PROCTER & GAMBLE CO
Form 10-Q
January 28, 2011

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, 2010

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 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 ¨

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 ¨

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 ¨ 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 þ

There were 2,800,783,600 shares of Common Stock outstanding as of December 31, 2010.

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, 2010 and 2009, the Consolidated Balance Sheets as of December 31, 2010 and June 30, 2010, and the Consolidated Statements of Cash Flows for the six months ended December 31, 2010 and 2009 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

	Three Months Ended December 31		Six Months Ended December 31	
Amounts in millions except per share amounts	2010	2009	2010	2009
Net Sales	$ 21,347	$ 21,027	$ 41,469	$ 40,834
Cost of products sold	10,287	9,736	19,976	19,134
Selling, general and administrative expense	6,800	6,636	12,732	12,597
Operating Income	4,260	4,655	8,761	9,103
Interest expense	209	224	417	511
Other non-operating income/(expense), net	10	53	(1)	76
Earnings from Continuing Operations Before Income Taxes	4,061	4,484	8,343	8,668
Income taxes on continuing operations	728	1,335	1,929	2,492
Net Earnings from Continuing Operations	3,333	3,149	6,414	6,176
Net Earnings from Discontinued Operations		1,510		1,790
Net Earnings	$ 3,333	$ 4,659	$ 6,414	$ 7,966
Per Common Share				
Basic net earnings from continuing operations	$ 1.17	$ 1.06	$ 2.24	$ 2.08
Basic net earnings from discontinued operations		0.52		0.61
Basic net earnings	1.17	1.58	2.24	2.69
Diluted net earnings from continuing operations	1.11	1.01	2.13	1.98
Diluted net earnings from discontinued operations		0.48		0.58
Diluted net earnings	1.11	1.49	2.13	2.56
Dividends	$ 0.4818	$ 0.4400	$ 0.9636	$ 0.8800
Diluted Weighted Average Common Shares Outstanding	3,000.2	3,118.5	3,013.0	3,114.5

See accompanying Notes to Consolidated Financial Statements

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

Amounts in millions			December 31 2010	June 30 2010
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents			$ 3,249	$ 2,879
Accounts receivable			6,551	5,335
Inventories				
Materials and supplies			2,121	1,692
Work in process			678	604
Finished goods			4,624	4,088
Total inventories			7,423	6,384
Deferred income taxes			963	990
Prepaid expenses and other current assets			3,644	3,194
TOTAL CURRENT ASSETS			21,830	18,782
PROPERTY, PLANT AND EQUIPMENT				
Buildings			7,303	6,868
Machinery and equipment			30,838	29,294
Land			893	850
Total property, plant and equipment			39,034	37,012
Accumulated depreciation			(19,082)	(17,768)
NET PROPERTY, PLANT AND EQUIPMENT			19,952	19,244
GOODWILL AND OTHER INTANGIBLE ASSETS				
Goodwill			55,760	54,012
Trademarks and other intangible assets, net			32,251	31,636
NET GOODWILL AND OTHER INTANGIBLE ASSETS			88,011	85,648
OTHER NONCURRENT ASSETS			4,480	4,498
TOTAL ASSETS			$ 134,273	$ 128,172
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Accounts payable			$ 6,267	$ 7,251
Accrued and other liabilities			9,816	8,559
Debt due within one year			11,158	8,472
TOTAL CURRENT LIABILITIES			27,241	24,282
LONG-TERM DEBT			21,317	21,360
DEFERRED INCOME TAXES			10,867	10,902
OTHER NONCURRENT LIABILITIES			10,135	10,189
TOTAL LIABILITIES			69,560	66,733
SHAREHOLDERS EQUITY				
Preferred stock			1,253	1,277
Common stock shares issued	31-Dec	4,007.7	4,008	
	30-Jun	4,007.6		4,008
Additional paid-in capital			61,985	61,697

Reserve for ESOP debt retirement	(1,355)	(1,350)
Accumulated other comprehensive income (loss)	(5,356)	(7,822)
Treasury stock	(64,383)	(61,309)
Retained earnings	68,212	64,614
Noncontrolling interest	349	324
TOTAL SHAREHOLDERS EQUITY	64,713	61,439
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 134,273	$ 128,172

See accompanying Notes to Consolidated Financial Statements

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended December 31	
Amounts in millions	2010	2009
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 2,879	$ 4,781
OPERATING ACTIVITIES		
Net earnings	6,414	7,966
Depreciation and amortization	1,400	1,529
Share-based compensation expense	180	205
Deferred income taxes	142	(7)
Gain on sale of businesses	(3)	(2,637)
Changes in:		
Accounts receivable	(931)	(826)
Inventories	(779)	48
Accounts payable, accrued and other liabilities	(377)	1,313
Other operating assets and liabilities	(650)	312
Other	(67)	(54)
TOTAL OPERATING ACTIVITIES	5,329	7,849
INVESTING ACTIVITIES		
Capital expenditures	(1,256)	(1,274)
Proceeds from asset sales	22	3,039
Acquisitions, net of cash acquired	(435)	(70)
Change in investments	128	(49)
TOTAL INVESTING ACTIVITIES	(1,541)	1,646
FINANCING ACTIVITIES		
Dividends to shareholders	(2,834)	(2,672)
Change in short-term debt	948	(2,902)
Additions to long-term debt	1,536	1,495
Reductions of long-term debt	(160)	(5,169)
Treasury stock purchases	(3,528)	(1,414)
Impact of stock options and other	510	318
TOTAL FINANCING ACTIVITIES	(3,528)	(10,344)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	110	198
CHANGE IN CASH AND CASH EQUIVALENTS	370	(651)
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 3,249	$ 4,130

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, 2010. The results of operations for the three-month and six-month periods ended December 31, 2010 are not necessarily indicative of annual results.

2. Comprehensive Income - Total comprehensive income is comprised primarily of net earnings, net currency translation gains and losses, impacts of net investment and cash flow hedges, net unrealized gains and losses on investment securities and defined benefit and other retiree benefit plan activities. Total comprehensive income for the three months ended December 31, 2010 and 2009 was $2,984 million and $4,386 million, respectively. For the six months ended December 31, 2010 and 2009, total comprehensive income was $8,880 million and $9,088 million, respectively.

3. Segment Information - Following is a summary of segment results. As discussed in Note 10, our divested global pharmaceutical 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 December 31			Six Months Ended December 31		
Amounts in millions		**Net Sales**	**Earnings from Continuing Operations Before Income Taxes**	**Net Earnings from Continuing Operations**	**Net Sales**	**Earnings from Continuing Operations Before Income Taxes**	**Net Earnings from Continuing Operations**
Beauty and Grooming GBU							
Beauty	**2010**	**$ 5,290**	**$ 1,141**	**$ 896**	**$ 10,219**	**$ 2,222**	**$ 1,725**
	2009	5,217	1,137	876	10,138	2,164	1,653
Grooming	**2010**	**2,164**	**635**	**482**	**4,062**	**1,159**	**880**
	2009	2,095	613	433	3,953	1,102	784
Health and Well-Being GBU							
Health Care	**2010**	**3,138**	**779**	**531**	**6,122**	**1,520**	**1,026**
	2009	3,071	790	534	6,050	1,620	1,084
Snacks and Pet Care	**2010**	**798**	**93**	**67**	**1,507**	**170**	**121**
	2009	835	143	98	1,590	256	172
Household Care GBU							
Fabric Care and Home Care	**2010**	**6,308**	**1,165**	**758**	**12,605**	**2,582**	**1,695**
	2009	6,311	1,433	965	12,441	2,943	1,974
Baby Care and Family Care	**2010**	**3,930**	**802**	**502**	**7,582**	**1,551**	**972**
	2009	3,817	925	579	7,406	1,810	1,136
Corporate	**2010**	**(281)**	**(554)**	**97**	**(628)**	**(861)**	**(5)**
	2009	(319)	(557)	(336)	(744)	(1,227)	(627)
Total	**2010**	**21,347**	**4,061**	**3,333**	**41,469**	**8,343**	**6,414**
	2009	21,027	4,484	3,149	40,834	8,668	6,176

4. Goodwill and Other Intangible Assets Goodwill as of December 31, 2010 is allocated by reportable segment and global business unit as follows (amounts in millions):

	Six Months Ended December 31, 2010
BEAUTY & GROOMING GBU	
Beauty, beginning of year	**$ 17,575**
Acquisitions and divestitures	(4)
Translation and other	721
Goodwill, December 31, 2010	**18,292**
Grooming, beginning of year	**20,384**
Acquisitions and divestitures	(16)
Translation and other	588
Goodwill, December 31, 2010	**20,956**
HEALTH & WELL-BEING GBU	
Health Care, beginning of year	**7,859**
Acquisitions and divestitures	(4)
Translation and other	156
Goodwill, December 31, 2010	**8,011**
Snacks and Pet Care, beginning of year	**2,203**
Acquisitions and divestitures	16
Translation and other	13
Goodwill, December 31, 2010	**2,232**
HOUSEHOLD CARE GBU	
Fabric Care and Home Care, beginning of year	**4,248**
Acquisitions and divestitures	94
Translation and other	118
Goodwill, December 31, 2010	**4,460**
Baby Care and Family Care, beginning of year	**1,445**
Acquisitions and divestitures	(1)
Translation and other	56
Goodwill, December 31, 2010	**1,500**
CORPORATE	
Corporate, beginning of year	**298**
Acquisitions and divestitures	11
Translation and other	
Goodwill, December 31, 2010	**309**
GOODWILL, beginning of year	**54,012**
Acquisitions and divestitures	96
Translation and other	1,652
Goodwill, December 31, 2010	**$ 55,760**

The increase in goodwill from June 30, 2010 is primarily due to currency translation across all GBUs and the acquisition of Ambi Pur in our Fabric Care and Home Care reportable segment.

Identifiable intangible assets as of December 31, 2010 are comprised of (amounts in millions):

	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets with determinable lives	**$ 8,900**	**$ 3,896**
Intangible assets with indefinite lives	**27,247**	
Total identifiable intangible assets	**$ 36,147**	**$ 3,896**

Defined life intangible assets consist principally of brands, patents, technology and customer relationships. Indefinite lived intangible assets consist primarily of brands.

The amortization of intangible assets for the three months ended December 31, 2010, and 2009 was $132 million and $143 million, respectively. For the six months ended December 31, 2010 and 2009, the amortization of intangible assets was $272 million and $288 million, respectively.

5. Pursuant to applicable accounting guidance for share-based payments, 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.

Total share-based compensation for the three months and six months ended December 31, 2010 and 2009 are summarized in the following table (amounts in millions):

	Three Months Ended December 31		Six Months Ended December 31	
	2010	2009	**2010**	2009
Share-Based Compensation				
Stock options	**$ 85**	$ 98	**$ 153**	$ 191
Other share-based awards	**8**	8	**27**	14
Total share-based compensation	**$ 93**	$ 106	**$ 180**	$ 205

Assumptions utilized in the model are evaluated and revised, as necessary, to reflect market conditions and experience.

6. Postretirement Benefits - The Company offers various postretirement benefits to its employees.

The components of net periodic benefit cost for defined benefit plans are as follows:

	Pension Benefits Three Months Ended December 31		Other Retiree Benefits Three Months Ended December 31	
Amounts in millions	2010	2009	2010	2009
Service Cost	64	57	35	26
Interest Cost	144	150	66	64
Expected Return on Plan Assets	(122)	(113)	(107)	(107)
Amortization of Deferred Amounts	5	4	(5)	(6)
Recognized Net Actuarial Loss	38	23	23	5
Gross Benefit Cost (Credit)	**129**	**121**	**12**	**(18)**
Dividends on ESOP Preferred Stock			(19)	(28)
Net Periodic Benefit Cost (Credit)	**129**	**121**	**(7)**	**(46)**

	Pension Benefits Six Months Ended December 31		Other Retiree Benefits Six Months Ended December 31	
	2010	2009	2010	2009
Service Cost	126	112	70	52
Interest Cost	284	297	131	127
Expected Return on Plan Assets	(241)	(224)	(215)	(214)
Amortization of Deferred Amounts	9	8	(10)	(11)
Recognized Net Actuarial Loss	75	46	47	9
Gross Benefit Cost (Credit)	**253**	**239**	**23**	**(37)**
Dividends on ESOP Preferred Stock			(39)	(56)
Net Periodic Benefit Cost (Credit)	**253**	**239**	**(16)**	**(93)**

For the year ending June 30, 2011, the expected return on plan assets is 7.0% and 9.2% for defined benefit and other retiree benefit plans, respectively.

7. 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.

For details on the Company s risk management activities, refer to the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

Fair Value Hierarchy

For a discussion of the Company s fair value measurement policies under the fair value hierarchy, refer to the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

The Company has not changed its valuation techniques for measuring the fair value of any financial assets and liabilities during the period.

The following table sets forth the Company s financial assets and liabilities as of December 31 and June 30, 2010 that are measured at fair value on a recurring basis during the period, segregated by level within the fair value hierarchy:

	Level 1		Level 2		Level 3		Total	
Amounts in millions	December 31, 2010	June 30, 2010	December 31, 2010	June 30, 2010	December 31, 2010	June 30, 2010	December 31, 2010	June 30, 2010
Assets at fair value:								
Investment securities	$ 24	$ 12	$	$	$ 23	$ 45	**$ 47**	$ 57
Derivatives relating to:								
Foreign currency hedges			1				**1**	
Other foreign currency instruments [1]			65	81			**65**	81
Interest rates			166	191			**166**	191
Net investment hedges			1	14			**1**	14
Commodities			5	10			**5**	10
Total assets at fair value [2]	24	12	238	296	23	45	**285**	353
Liabilities at fair value:								
Derivatives relating to:								
Foreign currency hedges			135	177			**135**	177
Other foreign currency instruments [1]			159	175			**159**	175
Net investment hedges			110	23			**110**	23
Commodities			1				**1**	
Total liabilities at fair value [3]			405	375			**405**	375

(1) Other foreign currency instruments are comprised of non-qualifying foreign currency financial instruments.
(2) Investment securities are presented in other noncurrent assets and all derivative assets are presented in prepaid expenses and other current assets or other noncurrent assets.
(3) All derivative liabilities are presented in accrued and other liabilities or other noncurrent liabilities.

The Company recognizes transfers between levels within the fair value hierarchy, if any, at the end of each quarter. There was no significant activity within the Level 3 assets and liabilities during the periods presented.

There were no significant assets or liabilities that were re-measured at fair value on a non-recurring basis during the periods presented.

Certain of the Company s financial instruments used in hedging transactions are governed by industry standard netting agreements with counterparties. If the Company s credit rating were to fall below the levels stipulated in the agreements, the counterparties could demand either collateralization or termination of the arrangement. The aggregate fair value of the instruments covered by these contractual features that are in a net liability position as of December 31, 2010 was $138 million. The Company has not been required to post any collateral as a result of these contractual features.

Fair Values of Other Financial Instruments

Other financial instruments, including cash equivalents, other investments and short-term debt, are recorded at cost, which approximates fair value. The fair value of the long-term debt was $22,743 million and $23,072 million at December 31 and June 30, 2010, respectively.

Disclosures about Derivative Instruments

The notional amounts and fair values of qualifying and non-qualifying financial instruments used in hedging transactions as of December 31 and June 30, 2010 are as follows:

	Notional Amount		Fair Value Asset (Liability)	
Amounts in Millions	**December 31, 2010**	**June 30, 2010**	**December 31, 2010**	**June 30, 2010**
Derivatives in Cash Flow Hedging Relationships				
Interest rate contracts	$	$	$	$
Foreign currency contracts	805	690	(134)	(177)
Commodity contracts	24	43	3	10
Total	829	733	(131)	(167)
Derivatives in Fair Value Hedging Relationships				
Interest rate contracts	8,255	7,942	166	191
Derivatives in Net Investment Hedging Relationships				
Net investment hedges	1,418	1,586	(109)	(9)
Derivatives Not Designated as Hedging Instruments				
Foreign currency contracts	11,204	11,845	(94)	(94)
Commodity contracts	54	19	1	
Total	11,258	11,864	(93)	(94)

The total notional amount of contracts outstanding at the end of the period is indicative of the level of the Company s derivative activity during the period.

	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives (Effective Portion)	
Amounts in Millions	**December 31, 2010**	**June 30, 2010**
Derivatives in Cash Flow Hedging Relationships		
Interest rate contracts	$ 17	$ 19
Foreign currency contracts	27	23
Commodity contracts	2	11
Total	46	53
Derivatives in Net Investment Hedging Relationships		
Net investment hedges	(70)	(8)

During the next 12 months, the amount of the December 31, 2010 accumulated other comprehensive income (OCI) 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-month and six-month periods ended December 31, 2010 and 2009 are as follows:

	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (1)			
	Three Months Ended December 31		Six Months Ended December 31	
Amounts in Millions	**2010**	**2009**	**2010**	**2009**
Derivatives in Cash Flow Hedging Relationships				
Interest rate contracts	$ 2	$ (2)	$ 4	$ (9)
Foreign currency contracts	(19)	29	(68)	(22)
Commodity contracts	4	(24)	18	(85)
Total	(13)	3	(46)	(116)

	Amount of Gain(Loss) Recognized in Income			
	Three Months Ended December 31		Six Months Ended December 31	
Amounts in Millions	**2010**	**2009**	**2010**	**2009**
Derivatives in Fair Value Hedging Relationships (2)				
Interest rate contracts	(87)	2	(25)	(3)
Debt	89		26	
Total	2	2	1	(3)
Derivatives in Net Investment Hedging Relationships (2)				
Net investment hedges	(1)	4	(1)	4
Derivatives Not Designated as Hedging Instruments (3)				
Foreign currency contracts	(110)	(146)	626	114
Commodity contracts	2		4	
Total	(108)	(146)	630	114

(1) The gain or loss on the effective portion of cash flow hedging relationships is reclassified from accumulated OCI into net income in the same period during which the related item affects earnings. Such amounts are included in the Consolidated Statements of Earnings as follows: interest rate contracts in interest expense, foreign currency contracts in selling, general and administrative expense and interest expense and commodity contracts in cost of products sold.

(2) The gain or loss on the ineffective portion of interest rate contracts and net investment hedges, if any, is included in the Consolidated Statements of Earnings in interest expense.

(3) The gain or loss on contracts not designated as hedging instruments is included in the Consolidated Statements of Earnings as follows: foreign currency contracts in selling, general and administrative expense and commodity contracts in cost of products sold.

8. New Accounting Pronouncements and Policies

No new accounting pronouncement issued or effective during the fiscal year has had or is expected to have a material impact on the Consolidated Financial Statements.

9. Commitments and Contingencies

Litigation

We are subject to various legal proceedings and claims arising out of our business which cover a wide range of matters such as governmental regulations, antitrust and trade regulations, product liability, patent and trademark matters, income taxes and other actions.

As previously disclosed, the Company is subject to a variety of investigations into potential competition law violations in Europe by the European Commission and national authorities from a number of countries, as detailed in Part II, Item 1, Legal Proceedings of this 10-Q. These matters involve a number of consumer products companies and/or retail customers. The Company s policy is to comply with all laws and regulations, including all antitrust and competition laws, and to cooperate with investigations by relevant regulatory authorities, which the Company is doing. Competition and antitrust law inquiries often continue for several years and, if violations are found, can result in substantial fines.

In response to the actions of the European Commission and national authorities, the Company launched its own internal investigations into potential violations of competition laws. The Company has identified violations in certain European countries and appropriate actions were taken.

Several countries in Europe have issued separate complaints pursuant to their investigations alleging that the Company, along with several other companies, engaged in violations of competition laws in those countries. The remaining matters involving the European Commission and several other countries are in various stages of the regulatory process. As a result of our initial and on-going analyses of the complaints, as well as a final decision issued by the authorities in Italy and additional information disclosed by the authorities in France, the Czech Republic and the European Commission during the quarter ended December 31, 2010, the Company has reserves totaling $574 million as of December 31, 2010 for potential fines for competition law violations. In accordance with US GAAP, certain of the reserves included in this amount represent the low end of a range of potential outcomes. Accordingly, the ultimate resolution of these matters may result in fines or costs in excess of the amounts reserved that could materially impact our income statement and cash flows in the period in which they are accrued and paid, respectively. We will continue to monitor developments for all of these investigations and will record additional charges as appropriate.

With respect to other litigation and claims, while considerable uncertainty exists in the opinion of management and our counsel, the ultimate resolution of the various lawsuits and claims will not materially affect our financial position, results of operations or cash flows.

We are also subject to contingencies pursuant to environmental laws and regulations that in the future may require us to take action to correct the effects on the environment of prior manufacturing and waste disposal practices. Based on currently available information, we do not believe the ultimate resolution of environmental remediation will have a material adverse effect on our financial position, results of operations or cash flows.

Income Tax Uncertainties

The Company is present in over 150 taxable jurisdictions and, at any point in time, has 50 60 audits underway at various stages of completion. We evaluate our tax positions and establish liabilities for uncertain tax positions that may be challenged by local authorities and may not be fully sustained, despite our belief that the underlying tax positions are fully supportable. Uncertain tax positions are reviewed on an ongoing basis and are adjusted in light of changing facts and circumstances, including progress of tax audits, developments in case law and closing of statute of limitations. Such adjustments are reflected in the tax provision as appropriate. We have tax years open ranging from 2001 and forward. Net adjustments to prior-year tax balances for uncertain tax positions resulted in a tax benefit of approximately $380 million in the current year. We are generally not able to reliably estimate the ultimate settlement amounts or timing until the close of the audit. At this time, we are not able to make a reasonable estimate of the range of potential changes to the balance of uncertain tax positions over the next 12 months or the impact of any such changes on the effective tax rate.

Additional information on the Commitments and Contingencies of the Company can be found in Note 10, Commitments and Contingencies, which appears in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

10. Discontinued Operations

In October 2009, the Company completed the divestiture of our global pharmaceuticals business to Warner Chilcott plc (Warner Chilcott) for $2.8 billion of cash, net of assumed and transferred liabilities. Under the terms of the agreement, Warner Chilcott acquired our portfolio of branded pharmaceutical products, our prescription drug product pipeline and manufacturing facilities in Puerto Rico and Germany. In addition, the majority of the employees working on the pharmaceuticals business were transferred to Warner Chilcott. The Company recorded an after-tax gain on the transaction of $1,464 million in the quarter ended December 31, 2009, which is included in net earnings from discontinued operations in the Consolidated Statement of Earnings for the three-month and six-month periods ended December 31, 2009. In accordance with the applicable accounting guidance for the disposal of long-lived assets, the results of the pharmaceuticals business are presented as discontinued operations and, as such, have been excluded from continuing operations and segment results for all periods presented.

Following is selected financial information included in net earnings from discontinued operations for the pharmaceuticals business:

	Three months ended December 31		Six months ended December 31	
Amounts in millions	**2010**	**2009**	**2010**	**2009**
Net sales	$	$ 196	$	$ 751
Earnings from discontinued operations		70		306
Income tax expense		(24)		(101)
Gain on sale of discontinued operations		2,438		2,632
Income tax benefit (expense) on sale		(974)		(1,047)
Net earnings from discontinued operations		1,510		1,790

The net gain on the sale of the pharmaceuticals business for the six-month period ended December 31, 2009 also includes an after-tax gain on the sale of the Actonel brand in Japan, which occurred prior to the divestiture to Warner Chilcott.

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, 2010
- Results of Operations Six Months Ended December 31, 2010
- Business Segment Discussion Three and Six Months Ended December 31, 2010
- 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 organic sales growth, core earnings per share growth, free cash flow and free cash flow productivity. These financial measures are not defined under accounting principles generally accepted in the United States of America (U.S. GAAP). The explanation 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 such 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 purpose is to provide products and services of superior quality and value that improve the lives of the world s consumers, now and for generations to come. 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, drug stores and high frequency stores, the neighborhood stores which serve many consumers in developing markets. We continue to expand our presence in other channels including department stores, perfumeries, pharmacies, salons and e-commerce.

We compete in multiple product categories and have three global business units (GBUs): Beauty and Grooming; Health and Well-Being; and Household Care. Under U.S. GAAP, the business units comprising the GBUs are aggregated into six reportable segments: Beauty; Grooming; Health Care; Snacks and Pet Care; Fabric Care and Home Care; and Baby Care and Family Care.

We have on-the-ground operations in approximately 80 countries through our Market Development Organization, which leads country business teams to build our brands in local markets and is organized along five geographic units: North America, Western Europe, Central & Eastern Europe/Middle East/Africa (CEEMEA), Latin America and Asia, which is comprised of Japan, Greater China and

ASEAN/Australia/India/Korea (AAIK). Throughout MD&A, we reference business results in developing markets, which we define as the aggregate of CEEMEA, Latin America, AAIK and Greater China, and developed markets, which are comprised of North America, Western Europe and Japan.

On October 30, 2009, we sold our global pharmaceuticals business to Warner Chilcott plc (Warner Chilcott) for $2.8 billion. Under the terms of the agreement, Warner Chilcott acquired our portfolio of branded pharmaceuticals products, prescription drug product pipeline and manufacturing facilities in Puerto Rico and Germany. The pharmaceuticals business had historically been part of the Health Care reportable segment. In accordance with applicable accounting guidance for the disposal of long-lived assets, the results of the pharmaceuticals business are presented as discontinued operations and, as such, are excluded from continuing operations and from segment results.

The table below provides more information about the components of our GBU structure.

GBU	**Reportable Segment**	**Categories**	**Billion-Dollar Brands**
Beauty and Grooming	Beauty	Cosmetics, Female Antiperspirant and Deodorant, Female Personal Cleansing, Female Shave Care, Hair Care, Hair Color, Hair Styling, Pharmacy Channel, Prestige Products, Salon Professional, Skin Care	Head & Shoulders, Olay, Pantene, Wella
	Grooming	Beauty Electronics, Home Small Appliances, Male Blades and Razors, Male Personal Care	Braun, Fusion, Gillette, Mach3
Health and Well-Being	Health Care	Feminine Care, Gastrointestinal, Incontinence, Rapid Diagnostics, Respiratory, Toothbrush, Toothpaste, Water Filtration, Other Oral Care	Always, Crest, Oral-B
	Snacks and Pet Care	Pet Care, Snacks	Iams, Pringles
Household Care	Fabric Care and Home Care	Additives, Air Care, Batteries, Dish Care, Fabric Enhancers, Laundry, Surface Care	Ace, Ariel, Dawn, Downy, Duracell, Gain, Tide
	Baby Care and Family Care	Baby Wipes, Diapers, Paper Towels, Tissues, Toilet Paper	Bounty, Charmin, Pampers

The following table provides the percentage of net sales and net earnings from continuing operations by reportable business segment for the three months ended December 31, 2010 (excludes net sales and net earnings in Corporate):

	Net Sales	**Net Earnings**
Beauty and Grooming GBU		
Beauty	24%	28%
Grooming	10%	15%
Health and Well-Being GBU		
Health Care	15%	16%
Snacks and Pet Care	4%	2%
Household Care GBU		
Fabric Care and Home Care	29%	23%
Baby Care and Family Care	18%	16%
Total	**100%**	**100%**

The following table provides the percentage of net sales and net earnings from continuing operations by reportable business segment for the six months ended December 31, 2010 (excludes net sales and net earnings in Corporate):

	Net Sales	Net Earnings
Beauty and Grooming GBU		
Beauty	24%	27%
Grooming	10%	14%
Health and Well-Being GBU		
Health Care	14%	16%
Snacks and Pet Care	4%	2%
Household Care GBU		
Fabric Care and Home Care	30%	26%
Baby Care and Family Care	18%	15%
Total	**100%**	**100%**

SUMMARY OF RESULTS

Following are highlights of results for the six months ended December 31, 2010 versus the six months ended December 31, 2009:

Net sales increased 2% to $41.5 billion as 7% volume growth was mostly offset by unfavorable foreign exchange, mix impacts and lower pricing. Organic sales, which exclude the impacts of acquisitions, divestitures and foreign exchange, were up 4%.

Operating margin declined 120 basis points behind a commodity-cost driven reduction in gross margin and increased marketing investments, partially offset by reduced foreign currency exchange costs.

Net earnings from continuing operations increased 4% to $6.4 billion mainly due to a lower effective tax rate and higher net sales, partially offset by operating margin contraction.

Net earnings were $6.4 billion, a decrease of 19% due to the divestiture of the discontinued pharmaceuticals business in the prior year period. Diluted net earnings per share were $2.13, a decline of 17%.

Diluted net earnings per share from continuing operations increased 8% to $2.13. Earnings per share growth exceeded net earnings growth due to the impact of share repurchase activity.

Core EPS, which is diluted net earnings per share from continuing operations excluding charges for pending European legal matters and a significant adjustment to an income tax reserve, increased 4% to $2.15.

Operating cash flow decreased $2.5 billion to $5.3 billion mainly due to an increase in working capital. Free cash flow, which is operating cash flow less capital expenditures, was $4.1 billion. Free cash flow productivity, which is the ratio of free cash flow to net earnings, was 64%.

FORWARD-LOOKING STATEMENTS

We discuss expectations regarding future performance, events and outcomes, such as our business outlook and objectives, in annual and quarterly reports, press releases and other written and oral communications. All such statements, except for historical and present factual information, are forward-looking statements, and are based on financial data and our business plans available only as of the time the statements are made, which may become out-of-date or incomplete. We assume no obligation to update any forward-looking statements as a result of new information, future events or other factors. Forward-looking statements are inherently uncertain and investors must recognize that events could be significantly different from our expectations. For more information on risks that could impact our results, refer to Part II Item 1A Risk Factors in this 10-Q filing.

Ability to Achieve Business Plans: We are a consumer products company and rely on continued demand for our brands and products. To achieve business goals, we must develop and sell products that appeal to consumers and retail trade customers. Our continued success is dependent on leading-edge innovation with respect to both products and operations and on the continued positive reputations of our brands. This means we must be able to obtain patents and respond to technological advances and patents granted to competition. Our success is also dependent on effective sales, advertising and marketing programs in an increasingly fragmented media environment. Our ability to innovate and execute in these areas will determine the extent to which we are able to grow existing sales and volume profitably, especially with respect to the product categories and geographic markets (including developing markets) in which we have chosen to focus. There are high levels of competitive activity in the environments in which we operate. To address these challenges, we must respond to competitive factors, including pricing, promotional incentives, trade terms and product initiatives. We must manage each of these factors, as well as maintain mutually beneficial relationships with our key customers, in order to effectively compete and achieve our business plans. As a company that manages a portfolio of consumer brands, our ongoing business model involves a certain level of ongoing acquisition and divestiture activities. We must be able to successfully manage the impacts of these activities, while at the same time delivering against base business objectives. Our success will also depend on our ability to maintain key information technology systems.

Cost Pressures: Our costs are subject to fluctuations, particularly due to changes in commodity prices, raw materials, cost of labor, foreign exchange and interest rates. Therefore, our success is dependent, in part, on our continued ability to manage these fluctuations through pricing actions, cost savings projects, sourcing decisions and certain hedging transactions. We also must manage our debt and currency exposure, especially in certain countries, such as Venezuela, China and India. We need to maintain key manufacturing and supply arrangements, including sole supplier and sole manufacturing plant arrangements. We must implement, achieve and sustain cost improvement plans, including our outsourcing projects and those related to general overhead and workforce optimization. Successfully managing these changes, including identifying, developing and retaining key employees, is critical to our success.

Global Economic Conditions: Economic changes, terrorist activity and political unrest may result in business interruption, inflation, deflation or decreased demand for our products. Our success will depend, in part, on our ability to manage continued global political and/or economic uncertainty, especially in our significant geographic markets, as well as any political or economic disruption due to terrorist and other hostile activities.

Regulatory Environment: Changes in laws, regulations and the related interpretations may alter the environment in which we do business. This includes changes in environmental, competitive and product-related laws, as well as changes in accounting standards and taxation requirements. Our ability to manage regulatory, tax and legal matters (including product liability, patent, intellectual property, competition law matters and tax policy) and to resolve pending legal matters within current estimates may impact our results.

RESULTS OF OPERATIONS   Three Months Ended December 31, 2010

The following discussion provides a review of results for the three months ended December 31, 2010 versus the three months ended December 31, 2009.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES

(Amounts in Millions Except Per Share Amounts)

Consolidated Earnings Information

	Three Months Ended December 31		
	2010	**2009**	**% CHG**
NET SALES	$ 21,347	$ 21,027	2%
COST OF PRODUCTS SOLD	10,287	9,736	6%
GROSS MARGIN	11,060	11,291	(2)%
SELLING, GENERAL & ADMINISTRATIVE EXPENSE	6,800	6,636	2%
OPERATING INCOME	4,260	4,655	(8)%
TOTAL INTEREST EXPENSE	209	224	
OTHER NON-OPERATING INCOME/(EXPENSE), NET	10	53	
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	4,061	4,484	(9)%
INCOME TAXES	728	1,335	
NET EARNINGS FROM CONTINUING OPERATIONS	3,333	3,149	6%
NET EARNINGS FROM DISCONTINUED OPERATIONS		1,510	
NET EARNINGS	3,333	4,659	(28)%
EFFECTIVE TAX RATE FROM CONTINUING OPERATIONS	17.9%	29.8%	
PER COMMON SHARE:			
BASIC NET EARNINGS CONTINUING OPERATIONS	$ 1.17	$ 1.06	
BASIC NET EARNINGS DISCONTINUED OPERATIONS	$	$ 0.52	
BASIC NET EARNINGS	$ 1.17	$ 1.58	
DILUTED NET EARNINGS CONTINUING OPERATIONS	$ 1.11	$ 1.01	10%
DILUTED NET EARNINGS DISCONTINUED OPERATIONS	$	$ 0.48	
DILUTED NET EARNINGS	$ 1.11	$ 1.49	(26)%
DIVIDENDS	$ 0.4818	$ 0.4400	9.5%
AVERAGE DILUTED SHARES OUTSTANDING	3,000.2	3,118.5	
COMPARISONS AS A % OF NET SALES			**Basis Pt Chg**
GROSS MARGIN	51.8%	53.7%	(190)
SELLING, GENERAL & ADMINISTRATIVE EXPENSE	31.8%	31.6%	20
OPERATING MARGIN	20.0%	22.1%	(210)
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	19.0%	21.3%	(230)
NET EARNINGS FROM CONTINUING OPERATIONS	15.6%	15.0%	60

Net sales increased 2% to $21.3 billion on 6% unit volume growth. Volume growth was broad based with growth in all major geographic regions. Volume increased double digits in developing regions and low single digits in developed regions. Five of the six business segments grew volume, led by high single-digit growth in the Fabric Care and Home Care and Baby Care and Family Care segments. Volume was up mid-single digits in the Beauty, Grooming and Health Care segments, and declined low single digits in the Snacks and Pet Care segment. Negative mix reduced net sales by 2% due mainly to disproportionate growth in developing regions and mid-tier value products, both of which have lower than Company average selling prices. Unfavorable foreign exchange lowered net sales by 2% as key foreign currencies weakened versus the U.S. dollar. Organic sales were up 3%.

	Net Sales Change Drivers 2010 vs. 2009 (Three Months Ended Dec. 31)					
	Volume with Acquisitions & Divestitures	Volume excluding Acquisitions & Divestitures	Foreign Exchange	Price	Mix/ Other	Net Sales Growth
Beauty and Grooming GBU						
Beauty	5%	6%	-1%	-1%	-2%	1%
Grooming	5%	5%	-3%	1%	0%	3%
Health and Well-Being GBU						
Health Care	5%	5%	-3%	0%	0%	2%
Snacks and Pet Care	-2%	-6%	-1%	0%	-1%	-4%
Household Care GBU						
Fabric Care and Home Care	7%	5%	-3%	-1%	-3%	0%
Baby Care and Family Care	8%	8%	-3%	0%	-2%	3%
Total Company	**6%**	**6%**	**-2%**	**0%**	**-2%**	**2%**

Sales percentage changes are approximations based on quantitative formulas that are consistently applied.

Gross margin declined 190 basis points to 51.8% of net sales for the quarter. The decline was mainly due to 160-basis point increase in commodity and energy costs and unfavorable product mix from disproportionate growth in developing regions and mid-tier value product. These were partially offset by the favorable impact of volume scale leverage and manufacturing cost savings.

Total selling, general and administrative expenses (SG&A) increased 2% driven by higher marketing and overhead spending, which were mostly offset by the impact of higher foreign currency exchange costs in the base period. Marketing spending increased primarily due to increased investments to support innovation and expansion plans. Overhead spending was up behind investments to support business growth and charges for potential competition law fines (see note 9 to the Consolidated Financial Statements), which totaled approximately $305 million in the current period and $267 million in the prior year period. We incurred approximately $226 million of foreign currency exchange costs in the base period primarily to swap Venezuelan bolivars for U.S. dollars in the parallel market and to remeasure a portion of our net monetary assets denominated in bolivars at the parallel market exchange rate. These costs were nominal in the current period. See the section titled Foreign Currency Translation Venezuela Impacts below for additional discussion. SG&A as a percentage of net sales increased 20 basis points as higher spending was only partially offset by scale leverage from an increase in net sales.

Interest expense declined $15 million versus the prior year period primarily due to lower interest rates on floating rate debt, partially offset by an increase in debt outstanding. Other non-operating income/(expense), net decreased $43 million primarily due to the impact of a prior-year gain on the acquisition of MDVIP, a physicians network focused on preventative medicine.

The effective tax rate on continuing operations decreased from 29.8% in the prior year to 17.9% primarily due to 930 basis points of net favorable discrete adjustments to income tax reserves in a number of jurisdictions. Net adjustments to tax balances for uncertain tax positions resulted in a benefit of approximately $378 million in the quarter, including a $252 million benefit related to the pending settlement of tax litigation primarily related to the deductibility of technology donations. We do not expect the magnitude of recent benefits from these adjustments to be sustainable. The current-quarter tax rate also benefited from the geographic mix of earnings, as an increased proportion of earnings were generated in lower tax jurisdictions during the quarter.

Net earnings from continuing operations increased 6% to $3.3 billion driven primarily by a lower effective tax rate and higher net sales, partially offset by a 210-basis point reduction in operating margin. The decline in operating margin resulted largely from a lower gross margin. Diluted net earnings per share from continuing operations increased 10% to $1.11. Earnings per share growth exceeded net earnings growth due to the impact of share repurchase activity.

Net earnings from discontinued operations decreased $1.5 billion mainly due to the impact of a gain on the divestiture of the global pharmaceuticals business in the prior year period.

Net earnings decreased 28% to $3.3 billion driven by the decrease in net earnings from discontinued operations, partially offset by an increase in net earnings from continuing operations. Diluted net earnings per share declined 26% to $1.11. The decline in earnings per share was less than the decline in net earnings due to the impact of share repurchases.

Foreign Currency Translation Venezuela Impacts

Venezuela is a highly inflationary economy under U.S. GAAP. As a result, the U.S. dollar is the functional currency for our subsidiaries in Venezuela. Any currency remeasurement adjustments for non-dollar denominated monetary assets and liabilities held by these subsidiaries and other transactional foreign exchange gains and losses are reflected in earnings.

The Venezuelan government has introduced a number of currency controls for companies operating in Venezuela. During calendar year 2010, there were two official exchange rates for imported goods. Those goods classified as essential, such as food, medicine and capital investments, had an exchange rate of 2.6 bolivars to the U.S. dollar, while payments for other non-essential goods had an exchange rate of 4.3. Many of our imported products fell into the essential classification and qualified for the 2.6 rate. In January 2011, the Venezuelan government announced the elimination of the 2.6 exchange rate on essential goods. Our overall results in Venezuela are reflected in our Consolidated Financial Statements at the 4.3 rate expected to be applicable to dividend repatriations.

There are also exchange controls over securities transactions in the parallel market, which has historically been used to pay for imported goods and services that do not qualify for exchange in the official market. The Central Bank of Venezuela is the only legal intermediary through which parallel market transactions can be executed. The government controls the underlying parallel exchange rate which was approximately 5.3 as of December 31, 2010. The notional amount of transactions that run through this parallel market mechanism is very restricted, which has eliminated our ability to access the parallel market to pay for imported goods and/or manage our local monetary asset balances.

As of December 31, 2010, we had net monetary assets denominated in local currency of approximately $590 million. Approximately $280 million of this balance has been remeasured using the parallel rate because we plan to use that amount of the net assets (largely cash) to satisfy U.S. dollar denominated liabilities that do not qualify for official rate dollars. The availability of the parallel market to settle these transactions is uncertain. The remaining net monetary asset balances are currently reflected within our Consolidated Financial Statements at the 4.3 official exchange rate. Depending on the future availability of U.S. dollars at the official rate, our local U.S. dollar needs and our overall repatriation plans, we have exposure for the differential between the official and parallel exchange rates on this portion of our local monetary assets.

Our ability to effectively manage sales and profit levels in Venezuela will be impacted by several factors, including the Company s ability to mitigate the effect of any potential future devaluation, further actions of the Venezuelan government, economic conditions in Venezuela, such as inflation and consumer spending, the availability of raw materials, utilities and energy and the future state of exchange controls in Venezuela including the availability of U.S. dollars at the official foreign exchange rate.

RESULTS OF OPERATIONS Six Months Ended December 31, 2010

The following discussion provides a review of results for the six months ended December 31, 2010 versus the six months ended December 31, 2009.

THE PROCTER & GAMBLE COMPANY AND SUBSIDIARIES

(Amounts in Millions Except Per Share Amounts)

Consolidated Earnings Information

	Six Months Ended December 31		
	2010	**2009**	**% CHG**
NET SALES	$ 41,469	$ 40,834	2%
COST OF PRODUCTS SOLD	19,976	19,134	4%
GROSS MARGIN	21,493	21,700	(1)%
SELLING, GENERAL & ADMINISTRATIVE EXPENSE	12,732	12,597	1%
OPERATING INCOME	8,761	9,103	(4)%
TOTAL INTEREST EXPENSE	417	511	
OTHER NON-OPERATING INCOME/(EXPENSE), NET	(1)	76	
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	8,343	8,668	(4)%
INCOME TAXES	1,929	2,492	
NET EARNINGS FROM CONTINUING OPERATIONS	6,414	6,176	4%
NET EARNINGS FROM DISCONTINUED OPERATIONS		1,790	
NET EARNINGS	6,414	7,966	(19)%
EFFECTIVE TAX RATE FROM CONTINUING OPERATIONS	23.1%	28.7%	
PER COMMON SHARE:			
BASIC NET EARNINGS - CONTINUING OPERATIONS	$ 2.24	$ 2.08	
BASIC NET EARNINGS - DISCONTINUED OPERATIONS	$	$ 0.61	
BASIC NET EARNINGS	$ 2.24	$ 2.69	
DILUTED NET EARNINGS - CONTINUING OPERATIONS	$ 2.13	$ 1.98	8%
DILUTED NET EARNINGS - DISCONTINUED OPERATIONS	$	$ 0.58	
DILUTED NET EARNINGS	$ 2.13	$ 2.56	(17)%
DIVIDENDS	$ 0.9636	$ 0.8800	9.5%
AVERAGE DILUTED SHARES OUTSTANDING	3,013.0	3,114.5	

COMPARISONS AS A % OF NET SALES			**Basis Pt Chg**
GROSS MARGIN	51.8%	53.1%	(130)
SELLING, GENERAL & ADMINISTRATIVE EXPENSE	30.7%	30.8%	(10)
OPERATING MARGIN	21.1%	22.3%	(120)
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	20.1%	21.2%	(110)
NET EARNINGS FROM CONTINUING OPERATIONS	15.5%	15.1%	40

Net sales increased 2% to $41.5 billion fiscal year to date on a 7% increase in unit volume. Volume growth was broad based with growth in all geographic regions, led by double-digit growth in Asia and CEEMEA. Five of the six business segments contributed to volume growth, with high single-digit growth in the Fabric Care and Home Care and the Baby Care and Family Care segments, mid-single-digit growth in the Beauty, Grooming and Health Care segments, and a low single-digit decline in the Snacks and Pet Care segment. Organic volume,

which excludes acquisitions and divestitures, was up 6%. Pricing reduced net sales by 1% mainly due to pricing adjustments executed in previous periods, partially offset by price increases taken in developing regions to offset currency devaluations. Mix reduced net sales by 2% due mainly to disproportionate growth in developing regions and mid-tier value products, both of which have lower than Company average selling prices. Unfavorable foreign exchange lowered net sales by 2% as key foreign currencies weakened versus the U.S. dollar. Organic sales were up 4% driven by unit volume growth, partially offset by lower pricing and unfavorable mix.

	Net Sales Change Drivers 2010 vs. 2009 (Six Months Ended Dec. 31)					
	Volume with Acquisitions & Divestitures	**Volume excluding Acquisitions & Divestitures**	**Foreign Exchange**	**Price**	**Mix/ Other**	**Net Sales Growth**
Beauty and Grooming GBU						
Beauty	5%	5%	-2%	0%	-2%	1%
Grooming	5%	5%	-3%	1%	0%	3%
Health and Well-Being GBU						
Health Care	5%	5%	-3%	-1%	0%	1%
Snacks and Pet Care	-1%	-5%	-1%	-1%	-2%	-5%
Household Care GBU						
Fabric Care and Home Care	8%	7%	-3%	-1%	-3%	1%
Baby Care and Family Care	9%	9%	-3%	-1%	-3%	2%
Total Company	**7%**	**6%**	**-2%**	**-1%**	**-2%**	**2%**

Sales percentage changes are approximations based on quantitative formulas that are consistently applied.

Gross margin contracted 130 basis points to 51.8% of net sales. The reduction in gross margin was driven mainly by a 160-basis point increase in commodity and energy costs and unfavorable product mix from disproportionate growth in developing regions and mid-tier value product. These impacts were partially offset by the favorable impact of volume scale leverage and manufacturing cost savings.

Total SG&A expense was up 1% to $12.7 billion as higher marketing spending was mostly offset by lower overhead spending and the impact of higher foreign currency exchange costs in the base period. Marketing spending increased behind continued investments in our innovation and expansion plans. Overhead spending declined behind productivity improvements and lower restructuring spending, partially offset by net charges for potential competition law fines (see note 9 to the Consolidated Financial Statements), which totaled approximately $306 million in the current year and $267 million in the prior year period. We incurred approximately $546 million of foreign currency exchange costs in the base period primarily to swap Venezuelan bolivars for U.S. dollars in the parallel market and to remeasure a portion of our net monetary assets denominated in bolivars at the parallel market exchange rate. These costs were nominal in the current period. See the section titled Foreign Currency Translation Venezuela Impacts above for additional discussion. SG&A as a percentage of net sales declined 10 basis points due to scale leverage from an increase in net sales.

Interest expense declined $94 million mainly due to lower interest rates on floating rate debt. Other non-operating income/(expense), net declined $77 million primarily due to the impact of a gain on the acquisition of MDVIP in the prior year period.

The effective tax rate on continuing operations decreased from 28.7% in the prior year to 23.1% primarily due to 460 basis points of net favorable discrete adjustments to income tax reserves in a number of jurisdictions. Net adjustments to tax balances for uncertain tax positions resulted in a benefit of approximately $380 million fiscal year to date, including a $252 million benefit related to the pending settlement of tax litigation primarily related to the deductibility of technology donations. We do not expect the magnitude of recent benefits from these adjustments to be sustainable. The tax rate also benefited from the geographic mix of earnings, as an increased proportion of earnings were generated in lower tax jurisdictions during the current year.

Net earnings from continuing operations increased 4% to $6.4 billion driven primarily by a lower effective tax rate and higher net sales, partially offset by a 120-basis point reduction in operating margin. The decline in operating margin resulted largely from lower gross margin. Diluted net earnings per share from continuing operations increased 8% to $2.13. Earnings per share growth exceeded net earnings growth due to the impact of share repurchase activity.

Net earnings from discontinued operations decreased $1.8 billion mainly due to the impact of the gain on the divestiture of the global pharmaceuticals business in the prior year period.

Net earnings declined 19% to $6.4 billion due to a reduction in net earnings from discontinued operations, partially offset by an increase in net earnings from continuing operations. Diluted net earnings per share declined 17% to $2.13. The decline in earnings per share was less than the decline in net earnings due to the impact of share repurchases.

BUSINESS SEGMENT DISCUSSION Three and Six Months Ended December 31, 2010

The following discussion provides a review of results by business segment. Analyses of the results for the three and six months ended December 31, 2010 are provided compared to the same three and six month periods ended December 31, 2009. The primary financial measures used to evaluate segment performance are net sales and net earnings from continuing operations. The table below provides supplemental information on net sales and net earnings from continuing operations by business segment for the three and six months ended December 31, 2010 versus the comparable prior year period (amounts in millions):

	Three Months Ended December 31, 2010					
	Net Sales	% Change Versus Year Ago	Earnings From Continuing Operations Before Income Taxes	% Change Versus Year Ago	Net Earnings From Continuing Operations	% Change Versus Year Ago
Beauty and Grooming GBU						
Beauty	$ 5,290	1%	$ 1,141	0%	$ 896	2%
Grooming	2,164	3%	635	4%	482	11%
Health and Well-Being GBU						
Health Care	3,138	2%	779	-1%	531	-1%
Snacks and Pet Care	798	-4%	93	-35%	67	-32%
Household Care GBU						
Fabric Care and Home Care	6,308	0%	1,165	-19%	758	-21%
Baby Care and Family Care	3,930	3%	802	-13%	502	-13%
Corporate	(281)	N/A	(554)	N/A	97	N/A
Total Company	21,347	2%	4,061	-9%	3,333	