10-Q 1 jas05cv.txt 10-Q - JAS 2005 UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549 FORM 10-Q (Mark one) [X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the Quarterly Period Ended September 30, 2005 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 1-434 THE PROCTER & GAMBLE COMPANY (Exact name of registrant as specified in its charter) Ohio 31-0411980 (State of incorporation) (I.R.S. Employer Identification No.) One Procter & Gamble Plaza, Cincinnati, Ohio 45202 (Address of principal executive offices) (Zip Code) Registrant's telephone number, including area code (513) 983-1100 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 [X] No [ ] Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [X] No [ ] Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X] There were 2,377,658,052 shares of Common Stock outstanding as of September 30, 2005. PART I. FINANCIAL INFORMATION Item 1. Financial Statements The Consolidated Statements of Earnings of The Procter & Gamble Company and subsidiaries (the "Company", "we" or "our") for the three months ended September 30, 2005 and 2004, the Consolidated Balance Sheets as of September 30, 2005 and June 30, 2005, and the Consolidated Statements of Cash Flows for the three months ended September 30, 2005 and 2004 follow. In the opinion of management, these unaudited consolidated financial statements contain all adjustments necessary to present fairly the financial position, results of operations and cash flows for the interim periods reported. However, such financial statements may not be indicative necessarily of annual results. THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS Amounts in millions except per share amounts Three Months Ended September 30 ------------------------------------ 2005 2004 ---------------- ---------------- NET SALES $ 14,793 $ 13,744 Cost of products sold 7,159 6,623 Selling, general and administrative expense 4,577 4,332 ---------------- ---------------- OPERATING INCOME 3,057 2,789 Interest expense 219 181 Other non-operating income, net 74 182 ---------------- ---------------- EARNINGS BEFORE INCOME TAXES 2,912 2,790 Income taxes 883 848 ---------------- ---------------- NET EARNINGS $ 2,029 $ 1,942 ================ ================ PER COMMON SHARE: Basic net earnings $ 0.82 $ 0.75 Diluted net earnings $ 0.77 $ 0.70 Dividends $ 0.28 $ 0.25 DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING 2,649.7 2,766.1 See accompanying Notes to Consolidated Financial Statements

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS Amounts in millions September 30 June 30 ASSETS 2005 2005 ------------ ------------ ~~CURRENT ASSETS Cash and cash equivalents $ 6,310 $ 6,389 Investment securities 1,749 1,744 Accounts receivable 4,690 4,185 Inventories Materials and supplies 1,371 1,424 Work in process 384 350 Finished goods 3,406 3,232 ------------ ------------ Total inventories 5,161 5,006 Deferred income taxes 849 1,081 Prepaid expenses and other current assets 1,805 1,924 ------------ ------------ TOTAL~~

~~CURRENT ASSETS 20,564 20,329 PROPERTY, PLANT AND EQUIPMENT Buildings 5,318 5,292 Machinery and equipment 20,631 20,397 Land 625 636 ------------ ------------ 26,574 26,325 Accumulated depreciation (12,318) (11,993) ------------ ------------ NET PROPERTY, PLANT AND EQUIPMENT 14,256 14,332 GOODWILL AND OTHER INTANGIBLE ASSETS Goodwill 19,793 19,816 Trademarks and other intangible assets, net 4,435 4,347 ------------ ------------ NET GOODWILL AND OTHER INTANGIBLE ASSETS 24,228 24,163 OTHER NON-CURRENT ASSETS 2,858 2,703 ------------ ------------ TOTAL ASSETS $ 61,906 $ 61,527~~

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~~LIABILITIES AND SHAREHOLDERS' EQUITY CURRENT LIABILITIES Accounts payable $ 3,423 $ 3,802 Accrued and other liabilities 6,247 7,531 Taxes payable 2,635 2,265 Debt due within one year 8,749 11,441 ------------ ------------ TOTAL~~

~~CURRENT LIABILITIES 21,054 25,039 LONG-TERM DEBT 21,046 12,887 DEFERRED INCOME TAXES 2,007 1,896 OTHER NON-CURRENT LIABILITIES 3,266 3,230 ------------ ------------ TOTAL LIABILITIES 47,373 43,052 SHAREHOLDERS' EQUITY Preferred stock 1,477 1,483 Common stock - shares issued - Sept 30 2,976.6 2,977 June 30 2,976.6 2,977 Additional paid-in capital 3,140 3,030 Reserve for ESOP debt retirement (1,269) (1,259) Accumulated other comprehensive income (1,485) (1,566) Treasury stock (22,558) (17,194) Retained earnings 32,251 31,004 ------------ ------------ TOTAL SHAREHOLDERS' EQUITY 14,533 18,475 ------------ ------------ TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY $ 61,906 $ 61,527~~

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See accompanying Notes to Consolidated Financial Statements THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS Three Months Ended Amounts in millions September 30 ------------------- 2005 2004 -------- -------- CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD $ 6,389 $ 4,232 OPERATING ACTIVITIES Net earnings 2,029 1,942 Depreciation and amortization 448 480 Share based compensation expense 95 122 Deferred income taxes 284 145 Changes in: Accounts receivable (539) (377) Inventories (149) (326) Accounts payable, accrued and other liabilities (243) 57 Other operating assets & liabilities 175 (112) Other 71 (19) -------- -------- TOTAL OPERATING ACTIVITIES 2,171 1,912 -------- -------- INVESTING ACTIVITIES Capital expenditures (401) (413) Proceeds from asset sales 26 366 Acquisitions (1,178) (335) Change in investment securities (17) (216) -------- -------- TOTAL INVESTING ACTIVITIES (1,570) (598) -------- -------- FINANCING ACTIVITIES Dividends to shareholders (727) (685) Change in short-term debt (1,230) (2,429) Additions to long-term debt 8,612 2,996 Reductions of long-term debt (1,858) (130) Impact of stock options and other 142 105 Treasury purchases (5,555) (622) -------- -------- TOTAL FINANCING ACTIVITIES (616) (765) -------- -------- EFFECT OF

EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS (64) 59 CHANGE IN CASH AND CASH EQUIVALENTS (79) 608 -------- -------- CASH AND CASH EQUIVALENTS, END OF PERIOD $ 6,310 $ 4,840 ======== ======== See accompanying Notes to Consolidated Financial Statements THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 1. These statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2005 and Form 8-Ks filed on September 23, 2005, and November 2, 2005 reflecting the Company's historical results as conformed for the adoption of SFAS 123 (Revised 2004), "Share-Based Payment" (SFAS 123(R)) and the change in our method of accounting for Treasury Stock. The results of operations for the three-month period ended September 30, 2005 are not indicative necessarily of annual results. 2. Comprehensive Income - Total comprehensive income is composed primarily of net earnings, net currency translation gains and losses, impacts of net investment and cash flow hedges and net unrealized gains and losses on securities. Total comprehensive income for the three months ended September 30, 2005 and 2004 was $2,110 million and $2,159 million, respectively. 3. Segment Information - Following is a summary of segment results.

SEGMENT INFORMATION Amounts in millions Three Months Ended September 30 --- ------------------ ------------------ --------- Earnings Before Net Sales Income Taxes Net Earnings ---- ------------------ ------------------ -------- ~~Beauty 2005 $ 4,989 $ 1,078 $ 783 2004 4,655 983 674 ------------- ------------------ ------------------ ------------- Health Care 2005 2,083 501 336 2004 1,844 360 245 Baby Care & Family Care 2005 2,999 510 320 2004 2,850 501 309 ------------- ------------------ ----------------- Family Health 2005 5,082 1,011 656 2004 4,694 861 554 -- ------------------ ------------------ ------------------ ------ Fabric Care & Home Care 2005 4,215 963 641 2004 3,810 877 585 Snacks & Coffee 2005 706 108 73 2004 740 120 78 ------------------ ------------------ ----------- Household Care~~

~~2005 4,921 1,071 714 2004 4,550 997 663 -- ------------------ ------------------ ------------------ ------ Corporate 2005 (199) (248) (124) 2004 (155) (51) 51 ---------- ------------------ ------------------ ----------------- Total 2005 $ 14,793 $ 2,912 $ 2,029 2004 13,744 2,790 1,942 ----------- ------------------ ------------------ ----------------~~

4. Goodwill and Other Intangible Assets - Goodwill as of September 30, 2005 is allocated by reportable segment and global business unit as follows (amounts in millions): Three Months Ended September 30, 2005 --------------------- Total Beauty, beginning of year $ 14,580 Acquistions & divestiture (19) Translation & other 8 Goodwill, September 30, 2005 14,569 Health Care, beginning of year 3,378 Acquistions & divestiture -- Translation & other (2) Goodwill, September 30, 2005 3,376 Baby Care & Family Care, beginning of year 955 Acquistions & divestiture (23) Translation & other 12 Goodwill, September 30, 2005 944 Total Family Health, beginning of year 4,333 Acquistions & divestiture (23) Translation & other 10 Goodwill, September 30, 2005 4,320 Fabric Care & Home Care, beginning of year 644 Acquistions & divestiture -- Translation & other -- Goodwill, September 30, 2005 644 Snacks & Coffee, beginning of year 259 Acquistions & divestiture -- Translation & other 1 Goodwill, September 30, 2005 260 Total Household Care, beginning of year 903 Acquistions & divestiture -- Translation & other 1 Goodwill, September 30, 2005 904 Goodwill, Net, beginning of year 19,816 Acquistions & divestiture (42) Translation & other 19 Goodwill, September 30, 2005 $ 19,793 Identifiable intangible assets as of September 30, 2005 are comprised of (amounts in millions): Gross Carrying Accumulated Amount Amortization --------------------------------- Amortizable intangible assets with determinable lives $ 2,257 $ 755 Intangible assets with indefinite lives 2,933 - --------------------------------- Total identifiable intangible assets $ 5,190 $ 755 --------------------------------- Amortizable intangible assets consist principally of patents, technology and trademarks. The non-amortizable intangible assets consist primarily of certain trademarks. The amortization of intangible assets for the three months ended September 30, 2005 was $49 million. 5. In December 2004, the Financial Accounting Standards Board (FASB) issued (SFAS 123(R)). This Statement revises SFAS No. 123 by eliminating the option to account for employee stock options under APB No. 25 and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (the "fair-value-based" method). We adopted SFAS 123(R) effective July 1, 2005 using the modified retrospective method. All prior periods were adjusted to give effect to the fair-value-based method of accounting for awards granted in fiscal years beginning on or after July 1, 1995. We provided revised Consolidated Financial Statements for the years ended June 30, 2005, 2004 and 2003 reflecting the adoption of SFAS 123(R) under the modified retrospective method in a Form 8-K dated November 2, 2005. The impact to the Company's net earnings of adopting SFAS 123(R) is consistent with the pro forma disclosures provided in previous financial statements. The impact of adopting SFAS 123(R) on Shareholders' Equity as of September 30, 2005, June 30, 2005 and June 30, 2004 is shown in Note 8. For the three months ended September 30, 2005 and 2004, we recognized total share-based compensation of $95 million and $122 million, respectively, of which $73 million and $82 million relate to additional compensation recognized under SFAS 123(R) for stock options, and $22 million and $40 million relate to compensation for other share-based awards, primarily restricted stock and restricted stock units. These amounts are reflected in Cost of Products Sold and Selling, General and Administrative Expense and have been allocated to the reportable segments. The fair value of each grant issued since January 1, 2005 was estimated using a binomial lattice-based model. The fair value of options granted prior to January 1, 2005 was estimated using the Black-Scholes option-pricing model. The utilization of the binomial lattice-based model did not have a significant impact on the valuation of stock options as compared to the Black-Scholes model. Assumptions utilized in the model are evaluated and revised, as necessary, to reflect market conditions and experience. 6. Postretirement Benefits - The Company offers various postretirement benefits to its employees. Additional information about these benefits is incorporated herein by reference to Note 8, Postretirement Benefits and Employee Stock Ownership Plan, which appears on page 54-58 of the Annual Report to Shareholders for the fiscal year ended June 30, 2005. The components of net periodic benefit cost are as follows:

Amounts in millions	Pension Benefits		Other Retiree Benefits	
	Three Months Ended September 30		Three Months Ended September 30	
	2005	2004	2005	2004
Service Cost	$ 47	$ 38	$ 24	$ 17
Interest Cost	61	58	39	36
Expected Return on Plan Assets	(47)	(43)	(90)	(83)
Amortization of Prior Service Cost and Prior Transition Amount	2	1	(5)	(5)
Recognized Net Actuarial Loss	19	8	1	-
Gross Benefit Cost	82	62	(31)	(35)
Dividends on ESOP Preferred Stock	-	-	(19)	(18)
Net Periodic Benefit Cost	$ 82	$ 62	$ (50)	$ (53)

In 2005, the expected return on plan assets is 7.1% and 9.5% for defined benefit and other retiree benefit plans, respectively. 7. On October 1, 2005, we completed our acquisition of The Gillette Company. Pursuant to the acquisition agreement, we exchanged 0.975 shares of The Procter & Gamble Company common stock, on a tax-free basis, for each share of The Gillette Company. Under the purchase method of accounting, the total consideration was approximately $54 billion, determined using the average Company stock prices beginning two days before and ending two days after January 28, 2005, the date the acquisition was announced. The acquisition will be reflected in our consolidated financial statements beginning in the quarter ending December 31, 2005. The Gillette Company is a leader in several global product categories including blades and razors, oral care and batteries. Total sales for Gillette during its most recent year ended December 31, 2004 were $10.5 billion. In connection with this acquisition, we also announced a share buyback plan under which we will acquire $18 to $22 billion of Company common stock in the open market or from private transactions. Through September 30, 2005, we repurchased $8.6 billion under this plan. The repurchases were financed by borrowings under a $24 billion three-year credit facility with a syndicate of banks. The facility was entered into on July 27, 2005 and replaced a $3.4 billion bridge credit facility. Proceeds will be used for general corporate purposes with the expectation that the majority of the funds will be used as part of the share repurchase program. This facility is initially secured by a pledge of certain of the Company shares acquired under the share buyback plan. This credit facility carries a variable interest rate. 8. Change in Method of Accounting for Treasury Stock - On July 1, 2005, we elected to change our method of accounting for Treasury Stock. We previously accounted for share repurchases as if the Treasury Stock was constructively retired by reducing Common Stock and Retained Earnings within Shareholders' Equity. Reissuances of repurchased shares were accounted for by increasing Common Stock and Additional Paid-In Capital. Our new method of accounting will present Treasury Stock as a separate component of Shareholders' Equity. We believe that our new accounting method is preferable as it more closely depicts the underlying intent of the share repurchases in which the shares are not retired. In addition, we believe that our new presentation of Shareholders' Equity provides greater visibility of our share repurchase activity, including our share buyback plan announced in connection with the Gillette acquition. We adopted SFAS No. 154, "Accounting Changes and Error Corrections", on July 1, 2005. Accordingly, we reflected this new accounting method retrospectively by adjusting prior periods. This change is limited to reclassifications within Shareholders' Equity and has no effect on our net earnings, cash flows or total assets. The following tables summarize the changes within Shareholders' Equity as of September 30, 2005, June 30, 2005 and June 30, 2004 from the change in our method of accounting for Treasury Stock (the June 30, 2005 and 2004 tables also reflect changes to equity from the adoption of FAS 123(R)):

Amounts in millions

As of September 30, 2005	As Computed Under Old Treasury Stock Method	Effect of Change	As Reported
Common Stock	$ 2,378	$ 599	$ 2,977
Preferred Stock	1,477	--	1,477
Additional Paid-In Capital	6,930	(3,790)	3,140
Reserve for ESOP Debt Retirement	(1,269)	--	(1,269)
Accumulated Other Comprehensive Income	(1,485)	--	(1,485)
Treasury Stock	--	(22,558)	(22,558)
Retained Earnings	6,502	25,749	32,251
Total Shareholders' Equity	$ 14,533	$ -	$ 14,533

Amounts in millions
Effect of As
Originally Treasury
Stock Effect of As
of June 30, 2005

Reported Change
SFAS 123(R) As
Adjusted -----------
-- ------------- ----
---------- ----------
--- ~~Common Stock~~
~~$ 2,473 $ 504 -- $~~
~~2,977 Preferred~~
~~Stock 1,483 -- --~~
~~1,483 Additional~~
~~Paid-In Capital~~
~~3,142 (3,659) 3,547~~
~~3,030 Reserve for~~
~~ESOP Debt~~
~~Retirement (1,259) -~~
~~- -- (1,259)~~
~~Accumulated Other~~
~~Comprehensive~~
~~Income (1,566) -- -~~
~~- (1,566) Treasury~~
~~Stock -- (17,194) --~~
~~(17,194) Retained~~
~~Earnings 13,204~~
~~20,349 (2,549)~~
~~31,004 ------------~~
~~------------ -------~~
~~------- ------------~~
~~Total Shareholders'~~
~~Equity $ 17,477 $ -~~
~~$ 998 $ 18,475~~

Amounts in millions Effect of As Originally Treasury Stock Effect of As of June 30, 2004 Reported Change SFAS 123(R) As Adjusted ------------- ------------- -------------- ------------- ~~Common Stock $ 2,544 $ 432 -- $ 2,976 Preferred Stock 1,526 -- -- 1,526 Additional Paid-In Capital 2,425 (3,098) 3,127 2,454 Reserve for ESOP Debt Retirement (1,283) - - -- (1,283) Accumulated Other Comprehensive Income (1,545) -- - - (1,545) Treasury Stock -- (12,925) -- (12,925) Retained Earnings 13,611 15,591 (2,215) 26,987 ------------- ------------- -------------- -------------~~

~~Total Shareholders' Equity $ 17,278 $ - $ 912 $ 18,190~~

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is organized in the following sections: Overview Results of Operations - Three Months Ended September 30, 2005 Business Segment Discussion - Three Months Ended September 30, 2005 Financial Condition Throughout MD&A, we refer to several measures used by management to evaluate performance including unit volume growth, net sales and after-tax profit. We also refer to organic sales growth (net sales excluding the impacts of acquisitions, divestitures and foreign exchange), free cash flow and free cash flow productivity, which are not defined under accounting principles generally accepted in the United States of America (U.S. GAAP). The explanation of these measures at the end of MD&A provides more details. Effective July 1, 2005, Procter & Gamble adopted SFAS 123 (R) which requires that all stock-based compensation, including grants of employee stock options, be accounted for using a fair value-based method. We have elected to adopt SFAS 123 (R) using the modified retrospective method. As a result, we have revised our historical results to include the effect of stock-based compensation. Therefore, all financial data provided in this Form 10-Q filing, including prior year data, have been revised to include the impact of stock option compensation expense. OVERVIEW -------- Our business is focused on providing branded products of superior quality and value to improve the lives of the world's consumers. We believe this will lead to leadership sales, profits and value creation, allowing employees, shareholders and the communities in which we operate to prosper. On October 1, 2005, we completed the acquisition of The Gillette Company ("Gillette"), a leading consumer products company that had $10.5 billion of sales in its most recent year ended December 31, 2004. The results of Gillette will be included in our results starting with the quarter ending on December 31, 2005; accordingly, results for the three months ended September 30, 2005 do not include any results related to Gillette. Procter & Gamble markets approximately 300 consumer products in more than 160 countries. Our products are sold primarily through mass merchandisers, grocery stores, membership club stores and drug stores. We compete in multiple product categories and have three global business units: P&G Beauty, P&G Family Health and P&G Household Care. Under U.S. Generally Accepted Accounting Principles, we have five reportable segments: Beauty, Health Care, Baby Care & Family Care, Fabric Care & Home Care, and Snacks & Coffee. We have operations in over 80 countries through our Market Development Organization, which leads country business teams to build our brands in local markets and is organized along seven geographic areas: North America, Western Europe, Northeast Asia, Latin America, Central and Eastern Europe/Middle East/Africa, Greater China and ASEAN/Australasia/India. The following table provides the percentage of net sales and net earnings by reportable business segment and global business unit for the three months ended September 30, 2005 (excludes net sales and net earnings in Corporate): NET SALES NET EARNINGS BEAUTY 33% 36% FAMILY HEALTH: 34% 31% Health Care 14% 16% Baby Care and Family Care 20% 15% HOUSEHOLD CARE: 33% 33% Fabric Care and Home Care 28% 30% Snacks and Coffee 5% 3% ----------------- ---- ---- TOTAL 100% 100% SUMMARY OF RESULTS. The following are highlights of the results for the quarter ended September 30, 2005. o Net sales increased eight percent and unit volume increased six percent. Growth was broad-based with all regions growing volume and sales during the period. o Operating earnings increased 10 percent. Volume growth, pricing, and scale leverage on overhead expenses were partially offset by higher commodity costs and the impact of Hurricane Katrina. o Net earnings grew four percent. Net earnings growth trailed operating earnings growth as a result of the prior year impact of the sale of the juice business and higher interest expenses associated with the previously announced $18 to $22 billion share repurchase program related to the Gillette acquisition. o Diluted net earnings per share were $0.77, an increase of 10%, in-line with operating earnings growth. o Operating cash flow increased by 14 percent versus the comparable prior year period. Free cash productivity was 87%, ahead of the prior year period free cash productivity of 77%. FORWARD LOOKING STATEMENTS. The markets in which the Company sells its products are highly competitive and comprised of both global and local competitors. Going forward, business and market uncertainties may affect results. Among the key factors that could impact results and must be managed by the Company are: (1) the ability to achieve business plans, including with respect to lower income consumers and growing existing sales and volume profitably despite high levels of competitive activity, especially with respect to the product categories and geographical markets (including developing markets) in which the Company has chosen to focus; (2) the ability to successfully execute, manage and integrate key acquisitions and mergers, including (i) the Domination and Profit Transfer Agreement with Wella, and (ii) the Company's merger with The Gillette Company, and to achieve the cost and growth synergies in accordance with the stated goals of the Gillette transaction; (3) the ability to manage and maintain key customer relationships; (4) the ability to maintain key manufacturing and supply sources (including sole supplier and plant manufacturing sources); (5) the ability to successfully manage regulatory, tax and legal matters (including product liability, patent, and other intellectual property matters), and to resolve pending matters within current estimates; (6) the ability to successfully implement, achieve and sustain cost improvement plans in manufacturing and overhead areas, including the Company's outsourcing projects; (7) the ability to successfully manage currency (including currency issues in volatile countries), debt (including debt related to the Company's announced plan to repurchase shares of the Company's stock), interest rate and certain commodity cost exposures; (8) the ability to manage the continued global political and/or economic uncertainty and disruptions, especially in the Company's significant geographical markets, as well as any political and/or economic uncertainty and disruptions due to terrorist activities; (9) the ability to successfully manage competitive factors, including prices, promotional incentives and trade terms for products; (10) the ability to obtain patents and respond to technological advances attained by competitors and patents granted to competitors; (11) the ability to successfully manage increases in the prices of raw materials used to make the Company's products; (12) the ability to stay close to consumers in an era of increased media fragmentation; and (13) the ability to stay on the leading edge of innovation. If the Company's assumptions and estimates are incorrect or do not come to fruition, or if the Company does not achieve all of these key factors, then the Company's actual results could vary materially from the forward-looking statements made herein, as that term is defined in the Private Securities Litigation Reform Act of 1995. RESULTS OF OPERATIONS - THREE MONTHS ENDED SEPTEMBER 30, 2005 -- The following discussion provides a review of results for the three months ended September 30, 2005 versus the three months ended September 30, 2004.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES (Amounts in Millions Except Per Share Amounts) Consolidated Earnings Information Three Months Ended September 30 ----------------------------------- 2005 2004 % CHG ----------------------------------- ~~NET SALES $ 14,793 $ 13,744 8 % COST OF PRODUCTS SOLD 7,159 6,623 8 % ------------------------- GROSS MARGIN 7,634 7,121 7 % SELLING, GENERAL & ADMINISTRATIVE EXPENSE 4,577 4,332 6 % ------------------------- OPERATING INCOME 3,057 2,789 10 % TOTAL INTEREST EXPENSE 219 181 OTHER NON-OPERATING INCOME, NET 74 182 ------------------------- EARNINGS BEFORE INCOME TAXES 2,912 2,790 4 % INCOME TAXES 883 848 NET EARNINGS $ 2,029 $ 1,942 4 %~~

~~EFFECTIVE TAX RATE 30.3 % 30.4 % PER COMMON SHARE: BASIC NET EARNINGS $ 0.82 $ 0.75 9 % DILUTED NET EARNINGS $ 0.77 $ 0.70 10 % DIVIDENDS $ 0.28 $ 0.25 AVERAGE DILUTED SHARES OUTSTANDING 2,649.7 2,766.1 COMPARISONS AS A % OF NET SALES ------------------------------- GROSS MARGIN 51.6 % 51.8 % (20) SELLING, GENERAL & ADMINISTRATIVE EXPENSE 30.9 % 31.5 % (60) OPERATING MARGIN 20.7 % 20.3 % 40 EARNINGS BEFORE INCOME TAXES 19.7 % 20.3 % (60) NET EARNINGS 13.7 % 14.1 % (40)~~

Unit volume for the July - September quarter grew six percent. Each of the Company's geographic regions grew volume during the period, led by developing markets with growth in the mid-teens. Beauty, family health, and household care each delivered volume growth of six percent or greater. This growth reflects progress on key brands and countries with all of the Company's top 10 brands and countries growing versus the prior year period. Growth came largely behind new product innovations across P&G's portfolio of brands such as Tide Coldwater, Tide with Febreze, Dawn Bleach Alternative, Naturella expansion in Central and Eastern Europe, Pampers Feel and Learn, and Charmin Mega-Roll. Organic volume, which excludes the impacts of acquisitions and divestitures - primarily the divestiture of the juice business during the prior year period - increased seven percent. Net sales for the quarter increased eight percent to $14.79 billion. Pricing contributed one percent to sales growth behind actions taken in various businesses and geographies that partially recovered the impact of higher commodity costs. Favorable foreign exchange rates also contributed one percent of sales growth. Organic sales, which exclude the impacts of acquisitions, divestitures, and foreign exchange, also increased eight percent.

Volume ------- --------------- -------- With Acquisitions Without Total & Acquisitions Mix/ Total Impact Divestitures & Divestitures FX Price Other Impact Ex-FX -------------- - -------------- - ------ ------- - -------- ------- -- --------- ~~BEAUTY 7% 7% 1% 0% -1% 7% 6% FAMILY HEALTH HEALTH CARE 11% 11% 1% 1% 0% 13% 12% BABY CARE AND FAMILY CARE 5% 6% 1% 1% -2% 5% 4% HOUSEHOLD CARE FABRIC CARE AND HOME CARE 8% 8% 1% 2% 0% 11% 10% SNACKS AND COFFEE -7% -7% 0% 5% -3% -5% -5% TOTAL COMPANY 6% 7% 1% 1% 0% 8% 7% NOTE: Sales percentage changes are approximations based on quantitative formulas that are consistently applied.~~

Gross margin decreased 20 basis points versus the prior year. Higher commodity costs reduced gross margins by over 100 basis points. Fixed cost leverage from volume growth, cost savings efforts and pricing did not fully offset the commodity cost impact. Selling, general, and administrative expenses (SG&A) increased six percent for the quarter, but decreased as a percentage of net sales by 60 basis points. This was primarily due to sales growth that outpaced the increase in SG&A spending. The increase in spending was due primarily to higher marketing support spending and higher overhead expenses, although both decreased as a percentage of sales. Beauty increased marketing spending to support new product launches and initiatives such as Lacoste Essentials, Always Cottony Soft, Naturella expansion in Central and Eastern Europe, Pantene Color Expressions, and Olay Quench Hand & Body Lotion. Baby care increased marketing spending primarily in North America behind direct-to-consumer marketing investments. Operating earnings increased 10 percent for the quarter to $3.06 billion. Operating earnings growth was due primarily to strong top-line growth, pricing, and scale leverage on overhead expenses. These benefits were partially offset by higher commodity prices and costs associated with Hurricane Katrina. Hurricane Katrina had a negative impact of approximately two percent on the Company's operating earnings growth due primarily to the disruption of the coffee business, write-offs of damaged inventory and physical assets, and clean-up and repair costs. Net earnings increased four percent to $2.03 billion in the current period. Net earnings growth trailed operating earnings growth primarily due to the prior year impact of the sale of the juice business and higher interest expenses in the current period. Interest expenses for the quarter increased $38 million versus the prior year period driven by the financing cost of the previously announced $18 to $22 billion share repurchase program associated with the Gillette acquisition. The Company repurchased $5.55 billion of P&G stock during the quarter under the share repurchase program, bringing cumulative repurchases under the program to $8.57 billion since January 2005. Interest expenses were partially offset by favorable currency mix on our total debt. Diluted net earnings per share were $0.77, an increase of 10%, in-line with operating earnings growth. The impact of accelerated share repurchases, net of associated interest and Gillette acquisition expenses was neutral on earnings per share for the quarter. BUSINESS SEGMENT DISCUSSION --------------------------- The following discussion provides a review of results by business segment. An analysis of the results for the three months ended September 30, 2005 are compared to the same period ended September 30, 2004. The table below provides supplemental information on net earnings by business segment for the three months ended September 30, 2005 versus the comparable prior year period:

Three Months Ended September 30, 2005 % Change Earnings % Change % Change Versus Before Versus Versus Net Sales Year Ago Income Taxes Year Ago Net Earnings Year Ago --

~~BEAUTY $ 4,989 7% $ 1,078 10% 783 16% FAMILY HEALTH HEALTH CARE 2,083 13% 501 39% 336 37% BABY CARE AND FAMILY CARE 2,999 5% 510 2% 320 4% HOUSEHOLD CARE FABRIC CARE AND HOME CARE~~

~~4,215 11%~~
~~963 10% 641~~
~~10%~~
~~SNACKS~~
~~AND~~
~~COFFEE 706~~
~~-5% 108 -10%~~
~~73 -6%~~
~~TOTAL~~
~~BUSINESS~~
~~SEGMENT~~
~~14,992 8%~~
~~3,160 11%~~
~~2,153 14%~~
~~CORPORATE~~
~~(199) n/a (248)~~
~~n/a (124) n/a --~~
~~---------------~~
~~---------------~~
~~---------------~~
~~---------------~~
~~---------------~~
~~----- TOTAL~~
~~COMPANY~~
~~14,793 8%~~
~~2,912 4%~~
~~2,029 4%~~

BEAUTY ------ Beauty unit volume increased seven percent, led by growth in developing markets. Growth was broad-based across hair care, skin care, and feminine care. The hair care business was led by double-digit volume growth in developing markets and globally on Pantene, Head & Shoulders and Rejoice. North America hair care volume declined versus the prior year period primarily due to the discontinuation of several minor brands. However, market share in US hair care was flat overall and up on Pantene, Herbal Essences, and Aussie. Skin care volume grew in upper single-digits led by double-digit growth on the Olay brand. Feminine care delivered volume growth in the upper single-digits behind double- digit growth on Always and Naturella. Net sales in beauty increased seven percent to $4.99 billion. Foreign exchange added one percent of sales growth. Mix reduced sales by one percent as a result of faster growth in developing markets, where unit sales price is generally lower than the global business unit average. Net earnings increased 16 percent to $783 million. Earnings growth was driven by top-line growth, scale benefits, and savings from the Wella integration. These were partially offset with increased marketing spending behind new product launches such as Lacoste Essentials, Always Cottony Soft, Naturella expansion in Central and Eastern Europe, Pantene Color Expressions and Olay Quench Hand & Body lotion. FAMILY HEALTH ------------- Health care delivered double-digit volume, sales and earnings growth. Unit volume increased 11 percent behind double-digit growth in pharmaceuticals & personal health, and high single-digit growth in oral care. Pharmaceuticals & personal health grew primarily behind double-digit volume increase on Actonel and Prilosec OTC. Prilosec OTC volume more than doubled versus the prior year level, largely driven by accelerated sales ahead of a mid-September price increase as well as share growth versus the prior year. Given this advanced shipping effect, we expect shipment growth in the quarter ending December 31, 2005 to moderate versus shipment levels in the current quarter ended September 30, 2005. In addition, Prilosec OTC volume was suppressed in the base period by shipment allocation. Oral care volume grew in high single-digits led by double- digit growth in developing markets. Health care net sales increased 13 percent to $2.08 billion. Pricing actions in the prior fiscal year on pharmaceuticals & personal health and pet health & nutrition added one percent to sales growth. Foreign exchange also contributed one point of sales growth. Net earnings increased 37 percent to $336 million. The net earnings increase resulted from volume growth, product mix benefits, and a favorable base period comparison. Baby care and family care unit volume increased five percent with balanced growth in both businesses. Volume growth was driven behind initiatives such as Pampers Feel and Learn and Charmin Mega-Roll. Net sales increased five percent to $3.00 billion including a positive foreign exchange impact of one percent. Pricing added one percent to sales growth behind the carryover impact of prior fiscal year increases in family care. Additionally, recent price increases in North America baby care more than offset competitive merchandising spending in Western Europe baby care. Mix reduced sales by two percent primarily due to growth in mid-tier products such as Bounty Basic and in developing markets, where unit sales price is generally lower than the global business unit average. Earnings increased four percent to $320 million driven primarily by volume growth. The benefits of cost savings efforts and pricing were largely offset by higher pulp and natural gas prices and increases in direct-to-consumer marketing investments in baby care. HOUSEHOLD CARE -------------- Fabric care and home care volume increased eight percent behind growth on Tide, Ariel, Downy, and Dawn. Growth was driven by new initiatives that began shipping this quarter, such as Tide with Febreze and Dawn Direct Foam, as well as the incremental benefit of prior year initiatives such as Tide Coldwater, Tide with a Touch of Downy, Ariel Ion Power Gel, Dawn Bleach Alternative, and Downy Simple Pleasures. Net sales increased 11 percent to $4.21 billion including a one percent increase from foreign exchange rates. The benefit of prior price increases, primarily in North America and Latin America, helped to offset higher commodity costs and increased sales by two percent. Net earnings increased 10 percent to $641 million behind the impacts of volume growth, pricing, ongoing savings programs, and foreign exchange gains from developing market currencies. These benefits were partially offset by rising commodity prices. Snacks and coffee results were impacted by Hurricane Katrina. The business experienced business disruption and damages to our manufacturing facilities in New Orleans. Unit volume declined seven percent primarily due to reduced coffee shipments in September. Net sales declined by five percent to $706 million. Coffee price increases taken last fiscal year in response to higher bean costs added five percent to sales growth. Mix effects reduced sales by three percent. Net earnings were $73 million, down six percent driven primarily by the business disruption and other damages associated with Hurricane Katrina. CORPORATE --------- Corporate includes certain operating and non-operating activities not allocated to specific business units. These include incidental businesses managed at the corporate level, financing and investing activities, certain restructuring charges and other general corporate items. Eliminations to adjust management reporting principles to United States Generally Accepted Accounting Principles (U.S. GAAP) are held in Corporate. In addition, Corporate includes the historical results of divested businesses, including the juice business, which was divested in August of 2004. For the quarter, net sales were impacted by the divestiture of the juice business, which recorded roughly one month of sales in the corporate segment during the base period. Net earnings in corporate were reduced primarily as a result of the base period gain on the sale of the juice business of $79 million and increased interest expenses. The increase in interest expenses was driven by the financing cost of the share repurchase program related to Gillette partially offset by favorable currency mix on our debt. FINANCIAL CONDITION ------------------- OPERATING ACTIVITIES -------------------- Cash generated from operating activities for the three months ended September 30, 2005 was $2.17 billion compared to $1.91 billion in the prior year period, an increase of 14%. The increase in cash from operating activities was driven by earnings growth adjusted for non-cash items (depreciation, amortization, stock based compensation and deferred income taxes). Deferred income tax expense increased $139 million driven primarily by the settlement of deferred tax liabilities on foreign exchange movements related to bonds which matured during the quarter. These were partially offset by a net increase in working capital due primarily to business growth. INVESTING ACTIVITIES -------------------- Investing activities in the current year used $1.57 billion compared to $598 million in the prior year. The increase was driven primarily by the settlement of a major portion of the Wella domination liability, which increased our total ownership in Wella to over 95%. Capital expenditures were $401 million, or three percent of net sales. Proceeds from asset sales decreased by $340 million due to the sale of the juice business, which was sold during the base period. FINANCING ACTIVITIES -------------------- Financing activities used net cash of $616 million in the current year compared to a use of cash of $765 million in the base period. During the quarter, the Company repurchased $5.55 billion of P&G stock as part of the repurchase program associated with the Gillette acquisition. This brings cumulative share repurchases under the plan to $8.57 billion. The cash used for the repurchase program was funded by debt, which had a net increase of $5.52 billion in the quarter. NON-GAAP MEASURES ----------------- Our discussion of financial results includes several measures not defined by U.S. GAAP. We believe these measures provide our investors with additional information about the underlying results and trends of the Company, as well as insight to some of the metrics used to evaluate management. When used in the MD&A, we have provided the comparable GAAP measure in the discussion. ORGANIC SALES GROWTH. Organic sales growth is a non-GAAP measure of sales growth excluding the impacts of acquisitions, divestitures and foreign exchange from year-over-year comparisons. We believe this provides investors with a more complete understanding of underlying sales trends by providing sales growth on a consistent basis. The reconciliation of reported sales growth to organic sales growth: Total Sales Growth 8% Less: Foreign Exchange Impact 1% Less: Acquisition/Divestiture Impact -1% --- Organic Sales Growth 8% OTHER MEASURES -------------- FREE CASH FLOW. Free cash flow is defined as operating cash flow less capital spending. We view free cash flow as an important measure because it is one factor in determining the amount of cash available for dividends and discretionary investment. Free cash flow is also one of the measures used to evaluate senior management and is a factor in determining their at-risk compensation. FREE CASH FLOW PRODUCTIVITY. Free cash flow productivity is defined as the ratio of free cash flow to net earnings. The Company's long-term target is to generate free cash at or above 90 percent of net earnings. Free cash flow is also one of the measures used to evaluate senior management. The reconciliation of free cash flow and free cash flow productivity is provided below: Operating Capital Free Net Free Cash ($MM) Cash Flow Spending Cash Flow Earnings Flow Productivity -- Jul-Sep'04 1,912 413 1,499 1,942 77% Jul-Sep'05 2,171 401 1,770 2,029 87% Item 3. Quantitative and Qualitative Disclosures about Market Risk There have been no material changes in the Company's exposure to market risk since June 30, 2005. See Item 7A in the Company's Annual Report on Form 10-K for the year ended June 30, 2005. Item 4. Controls and Procedures The Company's Chairman of the Board, President and Chief Executive, A.G. Lafley, and the Company's Chief Financial Officer, Clayton C. Daley, Jr., have evaluated the Company's internal controls and disclosure controls systems as of the end of the period covered by this report. Messrs. Lafley and Daley have concluded that the Company's disclosure controls systems are functioning effectively to provide reasonable assurance that the Company can meet its disclosure obligations. The Company's disclosure controls system is based upon a global chain of financial, staff and general business reporting lines that converge in the world-wide headquarters of the Company in Cincinnati, Ohio. The reporting process is designed to ensure that information required to be disclosed by the Company in the reports that it files or submits with the Commission is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Consistent with the SEC's suggestion, the Company has a Disclosure Committee consisting of key Company personnel designed to review the accuracy and completeness of all disclosures made by the Company. In connection with the evaluation described above, no changes in the Company's internal control over financial reporting occurred during the Company's first fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. PART II. OTHER INFORMATION Item 1. Legal Proceedings In October 2005, The Procter & Gamble Paper Products Company, a subsidiary of the Company, received an offer of settlement from the Ventura County Air Pollution Control District to settle alleged non-compliance with air rules standards concerning the subsidiary's Oxnard, California plant. As a result of this offer, the Company anticipates negotiating a settlement to resolve these issues. No judicial proceeding is pending. The Company's liability is estimated not to exceed $406,000. Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES Approximate dollar Total Number of value of shares that Shares Purchased as may yet be purchased Part of Publicly under our share Total Number of Average Price Paid Announced Plans or repurchase program Period Shares Purchased(1) per Share(2) Programs(3) ($ in Billions) (3) -- 7/1/05- 7/31/05 16,266,380 $54.90 12,552,408 18.3 8/1/05- 8/31/05 44,075,287 $54.56 44,039,700 15.9 9/1/05- 9/30/05 43,851,798 $56.06 43,850,200 13.4

(1) All share repurchases were made in open-market transactions. The number of shares purchased other than through a publicly announced repurchase plan were 3,751,157 for the quarter, including those purchased by P&G's Profit Sharing Trust. This table excludes shares withheld from employees to satisfy minimum tax withholding requirements on option exercises and other equity-based transactions. The Company administers employee cashless exercises through an independent, third party broker and does not repurchase stock in connection with cashless exercises. (2) Average price paid per share is calculated on a settlement basis and excludes commission. (3) On January 28, 2005 the Company announced a share buyback plan in connection with its planned acquisition of The Gillette Company. Pursuant to the plan, the Board of Directors authorized the Company and its subsidiaries to acquire in open market and/or private transactions $18 to $22 billion of shares of Company common stock to be financed by issuing a combination of long-term and short-term debt. The share repurchases are expected to be largely completed by June 30, 2006. Item 4. Submission of Matters to a Vote of Security Holders: At the Company's 2005 Annual Meeting of Shareholders held on October 11, 2005, the following actions were taken: The following Directors were elected for terms of office expiring in 2008: Broker Votes Non- Votes For Withheld Abstentions* Votes* -- BRUCE L. BYRNES 2,299,014,851

39,766,334 N/A N/A SCOTT D. COOK 2,307,794,743 30,986,442 N/A N/A CHARLES R. LEE 2,280,419,589 58,361,596 N/A N/A W. JAMES MCNERNEY, JR. 2,305,731,180 33,050,005 N/A N/A ERNESTO ZEDILLO 2,306,443,283 32,337,902 N/A N/A * Pursuant to the terms of the Notice of Annual Meeting and Proxy Statements, proxies received were voted, unless authority was withheld, in favor of the election of the five nominees named. In addition, the following Directors continued to serve as Directors after the meeting: Norman R. Augustine R. Kerry Clark Joseph T. Gorman A. G. Lafley Lynn M. Martin Johnathan A. Rodgers John F. Smith, Jr. Ralph Snyderman Robert D. Storey Margaret C. Whitman A proposal by the Board of Directors to ratify the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm to conduct the annual audit of the financial statements of the Company and its subsidiaries for the fiscal year ending June 30, 2006, was approved by the shareholders. The shareholders cast 2,275,288,282 votes in favor of this proposal and 42,037,800 votes against. There were 21,455,103 abstentions. A proposal by the Board of Directors to approve an amendment to the Amended Articles of Incorporation and Code of Regulations to eliminate the Executive Committee of the Board was approved by the shareholders. The shareholders cast 2,299,147,779 votes in favor of this proposal and 12,874,560 votes against. There were 26,758,846 abstentions. A proposal by the Board of Directors to approve an amendment to the Code of Regulations to provide for the annual election of Directors was approved by the shareholders. The shareholders cast 2,277,105,529 votes in favor of this proposal and 37,632,055 votes against. There were 24,043,601 abstentions. A shareholder resolution proposed by the People for the Ethical Treatment of Animals was defeated by the shareholders. The proposal requested that the Board report to shareholders on the Company's success and failure in achieving the objectives detailed in the Iams Company's Research Policy. The Board opposed the resolution. The shareholders cast 113,983,232 votes in favor of the resolution and 1,573,383,713 against. There were 182,422,692 abstentions and 468,991,548 broker non-votes. A shareholder resolution proposed by Mark Klein, M.D. was defeated by the shareholders. The proposal requested that the Company hire an investment bank to explore the sale of the Company. The Board opposed the resolution. The shareholders cast 33,665,692 votes in favor of the resolution and 1,799,274,270 against. There were 36,858,496 abstentions and 468,982,727 broker non-votes. A shareholder resolution proposed by the Laborers' Local Union and District Counsil Pension Fund was defeated by the shareholders. The proposal requested that the Company provide a report disclosing the Company's political contributions. The Board opposed the resolution. The shareholders cast 154,505,994 votes in favor of the resolution and 1,540,395,250 against. There were 174,878,842 abstentions and 469,001,099 broker non-votes. Although these actions occurred following the first quarter, the Company is voluntarily including this information here. Item 6. Exhibits Exhibits (3-1) Amended Articles of Incorporation. (3-2) Regulations. (11) Computation of Earnings per Share. (12) Computation of Ratio of Earnings to Fixed Charges. (18) Deloitte & Touche Preferability Letter. (31) Rule 13a-14(a)/15d-14(a) Certifications. (32) Section 1350 Certifications. 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. THE PROCTER & GAMBLE COMPANY /S/VALARIE L. SHEPPARD ------------------------------ (Valarie L. Sheppard) Vice President and Comptroller November 2, 2005 ------------------------------ Date EXHIBIT INDEX Exhibit No. (3-1) Amended Articles of Incorporation. (3-2) Regulations. (11) Computation of Earnings per Share. (12) Computation of Ratio of Earnings to Fixed Charges. (18) Deloitte & Touche Preferability Letter. (31) Rule 13a-14(a)/15d-14(a) Certifications. (32) Section 1350 Certifications.