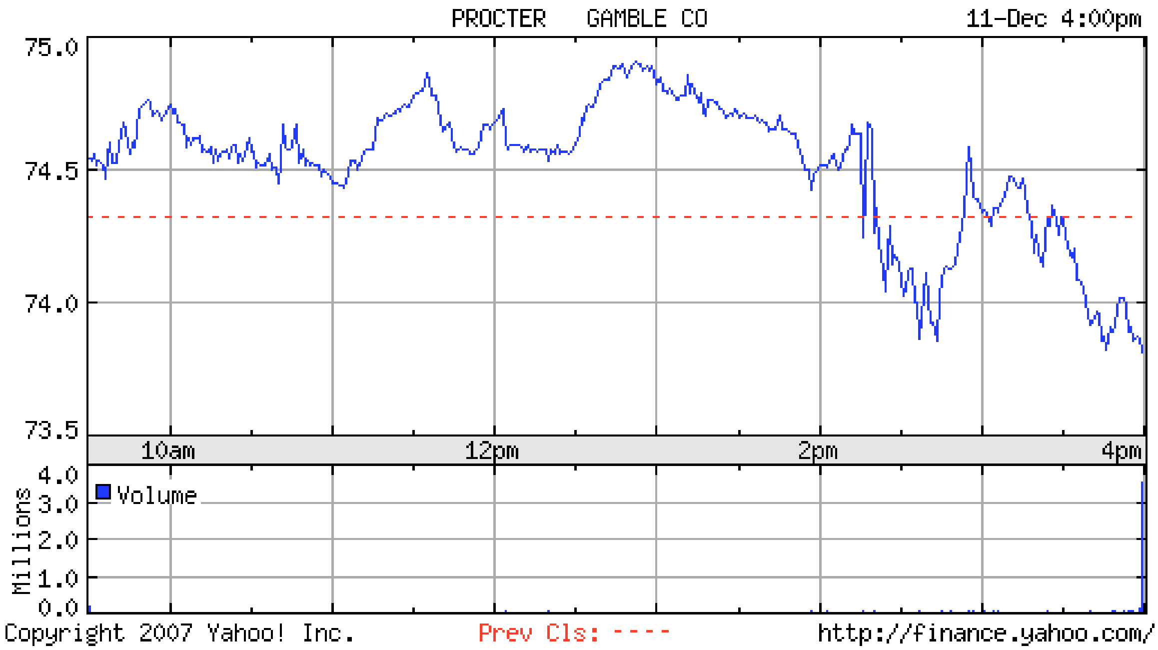
Proctor & Gamble (PG)



Symbol: PG
Exchange: NYSE
Industry: Personal & Household Products
Sector: Consumer Non-Cyclical
Purchase Price $43.43
Purchase Date November 2002
52week High $74.82
52week Low $60.42
Initial Floor 2 $74.26
Trailing Floor 3 $77.87
Beta 0.61
Market Cap $229.32 billion
Shares Outstanding 3.11 billion
Dividend Yield 1.90%
P/E Ratio 19.50
Competitor #1 Johnson & Johnson (JNJ)
Competitor #2 Colgate-Palmolive (CL)
Type of Security: Growth

Predicted Shareholder Return

1 year:	11.8%
Past 5 years:	13.3%
Past 10 years:	10.9%
Predicted Annual Return:	12.3%

Michael Porter developed a framework consisting of five competitive forces, which analyze how industry factors impacts a company's strategy. These factors are: the threat of new entrants, power of suppliers, power of buyers, availability of substitutes and competitive rivalry.

The sheer scale of products that are distributed under Procter & Gamble's name creates a challenge for new entrants. Since the Company has a significant amount of many market shares around the world, a company without the capital for heavy marketing or research and development, would hardly be able to compete. However, there is concern about firms that specialize in specific markets. This type of company could become a threat to P&G's corresponding business segment. Proctor and Gamble must continue to expand its operations internationally, due to the decline of the US dollar to other currencies and the emergence of new markets, such as India or China.

A codependent relationship exists between P&G and its suppliers. In order to generate above average revenues the Company needs various quality materials for product production at the best prices available. Suppliers of these materials also need key customers like P&G for profitable revenue generation but will most likely have little bargaining power because of its size. P&G can use its generous size and available cash to its advantage during the current credit crisis. Rising interest rates and the declining availability of credit should not affect P&G's relationship with its suppliers. The company's successful history and large market share can be used to back its borrowings, under the assumption that P&G continues to maintain its current market share.

Although P&G is a very large company, its future is dependent on buyers. Wal-Mart and affiliates represent 15% of the firm's total revenue in 2006. This percentage of total revenue gives Wal-Mart the ability to bargain with the Company for lower prices, which would result in lower earnings. The current credit crisis will not have a significant impact on P&G because of the diversity and "recession-proof" status of its products. The products that P&G offers can sustain a slowdown or recession in the US economy because of the their product types. Consumers will continue to purchase these goods through an economic correction. While P&G had disappointing 2nd quarter earnings due to higher commodity costs, analysts reported strong sales forecasts and growth opportunities.

There are considerable substitutes for all of P&G's product offerings, creating an intense competitive environment. In order to differentiate itself, the firm must continue to provide new, innovative products and branding to the customer. P&G notes that working collaboratively with customers and developing deep shopper and consumer understanding will improve the in-store presence of its products and win the "first moment of truth." This happens when customers choose which brands to buy. Winning the "second moment of truth," when consumers decide whether P&G products deliver on the brand promise, is essential for growth in such a competitive environment.

P&G has a presence in a variety of industries; Personal Goods, Household, Paper, Healthcare, and Food products. Companies in all of these industries are always fighting for their share of the market. Currently, the firm is a leader in numerous markets. The release of P&G's 2007 1Q Earnings report illustrated that the firm has a 40% share of the U.S. shampoo market and a 61% share of the U.S. laundry detergent market. This diversity in product development allows P&G to sustain cyclical economic events, such as the current credit crisis, because their products are spread out over different sectors.

Also, the type of products they sell are considered "recession-proof," in that they will continue to sell despite a slowdown in consumers markets because of their nature (personal health, food, etc).

To keep its current percentages of market share, P&G needs to place high priority on continued growth and research and product development activities. Marketing strategies and brand name awareness will set the Company apart from its competitors. An important growth factor is the implementation of their products to internationally emerging markets. This is for two reasons: Markets, such as India, are taking to American culture and consumerism and provide a budding market for US retailers. The decline of the US dollar to foreign currencies makes international trading promising due to the changeover of exchange rates. Growth in foreign markets will provide P&G with strong revenue, along with its "recession-proof" products available to American consumers.

According to the Company's Form-8K, the Company's annual financial targets are outlined through 2010:

- Organic sales growth of 4% to 6%. This is comprised of:
- 3% to 5% pre-Gillette organic sales target, plus
- 1% of growth acceleration through 2010 behind revenue synergies associated with the Gillette acquisition.
- Diluted net earnings per share (EPS) growth of 10% or better, excluding the net impact of Gillette dilution.
- Free cash flow productivity of 90% or greater (defined as the ratio of operating cash flow less capital expenditures to net earnings).

In order to achieve these targets, P&G focuses on its core strengths of consumer understanding, branding, innovation, go-to-market capability and global scale and scope against the following growth areas:

- Grow leading brands in our biggest markets and with winning customers.
- Shift portfolio mix to faster-growing businesses with higher gross margins that are less asset-intensive.
- Grow disproportionately in developing markets and with lower-income consumers.

Add to Management of Major Risks

If the reputation of one or more of our leading brands erodes significantly, it could have a material impact on our financial results .

PG's financial success is dependent on the success of its brands, particularly its billion-dollar brands. The success of these brands can suffer if marketing plans or product initiatives do not have the desired impact on a brand's image or its ability to attract consumers. The Company's results could be impacted if one of its leading brands suffers a substantial impediment to its reputation due to real or perceived quality issues.

A material change in customer relationships or in customer demand for our products could have a significant impact on our business.

PG's success is dependent on its ability to successfully manage relationships with our retail trade customers. PG's business could suffer if it cannot reach agreement with a key customer based on its own trade terms and principles. Further, there is a continuing trend towards retail trade consolidation and this leads to more complex work across broader geographic boundaries for both PG and key retailers. PG's business would be negatively impacted if a key customer were to significantly reduce the range or inventory level of its products.

Analysis of 3rd Quarter Earnings Conference Call

On Oct. 31st 2006, P&G held an earnings conference call to discuss its recently released 2007 3Q earnings, which ended on September 30th 2006. Chairman, President and CEO A.G. Lafley, CFO Clayt Daley, and Treasurer Jon Goodwin were present to a give a formal presentation on the Company's earnings and answer questions from analysts. Clayt Daley announced that P&G is off to a strong first quarter. The following are highlights of results for the three months ended September 30, 2007:

- Net sales grew eight percent to $20.2 billion.
  - Organic sales, which exclude the impacts of acquisitions, divestitures and foreign exchange, increased five percent.
- Unit volume increased five percent.
  - Every reportable segment and each of our geographic regions delivered year-on-year volume growth.
- Net earnings increased 14 percent to $3.1 billion.
  - Net earnings increased behind sales growth, operating profit margin improvement and a one-time tax benefit.
- Diluted net earnings per share were $0.92, an increase of 16 percent versus the comparable prior year period.
  - This included a $0.02 per share, or two percent, benefit from a one-time tax benefit incurred during the quarter.
- Operating cash flow was $3.2 billion, an increase of nine percent versus the prior year period.
  - Free cash flow productivity was 87 percent for the quarter, roughly in-line

with the year-ago period.

- Free cash flow productivity is defined as the ratio of operating cash flow less capital expenditures to net earnings.

	Net Sales	Net Earnings
Beauty GBU	32 %	35 %
Beauty	22 %	21 %
Grooming	10 %	14 %
Health and Well-Being GBU	22 %	24 %
Health Care	17 %	20 %
Snacks, Coffee and Pet Care	5 %	4 %
Household Care GBU	46 %	41 %
Fabric Care and Home Care	29 %	28 %
Baby Care and Family Care	17 %	13 %

Review of Business Segments:

Beauty

- Beauty net sales increased six percent during the quarter to $4.6 billion. Sales increased behind two percent volume growth, a one percent positive product mix impact from disproportionate growth in prestige fragrances and three points of favorable foreign exchange.
- In skin care, volume was up low-single digits as high-single digit growth in developing regions more than offset lower developed market volumes from the impact of a base period in North America that included the launch of Olay Definity.
- Hair care volume was also up low-single digits as high-single digit growth in developing regions more than offset a low-single digit volume decline in developed regions due to the timing of promotion and initiative activity in North America. Hair care market share in the US increased by nearly two points during the quarter.
- Net earnings in Beauty increased nine percent to $689 million primarily behind higher sales growth.

Grooming

- Grooming net sales increased nine percent to $2.0 billion during the quarter.
- Sales were up behind five percent volume growth, a positive one percent pricing impact and a four percent favorable foreign exchange impact.
- Blades and razors volume increased high-single digits behind growth in developing regions exceeding 20%. Market share in the U.S. was up four points on Fusion and two points on Venus behind the Venus Breeze launch.
- Braun volume was down mid-single digits for the quarter primarily due to

lower home appliances shipments resulting from shipment constraints in Western Europe and a de-emphasis of the home appliances business in the U.S.

- Net earnings in Grooming were up 17% for the quarter to $451 million behind sales growth and a 150-basis point earnings margin expansion.

Health Care

- Health Care net sales increased seven percent during the quarter to $3.6 billion behind a four percent increase in volume.
- Feminine care volume increased mid-single digits behind double-digit growth in developing regions.
- Oral care volume was up low-single digits behind high-single digit growth in developing regions
- Volume in pharmaceuticals and personal health was in-line with the year-ago period as the impact of adding the Swiss Precision Diagnostics business was offset by lower bas business shipments on the remaining categories.
- Net earnings in Health Care were up nine percent to $648 million behind sales growth and gross margin improvement.

Snacks, Coffee and Pet Care

- Snacks, Coffee and Pet Care net sales increased six percent to $1.1 billion during the quarter.
- Snacks volume was up double-digits behind the launch of Rice Infusion in Western Europe.
- Coffee volume increased mid-single digits behind the launch of Folgers Black Silk, Folgers House Blend and Dunkin' Donuts coffee.
- In pet care, volume was down due to continued negative impacts from the voluntary wet pet food recall in the U.S. last fiscal year.
- Net earnings in Snacks, Coffee and Pet Care increased 30% to $113 million as a result of sales growth, an insurance recovery related to Hurricane Katrina and lower overhead and marketing spending as a percentage of net sales.

Fabric Care and Home Care

- Fabric Care and Home Care net sales increased 10 percent to $5.9 billion. Volume was up eight percent and favorable foreign exchange added three percent to sales growth.
- Fabric care volume increased high-single digits behind the initial wave of the liquid laundry detergent compaction launch in North America and the launch of Tide Pure Essentials.
- Home care volume was up double-digits for the quarter behind the Dawn restage in North America, the launch of Febreze candles and continued expansion of auto-dishwashing products in Western Europe.
- Batteries volume was up mid-single digits behind double-digit volume growth in developing regions.

- Net earnings in Fabric Care and Home Care increased 10 percent to $916 million.

Baby Care and Family Care

- Baby Care and Family Care net sales increased 10 percent to $3.4 billion behind eight percent volume growth and a three percent favorable foreign exchange impact.
- Baby care volume in developed regions was up mid-single digits behind growth on Pampers Baby Stages of Development and on the Baby Dry caterpillar flex initiative.
- Family care volume was up behind the Charmin product restage and continued growth on the Basic product tier.
- Net earnings in Baby Care and Family Care were up 12 percent to $430 million behind sales growth and a 50-basis point improvement in before-tax profit margin.

Principal Executives – Options Exercised

Mr. Alan Lafley , 60
Exec. Chairman, Chief Exec. Officer and Pres
Pay $ 7.80M
Exercised $ 3.12M

Mr. Clayton C. Daley Jr., 56
Vice Chairman and Chief Financial Officer
Pay: $ 2.54M
Exercised: $ 208.00K

Mr. Robert A. McDonald , 54
Chief Operating Officer
Pay: N/A
Exercised: N/A

Ms. Susan E. Arnold , 53
Pres of Global Bus. Units
Pay: $ 2.55M
Exercised: $136.00K

Mr. Fabrizio Freda , 50
Pres of Global Snacks
Pay: N/A
Exercised: N/A

NET SHARE PURCHASE ACTIVITY

Insider Purchases - Last 6 Months (Thompson Financial)

	Shares	Trans

Purchases	N/A	0
Sales	134,919	10
Net Shares Purchased (Sold)	(134,919)	10
Total Insider Shares Held	3.17M	N/A
% Net Shares Purchased (Sold)	(4.1%)	N/A

Net Institutional Purchases - Prior Qtr to Latest Qtr

	Shares
Net Shares Purchased (Sold)	(7,707,710)
% Change in Institutional Shares Held	(0.4%)

Analyst Recommendations

Date	Research Firm	Action	From	To
11/29/07	Credit Suisse	Initiated		Neutral
10/25/07	Wachovia	Initiated		Outperform
10/8/07	Sun Trust R. H.	Downgrade	Buy	Neutral
8/28/07	BMO Cap. Mrkts.	Initiated		Outperform
7/7/07	Lehman Bros.	Downgrade	Overweight	Equal-Weight
6/8/07	Bernstein	Initiated		Outperform
3/22/07	Bear Stearns	Upgrade	Peer Perform	Outperform
3/15/07	CIBC Wrld Mrkts	Upgrade	Sector Perform	Sector Outperform
1/17/07	Goldman Sachs	Upgrade	Neutral	Buy
11/20/06	HSBC Securities	Upgrade	Neutral	Overweight

PRICE TARGET SUMMARY (Thompson/First Call)

Mean Target:
78.00
Median Target:
78.00
High Target:
90.00

Low Target:
70.00
No. of Brokers:
14

Professional Funds

BREAKDOWN

% of Shares Held by All Insider and 5% Owners: 0%
% of Shares Held by Institutional & Mutual Fund Owners: 59%
% of Float Held by Institutional & Mutual Fund Owners: 59%
Number of Institutions Holding Shares: 1388

TOP INSTITUTIONAL HOLDERS

Holder	Shares	% Out	Value*	Reported
Barclays Global	116,142,060	3.74	$8,169,432,500	30-Sep-07
BERKSHIRE	105,847,000	3.41	$7,445,277,980	30-Sep-07
STATE STREET	98,841,648	3.18	$6,952,521,520	30-Sep-07
VANGUARD	90,126,317	2.90	$6,339,485,137	30-Sep-07
FMR Corp.	85,188,923	2.74	$5,992,188,843	30-Sep-07
AXA	55,067,980	1.77	$3,873,481,713	30-Sep-07
NY Mellon Corp.	52,953,959	1.71	$3,724,781,476	30-Sep-07
NORTHERN	48,496,501	1.56	$3,411,243,880	30-Sep-07
JANUS CAPITAL	43,221,075	1.39	$3,040,170,415	30-Sep-07
BANK OF AMER.	36,586,958	1.18	$2,573,526,625	30-Sep-07

TOP MUTUAL FUND HOLDERS

Holder	Shares	% Out	Value*	Reported
VANGUARD 500	29,715,732	.96	$1,818,306,008	30-Jun-07
FIDELITY	22,608,170	.73	$1,590,258,677	30-Sep-07
VANGUARD TOTAL	18,584,349	.60	$1,137,176,315	30-Jun-07
COLLEGE*	18,290,909	.59	$1,119,220,721	30-Jun-07
VANGUARD Inst.	16,818,250	.54	$1,029,108,717	30-Jun-07
SPDR TRUST	15,179,574	.49	$940,829,996	30-Sep-06
FIDELITY GROWTH	11,700,000	.38	$822,978,000	30-Sep-07
LORD ABBETT	9,459,567	.30	$585,168,814	31-Jul-07
VANGUARD/Well.	9,132,375	.29	$596,435,411	31-Aug-07
DAVIS NEW YORK	8,803,000	.28	$544,553,580	31-Jul-07

* = College RETIREMENT EQUITIES FUND-STOCK ACCOUNT

Macroeconomic Review & Stock Market

Proctor & Gamble must incorporate its product diversity, size, and growth potential in the upcoming fiscal quarters. The current credit crisis in the US, which stemmed from adjustable-rate mortgages, plays a certain role in P&G's strategy. The large size of P&G will shield the company from the effects of the credit crisis, such as higher interest rates and initial principal payments. Because of this, the Federal Reserve has cut the interest rate three times in the last three months in an effort to encourage banks to borrow more freely from the Fed at a time when there are worries that a rising number of bad loans will prompt banks to tighten credit conditions too severely, adding another strain on the already fragile economy. The stock market entered a euphoric state as stocks rose each time the fed cut the rate, before coming to a correction in late November. Creditors will be more willing to allow P&G to borrow based on their free cash, net income, and global market share. P&G can use this effect to maintain and expand into its growth opportunities as companies focus on repayment of credit, rather than inherent growth. Although P&G faced disappointing second quarter results due to higher commodity costs, analysts predicted good sales forecasts and strong growth prospects. P&G should be able to maintain its market share in the US despite an economic slowdown because the everyday products it sells that most US families rely on (healthcare, food, etc.) These products deem P&G a "recession-proof" company and can strongly face cyclical economic events. P&G has benefited from its global market and international sales because of the decline in the US dollar to foreign currencies. Its market shares in over 80 countries allow for a positive changeover rate from most nations as currency is turned over into American dollars. P&G can use this availability of credit and boost in international sales to further expand into emerging foreign markets, such as India, who provide beneficial growth opportunities for retail companies.

Sales Considerations

SMIP should consider selling this stock when one or more of the following conditions are met:

1. When there is a severe increase in costs due to inflation specific to these inputs.
2. When P&G is no longer able to increase prices to cover increasing costs.
3. When P&G begins to lose significant market share to competitors - represented by slower revenue growth compared to competitors.
4. When the stock reaches the initial or trailing floor.
5. When international growth slows down significantly.