KEYCORP /NEW/
Form 10-Q
May 11, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2009
or

o **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 1-11302

(Exact name of registrant as specified in its charter)

Ohio	**34-6542451**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
127 Public Square, Cleveland, Ohio	**44114-1306**
(Address of principal executive offices)	(Zip Code)

(216) 689-6300

(Registrant s telephone number, including area code)

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. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Shares with a par value of $1 each	502,479,136 Shares
(Title of class)	(Outstanding at April 30, 2009)

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Consolidated Balance Sheets

in millions, except share data	**March 31, 2009 (Unaudited)**	**December 31, 2008**	**March 31, 2008 (Unaudited)**
ASSETS			
Cash and due from banks	**$ 637**	$ 1,257	$ 1,730
Short-term investments	**2,917**	5,221	577
Trading account assets	**1,279**	1,280	1,015
Securities available for sale	**8,530**	8,437	8,419
Held-to-maturity securities (fair value: $25, $25 and $29)	**25**	25	29
Other investments	**1,464**	1,526	1,561
Loans, net of unearned income of $2,143, $2,345 and $2,168	**73,703**	76,504	76,444
Less: Allowance for loan losses	**2,186**	1,803	1,298
Net loans	**71,517**	74,701	75,146
Loans held for sale	**1,124**	1,027	1,674
Premises and equipment	**847**	840	712
Operating lease assets	**889**	990	1,070
Goodwill	**917**	1,138	1,599
Other intangible assets	**112**	128	164
Corporate-owned life insurance	**2,994**	2,970	2,894
Derivative assets	**1,707**	1,896	1,508
Accrued income and other assets	**2,875**	3,095	3,394
Total assets	**$ 97,834**	$ 104,531	$ 101,492
LIABILITIES			
Deposits in domestic offices:			
NOW and money market deposit accounts	**$ 23,599**	$ 24,191	$ 26,527
Savings deposits	**1,795**	1,712	1,826
Certificates of deposit ($100,000 or more)	**13,250**	11,991	8,330
Other time deposits	**14,791**	14,763	12,933
Total interest-bearing	**53,435**	52,657	49,616
Noninterest-bearing	**11,760**	11,485	10,896
Deposits in foreign office interest-bearing	**801**	1,118	4,190
Total deposits	**65,996**	65,260	64,702
Federal funds purchased and securities sold under repurchase agreements	**1,565**	1,557	3,503
Bank notes and other short-term borrowings	**2,285**	8,477	5,464
Derivative liabilities	**932**	1,038	465
Accrued expense and other liabilities	**1,904**	2,523	4,252
Long-term debt	**14,978**	14,995	14,337

Total liabilities	**87,660**	93,850	92,723
EQUITY			
Preferred stock, $1 par value, authorized 25,000,000 shares:			
7.750% Noncumulative Perpetual Convertible Preferred Stock, Series A, $100 liquidation preference; authorized 7,475,000 shares; issued 6,575,000 shares	**658**	658	
Fixed-Rate Cumulative Perpetual Preferred Stock, Series B, $100,000 liquidation preference; authorized and issued 25,000 shares	**2,418**	2,414	
Common shares, $1 par value; authorized 1,400,000,000 shares; issued 584,061,120, 584,061,120 and 491,888,780 shares	**584**	584	492
Common stock warrant	**87**	87	
Capital surplus	**2,464**	2,553	1,659
Retained earnings	**6,160**	6,727	8,737
Treasury stock, at cost (85,487,810, 89,058,634, and 91,818,259 shares)	**(2,500)**	(2,608)	(2,689)
Accumulated other comprehensive income	**97**	65	393
Key shareholders equity	**9,968**	10,480	8,592
Noncontrolling interests	**206**	201	177
Total equity	**10,174**	10,681	8,769
Total liabilities and equity	**$ 97,834**	$ 104,531	$ 101,492

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Income (Unaudited)

dollars in millions, except per share amounts	Three months ended March 31, 2009	2008
INTEREST INCOME		
Loans	**$ 883**	$ 1,123
Loans held for sale	**12**	87
Securities available for sale	**108**	109
Held-to-maturity securities	**1**	1
Trading account assets	**13**	13
Short-term investments	**3**	9
Other investments	**12**	12
Total interest income	**1,032**	1,354
INTEREST EXPENSE		
Deposits	**300**	428
Federal funds purchased and securities sold under repurchase agreements	**1**	28
Bank notes and other short-term borrowings	**6**	39
Long-term debt	**111**	146
Total interest expense	**418**	641
NET INTEREST INCOME	**614**	713
Provision for loan losses	**875**	187
Net interest (loss) income after provision for loan losses	**(261)**	526
NONINTEREST INCOME		
Trust and investment services income	**117**	129
Service charges on deposit accounts	**82**	88
Operating lease income	**61**	69
Letter of credit and loan fees	**38**	37
Corporate-owned life insurance income	**27**	28
Electronic banking fees	**24**	24
Insurance income	**18**	15
Investment banking and capital markets income	**18**	8
Net securities (losses) gains	**(14)**	3
Net (losses) gains from principal investing	**(72)**	11
Net gains (losses) from loan securitizations and sales	**8**	(101)
Gain from sale/redemption of Visa Inc. shares	**105**	165
Other income	**80**	54
Total noninterest income	**492**	530
NONINTEREST EXPENSE		

Personnel		**362**		409
Net occupancy		**66**		66
Operating lease expense		**50**		58
Computer processing		**47**		47
Professional fees		**35**		23
FDIC assessment		**30**		2
Equipment		**22**		24
Marketing		**14**		14
Intangible assets impairment		**223**		
Other expense		**124**		90
Total noninterest expense		**973**		733
(LOSS) INCOME BEFORE INCOME TAXES		**(742)**		323
Income taxes		**(244)**		104
NET (LOSS) INCOME		**(498)**		219
Less: Net (loss) income attributable to noncontrolling interests		**(10)**		1
NET (LOSS) INCOME ATTRIBUTABLE TO KEY	**$**	**(488)**	**$**	**218**
Net (loss) income attributable to Key common shareholders	**$**	**(536)**	$	218
Per common share:				
Net (loss) income attributable to Key	**$**	**(1.09)**	$	.55
Net (loss) income attributable to Key assuming dilution		**(1.09)**		.54
Cash dividends declared		**.0625**		
Weighted-average common shares outstanding (000)		**492,813**		399,121
Weighted-average common shares and potential common shares outstanding (000)		**492,813**		399,769

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Changes in Equity (Unaudited)

Dollars in millions, except per share amounts	Preferred Stock Outstanding (000)	Common Shares Outstanding (000)	Key Shareholders Equity								
			Preferred Stock	Common Shares	Common Stock Warrant	Capital Surplus	Retained Earnings	Accumulated Treasury Stock at Cost	Other Comprehensive Income (Loss)	Noncontrolling Interests	Comprehensive Income (Loss)
BALANCE AT DECEMBER 31, 2007		388,793		$ 492		$ 1,623	$ 8,522	$ (3,021)	$ 130	$ 233	
Net income							218			1	$ 219
Other comprehensive income (loss):											
Net unrealized gains on securities available for sale, net of income taxes of $68 [a]									113		113
Net unrealized gains on derivative financial instruments, net of income taxes of $91									138		138
Net distribution to noncontrolling interests										(57)	(57)
Foreign currency translation adjustments									10		10
Net pension and postretirement benefit costs, net of income taxes									2		
Total comprehensive income											$ 424
Deferred compensation						(2)	(3)				
Common shares reissued:											
Acquisition of U.S.B. Holding Co., Inc.		9,895				58		290			
Stock options and other employee benefit plans		1,383				(20)		42			
BALANCE AT MARCH 31, 2008		400,071		$ 492		$ 1,659	$ 8,737	$ (2,689)	$ 393	$ 177	
BALANCE AT DECEMBER 31, 2008	6,600	495,002	$ 3,072	$ 584	$ 87	$ 2,553	$ 6,727	$ (2,608)	$ 65	$ 201	
Net loss							**(488)**			**(10)**	**$ (498)**
Other comprehensive income (loss):											
Net unrealized gains on securities available for sale, net of income taxes of $26 [a]									**44**		**44**
Net unrealized losses on derivative financial instruments, net of income taxes of ($5)									**(9)**		**(9)**
Net contribution from noncontrolling interests										**15**	**15**
Foreign currency translation adjustments									**(9)**		**(9)**
Net pension and postretirement benefit costs, net of income taxes									**6**		
Total comprehensive loss											**$ (457)**
Deferred compensation						**3**					
							(31)				

ash dividends declared on common shares .0625 per share)										
ash dividends declared on Noncumulative eries A										
eferred Stock ($1.9375 per share)							**(12)**			
ash dividends accrued on Cumulative eries B										
eferred Stock (5% per annum)							**(32)**			
mortization of discount on Series B eferred Stock			**4**				**(4)**			
ommon shares reissued for stock options and her employee benefit plans		**3,571**				**(92)**		**108**		
ALANCE AT MARCH 31, 2009	**6,600**	**498,573**	**$ 3,076**	**$ 584**	**$ 87**	**$ 2,464**	**$ 6,160**	**$ (2,500)**	**$ 97**	**$ 206**

(a) Net of reclassification adjustments.

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Cash Flows (Unaudited)

in millions	Three months ended March 31, 2009	2008
OPERATING ACTIVITIES		
Net (loss) income	**$ (498)**	$ 219
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Provision for loan losses	**875**	187
Intangible assets impairment	**223**	
Depreciation and amortization expense	**102**	110
Gain from sale/redemption of Visa Inc. shares	**(105)**	(165)
Net losses (gains) from principal investing	**72**	(11)
Net securities losses (gains)	**14**	(3)
Net (gains) losses from loan securitizations and sales	**(8)**	101
Liability to Visa		(64)
Deferred income taxes	**(176)**	(87)
Net increase in loans held for sale	**(181)**	(222)
Net decrease in trading account assets	**1**	41
Other operating activities, net	**(282)**	156
NET CASH PROVIDED BY OPERATING ACTIVITIES	**37**	262
INVESTING ACTIVITIES		
Proceeds from sale/redemption of Visa Inc. shares	**105**	165
Cash used in acquisitions, net of cash acquired		(157)
Net decrease in short-term investments	**2,304**	5
Purchases of securities available for sale	**(502)**	(331)
Proceeds from sales of securities available for sale	**16**	825
Proceeds from prepayments and maturities of securities available for sale	**458**	354
Purchases of held-to-maturity securities	**(6)**	(2)
Proceeds from prepayments and maturities of held-to-maturity securities	**6**	
Purchases of other investments	**(48)**	(174)
Proceeds from sales of other investments	**3**	84
Proceeds from prepayments and maturities of other investments	**28**	37
Net decrease (increase) in loans, excluding acquisitions, sales and transfers	**2,379**	(1,163)
Purchases of loans		(17)
Proceeds from loan securitizations and sales	**7**	144
Purchases of premises and equipment	**(33)**	(46)
Proceeds from sales of premises and equipment	**1**	
Proceeds from sales of other real estate owned	**5**	2
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	**4,723**	(274)
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	**736**	(202)
Net decrease in short-term borrowings	**(6,184)**	(1,610)
Net proceeds from issuance of long-term debt	**445**	2,241
Payments on long-term debt	**(300)**	(356)

Net proceeds from issuance of common shares		3
Tax benefits under recognized compensation cost for stock-based awards	**(2)**	
Cash dividends paid	**(75)**	(148)
NET CASH USED IN FINANCING ACTIVITIES	**(5,380)**	(72)
NET DECREASE IN CASH AND DUE FROM BANKS	**(620)**	(84)
CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD	**1,257**	1,814
CASH AND DUE FROM BANKS AT END OF PERIOD	**$ 637**	$ 1,730
Additional disclosures relative to cash flows:		
Interest paid	**$ 1,002**	$ 693
Income taxes (refunded) paid	**(126)**	15
Noncash items:		
Assets acquired		$ 2,810
Liabilities assumed		2,648
Loans transferred to portfolio from held for sale	**$ 84**	3,284
Loans transferred to other real estate owned	**45**	12

See Notes to Consolidated Financial Statements (Unaudited).

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Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The unaudited condensed consolidated interim financial statements include the accounts of KeyCorp and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

As used in these Notes:

- ***KeyCorp*** refers solely to the parent holding company;
- ***KeyBank*** refers to KeyCorp s subsidiary bank, KeyBank National Association; and
- ***Key*** refers to the consolidated entity consisting of KeyCorp and its subsidiaries.

The consolidated financial statements include any voting rights entity in which Key has a controlling financial interest. In accordance with Financial Accounting Standards Board (FASB) Revised Interpretation No. 46, Consolidation of Variable Interest Entities, a variable interest entity (VIE) is consolidated if Key has a variable interest in the entity and is exposed to the majority of its expected losses and/or residual returns (i.e., Key is considered to be the primary beneficiary). Variable interests can include equity interests, subordinated debt, derivative contracts, leases, service agreements, guarantees, standby letters of credit, loan commitments, and other contracts, agreements and financial instruments. See Note 8 (Variable Interest Entities), which begins on page 21, for information on Key s involvement with VIEs.

Management uses the equity method to account for unconsolidated investments in voting rights entities or VIEs in which Key has significant influence over operating and financing decisions (usually defined as a voting or economic interest of 20% to 50%, but not controlling). Unconsolidated investments in voting rights entities or VIEs in which Key has a voting or economic interest of less than 20% generally are carried at cost. Investments held by KeyCorp s registered broker-dealer and investment company subsidiaries (primarily principal investments) are carried at fair value.

Qualifying special purpose entities (SPEs), including securitization trusts, established by Key under the provisions of Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, are not consolidated. Information on SFAS No. 140 is included in Note 7 (Loan Securitizations and Mortgage Servicing Assets), which begins on page 18.

Management believes that the unaudited condensed consolidated interim financial statements reflect all adjustments of a normal recurring nature and disclosures that are necessary for a fair presentation of the results for the interim periods presented. Some previously reported amounts have been reclassified to conform to current reporting practices.

The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in Key s 2008 Annual Report to Shareholders.

Goodwill and Other Intangible Assets

Under SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and certain other intangible assets are subject to impairment testing, which must be conducted at least annually. Key performs the goodwill impairment testing in the fourth quarter of each year. Key s reporting units for purposes of this testing are its major business segments, Community Banking and National Banking. Due to the ongoing uncertainty regarding market conditions, which may continue to negatively impact the performance of Key s reporting units, management continues to monitor the impairment indicators for goodwill and other intangible assets and to evaluate the carrying amount of these assets, if necessary.

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During the first quarter of 2009, market conditions prompted management to review and evaluate the carrying amount of the goodwill and other intangible assets assigned to Key s Community Banking and National Banking units. This review indicated that the estimated fair value of the Community Banking unit was greater than its carrying amount, while the estimated fair value of the National Banking unit was less than its carrying amount, reflecting continued weakness in the financial markets. Based on the results of additional impairment testing required for the National Banking unit, Key recorded an after-tax noncash accounting charge of $187 million, or $.38 per common share, during the first quarter of 2009. Key s regulatory and tangible capital ratios were not affected by this adjustment. As a result of this charge, Key has now written off all of the goodwill that had been assigned to the National Banking unit.

Noncontrolling Interests

Key s Principal Investing unit and the Real Estate Capital and Corporate Banking Services line of business have noncontrolling (minority) interests. Key accounts for these interests in accordance with SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51. Key reports noncontrolling interests in subsidiaries as a component of equity on the consolidated balance sheets. Net (loss) income includes the revenues, expenses, gains and losses pertaining to both Key and the noncontrolling interests. The portion of net results attributable to the noncontrolling interests is disclosed separately on the face of Key s consolidated income statements to arrive at net (loss) income attributable to Key.

Offsetting Derivative Positions

In accordance with FASB Staff Position No. FIN 39-1, Amendment of FASB Interpretation 39, and Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts, Key takes into account the impact of master netting agreements that allow Key to settle all derivative contracts held with a single counterparty on a net basis and to offset the net derivative position with the related cash collateral when recognizing derivative assets and liabilities. Additional information regarding derivative offsetting is provided in Note 15 (Derivatives and Hedging Activities), which begins on page 30.

Accounting Pronouncements Adopted in 2009

Business combinations. In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. The new pronouncement requires the acquiring entity in a business combination to recognize only the assets acquired and liabilities assumed in a transaction (e.g., acquisition costs must be expensed when incurred), establishes the fair value at the date of acquisition as the initial measurement for all assets acquired and liabilities assumed, and requires expanded disclosures. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 (effective January 1, 2009, for Key). Early adoption was prohibited.

Noncontrolling interests. In December 2007, the FASB issued SFAS No. 160, which requires all entities to report noncontrolling interests in subsidiaries as a component of equity and sets forth other presentation and disclosure requirements. This guidance is effective for fiscal years beginning after December 15, 2008 (effective January 1, 2009, for Key). Early adoption was prohibited. Additional information regarding this guidance is provided in this note under the heading Noncontrolling Interests. Adoption of this guidance did not have a material effect on Key s financial condition or results of operations.

Accounting for transfers of financial assets and repurchase financing transactions. In February 2008, the FASB issued Staff Position No. FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This Staff Position provides guidance on accounting for a transfer of a financial asset and a repurchase financing, and presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing shall be evaluated separately. Staff Position No. FAS 140-3 is effective for fiscal years beginning after November 15, 2008 (effective January 1, 2009, for Key). Early adoption was prohibited. Adoption of this guidance did not have a material effect on Key s financial condition or results of operations.

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Disclosures about derivative instruments and hedging activities. In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which amends and expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This guidance requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts, and gains and losses on derivative instruments, and disclosures about credit risk contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008 (effective January 1, 2009, for Key). The required disclosures are provided in Note 15.

Determination of the useful life of intangible assets. In April 2008, the FASB issued Staff Position No. FAS 142-3, Determination of the Useful Life of Intangible Assets. This guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. This Staff Position is effective for fiscal years beginning after December 15, 2008 (effective January 1, 2009, for Key). Early adoption was prohibited. Adoption of this guidance did not have a material effect on Key s financial condition or results of operations.

Accounting for convertible debt instruments. In May 2008, the FASB issued Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). This guidance requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer s nonconvertible debt borrowing rate. This Staff Position is effective for fiscal years beginning after December 15, 2008 (effective January 1, 2009, for Key). Early adoption was prohibited. Key has not issued and does not have any convertible debt instruments outstanding that are subject to the accounting guidance in this Staff Position. Therefore, adoption of this guidance did not have an effect on Key s financial condition or results of operations.

Accounting Pronouncements Pending Adoption

Recognition and presentation of other-than-temporary impairments. In April 2009, the FASB issued Staff Position No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. This Staff Position provides new guidance on the recognition and presentation of other-than-temporary impairments of debt securities, and requires additional disclosures that are applicable to both debt and equity securities. This guidance will be effective for interim and annual periods ending after June 15, 2009 (effective June 30, 2009, for Key) with early adoption permitted. Adoption of this guidance is not expected to have a material effect on Key s financial condition or results of operations.

Interim disclosures about fair value of financial instruments. In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This guidance amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, and APB Opinion No. 28, Interim Financial Reporting, to require disclosures about the fair value of financial instruments in interim financial statements of publicly traded companies. This Staff Position will be effective for interim and annual periods ending after June 15, 2009 (effective June 30, 2009, for Key) with early adoption permitted.

Determining fair value when volume and level of activity have significantly decreased and identifying transactions that are not orderly. In April 2009, the FASB issued Staff Position No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. This Staff Position provides additional guidance for: (i) estimating fair value in accordance with SFAS No. 157, Fair Value Measurements, when the volume and level of activity for the asset or liability have significantly decreased, and (ii) identifying circumstances that indicate that a transaction is not orderly. This guidance emphasizes that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions (i.e., not a forced liquidation or distressed sale). Staff Position No. FAS 157-4 will be effective

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for interim and annual periods ending after June 15, 2009 (effective June 30, 2009, for Key) with early adoption permitted. Adoption of this accounting guidance is not expected to have a material effect on Key s financial condition or results of operations.

Employers disclosures about postretirement benefit plan assets. In December 2008, the FASB issued Staff Position No. FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets, which amends SFAS No. 132 (revised 2003), Employers Disclosures about Pensions and Other Postretirement Benefits. This guidance will require additional disclosures about assets held in an employer s defined benefit pension or other postretirement plan, including fair values of each major asset category and the levels within the fair value hierarchy as set forth in SFAS No. 157. This Staff Position will be effective for fiscal years ending after December 15, 2009 (effective December 31, 2009, for Key).

2. Earnings Per Common Share

Key s basic and diluted earnings per common share are calculated as follows:

	Three months ended March 31,	
dollars in millions, except per share amounts	**2009**	**2008**
EARNINGS		
Net (loss) income attributable to Key	**$ (488)**	$ 218
Less: Cash dividends declared on Series A Preferred Stock	**12**	
Cash dividends accrued on Series B Preferred Stock	**32**	
Amortization of discount on Series B Preferred Stock	**4**	
Net (loss) income attributable to Key common shareholders	**$ (536)**	$ 218
WEIGHTED-AVERAGE COMMON SHARES		
Weighted-average common shares outstanding (000)	**492,813**	399,121
Effect of dilutive convertible preferred stock, common stock options and other stock awards (000)		648
Weighted-average common shares and potential common shares outstanding (000)	**492,813**	399,769
EARNINGS PER COMMON SHARE		
Net (loss) income attributable to Key	**$ (1.09)**	$ .55
Net (loss) income attributable to Key assuming dilution	**(1.09)**	.54

3. Acquisition

Key completed the following acquisition in 2008.

U.S.B. Holding Co., Inc.

On January 1, 2008, Key acquired U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York. U.S.B. Holding Co. had assets of $2.840 billion and deposits of $1.804 billion at the date of acquisition. Under the terms of the agreement, Key exchanged 9,895,000 KeyCorp common shares, with a value of $348 million, and $194 million in cash for all of the outstanding shares of U.S.B. Holding Co. In connection with the acquisition, Key recorded goodwill of approximately $350 million in the Community Banking reporting unit. The acquisition expanded Key s presence in markets both within and contiguous to its current operations in the Hudson Valley.

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4. Line of Business Results

Community Banking

Regional Banking provides individuals with branch-based deposit and investment products, personal finance services, and loans, including residential mortgages, home equity and various types of installment loans. This line of business also provides small businesses with deposit, investment and credit products, and business advisory services. Regional Banking also offers financial, estate and retirement planning, and asset management services to assist high-net-worth clients with their banking, trust, portfolio management, insurance, charitable giving and related needs.

Commercial Banking provides midsize businesses with products and services that include commercial lending, cash management, equipment leasing, investment and employee benefit programs, succession planning, access to capital markets, derivatives and foreign exchange.

National Banking

Real Estate Capital and Corporate Banking Services consists of two business units, Real Estate Capital and Corporate Banking Services.

Real Estate Capital is a national business that provides construction and interim lending, permanent debt placements and servicing, equity and investment banking, and other commercial banking products and services to developers, brokers and owner-investors. This unit deals primarily with nonowner-occupied properties (i.e., generally properties in which at least 50% of the debt service is provided by rental income from nonaffiliated third parties). Real Estate Capital emphasizes providing clients with finance solutions through access to the capital markets.

Corporate Banking Services provides cash management, interest rate derivatives, and foreign exchange products and services to clients served by both the Community Banking and National Banking groups. Through its Public Sector and Financial Institutions businesses, Corporate Banking Services also provides a full array of commercial banking products and services to government and not-for-profit entities, and to community banks.

Equipment Finance meets the equipment leasing needs of companies worldwide and provides equipment manufacturers, distributors and resellers with financing options for their clients. Lease financing receivables and related revenues are assigned to other lines of business (primarily Institutional and Capital Markets, and Commercial Banking) if those businesses are principally responsible for maintaining the relationship with the client.

Institutional and Capital Markets, through its KeyBanc Capital Markets unit, provides commercial lending, treasury management, investment banking, derivatives, foreign exchange, equity and debt underwriting and trading, and syndicated finance products and services to large corporations and middle-market companies.

Through its Victory Capital Management unit, Institutional and Capital Markets also manages or offers advice regarding investment portfolios for a national client base, including corporations, labor unions, not-for-profit organizations, governments and individuals. These portfolios may be managed in separate accounts, common funds or the Victory family of mutual funds.

Consumer Finance provides government-guaranteed education loans to students and their parents, and processes tuition payments for private schools. Through its Commercial Floor Plan Lending unit, this line of business also finances inventory for automobile dealers. In October 2008, Consumer Finance exited retail and floor-plan lending for marine and recreational vehicle products and began to limit new education loans to those backed by government guarantee. This line of business continues to service existing loans in these portfolios and to honor existing education loan commitments. These actions are consistent with Key s strategy of de-emphasizing nonrelationship or out-of-footprint businesses.

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Other Segments

Other Segments consist of Corporate Treasury and Key s Principal Investing unit.

Reconciling Items

Total assets included under Reconciling Items primarily represent the unallocated portion of nonearning assets of corporate support functions. Charges related to the funding of these assets are part of net interest income and are allocated to the business segments through noninterest expense. Reconciling Items also includes intercompany eliminations and certain items that are not allocated to the business segments because they do not reflect their normal operations.

The table that spans pages 13 and 14 shows selected financial data for each major business group for the three-month periods ended March 31, 2009 and 2008. This table is accompanied by supplementary information for each of the lines of business that make up these groups. The information was derived from the internal financial reporting system that management uses to monitor and manage Key s financial performance. U.S. generally accepted accounting principles (GAAP) guides financial accounting, but there is no authoritative guidance for management accounting the way management uses its judgment and experience to make reporting decisions. Consequently, the line of business results Key reports may not be comparable with line of business results presented by other companies.

The selected financial data are based on internal accounting policies designed to compile results on a consistent basis and in a manner that reflects the underlying economics of the businesses. In accordance with Key s policies:

- Net interest income is determined by assigning a standard cost for funds used or a standard credit for funds provided based on their assumed maturity, prepayment and/or repricing characteristics. The net effect of this funds transfer pricing is charged to the lines of business based on the total loan and deposit balances of each line.

- Indirect expenses, such as computer servicing costs and corporate overhead, are allocated based on assumptions regarding the extent to which each line actually uses the services.

- Key s consolidated provision for loan losses is allocated among the lines of business primarily based on their actual net charge-offs, adjusted periodically for loan growth and changes in risk profile. The amount of the consolidated provision is based on the methodology that management uses to estimate Key s consolidated allowance for loan losses. This methodology is described in Note 1 (Summary of Significant Accounting Policies) under the heading Allowance for Loan Losses on page 79 of Key s 2008 Annual Report to Shareholders.

- Income taxes are allocated based on the statutory federal income tax rate of 35% (adjusted for tax-exempt interest income, income from corporate-owned life insurance, and tax credits associated with investments in low-income housing projects) and a blended state income tax rate (net of the federal income tax benefit) of 2.5%.

- Capital is assigned based on management s assessment of economic risk factors (primarily credit, operating and market risk) directly attributable to each line.

Developing and applying the methodologies that management uses to allocate items among Key s lines of business is a dynamic process. Accordingly, financial results may be revised periodically to reflect accounting enhancements, changes in the risk profile of a particular business or changes in Key s organizational structure.

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Three months ended March 31, *dollars in millions*	Community Banking 2009	Community Banking 2008	National Banking 2009	National Banking 2008
SUMMARY OF OPERATIONS				
Net interest income (loss) (TE)	**$ 415**	$ 422	**$ 286**	$ 338 [b]
Noninterest income	**189**	207	**251**	101
Total revenue (TE) [a]	**604**	629	**537**	439
Provision for loan losses	**81**	18	**789**	169
Depreciation and amortization expense	**36**	38	**66**	72
Other noninterest expense	**434**	387	**471** [b]	236
Income (loss) before income taxes (TE)	**53**	186	**(789)**	(38)
Allocated income taxes and TE adjustments	**20**	70	**(216)**	(14)
Net income (loss)	**33**	116	**(573)**	(24)
Less: Net (loss) income attributable to noncontrolling interests			**(2)**	
Net income (loss) attributable to Key	**$ 33**	$ 116	**$ (571)**	$ (24)
Percent of consolidated net income attributable to Key	**N/M**	53%	**N/M**	(11)%
Percent of total segments net income attributable to Key	**N/M**	103	**N/M**	(21)
AVERAGE BALANCES				
Loans and leases	**$ 28,940**	$ 28,085	**$ 46,197**	$ 44,162
Total assets [a]	**31,949**	31,016	**54,810**	56,193
Deposits	**51,560**	49,777	**12,214**	11,877
OTHER FINANCIAL DATA				
Net loan charge-offs	**$ 54**	$ 30	**$ 438**	$ 91
Return on average allocated equity	**4.13%**	15.93%	**(42.65)%**	(1.96)%
Average full-time equivalent employees	**8,887**	8,712	**3,024**	3,744

(a) Substantially all revenue generated by Key s major business groups is derived from clients with residency in the United States. Substantially all long-lived assets, including premises

and equipment, capitalized software and goodwill held by Key s major business groups are located in the United States.

(b) National Banking s results for the first quarter of 2009 include a noncash charge for goodwill and other intangible assets impairment of $223 million ($187 million after tax). During the first quarter of 2008, National Banking s taxable-equivalent net interest income and net results were reduced by $34 million and $21 million, respectively, as a result of its involvement with certain leveraged lease financing transactions which were challenged by the Internal Revenue Service (IRS).

(c) Reconciling Items for the first quarter of 2009 include a $105 million ($65 million after tax) gain from the sale of Key s remaining equity interest in Visa Inc. For the first quarter of 2008,

Reconciling Items include a $165 million ($103 million after tax) gain from the partial redemption of Key s equity interest in Visa Inc. and a $17 million charge to income taxes for the interest cost associated with the increase to Key s tax reserves for certain lease in, lease out (LILO) transactions.

TE = Taxable Equivalent, N/A = Not Applicable, N/M = Not Meaningful

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Other Segments 2009	Other Segments 2008	Total Segments 2009	Total Segments 2008	Reconciling Items 2009	Reconciling Items 2008	Key 2009	Key 2008
$ (45)	$ (27)	**$ 656**	$ 733	**$ (36)**	$ (29)	**$ 620**	$ 704
(33)	55	**407**	363	**85** [c]	167 [c]	**492**	530
(78)	28	**1,063**	1,096	**49**	138	**1,112**	1,234
		870	187	**5**		**875**	187
		102	110			**102**	110
10	11	**915**	634	**(44)**	(11)	**871**	623
(88)	17	**(824)**	165	**88**	149	**(736)**	314
(43)	(5)	**(239)**	51	**1**	44 [c]	**(238)**	95
(45)	22	**(585)**	114	**87**	105	**(498)**	219
(8)	1	**(10)**	1			**(10)**	1
$ (37)	$ 21	**$ (575)**	$ 113	**$ 87**	$ 105	**$ (488)**	$ 218
N/M	10%	**N/M**	52%	**N/M**	48%	**N/M**	100%
N/M	18	**N/M**	100	**N/A**	N/A	**N/A**	N/A
$ 156	$ 238	**$ 75,293**	$ 72,485	**$ 36**	$ 203	**$ 75,329**	$ 72,688
16,567	14,421	**103,326**	101,630	**489**	1,726	**103,815**	103,356
1,750	4,801	**65,524**	66,455	**(140)**	(169)	**65,384**	66,286
		$ 492	$ 121			**$ 492**	$ 121
N/M	N/M	**(25.34)%**	5.43%	**N/M**	N/M	**(19.12)%**	10.38%
41	43	**11,952**	12,499	**5,516**	5,927	**17,468**	18,426

Supplementary information (Community Banking lines of business)

Three months ended March 31, *dollars in millions*	Regional Banking 2009	Regional Banking 2008	Commercial Banking 2009	Commercial Banking 2008
Total revenue (TE)	**$ 511**	$ 528	**$ 93**	$ 101
Provision for loan losses	**69**	9	**12**	9
Noninterest expense	**419**	383	**51**	42
Net income	**14**	85	**19**	31
Average loans and leases	**20,004**	19,562	**8,936**	8,523
Average deposits	**47,784**	46,192	**3,776**	3,585
Net loan charge-offs	**53**	29	**1**	1
Net loan charge-offs to average loans	**1.07%**	.60%	**.05%**	.05%
Nonperforming assets at period end	**$ 216**	$ 142	**$ 115**	$ 62

Return on average allocated equity	**2.50%**	16.40%	**7.96%**	14.79%
Average full-time equivalent employees	**8,565**	8,380	**322**	332

TE = Taxable Equivalent

Supplementary information (National Banking lines of business)

Three months ended March 31, *dollars in millions*	**Real Estate Capital and Corporate Banking Services**		**Equipment Finance**		**Institutional and Capital Markets**		**Consumer Finance**	
	2009	**2008**	**2009**	**2008**	**2009**	**2008**	**2009**	**2008**
Total revenue (TE)	**$ 171**	$ 83	**$ 102**	$ 93	**$ 176**	$ 160	**$ 88**	$ 103
Provision for loan losses	**470**	45	**77**	24	**31**	16	**211**	84
Noninterest expense	**113**	60	**86**	95	**236**	105	**102**	48
Net (loss) income attributable to Key	**(270)**	(14)	**(38)**	(16)	**(101)**	24	**(162)**	(18)
Average loans and leases	**16,567**	16,497	**9,091**	10,596	**8,948**	7,632	**11,591**	9,437
Average loans held for sale	**269**	989	**28**	32	**267**	555	**514**	3,356
Average deposits	**9,987**	9,784	**17**	14	**1,773**	1,460	**437**	619
Net loan charge-offs	**218**	38	**44**	24	**45**	2	**131**	27
Net loan charge-offs to average loans	**5.34%**	.93%	**1.96%**	.91%	**2.04%**	.11%	**4.58%**	1.15%
Nonperforming assets at period end	**$ 1,072**	$ 732	**$ 215**	$ 69	**$ 59**	$ 12	**$ 300**	$ 98
Return on average allocated equity	**(45.38)%**	(3.00)%	**(21.71)%**	(6.94)%	**(33.33)%**	7.94%	**(60.95)%**	(7.94)%
Average full-time equivalent employees	**1,024**	1,233	**741**	885	**912**	938	**347**	688

TE = Taxable Equivalent

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5. Securities

Securities available for sale. These are securities that Key intends to hold for an indefinite period of time but that may be sold in response to changes in interest rates, prepayment risk, liquidity needs or other factors. Securities available for sale are reported at fair value. Unrealized gains and losses (net of income taxes) deemed temporary are recorded in shareholders equity as a component of accumulated other comprehensive income on the balance sheet. Unrealized losses on specific securities deemed to be other-than-temporary are included in net securities (losses) gains on the income statement, as are actual gains and losses resulting from the sales of securities using the specific identification method.

When Key retains an interest in loans it securitizes, it bears risk that the loans will be prepaid (which would reduce expected interest income) or not paid at all. Key accounts for these retained interests as debt securities and classifies them as available for sale.

Other securities held in the available-for-sale portfolio are primarily marketable equity securities.

Held-to-maturity securities. These are debt securities that Key has the intent and ability to hold until maturity. Debt securities are carried at cost, adjusted for amortization of premiums and accretion of discounts using the interest method. This method produces a constant rate of return on the adjusted carrying amount.

Other securities held in the held-to-maturity portfolio consist of foreign bonds, trust preferred securities and preferred equity securities.

The amortized cost, unrealized gains and losses, and approximate fair value of Key s securities available for sale and held-to-maturity securities are presented in the following tables. Gross unrealized gains and losses represent the difference between the amortized cost and the fair value of securities on the balance sheet as of the dates indicated. Accordingly, the amount of these gains and losses may change in the future as market conditions change.

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in millions	March 31, 2009 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	**$ 10**			**$ 10**
States and political subdivisions	**90**	**$ 1**		**91**
Collateralized mortgage obligations	**6,289**	**216**		**6,505**
Other mortgage-backed securities	**1,624**	**77**		**1,701**
Retained interests in securitizations	**166**	**1**		**167**
Other securities	**61**	**2**	**$ 7**	**56**
Total securities available for sale	**$ 8,240**	**$ 297**	**$ 7**	**$ 8,530**
HELD-TO-MATURITY SECURITIES				
States and political subdivisions	**$ 4**			**$ 4**
Other securities	**21**			**21**
Total held-to-maturity securities	**$ 25**			**$ 25**

in millions	December 31, 2008 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	$ 9	$ 1		$ 10
States and political subdivisions	90	1		91
Collateralized mortgage obligations	6,380	148	$ 5	6,523
Other mortgage-backed securities	1,505	63	1	1,567
Retained interests in securitizations	162	29		191
Other securities	71	1	17	55
Total securities available for sale	$ 8,217	$ 243	$ 23	$ 8,437
HELD-TO-MATURITY SECURITIES				
States and political subdivisions	$ 4			$ 4
Other securities	21			21
Total held-to-maturity securities	$ 25			$ 25

in millions	March 31, 2008 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	$ 18			$ 18
States and political subdivisions	92	$ 1		93
Collateralized mortgage obligations	6,355	170	$ 8	6,517
Other mortgage-backed securities	1,486	37	1	1,522
Retained interests in securitizations	153	33		186
Other securities	84	4	5	83
Total securities available for sale	$ 8,188	$ 245	$ 14	$ 8,419
HELD-TO-MATURITY SECURITIES				
States and political subdivisions	$ 8			$ 8
Other securities	21			21
Total held-to-maturity securities	$ 29			$ 29

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6. Loans and Loans Held for Sale

Key s loans by category are summarized as follows:

in millions	March 31, 2009	December 31, 2008	March 31, 2008
Commercial, financial and agricultural	**$ 25,405**	$ 27,260	$ 25,777
Commercial real estate:			
Commercial mortgage	**12,057** [(a)]	10,819	10,479
Construction	**6,208** [(a)]	7,717	8,473
Total commercial real estate loans	**18,265**	18,536 [(b)]	18,952
Commercial lease financing	**8,553**	9,039	10,000
Total commercial loans	**52,223**	54,835	54,729
Real estate residential mortgage	**1,759**	1,908	1,954
Home equity:			
Community Banking	**10,290**	10,124	9,678
National Banking	**998**	1,051	1,220
Total home equity loans	**11,288**	11,175	10,898
Consumer other Community Banking	**1,215**	1,233	1,266
Consumer other National Banking:			
Marine	**3,256**	3,401	3,653
Education	**3,700**	3,669	3,608
Other	**262**	283	336
Total consumer other National Banking	**7,218**	7,353	7,597
Total consumer loans	**21,480**	21,669	21,715
Total loans	**$ 73,703**	$ 76,504	$ 76,444

(a) In late March 2009, Key transferred $1.474 billion of loans from the construction portfolio to the commercial mortgage portfolio in accordance with regulatory guidelines pertaining to the

classification of loans that have reached a completed status.

(b) During the second quarter of 2008, Key transferred $384 million of commercial real estate loans ($719 million of primarily construction loans, net of $335 million in net charge-offs) from the loan portfolio to held-for-sale status.

Key uses interest rate swaps to manage interest rate risk; these swaps modify the repricing characteristics of certain loans. For more information about such swaps, see Note 19 (Derivatives and Hedging Activities), which begins on page 115 of Key s 2008 Annual Report to Shareholders.

Key s loans held for sale by category are summarized as follows:

in millions	**March 31, 2009**	**December 31, 2008**	**March 31, 2008**
Commercial, financial and agricultural	**$ 24**	$ 102	$ 291
Real estate commercial mortgage	**301**	273	1,139
Real estate construction	**151**	164 [(a)]	25
Commercial lease financing	**10**	7	31
Real estate residential mortgage	**183**	77	58
Home equity			1
Education	**453**	401	123
Automobile	**2**	3	6
Total loans held for sale	**$ 1,124**	$ 1,027	$ 1,674

(a) During the second quarter of 2008, Key transferred $384 million of commercial real estate loans

($719 million of primarily construction loans, net of $335 million in net charge-offs) from the loan portfolio to held-for-sale status.

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Changes in the allowance for loan losses are summarized as follows:

in millions	Three months ended March 31, 2009	2008
Balance at beginning of period	**$ 1,803**	$ 1,200
Charge-offs	**(520)**	(148)
Recoveries	**28**	27
Net loans charged off	**(492)**	(121)
Provision for loan losses	**875**	187
Allowance related to loans acquired, net		32
Balance at end of period	**$ 2,186**	$ 1,298

Changes in the liability for credit losses on lending-related commitments are summarized as follows:

in millions	Three months ended March 31, 2009	2008
Balance at beginning of period	**$ 54**	$ 80
Credit for losses on lending-related commitments		(27)
Balance at end of period [(a)]	**$ 54**	$ 53

(a) Included in accrued expense and other liabilities on the consolidated balance sheet.

7. Loan Securitizations and Mortgage Servicing Assets

Retained Interests in Loan Securitizations

A securitization involves the sale of a pool of loan receivables to investors through either a public or private issuance (generally by a qualifying SPE) of asset-backed securities. Generally, the assets are transferred to a trust that sells interests in the form of certificates of ownership. In previous years, Key sold education loans in securitizations; however, Key has not securitized any education loans since 2006 due to unfavorable market conditions.

When Key sells loans in securitizations, Key records a gain or loss when the net sale proceeds and residual interests, if any, differ from the loans allocated carrying amount. Gains or losses resulting from securitizations are recorded as one component of net gains (losses) from loan securitizations and sales on the income statement.

A servicing asset is recorded if Key purchases or retains the right to service securitized loans, and receives servicing fees that exceed the going market rate. Key generally retains an interest in securitized loans in the form of an interest-only strip, residual asset, servicing asset or security. Key s mortgage servicing assets are discussed under the heading Mortgage Servicing Assets on page 20. All other retained interests are accounted for as debt securities and classified as securities available for sale.

In accordance with Revised Interpretation No. 46, Consolidation of Variable Interest Entities, qualifying SPEs, including securitization trusts, established by Key under SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, are exempt from consolidation. Information related to Revised Interpretation No. 46 is included in Note 1 (Basis of Presentation), which begins on page 7.

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Management uses certain assumptions and estimates to determine the fair value to be allocated to retained interests at the date of transfer and at subsequent measurement dates. Primary economic assumptions used to measure the fair value of Key s retained interests in education loans and the sensitivity of the current fair value of residual cash flows to immediate adverse changes in those assumptions at March 31, 2009, are as follows:

dollars in millions

Fair value of retained interests	$	168
Weighted-average life (years)		1.0 - 6.7
PREPAYMENT SPEED ASSUMPTIONS (ANNUAL RATE)		4.00% - 30.00%
Impact on fair value of 1% CPR adverse change	$	(7)
Impact on fair value of 2% CPR adverse change		(10)
EXPECTED CREDIT LOSSES (STATIC RATE)		.14% - 26.40%
Impact on fair value of .25% adverse change	$	(4)
Impact on fair value of .50% adverse change		(8)
RESIDUAL CASH FLOWS DISCOUNT RATE (ANNUAL RATE)		8.50% - 14.00%
Impact on fair value of 1% adverse change	$	(6)
Impact on fair value of 2% adverse change		(12)
EXPECTED STATIC DEFAULT (STATIC RATE)		3.75% - 33.00%
Impact on fair value of 1% adverse change	$	(32)
Impact on fair value of 2% adverse change		(64)
VARIABLE RETURNS TO TRANSFEREES		(a)

These sensitivities are hypothetical and should be relied upon with caution. Sensitivity analysis is based on the nature of the asset, the seasoning (i.e., age and payment history) of the portfolio and historical results. Changes in fair value based on a 1% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption. In reality, changes in one factor may cause changes in another. For example, increases in market interest rates may result in lower prepayments and increased credit losses, which might magnify or counteract the sensitivities.

(a) Forward London Interbank Offered Rate (LIBOR) plus contractual spread over LIBOR ranging from .00% to 1.15%.

CPR = Constant
Prepayment Rate

The fair value measurement of Key s mortgage servicing assets is described under the heading Mortgage Servicing Assets on page 20. Management conducts a quarterly review of the fair values of its other retained interests. The historical performance of each retained interest and the assumptions used to project future cash flows are reviewed, assumptions are revised and present values of cash flows are recalculated, as appropriate.

The present values of cash flows represent the fair value of the retained interests. If the carrying amount of a retained interest classified as a security available for sale exceeds its fair value, impairment is indicated and recognized in earnings if considered to be other-than-temporary or recognized in equity as accumulated other comprehensive income if deemed to be temporary. Conversely, if the fair value of the retained interest exceeds its carrying value, the increase in fair value is recorded in equity as accumulated other comprehensive income.

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The table below shows the relationship between the education loans Key manages and those held in the loan portfolio. Managed loans include those held in portfolio and those securitized and sold, but still serviced by Key. Related delinquencies and net credit losses are also presented.

March 31, 2009 *in millions*	**Loan Principal**	**Loans Past Due 60 days or More**	**Net Credit Losses During the Quarter**
Education loans managed	$ 8,299	$ 247	$ 60
Less: Loans securitized	4,146	154	28
Loans held for sale or securitization	453	7	
Loans held in portfolio	$ 3,700	$ 86	$ 32

Mortgage Servicing Assets

Key originates and periodically sells commercial mortgage loans but continues to service those loans for the buyers. Key also may purchase the right to service commercial mortgage loans for other lenders. Changes in the carrying amount of mortgage servicing assets are summarized as follows:

	Three months ended March 31,	
in millions	**2009**	**2008**
Balance at beginning of period	**$ 242**	$ 313
Servicing retained from loan sales	**1**	2
Amortization	**(15)**	(28)
Balance at end of period	**$ 228**	$ 287
Fair value at end of period	**$ 384**	$ 425

The fair value of mortgage servicing assets is determined by calculating the present value of future cash flows associated with servicing the loans. This calculation uses a number of assumptions that are based on current market conditions. Primary economic assumptions used to measure the fair value of Key s mortgage servicing assets at March 31, 2009 and 2008, are:

- prepayment speed generally at an annual rate of 0.00% to 25.00%;
- expected credit losses at a static rate of 2.00%; and
- residual cash flows discount rate of 8.50% to 15.00%.

Changes in these assumptions could cause the fair value of mortgage servicing assets to change in the future. The volume of loans serviced and expected credit losses are critical to the valuation of servicing assets. A 1.00% increase in the assumed default rate of commercial mortgage loans at March 31, 2009, would cause a $9 million decrease in the fair value of Key s mortgage servicing assets.

Contractual fee income from servicing commercial mortgage loans totaled $16 million and $17 million for the three-month periods ended March 31, 2009 and 2008, respectively. Key has elected to remeasure servicing assets using the amortization method. The amortization of servicing assets is determined in proportion to, and over the period of, the estimated net servicing income. The amortization of servicing assets for each period, as shown in the preceding table, is recorded as a reduction to fee income. Both the contractual fee income and the amortization are recorded in other income on the income statement.

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Servicing assets are evaluated quarterly for possible impairment. This process involves classifying the assets based on the types of loans serviced and their associated interest rates, and determining the fair value of each class. If the evaluation indicates that the carrying amount of the servicing assets exceeds their fair value, the carrying amount is reduced through a charge to income in the amount of such excess. For the three-month periods ended March 31, 2009 and 2008, no servicing asset impairment occurred.

8. Variable Interest Entities

A VIE is a partnership, limited liability company, trust or other legal entity that meets any one of the following criteria:

- The entity does not have sufficient equity to conduct its activities without additional subordinated financial support from another party.

- The entity s investors lack the authority to make decisions about the activities of the entity through voting rights or similar rights, and do not have the obligation to absorb the entity s expected losses or the right to receive the entity s expected residual returns.

- The voting rights of some investors are not proportional to their economic interest in the entity, and substantially all of the entity s activities involve or are conducted on behalf of investors with disproportionately few voting rights.

Key s VIEs, including those consolidated and those in which Key holds a significant interest, are summarized below. Key defines a significant interest in a VIE as a subordinated interest that exposes Key to a significant portion, but not the majority, of the VIE s expected losses or residual returns.

	Consolidated VIEs	Unconsolidated VIEs		
March 31, 2009				**Maximum**
in millions	**Total Assets**	**Total Assets**	**Total Liabilities**	**Exposure to Loss**
Low-income housing tax credit (LIHTC) funds	$ 236	$ 202		
LIHTC investments	N/A	987		$ 362

N/A = Not Applicable

Key s involvement with VIEs is described below.

Consolidated VIEs

LIHTC guaranteed funds. Key Affordable Housing Corporation (KAHC) formed limited partnerships (funds) that invested in LIHTC operating partnerships. Interests in these funds were offered in syndication to qualified investors who paid a fee to KAHC for a guaranteed return. Key also earned syndication fees from these funds and continues to earn asset management fees. The funds assets primarily are investments in LIHTC operating partnerships, which totaled $225 million at March 31, 2009. These investments are recorded in accrued income and other assets on the balance sheet and serve as collateral for the funds limited obligations. Key has not formed new funds or added LIHTC partnerships since October 2003. However, Key continues to act as asset manager and provides occasional funding for existing funds under a guarantee obligation. As a result of this guarantee obligation, management has determined that Key is the primary beneficiary of these funds. Key did not record any expenses related to this guarantee obligation during the first three months of 2009. Additional information on return guarantee agreements with LIHTC investors is presented in Note 14 (Contingent Liabilities and Guarantees) under the heading Guarantees on page 27.

The partnership agreement for each guaranteed fund requires the fund to be dissolved by a certain date. In accordance with SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, the third-party interests associated with these funds are considered mandatorily

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redeemable instruments and are recorded in accrued expense and other liabilities on the balance sheet. The FASB has indefinitely deferred the measurement and recognition provisions of SFAS No. 150 for mandatorily redeemable third-party interests associated with finite-lived subsidiaries, such as Key s LIHTC guaranteed funds. Key adjusts the financial statements each period for the third-party investors share of the funds profits and losses. At March 31, 2009, the settlement value of these third-party interests was estimated to be between $171 million and $178 million, while the recorded value, including reserves, totaled $229 million.

Unconsolidated VIEs

LIHTC nonguaranteed funds. Although Key holds significant interests in certain nonguaranteed funds that Key formed and funded, management has determined that Key is not the primary beneficiary of those funds because Key does not absorb the majority of the expected losses of the funds. At March 31, 2009, assets of these unconsolidated nonguaranteed funds totaled $202 million. Key s maximum exposure to loss in connection with these funds is minimal, and Key does not have any liability recorded related to the funds. Management elected to cease forming these funds in October 2003.

LIHTC investments. Through the Community Banking business group, Key has made investments directly in LIHTC operating partnerships formed by third parties. As a limited partner in these operating partnerships, Key is allocated tax credits and deductions associated with the underlying properties. Management has determined that Key is not the primary beneficiary of these investments because the general partners are more closely associated with the business activities of these partnerships. At March 31, 2009, assets of these unconsolidated LIHTC operating partnerships totaled approximately $987 million. Key s maximum exposure to loss in connection with these partnerships is the unamortized investment balance of $293 million at March 31, 2009, plus $69 million of tax credits claimed but subject to recapture. Key does not have any liability recorded related to these investments because Key believes the likelihood of any loss in connection with these partnerships is remote. During the first three months of 2009, Key did not obtain significant direct investments (either individually or in the aggregate) in LIHTC operating partnerships. Key has additional investments in unconsolidated LIHTC operating partnerships that are held by the consolidated LIHTC guaranteed funds. Total assets of these operating partnerships were approximately $1.527 billion at March 31, 2009. The tax credits and deductions associated with these properties are allocated to the funds investors based on their ownership percentages. Management has determined that Key is not the primary beneficiary of these partnerships because the general partners are more closely associated with the business activities of these partnerships. Information regarding Key s exposure to loss in connection with these guaranteed funds is included in Note 14 under the heading Return guarantee agreement with LIHTC investors on page 28.

Commercial and residential real estate investments and principal investments. Key s Principal Investing unit and the Real Estate Capital and Corporate Banking Services line of business make equity and mezzanine investments, some of which are in VIEs. These investments are held by nonregistered investment companies subject to the provisions of the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, Audits of Investment Companies. Key is not currently applying the accounting or disclosure provisions of Revised Interpretation No. 46 to these investments, which remain unconsolidated; the FASB deferred the effective date of Revised Interpretation No. 46 for such nonregistered investment companies until the AICPA clarifies the scope of the Audit Guide.

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9. Nonperforming Assets and Past Due Loans

Impaired loans totaled $1.472 billion at March 31, 2009, compared to $985 million at December 31, 2008, and $839 million at March 31, 2008. Impaired loans had an average balance of $1.229 billion for the first quarter of 2009 and $679 million for the first quarter of 2008.

Key s nonperforming assets and past due loans were as follows:

in millions	**March 31, 2009**	**December 31, 2008**	**March 31, 2008**
Impaired loans	**$ 1,472**	$ 985	$ 839
Other nonaccrual loans	**266**	240	215
Total nonperforming loans	**1,738**	1,225	1,054
Nonperforming loans held for sale	**72**	90 [(a)]	9
Other real estate owned (OREO)	**147**	110	29
Allowance for OREO losses	**(4)**	(3)	(2)
OREO, net of allowance	**143**	107	27
Other nonperforming assets [(b)]	**44**	42	25
Total nonperforming assets	**$ 1,997**	$ 1,464	$ 1,115
Impaired loans with a specifically allocated allowance	**$ 1,327**	$ 876	$ 789
Specifically allocated allowance for impaired loans	**233**	178	177
Accruing loans past due 90 days or more	**$ 458**	$ 433	$ 283
Accruing loans past due 30 through 89 days	**1,407**	1,314	1,169

(a) During the second quarter of 2008, Key transferred $384 million of commercial real estate loans ($719 million of primarily construction loans, net of $335 million in net charge-offs) from the loan portfolio to held-for-sale status.

(b) Primarily investments held by the Private Equity unit within Key s Real Estate Capital and Corporate Banking Services line of business.

At March 31, 2009, Key did not have any significant commitments to lend additional funds to borrowers with loans on nonperforming status.

Management evaluates the collectibility of Key s loans as described in Note 1 (Summary of Significant Accounting Policies) under the heading Allowance for Loan Losses on page 79 of Key s 2008 Annual Report to Shareholders.

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10. Capital Securities Issued by Unconsolidated Subsidiaries

KeyCorp owns the outstanding common stock of business trusts that issued corporation-obligated mandatorily redeemable preferred capital securities. The trusts used the proceeds from the issuance of their capital securities and common stock to buy debentures issued by KeyCorp. These debentures are the trusts only assets; the interest payments from the debentures finance the distributions paid on the capital securities.

The capital securities provide an attractive source of funds: they constitute Tier 1 capital for regulatory reporting purposes, but have the same tax advantages as debt for federal income tax purposes. During the first quarter of 2005, the Federal Reserve Board adopted a rule that allows bank holding companies to continue to treat capital securities as Tier 1 capital, but imposed stricter quantitative limits that would have taken effect March 31, 2009. On March 17, 2009, in light of continued stress in the financial markets, the Federal Reserve Board delayed the effective date of these new limits until March 31, 2011. Management believes the new rule will not have any material effect on Key s financial condition.

KeyCorp unconditionally guarantees the following payments or distributions on behalf of the trusts:

- required distributions on the capital securities;
- the redemption price when a capital security is redeemed; and
- the amounts due if a trust is liquidated or terminated.

The capital securities, common stock and related debentures are summarized as follows:

dollars in millions	**Capital Securities, Net of Discount [a]**	**Common Stock**	**Principal Amount of Debentures, Net of Discount [b]**	**Interest Rate of Capital Securities and Debentures [c]**	**Maturity of Capital Securities and Debentures**
March 31, 2009					
KeyCorp Capital I	**$ 197**	**$ 8**	**$ 201**	**2.175%**	**2028**
KeyCorp Capital II	**224**	**8**	**220**	**6.875**	**2029**
KeyCorp Capital III	**281**	**8**	**263**	**7.750**	**2029**
KeyCorp Capital V	**175**	**5**	**194**	**5.875**	**2033**
KeyCorp Capital VI	**75**	**2**	**82**	**6.125**	**2033**
KeyCorp Capital VII	**306**	**8**	**284**	**5.700**	**2035**
KeyCorp Capital VIII	**277**		**335**	**7.000**	**2066**
KeyCorp Capital IX	**559**		**558**	**6.750**	**2066**
KeyCorp Capital X	**829**		**827**	**8.000**	**2068**
Union State Capital I	**20**	**1**	**21**	**9.580**	**2027**
Union State Statutory II	**20**		**20**	**4.750**	**2031**
Union State Statutory IV	**10**		**10**	**3.894**	**2034**
Total	**$ 2,973**	**$ 40**	**$ 3,015**	**6.743%**	
December 31, 2008	$ 3,042	$ 40	$ 3,084	6.931%	
March 31, 2008	$ 2,753	$ 40	$ 2,799	6.985%	

(a) The capital securities must be redeemed when the related debentures mature, or earlier if provided in the governing indenture. Each issue of capital securities carries an interest rate identical to that of the related debenture. Included in certain capital securities at March 31, 2009, December 31, 2008, and March 31, 2008, are basis adjustments of $390 million, $459 million and $170 million, respectively, related to fair value hedges. See Note 19 (Derivatives and Hedging Activities), which begins on page 115 of Key s 2008 Annual Report to Shareholders, for an explanation of fair value hedges.

(b) KeyCorp has the right to redeem its

debentures: (i) in whole or in part, on or after July 1, 2008 (for debentures owned by Capital I); March 18, 1999 (for debentures owned by Capital II); July 16, 1999 (for debentures owned by Capital III); July 31, 2006 (for debentures owned by Union State Statutory II); February 1, 2007 (for debentures owned by Union State Capital I); July 21, 2008 (for debentures owned by Capital V); December 15, 2008 (for debentures owned by Capital VI); April 7, 2009 (for debentures owned by Union State Statutory IV); June 15, 2010 (for debentures owned by Capital VII); June 15, 2011 (for debentures owned by Capital VIII); December 15, 2011 (for debentures owned by

Capital IX); and March 15, 2013 (for debentures owned by Capital X); and (ii) in whole at any time within 90 days after and during the continuation of a tax event, an investment company event or a capital treatment event (as defined in the applicable indenture). If the debentures purchased by Union State Statutory IV, Capital I, Capital V, Capital VI, Capital VII, Capital VIII, Capital IX or Capital X are redeemed before they mature, the redemption price will be the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Union State Capital I are redeemed before they mature, the redemption price

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will be 104.31% of the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Union State Statutory II are redeemed before they mature, the redemption price will be 104.50% of the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Capital II or Capital III are redeemed before they mature, the redemption price will be the greater of: (a) the principal amount, plus any accrued but unpaid interest or (b) the sum of the present values of principal and interest payments discounted at the Treasury Rate (as defined in the applicable indenture), plus 20 basis points (25 basis points for Capital III), plus any accrued but unpaid interest. When debentures are redeemed in response to tax or capital treatment events, the

redemption price generally is slightly more favorable to KeyCorp. Included in the principal amount of debentures at March 31, 2009, December 31, 2008, and March 31, 2008, are adjustments relating to hedging with financial instruments totaling $392 million, $461 million and $176 million, respectively.

(c) The interest rates for Capital II, Capital III, Capital V, Capital VI, Capital VII, Capital VIII, Capital IX, Capital X and Union State Capital I are fixed. Capital I has a floating interest rate equal to three-month LIBOR plus 74 basis points that reprices quarterly. Union State Statutory II has a floating interest rate equal to three-month LIBOR plus 358 basis points that reprices quarterly. Union State Statutory IV has a floating interest

rate equal to three-month LIBOR plus 280 basis points that reprices quarterly. The rates shown as the totals at March 31, 2009, December 31, 2008, and March 31, 2008, are weighted-average rates.

11. Shareholders Equity

Preferred Stock Conversion to Common Shares

On April 2, 2009, KeyCorp entered into an agreement with certain institutional shareholders pursuant to which KeyCorp and each of the institutional shareholders agreed to exchange KeyCorp s 7.750% noncumulative perpetual convertible preferred stock, Series A (Series A Preferred Stock) held by the institutional shareholders for KeyCorp s common shares, $1 par value. In the aggregate, KeyCorp exchanged 400,000 shares of the Series A Preferred Stock for 3,699,600 KeyCorp common shares, or approximately .74% of the issued and outstanding KeyCorp common shares, on April 7, 2009, the date on which the exchange transactions settled. The common shares of KeyCorp were issued in reliance upon the exemption set forth in Section 3(a)(9) of the Securities Act of 1933, as amended, for securities exchanged by the issuer and an existing security holder where no commission or other remuneration is paid or given directly or indirectly by the issuer for soliciting such exchange. KeyCorp utilized treasury shares to complete the transactions.

Supervisory Capital Assessment Program

To implement the United States Department of the Treasury s (the U.S. Treasury) Capital Assistance Program (CAP), the Federal Reserve, the Federal Reserve Banks, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency commenced a review of the capital of the nineteen largest U.S. banking institutions. This review, referred to as the Supervisory Capital Assessment Program (SCAP), involved a forward-looking capital assessment, or stress test, of all domestic bank holding companies with risk-weighted assets of more than $100 billion, including KeyCorp, at December 31, 2008. As announced on May 7, 2009, under the SCAP, KeyCorp s regulators determined that it needs to raise $1.8 billion in additional Tier 1 common equity or contingent common equity (i.e., mandatorily convertible preferred shares). Information regarding the CAP and KeyCorp s final SCAP assessment is included in the Capital section under the heading Financial Stability Plan on page 79.

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12. Employee Benefits

Pension Plans

The components of net pension cost for all funded and unfunded plans are as follows:

in millions	Three months ended March 31, 2009	2008
Service cost of benefits earned	**$ 12**	$ 13
Interest cost on projected benefit obligation	**15**	16
Expected return on plan assets	**(16)**	(23)
Amortization of losses	**10**	3
Net pension cost	**$ 21**	$ 9

Other Postretirement Benefit Plans

Key sponsors a contributory postretirement healthcare plan that covers substantially all active and retired employees hired before 2001 who meet certain eligibility criteria. Retirees contributions are adjusted annually to reflect certain cost-sharing provisions and benefit limitations. Key also sponsors life insurance plans covering certain grandfathered employees. These plans are principally noncontributory. Separate Voluntary Employee Beneficiary Association trusts are used to fund the healthcare plan and one of the life insurance plans.

The components of net postretirement benefit cost for all funded and unfunded plans are as follows:

in millions	Three months ended March 31, 2009	2008
Interest cost on accumulated postretirement benefit obligation	**$ 1**	$ 1
Expected return on plan assets	**(1)**	(1)
Net postretirement benefit cost		

13. Income Taxes

Lease Financing Transactions

On February 13, 2009, Key and the IRS entered into a closing agreement that resolves substantially all outstanding LILO and sale in, sale out (SILO) tax issues between Key and the IRS. Key has deposited $2.047 billion with the IRS to cover the anticipated amount of taxes and associated interest cost due to the IRS for all tax years affected by the settlement. Key expects the remaining LILO/SILO tax issues to be settled with the IRS in the near future with no additional tax or interest liability to Key.

During 2009, Key will amend its state tax returns to reflect the impact of the settlement on prior years state tax liabilities. While the settlement with the IRS provides a waiver of federal tax penalties, management anticipates that certain statutory penalties under state tax laws will be imposed on Key. Although Key intends to vigorously defend its position against the imposition of any such penalties, during the fourth quarter of 2008, management accrued $31 million for potential penalties in accordance with current accounting guidance.

Pursuant to FASB Staff Position No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction, management updated its assessment of the timing of the tax payments associated with the LILO/SILO settlement. As a result, Key recognized a $5 million

($3 million after-tax) increase to earnings during the first quarter of 2009.

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Unrecognized Tax Benefits

As permitted under FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, it is Key s policy to recognize interest and penalties related to unrecognized tax benefits in income tax expense.

14. Contingent Liabilities and Guarantees

Legal Proceedings

Tax disputes. The information pertaining to lease financing transactions presented in Note 13 (Income Taxes) is incorporated herein by reference.

Taylor litigation. On August 11, 2008, a purported class action case was filed against KeyCorp, its directors and certain employees (collectively, the Key parties), captioned *Taylor v. KeyCorp et al.,* in the United States District Court for the Northern District of Ohio. On September 16, 2008, a second and related case was filed in the same district court, captioned *Wildes v. KeyCorp et al*. The plaintiffs in these cases seek to represent a class of all participants in Key s 401(k) Savings Plan and allege that the Key parties breached fiduciary duties owed to them under the Employee Retirement Income Security Act (ERISA). On November 25, 2008, the Court consolidated the *Taylor* and *Wildes* lawsuits into a single action. Plaintiffs have since filed their consolidated complaint, which continues to name certain employees as defendants but no longer names any outside directors. Key strongly disagrees with the allegations contained in the complaints and the consolidated complaint, and intends to vigorously defend against them.

Madoff-related claims. In December 2008, Austin Capital Management, Ltd. (Austin), an investment firm owned by Key, which selects and manages hedge fund investments for its principally institutional customer base, determined that its funds had suffered investment losses of up to approximately $186 million resulting from the crimes perpetrated by Bernard L. Madoff and entities that he controls. The investment losses borne by Austin s clients stem from investments that Austin made in certain Madoff-advised hedge funds. During the first quarter of 2009, three purported class actions and one arbitration proceeding were filed against Austin seeking to recover losses incurred as a result of Madoff s crimes. The class action lawsuits and arbitration allege various claims, including negligence, fraud, breach of fiduciary duties and violations of federal securities laws and the ERISA. In the event Key were to incur any liability for this matter, Key believes such liability would be covered under the terms and conditions of its insurance policy, subject to a $25 million self-insurance deductible and usual policy exceptions.

In April 2009, management made the strategic decision to curtail Austin s operations and expects that the related charges will not be material.

Other litigation. In the ordinary course of business, Key is subject to other legal actions that involve claims for substantial monetary relief. Based on information presently known to management, management does not believe there is any legal action to which KeyCorp or any of its subsidiaries is a party, or involving any of their properties that, individually or in the aggregate, would reasonably be expected to have a material adverse effect on Key s financial condition.

Guarantees

Key is a guarantor in various agreements with third parties. The following table shows the types of guarantees that Key had outstanding at March 31, 2009. Information pertaining to the basis for determining the liabilities recorded in connection with these guarantees is included in Note 1 (Summary of Significant Accounting Policies) under the heading Guarantees on page 82 of Key s 2008 Annual Report to Shareholders.

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March 31, 2009 *in millions*	Maximum Potential Undiscounted Future Payments	Liability Recorded
Financial guarantees:		
Standby letters of credit	$ 13,756	$ 101
Recourse agreement with FNMA	699	6
Return guarantee agreement with LIHTC investors	198	48
Written interest rate caps [(a)]	225	31
Default guarantees	32	1
Total	$ 14,910	$ 187

(a) As of March 31, 2009, the weighted-average interest rate on written interest rate caps was .8%, and the weighted-average strike rate was 4.6%. Maximum potential undiscounted future payments were calculated assuming a 10% interest rate.

Management determines the payment/performance risk associated with each type of guarantee described below based on the probability that Key could be required to make the maximum potential undiscounted future payments shown in the preceding table. Management uses a scale of low (0-30% probability of payment), moderate (31-70% probability of payment) or high (71-100% probability of payment) to assess the payment/performance risk, and has determined that the payment/performance risk associated with each type of guarantee outstanding at March 31, 2009, is low.

Standby letters of credit. Many of Key s lines of business issue standby letters of credit to address clients financing needs. These instruments obligate Key to pay a specified third party when a client fails to repay an outstanding loan or debt instrument, or fails to perform some contractual nonfinancial obligation. Any amounts drawn under standby letters of credit are treated as loans; they bear interest (generally at variable rates) and pose the same credit risk to Key as a loan. At March 31, 2009, Key s standby letters of credit had a remaining weighted-average life of approximately 1.9 years, with remaining actual lives ranging from less than one year to as many as ten years.

Recourse agreement with Federal National Mortgage Association. KeyBank participates as a lender in the Federal National Mortgage Association (FNMA) Delegated Underwriting and Servicing program. As a condition to FNMA s delegation of responsibility for originating, underwriting and servicing mortgages, KeyBank has agreed to assume a limited portion of the risk of loss during the remaining term on each commercial mortgage loan KeyBank sells to FNMA. Accordingly, KeyBank maintains a reserve for such potential losses in an amount estimated by management to approximate the fair value of KeyBank s liability. At March 31, 2009, the outstanding commercial mortgage loans

in this program had a weighted-average remaining term of 6.8 years, and the unpaid principal balance outstanding of loans sold by KeyBank as a participant in this program was approximately $2.204 billion. As shown in the table above, the maximum potential amount of undiscounted future payments that KeyBank could be required to make under this program is equal to approximately one-third of the principal balance of loans outstanding at March 31, 2009. If KeyBank is required to make a payment, it would have an interest in the collateral underlying the related commercial mortgage loan.

Return guarantee agreement with LIHTC investors. KAHC, a subsidiary of KeyBank, offered limited partnership interests to qualified investors. Partnerships formed by KAHC invested in low-income residential rental properties that qualify for federal low income housing tax credits under Section 42 of the Internal Revenue Code. In certain partnerships, investors paid a fee to KAHC for a guaranteed return that is based on the financial performance of the property and the property s confirmed LIHTC status throughout a fifteen-year compliance period. If KAHC defaults on its obligation to provide the guaranteed return, Key is obligated to make any necessary payments to investors. These guarantees have expiration dates that extend through 2019, but there have been no new partnerships under this program since October 2003. Additional information regarding these partnerships is included in Note 8 (Variable Interest Entities), which begins on page 21.

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No recourse or collateral is available to offset Key s guarantee obligation other than the underlying income stream from the properties. Any guaranteed returns that are not met through distribution of tax credits and deductions associated with the specific properties from the partnerships remain Key s obligation.

As shown in the table on page 28, KAHC maintained a reserve in the amount of $48 million at March 31, 2009, which management believes will be sufficient to cover estimated future obligations under the guarantees. The maximum exposure to loss reflected in the table represents undiscounted future payments due to investors for the return on and of their investments.

Written interest rate caps. In the ordinary course of business, Key writes interest rate caps for commercial loan clients that have variable rate loans with Key and wish to limit their exposure to interest rate increases. At March 31, 2009, outstanding caps had a weighted-average life of approximately 1.6 years.

Key is obligated to pay the client if the applicable benchmark interest rate exceeds a specified level (known as the strike rate). These instruments are accounted for as derivatives. Key typically mitigates its potential future payments by entering into offsetting positions with third parties.

Default guarantees. Some lines of business participate in guarantees that obligate Key to perform if the debtor fails to satisfy all of its payment obligations to third parties. Key generally undertakes these guarantees in instances where the risk profile of the debtor should provide an investment return or to support its underlying investment. The terms of these default guarantees range from less than one year to as many as thirteen years, while some default guarantees do not have a contractual end date. Although no collateral is held, Key would receive a pro rata share should the third party collect some or all of the amounts due from the debtor.

Other Off-Balance Sheet Risk

Other off-balance sheet risk stems from financial instruments that do not meet the definition of a guarantee as specified in Interpretation No. 45 and from other relationships.

Liquidity facilities that support asset-backed commercial paper conduits. Key provides liquidity facilities to several unconsolidated third-party commercial paper conduits. These facilities obligate Key to provide funding if there is a credit market disruption or there are other factors that would preclude the issuance of commercial paper by the conduits. The liquidity facilities, all of which expire by November 10, 2010, obligate Key to provide aggregate funding of up to $845 million, with individual facilities ranging from $40 million to $125 million. The aggregate amount available to be drawn is based on the amount of current commitments to borrowers and totaled $684 million at March 31, 2009. Management periodically evaluates Key s commitments to provide liquidity.

Indemnifications provided in the ordinary course of business. Key provides certain indemnifications, primarily through representations and warranties in contracts that are entered into in the ordinary course of business in connection with loan sales and other ongoing activities, as well as in connection with purchases and sales of businesses. Key maintains reserves, when appropriate, with respect to liability that reasonably could arise in connection with these indemnities.

Intercompany guarantees. KeyCorp and certain Key affiliates are parties to various guarantees that facilitate the ongoing business activities of other Key affiliates. These business activities encompass debt issuance, certain lease and insurance obligations, the purchase or issuance of investments and securities, and certain leasing transactions involving clients.

Heartland Payment Systems Matter. Under an agreement between KeyBank and Heartland Payment Systems, Inc. (Heartland), Heartland utilizes KeyBank s membership in the Visa and MasterCard networks to register as an Independent Sales Organization for Visa and a Member Service Provider with MasterCard to provide merchant payment processing services for Visa and MasterCard transactions. On

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January 20, 2009, Heartland publicly announced its discovery of an alleged criminal breach of its credit card payment processing systems environment (the Intrusion) that reportedly occurred during 2008 and is alleged to have involved the malicious collection of in-transit, unencrypted payment card data that was being processed by Heartland.

In Heartland s Form 10-K filed with the Securities and Exchange Commission on March 16, 2009 (Heartland s 2008 Form 10-K), Heartland reported that it expects the major card brands, including Visa and MasterCard, to assert claims seeking to impose fines, penalties, and/or other assessments against Heartland and/or certain card brand members, such as KeyBank, as a result of the alleged potential breach of the respective card brand rules and regulations and the Intrusion. Heartland also indicated that it is likely that the overall costs associated with the Intrusion will be material to it, and that it may need to seek financing in order to pay such costs.

KeyBank has received letters from both Visa and MasterCard assessing fines, penalties or assessments related to the Intrusion. KeyBank is in the process of pursuing appeals of such fines, penalties or assessments. Visa and MasterCard (as well as Heartland and KeyBank) are each still investigating the matter, and they may revise their respective assessments. Under its agreement with Heartland, KeyBank has certain rights of indemnification from Heartland for costs assessed against it by Visa and MasterCard and other associated costs, and KeyBank has notified Heartland of its indemnification rights. In the event that Heartland is unable to fulfill its indemnification obligations to KeyBank, the charges (net of any indemnification) could be significant, although it is not possible to quantify at this time. Accordingly, under applicable accounting rules KeyBank has not established any reserve. For further information on Heartland and the Intrusion, please review Heartland s 2008 Form 10-K.

15. Derivatives and Hedging Activities

Key, mainly through its subsidiary bank, KeyBank, is party to various derivative instruments that are used for interest rate risk management, credit risk management and trading purposes. Derivative instruments are contracts between two or more parties that have a notional amount and underlying variable, require no net investment and allow for the net settlement of positions. The notional amount serves as the basis for the payment provision of the contract and takes the form of units, such as shares or dollars. The underlying variable represents a specified interest rate, index or other component. The interaction between the notional amount and the underlying variable determines the number of units to be exchanged between the parties and influences the market value of the derivative contract.

The primary derivatives that Key uses are interest rate swaps, caps, floors and futures, foreign exchange contracts, energy derivatives, credit derivatives and equity derivatives. Generally, these instruments help Key manage exposure to interest rate risk, mitigate the credit risk inherent in the loan portfolio, and meet client financing and hedging needs. Interest rate risk represents the possibility that economic value or net interest income will be adversely affected by fluctuations in interest rates. Credit risk is defined as the risk of loss arising from an obligor s inability or failure to meet contractual payment or performance terms.

Derivative assets and liabilities are recorded at fair value on the balance sheet, after taking into account the effects of master netting agreements. These master netting agreements allow Key to settle all derivative contracts held with a single counterparty on a net basis, and to offset net derivative positions with related cash collateral, where applicable. As a result, Key could have derivative contracts with negative fair values included in derivative assets on the balance sheet and contracts with positive fair values included in derivative liabilities.

At March 31, 2009, after taking into account the effects of bilateral collateral and master netting agreements, Key had $319 million of derivative assets and $149 million of derivative liabilities that relate to contracts entered into for hedging purposes. As of the same date, after taking into account the effects of such agreements, Key had trading derivative assets of $1.388 billion and trading derivative liabilities of $783 million.

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The following table summarizes the volume of Key s derivative transaction activity during the first quarter of 2009. Volume is represented by the notional amounts of Key s gross derivatives by type at March 31, 2009, and December 31, 2008, which are not affected by bilateral collateral and master netting agreements. Also presented are the average notional amounts of these derivatives for the first quarter of 2009.

					Average for the Three Months Ended March 31, 2009	
	March 31, 2009		**December 31, 2008**			
in millions	**Purchased**	**Sold**	**Purchased**	**Sold**	**Purchased**	**Sold**
Interest rate [(a)]	**$ 52,258**	**$ 55,336**	$ 47,066	$ 55,573	**$ 48,877**	**$ 54,464**
Foreign exchange	**11,235**	**587**	14,281	612	**13,733**	**596**
Energy and commodity [(b)]	**273**	**1,623**	320	1,632	**262**	**1,593**
Credit	**3,840**	**3,302**	3,892	3,294	**3,937**	**4,677**
Equity			2	2	**1**	**1**
Total derivatives	**$ 67,606**	**$ 60,848**	$ 65,561	$ 61,113	**$ 66,810**	**$ 61,331**

(a) Interest rate contracts purchased are defined as receive fixed/pay variable contracts, and interest rate contracts sold are defined as receive variable/pay fixed contracts.

(b) A portion of the energy and commodity contracts purchased are defined as receive fixed/pay variable contracts, and a portion of the energy contracts sold are defined as receive variable/pay

fixed contracts.

Interest Rate Risk Management

Fluctuations in net interest income and the economic value of equity may result from changes in interest rates, and differences in the repricing and maturity characteristics of interest-earning assets and interest-bearing liabilities. To minimize the volatility of net interest income and the economic value of equity, Key manages exposure to interest rate risk in accordance with guidelines established by the Asset/Liability Management Committee. The primary derivative instruments used to manage interest rate risk are interest rate swaps, which modify the interest rate characteristics of certain assets and liabilities. These instruments are used to convert the contractual interest rate index of agreed-upon amounts of assets and liabilities (i.e., notional amounts) to another interest rate index.

Key has designated certain receive fixed/pay variable interest rate swaps as fair value hedges, primarily to modify its exposure to interest rate risk. These contracts convert certain fixed-rate long-term debt into variable-rate obligations. As a result, Key receives fixed-rate interest payments in exchange for making variable-rate payments over the lives of the contracts without exchanging the underlying notional amounts.

Additionally, Key has designated certain receive fixed/pay variable interest rate swaps as cash flow hedges. These contracts effectively convert certain floating-rate loans into fixed-rate loans to reduce the potential adverse impact from interest rate decreases on future interest income. These contracts allow Key to receive fixed-rate interest payments in exchange for making variable-rate payments over the lives of the contracts without exchanging the underlying notional amounts. Similarly, Key has designated certain pay fixed/receive variable interest rate swaps as cash flow hedges to convert certain floating-rate debt into fixed-rate debt.

Key also uses interest rate swaps to hedge the floating-rate debt that funds fixed-rate leases entered into by Key s Equipment Finance line of business. These swaps are designated as cash flow hedges to mitigate the interest rate mismatch between the fixed-rate lease cash flows and the floating-rate payments on the debt.

Key has used pay fixed/receive variable interest rate swaps as cash flow hedges to manage the interest rate risk associated with anticipated sales of certain commercial real estate loans. These swaps protected against a possible short-term decline in the value of the loans that could result from changes in interest rates between the time they were originated and the time they were sold. During the first quarter of 2009, these hedges were terminated. Therefore, Key did not have any of these hedges outstanding at March 31, 2009.

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Foreign Currency Exchange Risk Management

The derivatives used for managing foreign currency exchange risk are cross currency swaps. Key has several outstanding issues of medium-term notes that are denominated in a foreign currency. The notes are subject to translation risk, which represents the possibility that changes in the fair value of the foreign-denominated debt will occur based on movement of the underlying foreign currency spot rate. It is Key s practice to hedge against potential fair value changes caused by changes in foreign currency exchange rates and interest rates. The hedge converts the notes to a variable-rate functional currency-denominated debt, which is designated as a fair value hedge of foreign currency exchange risk.

Credit Risk Management

Credit risk is the risk of loss arising from an obligor s inability or failure to meet contractual payment or performance terms. Like other financial services institutions, Key originates loans and extends credit, both of which expose Key to credit risk. Key actively manages its overall loan portfolio, and the associated credit risk, in a manner consistent with asset quality objectives. This process entails the use of credit derivatives ¾ primarily credit default swaps ¾ to mitigate Key s credit risk. Credit default swaps enable Key to transfer a portion of the credit risk associated with a particular extension of credit to a third party, and to manage portfolio concentration and correlation risks. Occasionally, Key also provides credit protection to other lenders through the sale of credit default swaps. In most instances, this objective is accomplished through the use of an investment-grade diversified dealer-traded basket of credit default swaps. These transactions may generate fee income, and diversify and reduce overall portfolio credit risk volatility. Although Key uses these instruments for risk management purposes, they are not treated as hedging instruments as defined by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities.

Trading Portfolio

Key s trading portfolio consists of the following instruments:

- interest rate swap, cap, floor and futures contracts entered into generally to accommodate the needs of commercial loan clients;
- energy swap and options contracts entered into to accommodate the needs of clients;
- foreign exchange forward contracts entered into to accommodate the needs of clients;
- positions with third parties that are intended to offset or mitigate the interest rate or market risk related to client positions discussed above; and
- interest rate swaps, foreign exchange forward contracts and credit default swaps used for proprietary trading purposes.

Key does not apply hedge accounting to any of these contracts.

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Fair Values and Gain/Loss Information Related to Derivative Instruments

The following table summarizes the fair values of Key s derivative instruments on a gross basis as of March 31, 2009, and where they are recorded on the balance sheet.

	Derivative Assets		Derivative Liabilities	
March 31, 2009 *in millions*	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives designated as hedging instruments:				
Interest rate	Derivative assets	$ 876	Derivative liabilities	$ 14
Foreign exchange	Derivative assets	46	Derivative liabilities	434
Total		922		448
Derivatives not designated as hedging instruments:				
Interest rate	Derivative assets	2,284	Derivative liabilities	2,075
Foreign exchange	Derivative assets	422	Derivative liabilities	380
Energy and commodity	Derivative assets	721	Derivative liabilities	751
Credit	Derivative assets	171	Derivative liabilities	173
Equity	Derivative assets	1	Derivative liabilities	
Total		3,599		3,379
Netting adjustments [(a)]		(2,814)		(2,895)
Total derivatives		$ 1,707		$ 932

(a) Netting adjustments represent the amounts recorded to convert Key s derivative assets and liabilities from a gross basis to a net basis in accordance with Key s January 1, 2008, adoption of FASB Interpretation No. 39, Offsetting of Amounts Related to

Certain Contracts, and FASB Staff Position No. FIN 39-1, Amendment of FASB Interpretation 39. The net basis takes into account the impact of master netting agreements that allow Key to settle all derivative contracts with a single counterparty on a net basis and to offset the net derivative position with the related cash collateral.

Fair value hedges. These hedging instruments are recorded at fair value and included in derivative assets or derivative liabilities on the balance sheet. The effective portion of a change in the fair value of a hedging instrument designated as a fair value hedge is recorded in earnings at the same time as a change in fair value of the hedged item, resulting in no effect on net income. The ineffective portion of a change in the fair value of such a hedging instrument is recognized in other income on the income statement with no corresponding offset. During the three-month period ended March 31, 2009, Key did not exclude any portion of hedging instruments from the assessment of hedge effectiveness. While some ineffectiveness is present in Key s hedging relationships, all of Key s fair value hedges remained highly effective during the first quarter.

The following table summarizes the net gains (losses) on Key s fair value hedges during the three-month period ended March 31, 2009, and where they are recorded on the income statement.

Three months ended March 31, 2009 *in millions*	**Income Statement Location of Net Gains (Losses) on Derivative**	**Net Gains (Losses) on Derivative**	**Hedged Item**	**Income Statement Location of Net Gains (Losses) on Hedged Item**	**Net Gains (Losses) on Hedged Item**
Interest rate	Other income	$ (84)	Long-term debt	Other income	$ 97 [(a)]
Interest rate	Interest expense	53			

Foreign exchange	Long-term debt Other income	(67)	Long-term debt	Other income	65 [a]
Foreign exchange	Interest expense Long-term debt	8	Long-term debt	Interest expense Long-term debt	(20) [b]
Total		$ (90)			$ 142

(a) Net gains on hedged items represent the change in fair value caused by fluctuations in interest rates.

(b) Net losses on hedged items represent the change in fair value caused by fluctuations in foreign currency exchange rates.

Cash flow hedges. These hedging instruments are recorded at fair value and included in derivative assets or derivative liabilities on the balance sheet. The effective portion of a gain or loss on a cash flow hedge is recorded as a component of accumulated other comprehensive income on the balance sheet. The amounts are reclassified into earnings in the same period in which the hedged transaction impacts earnings, such as when Key pays variable-rate interest on debt, receives variable-rate interest on commercial loans or sells commercial real estate loans. The ineffective portion of cash flow hedging transactions is included in other income on the income statement. During the three-month period ended March 31, 2009, Key did not exclude any portion of its hedging instruments from the assessment of hedge effectiveness. While some

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ineffectiveness is present in Key s hedging relationships, all of Key s cash flow hedges remained highly effective during the first quarter.

The following table summarizes the net gains (losses) on Key s cash flow hedges during the three-month period ended March 31, 2009, and where they are recorded on the income statement. The table includes the effective portion of net gains (losses) recognized in other comprehensive income (loss) (OCI) during the period, the effective portion of net gains (losses) reclassified from OCI into income during the current period, and the portion of net gains (losses) recorded directly in income, representing the amount of hedge ineffectiveness.

Three months ended March 31, 2009 *in millions*	Net Gains (Losses) Recognized in OCI (Effective Portion)	Income Statement Location of Net Gains (Losses) Reclassified From OCI Into Income (Effective Portion)	Net Gains (Losses) Reclassified From OCI Into Income (Effective Portion)	Income Statement Location of Net Gains (Losses) Recognized in Income (Ineffective Portion)	Net Gains (Losses) Recognized in Income (Ineffective Portion)
Interest rate	$ 64	Interest income Loans	$ 89	Other income	$ (1)
Interest rate	8	Interest expense Long-term debt	(4)	Other income	1
Interest rate	4	Net (losses) gains from loan securitizations and sales	5	Other income	
Total	$ 76		$ 90		

The change in accumulated other comprehensive income resulting from cash flow hedges is as follows:

in millions	December 31, 2008	2009 Hedging Activity	Reclassification of Gains to Net Income	March 31, 2009
Accumulated other comprehensive income resulting from cash flow hedges	$ 238	**$ 47**	**$ (56)**	**$ 229**

Given the interest rates, yield curves and notional amounts as of March 31, 2009, management would expect to reclassify an estimated $31 million of net losses on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months. The maximum length of time over which forecasted transactions are hedged is nineteen years.

Nonhedging instruments. Key s derivatives that are not used in hedging relationships are recorded at fair value in derivative assets and derivative liabilities on the balance sheet. Adjustments to the fair values of these instruments, as well as any premium paid or received, are included in investment banking and capital markets income on the income statement.

The following table summarizes the net gains (losses) on Key s derivative instruments that are not used in hedging relationships for the three-month period ended March 31, 2009, and where they are recorded on the income statement.

Three months ended March 31, 2009 *in millions*	**Income Statement Location of Net Gains (Losses)**	**Net Gains (Losses)**
Interest rate	Investment banking and capital markets income	$ 13
Foreign exchange	Investment banking and capital markets income	10
Energy and commodity	Investment banking and capital markets income	3
Credit	Investment banking and capital markets income	(19)
Equity [(a)]	Investment banking and capital markets income	
Total		$ 7

(a) Key enters into equity contracts to accommodate the needs of clients and offsets these positions with third parties. Key did not enter into any new equity contracts during the three months ended March 31, 2009.

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Counterparty Credit Risk

Like other financial instruments, derivatives contain an element of credit risk. This risk is measured as the expected positive replacement value of the contracts. Key uses several means to mitigate and manage exposure to credit risk on derivative contracts. Key generally enters into bilateral collateral and master netting agreements using standard forms published by the International Swaps and Derivatives Association (ISDA). These agreements provide for the net settlement of all contracts with a single counterparty in the event of default. Additionally, management monitors credit risk exposure to the counterparty on each contract to determine appropriate limits on Key s total credit exposure across all product types. Management reviews Key s collateral positions on a daily basis and exchanges collateral with its counterparties in accordance with ISDA and other related agreements. Key generally holds collateral in the form of cash and highly rated securities issued by the U.S. Treasury, government-sponsored enterprises or the Government National Mortgage Association. The cash collateral netted against derivative assets on the balance sheet totaled $810 million at March 31, 2009, $974 million at December 31, 2008, and $486 million at March 31, 2008. The cash collateral netted against derivative liabilities totaled $892 million at March 31, 2009, $586 million at December 31, 2008, and $309 million at March 31, 2008.

At March 31, 2009, the largest gross exposure to an individual counterparty was $468 million, which was secured with $82 million in collateral. Additionally, Key had a derivative liability of $409 million with this counterparty whereby Key pledged $39 million in collateral. After taking into account the effects of a master netting agreement and collateral, Key had a net exposure of $16 million.

The following table summarizes the fair value of Key s derivative assets by type. These assets represent Key s gross exposure to potential loss after taking into account the effects of master netting agreements and other means used to mitigate risk.

in millions	**March 31, 2009**	**December 31, 2008**	**March 31, 2008**
Interest rate	**$ 1,985**	$ 2,333	$ 1,513
Foreign exchange	**180**	279	255
Energy and commodity	**331**	214	196
Credit	**20**	42	5
Equity	**1**	2	25
Derivative assets before cash collateral	**2,517**	2,870	1,994
Less: Related cash collateral	**810**	974	486
Total derivative assets	**$ 1,707**	$ 1,896	$ 1,508

Key enters into derivative transactions with two primary groups: broker-dealers and banks, and clients. Since these groups have different economic characteristics, Key manages counterparty credit exposure and credit risk in a different manner for each group.

Key enters into transactions with broker-dealers and banks for purposes of asset/liability management, risk management and proprietary trading purposes. These types of transactions generally are high dollar volume. Key generally enters into bilateral collateral and master netting agreements with these counterparties. At March 31, 2009, after taking into account the effects of master netting agreements, Key had gross exposure of $1.839 billion to broker-dealers and banks. Key had net exposure of $446 million after the application of master netting agreements and cash collateral. Key s net exposure to broker-dealers and banks at March 31, 2009, was reduced to $238 million by $208 million of additional collateral held in the form of securities.

Additionally, Key enters into transactions with clients to accommodate their business needs. These types of transactions generally are low dollar volume. Key generally enters into master netting agreements with these counterparties. In addition, Key mitigates its overall portfolio exposure and market risk by entering into offsetting positions with other banks. Due to the smaller size and magnitude of the individual contracts with clients, collateral is generally not exchanged on these derivative transactions. In order to address the risk of default associated with the uncollateralized contracts, Key has established a reserve (included in

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derivative assets) in the amount of $30 million at March 31, 2009, which management estimates to be the potential future losses on amounts due from client counterparties in the event of default. At March 31, 2009, after taking into account the effects of master netting agreements, Key had gross exposure of $1.330 billion to these counterparties. Key had net exposure of $1.261 billion on its derivatives with clients after the application of master netting agreements, cash collateral and the related reserve.

Credit Derivatives

Key is both buyer and seller of credit protection through the credit derivative market. Key purchases credit derivatives to manage the credit risk associated with specific commercial lending obligations. Key also sells credit derivatives, mainly index credit default swaps, to diversify the concentration risk within its loan portfolio. In addition, Key has entered into derivatives for proprietary trading purposes. The following table summarizes the fair value of Key s credit derivatives purchased and sold by type as of March 31, 2009, and December 31, 2008. The fair value of credit derivatives presented below does not take into account the effects of bilateral collateral or master netting agreements.

	March 31, 2009			**December 31, 2008**		
in millions	**Purchased**	**Sold**	**Net**	**Purchased**	**Sold**	**Net**
Single name credit default swaps	**$ 132**	**$ (103)**	**$ 29**	$ 155	$ (104)	$ 51
Traded credit default swap indices	**30**	**(48)**	**(18)**	34	(47)	(13)
Other		**(13)**	**(13)**		(8)	(8)
Total credit derivatives	**$ 162**	**$ (164)**	**$ (2)**	$ 189	$ (159)	$ 30

Single name credit default swaps are bilateral contracts between a buyer and seller, whereby protection against the credit risk of a reference entity is sold. The protected credit risk is related to adverse credit events, such as bankruptcy, failure to make payments, and acceleration or restructuring of obligations specified in the credit derivative contract using standard documentation terms governed by the ISDA. The credit default swap contract will reference a specific debt obligation of the reference entity. As the seller of a single name credit derivative, Key would be required to pay the purchaser the difference between par value and the market price of the debt obligation (cash settlement) or receive the specified referenced asset in exchange for payment of the par value (physical settlement) if the underlying reference entity experiences a certain, predefined credit event. For a single name credit derivative, the notional amount represents the maximum amount that a seller could be required to pay under the credit derivative. In the event that physical settlement occurs and Key receives its portion of the related debt obligation, Key will join other creditors in the liquidation process, which may result in the recovery of a portion of the amount paid under the credit default swap contract. Key also may purchase offsetting credit derivatives for the same reference entity from third parties that will permit Key to recover the amount it pays should a credit event occur.

A traded credit default swap index represents a position on a basket or portfolio of reference entities. As a seller of protection on a credit default swap index, Key would be required to pay the purchaser if one or more of the entities in the index have a credit event. For a credit default swap index, the notional amount represents the maximum amount that a seller could be required to pay under the credit derivative. Upon a credit event, the amount payable is based on the percentage of the notional amount allocated to the specific defaulting entity.

The following table provides information on the types of credit derivatives sold by Key and held on the balance sheet at March 31, 2009, and December 31, 2008. This table includes derivatives sold both to diversify Key s credit exposure and for proprietary trading purposes. The payment/performance risk assessment is based on the default probabilities for the underlying reference entities debt obligations using the credit ratings matrix provided by Moody s, specifically Moody s Idealized Cumulative Default Rates, except as noted below. The payment/performance risk shown below represents a weighted-average of the default probabilities for all reference entities in the respective

portfolios. These default probabilities are directly correlated to the probability of Key having to make a payment under the credit derivative contracts.

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	March 31, 2009			December 31, 2008		
dollars in millions	**Notional Amount**	**Average Term (Years)**	**Payment / Performance Risk**	**Notional Amount**	**Average Term (Years)**	**Payment / Performance Risk**
Single name credit default swaps	**$ 1,537**	**1.72**	**8.09%**	$ 1,476	2.44	4.75%
Traded credit default swap indices	**1,706**	**.96**	**6.52**	1,759	1.51	4.67
Other	**59**	**1.50**	**Low [(a)]**	59	1.50	Low [(a)]
Total credit derivatives sold	**$ 3,302**			$ 3,294		

(a) The other credit derivatives are not referenced to an entity s debt obligation. Management determined the payment/performance risk based on the probability that Key could be required to pay the maximum amount under the credit derivatives. Key has determined that the payment/performance risk associated with the other credit derivatives is low (i.e., less than or equal to 30% probability of payment).

Credit Risk Contingent Features

Key has entered into certain derivative contracts that require Key to post collateral to the counterparties when these contracts are in a net liability position. The amount of collateral to be posted is generally based on thresholds related to Key s long-term senior unsecured credit ratings with Moody s Investors Service, Inc. (Moody s) and Standard and Poor s Ratings Services, a Division of The McGraw-Hill Companies, Inc. (S&P). The collateral to be posted is also based on minimum transfer amounts, which are specific to each Credit Support Annex (a component of the ISDA Master Agreement) that Key has signed with the counterparties. In a limited number of instances, counterparties also have the right to terminate their ISDA Master Agreements with Key if Key s ratings fall below a certain level, usually investment-grade level (i.e., Baa3 for Moody s and BBB- for S&P). At March 31, 2009, KeyBank s ratings with Moody s and S&P were A1 and A, respectively, and KeyCorp s ratings with Moody s and S&P were A2 and A-, respectively. Upon a downgrade of Key s ratings, Key could be required to post additional collateral under those ISDA

Master Agreements where Key is in a net liability position. As of March 31, 2009, the aggregate fair value of all derivative contracts with credit risk contingent features (i.e., those containing collateral posting or termination provisions based on Key s ratings) that were in a net liability position totaled $1.218 billion, which includes $1.262 billion in derivative assets and $2.480 billion in derivative liabilities. Key had $1.076 billion in cash and securities collateral posted to cover those positions as of March 31, 2009.

The following table summarizes the additional cash and securities collateral that KeyBank would have been required to deliver had the credit risk contingent features been triggered for the derivative contracts in a net liability position as of March 31, 2009. The additional collateral amoug-right:2px;">

Foreign exchange contracts

$

—

449

—

449

442

Cross currency interest rate swaps(2)

—

17

—

17

15

Total

—

466

—

466

457

Liabilities:

Foreign exchange contracts

—

403

—

403

452

Cross currency interest rate swaps[3]

—

699

—

699

594

Total

—

1,102

—

1,102

1,046

Derivatives not designated as hedging instruments:

Assets:

Foreign exchange contracts

—

22

—

22

29

Swiss Franc Option*

—

—

—

—

17

Total

—

22

—

22

46

Liabilities:

Foreign exchange contracts

—

41

—

41

34

Other Investments(4)

$
1,675

—

—

1,675

1,563

* Currency option related to the acquisition of Synthes, Inc., which expired in January 2012.

(1) As of January 1, 2012, these assets and liabilities are classified as Level 2 with the exception of Other Investments of $1,563 million which are classified as Level 1.
(2) Includes $14 million and $15 million of non-current assets for July 1, 2012 and January 1, 2012, respectively.
(3) Includes $699 million and $594 million of non-current liabilities for July 1, 2012 and January 1, 2012, respectively.
(4) Classified as non-current other assets.

Financial Instruments not measured at Fair Value:

The following financial assets and liabilities are held at carrying amount on the consolidated balance sheet as of July 1, 2012:

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(Dollars in Millions)	Carrying Amount	Estimated Fair Value
Financial Assets		
Current Investments		
Cash	$3,459	3,459
Government securities and obligations	10,857	10,857
Corporate debt securities	529	529
Money market funds	1,620	1,620
Time deposits	450	450
Total cash, cash equivalents and current marketable securities	$16,915	16,915

Fair value of government securities and obligations and corporate debt securities was estimated using quoted broker prices and significant other observable inputs.

Financial Liabilities		
Current Debt	$6,040	6,040
Non-Current Debt		
3 month LIBOR+0.09% FRN due 2014	750	750
1.20% Notes due 2014	999	1,014
2.15% Notes due 2016	898	950
5.55% Debentures due 2017	1,000	1,223
5.15% Debentures due 2018	898	1,091
4.75% Notes due 2019 (1B Euro 1.2434)	1,237	1,475
3% Zero Coupon Convertible Subordinated Debentures due in 2020	203	194
2.95% Debentures due 2020	541	576
3.55% Notes due 2021	446	503
6.73% Debentures due 2023	250	345
5.50% Notes due 2024 (500 GBP 1.5539)	772	993
6.95% Notes due 2029	294	436
4.95% Debentures due 2033	500	597
5.95% Notes due 2037	995	1,391
5.85% Debentures due 2038	700	958
4.50% Debentures due 2040	539	631
4.85% Notes due 2041	298	370
Other	205	202
Total Non-Current Debt	$11,525	13,699

The weighted average effective rate on non-current debt is 4.33%.

Fair value of the non-current debt was estimated using market prices, which were corroborated by quoted broker prices and significant other observable inputs.

NOTE 5 — INCOME TAXES

The worldwide effective income tax rates for the fiscal six months of 2012 and 2011 were 24.9% and 21.2%, respectively. The higher effective tax rate in 2012 as compared to 2011 was primarily due to lower tax rates associated with the Synthes integration and transaction costs and litigation accruals which added 2.8 points to the effective tax rate. The expiration of the Research and Development tax credit at year end 2011 increased the 2012 tax rate by 0.6

points.

NOTE 6 — PENSIONS AND OTHER POSTRETIREMENT BENEFITS

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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 second quarters of 2012 and 2011 include the following components:

	Retirement Plans		Other Benefit Plans	
	Fiscal Second Quarters Ended			
(Dollars in Millions)	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Service cost	$168	144	45	37
Interest cost	219	214	41	46
Expected return on plan assets	(308)	(277)	(1)	(1)
Amortization of prior service cost/(credit)	—	1	(1)	—
Amortization of net transition obligation	—	1	—	—
Recognized actuarial losses	124	98	20	12
Curtailments and settlements	—	—	—	—
Net periodic benefit cost	$203	181	104	94

Net periodic benefit cost for the Company's defined benefit retirement plans and other benefit plans for the first fiscal six months of 2012 and 2011 include the following components:

	Retirement Plans		Other Benefit Plans	
	Fiscal Six Months Ended			
(Dollars in Millions)	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Service cost	$329	287	89	74
Interest cost	441	427	82	94
Expected return on plan assets	(620)	(555)	(2)	(1)
Amortization of prior service cost/(credit)	2	4	(2)	(1)
Amortization of net transition obligation	—	1	—	—
Recognized actuarial losses	248	194	38	23
Curtailments and settlements	(1)	—	—	—
Net periodic benefit cost	$399	358	205	189

Company Contributions

For the fiscal six months ended July 1, 2012, the Company contributed $142 million and $17 million to its U.S. and international retirement plans, respectively. The Company plans to continue to fund its U.S. defined benefit plans to comply with the Pension Protection Act of 2006. International plans are funded in accordance with local regulations.

NOTE 7 — ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table sets forth the components of accumulated other comprehensive income:

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Gains/(Losses) (Dollars in Millions)	Foreign Currency Translation	Securities Available For Sale	Employee Benefit Plans	Derivatives & Hedges	Total Accumulated Other Comprehensive Income/(Loss)
January 1, 2012	$(1,526)	448	(4,386)	(168)	(5,632)
Net change	(796)	68	189	(33)	(572)
July 1, 2012	$(2,322)	516	(4,197)	(201)	(6,204)

Amounts in accumulated other comprehensive income are presented net of the related tax impact. Foreign currency translation is not adjusted for income taxes as it relates to permanent investments in international subsidiaries. For additional details on comprehensive income see the Consolidated Statements of Comprehensive Income.

NOTE 8 — EARNINGS PER SHARE

The following is a reconciliation of basic net earnings per share to diluted net earnings per share for the fiscal second quarters ended July 1, 2012 and July 3, 2011:

	Fiscal Second Quarters Ended	
(Shares in Millions)	July 1, 2012	July 3, 2011
Basic net earnings per share	$0.51	$1.01
Average shares outstanding — basic	2,747.4	2,740.5
Potential shares exercisable under stock option plans	138.1	168.9
Less: shares which could be repurchased under treasury stock method	(104.1)	(131.7)
Convertible debt shares	3.6	3.6
Accelerated share repurchase program	13.2	—
Average shares outstanding — diluted	2,798.2	2,781.3
Diluted earnings per share	$0.50	$1.00

The diluted earnings per share calculation for both fiscal second quarters ended July 1, 2012 and July 3, 2011 included the dilutive effect of convertible debt that was offset by the related reduction in interest expense.

The diluted earnings per share calculation for the fiscal second quarter ended July 1, 2012 included the dilutive effect of 13.2 million shares related to the accelerated share repurchase program, associated with the Synthes, Inc. acquisition. See Note10 to the Consolidated Financial Statements for additional details. A $1 increase/decrease in the volume weighted average share price would impact this estimate by approximately 2.8 million shares.

The diluted earnings per share calculation for the fiscal second quarters ended July 1, 2012 and July 3, 2011, excluded 57 million and 51 million shares, respectively, related to stock options, as the exercise price of these options was greater than their average market value, which 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 first fiscal six months ended July 1, 2012 and July 3, 2011:

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(Shares in Millions)	Fiscal Six Months Ended July 1, 2012	July 3, 2011
Basic net earnings per share	$1.94	$2.28
Average shares outstanding — basic	2,741.7	2,739.6
Potential shares exercisable under stock option plans	138.0	168.8
Less: shares which could be repurchased under treasury stock method	(104.1)	(133.9)
Convertible debt shares	3.6	3.6
Accelerated share repurchase program	13.2	—
Average shares outstanding — diluted	2,792.4	2,778.1
Diluted earnings per share	$1.91	$2.25

The diluted earnings per share calculation for both the first fiscal six months ended July 1, 2012 and July 3, 2011 included the dilutive effect of convertible debt that was offset by the related reduction in interest expense.

The diluted earnings per share calculation for the first fiscal six months ended July 1, 2012 included the dilutive effect of 13.2 million shares related to the accelerated share repurchase program, associated with the Synthes, Inc. acquisition. See Note10 to the Consolidated Financial Statements for additional details. A $1 increase/decrease in the volume weighted average share price would impact this estimate by approximately 2.8 million shares.

The diluted earnings per share calculation for the first fiscal six months ended July 1, 2012 and July 3, 2011, excluded 57 million and 52 million shares, respectively, related to stock options, as the exercise price of these options was greater than their average market value, which would result in an anti-dilutive effect on diluted earnings per share.

NOTE 9 — SEGMENTS OF BUSINESS AND GEOGRAPHIC AREAS

SALES BY SEGMENT OF BUSINESS

(Dollars in Millions)	Fiscal Second Quarters Ended July 1, 2012	July 3, 2011	Percent Change
Consumer			
United States	$1,313	$1,339	(1.9)%
International	2,306	2,454	(6.0)
Total	3,619	3,793	(4.6)
Pharmaceutical			
United States	3,094	3,239	(4.5)
International	3,197	2,994	6.8
Total	6,291	6,233	0.9
Medical Devices & Diagnostics			
United States	2,953	2,869	2.9
International	3,612	3,702	(2.4)
Total	6,565	6,571	(0.1)
Worldwide			
United States	7,360	7,447	(1.2)
International	9,115	9,150	(0.4)
Total	$16,475	$16,597	(0.7)%

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(Dollars in Millions)	Fiscal Six Months Ended July 1, 2012	July 3, 2011	Percent Change
Consumer			
United States	$2,629	$2,684	(2.0)%
International	4,585	4,791	(4.3)
Total	7,214	7,475	(3.5)
Pharmaceutical			
United States	6,120	6,630	(7.7)
International	6,304	5,662	11.3
Total	12,424	12,292	1.1
Medical Devices & Diagnostics			
United States	5,830	5,741	1.6
International	7,146	7,262	(1.6)
Total	12,976	13,003	(0.2)
Worldwide			
United States	14,579	15,055	(3.2)
International	18,035	17,715	1.8
Total	$32,614	$32,770	(0.5)%

OPERATING PROFIT BY SEGMENT OF BUSINESS

(Dollars in Millions)	Fiscal Second Quarters Ended July 1, 2012	July 3, 2011	Percent Change
Consumer [1]	$267	$549	(51.4)%
Pharmaceutical [2]	515	1,714	(70.0)
Medical Devices & Diagnostics[3]	1,875	1,275	47.1
Segments operating profit	2,657	3,538	(24.9)
Expense not allocated to segments[4]	(622)	(116)	
Worldwide income before taxes	$2,035	$3,422	(40.5)%

(Dollars in Millions)	Fiscal Six Months Ended July 1, 2012	July 3, 2011	Percent Change
Consumer [1]	$729	$1,122	(35.0)%
Pharmaceutical [2]	3,106	3,923	(20.8)
Medical Devices & Diagnostics [3]	3,953	3,219	22.8
Segments operating profit	7,788	8,264	(5.8)
Expense not allocated to segments [4]	(708)	(332)	
Worldwide income before taxes	$7,080	$7,932	(10.7)%

(1) Includes intangible asset write-downs of $294 million recorded in the fiscal second quarter and the first fiscal six months of 2012.
(2) Includes litigation expense of $658 million, intangible asset write-downs of $499 million and in-process research and development charges of $429 million recorded in the fiscal second quarter and the first fiscal six months of 2012.

Includes litigation expense of $290 million and $540 million recorded in the fiscal second quarter and the first fiscal six months of 2011,

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respectively.
(3) Includes Synthes integration/transaction costs of $192 million and $223 million recorded in the fiscal second quarter and the first fiscal six months of 2012, respectively. Includes intangible asset write-downs of $146 million recorded in the fiscal second quarter and the first fiscal six months of 2012. Includes restructuring expense of $676 million recorded in the fiscal second quarter and the first fiscal six months of 2011. Includes litigation expense of $25 million and ASR™ Hip related costs of $102 million recorded in the fiscal second quarter of 2011. Includes litigation expense of $36 million and ASR™ Hip related costs of $187 million recorded in the first fiscal six months of 2011.
(4) Amounts not allocated to segments include interest income/(expense), non-controlling interests and general corporate income/expense. Includes currency losses related to the Synthes acquisition of $382 million and $234 million recorded in the fiscal second quarter and the first fiscal six months of 2012, respectively, and litigation expense of $11 million recorded in the fiscal second quarter and the first fiscal six months of 2012, respectively. Includes a currency gain of $102 million related to the Synthes acquisition recorded in the fiscal second quarter and the first fiscal six months of 2011.

SALES BY GEOGRAPHIC AREA

(Dollars in Millions)	Fiscal Second Quarters Ended			
	July 1, 2012	July 3, 2011	Percent Change	
United States	$7,360	$7,447	(1.2	)%
Europe	4,165	4,543	(8.3	)
Western Hemisphere, excluding U.S.	1,728	1,543	12.0	
Asia-Pacific, Africa	3,222	3,064	5.2	
Total	$16,475	$16,597	(0.7	)%

(Dollars in Millions)	Fiscal Six Months Ended			
	July 1, 2012	July 3, 2011	Percent Change	
United States	$14,579	$15,055	(3.2	)%
Europe	8,359	8,726	(4.2	)
Western Hemisphere, excluding U.S.	3,442	2,979	15.5	
Asia-Pacific, Africa	6,234	6,010	3.7	
Total	$32,614	$32,770	(0.5	)%

NOTE 10— BUSINESS COMBINATIONS AND DIVESTITURES

On June 14, 2012, the Company completed the acquisition of Synthes, Inc., a global developer and manufacturer of orthopaedics devices, for a purchase price of $20.2 billion in cash and stock. The net acquisition cost of the transaction is $17.5 billion based on cash on hand at closing of $2.7 billion.

Under the terms of the agreement, each share of Synthes common stock was exchanged for CHF 55.65 in cash and 1.717 shares of Johnson & Johnson common stock, based on the calculated exchange ratio. The exchange ratio was calculated on June 12, 2012 and based on the relevant exchange rate and closing price of Johnson & Johnson common stock on that date, the total fair value of consideration transferred was $19.7 billion. When the acquisition was completed on June 14, 2012, based on the relevant exchange rate and closing price of Johnson & Johnson common stock on that date, the total fair value of the consideration transferred was $20.2 billion. Janssen Pharmaceutical, a company organized under the laws of Ireland and
a wholly owned subsidiary of Johnson & Johnson, used cash on hand to satisfy the cash portion of the merger consideration.

The stock portion of the merger consideration consisted of shares of Johnson & Johnson common stock purchased by Janssen Pharmaceutical, from two banks, pursuant to two accelerated share repurchase (ASR) agreements dated June 12, 2012. On June 13, 2012, Janssen Pharmaceutical purchased an aggregate of approximately 203.7 million shares of Johnson & Johnson common stock at an initial purchase price of $12.9 billion under the ASR agreements, with all of the shares delivered to Janssen Pharmaceutical on June 13, 2012. Final settlement of the transactions under each ASR agreement is expected to occur in the second quarter of 2013, and may occur earlier at the option of the two banks, as applicable, or later under certain

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circumstances. Based on the theoretical settlement of the ASR agreements an additional 13.2 million shares would be issued to settle the ASR agreements as of July 1, 2012.

In addition, while the Company believes that the transactions under each ASR agreement and a series of related internal transactions were consummated in a tax efficient manner in accordance with applicable law, it is possible that the Internal Revenue Service could assert one or more contrary positions to challenge the transactions from a tax perspective. If challenged, an amount up to the total purchase price for the Synthes shares could be treated as subject to applicable U.S. tax at approximately the statutory rate to the Company, plus interest.

The following table summarizes the consideration transferred to acquire Synthes, valued on the acquisition date of June 14th, 2012:

(Dollars in Millions)	
Cash (multiply 55.65CHF by shares of Synthes common stock outstanding by the exchange rate)[(A)]	$6,902
Common Stock (multiply 1.717 by shares of Synthes common stock outstanding by J&J stock price)[(B)]	$13,335
Total fair value of consideration transferred	$20,237

(A) Synthes common stock outstanding of 118.7 million shares as of the acquisition date and CHF/USD exchange rate of .95674

(B) Johnson & Johnson closing stock price on the New York Stock Exchange as of acquisition date of $65.45 per share.

The Company is in the process of finalizing the allocation of the purchase price to the individual assets acquired and liabilities assumed. The preliminary allocation of the purchase price included in the current period balance sheet is based on the best estimates of management and is preliminary and subject to change. To assist management in the allocation, the Company engaged valuation specialists to prepare independent appraisals. The completion of the purchase price allocation may result in adjustments to the carrying value of Synthes, Inc.'s recorded assets and liabilities, revisions of the useful lives of intangible assets, the determination of any residual amount that will be allocated to goodwill and related tax effects. The related depreciation and amortization from the acquired assets are also subject to revision based on the final allocation.

The following table presents the preliminary allocation of the purchase price related to Synthes, Inc. as of the date of acquisition:

(Dollars in Millions)	
Cash & Cash equivalents	$2,749
Inventory[(1)]	889
Accounts Receivable, net	738
Other current assets	249
Property, plant and equipment	1,253
Goodwill	5,371
Intangible assets	12,929
Other non-current assets	46
Total Assets Acquired	24,224
Current liabilities	825

Deferred Taxes	2,731
Other non-current liabilities	431
Total Liabilities Assumed	3,987
Net Assets Acquired	$20,237

(1) Includes $0.4 billion related to inventory step-up.

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The acquisition of Synthes, Inc. resulted in $5.4 billion of goodwill, which is allocated to the Medical Devices and Diagnostics segment. The goodwill is primarily attributable to synergies expected to arise from the business acquisition of Synthes, Inc. The goodwill is not expected to be deductible for tax purposes.

The preliminary purchase price allocation to the identifiable intangible assets included in the current period balance sheet is as follows:

(Dollars in Millions)	
Intangible assets with definite lives:	
Customer relationships	$9,950
Patents and technology	1,495
Total amortizable intangibles	11,445
Trademark and Trade name	1,420
In-process research and development	64
Total intangible assets	$12,929

The weighted average life for the $11,445 million of total amortizable intangibles is approximately 21 years.

The trade name asset values were determined to have an indefinite life based on a number of factors, including trade name history, the competitive environment, market share and future operating plans. The intangible assets with definite lives were assigned asset lives ranging from 7 to 22 years.

The majority of the intangible asset valuation relates to customer relationships, patents and technology and tradename intangible assets in the Company's trauma, cranio maxillofacial, spine and power tools business lines. Additionally, in-process research and development intangible assets were valued for technology programs for unapproved products.

The value of the IPR&D was calculated using cash flow projections discounted for the risk inherent in such projects. The discount rate applied was 14%.

The Company is in the process of executing the integration plans to combine businesses, sales organizations, systems and locations as a result of which the Company is and will continue to incur integration costs.

The operating results of Synthes, Inc. were reported in the Company's financial statements beginning on June 14, 2012. Total sales and net earnings for Synthes, Inc. for the second quarter ended July 1, 2012 were $193 million and $28 million, respectively.

The following table provides pro forma results of operations for the fiscal second quarters and the fiscal six months ended July 1, 2012 and July 3, 2011, as if Synthes, Inc. had been acquired as of January 3, 2011. The pro forma results include the effect of divestitures and certain purchase accounting adjustments such as the estimated changes in depreciation and amortization expense on the acquired tangible and intangible assets. However, pro forma results do not include any anticipated cost savings or other effects of the planned integration of Synthes, Inc. Accordingly, such amounts are not necessarily indicative of the results if the acquisition had occurred on the dates indicated or which may occur in the future.

	Unaudited Pro forma consolidated results			
	Fiscal Six Months Ended		Fiscal Second Quarters Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011

(Dollars in Millions Except Per Share Data)				
Net Sales	$34,481	34,609	17,410	17,524
Net Earnings	$5,641	6,108	1,631	2,772
Diluted Net Earnings per Common Share	$2.02	2.20	0.58	1.00

In 2012, the Company recorded acquisition related costs of $457 million, before tax, which were recorded in Other income and

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expense.

In connection with the Synthes acquisition, DePuy Orthopaedics, Inc. agreed to divest certain rights and assets related to its trauma business, to Biomet, Inc. and completed the initial closing for this transaction in the fiscal second quarter of 2012, including those countries that represented the majority of sales.

Additionally, during the fiscal second quarter of 2012, the Company acquired Guangzhou Bioseal Biotech Co., Ltd., a privately held biopharmaceutical company specializing in the design, development and commercialization of a porcine plasma-derived biologic product for controlling bleeding during surgery; CorImmun GmbH, a privately held drug development company in Germany, whose lead compound, COR-1, is a small cyclic peptide currently in early clinical development for the treatment of heart failure; and certain assets of the Angiotech Pharmaceuticals, Inc. barbed suture business.

During the fiscal first quarter of 2012, the Company completed the divestiture of its U.S. patents and other U.S. and Canadian intellectual property for BYSTOLIC® (nebivolol), which is currently approved in the U.S. for the treatment of hypertension, to Forest Laboratories Holdings Limited. Proceeds received from the divestiture were $357 million.

During the fiscal first quarter of 2011, the Company acquired substantially all of the outstanding equity of Crucell N.V. that it did not already own. Crucell is a global biopharmaceutical company focused on the research and development, production and marketing of vaccines and antibodies against infectious disease worldwide. The net purchase price of $2.0 billion was primarily recorded as non-amortizable intangible assets for $1.0 billion, amortizable intangible assets for $0.7 billion and goodwill for $0.5 billion. During the fiscal second quarter of 2012, the Company recorded a charge of $0.5 billion for the intangible asset write-down and $0.4 billion for the impairment of the in-process research and development related to the Crucell business.

NOTE 11 — LEGAL PROCEEDINGS

Johnson & Johnson and certain of its subsidiaries are involved in various lawsuits and claims regarding product liability, intellectual property, commercial and other matters; governmental investigations; and other legal proceedings that arise from time to time in the ordinary course of their business.

The Company records accruals for such contingencies when it is probable that a liability will be incurred and the amount of the loss can be reasonably estimated. As of July 1, 2012, the Company has determined that the liabilities associated with certain litigation matters are probable and can be reasonably estimated. The Company has accrued for these matters and will continue to monitor each related legal issue and adjust accruals for new information and further developments in accordance with ASC 450-20-25. For these and other litigation and regulatory matters currently disclosed for which a loss is probable or reasonably possible, the Company is unable to determine an estimate of the possible loss or range of loss beyond the amounts already accrued. These matters can be affected by various factors, including whether damages sought in the proceedings are unsubstantiated or indeterminate; scientific and legal discovery has not commenced or is not complete; proceedings are in early stages; matters present legal uncertainties; there are significant facts in dispute; or there are numerous parties involved.

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 accrued in the Company's balance sheet, is not expected to have a material adverse effect on the Company's financial position. However, the resolution in any reporting period of one or more of these matters, either alone or in the aggregate, may have a material adverse effect on the Company's results of operations and cash flows for that period.
PRODUCT LIABILITY

Certain of Johnson & Johnson's subsidiaries are involved in numerous product liability cases. The damages claimed are substantial, and while these subsidiaries are confident of the adequacy of the warnings and instructions for use that accompany the products at issue, it is not feasible to predict the ultimate outcome of litigation. The Company has established product liability accruals in compliance with ASC 450-20 based on currently available information, which in some cases may be limited. Changes to the accruals may be required in the future as additional information becomes available.

Multiple products of Johnson & Johnson's subsidiaries are subject to product liability claims and lawsuits in which claimants seek substantial compensatory and, where available, punitive damages, including LEVAQUIN®, the ASR™ XL Acetabular System and DePuy ASR™ Hip Resurfacing System, the PINNACLE® Acetabular Cup System, RISPERDAL®, pelvic meshes, DURAGESIC®/fentanyl patches and TOPAMAX®. As of July 1, 2012, in the U.S. there were approximately 3,400 plaintiffs with direct claims in pending lawsuits regarding injuries allegedly due to LEVAQUIN®, 7,200 with respect to the ASR™ XL Acetabular System and DePuy ASR™ Hip Resurfacing System, 1,700 with respect to the PINNACLE® Acetabular Cup

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System, 420 with respect to RISPERDAL®, 1,400 with respect to pelvic meshes, 35 with respect to DURAGESIC®/fentanyl patches and 60 with respect to TOPAMAX®.

In August 2010, DePuy Orthopaedics, Inc. (DePuy) announced a worldwide voluntary recall of its ASR™ XL Acetabular System and DePuy ASR™ Hip Resurfacing System used in hip replacement surgery. Claims for personal injury have been made against DePuy and Johnson & Johnson, and the number of pending lawsuits continues to increase. The Company continues to receive information with respect to potential costs associated with this recall. The Company has established a product liability accrual in anticipation of product liability litigation and costs associated with the DePuy ASR™ Hip Recall program. Changes to these accruals may be required in the future as additional information becomes available.

Claims for personal injury have been made against Ethicon, Inc. (Ethicon) and Johnson & Johnson arising out of Ethicon's pelvic mesh devices used to treat stress urinary incontinence and pelvic organ prolapse. The number of pending product liability lawsuits continues to increase, and the Company continues to receive information with respect to potential costs and the anticipated number of cases. In addition, a class action and several individual personal injury cases have been commenced in Canada seeking damages for alleged injury resulting from Ethicon's pelvic mesh devices. The Company has established a product liability accrual in anticipation of product liability litigation associated with Ethicon's pelvic mesh products. Changes to these accruals may be required in the future as additional information becomes available.

The Company believes that the ultimate resolution of these matters based on historical and reasonably likely future trends is not expected to have a material adverse effect on the Company's financial position, annual results of operations and cash flows. The resolution in any interim reporting period could have a material impact on the Company's results of operations and cash flows for that period.

INTELLECTUAL PROPERTY

Certain of Johnson & Johnson's subsidiaries are subject, from time to time, to legal proceedings and claims related to patent, trademark and other intellectual property matters arising out of their business. The most significant of these matters are described below.

PATENT INFRINGEMENT

Certain of Johnson & Johnson's subsidiaries are involved in lawsuits challenging the coverage and/or validity of the patents on their products. Although these subsidiaries believe that they have substantial defenses to these challenges with respect to all material patents, there can be no assurance as to the outcome of these matters, and a loss in any of these cases could potentially adversely affect the ability of these subsidiaries to sell their products, or require the payment of past damages and future royalties.

Medical Devices and Diagnostics

In October 2004, Tyco Healthcare Group, LP (Tyco) and U.S. Surgical Corporation filed a lawsuit against Ethicon Endo-Surgery, Inc. (EES) in the United States District Court for the District of Connecticut alleging that several features of EES's HARMONIC® Scalpel infringed four Tyco patents. In October 2007, on motions for summary judgment prior to the initial trial, a number of claims were found invalid and a number were found infringed. However, no claim was found both valid and infringed. Trial commenced in December 2007, and the court dismissed the case without prejudice on grounds that Tyco did not own the patents in suit. The dismissal without prejudice was affirmed on appeal. In January 2010, Tyco filed another complaint in the United States District Court for the District of Connecticut asserting infringement of three of the four patents from the previous lawsuit and adding new products.

Tyco is seeking monetary damages and injunctive relief. The case was tried in July 2012, and the parties are awaiting a decision from the court.

In October 2007, Bruce Saffran (Saffran) filed a patent infringement lawsuit against Johnson & Johnson and Cordis Corporation (Cordis) in the United States District Court for the Eastern District of Texas alleging infringement on U.S. Patent No. 5,653,760. In January 2011, a jury returned a verdict finding that Cordis's sales of its CYPHER® Stent willfully infringed a patent issued to Saffran. The jury awarded Saffran $482 million. In March 2011, the Court entered judgment against Cordis in the amount of $593 million, representing the jury verdict, plus $111 million in pre-judgment interest. Cordis has appealed the judgment. Because the Company believes that the potential for an unfavorable outcome is not probable, it has not established an accrual with respect to the case.

In November 2007, Roche Diagnostics Operations, Inc., et al. (Roche) filed a patent infringement lawsuit against LifeScan, Inc. (LifeScan) in the United States District Court for the District of Delaware, accusing LifeScan's entire OneTouch® line of blood

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glucose monitoring systems of infringement of two patents related to the use of microelectrode sensors. In September 2009, LifeScan obtained a favorable ruling on claim construction that precluded a finding of infringement. The Court entered judgment against Roche in July 2010 and Roche appealed. The Court of Appeals reversed the District Court's ruling on claim construction and remanded the case to the District Court for new findings on the issue. Roche is seeking monetary damages and injunctive relief.

In June 2009, Rembrandt Vision Technologies, L.P. (Rembrandt) filed a patent infringement lawsuit against Johnson & Johnson Vision Care, Inc. (JJVC) in the United States District Court for the Eastern District of Texas alleging that JJVC's manufacture and sale of its ACUVUE®ADVANCE® and ACUVUE® OASYS® Hydrogel Contact Lenses infringe their U.S. Patent No. 5,712,327 (the Chang patent). Rembrandt is seeking monetary relief. The case was transferred to the United States District Court for the Middle District of Florida, and the case was tried in May 2012. The jury returned a verdict holding that neither of the accused lenses infringe the '327 patent. Rembrandt has filed an appeal with the United States Court of Appeals for the Federal Circuit.

In November 2011, Howmedica Osteonics Corp. (Howmedica) and Stryker Ireland Ltd. (Stryker) filed a patent infringement lawsuit against DePuy Orthopaedics, Inc. (DePuy) in the United States District Court for the District of New Jersey alleging infringement by DePuy's PINNACLE® Acetabular Cup System and DURALOC® Acetabular Cup System of a patent relating to a dual-locking mechanism feature in an acetabular cup system. Howmedica and Stryker are seeking monetary damages and injunctive relief. DePuy filed its answer in February 2012 and filed a counterclaim asserting that Stryker's Trident Acetabular Hip System infringes DePuy's U.S. Patent No. 6,610,097. DePuy is seeking damages and injunctive relief from Howmedica and Stryker. No trial date has been set.

In May 2012, Medtronic Minimed, Inc., Medtronic Puerto Rico Operations Co. and MiniMed Distribution Corp. (collectively, Medtronic Minimed) filed a patent infringement lawsuit against Animas Corporation in the United States District Court for the Central District of California alleging that Animas' One®Touch® Ping® Glucose Management System infringes nine of their patents. Medtronic Minimed is seeking monetary damages and injunctive relief.

In June 2012, DePuy filed a declaratory judgment action against Orthopaedic Hospital (OH) in the United States District Court for the Northern District of Indiana seeking a declaration of the parties' rights and obligations under a Patent Rights and License Agreement between the parties related to development of a polyethylene material. OH has claimed that DePuy owes royalties on products made with anti-oxidant polyethylene. DePuy disputes that it owes such royalties to OH and is thus seeking a declaration from the Court on disputed contractual provisions. No trial date has been set.

Pharmaceutical

In May 2009, Abbott Biotechnology Ltd. (Abbott) filed a patent infringement lawsuit against Centocor (now JBI) in the United States District Court for the District of Massachusetts alleging that SIMPONI® infringes Abbott's U.S. Patent Nos. 7,223,394 and 7,541,031 (the Salfeld patents). Abbott is seeking monetary damages and injunctive relief. In April 2012, the parties participated in an arbitration on the issue of JBI's defense that Abbott is equitably estopped from asserting the patents. In May 2012, the arbitrator rejected JBI's defense. The case has been reinstated in the District Court and fact discovery is ongoing. No trial date has been set.

In August 2009, Abbott GmbH & Co. (Abbott GmbH) and Abbott Bioresearch Center filed a patent infringement lawsuit against Centocor (now JBI) in the United States District Court for the District of Massachusetts alleging that STELARA® infringes two United States patents assigned to Abbott GmbH. JBI filed a complaint in the United States District Court for the District of Columbia for a declaratory judgment of non-infringement and invalidity of the Abbott GmbH patents, as well as a Complaint for Review of a Patent Interference Decision that granted priority of invention

on one of the two asserted patents to Abbott GmbH. The cases have been transferred from the District of Columbia to the District of Massachusetts. Trial has been set for September 2012. Also in August 2009, Abbott GmbH and Abbott Laboratories Limited brought a patent infringement lawsuit in The Federal Court of Canada alleging that STELARA® infringes Abbott GmbH's Canadian patent. No trial date has been set in the Canadian Case. In each of these cases, Abbott is seeking monetary damages and injunctive relief.

LITIGATION AGAINST FILERS OF ABBREVIATED NEW DRUG APPLICATIONS (ANDAs)

The following summarizes lawsuits pending against generic companies that filed Abbreviated New Drug Applications (ANDAs) seeking to market generic forms of products sold by various subsidiaries of Johnson & Johnson 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 subsidiaries are not successful in these actions, or the statutory 30-month

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stays expire before the United States District Court rulings are obtained, the third-party companies involved will have the ability, upon approval of the United States Food and Drug Administration (FDA), to introduce generic versions of the products at issue, resulting in very substantial market share and revenue losses for those products.

CONCERTA®

A number of generic companies have filed ANDAs seeking approval to market generic versions of CONCERTA®. In September 2011, a settlement agreement was entered into with Kremers-Urban, LLC and KUDCO Ireland, Ltd. (collectively, KUDCO) pursuant to which KUDCO was granted a license under the patent-in-suit to market its generic version of CONCERTA® starting on July 1, 2012, when and if KUDCO obtains FDA approval.

In November 2010, ALZA Corporation (ALZA) and Ortho-McNeil-Janssen Pharmaceuticals, Inc. (OMJPI) (now Janssen Pharmaceuticals, Inc. (JPI)) filed a patent infringement lawsuit in the United States District Court for the District of Delaware against Impax Laboratories, Inc. (Impax), Teva Pharmaceuticals USA, Inc., and Teva Pharmaceutical Industries Ltd. (collectively, Teva) in response to Impax and Teva's filing of a major amendment to its ANDA seeking approval to market a generic version of CONCERTA® before the expiration of ALZA and JPI's patent relating to CONCERTA®. Impax and Teva filed counterclaims alleging non-infringement and invalidity. In May 2011, ALZA and JPI filed a second lawsuit against Teva in response to Teva's filing of a second major amendment to its ANDA seeking approval to market additional dosage strengths of its generic CONCERTA® product before the expiration of ALZA and JPI's patent relating to CONCERTA®. In each of the above cases, ALZA and JPI are seeking an Order enjoining the defendants from marketing its generic version of CONCERTA® prior to the expiration of ALZA and JPI's CONCERTA® patent.

ORTHO TRI-CYCLEN® LO

A number of generic companies have filed ANDAs seeking approval to market generic versions of ORTHO TRI-CYCLEN® LO. In February 2012, JPI and Watson Laboratories, Inc. and Watson Pharmaceuticals, Inc. (collectively, Watson) entered into a settlement agreement. Pursuant to the settlement agreement, the parties entered into a supply agreement whereby JPI will supply to Watson a combinational oral contraceptive containing certain specified compounds from December 31, 2015 (or earlier under certain circumstances) through the expiration of the '815 patent on December 6, 2019. In addition, in the event Watson does not wish to exercise its rights under the supply agreement, JPI has granted Watson a license to market Watson's ANDA product from December 31, 2015 (or earlier under certain circumstances) through December 6, 2019.

In January 2010, OMJPI (now JPI) filed a patent infringement lawsuit against Lupin Ltd. and Lupin Pharmaceuticals, Inc. (collectively, Lupin) in the United States District Court for the District of New Jersey in response to Lupin's ANDA seeking approval to market a generic version of ORTHO TRI-CYCLEN® LO prior to the expiration of the OTCLO patent. Lupin filed a counterclaim alleging invalidity of the patent. Trial concluded in June 2012, and oral argument has been scheduled for August 2012. In June 2012, the FDA approved Lupin's ANDA.

In November 2010, OMJPI (now JPI) filed a patent infringement lawsuit against Mylan Inc. and Mylan Pharmaceuticals, Inc. (collectively, Mylan), and Famy Care, Ltd. (Famy Care) in the United States District Court for the District of New Jersey in response to Famy Care's ANDA seeking approval to market a generic version of ORTHO TRI-CYCLEN® LO prior to the expiration of the OTCLO patent. Mylan and Famy Care filed counterclaims alleging invalidity of the patent.

In October 2011, JPI filed a patent infringement lawsuit against Sun Pharma Global FZE and Sun Pharmaceutical Industries (collectively, Sun) in the United States District Court for the District of New Jersey in response to Sun's ANDA seeking approval to market a generic version of ORTHO TRI-CYCLEN® LO prior to the expiration of the OTCLO patent.

In May 2012, JPI filed a patent infringement lawsuit against Haupt Pharma, Inc., Ranbaxy Laboratories Limited and Ranbaxy Inc. (collectively, Haupt) in the United States District Court for the District of New Jersey in response to Haupt's ANDA seeking approval to market a generic version of ORTHO TRI-CYCLEN® LO prior to the expiration of the OTCLO patent.

In each of the above cases, JPI is seeking an Order enjoining the defendants from marketing their generic versions of ORTHO TRI-CYLCEN® LO before the expiration of the OTCLO patent.

PREZISTA®

A number of generic companies have filed ANDAs seeking approval to market generic versions of PREZISTA®. In November 2010, Tibotec, Inc. (now Tibotec, LLC) and Tibotec Pharmaceuticals (now Janssen R&D Ireland) (collectively, Tibotec) filed a patent infringement lawsuit against Lupin, Ltd., Lupin Pharmaceuticals, Inc. (collectively, Lupin), Mylan, Inc. and Mylan

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Pharmaceuticals, Inc. (collectively, Mylan) in the United States District Court for the District of New Jersey in response to Lupin's and Mylan's respective ANDAs seeking approval to market generic versions of Tibotec's PREZISTA® product before the expiration of Tibotec's patent relating to PREZISTA®. Lupin and Mylan each filed counterclaims alleging non-infringement and invalidity. In July 2011, Tibotec filed another patent infringement lawsuit against Lupin in the United States District Court for the District of New Jersey in response to Lupin's supplement to its ANDA to add new dosage strengths for its proposed product. In August 2011, Tibotec and G.D. Searle & Company (G.D. Searle) filed a patent infringement lawsuit against Lupin and Mylan in response to their notice letters advising that their ANDAs are seeking approval to market generic versions of Tibotec's PREZISTA® product before the expiration of two patents relating to PREZISTA® that Tibotec exclusively licenses from G.D. Searle.

In March 2011, Tibotec and G.D. Searle filed a patent infringement lawsuit against Teva Pharmaceuticals USA, Inc. and Teva Pharmaceuticals, Ltd. (collectively, Teva) in the United States District Court for the District of New Jersey in response to Teva's ANDA seeking approval to market a generic version of PREZISTA® before the expiration of certain patents relating to PREZISTA® that Tibotec either owns or exclusively licenses from G.D. Searle.

In March 2011, Tibotec filed a patent infringement lawsuit against Hetero Drugs, Ltd. Unit III and Hetero USA Inc. (collectively, Hetero) in the United States District Court for the District of New Jersey in response to Hetero's ANDA seeking approval to market a generic version of PREZISTA® before the expiration of certain patents relating to PREZISTA® that Tibotec exclusively licenses from G.D. Searle. In July 2011, upon agreement by the parties, the Court entered a stay of the lawsuit pending a final decision in the lawsuit against Teva with respect to the validity and/or enforceability of the patents that Tibotec licenses from G.D. Searle, with Hetero agreeing to be bound by such final decision.

In September 2011, the Court consolidated the above lawsuits, as well as lawsuits brought by the United States Government against each of the defendants for infringement of a United States Government-owned patent relating to PREZISTA®, for purposes of pre-trial discovery and trial, with the proviso that after discovery is completed, any party can move to have the cases de-consolidated for trial.

In May and June 2012, Janssen Products, LP and Janssen R&D Ireland (collectively, Janssen) and G.D. Searle filed a patent infringement lawsuit against Lupin, Teva and Mylan in the United States District Court for the District of New Jersey, alleging infringement of newly issued United States Reissue Patent No. Re42,889, which Janssen exclusively licenses from G.D. Searle.

In each of the above lawsuits, Tibotec and Janssen are seeking an Order enjoining the defendants from marketing their generic versions of PREZISTA® before the expiration of the relevant patents.

OTHER INTELLECTUAL PROPERTY MATTERS

In September 2009, Centocor Ortho Biotech Products, L.P. (now Janssen Products, LP (JPLP)) intervened in an inventorship lawsuit filed by the University of Kansas Center for Research, Inc. (KUCR) against the United States of America (USA) in the United States District Court for the District of Kansas. KUCR alleges that two KUCR scientists should be added as inventors on two USA-owned patents relating to VELCADE®. The USA licensed the patents (and their foreign counterparts) to Millennium Pharmaceuticals, Inc. (MPI), who in turn sublicensed the patents (and their foreign counterparts) to JPLP for commercial marketing outside the United States. In July 2010, the parties reached a settlement agreement to resolve the disputes in this case and submitted the inventorship issue to arbitration. The arbitration took place in December 2011 and a decision in favor of KUCR was issued in March 2012. As a result, JPLP will be required to make the aforementioned pre-specified payments to KUCR. As a result of the settlement agreement, the outcome of the arbitration regarding inventorship will determine whether pre-specified payments will

be made to KUCR, but will not affect JPLP's right to market VELCADE®.

In December 2009, the State of Israel filed a lawsuit in the District Court in Tel Aviv Jaffa against Omrix Biopharmaceuticals, Inc. and various affiliates (Omrix). In the lawsuit, the State claims that an employee of a government-owned hospital was the inventor on several patents related to fibrin glue technology that the employee developed while he was a government employee. The State claims that he had no right to transfer any intellectual property to Omrix because it belongs to the State. The State is seeking damages plus royalties on QUIXIL™ and EVICEL™ products, or alternatively, transfer of the patents to the State.

In January 2011, Genentech, Inc. (Genentech) initiated an arbitration against UCB Celltech (Celltech) seeking damages for allegedly cooperating with Centocor (now JBI) to improperly terminate a prior agreement in which JBI was sublicensed under Genentech's Cabilly patents. JBI has an indemnity agreement with Celltech, and Celltech has asserted that JBI is liable for any damages Celltech may be required to pay Genentech in that arbitration. The arbitration hearing took place in June 2012, and the parties are awaiting a decision.

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In March 2012, Noramco, Inc. (Noramco) moved to intervene in three patent infringement lawsuits filed in the United States District Court for the Southern District of New York by Purdue Pharma L.P. and others (Purdue) against Noramco oxycodone customers, Impax Laboratories, Inc. (Impax), Teva Pharmaceuticals USA, Inc. (Teva) and Amneal Pharmaceuticals, LLC (Amneal). The lawsuits are in response to the defendants' respective ANDAs seeking approval to market generic extended release oxycodone products before the expiration of certain Purdue patents. Three of the asserted patents relate to oxycodone and processes for making oxycodone, and Noramco has agreed to defend the lawsuits on behalf of Impax, Teva and Amneal.

GOVERNMENT PROCEEDINGS

Like other companies in the pharmaceutical and medical devices and diagnostics industries, Johnson & Johnson and certain of its subsidiaries are subject to extensive regulation by national, state and local government agencies in the United States and other countries in which they operate. As a result, interaction with government agencies is ongoing. The most significant litigation brought by, and investigations conducted by, government agencies are listed below. It is possible that criminal charges and substantial fines and/or civil penalties or damages could result from government investigations or litigation.

AVERAGE WHOLESALE PRICE (AWP) LITIGATION

Johnson & Johnson and several of its pharmaceutical subsidiaries (the J&J AWP Defendants), 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. Payors alleged that they used those AWPs in calculating provider reimbursement levels. Many of these cases, both federal actions and state actions removed to federal court, were consolidated for pre-trial purposes in a Multi-District Litigation (MDL) in the United States District Court for the District of Massachusetts.

The plaintiffs in these cases included three 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 June 2007, after a trial on the merits, the MDL Court dismissed the claims of two of the plaintiff classes against the J&J AWP Defendants. In March 2011, the Court dismissed the claims of the third class against the J&J AWP Defendants without prejudice.

AWP cases brought by various Attorneys General have proceeded to trial against other manufacturers. Several state cases against certain of Johnson & Johnson's subsidiaries have been settled, including Kentucky, which had been set for trial in January 2012. Kansas is set for trial in March 2013, Louisiana is set for trial in June 2013, Illinois is set for trial in May 2014, and it is anticipated that Mississippi will be set for trial in October 2013. Other state cases are likely to be set for trial in due course. In addition, an AWP case against the J&J AWP Defendants brought by the Commonwealth of Pennsylvania was tried in Commonwealth Court in October and November 2010. The Court found in the Commonwealth's favor with regard to certain of its claims under the Pennsylvania Unfair Trade Practices and Consumer Protection Law (“UTPL”), entered an injunction, and awarded $45 million in restitution and $6.5 million in civil penalties. The Court found in the J&J AWP Defendants' favor on the Commonwealth's claims of unjust enrichment, misrepresentation/fraud, civil conspiracy, and on certain of the Commonwealth's claims under the UTPL. The J&J AWP Defendants have appealed the Commonwealth Court's UTPL ruling to the Pennsylvania Supreme Court. The Company believes that the J&J AWP Defendants have strong arguments supporting their appeal. Because the Company believes that the potential for an unfavorable outcome is not probable, it has not established an accrual with respect to the verdict.

RISPERDAL®

In January 2004, Janssen Pharmaceutica Inc. (Janssen Pharmaceutica) (now Janssen Pharmaceuticals, Inc. (JPI)) received a subpoena from the Office of the Inspector General of the United States 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® from 1997 to 2002. Documents subsequent to 2002 have also been requested by the Department of Justice. An additional subpoena seeking information about marketing of, and adverse reactions to, RISPERDAL® was received from the United States Attorney's Office for the Eastern District of Pennsylvania in November 2005. Numerous subpoenas seeking testimony from various witnesses before a grand jury were also received. JPI cooperated in responding to these requests for documents and witnesses. The United States Department of Justice and the United States Attorney's Office for the Eastern District of Pennsylvania (the Government) are continuing to actively pursue both criminal and civil actions. In February 2010, the Government served Civil Investigative Demands seeking additional information relating to sales and marketing of RISPERDAL® and sales and marketing of INVEGA®. The focus of these matters is the alleged promotion of RISPERDAL® and INVEGA® for off-label uses. The Government has notified JPI that there are also pending qui tam actions

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alleging off-label promotion of RISPERDAL®. The Government informed JPI that it will intervene in these qui tam actions and file a superseding complaint.

In addition, the Attorneys General of multiple states, including Alaska, Arkansas, Louisiana, Massachusetts, Mississippi, Montana, New Mexico, Pennsylvania, South Carolina, and Utah, have pending actions against Janssen Pharmaceutica (now JPI) seeking one or more of the following remedies: reimbursement of Medicaid or other public funds for RISPERDAL® prescriptions written for off-label use, compensation for treating their citizens for alleged adverse reactions to RISPERDAL®, civil fines or penalties, damages for “overpayments” by the state and others, violations of state consumer fraud statutes, punitive damages, or other relief relating to alleged unfair business practices. Certain of these actions also seek injunctive relief relating to the promotion of RISPERDAL®. In January 2012, JPI settled a lawsuit filed by the Attorney General of Texas. In April 2012, in the lawsuit brought by the Attorney General of Arkansas, the jury found against both JPI and Johnson & Johnson, and the court imposed penalties in the amount of approximately $1.2 billion. JPI and Johnson & Johnson have filed an appeal and believe that they have strong arguments supporting the appeal.

The Attorney General of West Virginia commenced suit in 2004 against Janssen Pharmaceutica (now JPI) based on claims of alleged consumer fraud as to DURAGESIC®, as well as RISPERDAL®. JPI was found liable and damages were assessed at $4.5 million. JPI filed an appeal, and in November 2010, the West Virginia Supreme Court reversed the trial court's decision. In December 2010, the Attorney General of West Virginia dismissed the case as it related to RISPERDAL® without any payment. Thereafter, JPI settled the case insofar as it related to DURAGESIC®.

In 2004, the Attorney General of Louisiana filed a multi-count Complaint against Janssen Pharmaceutica (now JPI). Johnson & Johnson was later added as a defendant. The case was tried in October 2010. The issue tried to the jury was whether Johnson & Johnson or JPI had violated the State's Medicaid Fraud Act (the Act) through misrepresentations allegedly made in the mailing of a November 2003 Dear Health Care Professional letter regarding RISPERDAL®. The jury returned a verdict that JPI and Johnson & Johnson had violated the Act and awarded $257.7 million in damages. The trial judge subsequently awarded the Attorney General counsel fees and expenses in the amount of $73 million. Johnson & Johnson and JPI have filed an appeal and believe that they have strong arguments supporting the appeal. The appeal was argued in January 2012, and the parties are awaiting a decision.

In 2007, the Office of General Counsel of the Commonwealth of Pennsylvania filed a lawsuit against Janssen Pharmaceutica (now JPI) on a multi-Count Complaint related to Janssen Pharmaceutica's sale of RISPERDAL® to the Commonwealth's Medicaid program. The trial occurred in June 2010. The trial judge dismissed the case after the close of the plaintiff's evidence. The Commonwealth filed an appeal in April 2011, and in July 2012, the Pennsylvania Appeals Court upheld the dismissal of the Commonwealth's case.

In 2007, the Attorney General of South Carolina filed a lawsuit against Johnson & Johnson and Janssen Pharmaceutica (now JPI) on several counts. In March 2011, the matter was tried on liability only, at which time the lawsuit was limited to claims of violation of the South Carolina Unfair Trade Practice Act, including, among others, questions of whether Johnson & Johnson or JPI engaged in unfair or deceptive acts or practices in the conduct of any trade or commerce by distributing the November 2003 Dear Health Care Professional letter regarding RISPERDAL® or in their use of the product's FDA-approved label. The jury found in favor of Johnson & Johnson and against JPI. In June 2011, the Court awarded civil penalties of approximately $327.1 million. JPI has appealed this judgment and the Company believes it has strong arguments supporting the appeal.

The Attorneys General of approximately 40 other states and the District of Columbia have indicated a potential interest in pursuing similar litigation against JPI, and have obtained a tolling agreement staying the running of the statute of limitations while they pursue a coordinated civil investigation of JPI regarding potential consumer fraud actions in connection with the marketing of RISPERDAL®.

In 2011, discussions to resolve criminal penalties under the Food Drug and Cosmetic Act related to the promotion of RISPERDAL® resulted in an agreement in principle with the United States Attorney's Office for the Eastern District of Pennsylvania on key issues relevant to a disposition of criminal charges pursuant to a single misdemeanor violation of the Food Drug and Cosmetic Act, but certain issues remain open before a settlement can be finalized. During 2011, the Company accrued amounts to cover the financial component of the proposed criminal settlement.

The Company has also now reached an agreement in principle with the United States Department of Justice to settle three pending civil False Claims Act matters that are pending in (1) the Eastern District of Pennsylvania concerning sales and marketing of RISPERDAL® and INVEGA®; (2) the Northern District of California regarding the sales and marketing of NATRECOR®, discussed separately below; and (3) the District of Massachusetts alleging that the defendants provided the Omnicare, Inc. (Omnicare) long-term care pharmacy with rebates and other payments regarding RISPERDAL® and other

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products, discussed separately below. Assuming these agreements are finalized, they will resolve the federal government's claims under the federal False Claims Act, resolve all pending state and federal government litigation regarding Omnicare and NATRECOR®, and settle the RISPERDAL® Medicaid-related claims for those states that opt into the settlement. On a parallel track, the Company has reached an agreement in principle with representatives of a group of 38 states and the District of Columbia to settle non-Medicaid actions in connection with the sales and marketing of RISPERDAL® and INVEGA®. With all the tentative settlement agreements described above, issues remain open that must be resolved before the settlements can be finalized.

The Company has accrued amounts, including an additional accrual made in the second quarter of 2012, to cover these tentative settlement agreements. However, the settlements will not resolve all pending state litigation matters regarding RISPERDAL®, and some states may elect to opt out of the settlements. To the extent any state has a claim and has or will elect to opt out of these settlements, the Company has accrued an amount equal to what that state would receive if it was participating in the settlements. Among other states, Arkansas, Louisiana and South Carolina are not expected to participate in the settlements. Because the Company believes there are strong arguments on appeal in those cases, the Company has only accrued an amount equal to what these states would receive if they participated in the settlements.

In the Company's opinion, the ultimate resolution of any of the above RISPERDAL® matters is not expected to have a material adverse effect on the Company's financial position, although the resolution in any reporting period could have a material impact on the Company's results of operations and cash flows for that period.

OMNICARE

In September 2005, Johnson & Johnson received a subpoena from the United States Attorney's Office for the District of Massachusetts, seeking documents related to the sales and marketing of eight drugs to Omnicare, Inc. (Omnicare), a manager of pharmaceutical benefits for long-term care facilities. In April 2009, Johnson & Johnson and certain of its pharmaceutical subsidiaries were served in two civil qui tam cases asserting claims under the Federal False Claims Act and related state law claims alleging that the defendants provided Omnicare with rebates and other alleged kickbacks, causing Omnicare to file false claims with Medicaid and other government programs. In January 2010, the government intervened in both of these cases, naming Johnson & Johnson, Ortho-McNeil-Janssen Pharmaceuticals, Inc. (now Janssen Pharmaceuticals, Inc. (JPI)), and Johnson & Johnson Health Care Systems Inc. as defendants. Subsequently, the Commonwealth of Massachusetts, Virginia, and Kentucky, and the States of California and Indiana intervened in the action. In February 2011, the United States District Court for the District of Massachusetts dismissed one qui tam case entirely and dismissed the other case in part, rejecting allegations that the defendants had violated their obligation to report its “best price” to health care program officials. The claims of the United States and individual states remain pending. In June 2012, the parties were granted their joint motion to stay the case pending resolution of the potential settlement discussed in the RISPERDAL® section above.

In November 2005, a lawsuit was filed by Scott Bartz, a former employee, in the United States District Court for the Eastern District of Pennsylvania against Johnson & Johnson and certain of its pharmaceutical subsidiaries (the J&J Defendants), along with co-defendants McKesson Corporation (McKesson) and Omnicare, Inc. The Bartz complaint raises many issues in common with the Omnicare-related litigation discussed above already pending before the United States District Court for the District of Massachusetts, such as best price and a number of kickback allegations. After investigation, the United States declined to intervene. In February 2011, the plaintiff filed an amended complaint. Thereafter, on the J&J Defendants' motion, the case was transferred to the United States District Court for the District of Massachusetts, where it is currently pending. The amended complaint alleges a variety of causes of action under the Federal False Claims Act and corresponding state and local statutes, including that the J&J Defendants engaged in various improper transactions that were allegedly designed to report false prescription drug prices to the federal government in order to reduce the J&J Defendants' Medicaid rebate obligations. The complaint further alleges that the

J&J Defendants improperly retaliated against the plaintiff for having raised these allegations internally. Bartz seeks multiple forms of relief, including damages and reinstatement to a position with the same seniority status. The J&J Defendants subsequently moved to dismiss the complaint in May 2011. In March 2012, the District Court dismissed Bartz's claims under the Federal False Claims Act, and declined to exercise supplemental jurisdiction over numerous related claims under state false claims act statutes. The District Court, however, denied the dismissal motion with regard to Bartz's claims that he was retaliated against in violation of the Federal False Claims Act and in violation of New Jersey's Conscientious Employee Protection Act. Discovery is proceeding on those two claims.

MCNEIL CONSUMER HEALTHCARE

Starting in June 2010, McNeil Consumer Healthcare Division of McNEIL-PPC, Inc. (McNeil Consumer Healthcare) and certain affiliates, including Johnson & Johnson (the Companies), received grand jury subpoenas from the United States Attorney's Office for the Eastern District of Pennsylvania requesting documents broadly relating to recalls of various products

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of McNeil Consumer Healthcare, and the FDA inspections of the Fort Washington, Pennsylvania and Lancaster, Pennsylvania manufacturing facilities, as well as certain documents relating to recalls of a small number of products of other subsidiaries. In addition, in February 2011, the government served McNEIL-PPC, Inc. (McNEIL-PPC) with a Civil Investigative Demand seeking records relevant to its investigation to determine if there was a violation of the Federal False Claims Act. The Companies are cooperating with the United States Attorney's Office in responding to these subpoenas.

The Companies have also received Civil Investigative Demands from multiple State Attorneys General Offices broadly relating to the McNeil recall issues. The Companies continue to cooperate with these inquiries. In January 2011, the Oregon Attorney General filed a civil complaint against Johnson & Johnson, McNEIL-PPC and McNeil Healthcare LLC in state court alleging civil violations of the Oregon Unlawful Trade Practices Act relating to an earlier recall of a McNeil OTC product. After a removal to federal court, the case was remanded back to state court in Oregon. The Companies filed a motion to dismiss in February 2012. In June 2012, the state court granted the Companies' motion to dismiss in its entirety, but granted Oregon leave to amend. In July 2012, Oregon filed an amended complaint.

In March 2011, the United States filed a complaint for injunctive relief in the United States District Court for the Eastern District of Pennsylvania against McNEIL-PPC and two of its employees, alleging that McNEIL-PPC is in violation of FDA regulations regarding the manufacture of drugs at the facilities it operates in Lancaster, Pennsylvania, Fort Washington, Pennsylvania, and Las Piedras, Puerto Rico. On the same day, the parties filed a consent decree of permanent injunction resolving the claims set forth in the complaint. The Court approved and entered the consent decree on March 16, 2011.

The consent decree, which is subject to ongoing enforcement by the court, requires McNEIL-PPC to take enhanced measures to remediate the three facilities. The Fort Washington facility, which was voluntarily shut down in April 2010, will remain shut down until a third-party consultant certifies that its operations will be in compliance with applicable law, and the FDA concurs with the third-party certification. The Lancaster and Las Piedras facilities may continue to manufacture and distribute drugs, provided that a third party reviews manufacturing records for selected batches of drugs released from the facilities, and certifies that any deviations reviewed do not adversely affect the quality of the selected batches. McNEIL-PPC has submitted a workplan to the FDA for remediation of the Lancaster and Las Piedras facilities; that plan is subject to FDA approval. Third-party batch record review may cease if the FDA has stated that the facilities appear to be in compliance with applicable law. Each facility is subject to a five-year audit period by a third party after the facility has been deemed by the FDA to be in apparent compliance with applicable law.

OTHER

In July 2005, Scios Inc. (Scios) received a subpoena from the United States Attorney's Office for the District of Massachusetts, seeking documents related to the sales and marketing of NATRECOR®. In August 2005, Scios was advised that the investigation would be handled by the United States Attorney's Office for the Northern District of California in San Francisco. In February 2009, two qui tam complaints were unsealed in the United States District Court for the Northern District of California, alleging, among other things, improper activities in the promotion of NATRECOR®. In June 2009, the United States government intervened in one of the qui tam actions, and filed a complaint against Scios and Johnson & Johnson seeking relief under the Federal False Claims Act and asserting a claim of unjust enrichment. In October 2011, the criminal matter was resolved. The civil case has been stayed pending resolution of the potential settlement discussed in the RISPERDAL® section above.

In June 2008, Johnson & Johnson received a subpoena from the United States Attorney's Office for the District of Massachusetts relating to the marketing of biliary stents by Cordis Corporation (Cordis). In February 2012, the

government informed Cordis that it was closing its investigation. In addition, in January 2010, a complaint was unsealed in the United States District Court for the Northern District of Texas seeking damages against Cordis for alleged violations of the Federal False Claims Act and several similar state laws in connection with the marketing of biliary stents. The United States Department of Justice and several states have declined to intervene at this time. In March 2012, the court issued an opinion dismissing one part of the complaint with prejudice and other parts of the complaint without prejudice. The plaintiff has filed a motion for partial reconsideration of the dismissal with prejudice.

In September 2011, Synthes, Inc. (Synthes) received a Civil Investigative Demand issued pursuant to the False Claims Act from the United States Attorney's Office for the Eastern District of Pennsylvania. The Demand sought information regarding allegations that fellowships had been offered to hospitals in exchange for agreements to purchase products. Synthes has produced documents and information in response to the Demand and is cooperating with the inquiry.

In October 2011, the European Commission announced that it opened an investigation concerning an agreement between Janssen-Cilag B.V. and Sandoz B.V. relating to the supply of fentanyl patches in The Netherlands. The investigation seeks to

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determine whether the agreement infringes European competition law.

In April 2012, Janssen Pharmaceuticals, Inc. (JPI) received a letter requesting certain documents from the United States Department of Justice relating to the marketing and promotion of DORIBAX®. JPI has provided documents and continues to cooperate with this government inquiry.

In May 2012, Acclarent, Inc. (Acclarent) received a subpoena from the United States Attorney's Office for the District of Massachusetts relating to the marketing by Acclarent of RELIEVA STRATUS™ MicroFlow Spacer and related products. Acclarent is producing information in response to the subpoena and is cooperating with the investigation.

In recent years, Johnson & Johnson has received numerous requests from a variety of United States Congressional Committees to produce information relevant to ongoing congressional inquiries. It is Johnson & Johnson's policy to cooperate with these inquiries by producing the requested information.

GENERAL LITIGATION

Starting in July 2006, five lawsuits were filed in United States District Court for the District of New Jersey by various employers and employee benefit plans and funds seeking to recover amounts they paid for RISPERDAL® for plan participants. In general, Plaintiffs allege that Johnson & Johnson and certain of its pharmaceutical subsidiaries engaged in off-label marketing of RISPERDAL® in violation of the federal and New Jersey RICO statutes. In addition, Plaintiffs asserted various state law claims. All of the cases were consolidated into one case seeking class action status, but shortly thereafter, one action was voluntarily dismissed. In December 2008, the Court dismissed the actions of the four remaining plaintiffs. In April 2010, those plaintiffs filed a new consolidated class action against Johnson & Johnson and Janssen, L.P. (now Janssen Pharmaceuticals, Inc. (JPI)); and in March 2011, that action was dismissed. In April 2011, one of those plaintiffs filed a notice of appeal with the United States Court of Appeals for the Third Circuit. That appeal was dismissed in July 2011.

In April 2009, Ortho-Clinical Diagnostics, Inc. (OCD) received a grand jury subpoena from the United States Department of Justice, Antitrust Division, requesting documents and information for the period beginning September 1, 2000 through the present, pertaining to an investigation of alleged violations of the antitrust laws in the blood reagents industry. OCD complied with the subpoena. In February 2011, OCD received a letter from the Antitrust Division indicating that it had closed its investigation in November 2010. In June 2009, following the public announcement that OCD had received a grand jury subpoena, multiple class action complaints seeking damages for alleged price fixing were filed against OCD. The various cases were consolidated for pre-trial purposes in the United States District Court for the Eastern District of Pennsylvania. Discovery is ongoing. Plaintiffs filed a motion for class certification and OCD filed an opposition to that motion. The Court heard argument on the motion for class certification in July 2012, and the parties are awaiting a decision.

In April 2010, a putative class action lawsuit was filed in the United States District Court for the Northern District of California by representatives of nursing home residents or their estates against Johnson & Johnson, Omnicare, Inc. (Omnicare), and other unidentified companies or individuals. In February 2011, Plaintiffs filed a second amended complaint asserting that certain rebate agreements between Johnson & Johnson and Omnicare increased the amount of money spent on pharmaceuticals by the nursing home residents and violated the Sherman Act and the California Business & Professions Code. The second amended complaint also asserted a claim of unjust enrichment. Plaintiffs sought multiple forms of monetary and injunctive relief. Johnson & Johnson moved to dismiss the second amended complaint in March 2011. The Court granted the motion in its entirety in August 2011, dismissing all claims asserted by Plaintiffs. In October 2011, the Court dismissed the action with prejudice. The plaintiffs filed a notice of appeal to the United States Court of Appeals for the Ninth Circuit in November 2011. In February 2012, Plaintiffs stipulated to a voluntary dismissal of the matter, with prejudice. Pursuant to the terms of the stipulation, the Ninth Circuit

dismissed the case in its entirety in March 2012.

Starting in May 2010, multiple complaints seeking class action certification related to the McNeil recalls have been filed against McNeil Consumer Healthcare and certain affiliates, including Johnson & Johnson, in the United States District Court for the Eastern District of Pennsylvania, the Northern District of Illinois, the Central District of California, the Southern District of Ohio and the Eastern District of Missouri. These consumer complaints allege generally that purchasers of various McNeil medicines are owed monetary damages and penalties because they paid premium prices for defective medications rather than less expensive alternative medications. All but one complaint seeks certification of a nation-wide class of purchasers of these medicines, whereas one complaint, the Harvey case, seeks certification of a class of MOTRIN® IB purchasers in Missouri. In October 2010, the Judicial Panel on Multidistrict Litigation consolidated all of the consumer complaints, except for the Harvey case, which was consolidated in March 2011, into one lawsuit: In re: McNeil Consumer Healthcare, et al., Marketing and Sales Practices Litigation, for pretrial proceedings in the United States District Court for the Eastern District of Pennsylvania. In January 2011, the plaintiffs in all of the cases except the Harvey case filed a Consolidated Amended Civil Consumer Class

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Action Complaint (CAC) naming additional parties and claims. In July 2011, the Court granted Johnson & Johnson's motion to dismiss the CAC without prejudice, but permitted the plaintiffs to file an amended complaint within thirty days of the dismissal order. In August 2011, the plaintiffs filed a Second Amended Civil Consumer Class Action Complaint (SAC). In July 2012, the Court granted Johnson & Johnson's motion to dismiss the SAC with prejudice.

Separately, in September 2011, Johnson & Johnson, Johnson & Johnson Inc. and McNeil Consumer Healthcare Division of Johnson & Johnson Inc. received a Notice of Civil Claim filed by Nick Field in the Supreme Court of British Columbia, Canada (the BC Civil Claim). The BC Civil Claim is a putative class action brought on behalf of persons who reside in British Columbia and who purchased during the period between September 20, 2001 and the present one or more various McNeil infants' or children's over-the-counter medicines that were manufactured at the Fort Washington, PA facility. The BC Civil Claim alleges that the defendants violated the BC Business Practices and Consumer Protection Act, and other Canadian statutes and common laws, by selling medicines that were allegedly not safe and/or effective or did not comply with Canadian Good Manufacturing Practices. The BC plaintiff served their affidavits in support of class certification in April 2012. The defendants responding affidavits were served in June 2012. The date for hearing of the certification application has not yet been scheduled.

In September 2010, a shareholder, Ronald Monk, filed a lawsuit in the United States District Court for the District of New Jersey seeking class certification and alleging that Johnson & Johnson and certain individuals, including executive officers and employees of Johnson & Johnson, failed to disclose that a number of manufacturing facilities were failing to maintain current good manufacturing practices, and that as a result, the price of Johnson & Johnson's stock declined significantly. Plaintiff seeks to pursue remedies under the Securities Exchange Act of 1934 to recover his alleged economic losses. In December 2011, Johnson & Johnson's motion to dismiss was granted in part and denied in part. Plaintiff moved the Court to reconsider part of the December 2011 ruling. Defendants filed answers to the remaining claims of the Amended Complaint in February 2012 and the case is proceeding to discovery. In May 2012, the Court denied Plaintiff's motion for reconsideration.

In April 2011, OMJ Pharmaceuticals, Inc. (OMJ PR) filed a lawsuit against the United States in United States District Court for the District of Puerto Rico alleging overpayment of federal income taxes for the tax years ended November 30, 1999 and November 30, 2000. OMJ PR alleges that the Internal Revenue Service erroneously calculated OMJ PR's tax credits under Section 936 of the Tax Code. Discovery is ongoing. OMJ filed a motion for summary judgment, and the United States filed a cross motion for summary judgment.

In August 2011, an arbitration panel ruled that Mitsubishi Tanabe Pharma Corporation (Tanabe), Janssen Biotech, Inc.'s (JBI's) distributor of REMICADE® in Japan, could seek to modify the proportion of net sales revenue that Tanabe must remit to JBI in exchange for distribution rights and commercial supply of REMICADE® (the Supply Price). Tanabe commenced the arbitration against Centocor Ortho Biotech, Inc. (now JBI) in 2009 pursuant to the parties' distribution agreement, which grants Tanabe the right to distribute REMICADE® in Japan and certain other parts of Asia. JBI has counterclaimed for an increase in the Supply Price. A hearing was held in November 2011 to determine the appropriate split of revenue and the parties are awaiting a decision.

Johnson & Johnson or its subsidiaries are also parties to a number of proceedings brought under the Comprehensive Environmental Response, Compensation, and Liability Act, commonly known as Superfund, and comparable state, local or foreign laws in which the primary relief sought is the cost of past and/or future remediation.

SHAREHOLDER DERIVATIVE ACTIONS

Starting in April 2010, a number of shareholder derivative lawsuits were filed in the United States District Court for the District of New Jersey against certain current and former directors and officers of Johnson & Johnson. Johnson & Johnson is named as a nominal defendant. These actions were consolidated in August 2010 into one lawsuit: In re Johnson & Johnson Derivative Litigation. Additionally, in September 2010, another shareholder derivative lawsuit

was filed by Michael Wolin in New Jersey Superior Court against certain current and former directors and officers of Johnson & Johnson. Johnson & Johnson is named as a nominal defendant in this action as well. The parties to this action have stipulated that it shall be stayed until the In re Johnson & Johnson Derivative Litigation is completely resolved.

These shareholder derivative actions are similar in their claims and collectively they assert a variety of alleged breaches of fiduciary duties, including, among other things, that the defendants allegedly engaged in, approved of, or failed to remedy or prevent defective medical devices, improper pharmaceutical rebates, improper off-label marketing of pharmaceutical and medical device products, violations of current good manufacturing practice regulations that resulted in product recalls, and that they failed to disclose the aforementioned alleged misconduct in the Company's filings under the Securities Exchange Act of 1934. Each complaint seeks a variety of relief, including monetary damages and corporate governance reforms. Johnson & Johnson moved to dismiss these actions on the grounds, inter alia, that the plaintiffs failed to make a demand upon the Board of

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Directors. In September 2011, In re Johnson & Johnson Derivative Litigation was dismissed without prejudice and with leave to file an amended complaint.

Johnson & Johnson filed a report in the In re Johnson & Johnson Derivative Litigation matter in July 2011, prepared by a Special Committee of the Board of Directors, which investigated the allegations contained in the derivative actions and in a number of shareholder demand letters that the Board received in 2010 raising similar issues. The Special Committee was assisted in its investigation by independent counsel. The Special Committee's report recommended: i) that Johnson & Johnson reject the shareholder demands and take whatever steps are necessary or appropriate to secure dismissal of the derivative litigation and ii) that the Board of Directors create a new Regulatory and Compliance Committee charged with responsibility for monitoring and oversight of the Company's Health Care Compliance and Quality & Compliance systems and issues. Johnson & Johnson's Board of Directors unanimously adopted the Special Committee's recommendations, and in April 2012, the Board of Directors created the Regulatory, Compliance & Government Affairs Committee.

In August 2011, two shareholders who had submitted shareholder demand letters in 2010 filed shareholder derivative lawsuits in the United States District Court for the District of New Jersey naming various current and former officers and directors as defendants and challenging the Board's rejection of their demands. In November 2011, the Court consolidated these two cases into Copeland v. Prince. Johnson & Johnson has secured an extension of time to respond to the complaint.

Two additional shareholder derivative lawsuits were filed in May 2011 in the United States District Court for the District of New Jersey, and two other shareholder derivative lawsuits were filed in New Jersey Superior Court in May 2011 and August 2011, all naming Johnson & Johnson's current directors as defendants and Johnson & Johnson as the nominal defendant. The complaints allege breaches of fiduciary duties related to the Company's compliance with the Foreign Corrupt Practices Act and participation in the United Nations Iraq Oil For Food Program, that the Company has suffered damages as a result of those alleged breaches, and that the defendants failed to disclose the alleged misconduct in the Company's filings under the Securities Exchange Act of 1934. Plaintiffs seek monetary damages, and the state court plaintiffs also seek corporate governance reforms. The federal lawsuits were consolidated in July 2011 into In re J&J FCPA Derivative Shareholder Litigation, and an amended consolidated complaint was filed in August 2011. In October 2011, Johnson & Johnson moved to dismiss the consolidated federal lawsuit on the grounds that the plaintiffs failed to make a demand upon the Board of Directors. The plaintiffs have secured an extension of time to respond to the motion. The state lawsuits were consolidated in November 2011 into In re J&J Shareholder Derivative Litigation, and a consolidated complaint was filed in December 2011. In January 2012, Johnson & Johnson moved to dismiss or stay the state lawsuits pending resolution of the federal lawsuit and moved to dismiss on the ground that the plaintiffs failed to make a demand on the Board of Directors. In May 2012, the Court granted Johnson & Johnson's motion to stay the state lawsuits pending resolution of In re J&J FCPA Derivative Shareholder Litigation.

In July 2012, the parties in each of the shareholder derivative cases pending in federal court discussed above (specifically, In re Johnson & Johnson Derivative Litigation, Copeland v. Prince, and In re J&J FCPA Derivative Shareholder Litigation) filed a Stipulation of Settlement, which after final court approval, will permanently resolve all of those actions in their entirety. The settlement was preliminarily approved by the court, and a final settlement hearing has been set for September 28, 2012.

In June 2012, two other shareholders who had submitted a shareholder demand letter in March 2010, the New Jersey Building Laborers Annuity and the New Jersey Building Laborers Pension Funds, filed an additional shareholder derivative lawsuit in New Jersey Superior Court naming various current and former officers and directors as defendants and also challenging the Board's rejection of their demands. This shareholder derivative lawsuit purports to allege the same claims that are the subject of the settlement described above. Johnson & Johnson intends to file a motion to dismiss this new state court action.

In September 2011, two additional shareholder derivative lawsuits were filed in the United States District Court for the District of New Jersey by Donovan Spamer and The George Leon Family Trust naming Johnson & Johnson's current directors and one former director as defendants and Johnson & Johnson as the nominal defendant. These lawsuits allege that the defendants breached their fiduciary duties in their decisions with respect to the compensation of the Chief Executive Officer during the period from 2008 through 2011, and that the defendants made misleading statements in Johnson & Johnson's annual proxy statements. Both of these lawsuits have been voluntarily dismissed without prejudice, but a similar lawsuit on behalf of The George Leon Family Trust was refiled in July 2012. The above settlement does not resolve these potential claims. The Board of Directors' evaluation of these allegations is ongoing.

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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 six months of 2012, worldwide sales were $32.6 billion, a total decrease of 0.5%, including operational growth of 2.2% as compared to 2011 first fiscal six months sales of $32.8 billion. Currency fluctuations had a negative impact of 2.7% for the first fiscal six months of 2012.

Sales by U.S. companies were $14.6 billion in the first fiscal six months of 2012, which represented a decrease of 3.2% as compared to the prior year. Sales by international companies were $18.0 billion, which represented a total increase of 1.8%, including an operational increase of 6.8%, and a negative currency impact of 5.0% as compared to the first fiscal six months sales of 2011.

Sales by companies in Europe experienced a decline of 4.2%, including operational growth of 2.9%, and a negative currency impact of 7.1%. Sales by companies in the Western Hemisphere, excluding the U.S., achieved growth of 15.5%, including operational growth of 22.7%, and a negative currency impact of 7.2%. Sales by companies in the Asia-Pacific, Africa region achieved sales growth of 3.7%, including operational growth of 4.5%, and a negative currency impact of 0.8%.

For the fiscal second quarter of 2012, worldwide sales were $16.5 billion, a total decrease of 0.7%, including operational growth of 3.5% as compared to 2011 fiscal second quarter sales of $16.6 billion. Currency fluctuations had a negative impact of 4.2% for the fiscal second quarter of 2012.

Sales by U.S. companies were $7.4 billion in the fiscal second quarter of 2012, which represented a decrease of 1.2% as compared to the prior year. Sales by international companies were $9.1 billion, which represented a total decrease of 0.4%, including an operational increase of 7.1%, and a negative currency impact of 7.5% as compared to the fiscal second quarter sales of 2011.

Sales by companies in Europe experienced a decline of 8.3%, including operational growth of 1.6%, and a negative currency impact of 9.9%. Sales by companies in the Western Hemisphere, excluding the U.S., achieved growth of 12.0%, including operational growth of 22.4%, and a negative currency impact of 10.4%. Sales by companies in the Asia-Pacific, Africa region achieved sales growth of 5.2%, including operational growth of 7.7%, and a negative currency impact of 2.5%.

U.S. Health Care Reform

Under the provisions of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, beginning in 2011, companies that sold branded prescription drugs to specified U.S. Government programs paid an annual non-tax deductible fee based on an allocation of each company's market share of total branded prescription drug sales from the prior year. The 2012 full year impact to selling, marketing and administrative expenses is estimated to be between $120 - $140 million. The 2011 full year impact to selling, marketing and administrative expenses was approximately$140 million. Under the current law, beginning in 2013, the Company will be required to pay a tax deductible 2.3% excise tax imposed on the sale of certain medical devices. The 2013 excise tax is estimated to be between $200 - $300 million and will be recorded in selling, marketing and

administrative expenses.

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ANALYSIS OF SALES BY BUSINESS SEGMENTS

Consumer

Consumer segment sales in the first fiscal six months of 2012 were $7.2 billion, a decrease of 3.5% as compared to the same period a year ago. Operational sales were flat and currency had a negative impact of 3.5% as compared to the same period a year ago. U.S. Consumer segment sales declined by 2.0%. International Consumer segment sales declined by 4.3%, including operational growth of 1.2% and a negative currency impact of 5.5%.

Major Consumer Franchise Sales — Fiscal Six Months Ended

(Dollars in Millions)	July 1, 2012	July 3, 2011	Total Change	Operations Change	Currency Change
OTC Pharm. & Nutritionals	$2,136	$2,212	(3.4)%	0.2 %	(3.6)%
Skin Care	1,820	1,828	(0.4)	2.2	(2.6)
Baby Care	1,118	1,159	(3.5)	1.0	(4.5)
Women’s Health	811	936	(13.4)	(8.5)	(4.9)
Oral Care	795	790	0.6	4.1	(3.5)
Wound Care/Other	534	550	(2.9)	(0.6)	(2.3)
Total Consumer Sales	$7,214	$7,475	(3.5)%	0.0%	(3.5)%

Consumer segment sales in the fiscal second quarter of 2012 were $3.6 billion, a decrease of 4.6% as compared to the same period a year ago, including operational growth of 0.6% and a negative currency impact of 5.2%. U.S. Consumer segment sales declined by 1.9%. International Consumer segment sales declined by 6.0%, including operational growth of 2.0% and a negative currency impact of 8.0%.

Major Consumer Franchise Sales — Fiscal Second Quarters Ended

(Dollars in Millions)	July 1, 2012	July 3, 2011	Total Change	Operations Change	Currency Change
OTC Pharm. & Nutritionals	$1,032	$1,083	(4.7)%	0.6 %	(5.3)%
Skin Care	913	929	(1.7)	2.2	(3.9)
Baby Care	578	598	(3.3)	3.2	(6.5)
Oral Care	408	399	2.3	7.5	(5.2)
Women’s Health	402	477	(15.7)	(8.7)	(7.0)
Wound Care/Other	286	307	(6.8)	(3.7)	(3.1)
Total Consumer Sales	$3,619	$3,793	(4.6)%	0.6 %	(5.2)%

The OTC Pharmaceuticals and Nutritionals franchise achieved operational growth of 0.6% as compared to the prior year fiscal second quarter. Sales in the U.S. increased due to the relaunch of selected key products and the impact of the acquisition of full ownership rights to certain digestive health products. McNEIL-PPC, Inc. continues to operate under a consent decree signed with the U.S. Food and Drug Administration (FDA), which governs certain McNeil Consumer Healthcare manufacturing operations. McNeil continues to operate the manufacturing facilities in Las Piedras, Puerto Rico and Lancaster, Pennsylvania; however, production volumes from these facilities continue to be impacted by additional review and approval processes required under the consent decree. The Company expects this to continue throughout 2012 and most of 2013. Plants operating under the consent decree will produce a simplified portfolio focused on key brands. The Fort Washington, Pennsylvania manufacturing site is not in operation at this

time. McNeil continues to work on the re-siting of the products previously produced at the Fort Washington facility to other facilities.

The Skin Care franchise achieved operational growth of 2.2% as compared to the prior year, primarily attributable to increased sales of NEUTROGENA® in the U.S.

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The Baby Care franchise experienced operational growth of 3.2% as compared to the prior year, primarily due to international sales of hair care and powders.

The Oral Care franchise achieved operational growth of 7.5% as compared to the prior year, primarily due to increased sales of LISTERINE® outside the U.S.

The Women's Health Franchise experienced an operational decline of 8.7% as compared to the prior year, primarily due to the impact of the divestiture of certain brands in the fiscal third quarter of 2011.

The Wound Care/Other franchise experienced an operational decline of 3.7% as compared to the prior year, due to competitive pressures.

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Pharmaceutical

Pharmaceutical segment sales in the first fiscal six months of 2012 were $12.4 billion, a total increase of 1.1% as compared to the same period a year ago with an operational increase of 3.9% and a negative currency impact of 2.8%. U.S. Pharmaceutical sales decreased by 7.7% as compared to the same period a year ago while international Pharmaceutical sales achieved growth of 11.3%, including operational growth of 17.3%, and a negative currency impact of 6.0%.

Major Pharmaceutical Therapeutic Area Sales — Fiscal Six Months Ended*

(Dollars in Millions)	July 1, 2012	July 3, 2011	Total Change	Operations Change	Currency Change
Total Immunology	$3,814	$3,235	17.9 %	19.1 %	(1.2)%
REMICADE®	3,044	2,656	14.6	15.6	(1.0)
SIMPONI®	241	162	48.8	51.3	(2.5)
STELARA®	469	342	37.1	40.4	(3.3)
Other Immunology	60	75	(20.0)	(16.6)	(3.4)
Total Infectious Diseases	1,543	1,759	(12.3)	(8.5)	(3.8)
INTELENCE®	171	148	15.5	19.4	(3.9)
LEVAQUIN®/FLOXIN®	45	593	(92.4)	(92.2)	(0.2)
PREZISTA®	697	579	20.4	24.9	(4.5)
Other Infectious Diseases	630	439	43.5	51.4	(7.9)
Total Neuroscience	3,361	3,525	(4.7)	(1.9)	(2.8)
CONCERTA®/methylphenidate	576	711	(19.0)	(17.2)	(1.8)
INVEGA®	263	248	6.0	7.8	(1.8)
INVEGA® SUSTENNA®/XEPLION®	356	142	**	**	(2.4)
RISPERDAL® CONSTA®	716	808	(11.4)	(7.7)	(3.7)
Other Neuroscience	1,450	1,616	(10.3)	(7.7)	(2.6)
Total Oncology	1,182	991	19.3	25.3	(6.0)
DOXIL®/CAELYX®	37	277	(86.6)	(85.9)	(0.7)
VELCADE®	671	627	7.0	13.4	(6.4)
ZYTIGA®	432	54	**	**	(3.6)
Other Oncology	42	33	27.3	33.2	(5.9)
Total Other	2,524	2,782	(9.3)	(6.6)	(2.7)
ACIPHEX®/PARIET®	454	486	(6.6)	(2.9)	(3.7)
PROCRIT®/EPREX®	777	872	(10.9)	(8.3)	(2.6)
Other	1,293	1,424	(9.2)	(6.8)	(2.4)
Total Pharmaceutical Sales	$12,424	$12,292	1.1 %	3.9 %	(2.8)%

* Prior year amounts have been reclassified to conform to current year presentation.
** Percentage greater than 100%

Pharmaceutical segment sales in the fiscal second quarter of 2012 were $6.3 billion, a total increase of 0.9% as compared to the same period a year ago with an operational increase of 5.1% and a negative currency impact of 4.2%. U.S. Pharmaceutical sales decreased by 4.5% as compared to the same period a year ago while international Pharmaceutical sales achieved growth of 6.8%, including operational growth of 15.5%, and a negative currency impact of 8.7%.

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Major Pharmaceutical Therapeutic Area Sales — Fiscal Second Quarters Ended*

(Dollars in Millions)	July 1, 2012	July 3, 2011	Total Change	Operations Change	Currency Change
Total Immunology	$1,919	$1,655	16.0 %	18.2 %	(2.2)%
REMICADE®	1,523	1,371	11.1	12.7	(1.6)
SIMPONI®	125	67	86.6	89.5	(2.9)
STELARA®	248	176	40.9	45.7	(4.8)
Other Immunology	23	41	(43.9)	(39.2)	(4.7)
Total Infectious Diseases	788	828	(4.8)	1.3	(6.1)
INTELENCE®	91	79	15.2	20.8	(5.6)
LEVAQUIN®/FLOXIN®	16	159	(89.9)	(89.4)	(0.5)
PREZISTA®	373	313	19.2	25.5	(6.3)
Other Infectious Diseases	308	277	11.2	20.2	(9.0)
Total Neuroscience	1,714	1,780	(3.7)	0.5	(4.2)
CONCERTA®/methylphenidate	268	349	(23.2)	(20.6)	(2.6)
INVEGA®	142	128	10.9	13.6	(2.7)
INVEGA® SUSTENNA®/XEPLION®	195	77	**	**	(3.4)
RISPERDAL® CONSTA®	355	404	(12.1)	(6.7)	(5.4)
Other Neuroscience	754	822	(8.3)	(4.2)	(4.1)
Total Oncology	586	552	6.2	14.1	(7.9)
DOXIL®/CAELYX®	13	138	(90.6)	(89.7)	(0.9)
VELCADE®	318	347	(8.4)	(0.1)	(8.3)
ZYTIGA®	232	49	**	**	(5.1)
Other Oncology	23	18	27.8	36.4	(8.6)
Total Other	1,284	1,418	(9.4)	(5.3)	(4.1)
ACIPHEX®/PARIET®	232	247	(6.1)	(0.5)	(5.6)
PROCRIT®/EPREX®	401	475	(15.6)	(12.1)	(3.5)
Other	651	696	(6.5)	(2.6)	(3.9)
Total Pharmaceutical Sales	$6,291	$6,233	0.9 %	5.1 %	(4.2)%

* Prior year amounts have been reclassified to conform to current year presentation.
** Percentage greater than 100%

Immunology products achieved strong operational sales growth of 18.2% as compared to the same period a year ago. This growth was primarily due to sales of REMICADE® (infliximab), a biologic approved for the treatment of a number of immune-mediated inflammatory diseases and SIMPONI® (golimumab). A significant increase in sales was driven by the impact of the agreement with Merck & Co., Inc. (Merck), which included distribution rights to REMICADE® and SIMPONI® whereby, effective July 1, 2011, certain territories were relinquished to the Company. On July 1, 2011, the Company began to record sales of product, previously recorded by Merck, from certain territories, including Canada, Brazil, Australia and Mexico, which were previously supplied by Merck. Additional contributors to the increase were sales of STELARA® (ustekinumab).

Infectious disease products achieved operational sales growth of 1.3% as compared to the same period a year ago. Major contributors were the successful launch of INCIVO® (telaprevir), a product for Hepatitis C, the continued momentum in market share growth of PREZISTA® (darunavir) and INTELENCE® (etravirine) for HIV, partially offset by lower sales of vaccines, primarily due to a supply disruption at a third-party supplier and lower sales of LEVAQUIN® (levofloxacin)/FLOXIN® (ofloxacin), an anti-infective, due to the loss of market exclusivity in the U.S. in June 2011.

Neuroscience products achieved operational sales growth of 0.5% as compared to the same period a year ago. Contributors to the growth were INVEGA® SUSTENNA® (paliperidone palmitate), in the U.S. and the launch of INVEGA® SUSTENNA®, known as XEPLION® in Europe and INVEGA® (paliperidone palmitate) sales in Japan. This growth was partially offset by lower sales of CONCERTA®/methylphenidate, DURAGESIC®/Fentanyl Transdermal (fentanyl transdermal system),

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RAZADYNE® (galantamine) and RISPERDAL®(risperidone), due to continued generic competition. The U.S. Supply and Distribution Agreement with Watson Laboratories, Inc. to distribute an authorized generic version of CONCERTA® became effective May 1, 2011. The original CONCERTA® patent expired in 2004 and parties have filed Abbreviated New Drug Applications (ANDAs) for generic versions of CONCERTA®, which are pending and may be approved at any time. An approval of another generic version of CONCERTA® is likely to result in a further reduction in CONCERTA® sales.

Oncology products achieved strong operational sales growth of 14.1% as compared to the same period a year ago. This growth was primarily due to sales of ZYTIGA®(abiraterone acetate), a product to treat chemo refractory metastatic castrate resistant prostate cancer. This growth was partially offset by lower sales of DOXIL®(doxorubicin HCI liposome injection)/CAELYX®(pegylated liposomal doxorubicin hydrochloride), due to supply restraints from the Company's third-party manufacturer. Operational sales of VELCADE® (bortezomib), a product for the treatment for multiple myeloma, for which the Company has commercial rights in markets outside the U.S. were flat versus the prior year due to timing of government tender contracts.

In the fiscal second quarter of 2012, Other Pharmaceutical sales experienced an operational decline of 5.3% as compared to the prior year fiscal second quarter primarily due to divestitures and lower sales of PROCRIT® (Epoetin alfa), due to the decline in the market, and EPREX® (Epoetin alfa), primarily due to generic competition.

Medical Devices and Diagnostics

Medical Devices and Diagnostics segment sales in the first fiscal six months of 2012 were $13.0 billion, a decrease of 0.2% as compared to the same period a year ago, including operational growth of 1.9% and a negative currency impact of 2.1%. U.S. Medical Devices and Diagnostics sales increased 1.6%. The international Medical Devices and Diagnostics sales decrease of 1.6% included operational growth of 2.2% and a negative currency impact of 3.8%. The acquisition of Synthes, Inc., net of the related divestiture, increased operational growth for the total Medical Devices and Diagnostics segment by 1.3%.

Major Medical Devices and Diagnostics Franchise Sales — Fiscal Six Months Ended*

(Dollars in Millions)	July 1, 2012	July 3, 2011	Total Change	Operations Change	Currency Change
General Surgery	$3,265	$3,321	(1.7)%	1.1 %	(2.8)%
Orthopaedics	3,121	2,972	5.0	6.9	(1.9)
Vision Care	1,487	1,454	2.3	3.3	(1.0)
Diabetes Care	1,343	1,318	1.9	4.7	(2.8)
Specialty Surgery	1,274	1,197	6.4	8.8	(2.4)
Diagnostics	1,026	1,071	(4.2)	(2.5)	(1.7)
Cardiovascular Care	986	1,222	(19.3)	(17.5)	(1.8)
Infection Prevention/Other	474	448	5.8	7.6	(1.8)
Total Medical Devices and Diagnostics Sales	$12,976	$13,003	(0.2)%	1.9 %	(2.1)%

* Prior year amounts have been reclassified to conform to current year presentation.

Medical Devices and Diagnostics segment sales in the fiscal second quarter of 2012 were $6.6 billion, a decrease of 0.1% as compared to the same period a year ago, including operational growth of 3.4% and a negative currency impact of 3.5%. U.S. Medical Devices and Diagnostics sales increased 2.9%. The international Medical Devices and Diagnostics sales decrease of 2.4% included operational growth of 3.8% and a negative currency impact of 6.2%. The acquisition of Synthes, Inc., net of the related divestiture, increased operational growth for the total Medical Devices and Diagnostics segment by 2.7%.

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Major Medical Devices and Diagnostics Franchise Sales — Fiscal Second Quarters Ended*

(Dollars in Millions)	July 1, 2012	July 3, 2011	Total Change	Operations Change	Currency Change
General Surgery	$1,640	$1,700	(3.5)%	0.9 %	(4.4)%
Orthopaedics	1,628	1,469	10.8	14.0	(3.2)
Vision Care	730	732	(0.3)	1.9	(2.2)
Diabetes Care	673	681	(1.2)	2.9	(4.1)
Specialty Surgery	646	620	4.2	7.8	(3.6)
Diagnostics	514	550	(6.5)	(3.8)	(2.7)
Cardiovascular Care	504	587	(14.1)	(10.9)	(3.2)
Infection Prevention/Other	230	232	(0.9)	2.3	(3.2)
Total Medical Devices and Diagnostics Sales	$6,565	$6,571	(0.1)%	3.4 %	(3.5)%

The General Surgery franchise achieved operational growth of 0.9% as compared to the prior year fiscal second quarter. Growth was attributable to new product launches, including SECURESTRAP™, PHYSIOMESH® and ECHELON FLEX™ powered ENDOPATH® Stapler, partially offset by lower sales of mechanical products and pelvic floor products.

The Orthopaedics franchise achieved operational growth of 14.0% as compared to the prior year fiscal second quarter. Growth was primarily due to sales of newly acquired products from Synthes, Inc. and sales of joint reconstruction and Mitek sports medicine products. Sales were impacted by the divestitures of the surgical instruments business of Codman & Shurtleff, Inc. in the fiscal fourth quarter of 2011 and the divestiture of certain rights and assets related to the DePuy trauma business. The positive impact on the Orthopaedics franchise operational sales growth due to the newly acquired products from Synthes, Inc. net of the related divestiture was 12.3%.

The Vision Care franchise achieved operational sales growth of 1.9% as compared to the prior year fiscal second quarter. The growth was driven by daily lenses and astigmatism lenses partially offset by lower sales of reusable lenses.

The Diabetes Care franchise achieved operational sales growth of 2.9% as compared to the prior year fiscal second quarter. Growth was driven by sales outside the U.S. with strong sales results in the emerging markets, partially offset by lower sales in certain developed markets.

The Specialty Surgery franchise achieved operational growth of 7.8% as compared to the prior year fiscal second quarter. Incremental sales from the acquisition of SterilMed and sales of energy and biosurgery products, were the major contributors to the growth.

The Diagnostics franchise experienced an operational sales decline of 3.8% as compared to the prior year. The decline was primarily due to lower sales in donor screening in the U.S.

The Cardiovascular Care franchise experienced an operational sales decline of 10.9% as compared to the prior year fiscal second quarter. Sales were impacted by the Company’s decision to exit the drug-eluting stent market in the second quarter of 2011 and lower sales of endovascular products, impacted by competitive launches and a disruption in the supply chain. The decline in sales was partially offset by strong growth in Biosense Webster's electrophysiology business. Sales for drug-eluting stents were approximately 1% and 11% of the total Cardiovascular Care franchise

sales in the fiscal second quarters of 2012 and 2011, respectively. Sales for drug-eluting stents were approximately 2% and 15% of the total Cardiovascular Care franchise sales in the first fiscal six months of 2012 and 2011, respectively.

The Infection Prevention/Other franchise achieved operational sales growth of 2.3% as compared to the prior year fiscal second quarter.

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ANALYSIS OF CONSOLIDATED EARNINGS BEFORE PROVISION FOR TAXES ON INCOME

Consolidated earnings before provision for taxes on income first fiscal six months of 2012 decreased to $7.1 billion as compared to $7.9 billion in the first fiscal six months of 2011, a decrease of 10.7%. Consolidated earnings before provision for taxes on income for the fiscal second quarter of 2012 decreased to $2.0 billion as compared to $3.4 billion in the fiscal second quarter of 2011, a decrease of 40.5%. Both periods in 2012 were unfavorably impacted by $1.4 billion attributed to intangible asset write-downs and in-process research and development, primarily related to the Crucell vaccine business and higher net litigation expense of $0.4 billion in the the fiscal second quarter and $0.1 billion in the first fiscal six months versus the prior year. In addition, the fiscal second quarter and the first fiscal six months of 2012 included higher costs related to the Synthes acquisition of $0.7 billion and $0.6 billion, respectively. Consolidated earnings before provision for taxes on income was favorably impacted by operating expenses of approximately $0.3 billion in the fiscal second quarter of 2012 and $0.4 billion in the first fiscal six months of 2012 primarily due to cost containment initiatives in selling, marketing and administrative expenses and the discontinuation of clinical development for the NEVO™ Sirolimus-Eluting Coronary Stent in research and development expense. The first fiscal six months of 2012 included higher gains of $0.2 billion, recorded in other income, as compared to the first fiscal six months of 2011. The fiscal second quarter and the first fiscal six months of 2011 included a $0.7 billion restructuring expense related to the Cardiovascular Care business and costs of $0.1 billion and $0.2 billion, respectively, related to the DePuy ASR™ Hip recalls. All other items decreased consolidated earnings before provision for taxes on income for the first fiscal six months of 2012 by approximately $0.2 billion, of which no single item was significant.

Cost of Products Sold

Consolidated costs of products sold for the first fiscal six months of 2012 increased to 30.8% from 30.4% of sales as compared to the same period a year ago. The increase of costs of products sold was the result of the $0.2 billion of ongoing remediation in the Consumer OTC business and unfavorable mix partially offset by a 2011 restructuring charge of $0.1 billion related to the cardiovascular business. The consolidated costs of products sold for the fiscal second quarter of 2012 at 31.2% of sales was flat to the prior year.

Selling, Marketing and Administrative Expenses

Consolidated selling, marketing and administrative expenses for the first fiscal six months of 2012 decreased to 30.6% from 31.3% of sales as compared to the same period a year ago. Consolidated selling, marketing and administrative expenses for the fiscal second quarter of 2012 decreased to 30.1% from 31.4% of sales as compared to the same period a year ago. The decrease of approximately $0.2 billion and $0.3 billion in the fiscal second quarter and first fiscal six months of 2012, respectively, was primarily due to cost containment initiatives across many of the businesses.

Research & Development Expense

Research & development activities represent a significant part of the Company’s business. These expenditures relate to the processes of discovering, testing and developing new products, improving existing products, as well as ensuring product efficacy and regulatory compliance prior to launch. The Company remains committed to investing in research & development with the aim of delivering high quality and innovative products. Worldwide costs of research and development activities for the first fiscal six months of 2012 were $3.4 billion, which was a decrease of 5.8% in spending as compared to the same period a year ago. Worldwide costs of research and development activities for the fiscal second quarter of 2012 were $1.8 billion which was a decrease of 6.2% in spending as compared to the same period a year ago. The decrease of approximately $0.1 billion and $0.2 billion in the fiscal second quarter and first fiscal six months of 2012, respectively, was primarily due to the discontinuation of the clinical development program for the NEVO™ Sirolimus-Eluting Coronary Stent and timing of expenditures.

In-Process Research and Development

Beginning in 2009, in accordance with U.S. GAAP for business combinations, purchased in-process research and development (IPR&D) is no longer expensed at the time of acquisition but capitalized as an asset and tested for impairment. During the fiscal second quarter of 2012, the Company recorded a charge for the partial impairment of the IPR&D related to the Crucell vaccine business in the amount of $0.4 billion. This charge relates to development projects which have been recently discontinued or delayed.

Other (Income) Expense, Net

Other (income) expense, net is the account where the Company records 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 assets,

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currency gains and losses, gains and losses relating to non-controlling interests, litigation settlements, as well as royalty income. The change in other (income) expense, net for the first fiscal six months of 2012, was unfavorable by $1.2 billion as compared to the same period a year ago. The change in other (income) expense, net for the fiscal second quarter of 2012, was unfavorable by $1.8 billion as compared to the same period a year ago. Both periods in 2012 were unfavorably impacted by $0.9 billion attributed to write-downs of intangible assets, primarily related to the Crucell vaccine business and higher net litigation expense of $0.4 billion in the fiscal second quarter and $0.1 billion in the first fiscal six months versus the prior year. In addition, the fiscal second quarter and the first fiscal six months of 2012 included higher costs related to the Synthes acquisition of $0.7 billion and $0.6 billion, respectively. The first fiscal six months of 2012 included higher gains of $0.2 billion as compared to the first fiscal six months of 2011, primarily related to a gain on the divestiture of BYSTOLIC®(nebivolol) in 2012 and a gain related to the Company's initial investment in Crucell in 2011. The fiscal second quarter and the first fiscal six months of 2011 included $0.1 billion and $0.2 billion, respectively, of DePuy ASR™ Hip recall costs.

Restructuring Expense

During the fiscal second quarter of 2011, Cordis Corporation, a subsidiary of Johnson & Johnson, announced the discontinuation of its clinical development program for the NEVO™ Sirolimus-Eluting Coronary Stent and cessation of the manufacture and marketing of CYPHER® and CYPHER SELECT® Plus Sirolimus-Eluting Coronary Stents by the end of 2011. The Company recorded a pre-tax charge of $0.7 billion, of which $0.1 billion is included in cost of products sold.

OPERATING PROFIT BY SEGMENT

Consumer Segment

Operating profit for the Consumer segment as a percent to sales in the first fiscal six months of 2012 was 10.1% versus 15.0% for the same period a year ago. Operating profit for the Consumer segment as a percent to sales in the fiscal second quarter of 2012 was 7.4% versus 14.5% for the same period a year ago. Both periods in 2012 were unfavorably impacted by $0.3 billion attributed to intangible asset write-downs and approximately $0.2 billion due to unfavorable product mix and remediation costs associated with the McNEIL-PPC consent decree. This was partially offset by cost containment initiatives realized in selling, marketing and administrative expenses in both periods of 2012.

Pharmaceutical Segment

Operating profit for the Pharmaceutical segment as a percent to sales in the first fiscal six months of 2012 was 25.0% versus 31.9% for the same period a year ago. Operating profit for the Pharmaceutical segment as a percent to sales in the fiscal second quarter of 2012 was 8.2% versus 27.5% for the same period a year ago. Both periods in 2012 were unfavorably impacted by $0.9 billion attributed to the write-down of intangible assets and in-process research and development, primarily related to the Crucell vaccine business and higher net litigation expense of $0.4 billion in the the fiscal second quarter and $0.1 billion in the first fiscal six months versus the prior year. This was partially offset by favorable operating expenses primarily related to cost containment initiatives. The first fiscal six months of 2012 included higher gains of $0.2 billion, primarily related to the divestiture of BYSTOLIC®(nebivolol) recorded in other income.

Medical Devices and Diagnostics Segment

Operating profit for the Medical Devices and Diagnostics segment as a percent to sales in the first fiscal six months of 2012 was 30.5% versus 24.8% for the same period a year ago. Operating profit for the Medical Devices and

Diagnostics segment as a percent to sales in the fiscal second quarter of 2012 was 28.6% versus 19.4% for the same period a year ago. The first fiscal six months and the fiscal second quarter of 2012 included integration costs of $0.2 billion associated with the acquisition of Synthes, Inc. and $0.1 billion attributed to the write-down of intangible assets. Operating expenses were favorably impacted by cost containment initiatives of approximately $0.1 billion and $0.3 billion in the fiscal second quarter and the first fiscal six months of 2012, respectively. The first fiscal six months and the fiscal second quarter of 2011 included a $0.7 billion restructuring expense related to the Cardiovascular Care business and costs of $0.2 billion and $0.1 billion, respectively, related to DePuy ASR™ Hip recall costs.

Interest (Income) Expense

Interest income decreased in both the first fiscal six months and the fiscal second quarter of 2012 as compared to the same period a year ago, due to lower rates of interest earned and lower average cash balances. The ending balance of cash, cash equivalents and marketable securities, was $16.9 billion at the end of the fiscal second quarter of 2012. This is a decrease of $12.8 billion from the same period a year ago. The decline in the average cash balance was due to the acquisition of Synthes,

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Inc. partially offset by cash generated from operating activities.

Interest expense increased slightly as a percent to sales in both the first fiscal six months and the fiscal second quarter of 2012 as compared to the same period a year ago due to a higher average debt balance. At the end of the fiscal second quarter of 2012, the Company's debt position was $17.6 billion compared to $18.7 billion from the same period a year ago. The reduction in debt in the first fiscal six months of 2012 of approximately $2.0 billion was primarily due to a reduction in commercial paper.

Provision for Taxes on Income

The worldwide effective income tax rates for the first fiscal six months of 2012 and 2011 were 24.9% and 21.2%, respectively. The higher effective tax rate in 2012 as compared to 2011 was primarily due to lower tax rates associated with Synthes integration and transaction costs and litigation accruals, which added 2.8 points to the effective tax rate. The expiration of the Research and Development tax credit at year end 2011 increased the 2012 tax rate by 0.6 points.

As of July 1, 2012, the Company had approximately $3.0 billion of liabilities from unrecognized tax benefits. The Company does not expect that the total amount of unrecognized tax benefits will change significantly during the next twelve months.

See Note 8 to the Consolidated Financial Statements in the Annual Report on Form 10-K for the fiscal year ended January 1, 2012 for more detailed information regarding unrecognized tax benefits.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

Cash and cash equivalents were $14.0 billion at the end of the fiscal second quarter of 2012 as compared with $24.5 billion at the fiscal year end of 2011. The primary uses of cash that contributed to the $10.5 billion decrease were approximately $13.4 billion net cash used by investing activities and $4.6 billion used by financing activities partially offset by $7.5 billion generated from operating activities.

Cash flow from operations of $7.5 billion was the result of $5.3 billion of net earnings and $2.9 billion of non-cash charges primarily related to depreciation and amortization, intangible asset write-downs, stock-based compensation, and deferred tax provision reduced by $0.7 billion related to changes in assets and liabilities, net of effects from acquisitions.

Investing activities use of $13.4 billion was primarily for acquisitions, net of cash acquired of $17.7 billion and $1.1 billion for additions to property, plant and equipment partially offset by net sales of investments in marketable securities of $4.7 billion and $0.7 billion of proceeds from the disposal of assets.

Financing activities use of $4.6 billion was primarily for dividends to shareholders of $3.2 billion and net retirement of short and long-term debt of $2.3 billion partially offset by $1.1 billion of net proceeds from stock options exercised/excess tax benefits.

In the fiscal second quarter of 2012, the Company continued to have access to liquidity through the commercial paper market. The Company anticipates that operating cash flows, existing credit facilities and access to the commercial paper markets will continue to provide sufficient resources to fund operating needs. However, the Company monitors the global capital markets on an ongoing basis and from time to time may raise capital when market conditions are favorable.

Dividends

On April 26, 2012, the Board of Directors declared a regular cash dividend of $0.61 per share, which was paid on June 12, 2012 to shareholders of record as of May 29, 2012.

On July 16, 2012, the Board of Directors declared a regular cash dividend of $0.61 per share payable on September 11, 2012 to shareholders of record as of August 28, 2012. The Company expects to continue the practice of paying regular quarterly cash dividends.

Concentration of Credit Risk

Global concentration of credit risk with respect to trade accounts receivables continues to be limited due to the large number of customers globally and adherence to internal credit policies and credit limits. Recent economic challenges in Italy, Spain, Greece and Portugal (the Southern European Region) have impacted certain payment patterns, which have historically been

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longer than those experienced in the U.S. and other international markets. The total net trade accounts receivable balance in the Southern European Region was approximately $2.0 billion as of July 1, 2012 and approximately $2.4 billion as of January 1, 2012. Approximately $1.3 billion as of July 1, 2012 and approximately $1.4 billion as of January 1, 2012 of the Southern European Region net trade accounts receivable balance related to the Company's Consumer, Vision Care and Diabetes Care businesses as well as certain Pharmaceutical and Medical Devices and Diagnostics customers, which are in line with historical collection patterns.

The remaining balance of net trade accounts receivable in the Southern European Region has been negatively impacted by the timing of payments from certain government owned or supported health care customers as well as certain distributors of the Pharmaceutical and Medical Devices and Diagnostics local affiliates. The total net trade accounts receivable balance for these customers were approximately $0.7 billion at July 1, 2012 and $1.0 billion at January 1, 2012. The Company continues to receive payments from these customers and in some cases late payment premiums. For customers where payment is expected over periods of time longer than one year, revenue and trade receivables have been discounted over the estimated period of time for collection. Allowances for doubtful accounts have been increased for these customers, but have been immaterial to date. The Company will continue to work closely with these customers on payment plans, monitor the economic situation and take appropriate actions as necessary. During the fiscal second quarter of 2012, approximately 60% of the receivables from government owned or supported health care customers in Spain were collected.

OTHER INFORMATION

New Accounting Standards

In July 2012, the Financial Accounting Standards Board (FASB) issued guidance and amendments related to testing indefinite lived intangible assets for impairment. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to determine the fair value. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. This update will become effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. However, early adoption is permitted. This adoption of this standard is not expected to have a material impact on the Company’s results of operations, cash flows or financial position.

During the fiscal first quarter of 2012, the Company adopted the FASB guidance and amendments issued related to goodwill impairment testing. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test. This update became effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard did not have a material impact on the Company’s results of operations, cash flows or financial position.

During the fiscal first quarter of 2012, the Company adopted the FASB amendment to the disclosure requirements for presentation of comprehensive income. The amendment requires that all non-owner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance became effective retrospectively for the interim periods and annual periods beginning after

December 15, 2011; however, the FASB agreed to an indefinite deferral of the reclassification requirement. For the Consolidated Statements of Comprehensive Income see page 6.

During the fiscal first quarter of 2012, the FASB issued amendments to disclosure requirements for common fair value measurement. These amendments result in convergence of fair value measurement and disclosure requirements between U.S. GAAP and IFRS. This guidance became effective prospectively for the interim periods and annual periods beginning after December 15, 2011. The adoption of this standard did not have a material impact on the Company's results of operations, cash flows or financial position.

Economic and Market Factors

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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 2001 through 2011 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).

The Company operates in certain countries where the economic conditions continue to present significant challenges. The Company continues to monitor these situations and take appropriate actions. Inflation rates 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 continue to result in pricing pressures that include health care cost containment and government legislation relating to sales, promotions and reimbursement.

Changes in the behavior and spending patterns of consumers of health care products and services, including delaying medical procedures, rationing prescription medications, reducing the frequency of physician visits and foregoing health care insurance coverage, as a result of a prolonged global economic downturn, will continue to impact the Company’s businesses.

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” included in Item 1. Financial Statements (unaudited)- Notes to Consolidated Financial Statements, Note 11.

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, but are not limited to, general industry conditions and competition; economic factors, 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; significant litigation or government action adverse to the Company; impact of business

combinations; financial distress and bankruptcies experienced by significant customers and suppliers; changes to governmental laws and regulations and U.S. and foreign health care reforms; trends toward health care cost containment; increased scrutiny of the health care industry by government agencies; changes in behavior and spending patterns of purchasers of health care products and services; financial instability of international economies and sovereign risk; disruptions due to natural disasters; manufacturing difficulties or delays; 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, 2012 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, 2012.

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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. Alex Gorsky, Chief Executive Officer, and Dominic J. Caruso, Vice President, Finance and Chief Financial Officer, reviewed and participated in this evaluation. Based on this evaluation, Messrs. Gorsky and Caruso concluded that, as of the end of the period covered by this report, 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 11 included in Part I, Item 1, Financial Statements (unaudited) — Notes to Consolidated Financial Statements.

Item 2 — UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers.
The following table provides information with respect to Common Stock purchases by the Company during the fiscal second quarter of 2012 pursuant to the accelerated share repurchase agreement, in connection with the acquisition of Synthes, Inc.

	Total Number of Shares Purchased	Average Price Paid per Share
Fiscal Month		
April 2, 2012 through April 29, 2012	—	$—
April 30, 2012 through May 27, 2012	—	$—
May 28, 2012 through July 1, 2012	203,740,056	$63.08
Total	203,740,056	

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 the Sarbanes-Oxley Act of 2002 — Furnished with this document.

Exhibit 101 XBRL (Extensible Business Reporting Language) The following materials from Johnson & Johnson's Quarterly Report on Form 10-Q for the quarter ended July 1, 2012, formatted in Extensive Business Reporting Language (XBRL), (i) consolidated balance sheets, (ii) consolidated statements of earnings, (iii) consolidated statements of comprehensive income (iv) consolidated statements of cash flows, and (v) the notes to the consolidated financial statements.

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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: August 1, 2012	By /s/ D. J. CARUSO D. J. CARUSO Vice President, Finance; Chief Financial Officer (Principal Financial Officer)
Date: August 1, 2012	By /s/ S. J. COSGROVE S. J. COSGROVE Controller (Principal Accounting Officer)