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Johnson & Johnson's Management Discusses Q3 2013 Results - Earnings Call Transcript

Oct.15.13 | About: Johnson & (JNJ)

Johnson & Johnson (NYSE:JNJ)

Q3 2013 Earnings Call

October 15, 2013, 8:30 am ET

Executives

Louise Mehrotra - Vice President of Investor Relations

Dominic Caruso - Chief Financial Officer, Vice President - Finance

Michel Orsinger - Worldwide Chairman of DePuy Synthes Companies

Analysts

Matthew Dodds - Citicorp

Mike Weinstein - JPMorgan

Kristen Stewart - Deutsche Bank

Larry Biegelsen - Wells Fargo

Tony Butler - Barclays Capital

Bruce Nudell - Credit Suisse

Jami Rubin - Goldman Sachs

Rick Wise - Stifel

Derrick Sung - Sanford Bernstein

Danielle Antalfy - Leerink Swann

Glenn Novarro - RBC Capital Markets

Bob Hopkins - Bank of America

Operator

Good morning, and welcome to the Johnson & Johnson third quarter 2013 earnings conference call. All participants will be able to listen-only until the question-and-answer session of the conference. This call is being recorded. If anyone has any objections you may disconnect at this time. (Operator Instructions).

I would now like to turn the call over to Johnson & Johnson, you may begin.

Louise Mehrotra

Good morning, and welcome. I am Louise Mehrotra, Vice President of Investor Relations for Johnson & Johnson and it is my pleasure this morning to review our business results for the third quarter of 2013. Joining me on the call today are Dominic Caruso, Vice President, Finance and Chief Financial Officer and Michel Orsinger, Worldwide Chairman of DePuy Synthes Companies.

A few logistics before we get into the details. This review is being made available to a broader audience via webcast accessible through the Investor Relations section of the Johnson & Johnson website. I will begin by briefly reviewing highlights of the third quarter for the corporation and highlights for our three business segments.

Following my remarks, Michel will provide an update on our DePuy Synthes business and the progress made on our near-term priorities in successfully integrating Synthes. Please note the presentations that accompanies Michel's remarks is available on our website.

Next Dominic will provide some additional commentary on the financial results and guidance for 2013. We will then open the call to your questions. We expect the call to last approximately 90 minutes. Included with the press release that was issued earlier this morning is a schedule of sales for key products and/or businesses to facilitate updating your models. These schedules are available on the Johnson & Johnson website as is the press release.

Before I get into the results, let me remind you that some of the statements made during this review may be considered forward-looking statements. The 10-K for the fiscal year 2012 identifies certain factors that could cause the company's actual results to differ

company does not undertake to update any forward-looking statements as a result of new information or future events or developments. The 10-K is available through the company and online.

During the review, non-GAAP financial measures are used to provide information pertinent to ongoing business performance. These non-GAAP financial measures should not be considered replacements for GAAP results. Tables reconciling these measures to the most comparable GAAP measures are available in the press release and on the Investor Relations section of the Johnson & Johnson website at investor.jnj.com.

Now, I would like to review our results for the third quarter of 2013. If you would refer to your copy of the press release, let's begin with the schedule titled, supplementary sales data by geographic area.

Worldwide sales to customers were \$17.6 billion for the third quarter of 2013, up 3.1% as compared to the third quarter of 2012. On an operational basis, sales were up 4.7% and currency had a negative impact of 1.6%. In the U.S., sales were up 1.7%. In regions outside the U.S., our operational growth was 7.1%, while the effect of currency exchange rates negatively impacted our reported results by 2.9 points. Europe grew 8.4% on an operational basis while the western hemisphere, excluding the U.S., grew by 8% operationally. Asia-Pacific/Africa region grew 5.1% operationally. The success of new product launches made strong contributions to the results in all regions.

If you now turn to the consolidated statements of earnings, net earnings were \$3 billion consistent with the 2012 results. Earnings per share were \$1.04 versus \$1.05 a year ago.

Please direct your attention to the box section of the schedule where we have provided earnings adjusted to exclude special items. As referenced in the accompanying table reconciling non-GAAP measures, 2013 third quarter net earnings were adjusted to exclude the after-tax special items of \$937 million, primarily related to an increase in the accrual for litigation expenses, in-process research and development and integration costs associated with the acquisition of Synthes.

Third quarter 2012, net earnings included after-tax special items of approximately \$553 million as shown in the reconciliation of non-GAAP financial measures, excluding these special items for both periods, net earnings for the current quarter were \$3.9 billion and diluted earnings per share were \$1.36, representing increases of 11.3% and 8.8%, respectively as compared to the same period in 2012.

I would now like to make some additional comments relative to the components leading to earnings before we move onto the segment highlights. For the third quarter of 2013, cost of goods sold at 30.4%, was down 240 basis points from the same period last year. In the third quarter of 2012, we recorded an inventory step up charge related to the Synthes acquisition. Excluding the inventory step up charge, which was treated as a special item, cost of goods sold decreased 150 basis points versus the same period last year. Positive mix, strong volume growth in our Pharmaceutical business and cost improvement initiatives across many of the businesses was partially offset by the impact of the medical device excise tax.

Third quarter selling, marketing and administrative expenses, were 30.2% of sales, or 40 basis points lower than our 2012 results due to cost containment initiatives across many of the businesses. Our investment in research and development as a percent of sales was 11.6%, up 30 basis points due to increased spending in the Pharmaceuticals business. Interest expense, net of interest income of \$87 million was down \$33 million versus the third quarter of 2012, due to a lower average debt level.

Other expense net of other income of \$943 million in the third quarter of 2013, compared to other income net of other expense of \$19 million in the same period last year. Excluding special items, other income net of other expense of \$43 million was \$132 million less than 2012, due primarily to the impact of 2012 gains on divestitures. Excluding special items, the effective tax rate was 18.9% in the third quarter of 2013 compared to 22.2% in the same period last year. Dominic will provide commentary on taxes in his remarks.

Turning now to business segment highlights, please refer to the supplementary sales schedule highlighting key products or businesses for the third quarter of 2013. I will begin with the consumer segment.

Worldwide consumer segment sales for the third quarter of 2013 of \$3.6 billion, increased 0.8% as compared to the same period last year. On an operational basis, sales increased 2%, while the impact of currency was negative 1.2%. U.S. sales were up 0.9%, while international sales grew 2.6% on an operational basis.

Excluding the impact of divestitures net of acquisitions, operational growth was approximately 2.5%. Baby care products increased on an operational basis by 2.6% when compared to the third quarter of 2012, due primarily to the impact of the health care products acquired earlier this year.

Sales in the Oral Care business decreased 3% operationally. Excluding the impact of the divestiture of manual toothbrushes in North America, operational sales were essentially flat.

For the third quarter of 2013, sales for OTC Pharmaceuticals increased 6.5% on an operational basis compared to the same period in 2012. U.S. sales were up 17.9%, driven by strong growth in analgesics and other key brands as we continue to make progress in returning a reliable supply of products to the marketplace.

International sales were up 2% operationally. Our skin care business grew 2.7% on an operational basis in the third quarter of 2013. Strong results for AVEENO were partially offset by the impact of divestitures. Excluding divestitures, operational growth was approximately 4%. Women's health grew 2.5% on an operational basis due to growth in international women's sanitary protection products. Wound care other sales decreased 6.9% on an operational basis impacted by competitive pressures as well as divestitures.

That completes our review of the consumer segment and I will now review highlights for the pharmaceutical segment. Worldwide net sales for the third quarter of \$7 billion increased 9.9% versus the same period last year. On an operational basis, sales increased 10.9% with a negative currency impact of one point. Sales in the U.S. increased 7.9%, while sales outside the U.S. increased on an operational basis by 14%.

Now reviewing sales for major therapeutic areas. Immunology products grew 13.4% operationally, with sales in the U.S. up 3% and sales outside the U.S. up 47.7% operationally. Earlier this year, the company made certain supply chain changes for REMICADE resulting in sales to distributors previously recorded as U.S. export sales now being recorded as international sales. Adjusting for this impact the U.S. immunology growth was approximately 8% and operational growth outside the U.S. was approximately 28%.

In the U.S., REMICADE excluding export sales was up 7.8%, SIMPONI was up 19.4% and STELARA was up 23.9%. Results were driven by market growth across the major products complemented by increased market share for both STELARA and SIMPONI. With the strength of our portfolio, we continue to be the U.S. market leader in immunology. REMICADE outside the U.S., adjusted for the supply chain change just mentioned, was up approximately 15% operationally due to strong growth in Canada and the emerging markets. STELARA made significant contributions to growth outside the U.S. due to

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