

JOHNSON & JOHNSON
Form 10-Q
October 30, 2015

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

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended September 27, 2015
or

☐ 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 1-3215

(Exact name of registrant as specified in its charter)

NEW JERSEY

22-1024240

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

One Johnson & Johnson Plaza
New Brunswick, New Jersey 08933
(Address of principal executive offices)

Registrant's telephone number, including area code (732) 524-0400

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 ☐ No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
(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 ☒ No

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

On October 23, 2015, 2,766,943,629 shares of Common Stock, \$1.00 par value, were outstanding.

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Part I — FINANCIAL INFORMATION

Item 1 — FINANCIAL STATEMENTS

JOHNSON & JOHNSON AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited; Dollars in Millions Except Share and Per Share Data)

	September 27, 2015	December 28, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$13,639	14,523
Marketable securities	23,667	18,566
Accounts receivable, trade, less allowances for doubtful accounts \$260 (2014, \$275)	11,366	10,985
Inventories (Note 2)	8,206	8,184
Deferred taxes on income	3,606	3,567
Prepaid expenses and other	3,010	3,486
Total current assets	63,494	59,311
Property, plant and equipment at cost	36,397	36,685
Less: accumulated depreciation	(20,846)	(20,559)
Property, plant and equipment, net	15,551	16,126
Intangible assets, net (Note 3)	25,988	27,222
Goodwill (Note 3)	21,279	21,832
Deferred taxes on income	3,150	3,396
Other assets	3,804	3,232
Total assets	\$133,266	131,119
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Loans and notes payable	\$5,677	3,638
Accounts payable	5,928	7,633
Accrued liabilities	5,062	6,553
Accrued rebates, returns and promotions	5,338	4,010
Accrued compensation and employee related obligations	2,324	2,751
Accrued taxes on income	931	500
Total current liabilities	25,260	25,085
Long-term debt (Note 4)	14,073	15,122
Deferred taxes on income	3,561	3,154
Employee related obligations	9,515	9,972
Other liabilities	9,303	8,034
Total liabilities	61,712	61,367
Shareholders' equity:		
Common stock — par value \$1.00 per share (authorized 4,320,000,000 shares; issued 3,119,843,000 shares)	\$3,120	3,120
Accumulated other comprehensive income (loss) (Note 7)	(12,861)	(10,722)
Retained earnings	102,748	97,245
Less: common stock held in treasury, at cost (352,562,000 and 336,620,000 shares)	21,453	19,891

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Total shareholders' equity	71,554	69,752
Total liabilities and shareholders' equity	\$133,266	131,119
See Notes to Consolidated Financial Statements		

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CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited; Dollars & Shares in Millions Except Per Share Amounts)

	Fiscal Third Quarters Ended					
	September 27, 2015	Percent to Sales		September 28, 2014	Percent to Sales	
Sales to customers (Note 9)	\$ 17,102	100.0	%	\$ 18,467	100.0	%
Cost of products sold	5,224	30.5		5,399	29.2	
Gross profit	11,878	69.5		13,068	70.8	
Selling, marketing and administrative expenses	5,081	29.7		5,468	29.6	
Research and development expense	2,154	12.6		2,023	11.0	
In-process research and development	10	0.1		—	—	
Interest income	(32)	(0.2)	)	(18)	(0.1))
Interest expense, net of portion capitalized	123	0.7		130	0.7	
Other (income) expense, net	420	2.5		(1,345)	(7.3))
Earnings before provision for taxes on income	4,122	24.1		6,810	36.9	
Provision for taxes on income (Note 5)	764	4.5		2,061	11.2	
NET EARNINGS	\$3,358	19.6	%	\$ 4,749	25.7	%
NET EARNINGS PER SHARE (Note 8)						
Basic	\$ 1.21			\$ 1.69		
Diluted	\$ 1.20			\$ 1.66		
CASH DIVIDENDS PER SHARE	\$0.75			\$ 0.70		
AVG. SHARES OUTSTANDING						
Basic	2,768.4			2,814.4		
Diluted	2,807.2			2,864.3		
See Notes to Consolidated Financial Statements						

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CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited; Dollars & Shares in Millions Except Per Share Amounts)

	Fiscal Nine Months Ended					
	September 27, 2015	Percent to Sales		September 28, 2014	Percent to Sales	
Sales to customers (Note 9)	\$ 52,263	100.0	%	\$ 56,077	100.0	%
Cost of products sold	15,863	30.4		16,893	30.1	
Gross profit	36,400	69.6		39,184	69.9	
Selling, marketing and administrative expenses	15,312	29.3		16,132	28.8	
Research and development expense	6,182	11.8		5,859	10.5	
In-process research and development	10	0.0		22	0.0	
Interest income	(75)	(0.1)	)	(50)	(0.1))
Interest expense, net of portion capitalized	392	0.7		394	0.7	
Other (income) expense, net	(859)	(1.6)	)	(1,033)	(1.8))
Earnings before provision for taxes on income	15,438	29.5		17,860	31.8	
Provision for taxes on income (Note 5)	3,244	6.2		4,058	7.2	
NET EARNINGS	\$ 12,194	23.3	%	\$ 13,802	24.6	%
NET EARNINGS PER SHARE (Note 8)						
Basic	\$ 4.39			\$ 4.89		
Diluted	\$ 4.33			\$ 4.81		
CASH DIVIDENDS PER SHARE	\$ 2.20			\$ 2.06		
AVG. SHARES OUTSTANDING						
Basic	2,774.8			2,822.0		
Diluted	2,817.1			2,871.2		

See Notes to Consolidated Financial Statements

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JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited; Dollars in Millions)

	Fiscal Third Quarters Ended		Fiscal Nine Months Ended	
	September 27, 2015	September 28, 2014	September 27, 2015	September 28, 2014
Net earnings	\$3,358	4,749	12,194	13,802
Other comprehensive income (loss), net of tax				
Foreign currency translation	(1,069	) (2,400	) (2,729	) (2,499
Securities:				
Unrealized holding gain (loss) arising during period	(44	) (35	) 267	6
Reclassifications to earnings	(46	) (1	) (127	) (1
Net change	(90	) (36	) 140	5
Employee benefit plans:				
Prior service cost amortization during period	(5	) (5	) (16	) (14
Gain (loss) amortization during period	159	101	477	301
Net change	154	96	461	287
Derivatives & hedges:				
Unrealized gain (loss) arising during period	160	14	26	(139
Reclassifications to earnings	38	(49	) (37	) (176
Net change	198	(35	) (11	) (315
Other comprehensive income (loss)	(807	) (2,375	) (2,139	) (2,522
Comprehensive income	\$2,551	2,374	10,055	11,280

See Notes to Consolidated Financial Statements

The tax effects in other comprehensive income for the fiscal third quarters were as follows for 2015 and 2014, respectively: Securities: \$48 million and \$19 million; Employee Benefit Plans: \$75 million and \$46 million; Derivatives & Hedges: \$107 million and \$19 million.

The tax effects in other comprehensive income for the fiscal nine months were as follows for 2015 and 2014, respectively: Securities: \$76 million and \$3 million; Employee Benefit Plans: \$226 million and \$139 million; Derivatives & Hedges: \$6 million and \$170 million.

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JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; Dollars in Millions)

	Fiscal Nine Months Ended		
	September 27, September 28,		
	2015	2014	
CASH FLOWS FROM OPERATING ACTIVITIES			
Net earnings	\$12,194	13,802	
Adjustments to reconcile net earnings to cash flows from operating activities:			
Depreciation and amortization of property and intangibles	2,713	2,904	
Stock based compensation	677	646	
Venezuela adjustments	—	89	
Asset write-downs	367	259	
Net gain on sale of assets/businesses	(1,274)	(2,336))
Deferred tax provision	233	297	
Accounts receivable allowances	2	(54))
Changes in assets and liabilities, net of effects from acquisitions:			
Increase in accounts receivable	(910)	(399))
Increase in inventories	(719)	(1,098))
Decrease in accounts payable and accrued liabilities	(1,558)	(827))
Decrease in other current and non-current assets	986	72	
Increase in other current and non-current liabilities	1,486	751	
NET CASH FLOWS FROM OPERATING ACTIVITIES	14,197	14,106	
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property, plant and equipment	(2,097)	(2,218))
Proceeds from the disposal of assets/businesses, net	1,620	4,481	
Acquisitions, net of cash acquired	(233)	(291))
Purchases of investments	(28,766)	(25,784))
Sales of investments	23,167	14,576	
Other	(35)	(147))
NET CASH USED BY INVESTING ACTIVITIES	(6,344)	(9,383))
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends to shareholders	(6,101)	(5,812))
Repurchase of common stock	(3,394)	(4,381))
Proceeds from short-term debt	2,107	629	
Retirement of short-term debt	(930)	(1,713))
Proceeds from long-term debt	3	17	
Retirement of long-term debt	(27)	(1,787))
Proceeds from the exercise of stock options/excess tax benefits	837	1,406	
Other	(50)	—)
NET CASH USED BY FINANCING ACTIVITIES	(7,555)	(11,641))
Effect of exchange rate changes on cash and cash equivalents	(1,182)	(191))
Decrease in cash and cash equivalents	(884)	(7,109))

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Cash and Cash equivalents, beginning of period	14,523	20,927
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$13,639	13,818
Acquisitions		
Fair value of assets acquired	\$477	305
Fair value of liabilities assumed and noncontrolling interests	(244	) (14
Net fair value of acquisitions	233	291
See Notes to Consolidated Financial Statements		

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — The accompanying unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited Consolidated Financial Statements of Johnson & Johnson and its subsidiaries (the Company) and related notes as contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2014. The unaudited interim financial statements include all adjustments (consisting only of normal recurring adjustments) and accruals necessary in the judgment of management for a fair statement of the results for the periods presented.

During the fiscal third quarter of 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update 2015-16 Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. This update will be effective for the Company for all annual and interim periods beginning after December 15, 2015. The amendments in this update should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this update with earlier application permitted for financial statements that have not been issued. This update is not expected to have a material impact on the Company's consolidated financial statements.

During the fiscal second quarter of 2015, the FASB issued Accounting Standard Update 2015-11: Simplifying the Measurement of Inventory. This update requires inventory to be measured at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. This update will be effective for the Company for all annual and interim periods beginning after December 15, 2016. The amendments in this update should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. This update will not have a material impact on the presentation of the Company's financial position.

During the fiscal second quarter of 2015, the FASB issued Accounting Standard Update 2015-03: Simplifying the Presentation of Debt Issuance Costs. This update requires capitalized debt issuance costs to be presented as a reduction to the carrying value of debt instead of being classified as a deferred charge, as currently required. This update will be effective for the Company for all annual and interim periods beginning after December 15, 2015 and is required to be applied retroactively for all periods presented. This update will not have a material impact on the presentation of the Company's financial position.

During the fiscal second quarter of 2015, the FASB issued Accounting Standard Update 2015-04: Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets. This update provides a practical expedient option to entities that have defined benefit plans and have a fiscal year-end that does not coincide with a calendar month-end. This option allows an entity to elect to measure defined benefit plan assets and obligations using the calendar month-end that is closest to its fiscal year-end. This update will be effective for the Company for all annual and interim periods beginning after December 15, 2015 and if the practical expedient is elected by an entity, it is required to be adopted on a prospective basis. Early adoption is permitted. The Company has elected to adopt the practical expedient to measure its defined benefit plans. This election is not expected to have a material impact on the Company's consolidated financial statements.

During the fiscal second quarter of 2014, the FASB issued Accounting Standards Update 2014-09: Revenue from Contracts with Customers. This standard replaces substantially all current revenue recognition accounting guidance. During the fiscal third quarter of 2015, the FASB approved a one year deferral to the effective date of Accounting Standards Update No. 2014-09 to be adopted by all public companies for all annual periods and interim reporting

periods beginning after December 15, 2017. Early adoption of this standard is permitted but not before the original effective for the year beginning after December 15, 2016. The Company is currently assessing the impact of the future adoption of this standard on its financial statements.

During the fiscal second quarter of 2014, the FASB issued amended guidance Accounting Standards Update No. 2014-10: Development Stage Entities: Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entity Guidance in Topic 810, Consolidation. The change in the current guidance will require the Company to determine if it should consolidate one of these entities based on the change in the consolidation analysis. This update to the consolidation analysis will become effective for all annual periods and interim reporting periods beginning after December 15, 2015. The adoption of this standard is not expected to have a material impact on the presentation of the Company's results of operations, cash flows or financial position.

During the fiscal third quarter of 2014, the FASB issued Accounting Standards Update No. 2014-15: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This standard requires management to evaluate, for each annual and interim reporting period, whether there are conditions and events, considered in the aggregate, that raise

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substantial doubt about an entity's ability to continue as a going concern within one year after the date the financial statements are issued or are available to be issued. If substantial doubt is raised, additional disclosures around management's plan to alleviate these doubts are required. This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2016. This standard is not expected to have any impact on current disclosures in the financial statements.

Annual Closing Date

The Company follows the concept of a fiscal year, which ends on the Sunday nearest to the end of the month of December. Normally each fiscal year consists of 52 weeks, but every five or six years the fiscal year consists of 53 weeks, as is the case in 2015.

NOTE 2 — INVENTORIES

(Dollars in Millions)	September 27, 2015	December 28, 2014
Raw materials and supplies	\$1,198	1,214
Goods in process	2,026	2,461
Finished goods	4,982	4,509
Total inventories	\$8,206	8,184

NOTE 3 — INTANGIBLE ASSETS AND GOODWILL

Intangible assets that have finite useful lives are amortized over their estimated useful lives. The latest annual impairment assessment of goodwill and indefinite lived intangible assets was completed in the fiscal fourth quarter of 2014. Future impairment tests for goodwill and indefinite lived intangible assets will be performed annually in the fiscal fourth quarter, or sooner, if warranted.

(Dollars in Millions)	September 27, 2015	December 28, 2014
Intangible assets with definite lives:		
Patents and trademarks — gross	\$8,298	9,074
Less accumulated amortization	4,687	4,700
Patents and trademarks — net	3,611	4,374
Customer relationships and other intangibles — gross	17,739	17,970
Less accumulated amortization	5,637	5,227
Customer relationships and other intangibles — net	12,102	12,743
Intangible assets with indefinite lives:		
Trademarks	7,084	7,263
Purchased in-process research and development	3,191	2,842
Total intangible assets with indefinite lives	10,275	10,105
Total intangible assets — net	\$25,988	27,222

Goodwill as of September 27, 2015 was allocated by segment of business as follows:

(Dollars in Millions)	Consumer	Pharm	Med Devices	Total
Goodwill, net at December 28, 2014	\$7,675	2,626	11,531	21,832
Goodwill, related to acquisitions	—	64	22	86
Goodwill, related to divestitures	(117)	(17)	(1)	(135)
Currency translation/Other	(350)	(56)	(98)	(504)
Goodwill, net as of September 27, 2015	\$7,208	2,617	11,454	21,279

See Note 10 to the Consolidated Financial Statements for more details related to business combinations and divestitures.

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⁽¹⁾Includes \$98 million classified as held for sale, a component of other assets on the Consolidated Balance Sheet, related to the divestiture of Cordis which was pending as of September 27, 2015.

The weighted average amortization periods for patents and trademarks and customer relationships and other intangible assets are 17 years and 24 years, respectively. The amortization expense of amortizable intangible assets included in cost of products sold was \$912 million and \$1,033 million for the fiscal nine months ended September 27, 2015 and September 28, 2014, respectively. The estimated amortization expense for the five succeeding years approximates \$1.2 billion, before tax, per year. Intangible asset write-downs are included in Other (income) expense, net.

NOTE 4 — FAIR VALUE MEASUREMENTS

The Company uses forward foreign exchange contracts to manage its exposure to the variability of cash flows, primarily related to the foreign exchange rate changes of future intercompany products and third-party purchases of materials denominated in a foreign currency. The Company uses cross currency interest rate swaps to manage currency risk primarily related to borrowings. Both types of derivatives are designated as cash flow hedges.

Additionally, the Company uses interest rate swaps as an instrument to manage interest rate risk related to fixed rate borrowings. These derivatives are treated as fair value hedges. The Company may use forward foreign exchange contracts designated as net investment hedges. Additionally, the Company uses forward foreign exchange contracts to offset its exposure to certain foreign currency assets and liabilities. These forward foreign exchange contracts are not designated as hedges and therefore, changes in the fair values of these derivatives are recognized in earnings, thereby offsetting the current earnings effect of the related foreign currency assets and liabilities.

The Company does not enter into derivative financial instruments for trading or speculative purposes, or that contain credit risk related contingent features or requirements to post collateral by either the Company or the counter-party. On an ongoing basis, the Company monitors counterparty credit ratings. The Company considers credit non-performance risk to be low, because the Company primarily enters into agreements with commercial institutions that have at least an "A" (or equivalent) credit rating. Refer to the table on significant financial assets and liabilities measured at fair value contained in this note for receivables and payables with these commercial institutions. As of September 27, 2015, the Company had notional amounts outstanding for forward foreign exchange contracts, cross currency interest rate swaps and interest rate swaps of \$27.8 billion, \$2.4 billion and \$2.2 billion, respectively.

All derivative instruments are recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether the derivative is designated as part of a hedge transaction, and if so, the type of hedge transaction.

The designation as a cash flow hedge is made at the entrance date of the derivative contract. At inception, all derivatives are expected to be highly effective. Changes in the fair value of a derivative that is designated as a cash flow hedge and is highly effective are recorded in accumulated other comprehensive income until the underlying transaction affects earnings, and are then reclassified to earnings in the same account as the hedged transaction. Gains and losses associated with interest rate swaps and changes in fair value of hedged debt attributable to changes in interest rates are recorded to interest expense in the period in which they occur. Gains and losses on net investment hedges are accounted for through the currency translation account and are insignificant. On an ongoing basis, the Company assesses whether each derivative continues to be highly effective in offsetting changes of hedged items. If and when a derivative is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current period earnings in Other (income) expense, net for forward foreign exchange contracts and cross currency interest rate swaps. For interest rate swaps designated as fair value hedges, hedge ineffectiveness, if any, is included in current period earnings within interest expense. For the current reporting

period, hedge ineffectiveness associated with interest rate swaps were not material.

As of September 27, 2015, the balance of deferred net gains on derivatives included in accumulated other comprehensive income was \$130 million after-tax. For additional information, see the Consolidated Statements of Comprehensive Income and Note 7. The Company expects that substantially all of the amounts related to forward foreign exchange contracts will be reclassified into earnings over the next 12 months as a result of transactions that are expected to occur over that period. The maximum length of time over which the Company is hedging transaction exposure is 18 months, excluding interest rate contracts. The amount ultimately realized in earnings may differ as foreign exchange rates change. Realized gains and losses are ultimately determined by actual exchange rates at maturity of the derivative.

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The following table is a summary of the activity related to derivatives designated as cash flow hedges for the fiscal third quarters in 2015 and 2014:

	Gain/(Loss) Recognized In Accumulated OCI ⁽¹⁾		Gain/(Loss) Reclassified From Accumulated OCI Into Income ⁽¹⁾		Gain/(Loss) Recognized In Other Income/Expense ⁽²⁾	
(Dollars in Millions)	Fiscal Third Quarters Ended					
Cash Flow Hedges By Income Statement Caption	September 27, 2015	September 28, 2014	September 27, 2015	September 28, 2014	September 27, 2015	September 28, 2014
Sales to customers ⁽³⁾	\$3	(43)	(24)	(2)	(3)	—
Cost of products sold ⁽³⁾	222	(37)	(34)	37	1	(2)
Research and development expense ⁽³⁾	(10)	25	7	8	—	—
Interest (income)/Interest expense, net ⁽⁴⁾	(13)	11	1	(6)	—	—
Other (income) expense, net ⁽³⁾	(42)	58	12	12	(1)	—
Total	\$160	14	(38)	49	(3)	(2)

The following table is a summary of the activity related to derivatives designated as cash flow hedges for the first fiscal nine months in 2015 and 2014:

	Gain/(Loss) Recognized In Accumulated OCI ⁽¹⁾		Gain/(Loss) Reclassified From Accumulated OCI Into Income ⁽¹⁾		Gain/(Loss) Recognized In Other Income/Expense ⁽²⁾	
(Dollars in Millions)	Fiscal Nine Months Ended					
Cash Flow Hedges By Income Statement Caption	September 27, 2015	September 28, 2014	September 27, 2015	September 28, 2014	September 27, 2015	September 28, 2014
Sales to customers ⁽³⁾	\$(52)	(73)	(95)	6	(5)	1
Cost of products sold ⁽³⁾	106	(187)	82	196	15	(4)
Research and development expense ⁽³⁾	(13)	28	(2)	(5)	—	(1)
Interest (income)/Interest expense, net ⁽⁴⁾	(42)	21	(2)	(12)	—	—
Other (income) expense, net ⁽³⁾	27	72	54	(9)	—	—
Total	\$26	(139)	37	176	10	(4)

All amounts shown in the table above are net of tax.

(1) Effective portion

(2) Ineffective portion

(3) Forward foreign exchange contracts

(4) Cross currency interest rate swaps

For the fiscal third quarters ended September 27, 2015 and September 28, 2014, a loss of \$8 million and a loss of \$2 million, respectively, was recognized in Other (income) expense, net, relating to forward foreign exchange contracts not designated as hedging instruments.

For the fiscal nine months ended September 27, 2015 and September 28, 2014, a gain of \$32 million and a loss of \$48 million, respectively, was recognized in Other (income) expense, net, relating to forward foreign exchange contracts not designated as hedging instruments.

Fair value is the exit price that would be received to sell an asset or paid to transfer a liability. Fair value is a market-based measurement determined using assumptions that market participants would use in pricing an asset or liability. The authoritative literature establishes a three-level hierarchy to prioritize the inputs used in measuring fair value. The levels within the hierarchy are described below with Level 1 having the highest priority and Level 3 having the lowest.

The fair value of a derivative financial instrument (i.e., forward foreign exchange contracts, interest rate contracts) is the aggregation by currency of all future cash flows discounted to its present value at the prevailing market interest rates and subsequently converted to the U.S. Dollar at the current spot foreign exchange rate. The Company does not believe that fair values of these derivative instruments materially differ from the amounts that could be realized upon settlement or maturity, or

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that the changes in fair value will have a material effect on the Company's results of operations, cash flows or financial position. The Company also holds equity investments which are classified as Level 1 and debt securities which are classified as Level 2. The Company did not have any other significant financial assets or liabilities which would require revised valuations under this standard that are recognized at fair value.

The following three levels of inputs are used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets and liabilities.

Level 2 — Significant other observable inputs.

Level 3 — Significant unobservable inputs.

The Company's significant financial assets and liabilities measured at fair value as of September 27, 2015 and December 28, 2014 were as follows:

	September 27, 2015		December 28, 2014
(Dollars in Millions)	Level 1	Level 2	