Agenda

• Credo & Awards
• Quick Figures
• Company Breakdown
  ➢ Consumer
  ➢ Medical Devices & Diagnostics
  ➢ Pharmaceuticals
• Geographic Sales Breakdown
• Risks
• Valuation
Quick Overview

- Hometown: New Jersey
- Divided into 3 business segments
  - Consumer Products
  - Pharmaceuticals
  - Medical Devices & Diagnostics (MD&D)
- Each arm can be examined as an individual company – Diversity within itself!

JNJ Credo

- Stakeholders over shareholders
- 50+ year history
- No explicit mission statement
- Serves as guidance for long term actions
- Socially responsible
- Consumers come first
- Thinking long-term
#1 Stunna’

- Ranked 1st by Fortune as America’s Most Admired Pharmaceutical Company
- Ranked 4th by Businessweek of nation’s top 50 major companies
- Ranked 1st by Chief Executive for top 20 company leaders
- Ranked 1st in WSJ as having America’s best corporate reputation for the 4th straight year

JNJ has been known for quality and continues to play up to its name.

Phat Figures

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<thead>
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<tbody>
<tr>
<td>Total Sales</td>
<td>$36,298</td>
<td>32,317</td>
<td>29,127</td>
<td>12.3%</td>
<td>10.8%</td>
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<tr>
<td>Net Income</td>
<td>6,597</td>
<td>5,668</td>
<td>4,953</td>
<td>16.4%</td>
<td>14.4%</td>
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<tr>
<td>Dividends</td>
<td>2,381</td>
<td>2,047</td>
<td>1,724</td>
<td>16.3%</td>
<td>18.7%</td>
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<tr>
<td>DPS</td>
<td>0.795</td>
<td>0.70</td>
<td>0.62</td>
<td>13.6%</td>
<td>12.9%</td>
</tr>
<tr>
<td>ROA</td>
<td>16.8%</td>
<td>15.4%</td>
<td>15.9%</td>
<td>9.0%</td>
<td>-3.1%</td>
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<tr>
<td>ROE</td>
<td>28.1%</td>
<td>25.4%</td>
<td>26.5%</td>
<td>10.6%</td>
<td>-4.1%</td>
</tr>
</tbody>
</table>
More “Phat” Figures

- Dividend increase each year for 41 consecutive years (Dividend Yield '03: $0.82/yr)
- Sales increase each year for 70 consecutive years
- Market Cap: $150 Billion
- '02 Earnings: $6.597 Billion
- Killer Q3: $10.46 Billion – 15% YoY Sales Growth
- 2002 Sales: $36.3 Billion – 12.3%YoY Growth
- 2003 est. Sales: $41.5 Billion - 14% Sales Growth
- Sitting on $3 Billion Cash
- Solvency: 1.8 – Safety First!
- Near 52 Week Low: 49.00 – Ripe Time to Buy

Consumer Products

Mature Product Lines
- Baby & Kids Care (#337)
- Skin/Hair Care ($421)
- McNeil Consumables ($498)
- Female Care Products ($358)

3Q Sales up 11% YoY
$1.84 Billion

Growth Brands
- Aveeno
- Neutrogena
- Splenda
- KY Warming Liquid
- Band-Aid Adhesives

International
- O.B. tampon & Liners
- Baby Skin Care
- Splenda
Consumer Products

Similar to Brand Management

- Advertising
- Distribution Channels
- Manufacturing

Advertising

“Having a Baby Changes Everything”

- Various target audiences
- Age: Generations D, Y, X, Baby Boomers
- Creates BRAND EQUITY and consequently market demand for product
- Determines profit margin
Distribution Channels

- **PROBLEM:** Lower-cost retailers (e.g., Wal-Mart) push downward pressure on prices

Johnson & Johnson’s Solutions

- **Strategy 1:** Increase sales volume
- **Strategy 2:** Increase brand equity and increase margins
- **Strategy 3:** Sell and produce internationally in order to raise sales and lower COGS

Return on Assets

- The objective for JNJ’s consumer arm is to maximize its RETURN ON ASSETS
- \( \text{ROA} = \text{the amount of income that is generated from the company’s assets} \)
- \( \text{ROA} = \text{Inventory Turnover} \times \text{Profit Margin} \)
- Objective is to maximize ROA by selling the right mixture of high turnover and high margin products
Sales Mix

Mature Product Lines
(High Turnover)
• Baby & Kids Care
• Skin/Hair Care
• McNeil Consumables

(High Margin)
• Female Care Products

Growth Brands
(High Margin)
• Aveeno
• Neutrogena
• Splenda
• KY Warming Liquid
• Band-Aid Adhesives

International
• O.B. tampon & Liners
• Baby Skin Care
• Splenda

Sales Breakdown

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
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<tbody>
<tr>
<td>Consumer</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>$3,605</td>
<td>$3,449</td>
<td>$3,403</td>
</tr>
<tr>
<td>International</td>
<td>2,959</td>
<td>2,871</td>
<td>2,868</td>
</tr>
<tr>
<td>18% Total</td>
<td>6,564</td>
<td>6,320</td>
<td>6,271</td>
</tr>
<tr>
<td>Pharmaceutical</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>11,191</td>
<td>10,240</td>
<td>8,441</td>
</tr>
<tr>
<td>International</td>
<td>5,232</td>
<td>4,611</td>
<td>4,220</td>
</tr>
<tr>
<td>47% Total</td>
<td>17,151</td>
<td>14,851</td>
<td>12,661</td>
</tr>
<tr>
<td>MD&amp;D</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>6,931</td>
<td>6,136</td>
<td>5,472</td>
</tr>
<tr>
<td>International</td>
<td>5,652</td>
<td>5,010</td>
<td>4,768</td>
</tr>
<tr>
<td>35% Total</td>
<td>12,583</td>
<td>11,146</td>
<td>10,240</td>
</tr>
<tr>
<td>Total Sales</td>
<td>$36,298</td>
<td>$32,517</td>
<td>$29,172</td>
</tr>
<tr>
<td>(10-12% Growth)</td>
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Manufacturing

Decentralized Production (Pros)
• Less control by corporate overlords
  – No control by single person
• Decisions made by local managers
• Value added for unit production is determined by market forces via transfer pricing

Decentralized Production (Cons)
• Barriers to communication
• Lack of information
• Wasted resources

Medical Devices & Diagnostics

• Room to grow: Devices must be constantly innovated
  – Cutler & McClellan
• Looking to cash in on the MD&D market
• Largest producer of MD&D products
  – catheters, sutures, forceps, orthopedics, medical sanitizers… virtually everything you need to stock a hospital/clinic
• 35% of current sales
• $12.6 Billion and still looking to grow strong!
MD&D: Stent Wars

- Currently owns the Stent market
  - $500MN dollar revenues
- Expected to be $5BN dollar market in 2005
- Boston Scientific in the registration phase
- Competitors take 50% market share by ‘05

NOT TO WORRY: IAG ends mid ’04, but more importantly, this is one micro product in the midst of a large division, which is simply one head of a three headed beast!

Pharmaceuticals

- Smaller than the behemoth companies but still a major player
- More focused on preventing non-lethal ailments
  - Ebola vs ADD
- 46% of Sales: $17.15BN
Pharmaceutical Issues

• Risk of inventory obsolesce (i.e. Procrit)
• Can only acquire short-term debt
• R&D vital to success
• Patent protections
• Need to lube the patent pipeline

Lubing the Dry Pipeline

• Acquisitions
  – Orquest Inc.
  – 3-Dimensional Pharmaceutical Inc.
  – Scios Inc.
  – Link Group Inc.
  – Tibotec-Virco
  – Obtech Medical
• Lots of new small fries to fill up the dry pipeline
• International growth (i.e. Remicade)
• Lots of free cash flow for R&D
**Risks?**

**Potential Risks**
- Wal-Mart price squeezing
  - Trimming fat returns
- Brand deterioration
  - BAND-AID
- Drug pipeline relatively dry
- MD&D competitors looking to steal market share
- Decrease in Procrit sales

**The Defense**
- Capable of finding the right sales mix
- Consumer products consists of only 18% sales
- BAND-AID growth impressive with new products
- Small fries
- Reputation and cash flows leverage against loss of market share

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**Historical Financials**

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<tr>
<td><strong>Average Sales Growth</strong></td>
<td><strong>11.14%</strong></td>
</tr>
<tr>
<td><strong>Average Net Income Growth</strong></td>
<td><strong>12.79%</strong></td>
</tr>
<tr>
<td><strong>Average Profit Margin</strong></td>
<td><strong>15.99%</strong></td>
</tr>
<tr>
<td><strong>Average Sales/NWC</strong></td>
<td><strong>18,258.12%</strong></td>
</tr>
<tr>
<td><strong>Average R&amp;D Expense Growth</strong></td>
<td><strong>18.80%</strong></td>
</tr>
<tr>
<td><strong>Average R&amp;D/Sales</strong></td>
<td><strong>10.79%</strong></td>
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## Valuation Assumptions

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Value</th>
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<tbody>
<tr>
<td>Risk-Free Rate</td>
<td>4.35%</td>
</tr>
<tr>
<td>Risk Premium</td>
<td>6.19%</td>
</tr>
<tr>
<td>Beta (2yr vs. S&amp;P)</td>
<td>.82</td>
</tr>
<tr>
<td>Cost of Equity</td>
<td>9.4%</td>
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**SHORT TERM: Buy / LONG TERM: Strong Buy**

**THANK YOU**