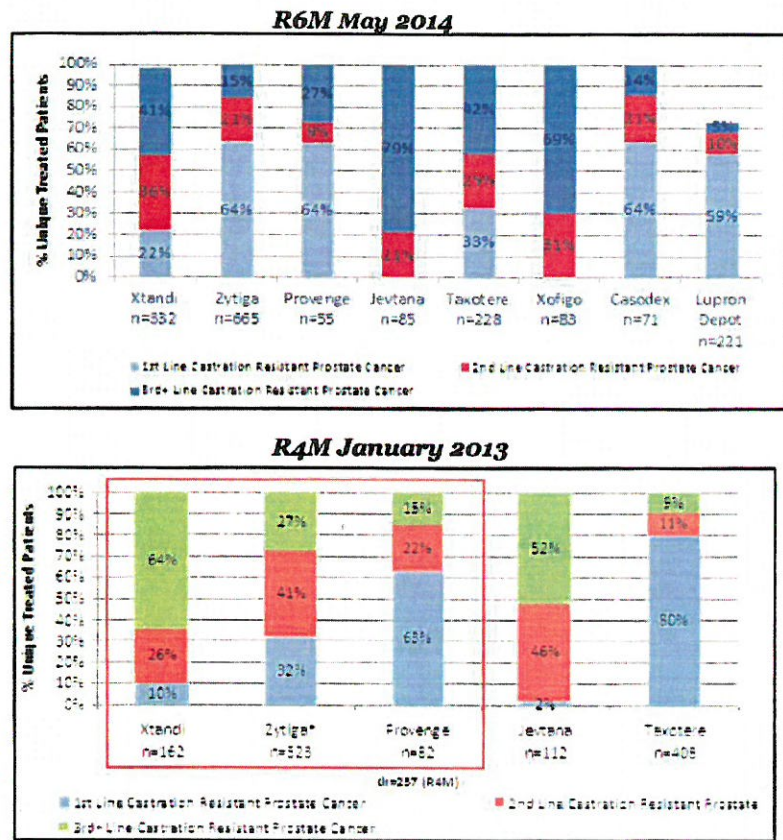
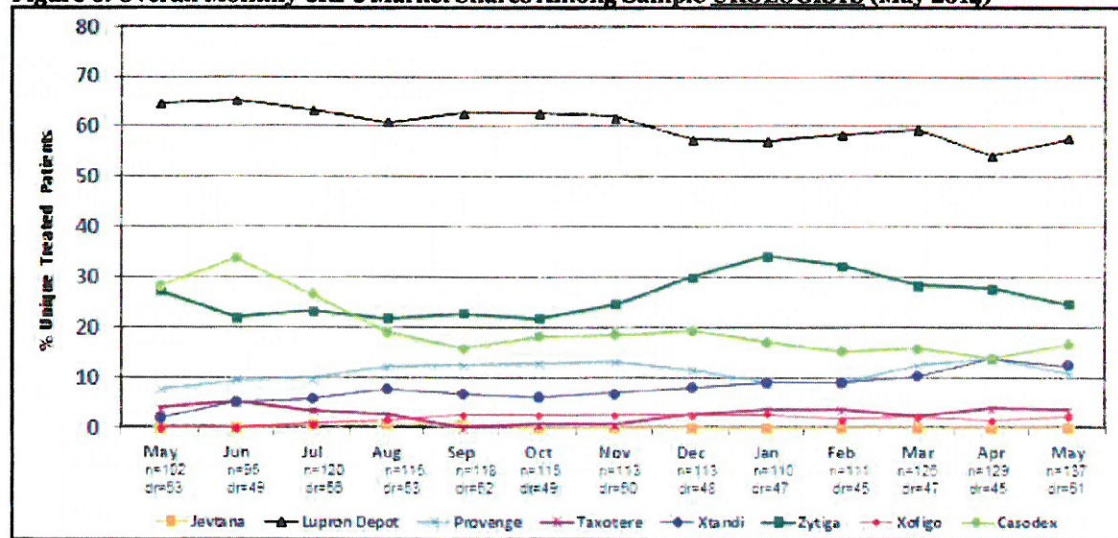


Figure 6. Overall Monthly CRPC Market Shares Among Sample UROLOGISTS (May 2014)



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