PROCTER & GAMBLE Co
Form 10-Q
October 24, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2014
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	31-0411980
(State of Incorporation)	(I.R.S. Employer Identification Number)
One Procter & Gamble Plaza, Cincinnati, Ohio	45202
(Address of principal executive offices)	(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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 þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

There were 2,702,118,733 shares of Common Stock outstanding as of September 30, 2014.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

	Three Months Ended September 30	
Amounts in millions except per share amounts	2014	2013
NET SALES	$20,792	$20,830
Cost of products sold	10,552	10,574
Selling, general and administrative expense	6,327	6,136
Goodwill and indefinite-lived intangible asset impairment charges	973	—
OPERATING INCOME	2,940	4,120
Interest expense	169	165
Interest income	31	21
Other non-operating income, net	21	5
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	2,823	3,981
Income taxes on continuing operations	820	942
NET EARNINGS FROM CONTINUING OPERATIONS	2,003	3,039
NET EARNINGS FROM DISCONTINUED OPERATIONS	17	18
NET EARNINGS	2,020	3,057
Less: Net earnings attributable to noncontrolling interests	30	30
NET EARNINGS ATTRIBUTABLE TO PROCTER & GAMBLE	$1,990	$3,027
BASIC NET EARNINGS PER COMMON SHARE [(1)]:		
Earnings from continuing operations	$0.70	$1.08
Earnings from discontinued operations	0.01	0.01
BASIC NET EARNINGS PER COMMON SHARE	0.71	1.09
DILUTED NET EARNINGS PER COMMON SHARE [(1)]:		
Earnings from continuing operations	0.68	1.03
Earnings from discontinued operations	0.01	0.01
DILUTED NET EARNINGS PER COMMON SHARE	$0.69	$1.04
DIVIDENDS PER COMMON SHARE	$0.644	$0.602
Diluted Weighted Average Common Shares Outstanding	2,888.0	2,924.3

(1)Basic net earnings per share and diluted net earnings per share are calculated on net earnings attributable to Procter & Gamble.

See accompanying Notes to Consolidated Financial Statements.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME / (LOSS)

	Three Months Ended September 30	
Amounts in millions	2014	2013
NET EARNINGS	$2,020	$3,057
OTHER COMPREHENSIVE INCOME / (LOSS), NET OF TAX		
Financial statement translation	(2,836)	1,049
Hedges	408	(239)
Investment securities	(3)	14
Defined benefit retirement plans	282	(56)
TOTAL OTHER COMPREHENSIVE INCOME / (LOSS), NET OF TAX	(2,149)	768
TOTAL COMPREHENSIVE INCOME / (LOSS)	(129)	3,825
Less: Total comprehensive income attributable to noncontrolling interests	12	35
TOTAL COMPREHENSIVE INCOME / (LOSS) ATTRIBUTABLE TO PROCTER & GAMBLE	$(141)	$3,790

See accompanying Notes to Consolidated Financial Statements.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

Amounts in millions			September 30, 2014	June 30, 2014
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents			$ 7,486	$ 8,558
Available-for-sale investment securities			3,360	2,128
Accounts receivable			6,197	6,386
Inventories				
Materials and supplies			1,829	1,742
Work in process			739	684
Finished goods			4,532	4,333
Total inventories			7,100	6,759
Deferred income taxes			916	1,092
Prepaid expenses and other current assets			3,914	3,845
Assets held for sale			134	2,849
TOTAL CURRENT ASSETS			29,107	31,617
PROPERTY, PLANT AND EQUIPMENT, NET			21,799	22,304
GOODWILL			51,361	53,704
TRADEMARKS AND OTHER INTANGIBLE ASSETS, NET			30,210	30,843
OTHER NONCURRENT ASSETS			5,706	5,798
TOTAL ASSETS			$ 138,183	$ 144,266
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES				
Accounts payable			$ 8,280	$ 8,461
Accrued and other liabilities			9,554	8,999
Liabilities held for sale			9	660
Debt due within one year			14,228	15,606
TOTAL CURRENT LIABILITIES			32,071	33,726
LONG-TERM DEBT			19,004	19,811
DEFERRED INCOME TAXES			10,271	10,218
OTHER NONCURRENT LIABILITIES			10,008	10,535
TOTAL LIABILITIES			71,354	74,290
SHAREHOLDERS' EQUITY				
Preferred stock			1,102	1,111
Common stock – shares issued –	September 2014	4,009.2		
	June 2014	4,009.2	4,009	4,009
Additional paid-in capital			64,028	63,911
Reserve for ESOP debt retirement			(1,331)	(1,340)
Accumulated other comprehensive income/(loss)			(9,811)	(7,662)
Treasury stock			(77,149)	(75,805)
Retained earnings			85,207	84,990
Noncontrolling interest			774	762
TOTAL SHAREHOLDERS' EQUITY			66,829	69,976

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 138,183	$144,266

See accompanying Notes to Consolidated Financial Statements.

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

	Three Months Ended September 30	
Amounts in millions	2014	2013
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$8,558	$5,947
OPERATING ACTIVITIES		
Net earnings	2,020	3,057
Depreciation and amortization	794	771
Share-based compensation expense	81	84
Deferred income taxes	(15)	(11)
Gain on purchase/sale of businesses	(234)	(2)
Goodwill and indefinite lived intangibles impairment charges	973	—
Changes in:		
Accounts receivable	(101)	(3)
Inventories	(568)	(452)
Accounts payable, accrued and other liabilities	812	(809)
Other operating assets and liabilities	(316)	(731)
Other	187	140
TOTAL OPERATING ACTIVITIES	3,633	2,044
INVESTING ACTIVITIES		
Capital expenditures	(810)	(725)
Proceeds from asset sales	2,948	2
Acquisitions, net of cash acquired	(15)	1
Purchases of available-for-sale investment securities	(1,342)	—
Proceeds from sales of available-for-sale investment securities	101	—
Change in other investments	(440)	(124)
TOTAL INVESTING ACTIVITIES	442	(846)
FINANCING ACTIVITIES		
Dividends to shareholders	(1,806)	(1,708)
Change in short-term debt	105	1,862
Additions to long-term debt	—	1,073
Reductions of long-term debt	(1,902)	—
Treasury stock purchases	(2,378)	(2,502)
Impact of stock options and other	966	304
TOTAL FINANCING ACTIVITIES	(5,015)	(971)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(132)	(52)
CHANGE IN CASH AND CASH EQUIVALENTS	(1,072)	175
CASH AND CASH EQUIVALENTS, END OF PERIOD	$7,486	$6,122

See accompanying Notes to Consolidated Financial Statements.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

These statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2014. In the opinion of management, the accompanying unaudited Consolidated Financial Statements of The Procter & Gamble Company and subsidiaries (the "Company," "Procter & Gamble," "we" or "our") contain all adjustments necessary to present fairly the financial position, results of operations and cash flows for the interim periods reported. However, the results of operations included in such financial statements may not necessarily be indicative of annual results.

2. New Accounting Pronouncements and Policies

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." This guidance outlines a single, comprehensive model for accounting for revenue from contracts with customers. We will adopt the standard on July 1, 2017. We are still evaluating the impact, if any, that the standard will have on our financial statements.
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.

3. Segment Information

As discussed in Note 11, the Pet Care divested business is presented as discontinued operations and is excluded from segment results for all periods presented.

Following is a summary of segment results:

		Three Months Ended September 30		
		Net Sales	Earnings / (Loss) from Continuing Operations Before Income Taxes	Net Earnings from Continuing Operations
Beauty, Hair and Personal Care	2014	$4,857	$926	$710
	2013	4,903	909	690
Grooming	2014	1,941	621	466
	2013	1,956	601	453
Health Care	2014	2,011	459	322
	2013	1,894	384	265
Fabric Care and Home Care	2014	6,538	1,180	783
	2013	6,666	1,296	857
Baby, Feminine and Family Care	2014	5,322	1,202	825
	2013	5,247	1,082	725
Corporate	2014	123	(1,565)	(1,103)
	2013	164	(291)	49
Total Company	2014	$20,792	$2,823	$2,003
	2013	20,830	3,981	3,039

Amounts in millions of dollars unless otherwise specified.

4. Goodwill and Other Intangible Assets

Goodwill is allocated by reportable segment as follows:

	Beauty, Hair and Personal Care	Grooming	Health Care	Fabric Care and Home Care	Baby, Feminine and Family Care	Corporate	Total Company
GOODWILL at June 30, 2014	$17,040	$20,939	$6,280	$4,535	$4,910	$—	$53,704
Acquisitions and divestitures	—	—	—	(2)	—	—	(2)
Goodwill impairment charges	—	—	—	(863)	—	—	(863)
Translation and other	(586)	(512)	(155)	(85)	(140)	—	(1,478)
GOODWILL at September 30, 2014	$16,454	$20,427	$6,125	$3,585	$4,770	$—	$51,361

During the quarter ended September 30, 2014, we determined that the estimated fair value of our Batteries reporting unit was less than its carrying amount. The underlying fair value assessment was triggered by an agreement that was reached in the quarter to sell a portion of the Batteries business and a related decision to pursue options to exit the remainder of the Batteries business. As previously disclosed in our Annual Report on Form 10-K for the year ended June 30, 2014, the results of our annual goodwill impairment testing during fiscal 2014 indicated a decline in the fair value of the Batteries reporting unit due to lower long-term market growth assumptions in certain key geographies. At that time, the estimated fair value of Batteries continued to exceed its underlying carrying value, but the fair value cushion had been reduced to about 5%. The agreement during the most recent quarter to sell a portion of the Batteries business is at a transaction value that is below the earnings multiple implied from the prior valuation of our Batteries business, which effectively eliminated our fair value cushion. As a result, the remaining business unit cash flows no longer support the remaining carrying amount of the Batteries business. In addition, management made the decision in October to pursue alternatives to exit the remainder of the Batteries business, which could include a sale or split-off transaction. The timing of any such transaction is uncertain.

Due largely to the above factors, we recorded a non-cash before and after-tax impairment charge of $863 to reduce the carrying amount of goodwill for the Batteries business unit to its estimated fair value. Following the impairment charge, the carrying value of the Batteries goodwill was $1,344. These same factors resulted in a decline in the fair value of our Duracell brand intangible asset below its carrying value. This resulted in a non-cash, before-tax impairment charge of $110 ($69 after tax) to reduce the carrying amount of this asset to its estimated fair value. The carrying value of our Duracell brand intangible asset was $2,135 as of September 30, 2014.

The test to evaluate goodwill for impairment is a two-step process. In the first step, we compare the fair value of the reporting unit to its carrying value. If the fair value of the reporting unit is less than its carrying value, we perform a second step to determine the implied fair value of the reporting unit's goodwill. The second step of the impairment analysis requires a valuation of a reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the resulting implied fair value of the reporting unit's goodwill is less than its carrying value, that difference represents an impairment. The impairment charges are included in Corporate for segment reporting.

The business unit valuations used to test goodwill and intangible assets for impairment are dependent on a number of significant estimates and assumptions, including macroeconomic conditions, overall category growth rates, competitive activities, cost containment and margin expansion and Company business plans. We believe these estimates and assumptions are reasonable. However, actual events and results of the Batteries reporting unit could differ substantially from those used in our valuations. To the extent such factors result in a reduction of the level of projected cash flows used to estimate the Batteries reporting unit fair value, we may need to record additional non-cash impairment charges in the future.

In addition, as previously disclosed in our Annual Report on Form 10-K for the year ended June 30, 2014, a key competitor announced its intent to split its consolidated business into two separate companies during 2015. One of those companies would operate primarily in the batteries category. While this proposed transaction has not been consummated, initial independent third party estimates of the competitor's stand-alone batteries business valuation are below the earnings multiple implied from the most recent valuation of our Batteries business. We attribute the implied valuation difference primarily to our more favorable business trends, primarily organic net sales and share growth, and brand equity. If our evaluation of exit alternatives results in the execution of a divestiture transaction, such a divestiture could result in an additional loss that could be material depending on the form of the transaction and/or valuations utilized by potential acquirers.

Amounts in millions of dollars unless otherwise specified.

In addition to the impairment charge, goodwill decreased from June 30, 2014 due to currency translation across all reportable segments.

Identifiable intangible assets at September 30, 2014 are comprised of:

	Gross Carrying Amount	Accumulated Amortization
Intangible assets with determinable lives	$9,120	$(5,221)
Intangible assets with indefinite lives	26,311	—
Total identifiable intangible assets	$35,431	$(5,221)

Intangible assets with determinable lives consist of brands, patents, technology and customer relationships. The intangible assets with indefinite lives consist primarily of brands. The amortization of intangible assets for the three months ended September 30, 2014 and 2013 was $119 and $134, respectively.

5. Share-Based Compensation and Postretirement Benefits

Total share-based compensation expense for the three months ended September 30, 2014 and 2013 was $81 and $84, respectively.

The Company offers various postretirement benefits to its employees. The total net periodic benefit cost for pension benefits for the three months ended September 30, 2014 and 2013 was $117 and $104, respectively. The total net periodic benefit cost for other retiree benefits for the three months ended September 30, 2014 and 2013 was $4 and $13, respectively. The components of the total net periodic benefit cost for both pension benefits and other retiree benefits for those interim periods, on an annualized basis, do not differ materially from the amounts disclosed in the Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

6. Risk Management Activities and Fair Value Measurements

As a multinational company with diverse product offerings, we are exposed to market risks, such as changes in interest rates, currency exchange rates and commodity prices.

The Company has not changed its valuation techniques in measuring the fair value of any financial assets and liabilities during the period. The Company recognizes transfers between levels within the fair value hierarchy, if any, at the end of each quarter. There were no transfers between levels during the periods presented. Also, there was no significant activity within the Level 3 assets and liabilities during the periods presented. Except for the impairment charges related to our Batteries business (see Note 4), there were no assets or liabilities that were remeasured at fair value on a non-recurring basis for the period ended September 30, 2014.

The following table sets forth the Company's financial assets as of September 30, 2014 and June 30, 2014 that are measured at fair value on a recurring basis during the period:

	Fair Value Asset	
	September 30, 2014	June 30, 2014
Investments		
U.S. government securities	$2,377	$1,631
Corporate bond securities	983	497
Other investments	33	30
Total	$3,393	$2,158

Amounts in millions of dollars unless otherwise specified.

Investment securities are presented in Available-for-sale investment securities and Other noncurrent assets. The amortized cost of U.S. government securities with maturities less than one year was $150 as of September 30, 2014 and $0 as of June 30, 2014. The amortized cost of U.S. government securities with maturities between one and five years was $2,248 as of September 30, 2014 and $1,649 as of June 30, 2014. The amortized cost of Corporate bond securities with maturities of less than a year was $77 as of September 30, 2014 and $39 as of June 30, 2014. The amortized cost of Corporate bond securities with maturities between one and five years was $909 as of September 30, 2014 and $458 as of June 30, 2014. The Company's investments measured at fair value are generally classified as Level 2 within the fair value hierarchy. There are no material investment balances classified as either Level 1 or Level 3 within the fair value hierarchy. Fair values are generally estimated based upon quoted market prices for similar instruments.

The fair value of long-term debt was $23,992 and $26,429 at September 30, 2014 and June 30, 2014, respectively. This includes the current portion ($2,651 and $4,400 as of September 30, 2014 and June 30, 2014, respectively) of debt instruments. Long-term debt is not recorded at fair value on a recurring basis, but is measured at fair value for disclosure purposes. Long-term debt with fair value of $1,681 and $1,682 at September 30, 2014 and June 30, 2014, respectively, is classified as Level 2 within the fair value hierarchy. All remaining long-term debt is classified as Level 1 within the fair value hierarchy. Fair values are generally estimated based on quoted market prices for identical or similar instruments.

The following table sets forth the notional amounts and fair values of qualifying and non-qualifying financial instruments used in hedging transactions as of September 30, 2014 and June 30, 2014:

	Notional Amount		Fair Value Asset/(Liability)	
	September 30, 2014	June 30, 2014	September 30, 2014	June 30, 2014
Derivatives in Cash Flow Hedging Relationships				
Foreign currency contracts	$951	$951	$239	$187
Derivatives in Fair Value Hedging Relationships				
Interest rate contracts	$7,671	$9,738	$191	$168
Derivatives in Net Investment Hedging Relationships				
Net investment hedges	$838	$831	$103	$48
Derivatives Not Designated as Hedging Instruments				
Foreign currency contracts	$8,964	$12,111	$(205)	$(42)

All derivative assets are presented in Prepaid expenses and other current assets and Other noncurrent assets. All derivative liabilities are presented in Accrued and other liabilities and Other noncurrent liabilities. The total notional amount of contracts outstanding at the end of the period is indicative of the Company's derivative activity during the period. The change in the notional balance of foreign currency contracts not designated as hedging instruments during the period reflects changes in the level of intercompany financing activity. All of the Company's derivative assets and liabilities measured at fair value are classified as Level 2 within the fair value hierarchy.

	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives (Effective Portion)	
	September 30, 2014	June 30, 2014
Derivatives in Cash Flow Hedging Relationships		
Interest rate contracts	$2	$3
Foreign currency contracts	8	14
Total	$10	$17
Derivatives in Net Investment Hedging Relationships		
Net investment hedges	$64	$30

The effective portion of gains and losses on derivative instruments that was recognized in other comprehensive income (OCI) during the three months ended September 30, 2014 and 2013, was not material. During the next 12 months, the amount of the September 30, 2014 accumulated OCI (AOCI) balance that will be reclassified to earnings is expected to be immaterial.

The amounts of gains and losses on qualifying and non-qualifying financial instruments used in hedging transactions for the three months ended September 30, 2014 and 2013 are as follows:

Amounts in millions of dollars unless otherwise specified.

	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income [1]	
	Three Months Ended September 30	
	2014	2013
Derivatives in Cash Flow Hedging Relationships		