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JNJ.N - Q2 2022 Johnson & Johnson Earnings Call

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## OVERVIEW:

Co. reported 2Q22 sales of \$24b, adjusted net earnings of \$6.9b and adjusted diluted EPS of \$2.59. Expects full-year 2022 midpoint of adjusted operational sales to be \$97.8b and adjusted EPS (on constant currency basis) to be \$10.65-10.75.

## CORPORATE PARTICIPANTS

**Jessica Moore** *Johnson & Johnson - VP of IR*

**Joaquin Duato** *Johnson & Johnson - CEO & Director*

**Joseph J. Wolk** *Johnson & Johnson - Executive VP & CFO*

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## PRESENTATION

### Operator

Good morning, and welcome to Johnson & Johnson's Second Quarter 2022 Earnings Conference Call. (Operator Instructions) 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 conference call over to Johnson & Johnson. You may begin.

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### Unidentified Company Representative

Please note that today's meeting may include forward-looking statements relating to, among other things, the company's future financial performance, product development, market position and business strategy and the anticipated separation of the company's Consumer Health business. You're cautioned not to rely on these statements, which are based on current expectations of future events using the information available as of today's date and are subject to certain risks and uncertainties that may cause the company's actual results to differ materially from those projected.

In particular, there is significant uncertainty about the duration and contemplated impact of the COVID-19 pandemic. A further description of these risks, uncertainties and other factors can be found in our SEC filings, including our 2021 Form 10-K, which is available at [investor.jnj.com](http://investor.jnj.com) and on the SEC's website.

Additionally, several of the products and compounds discussed today are being developed in collaboration with strategic partners or licensed from other companies. These slides acknowledge those relationships.

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### Joaquin Duato - Johnson & Johnson - CEO & Director

Good morning, everyone. This is Joaquin Duato, Chief Executive Officer of Johnson & Johnson. Thanks for joining us today. I am accompanied by Joe Wolk and Jessica Moore, and we have the privilege to share our second quarter financial results and answer questions you have regarding Johnson & Johnson's business.

During my first 6 months as CEO, I have had the opportunity to reconnect in person with colleagues, customers and stakeholders around the world. These conversations have energized me about the future of Johnson & Johnson. They have also made clear the critical role our company plays as a leader in bringing innovative health care solutions to patients and customers, both today and long into the future. And they further validated that the 3 strategic priorities I outlined earlier this year will continue to guide us in 2022 as we deliver on our mission to transform the future of human health.

Let me remind you of those priorities. First, we will continue to advance our industry-leading success in pharmaceuticals by delivering the innovative pipeline we highlighted at our Pharmaceutical Business Review last November. This includes our goal to grow this sector to \$60 billion by 2025, with growth in every year, including years facing the STELARA loss of exclusivity and continuing to deliver above-market compounded annual growth of at least 5%.

In the second quarter, we saw evidence of this plan coming to fruition with the launch of CARVYKTI in April. And in May, we received conditional marketing authorization in Europe. In addition, talquetamab was granted FDA Breakthrough Therapy designation in June. I have great confidence in the strength of our current portfolio, which remains underappreciated, and in our robust pipeline to meet our long-term goals and to deliver transformational medicines that help improve and save lives.

Our second priority, continue to strengthen our performance in MedTech. Over the past several years, this acceleration in performance has been driven by the delivery of differentiated solutions as well as improved commercial execution. We expect this improvement to continue, enabled by our innovative pipeline as well as the potential for expansion into higher-growth market segments.

Currently, 11 MedTech platforms each deliver over \$1 billion in revenue annually. And based on the most recent results, we are gaining or holding share in nearly all of these. With the positive momentum in this business and our improvement in competitiveness, MedTech has delivered 6% adjusted operational growth in the first half of 2022. We believe MedTech will continue to be a significant source of value for our investors and our stakeholders.

Third, we are separating our Consumer Health business to create 2 market-leading stand-alone companies. This separation can be a significant opportunity for value creation. The 2 new global entities will be well positioned to thrive in their respective markets and drive greater strategic and financial success. We are making excellent progress and remain on track to complete the separation in 2023.

In the second quarter, we announced the global leadership team for the new Consumer Health organization led by Thibaut Mongon as CEO designate and Paul Ruh as CFO designate. Having worked with both Thibaut and Paul for many years, I'm confident that we have selected the right leadership team to lead the new Consumer Health company in its next chapter.

The new Johnson & Johnson comprising our Pharmaceutical and MedTech businesses will remain the largest, most diversified healthcare products company in the world with over \$80 billion in sales. With enhanced operational focus, the new Johnson & Johnson will be poised to bring integrated, comprehensive, disease-centric technology and innovative solutions to enhance patient care. Our balance sheet will remain strong, allowing us to pursue both organic and inorganic opportunities in higher growth markets across both segments, while maintaining our strong dividend distribution.

With these clear priorities in place, we are confident in our ability to execute on both our short-term and long-term objectives. We are very pleased to have delivered solid sales and earnings growth through the first half of 2022, reporting adjusted operational sales and EPS growth of 8% and 8.5%, respectively.

Joe and Jess will share details reflecting above-market adjusted operational sales growth from Pharmaceuticals and continued resiliency in both MedTech and Consumer Health results that stand out given the current global macroeconomic challenges. We are well positioned across the globe to sustain our leadership position in healthcare. We aspire to accelerate growth while maintaining the diversification in our business and our discipline around capital allocation, which have been foundational to our success for over the past 135 years.

I look forward to addressing your questions soon. But for now, I will turn the call over to Jessica Moore to discuss those details. Jess?

**Jessica Moore** - *Johnson & Johnson - VP of IR*

Thank you, Joaquin. This is Jessica Moore, Vice President of Investor Relations for Johnson & Johnson. As a reminder, you can find additional material, including today's presentation and associated schedules, on the Investor Relations section of the Johnson & Johnson website at investor.jnj.com.

We continue to implement enhancements in order to assist you in evaluating our performance. In addition to today's presentation and associated schedules, we will be posting the transcript of today's call as well as an Excel version of key financial schedules.

I will now review the second quarter sales and P&L results for the corporation and the 3 segments. Following, Joe will provide additional business and financial commentary, before sharing an overview of our cash position, our capital allocation priorities and updated guidance for 2022. The remaining time will be available for your questions. We anticipate the webcast will last up to 60 minutes.

Now let's move to second quarter results. Worldwide sales were \$24 billion for the second quarter of 2022, an increase of 3% versus the second quarter of 2021. Operational sales growth, which excludes the effect of translational currency, increased 8% as currency had a negative impact of 5 points. In the U.S., sales increased 2.3%.

In regions outside the U.S., our reported growth was 3.8%. Operational sales growth outside the U.S. was 13.9% with currency negatively impacting our reported OUS results by 10.1 points. Excluding the net impact of acquisitions and divestitures, adjusted operational sales growth was 8.1% worldwide, 2.4% in the U.S. and 14.2% outside the U.S.

Turning now to earnings. For the quarter, net earnings were \$4.8 billion and diluted earnings per share was \$1.80 versus diluted earnings per share of \$2.35 a year ago. Excluding after-tax intangible asset amortization expense and special items for both periods, adjusted net earnings for the quarter were \$6.9 billion and adjusted diluted earnings per share was \$2.59, representing increases of 4.3% and 4.4%, respectively, compared to the second quarter of 2021. On an operational basis, adjusted diluted earnings per share increased 10.9%.

I will now comment on business segment sales performance highlights. Unless otherwise stated, percentages quoted represent the operational sales change in comparison to the second quarter of 2021 and, therefore, exclude the impact of currency translation. As stated last quarter, we plan to keep our comments brief to leave more time for Q&A. Please refer to the slides for additional segment and franchise commentary.

Beginning with Consumer Health. Worldwide Consumer Health sales of \$3.8 billion decreased 1.3%, with a decline of 3.6% in the U.S. and growth of 0.6% outside the U.S. Operational sales growth, which excludes the effect of translational currency, increased 2.3% as currency had a negative impact of 3.6 points. Excluding the impact of acquisitions and divestitures, worldwide growth was 2.9%.

Results were primarily driven by strategic price increases, growth in OTC outside the U.S. due to a strong cold, cough and flu season and digestive health category recovery. This growth was partially offset by a weaker allergy season and supply constraints in the U.S., although these have improved from prior quarters. Furthermore, the Consumer Health business was negatively impacted by regional COVID-19 mobility restrictions, mainly affecting the Skin Health/Beauty franchise.

Moving on to our Pharmaceutical segment. Worldwide Pharmaceutical sale of \$13.3 billion increased 6.7% with growth of 4.2% in the U.S. and 9.8% outside of the U.S. Operational sales growth, which excludes the effect of translational currency, increased 12.3% as currency had a negative impact of 5.6 points. Excluding the impact of acquisitions and divestitures, worldwide growth was 12.4%. Excluding COVID-19 vaccine sales, worldwide operational sales growth was 8.6%. Results in the quarter were impacted by unfavorable prior-period adjustments, offset by favorable discounts.

Pharmaceutical growth was driven by our broad portfolio of products paired with strong commercial access and execution, enabling us to continue to deliver above-market adjusted operational sales growth, including 5 assets with double-digit growth in the quarter. Growth was due to strength from DARZALEX, STELARA, ERLEADA and TREMFYA, along with our paliperidone long-acting portfolio, which was partially offset by biosimilar competition for REMICADE, along with a decrease in IMBRUVICA sales.

DARZALEX and ERLEADA continued to drive strong operational sales growth with increases of 46.1% and 56.9%, respectively. STELARA growth of 18.6% was driven by strong market growth and meaningful share gains in Crohn's disease and ulcerative colitis. This represents 5.4 points and 7.4 points of share gain, respectively, in the U.S. Results in the quarter benefited from favorable discounts, partially offset by unfavorable prior-period adjustments for a net favorable impact of approximately 400 basis points.

TREMFYA grew 29.7%, driven by market growth and share gains in psoriasis and psoriatic arthritis. This represents 2.3 points and 3.2 points of share gain, respectively, in the U.S. Results in the quarter were impacted by an unfavorable prior-period adjustment of approximately 750 basis points in unfavorable patient mix.

IMBRUVICA operational sales declined 7.2% worldwide due to increased competition, particularly in the U.S. IMBRUVICA maintains its market leadership position worldwide and continues to drive operational growth outside of the U.S. despite ongoing competitive pressures. Given these results, we remain confident in our ability to deliver our 11th consecutive year of above-market adjusted operational sales growth in 2022.

I'll now turn your attention to the MedTech segment. Worldwide MedTech sales of \$6.9 billion decreased 1.1% with growth of 1.6% in the U.S. and declines of 3.6% outside of the U.S. Operational sales growth, which excludes the effect of translational currency, increased 3.4% as currency had a negative impact of 4.5 points. Excluding the impact of acquisitions and divestitures, worldwide growth was 3.4%. Operational sales also grew sequentially versus the prior quarter despite headwinds related to regional COVID-19 mobility restrictions as well as labor and supply constraints.

Drivers for growth across the MedTech business include procedure recovery, focused commercial strategies and differentiated new products driving enhanced or sustained market share positions in nearly all of our 11 priority platforms, each generating over \$1 billion in annual sales. For additional context, all franchises were affected by regional COVID-19 mobility restrictions, and selling days had an immaterial impact on results in the quarter.

Now turning to our consolidated statement of earnings for the second quarter of 2022. I'd like to highlight a few noteworthy items that have changed compared to the same quarter of last year. Cost of products sold deleveraged by 50 basis points, primarily driven by increased supply network-related cost with the COVID-19 vaccine and inflation, partially offset by favorable mix. We continued to invest strategically in research and development at competitive levels, investing 15.4% of sales this quarter. The \$3.7 billion invested was a 9.1% increase versus the prior year, primarily due to portfolio progression in Pharmaceutical and MedTech.

The other income and expense line was an expense of \$273 million in the second quarter of 2022 compared to a net income of \$488 million in the second quarter of 2021. This was primarily driven by litigation, higher unrealized losses on securities and Consumer Health separation costs in the current year, partially offset by favorable employee benefit plan-related items.

Regarding taxes in the quarter, our effective tax rate was 17.6% versus 5.8% in the same period last year. This was primarily driven by a 2021 one-time tax benefit from an internal reorganization of certain international subsidiaries. Excluding special items, the effective tax rate was 15.4% versus 14.8% in the same period last year. I encourage you to review our upcoming second quarter 10-Q filing for additional details on specific tax matters.

Lastly, I'll direct your attention to the box section of the slide, where we have also provided our income before tax, net earnings and earnings per share adjusted to exclude the impact of intangible amortization expense and special items.

Now let's look at adjusted income before tax by segment. In the second quarter of 2022, our adjusted income before tax for the enterprise as a percentage of sales increased from 33.4% to 34%, primarily driven by favorable product and segment mix, partially offset by inflation and portfolio progression in R&D.

Pharmaceutical margin improved from 39.4% to 42%, primarily driven by favorable product mix and brand marketing expense leverage. MedTech margins declined from 28.6% to 26.5%, driven by inflation, unfavorable product mix and increased investments to support new product launches and research and development. Finally, Consumer Health margins declined from 28.6% to 25.9% due to commodity inflation, partially offset by supply chain efficiencies and one-time favorable items in 2021.

This concludes the sales and earnings portion of the Johnson & Johnson second quarter results. I'm now pleased to turn the call over to Joe Wolk. Joe?

**Joseph J. Wolk** - *Johnson & Johnson - Executive VP & CFO*

Thank you, Jess. As Joaquin and Jess commented, our results remained solid across our 3 segments in the second quarter and through the first half of 2022, particularly in light of macroeconomic headwinds, such as inflation, select countries experiencing continuing impact from COVID-19 and geopolitical matters. Our sustainable, resilient business continues to deliver on the robust operational guidance that we set forth at the beginning of the year, while advancing breakthrough innovation and fostering patient access to make a positive impact across many areas of health care.

As previously discussed, we did build-in a healthy assumption to account for inflation in our January guidance, planning for increased costs in labor, energy and transportation. We noted in April, and are doing so again today, that these pressures will continue to impact margins in the third and fourth quarters and into 2023. As such, we continue to pursue mitigation efforts, including cost-improvement initiatives, strategic price increases and contract negotiations with external supply partners.

As for segment performance and key events in the quarter, in MedTech, you may recall that performance in Q2 2021 was the strongest of the year for most of the MedTech peer set, including Johnson & Johnson, making this second quarter our toughest comp. On a sequential operational basis and in line with our expectations, we did see an acceleration in sales, even considering the regional COVID-19-related mobility restrictions this quarter.

As Joaquin noted, we are focused on continuing the strong cadence of innovation in this business, which includes launches such as the next-generation ECHELON 3000 Stapler, a digitally enabled device demonstrating improved patient outcomes based on clinical evidence. It also includes the EMBOGUARD Balloon Guide Catheter, designed to optimize the removal of blood clots and reduce procedure time in the treatment of ischemic stroke.

In Pharmaceuticals, we continued to advance our pipeline and delivered operational sales growth of 8.6%, excluding the COVID-19 vaccine in the second quarter, notably above what we delivered in the first quarter of this year. We continue to outpace the market. During the second quarter, we recorded our first sales in the U.S. of CARVYKTI, a CAR-T therapy for the treatment of multiple myeloma developed together with Legend Biotech and received the European Commission approval in May.

We also presented new data across our broad oncology portfolio at the American Society of Clinical Oncology and the European Hematology Association in June. If you haven't done so already, I encourage you to listen to the fireside chat with Peter Lebowitz, our Global R&D Head of Oncology about this promising new data, which can be found on our website.

A quick update on our COVID-19 vaccine for which we suspended sales guidance last quarter. Recognizing the global progress on vaccine development and distribution against COVID-19 and the amount of existing global supply, we are modifying our COVID-19 vaccine research programs and manufacturing capacity to levels that meet all customer contractual commitments. This will result in incremental costs for the year, which will be reflected as a special item. We are proud of the role our vaccine continues to play in the fight against COVID-19.

In our Consumer Health business, similar to MedTech, Q2 of 2021 was last year's strongest quarter with 10% adjusted operational sales growth. We remain focused on our 2022 performance objectives of delivering above-market growth in our over-the-counter medicines business, while overcoming industry-wide supply constraints and inflationary pressures that are primarily impacting our Skin Health business.

We continue to be excited about the creation of the new Consumer Health company. Great work is being done by our teams to effect this complex transaction. We look forward to sharing the new Consumer Health company's name and branding as well as the headquarters' location in the months ahead. Similarly, we look forward to sharing transaction options and further financial details, adhering to regulatory policies later in 2022.

Finally, I would like to offer my congratulations to Thibaut, Paul and the rest of the leadership team regarding their recent appointments.

Turning now to cash and capital allocation. We generated free cash flow of approximately \$8 billion in the first half of the year. As of the end of the second quarter, we have approximately \$32.6 billion of cash and marketable securities and approximately \$32.6 billion of debt for a net neutral cash position. Our capital allocation priorities remain unchanged. Investing in innovation that delivers meaningful products to address unmet needs continues to be our top priority.

In the first half of the year, we increased R&D investment by approximately 9% compared to the first half of 2021. The dividend priority Joaquin referenced translated to us distributing \$6 billion to shareholders so far this year. We also continue to vigorously evaluate acquisition opportunities that would enhance the current portfolio, build upon our capabilities and enable us to play in higher-growth markets while yielding solid financial returns.

Moving to full year 2022 guidance and key considerations. The major takeaway is we are maintaining the midpoints of our guidance for adjusted operational sales growth of 7% at \$97.8 billion and adjusted operational earnings per share of \$10.70 or 9.2% growth for the full year. Given our confidence in delivering full year guidance, based on what we know today, we are tightening the adjusted earnings per share range from \$10.65 to \$10.75 on a constant currency basis.

Regarding the remainder of the P&L, there are a few updates. Due to the prolonged impact of inflationary pressures, we are updating our operating margins to be flat versus 2021. Regarding interest expense, based on our year-to-date experience, we have reduced the expense to a neutral position. Again, given year-to-date trends, we are increasing and tightening our other income estimate to be a range of \$1.4 billion to \$1.5 billion to reflect the favorable impact of employee benefit-related items.

That may appear light given the current run rate, but we have some one-time items such as real estate sales and Johnson & Johnson Development Corp. gains, which we don't expect to repeat in the second half of this year. Finally, we are lowering our effective tax rate estimate, which is reflective of current law, to a range of 15.0% to 15.5% based on our year-to-date progression.

As we always do, let me give you a sense of the impact currency may have on potential full year reported results, specifically the strengthening U.S. dollar. Utilizing the euro spot rate relative to the U.S. dollar as of last week at 1.0, there is an incremental unfavorable currency impact of \$1.5 billion on reported sales and an unfavorable \$0.20 impact for the estimated reported adjusted earnings per share versus the projection utilized in April's guidance.

The full year unfavorable impact is now projected to be \$4 billion on reported sales and \$0.65 on reported adjusted earnings per share. As this chart illustrates, it's not just that the euro and U.S. dollar have reached parity, something we haven't seen in nearly 2 decades, it's also the rapid pace at which the fluctuations are occurring. A dynamic only experienced a few times over that same period.

In addition, while it's much too early to comment on 2023, we do think it is helpful to point out what the currency impact may be if current assumptions for our estimate holds. Of the current \$0.65 unfavorable impact I just referenced, about \$0.30 to \$0.35 will carry over into 2023's EPS. Certainly, there's a long way to go before we finalize next year's outlook, but wanted to give you a sense of how to think about the foreign currency impact.

Back to the current year. In terms of 2022 quarterly phasing considerations for your models, we continue to estimate that the back half will improve over the first half with a slight bias for higher growth in Q4 over Q3. In Consumer Health, we have seen quarter-over-quarter reduction in supply disruptions that we anticipate will continue. We also expect to see the benefit of recent strategic price increases in the back half of the year. Finally, the fourth quarter of 2021 had lower growth than the third quarter, resulting in an easier comparison.

For MedTech, we expect the second half to be stronger than the first half, driven by market recovery from continued enhancement of our competitive position through commercial execution and uptake from our recently launched products. We expect the fourth quarter 2022 to be slightly stronger than the third quarter. COVID-19 continues to be a dynamic situation regionally, and we continue to monitor any related impacts.

For Pharmaceuticals, we anticipate delivering another year of above-market adjusted operational sales growth in our base business, with sales modestly accelerating through the end of the year.



To close out the prepared remarks, Johnson & Johnson has continued to post solid results as our teams navigate a challenging external environment. Our financial performance reinforces our confidence in our ability to grow and deliver near- and long-term value. That is only possible because of our employees around the world, who we'd like to thank for remaining focused on delivering our innovative health care solutions and results for all of our Credo stakeholders.

Joaquin, Jess and I will now turn the discussion to the Q&A portion of the call. Kevin, can you please provide instructions for those participants on the call wishing to ask a question?

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## QUESTIONS AND ANSWERS

### Operator

Certainly. (Operator Instructions) Our first question is coming from Terence Flynn from Morgan Stanley.

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### Terence C. Flynn - Morgan Stanley, Research Division - Equity Analyst

Great, thanks for taking the question. Maybe a two-part on the myeloma franchise. Obviously, another very strong quarter for DARZALEX. Just wondering where conversion of Sub-Q stands in the U.S. and Europe? And then the second part relates to, if you can share any metrics on the early CARVYKTI launch. Joe, I know you called that out, but just any insight there and then progress on increasing the supply of that product. Thank You.

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### Joaquin Duato - Johnson & Johnson - CEO & Director

So thank you for the question. And let me start giving you a perspective on our myeloma franchise, which is one of the areas of strength for our Pharmaceutical business. On one hand, we continue to have a great progression with DARZALEX with 47% growth in this quarter. And Jess will update you on the exact numbers of the conversion from SubQ to -- from IV to SubQ. What are the exact numbers?

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### Jessica Moore - Johnson & Johnson - VP of IR

Yes. In the U.S., we're about 85%. In Europe, we're around 80%.

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### Joaquin Duato - Johnson & Johnson - CEO & Director

Okay. So it continues to move in the right direction, given the enhanced convenience and ease of use for the patient that our Sub-Q formulation offers. So DARZALEX is doing very well, and we feel very confident about the continuous progression of DARZALEX.

On the other hand, we are also proud of the commercial launch of CARVYKTI in the U.S. following FDA approval and also the recent approval of CARVYKTI in EMEA. And together with that to complement the strength of our myeloma franchise, we have received recently 2 Breakthrough Designations on our CD3 redirectors, 1 for teclistamab and another 1 for talquetamab. So we are proud to have a very comprehensive myeloma franchise that due to its breadth will enable us to work to try to convert myeloma into -- from an incurable disease to a chronic disease and potentially when they occur by sequencing and combining this treatment.

So great area of strength for the Pharmaceutical business of Johnson & Johnson, and it's an area that connects on how we are executing in our pipeline and progressing and what we discussed in our November R&D Day, where we portray our Pharmaceutical pipeline as one of the important drivers of us being able to achieve a \$60 billion number in 2025. So it's a good sign of how we are progressing in our pipeline and in our existing portfolio with DARZALEX.



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**Operator**

Our next question is coming from Larry Biegelsen from Wells Fargo.

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**Lawrence H. Biegelsen** - *Wells Fargo Securities, LLC, Research Division - Senior Medical Device Equity Research Analyst*

Good morning, thanks for taking the questions. Just I'll ask a high-level macro question. So Joaquin and Joe, at a high level, what are your assumptions for the macro headwinds in the second half? Joe, what's getting better, what's not? I'm sure people would love to hear about input costs and inflation; COVID trends around the world, especially China; and lastly, hospital labor shortages. Thanks so much for taking the questions.

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**Joseph J. Volk** - *Johnson & Johnson - Executive VP & CFO*

Sure. Thanks for the question, Larry. And again, another nice job with the currency reporting. The macro headwinds, I would say, I would classify it as kind of 2 categories. The first is really around supply constraints, some of what we commented to at the end of last year that kind of persisted into the first part of this year. I would say that was primarily in our Consumer franchise, where product supply and availability inputs, if you will, were somewhat constrained.

We are seeing, I would say, an alleviation of some of those constraints, and that's why we anticipate, specifically our Skin Health and Beauty business to be much stronger in the second half. We know that point-of-sale demand continues to be strong for products like AVEENO and NEUTROGENA, and we just didn't have enough on the shelf in the first half. We do anticipate that we'll have more availability on the shelf in the second half of this year.

And then there's the input cost themselves. As you probably noticed, we did have higher cost of goods in the quarter relative to last year of about 50 basis points. That's really across the board. So some of the raw materials that go into our product, they're certainly at a higher cost due to limited availability. There is some higher wage pressures, as you've noted. I would say that's less within the world of Johnson & Johnson and our manufacturing entities and more around the third-party manufacturers that we contract with.

But I would say, those have stabilized. We did have a healthy assumption around inflation coming into the year. We think that it has increased as we've progressed through these first 6 months by about 40%. So some of that will play into next year's thinking as well. As you know, the accounting is such where what we're building today, some of that gets released to the P&L early next year.

But we think we were able to manage it, as you saw in our results, able to slightly beat. And we're being much more selective in terms of our resource deployment. We've raised the bar on our selectivity of where we invest, but we're very proud of the fact that we were able to increase what we believe our future depends upon, and that's innovation by a 9% increase in R&D.

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**Operator**

Our next question is coming from Chris Schott from JPMorgan.

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**Christopher Thomas Schott** - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Thanks so much, Can I just get latest thoughts on business development for both Pharma and MedTech? I guess specifically, are you're seeing additional opportunities in the Pharma business with biotech valuations now having been depressed for, I guess, 3 or 4 quarters? And then on the MedTech business, I know this is a priority, Joaquin. Can you just talk about the landscape you're seeing as the company continues to engage on essential opportunities there?

And then just a final one, just maybe following up on the last comment. For operating margins, I know they're flat this year due to inflation. Can we think about the company resuming operating margin expansion in 2023? Or does some of these inflationary pressures you're seeing still need to annualize, and it's not as clear of what the directional trend for '23 will be at this point? Thanks so much.

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**Joaquin Duato** - *Johnson & Johnson - CEO & Director*

Thank you, Chris. And let me start with the M&A question first, and then Joe will address the operating margin question. So M&A has always been an important component of Johnson & Johnson innovation. As I was talking in the past 5 years, we executed about 40 acquisitions, some major licensing agreements, investing over \$16 billion. And specifically in our Pharmaceutical business, about half of our innovation, it's coming sourced externally.

So when we look at M&A, we took -- we take a strategic approach. The first thing we try to look at is what is the improvement in the standard of care that we are looking in that particular opportunity and to what extent it enables us to get into higher-growth markets. And we are agnostic about which sector. So we try to look at those opportunities in the context of the improvement in standard of care, entering to higher-growth markets and delivering a fair financial return.

So as we look at the opportunities today in the market, we are not opportunistic about it, and we are still looking always at the fundamentals of these companies. And obviously, there are different opportunities in the market that are interesting and can complement our existing franchises or build into adjacencies.

When it comes to MedTech, the focus continues to be strengthening our current strongholds and also accessing some high-growth market segments to accelerate growth. And the target areas are the ones that we are operating today: eye health, orthopedics, cardiology, surgery. Historically, it's been a predictor of our success to the extent we were closer to the areas that we have capabilities.

When it comes to pharmaceuticals, we are looking at our key therapeutic areas: immunology, oncology, neuroscience, pulmonary hypertension and also cardiovascular and metabolics. So we are agnostic, as you know, at the source of innovation, and we use multiple modalities to onboard innovation from acquisitions to equity investments to strategic collaborations.

So down the road, we continue to see M&A as an important source of building our pipeline and also fortifying our current portfolio, and we are now in a position that, for the first time, right, Joe, in the last 5 years, we're in a cash-neutral position. And we continue to look at the opportunities that are out there, and we'll continue to do it.

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**Joseph J. Wolk** - *Johnson & Johnson - Executive VP & CFO*

Yes. Well said. Chris, thanks for the question regarding operating margins. I don't want to get too far out in front of my skis with respect to projecting next year at this point. But maybe some considerations that you should have in mind. We always look to streamline our business where possible, look for inefficiencies and either let that fall to the bottom line or preferably put that into R&D.

So as we close out the second half of the year, I'd like to see how our pipeline is progressing. If some of that's accelerated, that's going to be reason for additional investment. I do think these inflationary pressures will be here to stay. I don't see a lot of decreases on the near-term horizon.

I'd also ask you not to lose sight of the fact that we are separating out our Consumer Health business, and we are taking that opportunity to look at, I would say, how we support our business, the infrastructure that's involved with a 2-segment company versus the historical 3-segment company we have. I'd like to see a little bit more of the separation timeline play out before we commit to any of those efficiencies that may be gained there and exactly when the timing of those may be incurred, whether that's the first half or second half of 2023.

**Operator**

Our next question today is coming from Joanne Wuensch from Citi.

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**Joanne Karen Wuensch** - Citigroup Inc., Research Division - MD

Good morning and thanks for taking the question. Two parts. The first part, I want to just spend some time on hospital volumes, what you're seeing in terms of elective surgeries throughout the summer and then into the back half of the year? And then I'll toss the second question on now to you. You talked about targeted price increases. How do you think about "the target"? And how well are they being accepted? And I'm thinking not just in -- across the board, but almost specifically in MedTech.

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**Joaquin Duato** - Johnson & Johnson - CEO & Director

Joe, do you want to start with the targeted price increases and I go then to the hospital volumes.

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**Joseph J. Wolk** - Johnson & Johnson - Executive VP & CFO

Sure. Yes. So the targeted price increases we referred to, Joanne, and thanks for the question. In Consumer, that's kind of keeping consistent with the peer set to offset the inflationary pressures. We do know that while folks are looking to more generally cut back spending, that's been in entertainment, dining out, when it comes health care, better health, looking better, products like AVEENO, NEUTROGENA, Tylenol, Listerine, they seem to do really well, and consumers will prioritize those.

Specifically to MedTech, as you probably appreciate, a lot of our portfolio is really governed by contracts that are already in place with hospital systems. So it's difficult, unless there is certain inflationary clauses within those contracts. That's what we mean when we say targeted. It's very selective, and I would say it's probably not the majority of the hospital volumes or hospital contracting that you may see. Joaquin, you want to talk about volumes?

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**Joaquin Duato** - Johnson & Johnson - CEO & Director

When it comes to hospital volumes and the trajectory of MedTech in general, right? Overall, our MedTech business delivered 6% competitive growth in the first half of 2022 and delivered just over 1% sequential operational growth Q2 versus Q1. So that is in the middle of the market headwinds due to mobility restrictions, inflation and supply challenges. So a very resilient performance of our J&J MedTech business.

The fundamentals of our business remain strong and competitive, and we continue to see market share positive trajectory in nearly all of our 11 priority platforms in which we are maintaining or gaining share in the most recent period of Q1 2022. And we see also good progression in our pipeline and new products launched. Overall, for the market, when we are talking about the market specifically, we saw improvements in procedure volume in North America, in EMEA and in LatAm. That remained above pre-COVID levels through the quarter. So that was the positive side.

On the other hand, we saw the impact of regional mobility restrictions in Asia Pacific. Moving forward, we estimate that we will have continuous improvement in the second half of the year due to continued market recovery and also our own competitive momentum while, at the same time, we're going to continue to monitor the COVID-19 dynamics and the mobility restrictions in Asia Pacific.

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**Operator**

Our next question is coming from Louise Chen from Cantor Fitzgerald.

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**Louise Alesandra Chen** - *Cantor Fitzgerald & Co., Research Division - Senior Research Analyst & MD*

Thanks for taking my question here. So I wanted to ask you about milvexian and Factor X1a inhibitors and what you see the market opportunity to be. Also, what data will you be presenting at ESC this year? And then can you give any color on indications you'll be pursuing in your Phase III studies? Thank you.

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**Joaquin Duato** - *Johnson & Johnson - CEO & Director*

Thank you for the question. And milvexian, it's an important component of our pipeline. As a matter of fact, when we met with you in November, milvexian was one of the 5 medicines that we estimated we're going to continue peak sales of about \$5 billion. That was together with CARVYKTI, milvexian, nipocalimab, amivantamab plus lazertinib and the TARIS platform. So those were the 5 medicines that were going to contributing -- to contribute more than \$5 billion. And clearly, milvexian, it's an important one in that context.

We are developing milvexian, as you know, in collaboration with BMS, and we see this as an important opportunity to improve the standard of care in the current indications for oral anticoagulants, which are very large. And they are easily to be estimated because you know where they are used today, but also the potential to expand into areas in which today, oral anticoagulants are not used to bleeding concerns. So we see a very significant market opportunity for milvexian as an improvement of this category versus the Factor Xa.

So there are 2 Phase II studies that are assessing the potential of milvexian to reduce the risk of cardiovascular events. One is the one of total knee replacement. Data on that one was presented earlier in 2021. And the second one, which I guess is the one you are referring to, is the one in secondary stroke prevention, which we want to determine whether the addition of milvexian to aspirin and clopidogrel is more effective than standard antiplatelet therapy in secondary stroke prevention.

The data, as you know, is already in-house, and we expect to present it in a medical meeting in 2022. Specifically, I think it's at the end of August in a European cardiology meeting. And at that point, we shall see. But for us, if the data pans out, obviously, milvexian could have a very significant market opportunity that goes beyond the existing Factor Xa plus.

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**Operator**

Next question is coming from Josh Jennings from Cowen.

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**Joshua Thomas Jennings** - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Hi, good morning, thanks for taking the questions. I had just 2 on the Medical Devices franchise. And the first is, it's just on the volume recovery. I think as we listen to hospital executives and insurers talk about the volume recovery, we consistently hear about this not getting back to pre-pandemic levels even as we sit in the first half of 2022. I just wanted to kind of sanity check and, Joe and Joaquin, if there's any kind of metrics you can give us in terms of where J&J's volumes sit relative to 2019 levels?

I know it's not the most appropriate comp here as we're a couple of years out from 2019, but wanted to just get your views on where the disconnect is in terms of the revenue growth that we're seeing from your businesses off of 2019 versus volume growth. And why we're hearing some of this -- the commentary that we're not back to pre-pandemic volumes yet?

And then the second question, I guess, is for Joaquin, and just thinking about your strategy and to accelerate momentum in the MedTech business had a nice start to 2022. But wanted to kind of get a better understanding of, I guess, the plan and the road map in terms of the number of quarters, years that you envision assessing success and hitting your internal targets? Is this a 2- to 3-year plan? Or could you see acute strategic -- new strategies implemented if you're not seeing the momentum that you expect to see over the next 6 months, 12 months, 18 months? Thanks for taking both questions.

**Joseph J. Wolk** - *Johnson & Johnson - Executive VP & CFO*

Josh, this is Joe. Let me try to answer the first part of that question, and then I'll turn it over to Joaquin for the second part, the first part being around volume recovery. To your point, and it's something that we struggle with internally, it's really still clunky when it comes to comparative analysis versus prior periods. So we do look back at 2019, I can tell you our operational sales growth for MedTech over the first 6 months is about 10% overall.

I would say half of that is -- maybe 2/3 is really attributable to just a great job that Ashley and her team have been doing with launching new products and better execution. So our cadence of innovation has improved. We've got a lot of new offerings across really all 4 of those major franchises, and we're picking up market share because of that. And then I would say, probably the rest is procedure volume.

Again, it gets really difficult to really draw comparisons around procedure volume because we still are dealing with the impact of COVID in the second quarter alone in China. That impacted growth and procedures were down roughly 25% with a little bit improvement towards the last month from what we saw in April and May.

So we continue to look at that as well. But I would say the improvement in MedTech has really come from the stated goals that you heard a couple of years ago from Ashley and team, and that's a better cadence of innovation. I think we're going to -- we had 10 new products launched in the first half of this year. Roughly the same amount is [expected] (corrected by company after the call) in the second half. And then again, attracting market share with better effectiveness through our sales force and commercial efforts.

**Joaquin Duato** - *Johnson & Johnson - CEO & Director*

Yes. Thank you, Josh, and thank you for the question on MedTech because it gives me an opportunity to talk more about the performance of our MedTech business. And a couple of aspects there. One is the current performance and then how we are improving our market share and commercial execution and also our new product introduction and our pipeline progression.

So in the first half of the year, I just commented that our group had competitive growth of 6%. It's also underlying by our growth in the first quarter of 8.6%. We'll see how the rest of the sector performs in this quarter, but our growth in the first half of the year was a competitive growth with 6%. So in that sense, my view is that we are already getting competitive growth rates in MedTech with 6% in the first half of the year.

The growth rate in the second quarter has to be also put into perspective in the fact that the comparison with the second quarter of 2021 is a difficult one. MedTech grew 59% in the second quarter of 2021. And also there was some impact of the mobility restrictions in Asia Pacific. So we are improving our commercial execution and improving our pipeline.

In the commercial execution, the data that we have from the first quarter shows that we are maintaining or gaining share in 10 of our 11 largest platforms. So that's a good indication that the recovery is in play. And on the new product pipeline, there's many exciting new developments that we are getting to market, starting with the fact that our MONARCH robotic platform has received 510(k) clearance for urology indications, which are going to open a new market for us in kidney stones.

We have now enrolled the first [U.S.] (added by company after the call) patient in our electrophysiology pulsed-field ablation study, which is going to give us another innovation in our very successful electrophysiology business. We just launched our new Stapler ECHELON 3000, which is a digitally enabled device that comes also with significant evidence on how it improves patient outcomes in the cerebrovascular franchise. We just launched EMOGUARD Balloon Guide Catheter, which is designed to optimize the removal of blood clots in ischemic stroke and reducing time.

So there's a number of very positive developments that are enhancing our ability to launch new products there. So we feel optimistic about the combination of executing on our commercial priorities and, at the same time, continue the good cadence of new product innovation that is going to take us to competitive growth as demonstrated by our 6% growth in the first half of the year.

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**Operator**

Our next question is coming from Chris Shibutani from Goldman Sachs.

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**Chris Shibutani** - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Good morning and thank you. A two-part question on the U.S. immunology market in general, and TREMFYA specifically. Across the category, what's your view on the outlook for how the balance of the year will progress in the immunology category based upon what you're seeing in terms of patient volume trends year-to-date? And then specifically on TREMFYA, the performance and outlook there, you highlighted some share gains in both psoriasis and psoriatic arthritis. Where are these gains coming from? Can you help us understand competitive dynamics versus other biologics?

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**Joaquin Duato** - *Johnson & Johnson - CEO & Director*

Thank you. Thank you. Great question, Chris. Overall, we see a recovery in the immunology market with new patient levels already exceeding pre-COVID levels. So we are optimistic about the recovery, specifically utilizing the metric of new patients. So that's progressing well for the immunology market.

When it comes to TREMFYA, it continues to deliver strong growth worldwide, with net trade sales growing in the quarter about 30%, despite the headwind of a prior-period adjustment that has reduced about 750 basis points. So a strong performance of TREMFYA.

When it comes to share, I think it was commented that we capture about 2.5 points incremental in psoriasis and about a larger amount in psoriatic arthritis, where we're already the market share leader. It was 3 points in psoriatic arthritis.

It's difficult to tell you where this is coming from. I mean, we are assuming that this is going to be coming from older therapies that are there in the market, and that's where it's coming from. But clearly, TREMFYA is doing really well, both in psoriasis and in psoriatic arthritis. And in psoriatic arthritis it's the market-leading in new-to-brand share.

We are also pleased with the fact that we have published recently first and best-in-class 5-year durability data, and also that we have been able to be the only IL-23 therapy to demonstrate inhibition of structural damage in PsA. So we are very positive about the trajectory of TREMFYA, which is a reflection of the strength of our immunology franchise.

Continuing with the future of TREMFYA, which I think it's important for you to consider, we are now fully enrolled in our trial in ulcerative colitis, and we are nearing fully enrollment completion in our trial in Crohn's disease. So that predicates well for the growth of TREMFYA moving forward.

Addition that -- in addition to that, we presented very encouraging and interesting data in IBD in combination of TREMFYA with SIMPONI, so guselkumab with golimumab that show best-in-class results and best-in-class data, and we are very pleased with that. And also, if you look at our pipeline, we are also continuing to progress into Phase II with our own oral IL-23. So very strong future of TREMFYA, one of the key products in our growth moving forward, a very strong future for our franchise in immunology.

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**Jessica Moore** - *Johnson & Johnson - VP of IR*

Thank you, Chris. Kevin, we have time for one last question.

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**Operator**

Our final question today is coming from David Risinger from SVB Securities.

**David Reed Risinger** - *SVB Securities LLC, Research Division - Senior MD*

Yes, thanks very much. So congrats on the results and the updates. My question is about proposed drug pricing legislation, which is concerning given its potential impact on innovation and the state of New Jersey where you're headquartered. So could you please comment on how the legislation would negatively impact incentives to pursue transformational new medicines for seniors? And what J&J is doing to educate senators in New Jersey and beyond?

**Joaquin Duato** - *Johnson & Johnson - CEO & Director*

Thank you for the question and a great question. First, it's difficult for us to comment on the content of the legislation or the feasibility of that legislation passing. There's been a lot of ups and downs there. While we are very closely following the dynamics, the situation is still fluid. So it's difficult for us to comment on the actual legislation or in the feasibility.

Now if we believe that the legislation is going to be based on the language that we know from the Senate Finance Committee, as you pointed out, that will have a significant detrimental effect on the ability of the industry, of companies to be able to invest in R&D and to develop new medicines.

Just for perspective, the biopharmaceutical industry invested about \$120 billion in R&D in 2020. Johnson & Johnson, ourselves, in our Pharmaceutical business, we invested \$12 billion in R&D in 2021. So as a company that invests heavily in R&D, we can tell you that the type of legislation that was proposed by the Senate Finance Committee with Medicare price setting will have a chilling effect in innovation that will be translated in less new medicines for patients.

Again, for perspective, since 2000, the pharmaceutical industry has introduced about 1,000 new medicines. The impact that this will have may affect the advances that we have in multiple areas that are still needed to be able to advance patient care. So it's a very serious situation that will affect innovation, will affect our ability to invest in R&D and to develop new medicines.

Now we are also engaging with different stakeholders in trying to educate them about the impact of this type of legislation and innovation. But at the same time, we also want to sit at the table and participate in discussions to address what we believe is the major issue, which is patient affordability and patient access, specifically in Part D. So we think that, that's something that the industry has to address with the relevant stakeholders, and we are very willing to sit at the table and shoulder the consequences of being able to address the patient affordability issue.

Now I always have -- I always need to remind to you that in a price-constrained environment, Johnson & Johnson performs relatively better than most of our peers and competitors based on a number of factors. First, our diversification. Second, we have about half of our sales that come outside of the U.S. And third, specifically in the Pharmaceutical business, we have been able to deliver above-market growth in the face of mid-single-digit niche price decreases.

So we know how to grow in a difficult pricing environment. As a matter of fact, all of our growth comes from volume. So if you're thinking about where to be in these circumstances, Johnson & Johnson really, it's a good place based on its diversification and our ability to drive growth through volume.

**Jessica Moore** - *Johnson & Johnson - VP of IR*

Wonderful. Thank you, David, and thanks to everyone for your questions and your continued interest in our company. We apologize to those that we couldn't get to because of time, but don't hesitate to reach out to the Investor Relations team with any remaining questions that you may have. I will now turn the call back to Joaquin for some brief closing remarks.



**Joaquin Duato** - *Johnson & Johnson - CEO & Director*

Thank you, everybody, for participating in the call. Again, very pleased with the solid results achieved by our teams year-to-date. It shows the quality and the market leadership of our franchises and the great execution of our company in the middle of these challenges. We are also making good progress in the 3 strategic priorities that I outlined at the outset of this call regarding the consumer separation and the creation of the new Johnson & Johnson, our ability to continue to grow in our Pharmaceutical business through the STELARA patent expiration and our continued recovery and competitive growth and MedTech.

As we conclude today, also a quick reminder on our recent ESG investor update, which highlighted progress against our 2025 Health for Humanity goals. I encourage all of you to listen to the webcast replay on our website if you didn't have a chance to do it already. We look forward to connecting with all of you again and keeping you updated on our continuous progress on future earnings calls. Thank you very much.

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### Operator

Thank you. That does conclude our webcast and teleconference today. You may disconnect your lines at this time and have a wonderful day. We thank you for your participation today.

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