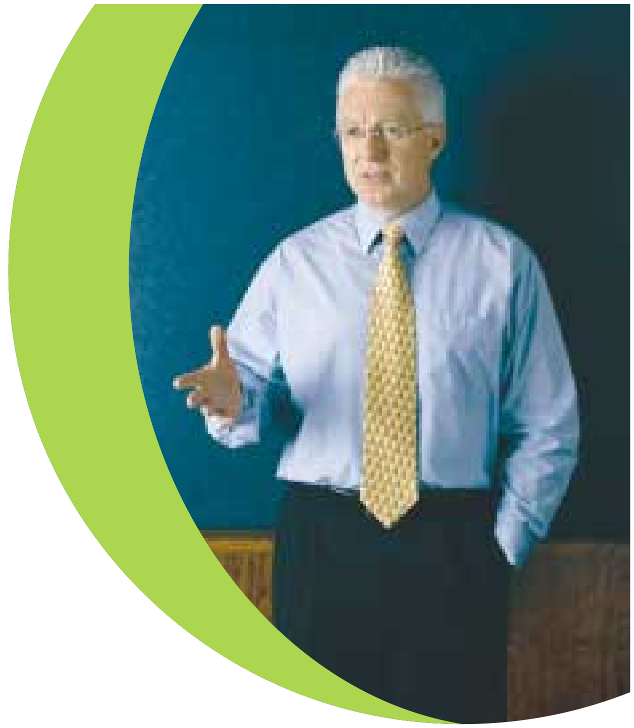


## Fellow Shareholders:

**A.G. Lafley**
Chairman of the Board,
President and
Chief Executive

P&G touches the lives of consumers around the world every day. Thirty million times a day, in more than 160 countries, P&G brands face their first moment of truth, when consumers stand in front of a store shelf – at a Wal-Mart store in West Virginia, a Carrefour store in France, a bodega in Mexico, a corner market in Egypt or a tiny "sari sari" store in the Philippines – and decide whether to buy a P&G brand, or a competing product.

A lot happens in that moment, as consumers assess the performance, quality and value P&G brands offer relative to other products on the shelf. When we strike the right balance between brand promise and store price, we win that first moment of truth.

Winning the first moment of truth is only half the battle. Soon after, P&G brands face a second moment of truth. Nearly two *billion* times a day, P&G products are put to the test when consumers use Tide to clean their clothes, Pampers to care for their babies, Pantene to care for their hair, Olay to improve the condition of their skin, Crest to brighten their smile. Every one of P&G's brands is put to this test.

In every one of those nearly two billion experiences, consumers decide whether P&G brands live up to their promises. When we get this right – when we deliver the benefits promised, when we provide a delightful and memorable usage experience, when we make everyday life a little bit better, a little more convenient, a little bit healthier and more beautiful – then we begin to earn the trust on which great brands are built.

At P&G, we've been competing for and winning these moments of truth for 165 years. As a result, we've built one of the largest and strongest portfolios of leading brands in the world.

We have made substantial progress over the past two years in strengthening P&G's business. We're back in the lead. We're committed to continuing this progress and to ensuring we squarely face changing marketplace realities – to get out in front and to stay in front of change.

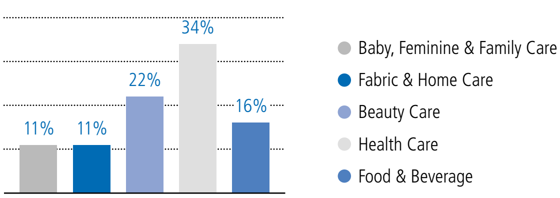
## Back on Track

Getting back in the lead has certainly been "Job One" over the past two years. With clear strategic choices, operational excellence and financial discipline, we are now returning to the consistent, reliable earnings and cash growth that shareholders expect from P&G.

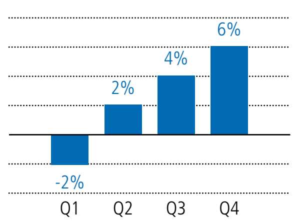
**We are delivering long-term growth objectives ahead of plan.** Our long-term goals are to consistently deliver double-digit core earnings per share growth, and 4% to 6% sales growth, excluding the impacts of foreign exchange. Core net earnings increased 10% to $5.1 billion. Core diluted net earnings per share, which excludes the impact of restructuring charges and the prior-year amortization of goodwill and indefinite-lived intangibles (which is no longer required under new accounting rules), increased 10% to $3.59. Core operating income increased 12% to $7.6 billion. Volume for the year grew 7%. Sales were up 4%, excluding foreign exchange impact, despite corrective pricing actions taken over the last 18 months. Consumers have reacted positively to the improved value our brands now offer, with volume and sales growth accelerating in the second half of the year.

This growth is broad-scale. Every business unit delivered profitable growth at rates above the corporate objective. Every geographic region delivered volume growth. We have work yet to do, but we have achieved P&G's long-term growth objectives a year earlier than we had projected.

Net Earnings Growth
(by segment versus previous year)




Net Sales Growth
(by quarter versus previous year)



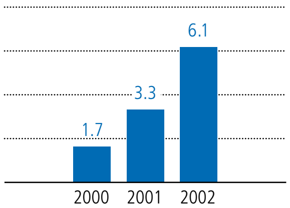
We achieved P&G's long-term growth objectives a year earlier than projected.

**We are increasing free cash flow.** Cash generation is a key indicator of a company's underlying health, and P&G's management is focused on creating leadership, sustained cash flow growth in each of our business units. Free cash flow – operating cash after capital spending – was $6.1 billion, up 83% from last year and more than triple the free cash flow generated two years ago. Capital spending improvement has been a key driver. Our objective was to reduce capital spending to 6% of sales by fiscal 2004, and we've exceeded that goal two years ahead of schedule. We are now resetting our capital spending target to below 5% of sales, and continue to look for opportunities to improve asset efficiencies.

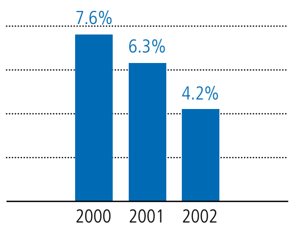
**We are delivering superior total shareholder return (TSR).** TSR is the key business unit metric upon which P&G's business planning and management compensation are based. The combination of strong earnings growth and focus on cash has resulted in superior business returns over the past year. P&G's share price has responded accordingly, outpacing the major indices of Dow Jones and the S&P 500.

These are substantial achievements, in tough economic times, in a very competitive global marketplace. These are the kinds of results P&G has delivered consistently and reliably for decades. This is the level of performance that P&G shareholders expect and also that we – the men and women of P&G – expect of ourselves. I want to commend the dedication, discipline and creativity of P&G people who delivered these results.

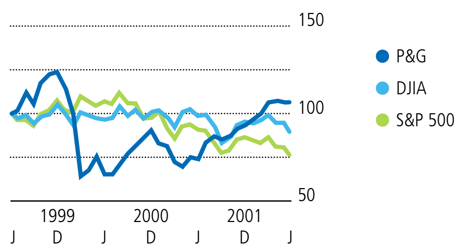
Free Cash Flow
(in billions of dollars)




Capital Spending
(as % of sales)




Total Shareholder Return
(indexed versus July 1999)



## Success Drivers

There are six drivers of P&G's success: consumer focus, strategic choices, operational excellence, financial discipline, organizational structure and brand-building capability.

**Consumer focus.** The consumer is boss and we put the consumer at the heart of all we do. First and foremost, this means getting the consumer value equation right on all our brands. It also means delivering superior, consumer-meaningful innovation. Competitive pressures make this a continuing challenge, but we are working hard in every part of our business to deliver a continual stream of innovation that meets consumer needs in ways that reset performance expectations and represent superior value.

We are also making sure that P&G business leaders – including me – get out of the office and into stores and homes to talk directly with people who buy and use our products. No other real-world experience clarifies the choices we must make as much as these conversations with consumers.

**Strategic choices.** We've focused on P&G's core categories, leading brands, and the biggest retail customers and country markets. And, we're investing in faster-growing, higher-margin, more asset-efficient businesses. A good example is the acquisition of Clairol, which complements the core Hair Care business and helps P&G enter the fast-growing hair colorant category. Strategic choices like these are paying off. For example, about one-fourth of total gross margin improvement in fiscal 2002 came from our emphasis on faster-growing, higher-margin businesses such as Beauty Care and Health Care.

**Operational excellence.** Execution determines success, and we've placed heightened emphasis on operational excellence at P&G. Again, Clairol is a good example. We closed this deal in less than six months and fully integrated business operations seven months later. Most important, we accomplished a smooth integration and we're on track to deliver the committed synergy savings ahead of schedule.

**Financial discipline.** We have reinforced P&G's long-standing commitment to financial discipline. Our efforts are seen most clearly in the Company's business results. Even before the highly publicized accounting failures at several companies, we took a number of specific

Recent P&G innovations include Pampers Baby Stages of Development diapers, Crest SpinBrush and Whitestrips, Olay Daily Facials and Total Effects, Tampax Pearl, Tide and Downy Clean Breeze, Swiffer and many others.


Iams in North America is another great example of operational excellence. Starting with a 25,000 store, 3,000 truck launch – P&G's largest ever – Iams has delivered nine consecutive quarters of market share growth.

steps to ensure strong corporate governance. We reiterated clear expectations for ethical behavior. We instituted a broad-based Financial Stewardship program – more than 18 months ago – to provide even more focus on fiduciary responsibilities, internal controls and accounting processes. We continue to engage openly with P&G's Board of Directors, and with the Board's Audit Committee, which is comprised entirely of independent directors. And we maintain an independent relationship with Deloitte & Touche, including formal processes to approve non-audit services. These practices are consistent with the way P&G has operated for decades, and we are continually renewing the organization's commitment to them.

**Organizational structure.** P&G's unique operating structure is creating meaningful competitive advantage. In 1999, we reorganized the Company by consolidating categories and brands into Global Business Units (GBUs), aggregating country and regional go-to-market capabilities into Market Development Organizations (MDOs) and providing single-source business services through a Global Business Services organization (GBS). It has taken some time to implement, but we're now reaping real advantage from consumer and market responsiveness and the substantial synergies made possible by the new structure. The success of Pampers Baby Stages of Development initiative in the United Kingdom is one good example. The business unit focused on delivering superior product, packaging and advertising; the MDO delivered an outstanding trial plan, superior in-store fundamentals and strong External Relations support. By "dividing and conquering" against a common business strategy and plan, we achieved more, faster. Since the launch, Pampers' U.K. market share is back to 51%, 16 points ahead of the #2 brand.

**Brand building.** Branding is more important than ever – and big, leading brands are more valuable than ever. In a sea of choices where confusion reigns, consumers value the reliable promise of their favorite brands. This plays to our strength: branding is in P&G's DNA. P&G has 12 billion-dollar brands in its portfolio today – and more are expected to come. These brands represent more than half of the Company's sales and earnings. Equally important, these brands account for the majority of P&G's consumer interactions – the millions of "moments of truth" we face and win every day.

## P&G's Billion-Dollar Brands

**Pampers**
Over 30 million babies experience the comfort and dryness of Pampers every day.

**Tide**
Tide cleans more than 32 million loads of laundry every day.

**Ariel**
More than 300 million pieces of clothing are washed with Ariel every day.

**Always/Whisper**
On an average day, over 25 million women are using Always.

**Pantene**
Nearly 1.7 million consumers purchase a Pantene product every day.

**Charmin**
Every day, 50 million households in North America squeeze the Charmin.




**Bounty**
Every day, 50 million North American households experience Bounty as the Quicker Picker-Upper.

**Iams**
Iams and Eukanuba provide 27 million dogs and cats with superior nutrition every day.


**Crest**
A Crest product brings a beautiful, healthy smile to over 150 million faces every day.

**Folgers**
Americans drink 85 million cups of Folgers every day.



**Pringles**
People pop 275 million Pringles every day.

**Downy/Lenor**
Downy softens and freshens over 21 million loads of laundry every day.


# 1 Changing Consumer Expectations

While we've made steady progress, we know we're in a fast-moving, global marketplace in which the magnitude, pace and scope of change are accelerating. To keep P&G in the lead, it is essential that we anticipate change and get in front of it. We're doing that with a focus on three "new realities" that are shaping the future marketplace.

First is the changing expectations of consumers. Our business has always been about consumer value and in today's demanding economic environment, value is more important than ever.

The key to winning in this environment is to reset expectations for performance *and* price. Olay Total Effects is a good illustration. In global research, women identified seven distinct signs of aging that affect the condition of their skin. Many products addressed one or two of these signs, but no single product fought all seven. Further, the products that performed best in this category were high-end department store brands priced at $60 or $70 a bottle. With Olay Total Effects, we created a single product for all seven signs of aging based on technology that rivals or exceeds the best department store skin care brands – and offered it at a fraction of the department store price but at the top end of mass skin care pricing. Olay Total Effects is now the #1 anti-aging moisturizer in the U.S., U.K., China, Canada and Australia – growing our total Olay Skin Care franchise by nearly 20%.

The difficulty of meeting this performance/value challenge in developing markets – such as China or Eastern Europe – is even greater. Consumers in these markets have similar performance expectations, but far less purchasing power. To succeed in these markets, it's often necessary to rethink the fundamentals – everything from manufacturing to product and packaging to marketing and distribution. We have experience winning in developing markets with a range of creative solutions: single-use Pantene sachets in China and van-based distribution in Poland, for example. And we continue to develop other approaches. This will be an area of increasing importance for P&G.


**Olay Total Effects**
Olay Total Effects is now the #1 anti-aging moisturizer in the U.S., U.K., China, Canada and Australia.


Herbal
Essences
VS
SASSOON
physique

2

## Retailers as Partners and Competitors

The second "new reality" is the changing nature of retailing. Increasingly, we have a dual relationship with retail customers: we are strong partners and sometimes competitors.

In concept, the need for tighter relationships between manufacturers and retailers is obvious: we both serve the same consumer, we both want to build consumer loyalty to our brands, we're both trying to grow sales faster and more profitably. But, in practice, retailers and manufacturers can work at cross purposes. Energy, resources and time that could be devoted to creating a delightful "first moment of truth" shopping experience can be spent in unproductive discussions over shelf space, pricing, discounts and terms.

Together with retail partners, we are working hard to change this practice. For example, we know consumers are often frustrated when buying hair care products. They find it hard to locate everything they want and are often left confused and searching for product information. We're working with more than 30 retailers to enhance the performance of their hair care departments. We've simplified the shopping experience, provided more consumer education and made it easier for consumers to find and ultimately use the products that best meet their needs. Shoppers are spending half the time *finding* products and more time in the aisle *browsing* and *discovering* products – all of which leads to increased volume, sales and profits for P&G *and* our retail partners. These changes are delivering department growth ranges between 10% and 44% for retailers and P&G.

Retailers are sometimes competitors as well as partners. Their own brands are growing as the retailers, themselves, grow. Private labels or store brands strive to match innovation quickly and try to present a compelling value alternative in many categories. This is healthy, in my opinion. It requires that we continue to lead innovation and to price P&G products competitively. Further, the growing strength of store brands underscores the importance of always being the #1 or #2 brand in any category. Brands that can't maintain this leadership stature will find it difficult to compete effectively with the best store brands. Based on our internal global share measures, we have the #1 or #2 brand in 17 of our 19 key global categories – categories that account for about 70% of sales and earnings. P&G is in a strong position, and ready to become an even better retail partner.



# 3 The New “Interconnected” Organization

The third “new reality” is the emerging importance of operating as an interconnected company. A recent report by industry consultant Booz Allen Hamilton noted “‘Vertical’ thinking (i.e., own or control every link in the supply chain) has given way to ‘virtual’ thinking (i.e., create a flexible web of supply relationships and focus exclusively on what one does best).”

At P&G, we see this as an enormous opportunity – in part, because that’s where the marketplace is headed and, even more so, because P&G has a strong history of developing partnerships that bring out the best in us and our partners. We’ve done it for years with advertising agencies, customers, joint venture partners and technology suppliers.

When Dr. John’s, the maker of SpinBrush toothbrushes, approached us about licensing the Crest name, we recognized the opportunity. Within five months of that first contact, we bought the company and then brought Crest’s new, powered SpinBrush to market in record time. Crest SpinBrush, now in 20 markets, has a 50% volume share of the growing powered-brush category in the U.S. and has quadrupled the sales of the original Dr. John’s product.

When we developed the bisphosphonate technology in Actonel, we increased marketing capability by partnering with Aventis, whose field sales force had broad access to and credibility with doctors. The partnership worked well, and today Actonel is a nearly $400 million brand and growing.

Our vision is that P&G will be the best company in the world at spotting, developing and leveraging partnerships in every area of the business. In fact, I want P&G to be a magnet for best-in-class partners who want to build significant new business together.

**Crest SpinBrush**
Now in 20 markets, Crest SpinBrush has a 50% volume share of the growing powered-brush category in the U.S.


**Actonel**
In partnership with Aventis, P&G has built Actonel into a nearly $400 million brand.

## The Next Generation of Leadership

The bottom line is this: P&G is getting back on track. We have what it takes and we're doing what it takes to stay in the lead – now, and in the future. We're making clear strategic choices, strengthening operational excellence and operating with rigorous financial discipline. We're delivering the earnings growth to which we've committed – ahead of plan. We're generating cash from every business unit – at record levels. We're delivering returns that exceed the performance of the Dow Jones index and the S&P 500. In short, we are returning to the level of performance you, and we, expect from P&G – and we are determined to keep it up.

I want to close this letter with one final point. The reason things work well at P&G is that everyone is an owner and a leader. We hire people because they're leaders. We give them the training, development and experience to become even stronger leaders. We promote people who deliver superior results, operate with integrity and strengthen those around them. We have a culture that values and embraces leadership. That's true at the top of our organization. In the middle. At entry-level. It's true of people who've just joined P&G, as well as those who've spent 20- or 30-year careers at P&G.

The key in such an organization is to provide individual and business unit growth opportunities, and then to empower people to lead and execute with excellence. That is precisely what we're doing at P&G. I have no doubt we have the right organization to keep our Company growing. In these past two years, I have witnessed a passionate sense of ownership for our business that deepens my confidence in P&G's future, no matter what challenges we may face.

As owners of Procter & Gamble, you can be assured that the pioneering spirit, operating discipline and dogged commitment to being in the lead that have always characterized this Company – for 165 years! – are as alive today as they have ever been.

A.G. Lafley
Chairman of the Board,
President and Chief Executive

August 5, 2002

## Management Changes

**John Pepper Retires**
On July 1, 2002, John Pepper retired as chairman after 39 years of service with P&G. Mr. Pepper will continue as chairman of the Board's Executive Committee until July 1, 2003.

Mr. Pepper served as the ninth Chairman of the Board and Chief Executive from July 1995 through September 1999, when he retired. He was re-elected chairman of the Board of Directors, in addition to his role as chairman of the Executive Committee of the Board, in June 2000.

To honor Mr. Pepper's life-long commitment to teaching and learning, and his devotion to developing P&G people, the Company's new corporate training center at the General Office in Cincinnati has been named "The John Pepper Learning Center."

"John Pepper is the heart and soul of P&G – the living embodiment of our Purpose, Values and Principles," A.G. Lafley told employees at Mr. Pepper's retirement reception. "We are eternally grateful for his enormous personal and professional contributions."

**Bruce Byrnes and Kerry Clark Named Vice-Chairmen**
Bruce Byrnes, President, Global Beauty & Feminine Care and Global Health Care, and Kerry Clark, President, Global Market Development & Business Operations, were named vice-chairmen of the Board of Directors and directors of the Company, effective July 1, 2002. Mr. Byrnes and Mr. Clark bring great breadth of business expertise and knowledge to their new roles, along with proven track records of results.