



Business Description:

Procter & Gamble Company (P&G) is a leading multinational corporation which provides highly competitive consumer packaged goods. Its diversified portfolio consists of some of the world's most well-known brands in multiple sectors including beauty, grooming, healthcare, fabric care, home care, baby, feminine and family care. Since its initiation in 1837, the company's business expanded on the continued growth and success of its premium quality brands and products and has been recognized as a market leader with 23 billion-dollar brands. As of June 2015, P&G operates in over 180 countries and territories and generates sales of more than \$83 billion per annum. The company is headquartered in Cincinnati, Ohio, United States, with approximately 118,000 operating employees.

Overview and Investment Thesis:

- **Leading brands with significant market share.** Within the 23 brands with sales over a billion, many of P&G's brands and products are widely recognized as market leaders. In beauty care sector, brands such as Pantene and Head & Shoulders together control over 20% of the global market share in retail hair care and color market. In grooming, approximately 70% of global blades and razors market share falls into its Gillette franchise including Fusion, Mach3, Prestobarba and Venus. It also holds over 20% of the male shavers market and over 40% of the female epilators market. In health care, P&G held approximately 20% of global market share in oral care and one of the top ten competitors in personal healthcare. In fabric care, its brands including Tide, Ariel and Downy controls over 25% of global market share. In home care, its market share is approximately 20% across the categories it competes. In baby care, the company controls over 30% of the global market share supported by its largest brand Pampers. In feminine care, P&G possesses over 30% of global market share, primarily driven by the Always brand. In family care, the company's North American business is comprised largely of Bounty and Charmin with over 70% market share of the US market.
- **Global scale with broad footprint.** Through its brands and products, P&G serves nearly 5 billion people in more than 180 countries worldwide. Benefiting from 177 years of brand building experience, the company takes its portfolio of brands to consumers through five regional selling and market operations, which include North America, Europe, Latin America, Asia and India/Middle East/Africa.
- **Significant portfolio restructuring.** In an effort to streamline and simplify operations while improving overall growth and profit margins, P&G has announced plans to divest its smaller brands over a multi-year period. The management has stated that the company will eliminate more than half of its brands, leaving the firm with 70 to 80 leading brands that produce about 80% of annual sales and 95% of pre-tax profit. Since the initiation of the long-term strategic plan in August 2014, P&G has already divested or consolidated over 40 brands with more in various stages of negotiation. As a continuing effort, on July 9, 2015, the company announced its sale of 43 beauty brands to Coty, including Miss Clairol, Covergirl and Max Factor. We believe there is significant upside in association with the restructuring of P&G's portfolio, as it will allow the firm to refocus on its core assets and compete in categories and brands that are structurally attractive and play to P&G's strengths. Furthermore, the strategic move will help the company to reallocate resources to leading brands, acquisitions and shareholder friendly actions such as dividend increases and share repurchases.
- **Substantial cost-savings opportunities.** In 2012, the company announced a \$10 billion productivity plan to achieve greater operation efficiency. Since then, the project has gained more scope as the firm reduced payrolls by 16%, which is over 50% above the original objective and two years sooner than planned.

P&G's manufacturing reliability and adherence to high quality standards resulted in less raw material usage, and reduced finished product scrapping. In addition, P&G also smoothed the localization of the supply chain which drives savings in transportation and warehousing costs.

- **Value creation driven by innovation.** Since its initiation, innovation has been the lifeblood of P&G. Due to its consistent success in innovation, the company was able to benefit from higher revenue and better margins, therefore capturing a greater share of value – both in terms of earnings and cash returns. From time to time, P&G's innovations have frequently been recognized as some of the most successful new products. For example, 7 of P&G's new launches including Tide Pods, ZzzQuil and Downy Infusions were among the top ten list of the 2013 New Product Pacesetters List.
- **Continued dividend increase.** In April 2015, P&G announced a 3% increase to its quarterly dividend distribution which represented the 59th consecutive years of dividend increase. P&G is expected to repurchase approximately \$5 billion worth of shares and distributes more than \$7 billion dividends during fiscal year 2015. With its strong cash flow and the healthy balance sheet, we believe the company is likely to continue returning value to shareholders via increasing dividend payments and share repurchases.
- **Strong credit quality.** P&G's favorable financial condition is highlighted by its solid credit ratings, Aa3 from Moody's and AA- from Standard & Poor's. In addition, the firm maintains in-place bank credit facilities of \$11 billion to support its ongoing commercial paper program. These credit facilities together with the positive credit ratings have enhanced P&G's ability to achieve optimal loan terms.
- **Experienced management team.** P&G's executive team is lead by industry experts who have in-depth knowledge about the firm. To smooth the transition period, the former president and CEO Alan George Lafley was reappointed. During his previous tenure with P&G between 2000 and 2009, the company more than doubled sales, increased free cash flow productivity by 111% and grew its portfolio of billion-dollar brands from 10 to 23. However, recently Mr. Lafley announced he would vacate the post this year and hand his role to an internal successor. Other core executives, such as Chief Financial Officer Jon R. Moeller, Chief Brand Officer Marc S. Pritchard, Chief Information Officer Linda W. Clement-Holmes and Chief Technology Officer Kathleen B. Fish, all have more than 20 years of experience with the firm.

Industry Growth Drivers/Trends: (Industry: Consumer Staples):

- **Consumer brand awareness.** We believe brand reputation continues to serve as one of the most important factors in health, baby and beauty products, especially in developing markets, where indications of product quality are limited. Through long standing of operations in Asia, Middle East and Africa, P&G has already established a highly reputable image via trust worthy brands including Pampers, Olay, Pantene and Head & Shoulders.
- **Industry has defensive characteristics.** The defensive nature of the consumer sector has often lead to stable sales, consistent earnings, and higher dividends. This is particularly true in a weakening economy, as consumer's demand for general household items remains resilient.
- **Emerging market opportunities.** The opportunities in emerging markets are largely due to their rapid economic expansions in the past few decades. Consumer purchase power in developing nations such as India and China has been growing at a high pace as highlighted by the nations' annual GDP per capita increase. We believe P&G is well positioned to take advantage of high growth in those markets and benefit from the shift towards consumption of those economies.



- **Change in government policy.** Birth rate in Asia is expected to pick up as aging domestic labor force will likely lead to the loosening of regulatory policy. In China, the decades long one-child policy is expected to come to an end. With widely recognized brand names and about a quarter of P&G's net sales derived from the Baby, Feminine and Family care sector, we believe P&G will realize material gains on its top line growth over the next few decades.

Competitive Advantages:

- **Leading brands:** P&G has some of the world's most well-known brands. The company boasts 23 billion-dollar brands, while claiming 80 leadership brands that contribute approximately 95% of pre-tax profit.
- **Global scale:** P&G has wide global exposure with its products and brands serving nearly 5 billion populations in over 180 countries.
- **Efficient supply chain:** The "localization" of the supply chain is driving savings in transportation and warehousing costs, where its competitors may not have the scale and budget to achieve so.

Competitors:

- **Beauty, hair and personal care:** Avon Products Inc., Estee Lauder Companies Inc., L'Oreal AS, Revlon Inc., Coty Inc.
- **Health Care:** CCA Industries Inc., Church and Dwight Co Inc., Ecolab Inc., United Guardian Inc., Johnson & Johnson Co.
- **Fabric care and home care:** Unilever NV, Colgate-Palmolive Co.

Customers:

- P&G's largest customer, Wal-Mart Stores, Inc. and its affiliates accounted for approximately 14% of consolidated net sales. Given the breadth and depth of the company's diversified portfolios of businesses, there is no other significant exposure to a single customer.

Barriers to Entry:

- **Economies of scale:** In order to compete in sectors that involve transportation, distribution and storage of goods and products, a start-up firm would need to spend significant amount of up-front outlays for laying out an efficient supply chain. A long established supply chain is likely to help larger companies achieve economies of scale, but it would be much more difficult for a new firm to duplicate.
- **Brand recognition:** In consumer goods industries, existing firms tend to have decades of operating exposure to their domestic geographic locations. Consumers may have an established brand loyalty which is likely to provide a barrier to new entrants.
- **Innovation capability:** Industry leading firms have the ability to consistently produce new products that satisfy the dynamic needs of consumers. New entrants with less financial resources tend to be less active in response to changing customer demand.

Officers and Directors:

- Chairman of the board, President, Chief Executive Officer, Alan George Lafley; Chief Financial Officer, Jon Moeller; Group President – Global Fabric and Home Care, Giovanni Ciserani; President – Latin America, Tarek Farahat; Group President – Europe, Mary Lynn Ferguson-McHugh.

Corporate Governance:

- 12 member board – of which 11 are considered independent directors, while one is the current Chief Executive Officer of P&G, Alan George Lafley.
- The Board of Directors has four committees including the Audit Committee, Compensation & Leadership Development Committee, Governance & Public Responsibility Committee, and Innovation & Technology Committee.
- P&G's environmental efforts are focused on conserving resources, using renewable resources and finding innovative ways to recycle or reuse waste. Its efforts in social responsibility are focused on improving health and hygiene and sharing the comforts of home for people in need.
- The company has committed to 25% less water in every dose of P&G liquid laundry detergents sold in North America by 2018. This implies that there will be less plastic, water and energy used to make, pack and ship products.
- P&G's Children's Safe Drinking Water program has provided more than seven billion liters of clean drinking water to those in greatest need. The program has helped save an estimated 40,000 lives, as drinking contaminated water is a primary cause of death and illness in developing countries.
- P&G's key management personnel remuneration is equivalent to 0.3% of the company's operating income.

Ownership:

- The Vanguard Group, Inc. 6.05%, State Street Global Advisors 4.41%, BlackRock Institutional Trust Co. 3.93% and Berkshire Hathaway Inc. 1.95%, Capital World Investors 1.76%.

Capital Allocation/Uses:

- During its fiscal year 2014, P&G generated \$14 billion in operating cash flow. Compared to fiscal year 2013, the company's operating cash flow decreased by 6% from \$14.9 billion. The decrease in operating cash flow was primarily driven by a \$1 billion discretionary contribution into a company pension plan. Free cash flow was \$10.1 billion in 2014, a decrease of 7% compare to prior year. Also, free cash flow to net earnings was 86%, a decline from 95% in previous year.
- In 2014, the company used \$3.8 billion of capital expenditure to support capacity expansion, innovation and cost savings. The spending figure declined by \$0.2 billion compared to prior year, and capital expenditure as a percentage of net sales decreased 30 basis points to 4.6% in 2014.
- Proceeds from asset sales in minor brand divestiture activities contributed \$570 million in cash. Those divested business include the Pert business in Latin America, and bleach business in Central and Eastern Europe, Middle East and Africa.
- P&G's first discretionary use of cash is dividend payments. Dividends per share increased 7% to \$2.45 per share in 2014. Total dividend payments to common and preferred shareholders were \$6.9 billion in 2014 and \$6.5 billion in 2013.
- In April 2015, P&G announced a 3% increase to its quarterly dividend distribution which represented the 59th consecutive years of dividend increase.
- P&G currently has a corporate rating of Aa3 from Moody's and AA- from Standard & Poor's. In addition, the firm maintains in-place bank credit facilities of \$11 billion to support its ongoing commercial paper program.
- Total debt levels increased during its fiscal year 2014, from \$31.5 billion to \$35.4 billion. This is largely due to debt issuances and an increase in commercial paper outstanding.



Financial Statement Summary (US\$ MM except per share items which is in US\$, years ended June 30):

	2014	2013	2012	2011	2010
Income Statement					
Total Revenue	83,062	82,581	83,680	81,104	77,567
EBITDA	19,201	18,565	18,072	18,333	18,840
Earnings per Share (Diluted)	3.89	3.74	3.12	3.85	3.47
Dividend per Share	2.45	2.29	2.14	1.97	1.80
Balance Sheet					
Total Debt	19,747	19,111	21,080	22,033	21,360
Total Equity	69,214	68,064	63,439	67,640	61,115
Total Debt: Total Equity	28.53%	28.08%	33.23%	32.57%	34.95%
Cash Flow Statement					
Operating Cash Flow	13,958	14,873	13,284	13,330	16,131

Key Profitability Ratios and Figures

Y/E December 31	2014	2013	2012	2011	2010
EBITDA Margin	23.10%	22.50%	21.60%	22.60%	24.30%
Current Ratio	0.94	0.80	0.88	0.80	0.77
Return on Invested Capital	10.70%	10.50%	8.60%	10.90%	10.50%
Fixed Asset Turnover	3.78	3.93	4.02	4.00	4.01

Business Segments (Years ended June 30):

Business Sectors Mix	Net Sales (%)		Total Assets (%)		Capital Expenditure (%)	
	2014	2013	2014	2013	2014	2013
Beauty	23.48%	24.17%	5.94%	6.03%	13.05%	13.50%
Grooming	9.64%	9.73%	16.47%	17.21%	9.59%	9.43%
Health Care	9.39%	9.30%	4.08%	4.26%	6.57%	6.19%
Fabric Care and Home Care	31.37%	31.32%	7.89%	8.06%	29.99%	26.55%
Baby, Feminine and Family Care	25.22%	24.80%	7.59%	7.85%	34.23%	38.92%
Corporate	0.89%	0.68%	58.03%	56.59%	6.57%	5.41%

Geographic Segments (Years ended June 30):

Geographic Mix	Revenues (%)		Non-current Assets (%)	
	2014	2013	2014	2013
United States	35.38%	35.99%	47.68%	49.03%
Other Foreign Countries	64.62%	64.01%	52.32%	50.97%

Sourced from Thomson Reuters and Company Reports

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