10-Q 1 ond05q.txt 10-Q OND 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 December 31, 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 a large 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 3,289,109,964 shares of Common Stock outstanding as of December 31, 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 and six months ended December 31, 2005 and 2004, the Consolidated Balance Sheets as of December 31, 2005 and June 30, 2005, and the Consolidated Statements of Cash Flows for the six months ended December 31, 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 necessarily be indicative of annual results.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS Amounts in millions except per share amounts Three Months Ended Six Months Ended December 31 December 31 ---------------------------------- -------------------------------- 2005 2004 2005 2004 --------------------------- ------------------- ------------- -- ~~NET SALES $ 18,337 $ 14,452 $ 33,130 $ 28,196 Cost of products sold 8,732 6,885 15,891 13,508 Selling, general and administrative expense 5,713 4,585 10,290 8,917 ------------- ------ -------- ------------ -- -------------- OPERATING INCOME 3,892 2,982 6,949 5,771 Interest expense 299 200 518 381 Other non-operating income, net 68 55 142 237 ------------- --- -------------- -- ------------ -------~~

~~------ EARNINGS BEFORE INCOME TAXES 3,661 2,837 6,573 5,627 Income taxes 1,115 862 1,998 1,710 --- ----------- --------- ----- -------------- -------------- NET EARNINGS $ 2,546 $ 1,975 $ 4,575 $ 3,917~~

~~PER COMMON SHARE: Basic net earnings $ 0.76 $ 0.77 $ 1.57 $ 1.52 Diluted net earnings $ 0.72 $ 0.72 $ 1.48 $ 1.42 Dividends $ 0.28 $ 0.25 $ 0.56 $ 0.50 DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING 3,547.0 2,752.1 3,098.0 2,759.1 See accompanying Notes to Consolidated Financial Statements~~

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS Amounts in millions December 31 June 30 ASSETS 2005 2005 ------------ -- ----------

~~CURRENT ASSETS Cash and cash equivalents $ 7,816 $ 6,389 Investment securities 1,996 1,744 Accounts receivable 6,056 4,185 Inventories Materials and supplies 1,598 1,424 Work in~~

~~process 652 350 Finished goods 4,187 3,232 ------------ ------------ Total inventories 6,437 5,006 Deferred income taxes 1,340 1,081 Prepaid expenses and other current assets 2,780 1,924 ------------ ------------ TOTAL CURRENT ASSETS 26,425 20,329 PROPERTY, PLANT AND EQUIPMENT Buildings 5,687 5,292 Machinery and equipment 24,221 20,397 Land 847 636 ------------ ------------ 30,755 26,325 Accumulated depreciation (12,530) (11,993) ------------ ------------ NET PROPERTY, PLANT AND EQUIPMENT 18,225 14,332 GOODWILL AND OTHER INTANGIBLE ASSETS Goodwill 52,792 19,816 Trademarks and other intangible assets, net 35,701 4,347 ------------ ------------ NET GOODWILL AND OTHER INTANGIBLE ASSETS 88,493 24,163 OTHER NON-CURRENT ASSETS 3,379 2,703 ------------ ------------ TOTAL ASSETS $ 136,522 $ 61,527~~

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~~LIABILITIES AND SHAREHOLDERS' EQUITY~~

~~CURRENT LIABILITIES Accounts payable $ 3,904 $ 3,802 Accrued and other liabilities 9,496 7,531 Taxes payable 2,497 2,265 Debt due within one year 4,608 11,441 ------ ------ ------------ TOTAL CURRENT LIABILITIES 20,505 25,039 LONG-TERM DEBT 31,394 12,887 DEFERRED INCOME TAXES 13,911 1,896 OTHER NON-CURRENT LIABILITIES 4,298 3,230 ------- ----- ------------ TOTAL LIABILITIES 70,108 43,052 SHAREHOLDERS' EQUITY Preferred stock 1,469 1,483 Common stock - shares issued - Dec 3 3,965.7 3,966 June 30 2,976.6 2,977 Additional paid-in capital 57,062 3,030 Reserve for ESOP debt retirement (1,273) (1,259) Accumulated other comprehensive income (1,557) (1,566) Treasury stock (27,002) (17,194) Retained earnings 33,749 31,004 ------------ ------------ TOTAL SHAREHOLDERS' EQUITY 66,414 18,475 ------------ ------------ TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY $~~

~~136,522 $ 61,527~~

~~See accompanying Notes to Consolidated Financial Statements~~

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS Six Months Ended Amounts in millions December 31 ------------------------- - 2005 2004 ----------- -----------

~~CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD $ 6,389 $ 4,232 OPERATING ACTIVITIES Net earnings 4,575 3,917 Depreciation and amortization 1,158 928 Share-based compensation expense 208 218 Deferred income taxes 271 345 Changes in: Accounts receivable (957) (387) Inventories 73 (582) Accounts payable, accrued and other liabilities (617) (490) Other operating assets and liabilities (96) (171) Other 131 185 ----------- ----------- TOTAL OPERATING ACTIVITIES 4,746 3,963 ----------- ----------- INVESTING ACTIVITIES Capital expenditures (1,029) (911) Proceeds from~~

~~asset sales 339 367 Acquisitions 249 (351) Change in investment securities 39 (111) ----------- ----------- TOTAL INVESTING ACTIVITIES (402) (1,006) ----------- ----------- FINANCING ACTIVITIES Dividends to shareholders (1,691) (1,335) Change in short-term debt (5,468) 50 Additions to long-term debt 15,412 3,041 Reductions of long-term debt (2,602) (1,565) Impact of stock options and other 510 217 Treasury purchases (9,032) (1,633) ----------- ----------- TOTAL FINANCING ACTIVITIES (2,871) (1,225) ----------- ----------- EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS (46) 437 CHANGE IN CASH AND CASH EQUIVALENTS 1,427 2,169 ----------- ----------- CASH AND CASH EQUIVALENTS, END OF PERIOD $ 7,816 $ 6,401~~

~~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 and six-month periods ended December 31, 2005 are not necessarily indicative 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 December 31, 2005 and 2004 was $2,474 million and $2,938 million, respectively. For the six months ended December 31, 2005 and 2004, total comprehensive income was $4,584 million and $5,096 million, respectively. 3. Segment Information - Following is a summary of segment results. As noted in footnote 4, the Company acquired The Gillette Company on October 1, 2005. Accordingly, results of the acquired Gillette businesses are only included in segment results for the three months ended December 31, 2005.

SEGMENT
INFORMATION
Amounts in
millions Three
Months Ended
December 31 Six
Months Ended
December 31 ----

----- Earnings
Before Earnings
Before Net Sales
Income Taxes
Net Earnings Net
Sales Income
Taxes Net
Earnings ---------

------------- ----

- ~~Beauty 2005 $~~
~~5,370 $ 1,166 $~~
~~848 $ 10,359 $~~
~~2,244 $ 1,631~~
~~2004 5,022~~
~~1,139 794 9,677~~
~~2,122 1,468 -----~~

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~~Health Care 2005~~
~~2,639 635 427~~
~~4,722 1,136 763~~
~~2004 2,043 458~~
~~302 3,887 818~~
~~547 Baby Care &~~
~~Family Care 2005~~
~~3,036 521 330~~
~~6,035 1,031 650~~
~~2004 2,978 559~~
~~347 5,828 1,060~~
~~656~~ -------------

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~~Family Health~~
~~2005 5,675~~
~~1,156 757~~
~~10,757 2,167~~
~~1,413 2004~~
~~5,021 1,017 649~~
~~9,715 1,878~~
~~1,203 -----------~~
~~----------------~~
~~----------------~~
~~---- -----------~~
~~----------------~~
~~-----------~~
~~Fabric Care &~~
~~Home Care 2005~~
~~4,081 888 593~~
~~8,296 1,851~~
~~1,234 2004~~
~~3,784 814 550~~
~~7,594 1,691~~
~~1,135 Snacks &~~
~~Coffee 2005 927~~
~~144 95 1,633~~
~~252 168 2004~~
~~846 183 120~~
~~1,586 303 198 --~~
~~----------------~~
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~~-- -------------~~
~~----------------~~
~~--------~~
~~Household Care~~
~~2005 5,008~~
~~1,032 688 9,929~~
~~2,103 1,402~~
~~2004 4,630 997~~
~~670 9,180 1,994~~
~~1,333 -----------~~
~~----------------~~
~~----------------~~
~~---- -----------~~
~~----------------~~
~~-----------~~
~~Blades & Razors~~
~~2005 1,153 375~~
~~272 1,153 375~~
~~272 2004 - - - - -~~
~~- Duracell &~~
~~Braun 2005~~
~~1,279 243 165~~
~~1,279 243 165~~
~~2004 - - - - - - - -~~
~~----------------~~
~~----------------~~
~~-- -------------~~
~~----------------~~
~~-------- Gillette~~
~~Business Unit~~
~~2005 2,432 618~~
~~437 2,432 618~~
~~437 2004 - - - - -~~

~~----------------- ----------------- ----------------- ----------------- ----------------- ------- Corporate 2005 (148) (311) (184) (347) (559) (308) 2004 (221) (316) (138) (376) (367) (87) ------- ----------------- ----------------- ----------------- ----------------- ---------------- Total 2005 $ 18,337 $ 3,661 $ 2,546 $ 33,130 $ 6,573 $ 4,575 2004 14,452 2,837 1,975 28,196 5,627 3,917 ----------- ----------------- ----------------- ----------------- ----------------- -----------~~

4. On October 1, 2005, we completed our acquisition of The Gillette Company. Pursuant to the acquisition agreement, which provided for the exchange of 0.975 shares of The Procter & Gamble Company common stock, on a tax-free basis, for each share of The Gillette Company, we issued 962 million shares of The Procter & Gamble Company common stock. The value of these shares was determined using the average of Company stock prices beginning two days before and ending two days after January 28, 2005, the date the acquisition was announced. We also issued 79 million stock options in exchange for Gillette's outstanding stock options. Under the purchase method of accounting, the total consideration was approximately $53.5 billion including common stock, the fair value of vested stock options and acquisition costs. The acquisition is reflected in our consolidated financial statements beginning in the three months ended 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 The Gillette Company during its most recent year ended December 31, 2004 were $10.5 billion. In order to obtain regulatory approval of the transaction, we were required to divest certain overlapping businesses. We completed the divestitures of the Spinbrush toothbrush business and Rembrandt, a Gillette oral care product line during the three months ended December 31, 2005. We will also divest Right Guard, a Gillette deodorant and will make Soft & Dri and Dry Idea, Gillette deodorant brands, available for purchase by the Right Guard buyer. In connection with the Gillette acquisition, we also announced a share buyback plan to acquire $18 to $22 billion of Company common stock in the open market or from private transactions. We have now narrowed the anticipated total repurchase to about $20 billion of Company common stock. Through December 31, 2005, we repurchased $12.0 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. We are in the process of obtaining independent appraisals for the purpose of allocating the purchase price to the individual assets acquired and liabilities assumed. This will result in potential adjustments to the carrying value of Gillette's recorded assets and liabilities, the establishment of certain additional intangible assets, revisions of the useful lives of intangible assets, some of which will have indefinite lives not subject to amortization, and the determination of any residual amount that will be allocated to goodwill. The preliminary allocation of the purchase price included in the current period balance sheet is based on the best estimates of management and is subject to revision based on final determination of asset fair values and useful lives. The related depreciation and amortization expense from the acquired assets is also subject to such revisions. We are also in the process of completing our analysis of integration plans, pursuant to which the Company will incur costs primarily related to the elimination of selling, general and administrative overlap between the two companies in areas like Global Business Services, corporate staff, and go-to-market support. Our preliminary estimate of the exit costs for these activities relating to the acquired Gillette business that have been recognized as an assumed liability is $1.1 billion. The following table presents the preliminary allocation of purchase price related to the Gillette business as of the date of acquisition (amounts in millions). Current assets $ 5,145 Property, plant and equipment 3,825 Goodwill 33,151 Intangible assets 31,519 Other non-current assets 915 --- Total assets acquired $ 74,555 --- Current liabilities 5,028 Non-current liabilities 16,070 Total liabilities assumed 21,098 --- Net assets acquired $ 53,457 --- The majority of the goodwill has been preliminarily allocated to the segments comprising the Gillette businesses (Blades & Razors, Duracell & Braun, Health Care and Beauty) A portion of the goodwill has been preliminarily

allocated to the other segments on the basis that certain cost synergies will benefit these businesses. See Note 5 for the preliminary allocation of goodwill to the segments. We have preliminarily estimated the fair value of Gillette's identifiable intangible assets as $31,519 million. The preliminary allocation of identifiable intangible assets is as follows (amounts in millions): Average Estimated Remaining Fair Value Useful Life ---------- ----------- Asset Class: Brand Intangibles - indefinite lived $ 23,589 Indefinite Brand Intangibles - definite lived 2,932 16 years Technology 3,735 14 years Customer Relationships 1,263 24 years -------- $ 31,519 The majority of this intangible valuation relates to brand intangibles. Our preliminary assessment as to brand intangibles that have an indefinite life and those that have a definite life was based on a number of factors, including competitive environment, market share, brand history, product life cycles, operating plan and the macroeconomic environment of the countries in which the brands are sold. The indefinite-lived brand intangibles include Gillette, Duracell, Oral B and Braun. The definite-lived brand intangibles comprise of certain global brand sub-names such as Mach 3 and Sensor in the blades and razors business and other regional or local brands. The definite-lived brand intangibles have asset lives ranging from 5 to 20 years. The technology intangibles are concentrated in the blades and razors and oral care businesses. The customer relationships intangibles have asset lives ranging from 20 to 30 years based on the very low historical and projected customer attrition rates among major retailers and distributors. The following table provides pro forma results of operations for the six months ended December 31, 2005 and 2004 and for the three months ended December 31, 2004 as if Gillette had been acquired as of the beginning of each fiscal year presented. The pro forma results include certain purchase accounting adjustments such as the estimated changes in depreciation and amortization expense on acquired tangible and intangible assets. However, pro forma results do not include any anticipated cost savings or other effects of the planned integration of Gillette. Accordingly, such amounts are not necessarily indicative of the results that would have occurred if the acquisition had occurred on the dates indicated or that may result in the future (amounts in millions). Six Months Ended Three Months Ended December 31 December 31 ------------------ ------------------ 2005 2004 2004 ------------------ ------------------ Net Sales $ 35,913 $ 33,995 $ 17,560 Net Earnings 4,763 4,691 2,332 Diluted Net Earnings per Common Share $ 1.33 $ 1.25 $ 0.62 5. Goodwill and Other Intangible Assets - Goodwill as of December 31, 2005 is allocated by reportable segment and global business unit as follows (amounts in millions): Six Months Ended December 31, 2005 ------------------------- Total Beauty, beginning of year $ 14,580 Acquisitions & divestiture 3,137 Translation & other (111) Goodwill, December 31, 2005 17,606 Health Care, beginning of year 3,378 Acquisitions & divestiture 4,087 Translation & other (5) Goodwill, December 31, 2005 7,460 Baby Care & Family Care, beginning of year 955 Acquisitions & divestiture 1,056 Translation & other 7 Goodwill, December 31, 2005 2,018 Total Family Health, beginning of year 4,333 Acquisitions & divestiture 5,143 Translation & other 2 Goodwill, December 31, 2005 9,478 Fabric Care & Home Care, beginning of year 644 Acquisitions & divestiture 1,383 Translation & other (2) Goodwill, December 31, 2005 2,025 Snacks & Coffee, beginning of year 259 Acquisitions & divestiture 285 Translation & other (1) Goodwill, December 31, 2005 543 Total Household Care, beginning of year 903 Acquisitions & divestiture 1,668 Translation & other (3) Goodwill, December 31, 2005 2,568 Blades & Razors, beginning of year - Acquisitions & divestiture 18,922 Translation & other - Goodwill, December 31, 2005 18,922 Duracell & Braun, beginning of year - Acquisitions & divestiture 4,218 Translation & other - Goodwill, December 31, 2005 4,218 Total Gillette Business Unit, beginning of year - Acquisitions & divestiture 23,140 Translation & other - Goodwill, December 31, 2005 23,140 Goodwill, Net, beginning of year 19,816 Acquisitions & divestiture 33,088 Translation & other (112) Goodwill, December 31, 2005 $ 52,792 The increase in goodwill from June 30, 2005 is primarily due to the preliminary allocation of the purchase price relating to the acquisition of The Gillette Company. Identifiable intangible assets as of December 31, 2005 are comprised of (amounts in millions): Gross Carrying Accumulated Amount Amortization ------------------------------ Amortizable intangible assets with determinable lives $ 10,242 $ 925 Intangible assets with indefinite lives 26,384 - ------------------------------ Total identifiable intangible assets $ 36,626 $ 925 ------------------------------ Amortizable intangible assets consist principally of patents, technology and trademarks. The non-amortizable intangible assets consist primarily of trademarks. The amortization of intangible assets for the three and six months ended December 31, 2005 was $187 million and $236 million, respectively. 6. 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. Total share-based compensation for the three months and six months ended December 31, 2005 and 2004 can be found in the following table (amounts in millions):

	Three Months Ended December 31		Six Months Ended December 31	
	2005	2004	2005	2004
Share-Based Compensation				
Stock Options	$ 104	$ 88	$ 177	$ 170
Other Share-Based Awards	9	8	31	48
Total Share-Based Compensation	$ 113	$ 96	$ 208	$ 218

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. 7. Postretirement Benefits - The Company offers various postretirement benefits to its employees. The components of net periodic benefit cost are as follows: Amounts in millions

	Pension Benefits		Other Retiree Benefits	
	Three Months Ended December 31		Three Months Ended December 31	
	2005	2004	2005	2004
~~Service Cost~~	~~$ 73~~	~~$ 40~~	~~$ 24~~	~~$ 17~~
~~Interest Cost~~	~~106~~	~~60~~	~~46~~	~~37~~
~~Expected Return on Plan Assets~~	~~(101)~~	~~(46)~~	~~(94)~~	~~(84)~~
~~Amortization of Prior Service Cost and Prior Transition Amount~~	~~2~~	~~2~~	~~(4)~~	~~(6)~~
~~Recognized Net Actuarial Loss~~	~~18~~	~~8~~	~~-~~	~~-~~
~~Gross Benefit Cost~~	~~98~~	~~64~~	~~(28)~~	~~(36)~~
~~Dividends on ESOP Preferred Stock~~	~~-~~	~~-~~	~~(19)~~	~~(18)~~
~~Net Periodic Benefit Cost~~	~~$ 98~~	~~$ 64~~	~~$ (47)~~	~~$ (54)~~

	Pension Benefits		Other Retiree Benefits	
	Six Months Ended December 31		Six Months Ended December 31	
	2005	2004	2005	2004
Service Cost	$ 120	$ 78	$ 48	$ 34
Interest Cost	167	118	85	73
Expected Return on Plan Assets	(148)	(89)	(184)	(167)
Amortization of Prior Service Cost and Prior Transition Amount	4	3	(9)	(11)
Recognized Net Actuarial Loss	37	16	1	-
Gross Benefit Cost	180	126	(59)	(71)
Dividends on ESOP Preferred Stock	-	-	(38)	(36)
Net Periodic Benefit Cost	$ 180	$ 126	$ (97)	$ (107)

In 2005, the expected return on plan assets is 7.3% and 9.3% for defined benefit and other retiree benefit plans, respectively. 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 December 31, 2005 Results of Operations - Six Months Ended December 31, 2005 Business Segment Discussion (three and six months ended December 31, 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 are included in the Financial Statements and Management's Discussion and Analysis for the three months ended December 31, 2005. In order to provide our investors with more insight into the results of the Blades & Razors and Duracell & Braun reporting segments, we have previously provided supplemental pro forma net sales and earnings data for these segments for each of the quarters in the Gillette Company's year ended June 30, 2005 (as presented in our Form 8-K released October 4, 2005). Management's discussion of the current quarter results of these two segments is in relation to such comparable prior year pro forma net sales and earnings data. 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 four global business units: P&G Beauty, P&G Family Health, P&G Household Care, and Gillette. Under U.S. Generally Accepted Accounting Principles, we have seven reportable segments: Beauty, Health Care, Baby Care & Family Care, Fabric Care & Home Care, Snacks & Coffee, Blades & Razors, and Duracell & Braun. 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 business segment for the six months ended December 31, 2005 (excludes net sales and net earnings in Corporate): Net Sales Net Earnings Beauty 31% 33% Family Health: 32% 29% Health Care 14% 16% Baby Care and Family Care 18% 13% Household Care: 30% 29% Fabric Care and Home Care 25% 25% Snacks and Coffee 5% 4% Gillette Business Unit: 7% 9% Blades and Razors 3% 6% Duracell and Braun 4% 3% ------------------ ---- ---- Total 100% 100% Note: Calculations above are based on only 3 months of Gillette results (October - December) The following table provides the percentage of net sales and net earnings by business segment for the three months ended December 31, 2005 (excludes net sales and net earnings in Corporate): Net Sales Net Earnings Beauty 29% 31% Family Health: 31% 28% Health Care 14% 16% Baby Care and Family Care 17% 12% Household Care: 27% 25% Fabric and Home Care 22% 22% Snacks and Coffee 5% 3% Gillette Business Unit: 13% 16% Blades and Razors 6% 10% Duracell and Braun 7% 6% ------------------ ---- ---- Total 100% 100% SUMMARY OF RESULTS. Following are highlights of results for the six months ended December 31, 2005: o Unit volume increased 17 percent. Organic volume, which excludes the impact of acquisitions and divestitures, increased seven percent. Growth was broad-based with every business unit and every geographic region delivering organic volume increases. o Net sales increased 17 percent to $33.13 billion. Organic sales, which exclude the impacts of foreign exchange, acquisitions, and divestitures, increased seven percent. o Net earnings increased 17 percent to $4.58 billion behind strong organic growth and the addition of the Gillette business, partially offset by increased commodity costs and acquisition-related expenses. o Diluted net earnings per share were $1.48, an increase of four percent versus the comparable prior year period. o Operating cash flow was $4.75 billion, an increase of 20 percent versus the prior year period. Free cash flow productivity was 81 percent. 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 Company's acquisition of The Gillette Company, including the ability to achieve the cost and growth synergies in accordance with the stated goals of the transaction and (ii), the Domination and Profit Transfer Agreement with Wella; (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 DECEMBER 31, 2005 -- The following discussion provides a review of results for the three months ended December 31, 2005 versus the three months ended December 31, 2004.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES (Amounts in Millions Except Per Share Amounts) Consolidated Earnings Information Three Months Ended December 31 -- 2005 2004 % CHG -- ~~NET SALES $ 18,337 $ 14,452 27 % COST OF PRODUCTS SOLD 8,732 6,885 27 % -- GROSS MARGIN 9,605 7,567 27 % SELLING, GENERAL & ADMINISTRATIVE EXPENSE 5,713 4,585 25 % -- OPERATING INCOME 3,892 2,982 31 % TOTAL INTEREST EXPENSE 299 200 OTHER NON-OPERATING INCOME, NET 68 55 -- EARNINGS BEFORE INCOME TAXES 3,661 2,837 29 % INCOME TAXES 1,115 862 NET EARNINGS 2,546 1,975 29 %~~

~~EFFECTIVE TAX RATE 30.5% 30.4 % PER COMMON SHARE: BASIC NET EARNINGS $ 0.76 $ 0.77 (1)% DILUTED NET EARNINGS $ 0.72 $ 0.72 0 % DIVIDENDS $ 0.28 $ 0.25 AVERAGE DILUTED SHARES OUTSTANDING 3,547.0 2,752.1 COMPARISONS AS A % OF NET SALES ------------------------------- Basis Pt Chg COST OF PRODUCTS SOLD 47.6 % 47.6 % - GROSS MARGIN 52.4 % 52.4 % - SELLING, GENERAL & ADMINISTRATIVE EXPENSE 31.2 % 31.7 % (50) OPERATING MARGIN 21.2 % 20.6 % 60 EARNINGS BEFORE INCOME TAXES 20.0 % 19.6 % 40 NET EARNINGS 13.9 % 13.7 % 20~~

Unit volume increased 27 percent during the December quarter driven by the addition of the Gillette business as well as organic volume growth. Organic volume, which excludes the impact of acquisitions and divestitures from year-over-year comparisons, increased six percent. Every business segment except Snacks and Coffee, which was impacted by Hurricane Katrina, delivered mid-single digit or higher organic volume growth. In addition, each of the Company's geographic regions delivered organic growth, with developing regions growing organic volume in the mid-teens. Net sales for the quarter increased 27 percent to $18.34 billion. Organic sales, which exclude acquisitions, divestitures and foreign exchange impacts, grew eight percent. Foreign exchange had a negative two percent impact on sales growth. Pricing and mix each had a positive one percent impact on sales growth.

Volume Net Sales ----------------------------- -- With Without Acquisitions Acquisitions Total & & Mix/ Total Impact Divestitures Divestitures FX Price Other Impact Ex-FX ----------------------------- --- ~~BEAUTY 9% 5% -2% 0% 0% 7% 9% FAMILY HEALTH HEALTH CARE 31% 8% -1% 1% -2% 29% 30% BABY CARE~~

~~AND FAMILY CARE 5% 5% -2% 1% -2% 2% 4% HOUSEHOLD CARE FABRIC CARE AND HOME CARE 7% 7% -2% 2% 1% 8% 10% SNACKS AND COFFEE 3% 3% -1% 9% -1% 10% 11% GILLETTE BUSINESS UNIT BLADES AND RAZORS N/A N/A N/A N/A N/A N/A N/A DURACELL AND BRAUN N/A N/A N/A N/A N/A N/A N/A TOTAL COMPANY 27% 6% -2% 1% 1% 27% 29% Note: Sales percentage changes are approximations based on quantitative formulas that are consistently applied * Figures include Gillette results for the October - December quarter only~~

Gross margin was 52.4 percent, flat versus the prior year period. The addition of the Gillette business added approximately 75 basis points to gross margin due to higher margins in the Blades and Razors segment, net of approximately 35 basis points of increased product costs from revaluing Gillette's opening inventory balances to fair value as of the acquisition date. The gross margin decline in our other businesses was caused primarily by higher commodity costs, which hurt gross margin by about 150 basis points in the quarter. Scale leverage, costs savings initiatives and pricing partially offset the increase in commodity costs. Total Selling, general, and administrative expenses (SG&A) increased 25%, or $1.13 billion, during the quarter versus the prior year period. The addition of Gillette drove approximately $1.0 billion of the total increase in the quarter, including approximately $200 million of acquisition related expenses. The acquisition related expenses were comprised of $135 million due to increased intangible asset amortization resulting from revaluing intangible assets in the opening balance sheet of the acquired Gillette business. The balance of the acquisition related expenses was due to incremental integration and overhead expenses such as legal and consulting fees. Total SG&A also increased due to higher marketing and overhead spending on our base businesses (total company excluding Gillette and acquisition related expenses), although both were lower as a percentage of sales. Marketing spending increased in support of new initiatives across key brands including Tide, Crest, Olay, Pantene, Naturella, and LaCoste. SG&A decreased as percentage of sales by 50 basis points. Sales growth and the mix benefits of adding the Gillette businesses more than offset the impact of acquisition related expenses. Interest expense for the quarter increased $99 million versus the prior year period driven by the financing cost of the previously announced share repurchase program associated with the Gillette acquisition. We repurchased $3.5 billion of P&G stock during the quarter as part of this program. This brings the cumulative value of shares purchased under the program to $12.0 billion. Net earnings increased 29 percent to $2.55 billion. Earnings growth was driven by organic growth, the addition of Gillette, and an improvement in SG&A as a percentage of sales, partially offset by commodity-driven increases in product costs. The contribution from Gillette was net of increased interest expense, higher costs from revaluing Gillette's opening asset balances to fair value as of the acquisition date and other one-time integration costs. Diluted net earnings per share were $0.72, in-line with comparable prior year period results. Earnings per share included an estimated $0.06-$0.07 cents per share of dilution related to the Gillette acquisition. The dilution estimate includes $0.03 of one-time charges, including costs from revaluing Gillette's opening inventory balances to fair value as of the acquisition date. RESULTS OF OPERATIONS - Six Months Ended December 31, 2005 The following discussion provides a review of results for the six months ended December 31, 2005 versus the six months ended December 31, 2004.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES (Amounts in Millions Except Per Share Amounts) Consolidated Earnings Information Six Months Ended December 31 --- 2005 2004 % CHG --- ~~NET SALES $ 33,130 $ 28,196 17% COST OF PRODUCTS SOLD 15,891 13,508 18% --- GROSS MARGIN 17,239 14,688 17% SELLING, GENERAL & ADMINISTRATIVE EXPENSE 10,290 8,917 15% --- OPERATING INCOME 6,949 5,771 20% TOTAL INTEREST EXPENSE 518 381 OTHER NON-OPERATING INCOME, NET 142 237 --- EARNINGS BEFORE INCOME TAXES 6,573 5,627 17% INCOME TAXES 1,998 1,710 NET EARNINGS $ 4,575 $ 3,917 17%~~

~~EFFECTIVE TAX RATE 30.4 % 30.4 % PER COMMON SHARE: BASIC NET EARNINGS $ 1.57 $ 1.52 3 % DILUTED NET EARNINGS $ 1.48 $ 1.42 4 % DIVIDENDS $ 0.56 $ 0.50 AVERAGE DILUTED SHARES OUTSTANDING 3,098.0 2,759.1 COMPARISONS AS A % OF NET SALES ------------------------------ Basis Pt Chg COST OF PRODUCTS SOLD 48.0 % 47.9 % 10 GROSS MARGIN 52.0 % 52.1 % (10) SELLING, GENERAL & ADMINISTRATIVE EXPENSE 31.1 % 31.6 % (50) OPERATING MARGIN 21.0 % 20.5 % 50 EARNINGS BEFORE INCOME TAXES 19.8 % 20.0 % (20) NET EARNINGS 13.8 % 13.9 % (10)~~

Fiscal year to date, unit volume increased 17 percent. Organic volume, which excludes the impact of acquisitions and divestitures, increased seven percent. Growth was broad-based across businesses and geographies. Every business segment except Snacks and Coffee, which was impacted by Hurricane Katrina, delivered mid-single digit or higher organic volume growth. In addition, each of the Company's regions delivered organic growth led by double-digit growth in developing regions. For the first six months of the fiscal year, net sales increased 17 percent to $33.13 billion driven by the addition of the Gillette business as well as growth on the base P&G businesses. Organic sales, which exclude the impact of acquisitions and divestitures, increased seven percent. Favorable product mix, resulting largely from the addition of the Gillette business offset the mix impact of disproportionate growth in developing regions where average selling price is lower than the global average. Pricing activity in Health Care, Baby and Family Care, Fabric and Home Care, and Snacks and Coffee had a positive one percent impact on sales growth. Foreign exchange was neutral during the period.

Volume Net Sales --------- --------------- ----- ---------- --------------- ------------- With Without Acquisitions Acquisitions Total & & Mix/ Total Impact Divestitures Divestitures FX Price Other Impact Ex-FX --------------- -------------- - ---------------

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~~BEAUTY 8% 6% -1% 0% 0% 7% 8% FAMILY HEALTH HEALTH CARE 21% 10% 0% 1% -1% 21% 21% BABY CARE AND FAMILY CARE 5% 6% 0% 1% -2% 4% 4% HOUSEHOLD CARE FABRIC CARE AND HOME CARE 7% 7% 0% 2% 0% 9% 9% SNACKS AND COFFEE -1% -1% -1% 7% -2% 3% 4% GILLETTE BUSINESS UNIT BLADES AND RAZORS N/A N/A N/A N/A N/A N/A N/A DURACELL AND BRAUN N/A N/A N/A N/A N/A N/A N/A TOTAL COMPANY 17% 7% 0% 1% 0% 18% 18% Note: Sales percentage changes are approximations based on quantitative formulas that are consistently applied * Figures include Gillette results for the October - December quarter only~~

Gross margin was 52.0 percent fiscal year to date, a 10 basis point decrease versus the comparable base period. Adding the Gillette business added approximately 40 basis points to gross margin due to higher margins in the Blades and Razors segment, net of approximately 20 basis points of increased product costs from revaluing Gillette's opening inventory balances to fair value as of the acquisition date. Gross margin on the Company's base businesses declined by approximately 50 basis points driven by higher commodity costs, which negatively impacted gross margin by about 130 basis points. Scale benefits of volume growth, price increases and cost savings programs partially offset the increase in commodity costs. Total Selling, general, and administrative expenses (SG&A) increased 15%, or $1.37 billion, fiscal year to date versus the prior year period. The addition of Gillette drove approximately $1.0 billion of the total increase in the period, including approximately $200 million of acquisition related expenses. The acquisition related expenses were comprised of $135 million due to increased intangible asset amortization resulting from revaluing intangible assets in the opening balance sheet of the acquired Gillette business. The balance of the acquisition related expenses was due to incremental integration and overhead expenses such as legal and consulting fees. Total SG&A also increased due to higher marketing and overhead spending on our base businesses (total company excluding Gillette and acquisition related expenses), although both were lower as a percentage of sales. SG&A decreased as percentage of sales by 50 basis points. Sales growth and the mix benefits of adding the Gillette businesses more than offset the impact of acquisition related expenses. Interest expense increased fiscal year to date by $137 million versus the prior year period driven by the financing cost of the previously announced share repurchase program associated with the Gillette acquisition. The Company repurchased $9.0 billion of P&G stock fiscal year to date under this program, bringing cumulative repurchases under the program to $12.0 billion since January 2005. Net earnings increased 17 percent to $4.58 billion behind organic growth, the impact of adding the Gillette business, and improved SG&A as a percentage of sales, partially offset by increased commodity costs. Diluted net earnings per share increased four percent to $1.48 compared during the period. BUSINESS SEGMENT DISCUSSION -------------------------- The following discussion provides a review of results by business segment. An analysis of the results for the three and six months ended December 31, 2005 is provided compared to the same three and six month periods ended December 31, 2004. The primary financial measures used to evaluate segment performance are net sales and net earnings. The table below provides supplemental information on net earnings by business segment for the three and six months ended December 31, 2005 versus the comparable prior year period:

Three Months Ended December 31, 2005 -- Earnings % Change Before % Change % Change Net Versus Income Versus Net Versus Sales Year Ago Taxes Year Ago Earnings Year Ago -- ~~BEAUTY $ 5,370 7% $1,166 2% $848 7% HEALTH CARE 2,639 29% 635 39% 427 41% BABY CARE AND FAMILY CARE 3,036 2% 521 -7% 330 -5%~~ ------------------------------

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~~FAMILY~~
~~HEALTH~~
~~5,675 13%~~
~~1,156 14%~~
~~757 16%~~
~~FABRIC~~
~~CARE AND~~
~~HOME CARE~~
~~4,081 8% 888~~
~~9% 593 8%~~
~~SNACKS~~
~~AND~~
~~COFFEE 927~~
~~10% 144 -~~
~~21% 95 -20%~~
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~~HOUSEHOLD~~
~~CARE 5,008~~
~~8% 1,032 3%~~
~~688 3%~~
~~BLADES~~
~~AND~~
~~RAZORS~~
~~1,153 N/A 375~~
~~N/A 272 N/A~~
~~DURACELL~~
~~AND BRAUN~~
~~1,279 N/A 243~~
~~N/A 165 N/A~~
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~~GILLETTE~~
~~BUSINESS~~
~~UNIT 2,432~~
~~N/A 618 N/A~~
~~437 N/A~~
~~TOTAL~~
~~BUSINESS~~
~~SEGMENT~~
~~18,485 26%~~
~~3,972 26%~~
~~2,730 29%~~
~~CORPORATE~~
~~(148) N/A~~
~~(311) N/A~~
~~(184) N/A ----~~
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~~TOTAL COMPANY 18,337 27% 3,661 29% 2,546 29%~~
Six Months Ended December 31, 2005 -- Earnings % Change Before % Change % Change Net Versus Income Versus Net Versus Sales Year Ago Taxes Year Ago Earnings Year Ago --
~~BEAUTY $10,359 7% $2,244 6% $1,631 11%~~
~~HEALTH CARE 4,722 21% 1,136 39% 763 40%~~
~~BABY CARE AND FAMILY CARE 6,035 4% 1,031 -3% 650 -1% --~~
~~FAMILY HEALTH 10,757 11% 2,167 15% 1,413 17%~~
~~FABRIC CARE AND HOME CARE 8,296 9% 1,851 9% 1,234 9%~~
~~SNACKS~~

~~AND COFFEE 1,633 3% 252 -17% 168 -15%~~ ~~--~~

~~HOUSEHOLD CARE 9,929 8% 2,103 5% 1,402 5%~~

~~BLADES AND RAZORS 1,153 N/A 375 N/A 272 N/A~~

~~DURACELL AND BRAUN 1,279 N/A 243 N/A 165 N/A~~ ~~--~~

~~GILLETTE BUSINESS UNIT 2,432 N/A 618 N/A 437 N/A~~

~~TOTAL BUSINESS SEGMENT 33,477 17% 7,132 19% 4,883 22%~~

~~CORPORATE (347) N/A (559) N/A (308) N/A~~ ~~--~~

~~TOTAL COMPANY 33,130 17% 6,573 17% 4,575 17%~~

* Figures include Gillette results for the October - December quarter only BEAUTY ------ Beauty volume increased nine percent during the quarter, including the addition of Gillette Personal Care. Organic volume, which excludes the impact of acquisitions and divestitures, increased five percent. Skin Care delivered double digit volume growth behind product innovations including Olay Regenerist and Total Effects Cleansing. The Feminine Care business delivered volume growth in the upper-single digits behind Always softness innovations, scent line extensions, Naturella expansion, and continued growth of Tampax Pearl. Retail Hair Care volume was up mid-single digits. Growth in developing regions and in hair colorants behind innovations on Koleston, Wellaton, and Nice n' Easy was partially offset by a volume decrease in developed regions resulting primarily from the discontinuation of minor shampoo brands in the US. Cosmetics volume declined in the mid-single digits versus a base period that included pipeline shipments ahead of a major initiative launch. Net sales increased seven percent to $5.37 billion, including a negative two percent foreign exchange

impact. Net earnings increased seven percent to $848 million. Volume growth was partially offset by higher commodity costs and increased marketing investments to support initiative programs, primarily in developing regions. Beauty volume increased eight percent fiscal year to date, including three months of results of Gillette Personal Care. Organic volume, which excludes acquisitions and divestitures, increased six percent, led by double digit organic growth in developing regions. Volume growth was driven by initiative activity on Pantene, Head & Shoulders, Rejoice, Olay, Always, and Naturella. Net sales increased seven percent to $10.36 billion including a negative one percent foreign exchange impact. Net earnings increased 11 percent to $1.63 billion. Volume growth was partially offset by higher commodity costs and increased marketing investments to support initiative programs, primarily in developing regions. FAMILY HEALTH ------------- Health Care delivered 31 percent volume growth in the quarter, including the addition of Gillette Oral Care. Organic volume, which excludes acquisitions and divestitures, increased eight percent. Volume increases on our base business were driven by Pharmaceuticals and Personal Health behind continued growth on Actonel and Prilosec OTC. Oral Care also grew behind Crest, which delivered double-digit organic volume growth, net of the impact of the Spinbrush divestiture required in order to obtain regulatory approval of the Gillette acquisition. Growth on Crest was driven by share increases in North America and continued strength in developing markets. Net sales increased 29 percent to $2.64 billion behind organic volume growth as well as the addition of Gillette Oral Care. Pricing had a positive one percent impact on sales growth from prior period increases on Actonel and Prilosec OTC. Foreign exchange had a negative one percent impact on sales growth. Product mix reduced sales by two percent due primarily to the impact of adding Gillette Oral Care, which has a lower average selling price than the balance of the segment, and the impact of disproportionate growth in developing regions, where average selling prices are lower than the balance of the segment. Net earnings increased 41 percent to $427 million behind volume growth, including the addition of Gillette Oral Care, and margin expansion on P&G's base business. Margins expanded primarily due to scale benefits of volume growth, favorable product mix and pricing. Fiscal year to date, Health Care volume increased 21 percent, including three months of Gillette Oral Care results. Organic volume, which excludes the impact of acquisitions and divestitures, increased 10 percent behind double digit growth in Pharmaceuticals and Personal Health and upper-single digit organic growth in Oral Care. Net sales grew 21 percent to $4.72 billion. Pricing on Actonel and Prilosec OTC had a positive one percent impact on sales. This was offset by a negative one percent mix impact due to adding Gillette Oral Care, which has a lower average selling price than the segment average, and the impact of disproportionate growth in developing regions, where average selling prices are lower than the balance of the segment. Organic sales, which exclude the impact of acquisitions and divestitures, increased 11 percent. Net earnings increased 40 percent to $763 million behind organic volume growth, the addition of Gillette Oral Care, and margin expansion on the base P&G business. Margins expanded primarily due to scale benefits of volume growth, favorable product mix and pricing. Baby Care and Family Care delivered volume growth of five percent during the quarter. Volume increased behind product initiatives such as Pampers Full Motion in Western Europe and Bounty and Charmin "Basic," as well as double digit growth in developing markets. Baby Care volume declined in developed regions due to high levels of competitive pricing activity in North America. Net sales increased two percent to $3.04 billion, including a negative two percent foreign exchange impact. Pricing added one percent to sales growth, but was offset by a negative two percent product mix impact from growth in developing markets and Bounty and Charmin "Basic," both of which have lower relative sales prices than the segment average. Net earnings declined five percent to $330 million versus the base period. Earnings in the quarter were negatively impacted by the increase in energy costs that followed the hurricanes last September and reduced volume in North America Baby Care, both of which also contributed to the decline in the segment's earnings margin. Baby Care and Family Care volume increased five percent fiscal year to date. Organic volume, which excludes the impact of acquisitions and divestitures, increased six percent. Volume increased in both Baby Care and Family Care behind product initiatives and double digit growth in developing regions. Net sales increased four percent to $6.04 billion. Pricing had a positive one percent impact on sales but was offset by a negative two percent mix impact due to growth in mid-tier Basic products and disproportionate growth in developing regions. Net earnings declined one percent to $650 million as volume growth and pricing were offset by increased energy costs and unfavorable product mix. HOUSEHOLD CARE -------------- Fabric Care and Home Care delivered volume growth of seven percent for the quarter. Volume was driven by innovations such as Tide with Febreze, Tide Coldwater, Ariel Ion Power Gels, Cascade Action Packs, Febreze Air Effects and the expansion of Bold in Japan coupled with very strong customer support behind key initiatives. Fabric Care grew volume in the upper-single digits behind double digit global growth on Tide. Net sales increased eight percent to $4.08 billion, including a negative two percent foreign exchange impact. Pricing in the Fabric Care and Home Care businesses added two points to sales growth. Favorable product mix, primarily due to disproportionate growth on Tide, added an additional one point to sales growth. Net earnings increased eight percent to $593 million. Earnings growth reflects top line progress, as well as cost savings and pricing to mitigate commodity price increases. Fiscal year to date, Fabric Care and Home Care volume increased seven percent behind innovations on Tide, Ariel, Dawn, Febreze, Downy, and Cascade. Net sales increased nine percent to $8.30 billion. Pricing, primarily in North America and Latin America, added two points to sales growth. Net earnings increased nine percent to $1.23 billion. Volume growth, pricing, and cost savings programs more than offset increased commodity costs. Snacks and Coffee results were impacted by Hurricane Katrina, which occurred in August 2005. The business experienced significant disruption and damages to our manufacturing facilities in New Orleans. Beginning in December, these facilities were fully operational. Snacks and Coffee volume grew three percent in the quarter, as a mid-single digit decline in Coffee volume partially offset growth in other businesses. Snacks volume was up mid-single digits. Sales were $927 million, an increase of 10 percent. Pricing actions taken in the prior year in response to rising coffee prices added 9 percent to sales, which was partially offset by 1 percent each from negative product mix and foreign exchange. Earnings declined 20% to $95 million, as sales growth was offset by increased costs related to Hurricane Katrina and negative product mix. Fiscal year to date, Snacks and Coffee volume declined one percent. Lower Coffee shipments following the hurricane more than offset growth in other businesses. Snacks volume was up mid-single digits in the period. Net sales increased three percent to $1.63 billion, including a negative one percent foreign exchange impact. Pricing in Coffee added seven percent to sales. The mix effect of lower Coffee shipments had a negative two percent impact on sales. Earnings declined 15 percent to $168 million as sales growth was offset by negative product mix and increased costs, primarily related to Hurricane Katrina. ACQUIRED GILLETTE REPORTED SEGMENTS ----------------------------------- As disclosed in note 4 to the consolidated financial statements, we completed the acquisition of The Gillette Company on October 1, 2005. This acquisition resulted in two new reportable segments for the Company: Blades and Razors and Duracell and Braun. The Gillette Oral Care and Personal Care businesses were subsumed within the Health Care and Beauty reportable segments, respectively. Because the acquisition was completed in the current period, there are no results for these segments in our prior year period. In order to provide our investors with more insight into the results of the Blades & Razors and Duracell & Braun reporting segments, we have previously provided supplemental pro forma net sales and earnings data for these segments for each of the quarters in the Gillette Company's year ended June 30, 2005 (as presented in our Form 8-K released October 4, 2005). Management's discussion of the current quarter results of these two segments is in relation to such comparable prior year pro forma net sales and earnings data. With respect to the earnings data, this analysis is based on Earnings before Income Taxes. The previously disclosed Blades & Razors and Duracell & Braun pro forma information reconciled "Profit from Operations," the measure used by Gillette in its historical filings, to Earnings before Income Taxes, the comparable measure used by the Company. Gillette did not allocate income tax expense to its reporting segments. Blades and Razors sales increased six percent to $1.15 billion over the pro forma prior year quarter. Positive pricing of two percent offset a negative two percent foreign exchange impact. Sales growth was driven by M3Power, Venus Vibrance, and Venus Disposables as well as continued consumer trade-up in developing markets. Earnings before income taxes increased 11 percent to $375 million versus previously published pro forma prior year results. Earnings increased behind sales, a more profitable product mix of replacement blades versus razors, price increases and lower overhead and manufacturing expenses, primarily as a result of savings realized from Gillette's Functional Excellence program. Earnings growth was also favorably impacted by base period charges for severance and other exit charges associated with Gillette's Functional Excellence program, the European Manufacturing Realignment program, and other asset write-downs. These earnings drivers were partially offset by acquisition-related expenses in the current period of $116 million (before-tax), including increased amortization expense from revaluing acquired fixed and intangible assets and increased product costs from revaluing opening inventory balances at fair value. Reported net earnings for the segment were $272 million. Duracell and Braun delivered one percent sales growth to $1.28 billion during the quarter. Volume growth was offset by a negative two percent impact from foreign exchange. A price increase on Duracell had a positive impact on segment sales, but was more than offset by a year-on-year increase in total promotion expenses in the segment; the net impact of pricing on segment sales was negative one percent. Duracell pricing in the U.S. continues to trend upwards following the list price increase taken in August 2005 and the roll-out across trade accounts. Duracell sales increased behind share growth, while Braun sales were driven by new product initiatives such as 360 Complete, Tassimo, and Contour. Earnings before income taxes increased 46 percent to $243 million versus previously published pro forma prior year results. Earnings growth was driven primarily by volume as well as lower overhead and manufacturing costs, primarily resulting from the Functional Excellence program. Earnings growth was also favorably impacted by base period charges for severance and other exit charges associated with Gillette's Functional Excellence program as well as other asset write-downs. These earnings drivers were partially offset by acquisition-related expenses in the current period of $43 million (before tax), including increased amortization expense from revaluing acquired fixed and intangible assets and increased product costs from revaluing opening inventory balances at fair value. Reported net earnings for the segment were $165 million. We expect earnings before income taxes growth indices to moderate in the second half of the fiscal year versus the quarter ended December 31, 2005. This is primarily due to the lapping of the Functional Excellence program benefits coupled with increased investments behind the Fusion blade system launch. CORPORATE --------- Corporate includes certain operating and non-operating activities not allocated to specific business units. These include: the incidental businesses managed at the corporate level, financing and investing activities, certain restructuring charges, other general corporate items and the historical results of certain divested categories, including the juice business that was divested in August of 2004 and the Gillette brands (primarily Rembrandt and Right Guard) that will be divested as required by the Gillette acquisition. Corporate also includes reconciling items to adjust the accounting policies used in the segments to U.S. GAAP. The most significant reconciling items include income taxes (to adjust from statutory rates that are reflected in the segments to the overall Company effective tax rate), adjustments for unconsolidated entities (to eliminate sales, cost of products sold and SG&A for entities that are consolidated in the segments but accounted for using the equity method for U.S. GAAP) and minority interest adjustments for subsidiaries where we do not have 100% ownership. Because both unconsolidated entities and less than 100 percent owned subsidiaries are managed as integral parts of the Company, they are accounted for similar to a wholly-owned subsidiary for management and segment purposes. This means our segment results recognize 100 percent of each income statement component through before-tax earnings in the segments, with eliminations in Corporate. In determining segment net earnings, we apply the statutory tax rates (with adjustments to arrive at the Company's effective tax rate in Corporate) and eliminate the share of earnings applicable to other ownership interests, in a manner similar to minority interest. The decline in net earnings for the quarter and year to date is primarily driven by the impact of the base period gain on the sale of the juice business and a current period increase in net interest expense due to the financing cost of the share repurchase program announced in connection with the Gillette acquisitions. FINANCIAL CONDITION ------------------- Operating Activities -------------------- Cash generated from operating activities for the six months ended December 31, 2005 was $4.75 billion versus $3.96 billion in the comparable prior period. Strong earnings, adjusted for non-cash items (primarily depreciation, amortization, stock-based compensation, and deferred income taxes) generated $6.46 billion. This was partially offset by an increase in working capital items, primarily accounts receivable and accounts payable. Accounts receivable increased to support business growth. Days sales in receivables were flat versus the comparable prior year period. Accounts payable, accrued, and other liabilities days were down largely due to our continued efforts to accelerate payments to suppliers in order to maximize payment discounts. Inventory days on hand were down marginally resulting in a slight improvement to cash flow. Investing Activities -------------------- Investing activities in the current year decreased cash by $402 million, compared to the prior year period when investing activities reduced cash by $1.01 billion. Acquisitions provided a net source of cash. A cash balance of $1.60 billion received in the Gillette acquisition, representing Gillette's cash balances at the acquisition date, was partially offset by cash used for other acquisitions, including settlement of a major portion of the Wella domination liability. Capital expenditures as a percentage of sales were 3.1 percent, in-line with the comparable prior year period. Financing Activities ------------------- Total cash used by financing activities was $2.87 billion versus $1.23 billion in the comparable base period. Our net debt position increased by $7.34 billion, primarily to fund the share repurchase program associated with the acquisition of Gillette. This was offset by $9.03 billion of treasury purchases during the period. 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 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 for the October - December 2005 quarter: Total P&G ----- Total Sales Growth 27% Foreign Exchange Impact 2% Acquisition/Divestiture Impact -21% ----- Organic Sales Growth 8% The reconciliation of reported sales growth to organic sales for the fiscal year to date period ended December 31, 2005: Total P&G

----- Total Sales Growth 17% Foreign Exchange Impact 0% Acquisition/Divestiture Impact -10% ----- Organic Sales Growth 7% 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 '05 2,171 401 1,770 2,029 87% Oct - Dec '05 2,575 628 1,947 2,546 76% --- Jul - Dec '05 4,746 1,029 3,717 4,575 81% 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 Officer, A. G. Lafley, and the Company's Chief Financial Officer, Clayton Daley, Jr., are responsible for evaluating the effectiveness of our disclosure controls systems. Messrs. Lafley and Daley have evaluated and 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. On October 1, 2005, the Company completed its acquisition of The Gillette Company ("Gillette"), at which time Gillette became a subsidiary of the Company. The Company considers the transaction material to the results of its operations, financial position, and cash flows from the date of the acquisition through December 31, 2005, and believes that the internal controls and procedures of Gillette have a material effect on the Company's internal control over financial reporting. See Note 4 to our Consolidated Financial Statements included in Item 1 for discussion of the acquisition and related financial data. The Company is now in the process of integrating the Gillette operations. The Company has extended its Section 404 compliance program under the Sarbanes-Oxley Act of 2002 and the applicable rules and regulations under such Act to include Gillette. The Company will report on its assessment of its combined operations within the time period provided by the Act and the applicable Securities Exchange Commission rules and regulations concerning business combinations. Except for the Gillette acquisition, Messrs. Lafley and Daley have concluded that there has been no change in the Company's internal control over financial reporting for the quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. PART II. OTHER INFORMATION Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share(2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(3)	Approximate dollar value of shares that may yet be purchased under our share repurchase program ($ in Billions) (3),(4)
10/1/05-10/31/05	39,187,635	$56.59	39,160,912	9.2
11/1/05-11/30/05	13,603,137	$56.98	13,370,271	8.4
12/1/05-12/31/05	9,679,434	$55.85	8,475,474	8.0

(1) This category includes 1,463,549 shares acquired by the Company under various compensation and benefit plans, including The Gillette Company Global Employee Stock Ownership Program and The Procter & Gamble 2001 Stock and Incentive Compensation Plan. 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 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. We have now narrowed the anticipated total repurchase pursuant to this authority to about $20 billion of Company common stock. The share repurchases are expected to be largely completed by mid-calendar year 2006. (4) The share value in this category is now measured against the revised target as described in footnote 3 to this table, which remains within the authority of the previously announced buyback plan. Item 6. Exhibits Exhibits (3-1) Amended Articles of Incorporation (Incorporated by reference to Exhibit (3-1) of the Company's Form 10-Q for the quarter ended September 30, 2005). (3-2) Regulations (Incorporated by reference to Exhibit (3-2) of the Company's Form 10-Q for the

quarter ended September 30, 2005). (10-1) The Procter & Gamble Company Executive Deferred Compensation Plan* (10-2) The Gillette Company 1971 Stock Option Plan* (10-3) The Gillette Company 2004 Long-Term Incentive Plan* (10-4) Amended and Restated Employment Agreement, dated December 23, 2004, between The Gillette Company and James M. Kilts (Incorporated by reference to Exhibit 10-G of the Annual Report on Form 10-K filed by The Gillette Company for the year ended December 31, 2004, Commission File No. 1-922)* (10-5) Amendment No. 1 to the Amended and Restated Employment Agreement dated as of December 23, 2004, entered into as of January 27, 2005, between The Gillette Company and James M. Kilts (Incorporated by reference to Exhibit 10.2 of the Form 8-K filed by The Gillette Company on January 28, 2005, Commission File No. 1-922)* (10-6) Stock Option Agreement, dated January 19, 2001, between The Gillette Company and James M. Kilts, filed as Exhibit A to the Amended and Restated Employment Agreement between The Gillette Company and James M. Kilts (Incorporated by reference to Exhibit 10-G of the Annual Report on Form 10-K filed by The Gillette Company for the year ended December 31, 2004, Commission File No. 1-922)* (10-7) The Gillette Company Executive Life Insurance Program (Incorporated by reference to Exhibit 10(d) of the Annual Report on Form 10-K filed by The Gillette Company for the year ended December 31, 2000, Commission File No. 1-922) (10-8) The Gillette Company Personal Financial Planning Reimbursement Program (Incorporated by reference to Exhibit 10(o) of the Annual Report on Form 10-K filed by The Gillette Company for the year ended December 31, 2004, Commission File No. 1-922)* (10-9) The Gillette Company Senior Executive Financial Planning Program (Incorporated by reference to Exhibit 10(p) of the Annual Report on Form 10-K filed by The Gillette Company for the year ended December 31, 2004, Commission File No. 1-922)* (10-10) The Gillette Company Estate Preservation Plan* (10-11) The Gillette Company Deferred Compensation Plan (Incorporated by reference to Exhibit 10(t) of the Annual Report on Form 10-K filed by The Gillette Company for the year ended December 31, 2004, Commission File No. 1-922)* (11) Computation of Earnings per Share. (12) Computation of Ratio of Earnings to Fixed Charges. (31) Rule 13a-14(a)/15d-14(a) Certifications. (32) Section 1350 Certifications. * Compensatory plan or arrangement 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 January 30, 2006 ------------------------------- Date EXHIBIT INDEX Exhibit No. (3-1) Amended Articles of Incorporation (Incorporated by reference to Exhibit (3-1) of the Company's Form 10-Q for the quarter ended September 30, 2005). (3-2) Regulations (Incorporated by reference to Exhibit (3-2) of the Company's Form 10-Q for the quarter ended September 30, 2005). 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