

Edgar Filing: AVON PRODUCTS INC - Form 10-Q/A

AVON PRODUCTS INC  
Form 10-Q/A  
August 12, 2002

FORM 10-Q/A

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Quarterly Report Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

For the quarterly period ended September 30, 1999

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 1-4881

AVON PRODUCTS, INC.

-----  
(Exact name of registrant as specified in its charter)

New York

13-0544597

-----  
(State or other jurisdiction of  
Incorporation or organization)

-----  
(I.R.S. Employer  
Identification No.)

1345 Avenue of the Americas, New York, N.Y. 10105-0196

-----  
(Address of principal executive offices)

(212) 282-5000

-----  
(Telephone Number)

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  No

The number of shares of Common Stock (par value \$.25) outstanding at  
October 31, 1999 was 242,304,430.

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### Introductory Note--Restatements

In connection with the settlement of the previously disclosed investigation by the Securities and Exchange Commission ("SEC") relating to the write off of an order management software system known as the "FIRST" project, Avon has restated its Consolidated Financial Statements as of December 31, 2001, 2000 and 1999 and for the years then ended and for each of the fiscal quarters ended March 31, 1999 through March 31, 2002. Avon had written off \$14.8 pretax, or \$10.0 after tax, of FIRST assets in the first quarter of 1999 and \$23.9 pretax, or \$14.5 after tax, of FIRST assets in the third quarter of 2001. Avon has restated its financial statements to reflect the additional write off as of March 31, 1999 of all capitalized costs (\$23.3 pretax, or \$14.0 after tax), associated with the FIRST project as of that date and a reversal of the charge recorded in the third quarter of 2001. Other FIRST-related activity (capitalized costs and amortization) recorded during 1999-2002 has also been restated. A description of the adjustments that comprise the restatements is set forth in Notes 2 and 10 of the Notes to Consolidated Financial Statements filed with this Form 10-Q/A.

The accompanying financial statements have been restated to reflect the restatements discussed above as well as the accounting changes outlined in Note 2. No attempt has been made in this Form 10-Q/A to modify or update any

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disclosures except as required to reflect the results of the restatements discussed above and any changes made to prior period financial information for which a Form 10-Q/A was not filed.

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### PART I. FINANCIAL INFORMATION

#### AVON PRODUCTS, INC. CONSOLIDATED STATEMENTS OF OPERATIONS (In millions, except per share data)

	Three months ended September 30	
	1999	1998
	(Restated Note 2) -----	
	----- (unaudited)	
Net sales.....	\$1,250.6	\$1,233.2
Other revenue.....	9.1	8.7
	-----	-----
Total revenue.....	1,259.7	1,241.9
Costs, expenses and other:		
Cost of sales .....	465.0	478.2
Marketing, distribution and administrative expenses.....	648.6	636.6
Special charge.....	-	46.0
	-----	-----
Operating profit .....	146.1	81.1
Interest expense.....	9.8	9.4
Interest income.....	(2.4)	(3.3)
Other expense (income), net.....	2.6	(1.5)
	-----	-----
Total other expenses.....	10.0	4.6
Income before taxes and minority interest..	136.1	76.5
Income taxes.....	47.7	36.7
	-----	-----
Income before minority interest.....	88.4	39.8
Minority interest.....	(.3)	1.7
	-----	-----
Net income.....	\$ 88.1	\$ 41.5
	=====	=====
Earnings per share:		
Basic .....	\$ .34	\$ .16
	=====	=====
Diluted.....	\$ .34	\$ .16
	=====	=====

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In millions, except per share data)

	Nine months ended September 30	
	1999	1998
	(Restated Note 2)	
	(unaudited)	
Net sales.....	\$3,722.5	\$3,663.8
Other revenue.....	27.4	26.3
	-----	-----
Total revenue.....	3,749.9	3,690.1
Costs, expenses and other:		
Cost of sales* .....	1,424.9	1,446.9
Marketing, distribution and administrative expenses.....	1,922.3	1,886.5
Special charge.....	90.4	116.5
Asset impairment charge.....	38.1	-
	-----	-----
Operating profit.....	274.2	240.2
Interest expense.....	27.7	25.6
Interest income.....	(7.8)	(11.5)
Other (income)expense, net.....	(4.6)	2.6
	-----	-----
Total other expenses.....	15.3	16.7
	-----	-----
Income before taxes and minority interest..	258.9	223.5
Income taxes.....	116.4	106.7
	-----	-----
Income before minority interest.....	142.5	116.8
Minority interest.....	2.3	5.1
	-----	-----
Net income.....	\$ 144.8	\$ 121.9
	=====	=====
Earnings per share:		
Basic .....	\$ .55	\$ .46
	=====	=====
Diluted.....	\$ .55	\$ .46
	=====	=====

\*1999 and 1998 include one-time charges of \$46.0 and \$37.9, respectively, for inventory write-downs.

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.  
CONSOLIDATED BALANCE SHEETS  
(In millions)

	September 30 1999 (Restated Note 2)	December 31 1998
	-----	-----
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and equivalents.....	\$ 101.3	\$ 105.6
Accounts receivable.....	500.5	492.6
Inventories.....	577.5	538.4
Prepaid expenses and other.....	219.0	204.8
	-----	-----
Total current assets.....	1,398.3	1,341.4
	-----	-----
Property, plant and equipment, at cost..	1,432.7	1,392.8
Less accumulated depreciation.....	736.4	722.9
	-----	-----
	696.3	669.9
	-----	-----
Other assets.....	416.0	422.2
	-----	-----
Total assets.....	\$2,510.6	\$2,433.5
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Debt maturing within one year.....	\$ 395.7	\$ 55.3
Accounts payable.....	342.3	416.9
Accrued compensation.....	165.2	161.3
Other accrued liabilities.....	365.4	308.2
Sales and other taxes.....	95.2	106.2
Income taxes.....	286.9	281.6
	-----	-----
Total current liabilities.....	1,650.7	1,329.5
	-----	-----
Long-term debt.....	204.7	201.0
Employee benefit plans.....	395.8	390.0
Deferred income taxes.....	28.6	36.3
Other liabilities.....	185.6	191.6
	-----	-----
Shareholders' equity:		
Common stock.....	88.1	87.8
Additional paid-in capital.....	809.3	780.0
Retained earnings.....	722.8	719.1
Accumulated other comprehensive income.	(346.3)	(301.3)
Treasury stock, at cost.....	(1,228.7)	(1,000.5)
	-----	-----
Total shareholders' equity.....	45.2	285.1
	-----	-----
Total liabilities and shareholders' equity	\$2,510.6	\$2,433.5
	=====	=====

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In millions)

	Nine months ended September 30	
	1999	1998
	(Restated Note 2)	-----
	----- (unaudited)	
Cash flows from operating activities:		
Net income.....	\$ 144.8	\$ 121.9
Adjustments to reconcile net income to net cash provided/(used) by operating activities:		
Special and non-recurring charges.....	85.6	104.4
Asset impairment charge.....	38.1	-
Depreciation and amortization.....	60.8	51.2
Provision for doubtful accounts.....	65.0	66.8
Translation gains.....	(.8)	(8.6)
Deferred income taxes.....	(30.9)	(21.1)
Amortization of debt discount.....	(5.0)	-
Other.....	5.3	3.0
Changes in assets and liabilities:		
Accounts receivable.....	(115.6)	(148.0)
Inventories.....	(111.4)	(125.1)
Prepaid expenses and other.....	(16.8)	(27.2)
Accounts payable and accrued liabilities.....	(59.0)	(31.5)
Income and other taxes.....	3.9	4.9
Noncurrent assets and liabilities.....	19.2	(4.3)
	-----	-----
Net cash provided(used)by operating activities..	83.2	(13.6)
	-----	-----
Cash flows from investing activities:		
Capital expenditures.....	(120.1)	(110.9)
Disposal of assets.....	6.2	7.2
Other investing activities.....	(16.4)	(.6)
	-----	-----
Net cash used by investing activities.....	(130.3)	(104.3)
	-----	-----
Cash flows from financing activities:		
Cash dividends.....	(142.7)	(135.7)
Book overdraft.....	23.3	-
Debt, net (maturities of three months or less).	339.8	202.9
Proceeds from short-term debt.....	38.6	76.6
Retirement of short-term debt.....	(37.0)	(116.2)
Proceeds from long-term debt.....	-	100.0
Retirement of long-term debt.....	(.2)	(.5)
Repurchase of common stock.....	(182.7)	(75.0)
Proceeds from exercise of stock options.....	23.9	17.5
	-----	-----
Net cash provided by financing activities.....	63.0	69.6
	-----	-----
Effect of exchange rate changes on cash and equivalents.....	(20.2)	3.6
	-----	-----

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Net decrease in cash and equivalents.....	(4.3)	(44.7)
Cash and equivalents beginning of period.....	105.6	141.9
	-----	-----
Cash and equivalents end of period.....	\$101.3	\$ 97.2
	=====	=====

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollars in millions, except share data)

1. ACCOUNTING POLICIES

The accompanying Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the Notes thereto contained in Avon's 1998 Annual Report to Shareholders. The interim financial statements are unaudited but include all adjustments, consisting of normal recurring accruals, that management considers necessary to fairly present the results for the interim periods. Results for interim financial periods are not necessarily indicative of results for a full year. The year end balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

In May 1999, the Financial Accounting Standards Board issued an Exposure Draft delaying the effective date of Financial Accounting Standard ("FAS") No. 133, Accounting for Derivative Instruments and Hedging Activities, by one year. FAS No. 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 (January 1, 2001 for the Company). FAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction. For fair-value hedge transactions in which the Company is hedging changes in the fair value of an asset, liability, or firm commitment, changes in the fair value of the derivative instrument are included in the income statement along with the offsetting changes in the hedged item's fair value. For cash-flow hedge transactions, in which the Company is hedging the variability of cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified to earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all of the hedges will be recognized in current-period earnings. The Company has not yet determined the impact that the adoption of FAS No. 133 will have on its earnings or statement of financial position.

To conform to the 1999 presentation, certain reclassifications were made to prior years financial information.

2. RESTATEMENTS AND ACCOUNTING CHANGES

Restatements

In connection with the settlement of a previously disclosed investigation

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by the Securities and Exchange Commission relating to the write off of an order management software system known as the "FIRST" project, Avon has restated its Consolidated Financial Statements as of December 31, 2001, 2000 and 1999 and for the years then ended and for each of the fiscal quarters ended March 31, 1999 through March 31, 2002. See Introductory Note-Restatements and Note 10 of the Notes to Consolidated Financial Statements, "Asset Impairment Charge".

The accompanying financial statements have been restated to reflect the restatements discussed above as well as the accounting changes outlined in this Note. No attempt has been made in this Form 10-Q/A to modify or update any disclosures except as required to reflect the results of the restatements discussed above and any changes made to prior period financial information for which a Form 10-Q/A was not filed.

The principal adjustments comprising the restatements are as follows:

- o Reclassification of \$14.8 of pre-tax charges recorded in the first quarter of 1999 related to the write off of a portion of the FIRST project, out of the "Special charges" line and into the "Asset impairment charge" line;
- o An additional Asset impairment charge of \$23.3 pretax in the first quarter of 1999 to reflect the write off of all capitalized costs associated with the FIRST project as of March 31, 1999;
- o Reversal of the third quarter 2001 Asset impairment charge of \$23.9 pretax related to the abandonment of the FIRST project; and
- o Restatement of all other activity related to the FIRST project, consisting of costs incurred and capitalized subsequent to March 31, 1999 and amortization, recorded from the second quarter of 1999 through the first quarter of 2002.

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AVON PRODUCTS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in millions, except share data)

These adjustments resulting from the restatements are reflected in Management's Discussion & Analysis and the following notes: Special and Non-Recurring Charges, Earnings per Share, Comprehensive Income, Segment Information and Asset Impairment Charge.

The effects of these restatements on the Consolidated Financial Statements are set forth below:

Consolidated Statements of Operations			
	Three Months ended September 30, 1999		Nine Mon Septembe
	As Reported(1)	As Restated(2)	As Reported(1)
Marketing, distribution and administrative expenses	\$ 648.4	\$ 648.6	\$1,919.0
Special charges	-	-	105.2
Asset impairment charge	-	-	-



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Operating profit	146.3	146.1	300.8
Income before taxes and minority interest			
interest	136.3	136.1	285.4
Income taxes	47.8	47.7	127.0
Income before minority interest	88.5	88.4	158.4
Net income	88.2	88.1	160.7
Earnings per share:			
Basic	\$ .34	\$ .34	\$ .62
Diluted	\$ .34	\$ .34	\$ .61

### Consolidated Balance Sheet As of September 30, 1999

	As Reported(3)	As Restated(2)
	-----	-----
Property, plant and equipment, at cost	\$1,435.4	\$1,432.7
Other assets	429.3	416.0
Total assets	2,526.6	2,510.6
Retained earnings	738.8	722.8
Total liabilities and shareholder's equity	2,526.6	2,510.6

- (1) As reported (as prior period comparative data) in the Company's Form 10-K for the year ended December 31, 2000, which includes the effect of the accounting changes outlined below.
- (2) Includes the effects of restatements and accounting changes.
- (3) As reported in the Company's Form 10-Q for the quarter ended September 30, 1999.

#### Accounting Changes

In addition, the Form 10-Q/A reflects the following changes to prior period financial information for which a Form 10-Q/A was not previously filed. These changes are primarily the result of the previously disclosed adoption of new accounting pronouncements and are unrelated to the restatements described above and the FIRST project:

- o Accounting changes made to reported 1999 financial information as a result of the adoption of Emerging Issues Task Force ("EITF") 00-10, "Accounting for Shipping and Handling Fees and Costs". The adoption of EITF 00-10 resulted in increases in Marketing, distribution and administrative expenses and Other Revenue of \$9.1 and \$27.4 for the three and nine months ended September 30, 1999, respectively, and \$8.7 and \$26.3 for the three and nine months ended September 30, 1998, respectively. The adoption of this EITF had no impact on Net income or Earnings per share.
- o Reclassifications made to reported financial information to conform with the 1999 full year presentation.

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### 3. INFORMATION RELATING TO THE STATEMENT OF CASH FLOWS

"Net cash provided (used) by operating activities" includes the following cash payments for interest and income taxes:

	Nine months ended September 30	
	1999	1998
	----	----
Interest.....	\$ 34.0	\$ 30.3
Income taxes, net of refunds received....	117.9	124.8

Non-cash financing activities include \$45.5 of common stock repurchased in September 1999 not settled until October 1999.

### 4. EARNINGS PER SHARE

Basic earnings per share ("EPS") are computed by dividing net income by the weighted-average number of shares outstanding during the year. Diluted earnings per share are calculated to give effect to all potentially dilutive common shares that were outstanding during the year.

For the three and nine months ended September 30, 1999 and 1998, the number of shares used in the computation of basic and diluted earnings per share are as follows:

	Three Months ended September 30		Nine Months ended September 30	
	1999	1998	1999	1998
	----	----	----	----
Basic EPS:				
Weighted-average shares	260.40	263.16	261.31	263.42
Incremental shares from assumed conversion of stock options	2.53	2.62	2.90	1.80
	-----	-----	-----	-----
Diluted EPS:				
Adjusted weighted- average shares	262.93	265.78	264.21	265.22
	=====	=====	=====	=====

The Company purchased approximately 5,895,800 shares of common stock for \$228.2 during the first nine months of 1999, as compared to approximately 2,211,000 shares of common stock for \$75.0 during the first nine months of 1998. Of the 5,895,800 shares repurchased, 1,779,800 shares repurchased for \$45.5 in September 1999 were not settled until October 1999. Accordingly, \$45.5 has been included in Other accrued liabilities on the Consolidated Balance Sheet.

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(Dollars in millions, except share data)

### 5. INVENTORIES

	September 30 1999 -----	December 31 1998 -----
Raw materials.....	\$166.5	\$140.6
Finished goods.....	411.0	397.8
	-----	-----
	\$577.5	\$538.4
	=====	=====

### 6. DIVIDENDS

Cash dividends paid per share of common stock were \$.18 and \$.54 for the three and nine months ended September 30, 1999, respectively, and \$.17 and \$.51 for the corresponding 1998 period. On February 4, 1999, the Company increased the annual dividend rate to \$.72 from \$.68.

### 7. CONTINGENCIES

Various lawsuits and claims (asserted and unasserted), arising in the ordinary course of business or related to businesses previously sold, are pending or threatened against Avon.

In 1991, a class action suit was initiated against Avon on behalf of certain classes of holders of Avon's Preferred Equity-Redemption Cumulative Stock ("PERCS"). This lawsuit alleges various contract and securities law claims relating to the PERCS (which were fully redeemed that year). Avon has rejected the assertions in this case, believes it has meritorious defenses to the claims and is vigorously contesting this lawsuit. It is anticipated that a trial may take place as early as Spring 2000.

In the opinion of Avon's management, based on its review of the information available at this time, the difference, if any, between the total cost of resolving such contingencies and reserves recorded by Avon at September 30, 1999 should not have a material adverse impact on Avon's consolidated financial position, results of operations, or cash flows.

### 8. COMPREHENSIVE INCOME

For the three and nine months ended September 30, 1999 and 1998, the components of comprehensive income are as follows:

	Three Months ended September 30		Nine Months ended September 30	
	1999 -----	1998 -----	1999 -----	1998 -----
Net Income	\$ 88.1	\$ 41.5	\$ 144.8	\$ 121.9
Other comprehensive income (loss): Change in equity due to foreign currency translation and transaction adjustments	(4.8)	(1.2)	(45.0)	(18.9)
	-----	-----	-----	-----
Comprehensive income	\$ 83.3	\$ 40.3	\$ 99.8	\$ 103.0
	=====	=====	=====	=====

AVON PRODUCTS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollars in millions, except share data)

9. SPECIAL AND NON-RECURRING CHARGES

In October 1997, the Company announced a worldwide business process redesign program in order to streamline operations and improve profitability, through margin improvement and expense reductions. The special and non-recurring charges associated with this program totaled \$46.0 pretax (\$38.6 net of tax, or \$.14 per diluted share) and \$154.4 pretax (\$122.8 net of tax, or \$.46 per diluted share) for the three months and nine months ended September 30, 1998, respectively.

For the nine months ended September 30, 1999, special and non-recurring charges related to this program totaled \$136.4 pretax (\$111.9 net of tax, or \$.43 per share on a basic and diluted basis).

For the nine months ended September 30, 1999, special and non-recurring charges by business segment are as follows:

North America	\$ 33.6
Latin America	14.7
Europe	69.8
Pacific	11.8
Corporate	6.5
	-----
Total	\$ 136.4
	=====

For the nine months ended September 30, 1999, special and non-recurring charges by category of expenditures are as follows:

	Special Charge	Cost of Sales Charge	Total
	-----	-----	-----
Employee Severance Costs	\$ 57.0		\$ 57.0
Inventories		\$ 46.0	46.0
Write-down of Assets to Net Realizable Value	11.6		11.6
Recognition of Foreign Currency Translation Adjustment	9.8		9.8
Other	12.0		12.0
	-----	-----	-----
Total	\$ 90.4	\$ 46.0	\$ 136.4
	=====	=====	=====

Employee severance costs are expenses, both domestic and international, associated with the realignment of the Company's global operations. Certain employee severance costs were accounted for in accordance with the Company's existing FAS 112, ("Employers' Accounting for Post employment Benefits"), severance plans. Remaining severance costs were accounted for in accordance with other existing accounting literature. The workforce will be reduced by 1,374 associates, or 4% of the total. Approximately 65% of the employees to be terminated relate to facility reorganizations and closures.

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Inventory related charges represent losses to write-down the carrying value of non-strategic inventory prior to disposal. The charges primarily result from a new business strategy for product dispositions which fundamentally changes the way the Company markets and sells certain inventory. This new strategy, approved and effective in March 1999, is meant to complement other redesign initiatives, with the objective of reducing inventory clearance sales, building core brochure sales and building global brands.

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AVON PRODUCTS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollars in millions, except share data)

The write-down of assets (primarily fixed and other assets) mainly relates to the restructuring of operations in Western Europe, including the closure of a jewelry manufacturing facility in Ireland. By centralizing certain key functional areas and exiting unprofitable situations, the Company plans to increase operating efficiencies and ultimately, profit growth in the long-term.

The recognition of foreign currency translation adjustment relates to the closure of the jewelry manufacturing facility.

The "Other" category primarily represents contract termination costs, legal and consulting fees and other costs associated with the facility closures.

The liability balance at September 30, 1999 is as follows:

	Special Charge	Cost of Sales Charge	Total
	-----	-----	-----
Balance at December 31, 1998	\$ 28.5	\$ -	\$ 28.5
Provision	90.4	46.0	136.4
Cash expenditures	(51.0)		(51.0)
Non-cash write offs	(26.5)	(46.0)	(72.5)
	-----	-----	-----
Balance at September 30, 1999	\$ 41.4	\$ -	\$ 41.4
	=====	=====	=====

The balance at September 30, 1999 relates primarily to employee severance costs that will be paid during 1999 and 2000.

### 10. ASSET IMPAIRMENT CHARGE

In the first quarter of 1999, Avon originally recorded a Special charge of \$151.2 pretax, which included the write off of \$14.8 in pre-tax costs (\$10.0 after tax) associated with a portion of the order management software system known as the FIRST project. The balance of the FIRST project's development costs had been carried as an asset until the third quarter of 2001, when Avon recorded a pre-tax charge of \$23.9 (\$14.5 after tax) to write off the carrying value of costs related to that project. The non-cash charge recorded in the third quarter of 2001 included software development costs, certain hardware, software interfaces and other related costs. Prior to the write off, the capitalized software was included in Property, plant and equipment, at cost and Other assets on the Consolidated Balance Sheet.

The decision to abandon the FIRST project was based on various factors,

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including project management and implementation issues and costs, costs for ongoing support, and changes in Avon business strategies.

The FIRST project, and the Special charge reported by Avon in the first quarter of 1999 that included the write off of \$14.8 in pre-tax costs associated with FIRST, were the subject of a formal investigation by the SEC commenced in August 2000. Avon has settled that matter with the SEC and, as part of that settlement, has restated its financial statements to reflect the additional write off as of March 31, 1999 of all capitalized costs (\$23.3 pretax, and \$14.0 after tax) associated with the FIRST project as of that date for a total first quarter write off of \$38.1 pretax (\$24.0 after tax). Avon has also reversed the charge recorded in the third quarter of 2001, and has restated all other FIRST-related activity recorded during 1999-2002.

See the Introductory Note - Restatements and Note 2 of the Notes to Consolidated Financial Statements, "Restatements and Accounting Changes".

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AVON PRODUCTS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in millions, except share data)

### 11. SEGMENT INFORMATION

Summarized financial information concerning the Company's reportable segments is as follows:

	Three Months Ended September 30			
	1999		1998	
	Net Sales	Operating Profit	Net Sales	Operating Profit
North America:				
U.S.	\$ 405.7	\$ 57.0	\$ 413.0	\$ 56.5
Other*	66.0	8.0	65.7	6.1
Total	471.7	65.0	478.7	62.6
International:				
Latin America	398.6	91.3	416.2	91.6
Pacific	178.9	24.5	148.3	15.0
Europe	201.4	23.5	190.0	14.9
Total	778.9	139.3	754.5	121.5
Total from operations	\$1,250.6	\$ 204.3	\$1,233.2	\$ 184.1
Global expenses		(58.2)		(57.0)
Special and non-recurring charges		-		(46.0)
Operating profit		\$ 146.1		\$ 81.1

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\*Includes operating information for Puerto Rico, Dominican Republic, Canada and for Discovery Toys.

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AVON PRODUCTS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in millions, except share data)

	Nine Months Ended September 30			
	1999		1998	
	Net Sales	Operating Profit	Net Sales	Operating Profit
North America:				
U.S.	\$1,264.5	\$ 225.5	\$1,232.0	\$ 207.0
Other*	190.0	27.6	192.7	21.6
Total	1,454.5	253.1	1,424.7	228.6
International:				
Latin America	1,169.4	245.9	1,204.5	236.8
Pacific	505.4	60.9	446.0	36.1
Europe	593.2	69.3	588.6	58.7
Total	2,268.0	376.1	2,239.1	331.6
Total from operations	\$3,722.5	\$ 629.2	\$3,663.8	\$ 560.2
Global expenses		(180.5)		(165.6)
Special and non-recurring charges		(136.4)		(154.4)
Asset impairment charge		(38.1)		-
Operating profit		\$ 274.2		\$ 240.2

\*Includes operating information for Puerto Rico, Dominican Republic, Canada and for Discovery Toys.

### 12. OTHER FINANCING ACTIVITIES

At September 30, 1999, the Company had entered into forward contracts to purchase approximately 2,913,200 shares of Avon common stock at an average rate of \$40.65 per share as of September 30, 1999. The contracts mature over the next 2 years and provide for physical or net settlement to the Company. Accordingly, no adjustment for subsequent changes in fair value has been recognized. Subsequent to September 30, 1999, 480,000 shares were purchased under these contracts.

### 13. SUBSEQUENT EVENTS

In October 1999, the Company's Board of Directors approved a significant

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acceleration of the Company's share repurchase program. This will substantially complete the Company's current \$1.1 billion buyback program, which had been scheduled to run through 2001.

Subsequent to September 30, 1999, the Company purchased approximately 17 million shares of its common stock for approximately \$488.0 under this program, funded by short-term borrowings.

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### AVON PRODUCTS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in millions, except share data)

In November of 1999, the Company issued \$500.0 of notes payable (the "Notes") in a private offering to institutional investors. The Notes are unsubordinated, unsecured obligations of the Company. \$200.0 of the Notes bear interest at a per annum rate equal to 6.90% and mature on November 15, 2004 and will be repaid at par. \$300.0 of the Notes bear interest at a per annum rate equal to 7.15% and mature on November 15, 2009 and will be repaid at par. Interest on the Notes is payable semi-annually. The indenture under which the Notes were issued limits the incurrence of indebtedness, and the restricting of sales and leaseback transactions, sales of assets and transactions involving mergers, sales or consolidation. The proceeds from this issuance will be used for general corporate purposes, including repayment of outstanding short-term borrowings incurred to finance the acceleration of the Company's share repurchase program discussed above.

In connection with the offering, Avon entered into a five-year and ten-year interest rate swap contract with notional amounts of \$200.0 and \$300.0, respectively to effectively convert fixed interest to a variable interest rate, based on commercial paper rates.

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### AVON PRODUCTS, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Dollars in millions, except share data)

#### ITEM 2. Management's Discussion and Analysis of the Results of Operations and Financial Condition (Restated)

##### Results of Operations

##### Consolidated

Consolidated net sales for the three-month and nine-month periods of 1999 increased 1% and 2%, respectively, over the same periods of 1998. Third quarter sales improvements in the Pacific and Europe regions were partially offset by declines in Latin America, primarily Brazil, and in North America. The year-to-date sales growth reflected increases in North America, primarily in the U.S., and in International. Excluding the impact of foreign currency exchange, consolidated net sales rose 8% and 9% in the three-month and



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nine-month periods of 1999, respectively, over the comparable periods of the prior year.

Cost of sales as a percentage of Net sales increased 1.6 percentage points in the third quarter and 1.2 percentage points in the nine-month period of 1999 compared to the same periods of 1998. The cost of sales for the nine months ended September 30, 1999 and 1998 include one-time charges of \$46.0 and \$37.9, respectively, for inventory write-downs related to the Company's business process redesign ("BPR") program. See Note 9 for further detail. Excluding these charges, the gross margin increased 1.5 percentage points on a September year-to-date basis. The higher gross margin in both the third quarter and year-to-date period resulted from improvements in all regions, most significantly in the U.S, Japan, the United Kingdom, Germany, Mexico, Argentina and Central Europe. Third quarter improvements were partially offset by a gross margin decline in Brazil.

Marketing, distribution and administrative expenses increased \$12.0 (2%) and \$35.8 (2%) in the third quarter and nine-month periods of 1999, respectively, over the same periods of 1998 primarily due to increases in the U.S., Mexico and Japan as well as higher global expenses, partially offset by lower expenses in Brazil and Russia. Marketing, distribution, and administrative expenses increased slightly as a percentage of total revenue to 51.5% in the third quarter of 1999 from 51.3% in 1998 and to 51.3% in the first nine months of 1999 from 51.1% in 1998. 1999 expense ratio improvements in Brazil, Central Europe and China were more than offset by unfavorable expense ratios in Mexico, Argentina, Germany, and the U.S.

The nine months ended 1999 and 1998 results include special charges of \$90.4 and \$116.5, respectively for the Company's BPR program. The third quarter 1998 results also include special charges of \$46.0 related to the BPR program. These charges are primarily related to employee severance benefits worldwide, as well as facility reorganizations. See Note 9 for further detail.

An Asset impairment charge of \$38.1 pretax was recorded in the nine months ended September 30, 1999 related to the write off of an order management software system. See Note 10 for further detail.

Interest expense increased to \$9.8 in the third quarter of 1999 as compared with \$9.4 in 1998, and to \$27.7 in the first nine months of 1999 compared with \$25.6 in 1998 primarily as a result of increased domestic borrowings.

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AVON PRODUCTS, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE  
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Interest income decreased \$.9 in the third quarter of 1999 due to lower average short-term investments as well as lower interest rates in Brazil. For the nine-month period, interest income decreased \$3.7 compared to prior year primarily due to a Mexico tax refund claim recognized in June 1998.

Other expense (income) of \$2.6 in the third quarter of 1999 was \$4.1 unfavorable to the comparable period of 1998 mainly due to unfavorable net foreign exchange in 1999. However, other expense (income) of (\$4.6) for the nine-month period of 1999 was \$7.2 favorable over the nine-month period of 1998

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due primarily to favorable net foreign exchange resulting from gains on Brazilian currency forward contracts.

Excluding the special charges, the effective tax rate for the third quarter 1999 was 35.0% versus 36.0% for the third quarter 1998 due to the earnings mix and tax rates of international subsidiaries. Excluding the special and non-recurring charges, the effective tax rate was 35.6% for the first nine months of 1999 compared to 36.6% in the comparable period of 1998.

Minority interest decreased \$2.0 and \$2.8 in the third quarter and nine-month period of 1999, respectively, compared to 1998, primarily due to lower losses in Japan and China in 1999.

The following discussion addresses net sales and operating profit by reportable segment as presented in Note 11:

### North America

Net sales decreased 1% in the third quarter while net sales for the nine-month period of 1999 grew 2% over prior year. The U.S. business, which represents almost 90% of the North American segment, reported a sales decline of 2% for the third quarter and a 3% increase for the September year-to-date period. The third quarter decline resulted from a 6% decrease in the number of units sold as well as a 1% decrease in active Representatives. U.S. sales of cosmetics, fragrance and toiletries ("CFT") decreased 10% during the third quarter primarily due to underperformance of women's new products, particularly Forever Amber and Skintrition. Additionally, the existing line under performed primarily due to less exposure in the brochure in 1999. However, within the CFT category, color cosmetics had a strong increase particularly in the face and eye segment due to new product launches. The third quarter sales decline also reflects decreases in the apparel category mainly due to the rebalancing of resources to support more profitable segments. These decreases were partially offset by growth in the fashion jewelry and accessories category driven by higher sales of fine jewelry and strong sales in the novelty jewelry segment which included such innovative products as Solar Magic, Four Way Locket and children's giftsets. Sales of gift and decorative items and home entertainment products also increased during the third quarter primarily due to a focus on religious and inspirational products.

On a September year-to-date basis, sales in the U.S. increased 3% due to growth in the fashion jewelry and accessories category reflecting success of sterling silver and bolder jewelry designs, the introduction of licensed luggage and strong performance in watches and handbags. Additionally, the home entertainment and gift and decorative category posted double-digit percentage increases reflecting increased sales of inspirational and religious products. These year-to-date improvements were partially offset by continued declines in CFT and apparel categories.

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AVON PRODUCTS, INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE  
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Operating profit in North America increased 4% and 11% in the third quarter and first nine months of 1999, respectively, compared with the same periods in 1998. This improvement is primarily attributable to a higher gross

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margin in the U.S. due to supply chain cost improvements and pricing in the non-CFT categories and product category management, partially offset by an unfavorable expense ratio due to increased spending on strategic initiatives such as the internet and the opening of express and beauty centers.

### International

International U.S. dollar net sales for the third quarter and first nine months of 1999 increased 3% and 1%, respectively, over the comparable periods in 1998. Sales growth in the Pacific and Europe regions was partially offset by a decline in Latin America for both the third quarter and nine-month period of 1999. However, excluding the effect of foreign currency exchange, sales increased 14% and 13% during the third quarter and first nine months of 1999, respectively.

The sales improvement in the Pacific region for both the third quarter and first nine months of 1999 was driven by strong increases in units and customers served in the Philippines, Australia and Taiwan. Local currency sales in Japan decreased due to a lower average order size. However, Japan's U.S. dollar sales increased significantly due to favorable currency impact. Excluding the effect of foreign currency exchange, sales in the Pacific increased 7% and 6% in the third quarter and first nine months of 1999, respectively.

In Europe, sales increased 6% and 1% in the third quarter and nine-month period of 1999, respectively, due to growth in the United Kingdom and Central Europe, partially offset by declines in Russia and Germany. A higher average order size and increased distributorship sales fueled the increase in the United Kingdom. Additionally, in the United Kingdom, the launch of a new brochure to enhance Avon's image contributed to the sales growth. The improvement in Central Europe, primarily in Poland, resulted from continued increases in units, customers served and active Representatives. Poland's success reflects strong growth in the CFT category, increased Representative retention and a change in the campaign cycle including a new brochure every 4 weeks versus 6 weeks in prior year. Sales were lower in Russia due to the continued economic crisis and ruble devaluation, and in Germany due to a weak economic environment. Excluding the impact of exchange, Europe sales grew 17% and 11% in the third quarter and first nine months of 1999, respectively.

The U.S dollar sales decline in Latin America resulted from significant decreases in Brazil as a result of the real devaluation and in Argentina as a result of weak economic conditions. These declines were partially offset by sales growth in Mexico, Venezuela and Central America. Mexico's sales increase during the third quarter resulted mainly from inflation-related price increases in 1999; however, September year-to-date increases resulted from both operational growth including new product launches in the cosmetics, home and fashion lines as well as economic growth reflecting consumer price increases. Central America posted double-digit increases in units, customers served and active Representatives in both the third quarter and nine-month period in 1999. Excluding the impact of exchange, sales in Latin America increased 15% and 18% in the third quarter and first nine months of 1999, respectively. Local currency sales and units continue to grow over 20% in Brazil in both the third quarter and first nine months of 1999. Active Representatives in Brazil were also up double-digits driven by recruiting and retention strategies in place including strong training and incentive programs.

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### RESULTS OF OPERATIONS AND FINANCIAL CONDITION

(Dollars in millions, except share data)

International operating profit increased 15% and 13% in the third quarter and nine-month period of 1999, respectively, compared to the same periods in 1998.

Operating profit growth in the Pacific of 63% and 69% in the third quarter and first nine months of 1999, respectively, resulted from U.S. dollar sales growth, discussed above, and operating margin improvements in nearly all markets, most significantly in Japan and China. Japan's gross margin improved due to product cost savings initiatives in CFT and improved sourcing decisions for non-CFT as well as a business-wide product profitability screening process that led to the elimination of many low-margin products in the apparel and jewelry segments. Additionally, BPR efforts continue to generate significant savings across all expense areas in Japan. China's year-to-date improvement in 1999 reflects the suspension of operations for most of the second quarter of 1998 due to governmental restrictions on direct-selling companies. However, China's operating margin improved significantly during the third quarter of 1999, which was on a comparable basis to prior year, due to a shift in sales mix to higher margin items. Philippines and Taiwan also reported increases in operating profit driven primarily by the sales growth, discussed above. As a result, the operating margin in the Pacific was up 3.5 points and 3.9 points for the third quarter and first nine months of 1999, respectively, over prior year.

In Latin America, operating profit was level in the third quarter but increased 4% in the nine-month period of 1999 compared to the same periods in 1998. For the third quarter period, continued declines in Brazil resulting from the real devaluation in 1999 were offset by increases in Mexico and Venezuela. Higher operating profit in Mexico resulted from the sales growth and gross margin improvement, partially offset by increased advertising expense and incentive programs in 1999. The year-to-date 4% operating profit increase was due to improvements in Mexico and Venezuela driven by higher sales and, to a lesser extent, in Brazil due to aggressive cost reduction efforts and strict expense management. Brazil reported a 4.0 point operating margin improvement in the first nine months of 1999. These improvements were partially offset by declines in Argentina and Chile due to the sales shortfalls and weak economic conditions.

The Brazilian real devalued significantly in January 1999 and, as a result, negatively affected Brazil's U.S. dollar results in 1999. Brazil's third quarter and September year-to-date 1999 sales, although up over 20% in local currency, were down approximately 20% in U.S. dollars due to the devaluation. In response to this situation, several actions have been taken by local management to offset the devaluation, including a focused effort directed at vendor negotiations and additional local sourcing to reduce imports.

Operating profit in Europe increased 58% and 18% in the third quarter and nine-month period of 1999, respectively. This improvement was primarily driven by increases in the United Kingdom, Central Europe and Italy. The United Kingdom continues to focus on category and customer growth, image enhancement and expense control. For both the third quarter and nine-month period of 1999, the United Kingdom, Central Europe and Italy reported significant growth in operating margins due to higher gross margins which resulted from a continuing focus on pricing strategies and improved profitability of non-CFT categories. Additionally, Russia's third quarter operating results were slightly above last year due to substantial reduction in their operating expenses. However, on a year-to-date basis, the improvements in the above markets were partially offset by declines in Russia resulting from the ruble devaluation during the second half of 1998. Management in Russia will continue to manage expenses tightly and

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seek to increase market share and improve margins through pricing flexibility and tight expense management.

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### AVON PRODUCTS, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Dollars in millions, except share data)

#### Global Expenses

Global expenses increased 2% and 9% in the third quarter and first nine months of 1999, respectively, over the same periods in 1998 primarily due to increased investments in global marketing, research and development and information technology systems, as well as costs related to the work on the Company's new strategic initiatives.

#### Liquidity and Capital Resources

##### Cash Flows

Excluding changes in debt, there was a net decrease in cash of \$345.5 in the first nine months of 1999 compared with a decrease of \$307.5 in the comparable period of 1998. The \$38.0 variance primarily reflects increased repurchases of common stock, an unfavorable effect of foreign currency exchange, increased cash used for investing activities due to the acquisition of the remaining interest in a manufacturing facility in Poland and higher capital expenditures, including a new manufacturing and distribution facility in Mexico. These uses of cash were partially offset by lower net cash used by operations reflecting a higher net income (adjusted for the non-cash portion of the special charges), a favorable consolidated working capital level and a higher cash usage in 1998 related to the funding of the Company's benefit plans.

For the first nine months of 1999, the Company purchased approximately 5,895,800 shares of common stock for \$228.2 compared with \$75.0 spent for the repurchase of approximately 2,211,000 shares during the comparable period in 1998. Of the 5,895,800 shares repurchased, 1,779,800 shares repurchased for \$45.5 in September 1999 were not settled until October 1999. Accordingly, \$45.5 has been included in Other accrued liabilities on the Consolidated Balance Sheet.

In October 1999, the Company's Board of Directors approved a significant acceleration of the Company's share repurchase program. This will substantially complete the Company's current \$1.1 billion buyback program, which had been scheduled to run through 2001. See Note 11 for further detail of this program.

#### Capital Resources

Total debt increased \$344.1 to \$600.4 from \$256.3 at December 31, 1998, principally due to normal seasonal working capital requirements and borrowings to support the continuing stock buyback program. Total debt of \$600.4 at September 30, 1999 was \$104.8 higher than total debt of \$495.6 at September 30, 1998 primarily to fund the accelerated stock buyback program in 1999. In addition, at September 30, 1999 and December 31, 1998, other non-current liabilities include approximately \$107.9 and \$112.4, respectively, related to securities lending activities.

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At September 30, 1999, there were no borrowings under the amended and restated revolving credit and competitive advance facility agreement. This agreement is also used to support the Company's commercial paper borrowings of which \$330.0 was outstanding at September 30, 1999. At September 30, 1999, there were \$10.0 of borrowings outstanding under uncommitted lines of credit.

Subsequent to September 30, 1999, the Company purchased approximately 17 million shares of its common stock for approximately \$488.0 under this program, funded by short-term borrowings.

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### AVON PRODUCTS, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Dollars in millions, except share data)

As discussed in Note 13 to the Consolidated Financial Statements the Company issued \$500.0 of unsubordinated, unsecured notes payable in a private offering to institutional investors. The proceeds from this issuance will be used for general corporate purposes, including the repayment of outstanding short-term borrowings incurred to finance the acceleration of the Company's share repurchase program discussed above.

In connection with the offering, Avon entered into a five-year and ten-year interest rate swap contract with notional amounts of \$200.0 and \$300.0, respectively to effectively convert fixed interest to a variable interest rate, based on commercial paper rates.

Management currently believes that cash from operations and available financing alternatives are adequate to meet anticipated requirements for working capital, dividends, capital expenditures, the stock repurchase program and other cash needs.

#### Working Capital

As of September 30, 1999, current liabilities exceeded current assets by \$252.4, while at December 31, 1998 current assets exceeded current liabilities by \$11.9. The increase of current liabilities over current assets of \$264.3 was primarily due to the increase in net debt (debt less cash and equivalents), as discussed in the Debt section, and other accrued liabilities, mainly due to the accrual for special and non-recurring charges, partially offset by a decrease in accounts payable and increase in inventories, reflecting the seasonal pattern of Avon's operations.

Although current liabilities exceeded current assets at September 30, 1999, management believes this is due to the Company's direct selling business format which results in lower receivable and working capital levels as well as the Company's practice of repurchasing shares with available cash. Avon's liquidity results from its ability to generate significant cash flows from operations and its ample unused borrowing capacity.

At September 30, 1999, the large excess of current liabilities over current assets reflects the aforementioned acceleration of the Company's share repurchase program and the related short-term borrowings, pending issuance of long term debt discussed in Note 13. Avon's credit agreements do not contain any provisions or requirements with respect to working capital.

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### Financial Instruments and Risk Management Strategies

The Company operates globally, with manufacturing and distribution facilities in various locations around the world.

The Company may reduce its exposure to fluctuations in interest rates and foreign exchange rates by creating offsetting positions through the use of derivative financial instruments. The Company currently does not use derivative financial instruments for trading or speculative purposes, nor is the Company a party to leveraged derivatives.

The Company periodically uses interest rate swaps to hedge portions of interest payable on its debt. In addition, the Company may periodically employ interest rate caps to reduce exposure, if any, to increases in variable interest rates.

At September 30, 1999, the Company had a five-year interest rate swap contract with a notional amount of \$50.0 to effectively convert fixed interest on a portion of the \$100.0 bonds to a variable interest rate, based on LIBOR.

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The Company may periodically hedge foreign currency royalties, net investments in foreign subsidiaries, firm purchase commitments and contractual foreign currency cash flows or obligations, including third-party or intercompany foreign currency transactions. The Company regularly monitors its foreign currency exposures and ensures that hedge contract amounts do not exceed the amounts of the underlying exposures.

At September 30, 1999, the Company held foreign currency forward contracts with notional amounts totaling \$376.7 and option contracts with notional amounts totaling \$20.0 to hedge foreign currency items. Only \$40.7 of these contracts have maturities after 1999. Also outstanding at September 30, 1999 were foreign contracts totaling \$15.0 which do not qualify as hedging transactions under the current accounting definitions and accordingly, have been marked to market. The mark-to-market adjustment at September 30, 1999 was insignificant. The Company's risk of loss on the options in the future is limited to premiums paid, which are insignificant.

At September 30, 1999, the Company has entered into forward contracts to purchase approximately 2,913,200 shares of Avon common stock at an average rate of \$40.65 per share as of September 30, 1999. The contracts mature over the next 2 years and provide for physical or net share settlement to the Company. Accordingly, no adjustment for subsequent changes in fair value has been recognized. Subsequent to September 30, 1999, 480,000 shares were purchased under these contracts.

The Company attempts to minimize its credit exposure to counterparties by entering into interest rate swap and cap contracts only with major international financial institutions with "A" or higher credit ratings as issued by Standard & Poor's Corporation. The Company's foreign currency and interest rate derivatives are comprised of over-the-counter forward contracts

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or options with major international financial institutions. Although the Company's theoretical credit risk is the replacement cost at the then estimated fair value of these instruments, management believes that the risk of incurring losses is remote and that such losses, if any, would not be material.

### Other Information

#### Euro

A single currency called the euro was introduced in Europe on January 1, 1999. Eleven of the fifteen member countries of the European Union adopted the euro as their common legal currency on that date. Fixed conversion rates between these participating countries' existing currencies (the "legacy currencies") and the euro were established as of that date. The legacy currencies are scheduled to remain legal tender as denominations of the euro until June 30, 2002 after which they will be withdrawn from circulation. During this transition period, parties may settle transactions using either the euro or a participating country's legal currency. Beginning in January 2002, new euro-denominated bills and coins will be issued.

Avon operating subsidiaries affected by the euro conversion have established plans to address issues raised by the euro currency conversion. These issues include, among others, the need to adapt information technology systems, business processes and equipment to accommodate euro-denominated transactions, the impact of one common currency on pricing and recalculating currency risk. Avon does not expect system and equipment conversion costs to be material. Due to the numerous uncertainties associated with the market impact of the euro conversion, the Company cannot reasonably estimate the effects one common currency will have on pricing and the resulting impact, if any, on results of operations, financial condition or cash flows.

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### Year 2000

#### General

The "Year 2000 issue" is the result of computer programs being written using two digits rather than four to define the applicable year. If the Company's computer programs with date-sensitive functions are not Year 2000 compliant, they may fail or make miscalculations due to interpreting a date, including "00" to mean 1900, not 2000. The result may be disruptions in operations, including, among other things, a temporary inability to process transactions or engage in similar normal business activities.

The Company commenced its worldwide Year 2000 initiative in early 1996. The Company has developed a comprehensive project plan as a means for ensuring that all information technology ("IT") systems, including applications, operating systems, mainframe, mid range and client server platforms, all non-information technology ("Non-IT") systems, including embedded applications and equipment and key third parties are Year 2000 compliant by December 31, 1999. The Company has identified high risk applications that are critical to its business, recognizing the fact that timely compliance of these systems is



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crucial, and, therefore, has designed its programs to address these systems first. Furthermore, the Company has established a project team to identify and address the Company's Year 2000 risks and issues in an attempt to ensure the integrity and reliability of the Company's information systems and business processes.

### Project Plan

The Company's Year 2000 project plan is divided into four major sections, including: Infrastructure, Application Software, Validation of Third Party Compliance and Embedded Systems. The project has five phases, which are common to all sections: 1) identifying, inventorying and prioritizing Year 2000 items; 2) assessing Year 2000 compliance of identified items and related potential risks in circumstances of non-compliance of these items; 3) remediating, replacing or upgrading, as appropriate, material items that are determined not to be Year 2000 compliant; 4) validation testing of material items to ensure compliance; and 5) contingency planning and implementation. The Company utilizes internal resources and outside consultants to renovate and test its IT and Non-IT systems for Year 2000 compliance. None of the Company's other information technology projects have been deferred due to the implementation of the Year 2000 project.

The Infrastructure section consists of hardware, including mainframe and AS/400 platforms, and software, including operating systems, other than Applications Software. This section has been completed for all phases.

The Applications Software section includes the conversion of both in-house developed and vendor-supplied software applications. In-house developed software that is not Year 2000 compliant has undergone remediation of its application, whereas non-compliant vendor provided software has been upgraded or replaced, where available by the supplier. This section's testing phase, which includes procedures for independent validation and verification of code has been completed. In addition, end-to-end testing to verify the data integrity of internal and external system interfaces has also been completed.

Validation of Third Party Compliance includes the process of recognizing, prioritizing and communicating with key suppliers and service providers with whom the Company has a direct and significant relationship and are believed to be critical to its business operations. The validation of third party compliance and preparation of any necessary

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contingency plans has been completed. Follow-up reviews are scheduled for the remainder of 1999.

The Embedded Systems section includes all hardware, software and associated embedded computer chips that are utilized in operating and maintaining the internal functions of the Company's facilities, i.e. climate control systems. The Company has elected to employ a regional-based strategy for addressing Year 2000 compliance of its embedded systems. Both the U.S. and international operations have completed the remediation and testing of embedded systems.

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### Costs

The total estimated cost associated with achieving worldwide Year 2000 compliance will be approximately \$32.7, of which \$28.3 has been spent to date. Replacement costs and costs associated with the validation of third party compliance are included in these figures. The Company does not separately track the internal costs incurred for the Year 2000 project, those costs primarily being related to payroll costs for the Company's information systems group. The Company's policy is to expense as incurred information system maintenance and modification costs and to capitalize costs related to system replacement. The costs of the Company's Year 2000 compliance efforts are being funded through operating cash flows.

### Risks

The Company expects to identify and resolve all Year 2000 problems that may adversely affect its business operations. However, management believes that it is not possible to determine with complete certainty that all Year 2000 matters affecting the Company have been or will be identified or corrected, resulting in part from the uncertainty of the Year 2000 readiness of third party suppliers. Thus, the Company is unable to determine at this time whether the consequences of Year 2000 failures will have a material impact on the Company's results of operations, liquidity or financial condition. The Company believes, however, that its risk of being adversely impacted by Year 2000 failures is mitigated due to its product portfolio being so diversified, with the vast majority of its items not being date-sensitive. The strategy employed by the Company's Year 2000 project is expected to significantly reduce the Company's level of uncertainty about the Year 2000 issue and the Year 2000 compliance of key third parties who materially impact its business.

### Contingency Plans

Development of contingency plans has been completed.

### Disclaimer

Readers are cautioned that forward-looking statements contained in the Year 2000 Update should be read in conjunction with the Company's disclosure under the heading "CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" on page 26.

### Recent Developments

On November 4, 1999 the Company announced that its president and chief operating officer, Andrea Jung, has been named president and chief executive officer ("CEO"), succeeding chairman and CEO Charles R. Perrin in his capacity as CEO. Mr. Perrin is retiring from Avon. The Company also announced that outside director Stanley C. Gault, has been elected non-executive chairman of the board of directors. All changes are effective immediately.

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements in this report which are not historical facts or information are forward-looking statements, including, but not limited to, the

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information set forth in "Other Information" herein. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, levels of activity, performance or achievement of the Company, or industry results, to be materially different from any future results, levels of activity, performance or achievement expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions; the ability of the Company to implement its business strategy; the Company's access to financing and its management of foreign currency risks; the Company's ability to successfully identify new business opportunities; the Company's ability to attract and retain key executives; the Company's ability to achieve anticipated cost savings and profitability targets; changes in the industry; competition; the effect of regulatory and legal restrictions imposed by foreign governments; the effect of regulatory and legal proceedings and other factors discussed in Item 1 of the Company's Form 10-K/A. As a result of the foregoing and other factors, no assurance can be given as to the future results and achievements of the Company. Neither the Company nor any other person assumes responsibility for the accuracy and completeness of these statements.

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AVON PRODUCTS, INC.  
PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

There are no exhibits.

(b) Reports on Form 8-K.

There were no reports on Form 8-K filed during the third quarter of 1999.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AVON PRODUCTS, INC.

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(Registrant)

Date: August 12, 2002

By /s/ JANICE MAROLDA

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Janice Marolda  
Vice President,  
Controller  
Principal Accounting Officer

Signed both on behalf of the

registrant and as principal  
accounting officer.