PROCTER & GAMBLE CO
Form 10-Q
February 01, 2008

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, 2007

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to ___

Commission file number 1-434

THE PROCTER & GAMBLE COMPANY

(Exact name of registrant as specified in its charter)

Ohio (State of Incorporation)	31-0411980 (I.R.S. Employer Identification No.)
One Procter & Gamble Plaza, Cincinnati, Ohio (Address of principal executive offices)	45202 (Zip Code)

(513) 983-1100
Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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 3,077,498,216 shares of Common Stock outstanding as of December 31, 2007.

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 and six months ended December 31, 2007 and 2006, the Consolidated Balance Sheets as of December 31, 2007 and June 30, 2007, and the Consolidated Statements of Cash Flows for the six months ended December 31, 2007 and 2006 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

Amounts in millions	Three Months Ended December 31 2007	Three Months Ended December 31 2006	Six Months Ended December 31 2007	Six Months Ended December 31 2006
NET SALES	$ 21,575	$ 19,725	$ 41,774	$ 38,510
Cost of products sold	10,394	9,287	19,913	18,152
Selling, general and administrative expense	6,467	6,088	12,729	11,954
OPERATING INCOME	4,714	4,350	9,132	8,404
Interest expense	389	339	748	697
Other non-operating income, net	192	79	385	259
EARNINGS BEFORE INCOME TAXES	4,517	4,090	8,769	7,966
Income taxes	1,247	1,228	2,420	2,406
NET EARNINGS	$ 3,270	$ 2,862	$ 6,349	$ 5,560
PER COMMON SHARE:				
Basic net earnings	$ 1.04	$ 0.89	$ 2.02	$ 1.73
Diluted net earnings	$ 0.98	$ 0.84	$ 1.90	$ 1.63
Dividends	$ 0.35	$ 0.31	$ 0.70	$ 0.62
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	3,341.5	3,406.5	3,348.2	3,410.1

See accompanying Notes to
Consolidated Financial Statements

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

Amounts in Millions	December 31	June 30
ASSETS	2007	2007
CURRENT ASSETS		
Cash and cash equivalents	$ 5,349	$ 5,354
Investment securities	696	202
Accounts receivable	7,688	6,629
Inventories		
Materials and supplies	1,860	1,590
Work in process	619	444
Finished goods	5,211	4,785
Total inventories	7,690	6,819
Deferred income taxes	2,143	1,727
Prepaid expenses and other current assets	3,394	3,300
TOTAL CURRENT ASSETS	26,960	24,031
PROPERTY, PLANT AND EQUIPMENT		
Buildings	6,681	6,380
Machinery and equipment	28,513	27,492
Land	865	849
	36,059	34,721
Accumulated depreciation	(16,171)	(15,181)
NET PROPERTY, PLANT AND EQUIPMENT	19,888	19,540
GOODWILL AND OTHER INTANGIBLE ASSETS		
Goodwill	58,216	56,552
Trademarks and other intangible assets, net	34,168	33,626
NET GOODWILL AND OTHER INTANGIBLE ASSETS	92,384	90,178
OTHER NON-CURRENT ASSETS	5,169	4,265
TOTAL ASSETS	$ 144,401	$ 138,014
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 4,829	$ 5,710
Accrued and other liabilities	11,818	9,586
Taxes payable	1,263	3,382
Debt due within one year	13,569	12,039
TOTAL CURRENT LIABILITIES	31,479	30,717

LONG-TERM DEBT			23,528	23,375
DEFERRED INCOME TAXES			11,579	12,015
OTHER NON-CURRENT LIABILITIES			9,572	5,147
TOTAL LIABILITIES			76,158	71,254
SHAREHOLDERS' EQUITY				
Preferred stock			1,386	1,406
Common stock - shares issued -	Dec 31	3,997.8	3,998	
	June 30	3,989.7		3,990
Additional paid-in capital			59,712	59,030
Reserve for ESOP debt retirement			(1,318)	(1,308)
Accumulated other comprehensive income			2,466	617
Treasury stock			(43,648)	(38,772)
Retained earnings			45,647	41,797
TOTAL SHAREHOLDERS' EQUITY			68,243	66,760
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			$ 144,401	$ 138,014

See accompanying Notes to Consolidated Financial Statements

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

Amounts in millions	Six Months Ended December 31 2007	2006
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 5,354	$ 6,693
OPERATING ACTIVITIES		
Net earnings	6,349	5,560
Depreciation and amortization	1,503	1,489
Share-based compensation expense	242	289
Deferred income taxes	325	201
Changes in:		
Accounts receivable	(703)	(1,668)
Inventories	(589)	(486)
Accounts payable, accrued and other liabilities	(97)	8
Other operating assets and liabilities	126	(110)
Other	215	120
TOTAL OPERATING ACTIVITIES	7,371	5,403

INVESTING ACTIVITIES				
Capital expenditures		(1,184)		(1,239)
Proceeds from asset sales		747		135
Acquisitions		24		(139)
Change in investment securities		(502)		620
TOTAL INVESTING ACTIVITIES		(915)		(623)
FINANCING ACTIVITIES				
Dividends to shareholders		(2,267)		(2,045)
Change in short-term debt		1,163		9,873
Additions to long-term debt		5,038		7
Reductions of long-term debt		(6,129)		(12,488)
Impact of stock options and other		979		730
Treasury purchases		(5,481)		(2,713)
TOTAL FINANCING ACTIVITIES		(6,697)		(6,636)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		236		150
CHANGE IN CASH AND CASH EQUIVALENTS		(5)		(1,706)
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	5,349	$	4,987

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, 2007. The results of operations for the three-month and six-month period ended December 31, 2007 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 investment securities. Total comprehensive income for the three months ended December 31, 2007 and 2006 was $4,086 million and $3,513 million, respectively. For the six months ended December 31, 2007 and 2006, total comprehensive income was $8,199 million and $6,176 million, respectively.

3. Segment Information - Following is a summary of segment results. In May 2007, we announced a number of changes to our organization structure and certain of our key leadership positions. The changes became effective on July 1, 2007 and resulted in changes to our GBU and reporting segment structure. The businesses that previously comprised the Gillette GBU are now included within the Beauty and Household Care GBUs. The Braun business has been combined with the Blades and Razors business to form the Grooming reportable segment within the Beauty GBU. The Grooming reportable segment also includes all face and shave prep products which were previously reported within the Beauty reportable segment. Duracell was moved to our Household Care GBU and will be reported as part of our Fabric Care and Home Care reportable segment. Finally, our feminine care business, which previously was part of our Beauty GBU and reportable segment, is now part of our Health and Well-Being GBU and will be reported as part of the Health Care reportable segment. The following segment information reflects the new segment reporting structure.

SEGMENT INFORMATION

Amounts in millions

		Three Months Ended December 31			Six Months Ended December 31		
		Net Sales	Earnings Before Income Taxes	Net Earnings	Net Sales	Earnings Before Income Taxes	Net Earnings
Beauty GBU							
Beauty	2007	$ 5,137	$ 1,120	$ 883	$ 9,736	$ 2,004	$ 1,572
	2006	4,656	1,027	804	8,980	1,862	1,438
Grooming	2007	2,161	596	429	4,176	1,210	880
	2006	1,976	530	386	3,821	1,057	771
Health & Well-Being GBU							
Health Care	2007	3,772	1,056	715	7,331	2,036	1,363
	2006	3,407	960	648	6,743	1,838	1,241
Snacks, Coffee and Pet Care	2007	1,302	201	127	2,425	385	240
	2006	1,253	232	150	2,316	376	237

Household Care GBU							
Fabric Care and Home Care	2007	6,074	1,306	882	11,978	2,662	1,798
	2006	5,511	1,234	834	10,863	2,459	1,665
Baby Care and Family Care	2007	3,374	652	418	6,794	1,330	848
	2006	3,119	548	341	6,218	1,148	724
Corporate	2007	(245)	(414)	(184)	(666)	(858)	(352)
	2006	(197)	(441)	(301)	(431)	(774)	(516)
Total	2007	21,575	4,517	3,270	41,774	8,769	6,349
	2006	19,725	4,090	2,862	38,510	7,966	5,560

4. The Company acquired the Gillette Company in October 2005. At that time, we recognized an assumed liability for Gillette exit costs of $1.23 billion, including $854 million in separations related to approximately 5,500 people, $55 million in employee relocation costs and $320 million in other exit costs. These costs are 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, as well as redundant manufacturing capacity. As of December 31, 2007, the remaining liability was $515 million. Total integration plan charges against the assumed liability were $58 million for the three months ended December 31, 2007 and $126 million for the six months ended December 31, 2007. We expect such activities to be substantially complete by June 30, 2008.

5. Goodwill and Other Intangible Assets - Goodwill as of December 31, 2007 is allocated by reportable segment and global business unit as follows (amounts in millions):

BEAUTY GBU	Six Months Ended December 31, 2007
Beauty, beginning of year	$ 15,359
Acquisitions and divestitures	(50)
Translation and other	785
Goodwill, December 31, 2007	16,094
Grooming, beginning of year	24,211
Acquisitions and divestitures	(178)
Translation and other	790
Goodwill, December 31, 2007	24,823
HEALTH & WELL-BEING GBU	
Health Care, beginning of year	8,482
Acquisitions and divestitures	(38)
Translation and other	186
Goodwill, December 31, 2007	8,630
Snacks, Coffee and Pet Care, beginning of year	2,407
Acquisitions and divestitures	(3)
Translation and other	20
Goodwill, December 31, 2007	2,424

HOUSEHOLD CARE GBU		
Fabric Care and Home Care, beginning of year		4,470
Acquisitions and divestitures		(29)
Translation and other		135
Goodwill, December 31, 2007		4,576
Baby Care and Family Care, beginning of year		1,623
Acquisitions and divestitures		(31)
Translation and other		77
Goodwill, December 31, 2007		1,669
GOODWILL, Net, beginning of year		56,552
Acquisitions and divestitures		(329)
Translation and other		1,993
Goodwill, December 31, 2007	$	58,216

The increase in goodwill from June 30, 2007 is primarily due to currency translation.

Identifiable intangible assets as of December 31, 2007 are comprised of (amounts in millions):

	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets with determinable lives	$ 8,802	$ 2,299
Intangible assets with indefinite lives	27,665	-
Total identifiable intangible assets	$ 36,467	$ 2,299

Amortizable intangible assets consist principally of brands, patents, technology and customer relationships. The non-amortizable intangible assets consist primarily of brands.

The amortization expense of intangible assets for the three months ended December 31, 2007 and 2006 was $155 million and $168 million, respectively. For the six months ended December 31, 2007 and 2006, the amortization expense of intangible assets was $312 million and $331 million respectively.

6. Pursuant to SFAS 123(R) "Share-Based Payment", companies must 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).

Total share-based compensation for the three months and six months ended December 31, 2007 and 2006 are summarized in the following table (amounts in millions):

	Three Months Ended December 31		Six Months Ended December 31	
	2007	2006	2007	2006
Share-Based Compensation				
SFAS 123(R) Stock Options	$ 131	$ 129	$ 229	$ 259
Other Share-Based Awards	5	2	13	30
Total Share-Based Compensation	$ 136	$ 131	$ 242	$ 289

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 Three Months Ended December 31		Other Retiree Benefits Three Months Ended December 31	
	2007	2006	2007	2006
Service Cost	$ 69	$ 67	$ 24	$ 21
Interest Cost	136	118	56	51
Expected Return on Plan Assets	(139)	(111)	(107)	(101)
	4	3	-	(6)

Amortization of Deferred Amounts								
Recognized Net Actuarial Loss		5		11		(3)		-
Gross Benefit Cost		75		88		(30)		(35)
Dividends on ESOP Preferred Stock		-		-		(23)		(21)
Net Periodic Benefit Cost (Credit)	$	75	$	88	$	(53)	$	(56)

Amounts in millions	Pension Benefits Six Months Ended December 31		Other Retiree Benefits Six Months Ended December 31	
	2007	2006	2007	2006
Service Cost	$ 135	$ 133	$ 47	$ 41
Interest Cost	266	236	112	102
Expected Return on Plan Assets	(273)	(221)	(214)	(203)
Amortization of Deferred Amounts	7	6	-	(11)
Recognized Net Actuarial Loss	12	22	(7)	1
Gross Benefit Cost	$ 147	$ 176	$ (62)	$ (70)
Dividends on ESOP Preferred Stock	-	-	(46)	(42)
Net Periodic Benefit Cost (Credit)	$ 147	$ 176	$ (108)	$ (112)

For the year ending June 30, 2008, the expected return on plan assets is 7.4% and 9.3% for defined benefit and other retiree benefit plans, respectively.

8. New Accounting Standards

On July 1, 2007, we adopted FASB Interpretation 48, “Accounting for Uncertainty in Income Taxes” (FIN 48). FIN 48 addresses the accounting and disclosure of uncertain tax positions. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The difference between the tax benefit recognized in the financial statements for a position in accordance with FIN 48 and the tax benefit claimed in the tax return is referred to as an unrecognized tax benefit.

The adoption of FIN 48 resulted in a decrease to retained earnings as of July 1, 2007 of $232 million, which was reflected as a cumulative effect of a change in accounting principle, with a corresponding increase to the net liability for unrecognized tax benefits. The impact primarily reflects the accrual of additional statutory interest and penalties as required by FIN 48, partially offset by adjustments to existing unrecognized tax benefits to comply with FIN 48 measurement principles. The implementation of FIN 48 also resulted in a reduction in our net tax liabilities for uncertain tax positions related to prior acquisitions accounted for under purchase accounting, resulting in an $80 million decrease to goodwill. Additionally, the Company historically classified unrecognized tax benefits in current taxes payable. As a result of the adoption of FIN 48, unrecognized tax benefits not expected to be paid in the next 12 months were reclassified to other non-current liabilities.

The total amount of unrecognized tax benefits at July 1, 2007 is $2,971 million, excluding any related accruals for interest and penalties. Included in the total unrecognized tax benefits is $1,893 million that, if recognized, would impact the effective tax rate in future periods. We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. Accrued interest and penalties as of July 1, 2007 were $589 million and $128 million, respectively, on an after tax basis. At this time, we are not able to make a reasonable estimate of the amount of unrecognized tax benefits and related interests and penalties that are expected to be paid in the next 12 months. On an ongoing basis, adjustments will be made to the liability for unrecognized tax benefits to reflect the impact of audit developments, tax law changes, statute expirations, as well as for the accrual of additional current year tax exposures and for interest and penalties on existing liabilities.

P&G files income tax returns in multiple federal, state and local US and foreign jurisdictions. The Company is subject to examination by the taxing authorities in these jurisdictions, with open tax years generally ranging from 1997 and forward. The Company has on-going audits in various stages of completion in several jurisdictions, one or more of which might conclude within the next 12 months. Audit outcomes and the timing of audit settlements are subject to significant uncertainty at this time. Such settlements will involve some or all of the following: the payment of additional taxes, the adjustment of certain deferred taxes and/or the recognition of unrecognized tax benefits. It is possible that the amount of unrecognized benefit with respect to certain of our uncertain tax positions will significantly increase or decrease within the next twelve months related to the audits described above. At this time, we are not able to make a reasonable estimate of the range of impact on the balance of unrecognized tax benefits or the impact on the effective tax rate related to these items.

The unrecognized tax benefits described above will be included in the Company's annual Form 10-K contractual obligations table to the extent the Company is able to make reliable estimates of the timing of cash settlements with the respective taxing authorities. If not, the total amount of unrecognized tax benefits will be disclosed in a footnote to the contractual obligations table. At this time, the Company can not make a reliable estimate as to the timing of cash settlements.

In December 2007, the FASB issued SFAS 141 (Revised), Business Combinations (SFAS 141R) and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 141R and SFAS 160 revise the method of accounting for a number of aspects of business combinations and non-controlling interests, including acquisition costs, contingencies (including contingent assets, contingent liabilities and contingent purchase price), the impacts of partial and step-acquisitions (including the valuation of net assets attributable to non-acquired minority interests), and post acquisition exit activities of acquired businesses. SFAS 141R and SFAS 160 will be effective for the company during our fiscal year beginning July 1, 2009.

No other new accounting pronouncement issued or effective during the fiscal year had or is expected to have a material impact on the consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this discussion is to provide an understanding of P&G’s financial results and condition by focusing on changes in certain key measures from year to year. Management's Discussion and Analysis (MD&A) is organized in the following sections:

- Overview
- Summary of Results
- Forward-Looking Statements
- Results of Operations – Three Months Ended December 31, 2007
- Results of Operations – Six Months Ended December 31, 2007
- Business Segment Discussion – Three Months Ended December 31, 2007
- Business Segment Discussion – Six Months Ended December 31, 2007

- Financial Condition
- Reconciliation of Non-GAAP Measures

Throughout MD&A, we refer to measures used by management to evaluate performance, including unit volume growth, net outside sales and after-tax profit. We also refer to financial measures that are not defined under accounting principles generally accepted in the United States of America (U.S. GAAP), including organic sales growth, free cash flow and free cash flow productivity. The explanation of these measures at the end of MD&A provides more details on the use and the derivation of these measures. Management also uses certain market share and market consumption estimates to evaluate performance relative to competition despite some limitations on the availability and comparability of share information. References to market share and market consumption in MD&A are based on a combination of vendor-reported consumption and market size data, as well as internal estimates.

OVERVIEW

P&G's business is focused on providing branded consumer goods products. Our goal is to provide products of superior quality and value to improve the lives of the world's consumers. We believe this will result in leadership sales, profits and value creation, allowing employees, shareholders and the communities in which we operate to prosper.

Our products are sold in more than 180 countries primarily through mass merchandisers, grocery stores, membership club stores and drug stores. We have also expanded our presence in "high frequency stores," the neighborhood stores which serve many consumers in developing markets. We compete in multiple product categories and have three global business units (GBUs): Beauty; Health and Well-Being; and Household Care. Under U.S. Generally Accepted Accounting Principles, the business units comprising the GBUs are aggregated into six reportable segments: Beauty; Grooming; Health Care; Snacks, Coffee and Pet Care; Fabric Care and Home Care; and Baby Care and Family Care. We have on-the-ground 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 comprised of three developed regions (North America, Western Europe and Northeast Asia) and four developing regions (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 for the three months ended December 31, 2007 (excludes net sales and net earnings in Corporate):

	Net Sales	Net Earnings
Beauty GBU	34%	37%
Beauty	24%	25%
Grooming	10%	12%
Health and Well-Being GBU	23%	25%
Health Care	17%	21%
Snacks, Coffee and Pet Care	6%	4%