

Data as of 12-31-04

Procter & Gamble PG

1	2	3
Rating ★★★	Fair Value \$58.00	Last Close \$55.08
	Consider Buy \$44.70	Consider Sell \$72.70
		Yield % 1.8

Company Profile

Since its founding in 1837, Procter & Gamble has become the world's largest consumer-product manufacturer with a lineup of famous brands. The company's nearly 300 brands, including 16 that each generate more than \$1 billion in annual sales, are sold through five global business units. Top-selling brands include Tide laundry detergent, Charmin toilet paper, Pantene shampoo, Cover Girl cosmetics, coffee, and Lams wool.

4	5	6	7	8	9
Industry Household & Personal Products	Business Risk Avg	Moat Size Wide	Investment Style Large Core	Sector Consumer Goods	
10	11	12	13	14	15
Net Cap 12 \$Mil	Trailing Sales \$Mil	Operating Cash Flow	Return On Assets%	Debt/ Equity	Total Return% 1 Yr 3 Yr
139,721	52,956	14.4	11.4	0.8	13.4 14.3
27,129	10,354	15.8	16.7	3.2	5.0 -1.5
38,130	47,816	8.1	6.5	1.5	6.5 8.7

Management

A.G. Lafley headed P&G's beauty-care business before replacing Durk Jager as CEO in June 2000. We think Lafley's appointment marked a change in P&G's direction to beauty care. For the 2004 fiscal year, Lafley's salary and bonus increased to \$5.2 million, and long-term incentive pay more than tripled to \$3.86 million, which Lafley has elected to take in the form of restricted stock. We believe P&G's executive compensation program does a good job of putting most of the compensation into at-risk incentive programs tied to the long-term performance of the company. Key executives must own stock directly in amounts equal to various multiples of their base salary. Officers and directors own less than 1% of shares outstanding.



11	12	13
Annual Total Return %	Valuation Ratios	Major Fund Holders
21.6	Price/Earnings 22.8	Midas Special Equities 7.63
-27.1	Price/Book 8.3	ING Corporate Leaders Trust 6.49
3.1	Price/Sales 2.6	Rydex Consumer Products Inv 6.11
11.3	Debt/Cash Flow 14.4	ABN AMRO/Montag & Caldwell Growth N 5.12
18.5		
12.4		

Morningstar Grades

Growth A 	2001	2002	2003	2004	TTM
Revenue %	-1.8	2.5	7.9	18.5	
Earnings/Share %	-16.2	49.3	19.7	25.4	
Book Value/Share %	-0.7	17.4	21.6	8.2	
Dividends/Share %	9.4	8.6	7.9	13.7	

A sound restructuring plan, strategic acquisitions, and a focus on higher-margin product segments have propelled P&G to 6.4% sales growth over the past five years. Operating income has increased 9.5% per year on average over this same time frame.

Profitability A 	2002	2003	2004	TTM
Return on Assets %	10.7	11.9	11.4	11.4
Oper Cash Flow \$Mil	7,742	8,700	9,362	9,674
- Cap Spending \$Mil	1,679	1,482	2,024	2,073
= Free Cash Flow \$Mil	6,063	7,218	7,338	7,601

P&G is very profitable with returns on invested capital averaging more than 14% over the past five years. The firm generates above-average returns on equity, and free cash flows to operating income have averaged 71% over the past five years.

Financial Health A- 	2002	2003	2004	09-30-04
Long-term Debt \$Mil	11,201	11,475	12,554	13,731
Total Equity \$Mil	12,072	14,606	15,752	16,845
Debt/Equity Ratio	0.9	0.8	0.8	0.8

P&G's debt/equity ratio is 1.32, but we are comfortable with the company's debt load, as earnings before interest and taxes are 15.8 times interest expense.

14 **Thesis** By Lauren DeSanto, 11-17-2004 Stock Price as of Analysis: \$54.49

For a textbook case on how to dominate a product category, look no further than Procter & Gamble and laundry detergent. The company's detergent brands include Tide, Ariel, Downy, Gain, and Era, and they clean up in sales.

But we wouldn't give a company a wide moat simply because it dominates a single product category. We think P&G is a terrific example of a wide-moat firm because it dominates multiple categories in its industry and reinvests its cash flows to develop innovative products and strengthen its brands. Its moat was built with its brands, and with 16 different brands each contributing more than \$1 billion a year in sales, we see P&G meeting its long-term sales target of 4%-6% growth per year.

The company's strategy is to build sales in its higher-margin, higher-growth segments, so P&G is actively focused on its beauty-care business, where customers will pay a premium for products with even minor improvements. The global market for beauty care is estimated to be \$170 billion, and with P&G's share at less than 10%, the company foresees plenty of room for growth. Beauty care now eclipses the company's fabric and home-care division in sales and earnings contribution and is a less capital intensive segment than others in which P&G competes.

P&G's brands serve different roles in the marketplace, occupying various price points to appeal to shoppers of all income levels. These brands, which ostensibly compete with one another, offer P&G significant marginal revenue and are the cornerstone of the company's competitive advantage and its consumer reach. The question for P&G is how much advantage does each brand provide and for how long. Retailers and competitors present the most risk to this advantage and P&G's margins. The company drives 17% of its sales through Wal-Mart, a retailer notorious for forcing out underperforming products. P&G must maintain brand leadership in all its product categories to retain shelf space and ward off competitors. Preserving this brand leadership and market share requires hefty ad spending, which erodes the bottom line.

Still, P&G has a solid, balanced portfolio of products from which to originate new products, and a robust cash flow from which to fund innovation and brand development. We would gladly pick up shares of this solid performer at the right price.

1 Star Rating

Indicates if the stock is overvalued, undervalued, or fairly priced

2 Morningstar Fair Value

Our analysts' estimate of the stock's fair value price

3 Buy/Sell Prices

Incorporating a margin of safety, we give our estimate of when you should buy—or sell

4 Major Competitors

How the company stacks up against its main rivals

5 Business Risk

A below average, average, or above average risk rating for each company

6 Moat Size

A measure of the company's competitive advantages

7 Morningstar Style Box

A snapshot view of the company's size and value or growth characteristics

8 Expanded Management

Even more about the background and strategies of top management

9 Fiduciary Grade

An easy way to tell if management is working for you or themselves

10 Price History

Five years of price history and the stock's strength relative to the S&P 500

11 Five-Year Financial History

Key measures for the past five years and trailing 12 months

12 Valuation Ratios

How the stock measures up to its industry and the S&P 500

13 Major Fund Holders

Which funds have big percentages of their assets in this stock

14 Morningstar Grades

A snapshot of the company's growth, profitability, and financial health

15 Thesis

Our independent opinion of the company, including detailed analysis of strengths and weaknesses