

AVON PRODUCTS INC
Form 10-Q
October 30, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2008

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
(State or other jurisdiction of

13-0544597
(I.R.S. Employer
Identification No.)

Incorporation or organization)

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

(Address of principal executive offices) (Zip code)

(212) 282-5000

(Telephone Number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock (par value \$.25) outstanding at September 30, 2008, was 426,296,868.

Table of Contents

TABLE OF CONTENTS

| | Page Numbers |
|--|-------------------------|
| Part I. Financial Information | |
| Item 1. <u>Financial Statements (Unaudited)</u> | |
| Consolidated Statements of Income | |
| <u>Three Months Ended September 30, 2008 and September 30, 2007</u> | 3 |
| <u>Nine Months Ended September 30, 2008 and September 30, 2007</u> | 4 |
| <u>Consolidated Balance Sheets September 30, 2008 and December 31, 2007</u> | 5 |
| <u>Consolidated Statements of Cash Flows Nine Months Ended September 30, 2008 and September 30, 2007</u> | 6 |
| <u>Notes to Consolidated Financial Statements</u> | 7-18 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 19-33 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 34 |
| Item 4. <u>Controls and Procedures</u> | 34 |
| Part II. Other Information | |
| Item 1. <u>Legal Proceedings</u> | 35 |
| Item 1A. <u>Risk Factors</u> | 35 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 35 |
| Item 6. <u>Exhibits</u> | 35 |
| <u>Signature</u> | 36 |

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS
AVON PRODUCTS, INC.****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

| In millions, except per share data | Three Months Ended September 30 | |
|--|--|-----------------|
| | 2008 | 2007 |
| Net sales | \$ 2,618.7 | \$ 2,326.1 |
| Other revenue | 26.0 | 23.0 |
| Total revenue | 2,644.7 | 2,349.1 |
| Costs, expenses and other: | | |
| Cost of sales | 975.0 | 889.0 |
| Selling, general and administrative expenses | 1,372.6 | 1,236.6 |
| Operating profit | 297.1 | 223.5 |
| Interest expense | 24.6 | 29.2 |
| Interest income | (10.1) | (10.2) |
| Other expense (income), net | 3.4 | (3.2) |
| Total other expenses | 17.9 | 15.8 |
| Income before taxes and minority interest | 279.2 | 207.7 |
| Income taxes | 54.5 | 68.6 |
| Income before minority interest | 224.7 | 139.1 |
| Minority interest | (2.1) | |
| Net income | \$ 222.6 | \$ 139.1 |
| Earnings per share: | | |
| Basic | \$.52 | \$.32 |
| Diluted | \$.52 | \$.32 |
| Weighted-average shares outstanding: | | |
| Basic | 425.74 | 430.03 |
| Diluted | 429.75 | 433.03 |
| Cash dividends per common share | \$.20 | \$.185 |

The accompanying notes are an integral part of these statements.

Table of Contents**AVON PRODUCTS, INC.****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

| In millions, except per share data | Nine Months Ended September 30 | |
|--|---|-----------------|
| | 2008 | 2007 |
| Net sales | \$ 7,807.6 | \$ 6,795.8 |
| Other revenue | 74.9 | 67.4 |
| Total revenue | 7,882.5 | 6,863.2 |
| Costs, expenses and other: | | |
| Cost of sales | 2,892.1 | 2,642.6 |
| Selling, general and administrative expenses | 4,023.2 | 3,572.4 |
| Operating profit | 967.2 | 648.2 |
| Interest expense | 76.8 | 83.8 |
| Interest income | (27.9) | (32.8) |
| Other expense (income), net | 16.1 | (1.4) |
| Total other expenses | 65.0 | 49.6 |
| Income before taxes and minority interest | 902.2 | 598.6 |
| Income taxes | 254.3 | 195.2 |
| Income before minority interest | 647.9 | 403.4 |
| Minority interest | (5.0) | (1.6) |
| Net income | \$ 642.9 | \$ 401.8 |
| Earnings per share: | | |
| Basic | \$ 1.51 | \$.92 |
| Diluted | \$ 1.49 | \$.92 |
| Weighted-average shares outstanding: | | |
| Basic | 426.36 | 435.13 |
| Diluted | 430.14 | 438.38 |
| Cash dividends per common share | \$.60 | \$.555 |

The accompanying notes are an integral part of these statements.

Table of Contents**AVON PRODUCTS, INC.****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

| In millions | September 30 2008 | December 31 2007 |
|--|------------------------------|-----------------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 967.0 | \$ 963.4 |
| Accounts receivable, net | 704.4 | 795.0 |
| Inventories | 1,236.8 | 1,041.8 |
| Prepaid expenses and other | 898.1 | 715.2 |
| Total current assets | 3,806.3 | 3,515.4 |
| Property, plant and equipment, at cost | 2,529.0 | 2,362.4 |
| Less accumulated depreciation | (1,156.9) | (1,084.2) |
| | 1,372.1 | 1,278.2 |
| Other assets | 950.2 | 922.6 |
| Total assets | \$ 6,128.6 | \$ 5,716.2 |
| Liabilities and Shareholders Equity | | |
| Current Liabilities | | |
| Debt maturing within one year | \$ 732.4 | \$ 929.5 |
| Accounts payable | 728.8 | 800.3 |
| Accrued compensation | 254.9 | 285.8 |
| Other accrued liabilities | 629.2 | 713.2 |
| Sales taxes and taxes other than income | 227.0 | 222.3 |
| Income taxes | 75.6 | 102.3 |
| Total current liabilities | 2,647.9 | 3,053.4 |
| Long-term debt | 1,677.7 | 1,167.9 |
| Employee benefit plans | 388.8 | 388.7 |
| Long-term income taxes | 176.3 | 208.7 |
| Other liabilities | 178.7 | 185.9 |
| Total liabilities | \$ 5,069.4 | \$ 5,004.6 |
| Contingencies (Note 5) | | |
| Shareholders Equity | | |
| Common stock | 185.6 | 184.7 |
| Additional paid-in capital | 1,861.4 | 1,724.6 |
| Retained earnings | 3,972.4 | 3,586.5 |
| Accumulated other comprehensive loss | (423.0) | (417.0) |
| Treasury stock, at cost | (4,537.2) | (4,367.2) |
| Total shareholders equity | \$ 1,059.2 | \$ 711.6 |

| | | |
|--|------------|------------|
| Total liabilities and shareholders equity | \$ 6,128.6 | \$ 5,716.2 |
|--|------------|------------|

The accompanying notes are an integral part of these statements.

Table of Contents**AVON PRODUCTS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

| In millions | Nine Months Ended September 30 | |
|---|---|----------------|
| | 2008 | 2007 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 642.9 | \$ 401.8 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 143.0 | 126.9 |
| Provision for doubtful accounts | 149.1 | 113.9 |
| Provision for obsolescence | 54.2 | 152.6 |
| Share-based compensation | 46.5 | 48.1 |
| Deferred income taxes | 8.7 | (8.1) |
| Other | 33.1 | 27.4 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (63.8) | (122.5) |
| Inventories | (262.6) | (426.4) |
| Prepaid expenses and other | (183.5) | (80.8) |
| Accounts payable and accrued liabilities | (178.8) | 13.4 |
| Income and other taxes | (49.2) | (61.4) |
| Noncurrent assets and liabilities | (36.9) | (122.0) |
| Net cash provided by operating activities | 302.7 | 62.9 |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (238.3) | (139.9) |
| Proceeds from disposal of assets | 8.5 | 10.3 |
| Acquisitions and other investing | .1 | (18.7) |
| Purchases of investments | (60.5) | (40.8) |
| Proceeds from sale of investments | 26.6 | 39.3 |
| Net cash used by investing activities | (263.6) | (149.8) |
| Cash Flows from Financing Activities* | | |
| Cash dividends | (262.3) | (244.4) |
| Debt, net (maturities of three months or less) | (189.8) | 420.9 |
| Proceeds from debt | 547.1 | 18.9 |
| Repayment of debt | (62.4) | (17.0) |
| Proceeds from exercise of stock options | 80.8 | 53.6 |
| Excess tax benefit realized from share-based compensation | 12.3 | 11.2 |
| Repurchase of common stock | (171.4) | (555.7) |
| Net cash used by financing activities | (45.7) | (312.5) |
| Effect of exchange rate changes on cash and equivalents | 10.2 | 41.0 |
| Net increase (decrease) in cash and equivalents | 3.6 | (358.4) |
| Cash and equivalents at beginning of year | 963.4 | 1,198.9 |
| Cash and equivalents at end of period | \$ 967.0 | \$ 840.5 |

* Non-cash financing activities in 2008 and 2007 included the change in fair market value of interest rate swap agreements of \$4.9 and (\$2.5), respectively.

The accompanying notes are an integral part of these statements.

Table of Contents

AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

1. ACCOUNTING POLICIES

Basis of Presentation

We prepare our unaudited interim consolidated financial statements in conformity with accounting principles generally accepted in the United States. We consistently applied the accounting policies described in our 2007 Annual Report on Form 10-K (2007 Form 10-K) in preparing these unaudited financial statements. In our opinion, we made all adjustments of a normal recurring nature that are necessary for a fair statement of the results for the interim periods. Results for interim periods are not necessarily indicative of results for a full year. You should read these unaudited interim consolidated financial statements in conjunction with our consolidated financial statements contained in our 2007 Form 10-K. When used in these notes, the terms Avon, Company, we or us mean Avon Products, Inc.

For interim consolidated financial statement purposes, we compute our tax provision on the basis of our estimated annual effective income tax rate, and provide for accruals under our various employee benefit plans by allocating the estimated annual expense equally among quarters.

We have reclassified some prior year amounts in the consolidated financial statements and accompanying notes for comparative purposes. In order to consistently report certain distribution and sourcing costs across all segments, we reclassified net amounts of \$4.0 and \$12.1 from cost of sales to selling, general and administrative expenses on the Consolidated Statements of Income for the three and nine months ended September 30, 2007, respectively. We also reclassified \$45.4 from accounts receivable, net to prepaid expenses and other on the Consolidated Balance Sheet for the year ended December 31, 2007, and reclassified \$11.0 from changes in inventory to obsolescence expense on the Consolidated Statement of Cash Flows for the nine months ended September 30, 2007.

New Accounting Standards Implemented

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued Staff Position 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until January 1, 2009. We adopted SFAS 157 as of January 1, 2008, with the exception of the application of the statement to non-recurring, nonfinancial assets and liabilities. The adoption of SFAS 157 did not have a material impact on our consolidated financial statements. See Note 11, Fair Value, for additional information.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment to FASB Statement No. 115*, (SFAS 159), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. We adopted SFAS 159 as of January 1, 2008. The adoption of SFAS 159 had no impact on our consolidated financial statements, as we did not choose to measure the items at fair value.

New Accounting Standards to be Implemented

In February 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*, (SFAS 161) which changes, among other things, the disclosure requirements for derivative instruments and hedging activities. We will be required to provide enhanced disclosures about how and why we use derivative instruments, how they are accounted for, and how they affect our financial performance. SFAS 161 is effective January 1, 2009, for Avon.

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in millions, except per share data)

In June 2008, the FASB issued FASB Staff Position Emerging Issues Task Force 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, (FSP EITF 03-6-1), which addresses whether instruments granted in share-based payment awards are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method. FSP EITF 03-6-1 is effective January 1, 2009 for Avon and requires prior period EPS presented to be adjusted retrospectively. Our grants of restricted stock and restricted stock units contain non-forfeitable rights to dividend equivalents and are considered participating securities as defined in FSP EITF 03-6-1 and will be included in computing earnings per share using the two-class method beginning with our first quarter 2009 Form 10-Q. The adoption of FSP EITF 03-6-1 will not have a material impact on the calculation of basic or diluted earnings per share.

2. EARNINGS PER SHARE AND SHARE REPURCHASES

| Components of Basic and Diluted Earnings per Share | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|------------------------------------|----------|-----------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| (shares in millions) | | | | |
| Numerator: | | | | |
| Net income | \$ 222.6 | \$ 139.1 | \$ 642.9 | \$ 401.8 |
| Denominator: | | | | |
| Basic EPS weighted-average shares outstanding | 425.74 | 430.03 | 426.36 | 435.13 |
| Diluted effect of assumed conversion of stock-based awards | 4.01 | 3.00 | 3.78 | 3.25 |
| Diluted EPS adjusted weighted-average shares outstanding | 429.75 | 433.03 | 430.14 | 438.38 |
| Earnings per Share: | | | | |
| Basic EPS | \$.52 | \$.32 | \$ 1.51 | \$.92 |
| Diluted EPS | \$.52 | \$.32 | \$ 1.49 | \$.92 |

For the three and nine months ended September 30, 2008 and 2007, we did not include stock options to purchase 8.8 million shares and 12.6 million shares of Avon common stock, respectively, in the calculations of diluted earnings per share because their inclusion would be anti-dilutive.

We purchased approximately 4.6 million shares of Avon common stock for \$171.4 during the first nine months of 2008, as compared to approximately 14.7 million shares of Avon common stock for \$557.8 during the first nine months of 2007 under our previously announced share repurchase program and through acquisition of stock from employees in connection with tax payments upon vesting of restricted stock units. At September 30, 2007, purchases of approximately 58,000 shares for \$2.1 were not settled until October 2007.

3. INVENTORIES

| Components of Inventories | September 30 2008 | December 31 2007 |
|---------------------------|----------------------|---------------------|
| Raw materials | \$ 370.2 | \$ 337.8 |
| Finished goods | 866.6 | 704.0 |

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

| | | | | |
|-------|----|---------|----|---------|
| Total | \$ | 1,236.8 | \$ | 1,041.8 |
|-------|----|---------|----|---------|

Table of Contents

AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

4. EMPLOYEE BENEFIT PLANS

| | Three Months Ended September 30 | | | | | |
|---------------------------------------|---------------------------------|---------|----------------|--------|-------------------------|--------|
| | Pension Benefits | | | | Postretirement Benefits | |
| | U.S. Plans | | Non-U.S. Plans | | 2008 | 2007 |
| Net Periodic Benefit Costs | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | \$ 4.2 | \$ 6.4 | \$ 4.3 | \$ 5.3 | \$.8 | \$.9 |
| Interest cost | 11.3 | 11.8 | 10.7 | 10.9 | 2.6 | 2.4 |
| Assumed return on plan assets | (13.1) | (13.4) | (11.9) | (11.4) | (.9) | (.6) |
| Amortization of prior service cost | (.2) | (.5) | (.4) | (.5) | (1.5) | (1.5) |
| Amortization of actuarial losses | 6.5 | 9.0 | 2.8 | 3.7 | .2 | .4 |
| Amortization of transition obligation | | | | | | |
| Curtailments/ settlements | | 2.4 | (2.2) | .4 | | |
| Net periodic benefit costs | \$ 8.7 | \$ 15.7 | \$ 3.3 | \$ 8.4 | \$ 1.2 | \$ 1.6 |

| | Nine Months Ended September 30 | | | | | |
|---------------------------------------|--------------------------------|---------|----------------|---------|-------------------------|--------|
| | Pension Benefits | | | | Postretirement Benefits | |
| | U.S. Plans | | Non-U.S. Plans | | 2008 | 2007 |
| Net Periodic Benefit Costs | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | \$ 13.3 | \$ 19.1 | \$ 13.0 | \$ 15.5 | \$ 2.5 | \$ 2.6 |
| Interest cost | 34.2 | 35.5 | 32.1 | 32.1 | 8.0 | 7.4 |
| Assumed return on plan assets | (38.7) | (40.2) | (35.6) | (33.5) | (2.4) | (1.7) |
| Amortization of prior service cost | (.8) | (1.5) | (1.2) | (1.5) | (4.5) | (4.6) |
| Amortization of actuarial losses | 21.8 | 27.0 | 8.3 | 10.7 | .8 | 1.1 |
| Amortization of transition obligation | | | | .1 | | |
| Curtailments/ settlements | | 4.3 | (2.2) | .4 | | |
| Net periodic benefit costs | \$ 29.8 | \$ 44.2 | \$ 14.4 | \$ 23.8 | \$ 4.4 | \$ 4.8 |

We previously disclosed in our financial statements for the year ended December 31, 2007, that we expected to contribute approximately \$9 and \$23 to our U.S. and non-U.S. pension plans, respectively, in 2008. As of September 30, 2008, we made approximately \$13.5 and \$11.1 of contributions to the U.S. and non-U.S. pension plans, respectively. We anticipate contributing approximately \$1 and \$10 to fund our U.S. and non-U.S. pension plans, respectively, during the remainder of 2008. As of September 30, 2008, we contributed approximately \$3 to our U.S. postretirement benefit plan. Our funding requirements may be impacted by regulations or interpretations thereof.

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in millions, except per share data)****5. CONTINGENCIES**

Blakemore, et al. v. Avon Products, Inc., et al. was a purported class action in the Superior Court of the State of California on behalf of Avon Sales Representatives who since March 24, 1999, received products from Avon they did not order, thereafter returned the unordered products to Avon, and did not receive credit for those returned products. The complaint sought unspecified compensatory and punitive damages, restitution and injunctive relief for alleged unjust enrichment and violation of the California Business and Professions Code. This action was commenced in March 2003. In January 2006, we filed a motion to strike the plaintiffs' asserted nationwide class. In February 2006, the trial court declined to grant our motion but instead certified the issue to the Court of Appeal on an interlocutory basis. In April 2006, the Court of Appeal denied our motion and instructed the trial court to consider the issue at a subsequent point in the proceedings. In September 2007, plaintiffs filed a motion seeking class certification on behalf of all Avon Sales Representatives who, since March 24, 1999, and while residing in California, received products from Avon they did not order, returned the unordered products to Avon, paid for the unordered products, and/or paid shipping costs for their return and did not receive reimbursement therefore by Avon or Avon initially made reimbursement therefore by means of a credit and later reversed the credit. In June 2008, Avon filed its opposition to the motion for class certification. We believe that this action is a dispute over purported customer service issues and is an inappropriate subject for consideration as a class action. On September 5, 2008, the court granted plaintiffs' Request for Dismissal with prejudice. The case is officially closed.

In December 2002, our Brazilian subsidiary received a series of excise and income tax assessments from the Brazilian tax authorities asserting that the establishment in 1995 of separate manufacturing and distribution companies in that country was done without a valid business purpose. The assessments assert tax deficiencies during portions of the years 1997 and 1998 of approximately \$115.7 at the exchange rate on September 30, 2008, plus penalties and accruing interest totaling approximately \$217.2 at the exchange rate on September 30, 2008. In July 2003, a first-level appellate body rejected the basis for income tax assessments representing approximately 74% of the total assessment, or \$247.6 (including interest). In March 2004, that rejection was confirmed in a mandatory second-level appellate review. The remaining assessments relating to excise taxes (approximately \$85.3) were not affected and are awaiting a decision at the first administrative level. In December 2003, an additional assessment was received in respect of excise taxes for the balance of 1998, totaling approximately \$172.4 at the exchange rate on September 30, 2008, and asserting a different theory of liability based on purported market sales data. In January 2005, an unfavorable first administrative level decision was received with respect to the appeal of that assessment and a further appeal has been taken. In December 2004, an additional assessment was received in respect of excise taxes for the period from January 1999 to December 2001, totaling approximately \$382.6 at the exchange rate on September 30, 2008, and asserting the same theory of liability as in the December 2003 assessment. We appealed that assessment. In September 2005, an unfavorable first administrative level decision was received with respect to the appeal of the December 2004 assessment, and a further appeal is being taken. The assessments issued in 2003 and 2004 are awaiting a decision at the second administrative level. In the event that assessments are upheld in the earlier stages of review, it may be necessary for us to provide security to pursue further appeals, which, depending on the circumstances, may result in a charge to income. It is not possible to make a reasonable estimate of the amount or range of expense that could result from an unfavorable outcome in respect of these or any additional assessments that may be issued for subsequent periods. The structure adopted in 1995 is comparable to that used by many companies in Brazil, and we believe that it is appropriate, both operationally and legally, and that the assessments are unfounded. This matter is being vigorously contested and in the opinion of our outside counsel the likelihood that the assessments ultimately will be upheld is remote. Management believes that the likelihood that the assessments will have a material impact on our consolidated financial position, results of operations or cash flows is correspondingly remote.

Kendall v. Employees' Retirement Plan of Avon Products and the Retirement Board is a purported class action commenced in April 2003 in the United States District Court for the Southern District of New York. Plaintiff is a retired employee of Avon who, before retirement, had been on paid disability leave for approximately 19 years. The initial complaint alleged that the Employees' Retirement Plan of Avon Products (the Retirement Plan) violated the Employee Retirement Income Security Act (ERISA) and, as a consequence, unlawfully reduced the amount of plaintiff's pension. Plaintiff sought a reformation of the Retirement Plan and recalculation of benefits under the terms of the Retirement Plan, as reformed for plaintiff and for the purported class. In November 2003, plaintiff filed an amended complaint alleging additional Retirement Plan violations of ERISA and seeking, among other things, elimination of a

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in millions, except per share data)**

social security offset in the Retirement Plan. The purported class includes all Plan participants, whether active, inactive or retired, and their beneficiaries and/or Estates, with one hour of service on or after January 1, 1976, whose accrued benefits, pensions or survivor's benefits have been or will be calculated and paid based on the Plan's unlawful provisions. In February 2004, we filed a motion to dismiss the amended complaint. In September 2007, the trial court granted our motion to dismiss and plaintiff thereafter appealed that decision to the United States Court of Appeals for the Second Circuit. While it is not possible to predict the outcome of litigation, management believes that there are meritorious defenses to the claims asserted and that this action should not have a material adverse effect on our consolidated financial position, results of operations or cash flows. This action is being vigorously contested.

In August 2005, we reported the filing of class action complaints for alleged violations of the federal securities laws in actions entitled *Nilesh Patel v. Avon Products, Inc. et al.* and *Michael Cascio v. Avon Products, Inc. et al.*, respectively, which subsequently have been consolidated. A consolidated amended class action complaint for alleged violations of the federal securities laws was filed in the consolidated action in December 2005 in the United States District Court for the Southern District of New York (Master File Number 05-CV-06803) under the caption *In re Avon Products, Inc. Securities Litigation* naming Avon, an officer and two officer/directors. The consolidated action, brought on behalf of purchasers of our common stock between February 3, 2004 and September 20, 2005, seeks damages for alleged false and misleading statements concerning Avon's operations and performance in China, the United States . . . and Mexico. The consolidated amended complaint also asserts that during the class period certain officers and directors sold shares of our common stock. In February 2006, we filed a motion to dismiss the consolidated amended class action complaint, asserting, among other things, that it failed to state a claim upon which relief may be granted, and the plaintiffs have opposed that motion.

In August 2005, we reported the filing of a complaint in a shareholder derivative action purportedly brought on behalf of Avon entitled *Robert L. Garber, derivatively on behalf of Avon Products, Inc. v. Andrea Jung et al. as defendants, and Avon Products, Inc. as nominal defendant*. An amended complaint was filed in this action in December 2005 in the United States District Court for the Southern District of New York (Master File Number 05-CV-06803) under the caption *In re Avon Products, Inc. Securities Litigation* naming certain of our officers and directors. The amended complaint alleges that defendants' violations of state law, including breaches of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment, between February 2004 and the present, have caused losses to Avon. In February 2006, we filed a motion to dismiss the amended complaint, asserting, among other things, that it failed to state a claim upon which relief may be granted, and the plaintiffs have opposed that motion.

In October 2005, we reported the filing of class action complaints for alleged violations of the Employee Retirement Income Security Act (ERISA) in actions entitled *John Rogati v. Andrea Jung, et al.* and *Carolyn Jane Perry v. Andrea Jung, et al.*, respectively, which subsequently have been consolidated. A consolidated class action complaint for alleged violations of ERISA was filed in the consolidated action in December 2005 in the United States District Court for the Southern District of New York (Master File Number 05-CV-06803) under the caption *In re Avon Products, Inc. ERISA Litigation* naming Avon, certain officers, Avon's Retirement Board and others. The consolidated action purports to be brought on behalf of the Avon Products, Inc. Personal Savings Account Plan and the Avon Products, Inc. Personal Retirement Account Plan (collectively the Plan) and on behalf of participants and beneficiaries of the Plan for whose individual accounts the Plan purchased or held an interest in Avon Products, Inc. . . . common stock from February 20, 2004 to the present. The consolidated complaint asserts breaches of fiduciary duties and prohibited transactions in violation of ERISA arising out of, inter alia, alleged false and misleading public statements regarding Avon's business made during the class period and investments in Avon stock by the Plan and Plan participants. In February 2006, we filed a motion to dismiss the consolidated complaint, asserting that it failed to state a claim upon which relief may be granted, and the plaintiffs have opposed that motion.

It is not possible to predict the outcome of litigation and it is reasonably possible that there could be unfavorable outcomes in the *In re Avon Products, Inc. Securities Litigation*, *In re Avon Products, Inc. Securities Litigation* (derivative action) and *In re Avon Products, Inc. ERISA Litigation* matters. Management is unable to make a meaningful estimate of the amount or range of loss that could result from unfavorable outcomes but, under some circumstances, adverse awards could be material to our consolidated financial position, results of operations or cash flows.

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

We are voluntarily conducting an internal investigation of our China operations, focusing on compliance with the Foreign Corrupt Practices Act. The internal investigation, which is being conducted under the oversight of the Audit Committee, commenced in June 2008 after we received an allegation that certain travel, entertainment and other expenses may have been improperly incurred in connection with our China operations. We have voluntarily contacted the Securities and Exchange Commission and the United States Department of Justice to advise both agencies that an internal investigation is underway. Because the internal investigation is in its early stage, we cannot predict how the resulting consequences, if any, may impact our internal controls, business, results of operations or financial position.

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in millions, except per share data)**

Various other lawsuits and claims, arising in the ordinary course of business or related to businesses previously sold, are pending or threatened against Avon. In management's opinion, based on its review of the information available at this time, the total cost of resolving such other contingencies at September 30, 2008, should not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

6. COMPREHENSIVE INCOME

| Components of Comprehensive Income | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|----------|-----------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 222.6 | \$ 139.1 | \$ 642.9 | \$ 401.8 |
| Foreign currency translation adjustments | (158.5) | 56.0 | (4.4) | 125.2 |
| Change in unrealized (losses) gains from available-for-sale securities | (.3) | .1 | (.6) | .1 |
| Change in derivative losses on cash flow hedges | 1.3 | (3.5) | (5.6) | (5.8) |
| Amortization of net actuarial losses, prior service cost, and transition obligation, net of taxes | 5.1 | 6.8 | 15.3 | 20.2 |
| Comprehensive income | \$ 70.2 | \$ 198.5 | \$ 647.6 | \$ 541.5 |

We received final valuations as of January 1, 2008, for our U.S. pension and postretirement plans during May 2008 and, as a result, recorded after-tax actuarial losses of \$2.0 and \$4.4 for our U.S. pension plan and postretirement plan, respectively, to accumulated other comprehensive loss. During the three and nine months ended September 30, 2008, we also recorded after-tax actuarial losses of \$4.3 to accumulated other comprehensive loss due to a mid-year valuation caused by a curtailment.

7. SEGMENT INFORMATION

Summarized financial information concerning our reportable segments was as follows:

| | Three Months Ended September 30 2008 | | September 30 2007 | |
|--------------------------------------|---|-------------------------------|----------------------|-------------------------------|
| | Total Revenue | Operating Profit (Loss) | Total Revenue | Operating Profit (Loss) |
| Latin America | \$ 1,064.8 | \$ 207.1 | \$ 854.8 | \$ 143.5 |
| North America | 584.5 | 29.9 | 605.2 | 42.0 |
| Central & Eastern Europe | 382.4 | 59.3 | 327.4 | 68.5 |
| Western Europe, Middle East & Africa | 315.8 | 18.3 | 292.8 | 10.6 |
| Asia Pacific | 221.4 | 24.3 | 208.1 | 12.4 |
| China | 75.8 | (7.3) | 60.8 | (4.8) |
| Total from operations | 2,644.7 | 331.6 | 2,349.1 | 272.2 |
| Global and other | | (34.5) | | (48.7) |
| Total | \$ 2,644.7 | \$ 297.1 | \$ 2,349.1 | \$ 223.5 |

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in millions, except per share data)

| | Nine Months Ended September 30 | | | |
|--------------------------------------|--------------------------------|-------------------------------|-------------------|-------------------------------|
| | 2008 | | 2007 | |
| | Total Revenue | Operating Profit (Loss) | Total Revenue | Operating Profit (Loss) |
| Latin America | \$ 2,939.8 | \$ 515.2 | \$ 2,309.2 | \$ 345.9 |
| North America | 1,811.4 | 169.0 | 1,855.6 | 160.7 |
| Central & Eastern Europe | 1,236.6 | 244.0 | 1,019.2 | 191.8 |
| Western Europe, Middle East & Africa | 987.4 | 79.5 | 874.4 | 39.5 |
| Asia Pacific | 666.0 | 74.8 | 610.9 | 49.5 |
| China | 241.3 | (1.6) | 193.9 | (3.9) |
| Total from operations | 7,882.5 | 1,080.9 | 6,863.2 | 783.5 |
| Global and other | | (113.7) | | (135.3) |
| Total | \$ 7,882.5 | \$ 967.2 | \$ 6,863.2 | \$ 648.2 |

Our consolidated net sales by classes of principal products were as follows:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|------------------------------|------------------------------------|-------------------|-----------------------------------|-------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Beauty ⁽¹⁾ | \$ 1,905.3 | \$ 1,656.5 | \$ 5,646.0 | \$ 4,830.0 |
| Beauty Plus ⁽²⁾ | 474.4 | 432.1 | 1,464.9 | 1,310.8 |
| Beyond Beauty ⁽³⁾ | 239.0 | 237.5 | 696.7 | 655.0 |
| Net sales | 2,618.7 | 2,326.1 | 7,807.6 | 6,795.8 |
| Other revenue ⁽⁴⁾ | 26.0 | 23.0 | 74.9 | 67.4 |
| Total revenue | \$ 2,644.7 | \$ 2,349.1 | \$ 7,882.5 | \$ 6,863.2 |

⁽¹⁾ Beauty includes cosmetics, fragrances, skin care and toiletries.⁽²⁾ Beauty Plus includes fashion jewelry, watches, apparel and accessories.⁽³⁾ Beyond Beauty includes home products and gift and decorative products.⁽⁴⁾ Other primarily includes shipping and handling fees billed to Representatives. Sales from Health and Wellness products and *mark.* are included among these categories based on product type.

8. SUPPLEMENTAL BALANCE SHEET INFORMATION

| | September 30, 2008 | December 31, 2007 |
|-----------------------------------|-------------------------------|------------------------------|
| Components of Other Assets | | |
| Deferred tax assets | \$ 296.6 | \$ 272.9 |
| Goodwill (Note 10) | 226.7 | 222.2 |
| Intangible assets (Note 10) | 32.8 | 43.6 |
| Pension assets | 32.5 | 40.0 |
| Investments | 119.6 | 127.3 |
| Deferred software | 101.8 | 95.9 |
| Other | 140.2 | 120.7 |
| Other assets | \$ 950.2 | \$ 922.6 |

Table of Contents

AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

9. RESTRUCTURING INITIATIVES

In November 2005, we announced a multi-year turnaround plan to restore sustainable growth. As part of our turnaround plan, restructuring initiatives include:

enhancement of organizational effectiveness, including efforts to flatten the organization and bring senior management closer to consumers through a substantial organization downsizing;

implementation of a global manufacturing strategy through facilities realignment;

implementation of additional supply chain efficiencies in distribution; and

streamlining of transactional and other services through outsourcing and moves to lower-cost countries.

We have approved and announced all of the initiatives that are part of our restructuring plan. We expect to record total restructuring charges and other costs to implement restructuring initiatives of approximately \$530 before taxes. Through September 30, 2008, we have recorded total costs to implement, net of adjustments, of \$496.8 (\$53.2 in the first nine months of 2008, \$158.3 in 2007, \$228.8 in 2006, and \$56.5 in 2005) for actions associated with our restructuring initiatives.

Restructuring Charges First, Second and Third Quarters of 2008

During the three and nine months ended September 30, 2008, we recorded total costs to implement associated with previously approved initiatives that are part of our multi-year restructuring plan of \$14.4 and \$53.2, respectively, and the costs consisted of the following:

net charges of \$3.8 and \$18.5, respectively, primarily for severance and pension benefits;

implementation costs of \$6.4 and \$27.0, respectively, for professional service fees, primarily associated with our initiatives to outsource certain finance and human resource processes; and

accelerated depreciation of \$4.2 and \$7.7, respectively, associated with our initiatives to realign certain distribution operations and close certain manufacturing operations.

Of the total costs to implement, \$11.8 and \$50.3 was recorded in selling, general and administrative expenses for the three and nine months ended September 30, 2008, respectively, and \$2.6 and \$2.9 was recorded in cost of sales for the three and nine months ended September 30, 2008, respectively.

Restructuring Charges First, Second and Third Quarters 2007

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

During the first three quarters of 2007, exit and disposal activities that are a part of our multi-year restructuring plan were approved. Specific actions for this phase of our multi-year restructuring plan included:

the reorganization of certain functions, primarily sales-related organizations;

automation of certain distribution processes; and

outsourcing of certain finance, customer service, and information technology processes.

The actions described above are expected to be completed by the end of 2008, except for the outsourcing of certain information technology processes, which is expected to be completed by the end of 2011.

In connection with initiatives that had been approved to date, we recorded total costs to implement for the three and nine months ended September 30, 2007, of \$27.2 and \$57.4, respectively, and the costs consisted of the following:

charges of \$19.2 and \$31.5, respectively, primarily for employee-related costs, including severance, pension and other termination benefits;

favorable adjustments of \$.5 and \$3.5, respectively, primarily relating to certain employees pursuing reassignments to other positions and higher than expected turnover (employees leaving prior to termination); and

implementation costs of \$8.5 and \$29.4, respectively, for professional service fees associated with our initiatives to outsource certain human resource, finance, customer service, and information technology processes and accelerated depreciation associated with our initiatives to realign certain distribution operations and close certain manufacturing operations.

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in millions, except per share data)

Of the total costs to implement, \$27.6 and \$57.1 was recorded in selling, general and administrative expenses for the three and nine months ended September 30, 2007, respectively, and a favorable adjustment of \$.4 and a charge of \$.3 were recorded in cost of sales for the three and nine months ended September 30, 2007, respectively.

The liability balances for the initiatives that have been approved to date are shown below.

| | Employee- Related Costs | Asset Write-offs | Inventory Write-offs | Currency Translation Adjustment Write-offs | Contract Terminations/ Other | Total |
|----------------------------|-------------------------------|---------------------|-------------------------|---|------------------------------------|----------|
| Balance December 31, 2007 | \$ 143.2 | \$ | \$ | \$ | \$.7 | \$ 143.9 |
| 2008 Charges | 17.8 | | | | 1.1 | 18.9 |
| Adjustments | (.4) | | | | | (.4) |
| Cash payments | (45.6) | | | | (1.7) | (47.3) |
| Non-cash write-offs | 2.2 | | | | | 2.2 |
| Foreign exchange | (2.8) | | | | | (2.8) |
| Balance September 30, 2008 | \$ 114.4 | \$ | \$ | \$ | \$.1 | \$ 114.5 |

The following table presents the restructuring charges incurred to date, net of adjustments, under our multi-year restructuring plan that began in the fourth quarter of 2005, along with the charges expected to be incurred under the plan:

| | Employee- Related Costs | Asset Write-offs | Inventory Write-offs | Currency Translation Adjustment Write-offs | Contract Terminations/ Other | Total |
|--|-------------------------------|---------------------|-------------------------|---|------------------------------------|----------|
| Charges incurred to date | \$ 344.5 | \$ 10.8 | \$ 7.4 | \$ 11.6 | \$ 8.0 | \$ 382.3 |
| Charges to be incurred on approved initiatives | 26.0 | | | | | 26.0 |
| Total expected charges | \$ 370.5 | \$ 10.8 | \$ 7.4 | \$ 11.6 | \$ 8.0 | \$ 408.3 |

The charges, net of adjustments, of initiatives approved to date by reportable business segment were as follows:

| | Latin America | North America | Central & Eastern Europe | Western Europe, Middle East & Africa | Asia Pacific | China | Corporate | Total |
|---------------------|------------------|------------------|--------------------------------|---|-----------------|--------|-----------|---------|
| 2005 | \$ 3.5 | \$ 6.9 | \$ 1.0 | \$ 11.7 | \$ 18.2 | \$ 4.2 | \$ 6.1 | \$ 51.6 |
| 2006 | 34.6 | 61.8 | 6.9 | 45.1 | 22.2 | 2.1 | 29.5 | 202.2 |
| 2007 | 14.9 | 7.0 | 4.7 | 65.1 | 4.3 | 1.3 | 12.7 | 110.0 |
| First Quarter 2008 | .3 | | .4 | 13.6 | | | (.5) | 13.8 |
| Second Quarter 2008 | .2 | .4 | (.2) | 1.3 | .4 | (.1) | (1.1) | .9 |

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

| | | | | | | | | | |
|--|---------|---------|---------|----------|---------|--------|---------|----------|-----|
| Third Quarter 2008 | 3.4 | (1.3) | 1.0 | .7 | | | | | 3.8 |
| Charges recorded to date | \$ 56.9 | \$ 74.8 | \$ 13.8 | \$ 137.5 | \$ 45.1 | \$ 7.5 | \$ 46.7 | \$ 382.3 | |
| Charges to be incurred on approved initiatives | 4.7 | 3.6 | | 2.8 | 10.9 | | 4.0 | 26.0 | |
| Total expected charges | \$ 61.6 | \$ 78.4 | \$ 13.8 | \$ 140.3 | \$ 56.0 | \$ 7.5 | \$ 50.7 | \$ 408.3 | |

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in millions, except per share data)

As noted previously, we expect to record total costs to implement of approximately \$530 before taxes for all restructuring initiatives, including restructuring charges and other costs to implement. The amounts shown in the tables above as charges recorded to date relate to initiatives that have been approved and recorded in the financial statements as the costs are probable and estimable. The amounts shown in the tables above as total expected charges represent charges recorded to date plus charges yet to be recorded for approved initiatives as the relevant accounting criteria for recording have not yet been met. In addition to the charges included in the tables above, we will incur other costs to implement restructuring initiatives such as consulting, other professional services, and accelerated depreciation.

10. GOODWILL AND INTANGIBLE ASSETS*Goodwill*

| | Latin America | Central & Eastern Europe | Western Europe, Middle East & Africa | Asia Pacific | China | Total |
|-------------------------------|------------------|--------------------------------|---|-----------------|---------|----------|
| Balance at December 31, 2007 | \$ 94.9 | \$ 8.8 | \$ 37.8 | \$ 10.4 | \$ 70.3 | \$ 222.2 |
| Adjustments | | | .3 | | | .3 |
| Foreign exchange | | | (1.1) | .6 | 4.7 | 4.2 |
| Balance at September 30, 2008 | \$ 94.9 | \$ 8.8 | \$ 37.0 | \$ 11.0 | \$ 75.0 | \$ 226.7 |

Intangible assets

| | September 30, 2008 | | December 31, 2007 | |
|-----------------------------|--------------------|-----------------------------|--------------------|-----------------------------|
| | Carrying Amount | Accumulated Amortization | Carrying Amount | Accumulated Amortization |
| Amortized Intangible Assets | | | | |
| Customer relationships | \$ 38.4 | \$ (24.0) | \$ 37.9 | \$ (18.4) |
| Licensing agreements | 42.5 | (26.1) | 41.2 | (19.9) |
| Noncompete agreements | 7.5 | (5.5) | 8.4 | (5.6) |
| Total | \$ 88.4 | \$ (55.6) | \$ 87.5 | \$ (43.9) |

Estimated Amortization Expense:

| | |
|------|---------|
| 2008 | \$ 16.3 |
| 2009 | 14.0 |
| 2010 | 2.0 |
| 2011 | 2.0 |
| 2012 | 2.0 |

Aggregate amortization expense during the three and nine months ended September 30, 2008, was \$3.3 and \$11.9, respectively, compared to \$4.5 and \$12.9, respectively, for the same periods of 2007.

Table of Contents**AVON PRODUCTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in millions, except per share data)

11. FAIR VALUE

We adopted SFAS 157 as of January 1, 2008, with the exception of the application of the statement to non-recurring, nonfinancial assets and liabilities which becomes effective January 1, 2009. The adoption of SFAS 157 did not have a material impact on our fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.

Level 3 - Unobservable inputs based on our own assumptions.

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2008:

| | Level 1 | Level 2 | Level 3 | Total |
|------------------------------------|----------------|----------------|-----------|----------------|
| Assets: | | | | |
| Available-for-sale securities | \$ 18.0 | \$ | \$ | \$ 18.0 |
| Interest-rate swap agreements | | 24.3 | | 24.3 |
| Foreign exchange forward contracts | | 3.8 | | 3.8 |
| Total | \$ 18.0 | \$ 28.1 | \$ | \$ 46.1 |
| Liabilities: | | | | |
| Interest-rate swap agreements | \$ | \$ 15.3 | \$ | \$ 15.3 |
| Foreign exchange forward contracts | | 4.7 | | 4.7 |
| Total | \$ | \$ 20.0 | \$ | \$ 20.0 |

The fair values of our available-for-sale securities are based on quoted prices. The fair values of our interest-rate swap agreements are based on LIBOR yield curves at the reporting date. The fair values of our foreign exchange forward contracts are based on quoted forward foreign exchange prices at the reporting date.

The available-for-sale securities are held in a trust in order to fund future benefit payments for non-qualified retirement plans. As of September 30, 2008, we have recorded a net unrealized loss of \$.2 in accumulated other comprehensive loss, within shareholders' equity, associated with the available-for-sale securities. The foreign exchange forward contracts and interest rate swap agreements are hedges of either recorded assets or liabilities or anticipated transactions. Changes in values of the underlying hedged assets and liabilities or anticipated transactions are not reflected in the table above.

Table of Contents

AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

12. DEBT AND FINANCIAL INSTRUMENTS

In August 2008, we entered into an amendment of our one-year Japanese yen 11.0 billion (\$103.9 at the exchange rate on September 30, 2008) uncommitted credit facility with the Bank of Tokyo-Mitsubishi UFJ, Ltd. The amendment provides for the extension of the yen credit facility until August 2009.

In March 2008, we issued \$500.0 principal amount of notes payable in a public offering. \$250.0 of the notes bear interest at a per annum coupon rate equal to 4.8%, payable semi-annually, and mature on March 1, 2013 (the 2013 Notes). \$250.0 of the notes bear interest at a per annum coupon rate of 5.75%, payable semi-annually, and mature on March 1, 2018 (the 2018 Notes). The net proceeds from the offering of \$496.3 were used to repay outstanding indebtedness under our commercial paper program and for general corporate purposes.

The indentures under which the above notes were issued contain certain covenants, including limits on the incurrence of liens and restrictions on sale/leaseback transactions and transactions involving a merger, consolidation or sale of substantially all of our assets. At September 30, 2008, we were in compliance with all covenants in our indentures.

In August 2007, we entered into treasury lock agreements (the locks) with notional amounts totaling \$500.0 that expired on January 31, 2008. On January 31, 2008, we extended the maturity date of the locks to July 31, 2008, and the locks were designated as cash flow hedges of the anticipated interest payments on \$250.0 principal amount of the 2013 Notes and \$250.0 principal amount of the 2018 Notes. The losses on the locks of \$38.0 were recorded in accumulated other comprehensive loss. \$19.2 and \$18.8 of the losses are being amortized to interest expense over five years and ten years, respectively.

In June 2008, we entered into two five-year interest-rate-swap contracts with notional amounts totaling \$250.0 and one 10-year interest-rate-swap contract with a notional amount of \$125.0 to effectively convert fixed interest rates on the 2013 Notes and 2018 Notes to variable interest rates, based on LIBOR.

13. UNCERTAIN TAX POSITIONS

At December 31, 2007, we had \$154.3 of total gross unrecognized tax benefits, of which approximately \$141 would impact the effective tax rate, if recognized. At September 30, 2008, we had \$97.4 of total gross unrecognized tax benefits, of which approximately \$85 would impact the effective tax rate, if recognized. During the third quarter of 2008, the amount of gross unrecognized tax benefits decreased by \$63.4 due to a settlement with taxing authorities. We anticipate that it is reasonably possible that the total amount of unrecognized tax benefits could decrease in the range of \$10 to \$15 within the next 12 months due to the closure of tax years by expiration of the statute of limitations and audit settlements.

Table of Contents

AVON PRODUCTS, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in millions, except per share data)**

OVERVIEW

We are a global manufacturer and marketer of beauty and related products. Our business is conducted worldwide, primarily in the direct selling channel. We presently have sales operations in approximately 66 countries and territories, including the United States, and distribute products in approximately 48 more. Our reportable segments are based on geographic operations in six regions: Latin America; North America; Central & Eastern Europe; Western Europe, Middle East & Africa; Asia Pacific; and China. We centrally manage global Brand Marketing and Supply Chain organizations. Product categories include: Beauty, which consists of cosmetics, fragrances, skin care and toiletries; Beauty Plus, which consists of fashion jewelry, watches, apparel and accessories; and Beyond Beauty, which consists of home products and gift and decorative products. Sales from Health and Wellness products and *mark.*, a global cosmetics brand that focuses on the market for young women, are included among these categories based on product type. Sales are made to the ultimate consumer principally through over 5.5 million independent Representatives, who are independent contractors and not employees of Avon. The success of our business is highly dependent on recruiting, motivating and retaining Representatives.

We view the geographic diversity of our businesses as a strategic advantage. In developed markets, such as the United States, we seek to achieve growth in line with that of the overall beauty market, while in developing and emerging markets we seek to achieve higher growth targets. During 2007, approximately 80% of our consolidated revenue was derived from operations outside the U.S. When we first penetrate a market, we experience high growth rates and, as we reach scale in these markets, growth rates decline.

At the end of 2005, we launched a comprehensive, multi-year turnaround plan to restore sustainable growth. In January 2008, we announced the final initiatives of the restructuring program under our turnaround plan. In 2007, we completed the analysis of our optimal product portfolio and made decisions on exit strategies for non-optimal products under our Product Line Simplification program (*PLS*). In 2007, we also launched our Strategic Sourcing Initiative (*SSI*). We expect our restructuring initiatives to deliver annualized savings of approximately \$430 once all initiatives are fully implemented by 2011-2012. We also expect to achieve annualized benefits in excess of \$200 each from *PLS* and *SSI*, which would bring total annualized savings and benefits from all three programs to over \$830 when fully implemented. After more than two years of implementing our turnaround plan, we believe we have repositioned Avon for long-term sustainable, profitable growth.

During the first nine months of 2008, revenue grew in all segments except North America, which was adversely affected by the slowing macroeconomic environment, higher year-over-year fuel prices, deteriorating consumer confidence and service-related problems experienced during the first half of 2008. We continued to benefit from strength in developing and emerging markets around the globe that more than offset the unfavorable impact of economic softness in North America. See the Segment Review section of Management's Discussion and Analysis of Financial Condition and Results of Operations for additional information related to changes in revenue by segment.

During the first nine months of 2008, revenue increased 15%, and Active Representatives increased 9% (with increases in all segments), fueled by investments in advertising and the Representative Value Proposition (*RVP*). Sales from each of our product categories increased, with products in the Beauty category increasing 17%.

Operating margin increased during the first nine months of 2008, reflecting gross margin gains and leverage of revenue growth while containing overhead costs, partially offset by continued investment in our brand and channel.

We increased our investment in advertising by \$29.9 or 11% during the first nine months of 2008. Approximately 65% of the incremental spending was spent in Russia, China, Brazil and Colombia. The incremental spending on advertising was at a rate somewhat less than revenue growth. The advertising investments supported new product launches, such as *Anew Ultimate Contouring Eye System*, *Pro-to-Go Lipstick*, *Avon Solutions Hydra-Radiance*, *Anew Rejuvenate* line of skin care, *Anew Ultimate Age Repair Elixir*, *Supershock Mascara* and *U by Ungaro* fragrances. Advertising investments also included advertising to recruit Representatives.

Table of Contents

AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

We invested approximately \$74 incrementally in our Representatives (RVP) during the first nine months of 2008 through continued implementation of our Sales Leadership program, enhanced incentives, increased sales campaign frequency, improved commissions and new e-business tools. This incremental investment was ahead of revenue growth. Investing in RVP will continue to be a key strategy.

We have continued to forge alliances with celebrities, including alliances with Patrick Dempsey and Ferragamo Parfums S.P.A. for the U by Ungaro line of fragrances.

We began to implement PLS in the U.K. during the first half of 2008 and early results appear to be favorable; however, the transition is a long process and will continue into 2009. In the third quarter of 2008, we began implementing PLS in several other large markets. As expected, we did not realize significant benefits from PLS during the first nine months of 2008. We expect to realize benefits of approximately \$40 and \$120 for full-year 2008 and 2009, respectively, and in excess of \$200 in 2010. In the first nine months of 2007, we recorded PLS charges of \$84.1, primarily incremental inventory obsolescence expense of \$68.1. We recorded final PLS charges in the fourth quarter of 2007.

We realized benefits of approximately \$75 from SSI through the first nine months of 2008. We expect to realize approximately 50% of total expected annualized benefits by the end of 2008, with annualized benefits from this initiative in excess of \$200 by the end of 2009, with a full year of benefit in 2010. As a result, we expect to realize benefits of approximately \$100 and \$175 in 2008 and 2009, respectively, and benefits in excess of \$200 in 2010.

Costs to implement restructuring initiatives were \$4.2 lower in the first nine months of 2008 compared to the first nine months of 2007, due to lower costs to implement previously approved initiatives. Actions implemented under our restructuring initiatives resulted in savings of approximately \$200 in the first nine months of 2008, as compared to savings of approximately \$175 in the first nine months of 2007. We expect to achieve annualized savings of approximately \$430 once all initiatives are fully implemented by 2011-2012. We expect the savings to reach approximately \$270 in 2008 and \$300 in 2009.

Additional information regarding our turnaround plan and strategic initiatives is contained in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2007, filed with the U.S. Securities and Exchange Commission.

OUTLOOK

Our strategy is to invest in both our brand and direct-selling channel to drive sustainable, profitable growth. As a result, we continue to expect revenue growth over the long term to average mid-single digits, excluding the impact of foreign exchange.

As of the date of this filing, we have not experienced a measureable impact from the current economic and financial crisis on our business outside of North America. While we consider the consequences of possible deterioration in these economies and remain watchful of our business trends in these markets, we expect 2008 fourth quarter local-currency revenue growth rates in these markets similar to those of the third quarter of 2008. The negative consumer environment in North America continues to weigh on our performance in that region, and we expect the trend to further deteriorate in the fourth quarter of 2008. Additionally, recent significant movements in foreign-exchange rates, if maintained at current levels, will negatively impact our fourth-quarter and full-year 2008 growth rates and operating margins. As a result, we now expect a 2008 full-year operating margin in the range of 13%, compared with our previous expectation of an operating margin approaching 2005's level of approximately 14%. We are providing no operating margin guidance beyond 2008.

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

We believe that our strong operating cash flow, combined with global cash balances approaching \$1 billion and our investment-grade credit rating (Standard & Poor's rating of single A and Moody's rating of A2), should more than enable us to meet our financial needs.

Table of Contents

AVON PRODUCTS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

STRATEGIC INITIATIVES

Product Line Simplification

During 2006, we began to analyze our product line, under our PLS program, to develop a smaller range of better performing, more profitable products. The overall goal of PLS is to identify an improved product assortment to drive higher sales of more profitable products. During 2007, we completed the analysis of our product portfolio, concluded on the appropriate product assortment going forward and made decisions regarding the ultimate disposition of products that will no longer be part of our improved product assortment (such as selling at a discount, donation, or destruction). During the first quarter of 2008, we began to implement PLS in the U.K. In the third quarter of 2008, we began implementing PLS in several other large markets.

We expect that sales and marketing benefits will account for approximately 85% of our projected benefits. Improving our product assortment will allow us to increase exposure and improve presentation of the remaining products within our brochure, which is expected to yield more pleasurable consumer shopping experiences, easier Representative selling experiences, and greater sales per brochure page. A second source of benefits from PLS results from transferable demand. Transferable demand refers to the concept that when products with redundant characteristics are removed from our product assortment, some demand from the eliminated products will transfer to the remaining products that offer similar or comparable product characteristics. As part of PLS, when we identify products that have sufficient overlap of characteristics, we will eliminate the products with the lowest profitability and we expect the products that we retain will generate more profit. A third source of benefits from PLS is less price discounting. As we implement operating procedures under PLS, we anticipate introducing fewer new products and lengthening the lifecycle of products in our offering, which we expect will lead to less aggressive price discounting over a product's life cycle.

In addition to the benefits above, we also expect supply chain benefits to account for approximately 15% of our projected benefits. We expect improvements to cost of sales once PLS is fully implemented, primarily from a reduction in inventory obsolescence expense as a result of better managed inventory levels, lower variable spending on warehousing, more efficient manufacturing utilization and lower purchasing costs. We also expect operating expenses to benefit from a reduction in distribution costs and benefits to inventory productivity.

Strategic Sourcing Initiative

We launched SSI in 2007. This initiative is expected to reduce direct and indirect costs of materials, goods and services. Under this initiative, we are shifting our purchasing strategy from a local, commodity-oriented approach towards a globally-coordinated effort which leverages our volumes, allows our suppliers to benefit from economies of scale, utilizes sourcing best practices and processes, and better matches our suppliers capabilities with our needs. Beyond lower costs, our goals from SSI include improving asset management, service for Representatives and vendor relationships. During 2007, we completed an analysis, based on 2006 data, which identified approximately \$4,000 of spending to be targeted for cost reductions. Additionally, during 2007, we implemented the first of three waves of this initiative, which has addressed approximately 38% of the identified spending and is expected to generate approximately 50% of the expected benefits. During the fourth quarter of 2007, we launched the second wave of this initiative, which is expected to address 45% of the identified spending and generate approximately 30% of the expected benefits. We are currently in the process of implementing the second wave of this initiative.

Restructuring Initiatives

We launched our multi-year restructuring program in late 2005. In January 2008, we announced the final initiatives that are part of this program. We expect to record total restructuring charges and other costs to implement our restructuring initiatives of approximately \$530 before taxes, of which we have recorded \$496.8 through September 30, 2008 (\$53.2 in 2008, \$158.3 in 2007, \$228.8 in 2006, and \$56.5 in 2005). We expect to record a majority of the remaining costs by the end of 2009.

Enterprise Resource Planning System

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

We are in the midst of a multi-year global roll-out of an enterprise resource planning (ERP) system, which is expected to improve the efficiency of our supply chain and financial transaction processes. We began our global roll-out in Europe in 2005 and have since implemented ERP in our European manufacturing facilities, our larger European direct selling operations and in the U.S. As part of this continuing global roll-out, we expect to implement ERP in several countries over the next several years leveraging the knowledge gained from our previous implementations.

Table of Contents

AVON PRODUCTS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

During 2008, we are working to improve the effectiveness of ERP in the U.S. and are beginning to implement in the other markets within North America, as well as in certain smaller European direct selling operations. During 2008, we also began the multi-year implementation process in Latin America in one market. In Latin America, we plan to implement modules of ERP in a gradual manner across key markets over the next several years.

NEW ACCOUNTING STANDARDS

New Accounting Standards Implemented

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, (SFAS 157), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued Staff Position 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until January 1, 2009. We adopted SFAS 157 as of January 1, 2008, with the exception of the application of the statement to non-recurring, nonfinancial assets and liabilities. The adoption of SFAS 157 did not have a material impact on our consolidated financial statements. See Note 11, Fair Value, for additional information.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment to FASB Statement No. 115*, (SFAS 159), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. We adopted SFAS 159 as of January 1, 2008. The adoption of SFAS 159 had no impact on our consolidated financial statements, as we did not choose to measure the items at fair value.

New Accounting Standards to be Implemented

In February 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*, (SFAS 161), which establishes, among other things, the disclosure requirements for derivative instruments and hedging activities. We will be required to provide enhanced disclosures about how and why we use derivative instruments, how they are accounted for, and how they affect our financial performance. SFAS 161 is effective January 1, 2009, for Avon.

In June 2008, the FASB issued FASB Staff Position Emerging Issues Task Force 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, (FSP EITF 03-6-1), which addresses whether instruments granted in share-based payment awards are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method. Our grants of restricted stock and restricted stock units contain non-forfeitable rights to dividend equivalents and are considered participating securities as defined in FSP EITF 03-6-1 and will be included in computing earnings per share using the two-class method. FSP EITF 03-6-1 is effective January 1, 2009, for Avon and requires prior period EPS presented to be adjusted retrospectively. The adoption of FSP EITF 03-6-1 will not have a material impact on the calculation of basic or diluted earnings per share.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Dollars in millions, except per share data)

RESULTS OF OPERATIONS THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AS COMPARED TO 2007**Consolidated**

| | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|---|---------------------------------|------------|---|--------------------------------|------------|---|
| | 2008 | 2007 | Favorable (Unfavorable) %/Point Change | 2008 | 2007 | Favorable (Unfavorable) %/Point Change |
| Total revenue | \$ 2,644.7 | \$ 2,349.1 | 13% | \$ 7,882.5 | \$ 6,863.2 | 15% |
| Cost of sales | 975.0 | 889.0 | (10)% | 2,892.1 | 2,642.6 | (9)% |
| Selling, general and administrative expenses | 1,372.6 | 1,236.6 | (11)% | 4,023.2 | 3,572.4 | (13)% |
| Operating profit | 297.1 | 223.5 | 33% | 967.2 | 648.2 | 49% |
| Interest expense | 24.6 | 29.2 | 16% | 76.8 | 83.8 | 8% |
| Interest income | (10.1) | (10.2) | | (27.9) | (32.8) | (15)% |
| Other expense (income), net | 3.4 | (3.2) | N/A | 16.1 | (1.4) | N/A |
| Net income | 222.6 | 139.1 | 60% | \$ 642.9 | 401.8 | 60% |
| Diluted earnings per share | .52 | .32 | 63% | 1.49 | .92 | 62% |
| Advertising expenses* | 105.8 | 95.6 | (11)% | 290.1 | 260.2 | (11)% |
| Gross margin | 63.1% | 62.2% | .9 | 63.3% | 61.5% | 1.8 |
| Selling, general and administrative expenses as a % of total revenue | 51.9% | 52.6% | .7 | 51.0% | 52.1% | 1.1 |
| Operating margin | 11.2% | 9.5% | 1.7 | 12.3% | 9.4% | 2.9 |
| Effective tax rate | 19.5% | 33.0% | 13.5 | 28.2% | 32.6% | 4.4 |
| Units sold | | | (1)% | | | 2% |
| Active Representatives | | | 5% | | | 9% |

* Advertising expenses are included within selling, general and administrative expenses.

Revenue

Total revenue for the third quarter of 2008 increased 13%, with foreign exchange contributing 7 percentage points to the revenue growth. Revenue grew in all segments, except North America. Revenue growth was driven by an increase of 5% in Active Representatives.

On a category basis, the increase in revenue for the third quarter of 2008 was primarily driven by an increase of 15% in Beauty sales, with increases in all sub-categories of Beauty. Within the Beauty category, fragrance grew 18%, color grew 19%, skin care grew 9%, and personal care grew 13%. Beauty Plus sales increased 10% and Beyond Beauty sales increased 1%.

Total revenue for the first nine months of 2008 increased 15%, with foreign exchange contributing 8 percentage points to the revenue growth. Revenue grew in all segments, except North America. Revenue growth was driven by an increase of 9% in Active Representatives.

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

On a category basis, the increase in revenue for the first nine months of 2008 was primarily driven by an increase of 17% in Beauty sales, with increases in all sub-categories of Beauty. Within the Beauty category, fragrance grew 18%, color grew 20%, skin care grew 12%, and personal care grew 15%. Beauty Plus sales increased 12% and Beyond Beauty sales increased 6%.

Table of Contents

AVON PRODUCTS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

See the Segment Review section of Management's Discussion and Analysis of Financial Condition and Results of Operations for additional information related to changes in revenue by segment.

Gross Margin

Gross margin for the third quarter and first nine months of 2008 increased .9 point and 1.8 points, respectively, primarily due to increased pricing, partially offset by supply chain impacts including higher commodity costs and unfavorable foreign exchange on product cost in Europe. Gross margin for the first nine months of 2008 also benefited from a decrease in inventory obsolescence provisions in 2008, which benefited gross margin by approximately 1.3 points. The third quarter and first nine months of 2007 included incremental inventory obsolescence charges of \$.7 and \$68.1, respectively, related to our PLS program. Obsolescence expense for the first nine months of 2008 also benefited by approximately \$13 from changes in estimates to our disposition plan under our PLS program.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the third quarter of 2008, increased \$136.0, primarily due to higher variable expenses, such as freight from increased sales volume; higher investments in RVP and advertising of approximately \$32; and the impact of foreign exchange. These higher costs were partially offset by lower costs incurred to implement our restructuring initiatives of \$15.8. While overhead expenses increased during the third quarter of 2008, the increase was due to the impact of foreign exchange.

Selling, general and administrative expenses for the first nine months of 2008, increased \$450.8, primarily due to higher variable expenses, such as freight from increased sales volume; higher investments in RVP and advertising of approximately \$104; higher overhead primarily due to investments in information technology and higher marketing costs; and the impact of foreign exchange. These higher costs were partially offset by lower costs incurred to implement our restructuring initiatives of \$6.8.

See the Segment Review section of Management's Discussion and Analysis of Financial Condition and Results of Operations for additional information related to changes in operating margin by segment.

Other Expense

Interest expense for the third quarter and first nine months of 2008 decreased, primarily due to lower interest rates. At September 30, 2008, we held interest rate swap agreements that effectively converted approximately 40% of our outstanding long-term, fixed-rate borrowings to a variable interest rate based on LIBOR.

Interest income decreased for the third quarter and first nine months of 2008, primarily due to lower interest rates.

Other expense (income), net increased for the third quarter and first nine months of 2008, primarily due to higher net foreign exchange losses.

Effective Tax Rate

The effective tax rate for the third quarter and first nine months of 2008 was 19.5% and 28.2%, respectively, compared to rates of 33.0% and 32.6%, respectively, for the same periods of 2007. The three and nine months periods of 2008 include net benefits of 13.6 points and 4.2 points, respectively, resulting from an audit settlement, which was partially offset by the establishment of a valuation allowance against deferred tax assets relating to loss carryforwards.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Dollars in millions, except per share data)

Segment Review*Latin America*

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|------------------------|---------------------------------|----------|------------------|----------------|--------------------------------|------------|------------------|----------------|
| | 2008 | 2007 | % / Point Change | | 2008 | 2007 | % / Point Change | |
| | | | US\$ | Local Currency | | | US\$ | Local Currency |
| Total revenue | \$ 1,064.8 | \$ 854.8 | 25% | 13% | \$ 2,939.8 | \$ 2,309.2 | 27% | 15% |
| Operating profit | 207.1 | 143.5 | 44% | 29% | 515.2 | 345.9 | 49% | 32% |
| Operating margin | 19.4% | 16.8% | 2.6 | 2.4 | 17.5% | 15.0% | 2.5 | 2.1 |
| Units sold | | | | % | | | | 4% |
| Active Representatives | | | | 4% | | | | 7% |

Total revenue increased for the third quarter and first nine months of 2008, driven by a larger average order and growth in Active Representatives, as well as favorable foreign exchange. Growth in Active Representatives reflects significant investments in RVP and a continued high level of investment in advertising. Revenue for the third quarter and first nine months of 2008 benefited from continued growth in substantially all markets. In particular, during the third quarter of 2008, revenue grew over 30% in Brazil, nearly 40% in Venezuela and nearly 10% in Mexico and for the first nine months of 2008 revenue grew nearly 40% in Brazil, almost 40% in Venezuela and 10% in Mexico. We have experienced a deceleration of growth in Colombia due to economic conditions.

The increase in operating margin in Latin America for the third quarter and first nine months of 2008 was primarily due to the impact of higher revenues, increased pricing and favorable foreign exchange, partially offset by higher investments in RVP. During the third quarter of 2008, operating margin was also unfavorably impacted by higher obsolescence expense. During the first nine months of 2008, operating margin was negatively impacted by higher costs of imports in Venezuela. Operating margin for the third quarter and first nine months of 2007 benefited from the recognition of unclaimed sales-related tax credits.

Currency restrictions enacted by the Venezuelan government in 2003 have impacted the ability of our subsidiary in Venezuela (Avon Venezuela) to obtain foreign currency at the official rate to pay for imported products. Unless official foreign exchange is made more readily available, Avon Venezuela's operations will continue to be negatively impacted as it will need to obtain more of its foreign currency needs from non-government sources where the exchange rate is less favorable than the official rate.

At September 30, 2008, Avon Venezuela had cash balances of approximately \$110, primarily denominated in bolivars. During 2007, Avon Venezuela remitted dividends of approximately \$40 at the official exchange rate. Avon Venezuela continues to receive official foreign exchange for some of its imports and other remittances. As a result, we continue to use the official rate to translate the financial statements of Avon Venezuela into U.S. dollars. During the first nine months of 2008, Avon Venezuela's revenue and operating profit represented approximately 4% and 8% of consolidated revenue and consolidated operating profit, respectively.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Dollars in millions, except per share data)

North America

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|------------------------|---------------------------------|----------|------------------|-------------------|--------------------------------|------------|------------------|-------------------|
| | 2008 | 2007 | % / Point Change | | 2008 | 2007 | % / Point Change | |
| | | | US\$ | Local Currency | | | US\$ | Local Currency |
| Total revenue | \$ 584.5 | \$ 605.2 | (3)% | (4)% | \$ 1,811.4 | \$ 1,855.6 | (2)% | (3)% |
| Operating profit | 29.9 | 42.0 | (29)% | (29)% | 169.0 | 160.7 | 5% | 3% |
| Operating margin | 5.1% | 6.9% | (1.8) | (1.9) | 9.3% | 8.7% | .6 | .6 |
| Units sold | | | | (5)% | | | | (3)% |
| Active Representatives | | | | 1% | | | | 3% |

North America consists largely of Avon's U.S. business.

Revenue growth for the third quarter and first nine months of 2008 was impacted by the macroeconomic environment, including the negative impact of higher year-over-year fuel prices and deteriorating consumer confidence. Sales of non-Beauty products declined 7% and 6% for each of the third quarter and first nine months of 2008, respectively, consistent with the general retail environment. Sales of Beauty products were flat for the third quarter of 2008 and increased 1% for the first nine months of 2008. The negative consumer environment in North America continues to weigh on our performance in that region, and we expect the trend to further deteriorate in the fourth quarter of 2008.

Total revenue decreased for the third quarter and first nine months of 2008, as the lower average order received from Representatives more than offset an increase in Active Representatives. Growth in Active Representatives benefited from continued investments in RVP and recruiting advertising, and more frequent brochure distribution in Canada. Average order was impacted by a shift in product mix, reflecting declines in sales of non-beauty products. Revenue growth for the first nine months of 2008 was also negatively impacted by service-related problems experienced during the first half of 2008.

The decrease in operating margin for the third quarter of 2008 was primarily due to higher variable selling costs, including paper for the brochure, bad debt and transportation, and higher spending on RVP, partially offset by lower overhead expense. The increase in operating margin for the first nine months of 2008 was primarily driven by lower obsolescence and overhead expenses, partially offset by higher variable selling costs and higher spending on RVP.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****(Dollars in millions, except per share data)***Central & Eastern Europe*

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|------------------------|---------------------------------|----------|------------------|----------------|--------------------------------|------------|------------------|----------------|
| | 2008 | 2007 | % / Point Change | | 2008 | 2007 | % / Point Change | |
| | | | US\$ | Local Currency | | | US\$ | Local Currency |
| Total revenue | \$ 382.4 | \$ 327.4 | 17% | 5% | \$ 1,236.6 | \$ 1,019.2 | 21% | 8% |
| Operating profit | 59.3 | 68.5 | (13)% | (25)% | 244.0 | 191.8 | 27% | 10% |
| Operating margin | 15.5% | 20.9% | (5.4) | (6.0) | 19.7% | 18.8% | .9 | .3 |
| Units sold | | | | 2% | | | | 7% |
| Active Representatives | | | | 5% | | | | 17% |

Beginning at the end of June 2007, we provided our Representatives with additional selling opportunities through more frequent brochure distribution, which encourages more frequent customer contact. Active representative growth of 23% during the first half of 2008 benefited from the increased brochure distribution frequency. As of the beginning of the third quarter of 2008, brochure distribution frequency is on a comparable basis with the prior year.

Total revenue increased for the third quarter and first nine months of 2008, reflecting growth in Active Representatives, as well as favorable foreign exchange. Average order for the third quarter of 2008 was flat as we anniversaried the launch of the additional selling opportunities. Revenue for the first nine months of 2008 was impacted by a lower average order during the first half of 2008 as our Representatives transitioned to the shorter selling cycle.

For the third quarter and first nine months of 2008, the region's revenue growth benefited from increases in Russia of 12% and 18%, respectively, as well as growth in other markets in the region, led by Ukraine with growth of 50% and 43%, respectively. The revenue increase in Russia for both periods of 2008 was primarily due to strong growth in Active Representatives, as well as favorable foreign exchange. We completed the roll-out of Sales Leadership and improved the discount structure we offer Representatives in Russia near the end of the third quarter of 2008.

The decrease in operating margin for the third quarter of 2008 was primarily due to higher spending on RVP and advertising, and the impact of unfavorable foreign exchange on product cost, partially offset by the impact of higher revenue, increased pricing and lower inventory obsolescence expense. The increase in operating margin for the first nine months of 2008 was primarily driven by lower inventory obsolescence expense, the impact of higher revenue and increased pricing, partially offset by higher spending on RVP and advertising, and the impact of unfavorable foreign exchange on product cost.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Dollars in millions, except per share data)

Western Europe, Middle East & Africa

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|------------------------|---------------------------------|----------|------------------|-------|--------------------------------|----------|------------------|-------|
| | 2008 | 2007 | % / Point Change | | 2008 | 2007 | % / Point Change | |
| | | | US\$ | Local | | | US\$ | Local |
| Total revenue | \$ 315.8 | \$ 292.8 | 8% | 6% | \$ 987.4 | \$ 874.4 | 13% | 7% |
| Operating profit | 18.3 | 10.6 | 73% | 67% | 79.5 | 39.5 | 101% | 82% |
| Operating margin | 5.8% | 3.6% | 2.2 | 2.0 | 8.1% | 4.5% | 3.6 | 3.2 |
| Units sold | | | | (5)% | | | | % |
| Active Representatives | | | | 6% | | | | 4% |

Total revenue increased for the third quarter and first nine months of 2008 due to growth in Active Representatives and favorable foreign exchange. Revenue for the third quarter and first nine months of 2008 increased in most markets, particularly in Turkey, Italy and the United Kingdom. Revenue increased despite implementation activities related to a major restructuring of our direct-selling businesses and the realignment of certain manufacturing and distribution facilities.

Revenue growth in the United Kingdom of 1% and 5% for the third quarter and first nine months of 2008, respectively, was driven by an increase in Active Representatives, benefiting from investments in representative recruiting. Revenue in the United Kingdom also benefited from the continued roll-out of PLS and strong merchandising. Revenue growth in Turkey of over 20% for both the third quarter and first nine months of 2008 was due to a larger average order, as well as favorable foreign exchange. Revenue in Turkey also benefited from continued high levels of investments in advertising and RVP.

The increase in operating margin for the third quarter and first nine months of 2008 was primarily driven by the impact of higher revenue, increased pricing and lower inventory obsolescence expenses. These benefits to operating margin were partially offset by the impact of unfavorable foreign exchange on product cost and higher spending on RVP and advertising. Additionally, operating margin for the first nine months of 2008 was impacted by higher costs to implement restructuring initiatives.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(Dollars in millions, except per share data)

Asia Pacific

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|------------------------|---------------------------------|----------|------------------|----------------|--------------------------------|----------|------------------|----------------|
| | | | % / Point Change | | | | % / Point Change | |
| | 2008 | 2007 | US\$ | Local Currency | 2008 | 2007 | US\$ | Local Currency |
| Total revenue | \$ 221.4 | \$ 208.1 | 6% | 2% | \$ 666.0 | \$ 610.9 | 9% | 0% |
| Operating profit | 24.3 | 12.4 | 96% | 87% | 74.8 | 49.5 | 51% | 34% |
| Operating margin | 11.0% | 6.0% | 5.0 | 4.9 | 11.2% | 8.1% | 3.1 | 2.8 |
| Units sold | | | | 3% | | | | 1% |
| Active Representatives | | | | 1% | | | | 3% |

Total revenue increased for the third quarter driven by growth in Active Representatives and a larger average order, as well as favorable foreign exchange. Total revenue increased for the first nine months of 2008, primarily reflecting favorable foreign exchange. Revenue growth was primarily due to increases in the Philippines of 20% and 25% in the third quarter and first nine months of 2008, respectively, reflecting growth in Active Representatives, supported by RVP initiatives, as well as favorable foreign exchange. Revenue in Japan decreased 4% for the third quarter. Revenue in Japan increased 1% for the first nine months of 2008 due to favorable foreign exchange. Local currency sales in Japan declined for the third quarter and first nine months of 2008 due to lower sales from both direct mail and direct selling. We expect to continue to see downward pressure in Japan going forward. Revenue in Taiwan decreased for the third quarter of 2008 and first nine months of 2008, reflecting the impact of a field restructuring and economic weakness, partially offset by favorable foreign exchange.

Operating margin increased for the third quarter and first nine months of 2008, primarily due to the impact of lower overhead, increased pricing and lower inventory obsolescence expenses, partially offset by higher spending on RVP.

China

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|------------------------|---------------------------------|---------|------------------|----------------|--------------------------------|----------|------------------|----------------|
| | | | % / Point Change | | | | % / Point Change | |
| | 2008 | 2007 | US\$ | Local Currency | 2008 | 2007 | US\$ | Local Currency |
| Total revenue | \$ 75.8 | \$ 60.8 | 25% | 13% | \$ 241.3 | \$ 193.9 | 24% | 13% |
| Operating profit | (7.3) | (4.8) | (52)% | (43)% | (1.6) | (3.9) | 59% | 65% |
| Operating margin | (9.6)% | (7.9)% | (1.7) | (2.1) | (.7)% | (2.0)% | 1.3 | 1.3 |
| Units sold | | | | (5)% | | | | 7% |
| Active Representatives | | | | 98% | | | | 75% |

The results in China for the nine months ended September 30, 2008, were negatively impacted by the earthquake and subsequent flooding that occurred during the second quarter of 2008. The third quarter 2008 results reflect some residual impact of the natural disasters on ordering activity which was more than offset by our actions to re-engage our Representatives.

Revenue in China increased for third quarter and first nine months of 2008, primarily due to an increase in Active Representatives, partially offset by a lower average order. The growth in Active Representatives reflects continued expansion of our direct selling efforts, which were supported with significant Representative recruiting, television advertising and field incentives. The lower average order results from the continued expansion of direct selling, as Representatives order in smaller quantities than beauty boutiques, and orders from new Representatives tend to be smaller than the average direct selling order. Beauty boutique ordering activity levels have remained steady during this extended period of direct selling expansion, as our beauty boutique operators continue to service our Representatives. Because of the small scale of our business, limited product selection and the role of the Beauty boutiques as a retail establishment, promotion schedules can cause dramatic shifts

in units and price mix year over year.

Table of Contents**AVON PRODUCTS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****(Dollars in millions, except per share data)**

Operating margin for third quarter and first nine months of 2007 benefited from a reduction of a reserve for statutory liabilities, which was a key driver of the change in operating margin. The decrease in operating margin for the third quarter of 2008 reflects costs associated with the 2008 earthquake and floods, partially offset by the impact of higher revenue and lower product costs. The increase in operating margin for the first nine months of 2008 was primarily driven by the impact of higher revenue and lower product costs, partially offset by ongoing higher spending on RVP and advertising and costs associated with the 2008 earthquake and floods.

For information concerning an internal investigation into our China operations, see Risk Factors and Note 5, Contingencies.

Global Expenses

| | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|-----------------------|------------------------------------|----------|----------|-----------------------------------|----------|----------|
| | 2008 | 2007 | % Change | 2008 | 2007 | % Change |
| Total Global expenses | \$ 129.4 | \$ 130.3 | 1% | \$ 398.1 | \$ 388.4 | (2)% |
| Allocated to segments | (94.9) | (81.6) | 16% | (284.4) | (253.1) | 12% |
| Net Global expenses | \$ 34.5 | \$ 48.7 | 29% | \$ 113.7 | \$ 135.3 | 16% |

The increase in the amount allocated to the segments in the third quarter and first nine months of 2008 was primarily due to higher global marketing and research and development costs, higher information technology costs and higher costs related to global initiatives. The decrease in net global expenses was primarily due to lower professional service fees associated with our restructuring and PLS initiatives.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of funds historically have been cash flows from operations, commercial paper and borrowings under lines of credit. We currently believe that existing cash, cash from operations (including the impacts of cash required for restructuring initiatives) and available sources of public and private financing are adequate to meet anticipated requirements for working capital, dividends, capital expenditures, the share repurchase program, possible acquisitions and other cash needs in the short and long term.

We may, from time to time, seek to repurchase our equity or to retire our outstanding debt, in open market purchases, privately negotiated transactions, pursuant to derivative instruments or otherwise. During 2008, we repurchased approximately 4.6 million shares of our common stock for an aggregate purchase price of approximately \$171.4.

Retirements of debt will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors, and the amounts involved may be material. We may also elect to incur additional debt or issue equity or convertible securities to finance ongoing operations, acquisitions or to meet our other liquidity needs.

Any issuances of equity securities or convertible securities could have a dilutive effect on the ownership interest of our current shareholders and may adversely impact earnings per share in future periods.

Our liquidity could also be impacted by dividends, capital expenditures and acquisitions. At any given time, we may be in the process of discussing and negotiating an acquisition. An acquisition may be accretive or dilutive and by its nature, involve numerous risks and uncertainties. See our Cautionary Statement for purposes of the Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995.

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

While recent turmoil in global financial markets has limited access to capital for many companies, we are not currently experiencing any limitations in issuing commercial paper, reflecting our investment-grade credit rating (Standard & Poor's rating of single A and Moody's rating of A2). In addition, our commercial paper program is fully supported by a revolving line of credit. Management is not aware of any issues currently impacting our lenders' ability to honor their commitment to extend credit under the revolving line of credit. It is unclear the extent to which this credit crisis will persist and what overall impact it may have on Avon.

Table of Contents

AVON PRODUCTS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

Cash Flows

Net Cash Provided by Operating Activities

Net cash provided by operating activities during the first nine months of 2008 was \$239.8 higher than during the first nine months of 2007, primarily due to higher cash-related net income in 2008, favorable movements in inventories and accounts receivable, and lower contributions to retirement-related plans in 2008. These cash inflows were partially offset by additional payments of value added taxes due to a tax law change in Brazil that we expect to recover in the future, higher incentive-based compensation payments in 2008 related to our 2006-2007 Turnaround Incentive Plan and a payment of \$38.0 upon settlement of treasury lock agreements associated with our \$500 debt issuance during the first quarter of 2008.

We expect cash provided by operating activities for full-year 2008 to be substantially higher than full-year 2007.

Inventory levels increased during 2008, to \$1,236.8 at September 30, 2008, from \$1,041.8 at December 31, 2007, reflecting the impact of foreign exchange, business growth and actions taken in an effort to ensure service levels to our Representatives. New inventory life cycle management processes leveraged with initiatives such as PLS, SSI, ERP implementation and the Sales and Operations Planning process are expected to improve inventory levels in the long-term. We expect these initiatives to help us deliver improvements of a three inventory day reduction in 2008 and a three to five inventory day reduction for the next three to four years.

During 2008, the plan assets of our funded pension plans have experienced losses due to unfavorable market returns. The resulting decrease in plan assets may impact future funding decisions. During 2009, we expect to make contributions to our funded pension plans in the range of \$65 to \$70.

Net Cash Used by Investing Activities

Net cash used by investing activities during the first nine months of 2008 was \$113.8 higher than during the first nine months of 2007, primarily due to higher capital expenditures, driven by spending for the new distribution facility in North America. 2007 included a payment associated with an acquisition of a licensee in Egypt.

Net Cash Used by Financing Activities

Net cash used by financing activities during the first nine months of 2008 was \$266.8 lower than during the first nine months of 2007, primarily due to lower repurchases of common stock during the first nine months of 2008.

We increased our quarterly dividend payments to \$.20 per share in 2008 from \$.185 per share in 2007.

Capital Resources

We maintain a \$1.0 billion revolving credit and competitive advance facility (the credit facility). There were no borrowings under this credit facility as of September 30, 2008.

We also maintain a \$1.0 billion commercial paper program, which is supported by the credit facility. At September 30, 2008, \$509.6 was outstanding under this program.

We also maintain a one-year Japanese yen 11.0 billion (\$103.9 at the exchange rate on September 30, 2008) uncommitted credit facility. In August 2008, we entered into an amendment with the Bank of Tokyo-Mitsubishi UFJ, Ltd. that provides for the extension of the yen credit facility until August 2009. At September 30, 2008, \$86.9 (Japanese yen 9.2 billion) was outstanding under the yen credit facility.

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

In March 2008, we issued \$500.0 principal amount of notes payable in a public offering. \$250.0 of the notes bear interest at a per annum coupon rate equal to 4.8%, payable semi-annually, and mature on March 1, 2013 (the 2013 Notes). \$250.0 of the notes bear interest at a per annum coupon rate of 5.75%, payable semi-annually, and mature on March 1, 2018 (the 2018 Notes). The net proceeds from the offering of \$496.3 were used to repay outstanding indebtedness under our commercial paper program and for general corporate purposes. In August 2007, we entered

Table of Contents

AVON PRODUCTS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

into treasury lock agreements (the "locks") with notional amounts totaling \$500.0 designated as cash flow hedges of the anticipated interest payments on \$250.0 principal amount of the 2013 Notes and \$250.0 principal amount of the 2018 Notes. The losses on the locks of \$38.0 were recorded in accumulated other comprehensive loss. \$19.2 and \$18.8 of the losses are being amortized to interest expense over five years and ten years, respectively.

In June 2008, we entered into two five-year interest-rate-swap contracts with notional amounts totaling \$250.0 and one 10-year interest-rate-swap contract with a notional amount of \$125.0 to effectively convert fixed interest rates on the 2013 Notes and 2018 Notes to variable interest rates, based on LIBOR.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT STRATEGIES

Interest Rate Risk

Our long-term, fixed-rate borrowings are subject to interest rate risk. We use interest rate swaps, which effectively convert the fixed rate on the debt to a floating interest rate, to manage our interest rate exposure. At September 30, 2008, and December 31, 2007, we held interest-rate-swap agreements that effectively converted approximately 40% and 30%, respectively, of our outstanding long-term, fixed-rate borrowings to a variable interest rate based on LIBOR. Our total exposure to floating interest rates at both September 30, 2008, and December 31, 2007, was approximately 60%.

Foreign Currency Risk

We operate globally, with operations in various locations around the world. We derive approximately 75% to 80% of our consolidated revenue from operations of subsidiaries outside of the U.S. The functional currency for most of our foreign operations is the local currency. We may reduce our exposure to fluctuations in cash flows associated with changes in foreign exchange rates by creating offsetting positions through the use of derivative financial instruments.

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

Statements in this report that are not historical facts or information are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as estimate, project, forecast, plan, believe, may, expect, anticipate, intend, expectation and similar expressions, or the negative of those expressions, may identify forward-looking statements. Such forward-looking statements are based on management's reasonable current assumptions and expectations. Such forward-looking statements involve risks, uncertainties and other factors, which may cause the actual results, levels of activity, performance or achievement of Avon to be materially different from any future results expressed or implied by such forward-looking statements, and there can be no assurance that actual results will not differ materially from management's expectations. Such factors include, among others, the following:

our ability to implement the key initiatives of and realize the operating margins and projected benefits (in the amounts and time schedules we expect) from our global business strategy, including our multi-year restructuring initiatives, product mix and pricing strategies, enterprise resource planning, customer service initiatives, product line simplification program, sales and operation planning process, strategic sourcing initiative, outsourcing strategies, zero-overhead-growth philosophy, cash flow from operations and cash management, tax, foreign currency hedging and risk management strategies;

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

our ability to realize the anticipated benefits (including our projections concerning future revenue and operating margin increases) from our multi-year restructuring initiatives or other strategic initiatives on the time schedules or in the amounts that we expect, and our plans to invest these anticipated benefits ahead of future growth;

the possibility of business disruption in connection with our multi-year restructuring initiatives or other strategic initiatives;

our ability to realize sustainable growth from our investments in our brand and the direct-selling channel;

a general economic downturn or recession in one or more of our geographic regions, such as North America, and the ability of our broad-based geographic portfolio to withstand an economic downturn or recession in one or more particular regions;

the inventory obsolescence and other costs associated with our product line simplification program;

Table of Contents

AVON PRODUCTS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

our ability to effectively implement initiatives to reduce inventory levels in the time period and in the amounts we expect;

our ability to achieve growth objectives or maintain rates of growth, particularly in our largest markets and developing and emerging markets;

our ability to successfully identify new business opportunities and identify and analyze acquisition candidates, and our ability to negotiate and consummate acquisitions as well as to successfully integrate or manage any acquired business;

the effect of political, legal and regulatory risks, as well as foreign exchange or other restrictions, imposed on us, our operations or our Representatives by governmental entities;

our ability to successfully transition our business in China in connection with the resumption of direct selling in that market, our ability to operate using the direct-selling model permitted in that market and our ability to retain and increase the number of Active Representatives there over a sustained period of time;

the effect of economic factors, including inflation and fluctuations in interest rates and currency exchange rates, and the potential effect of such fluctuations on revenues, expenses and resulting margins;

general economic and business conditions in our markets, including social, economic and political uncertainties in Latin America, China, Asia Pacific, Central and Eastern Europe and the Middle East;

any consequences of the internal investigation of our China operations;

information technology systems outages, disruption in our supply chain or manufacturing and distribution operations, or other sudden disruption in business operations beyond our control as a result of events such as acts of terrorism or war, natural disasters, pandemic situations and large scale power outages;

the risk of product or ingredient shortages resulting from our concentration of sourcing in fewer suppliers;

the quality, safety and efficacy of our products;

the success of our research and development activities;

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

our ability to attract and retain key personnel and executives;

competitive uncertainties in our markets, including competition from companies in the cosmetics, fragrances, skin care and toiletries industry, some of which are larger than we are and have greater resources;

our ability to implement our Sales Leadership program globally, to generate Representative activity, to increase Representative productivity, to improve Internet-based tools for our Representatives, and to compete with other direct- selling organizations to recruit, retain and service Representatives;

the impact of the seasonal nature of our business, adverse effect of rising energy, commodity and raw material prices, changes in market trends, purchasing habits of our consumers and changes in consumer preferences, particularly given the global nature of our business and the conduct of our business in primarily one channel;

our ability to continue to help offset higher commodity costs through the savings and benefits from our strategic initiatives, strategic price increases and holding cost growth below our revenue growth;

our ability to protect our intellectual property rights;

the risk of an adverse outcome in our material pending and future litigations;

our ratings and our access to financing and ability to secure financing at attractive rates; and

the impact of possible pension funding obligations, increased pension expense and any changes in pension regulations or interpretations thereof on our cash flow and results of operations.

Additional information identifying such factors is contained in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007, filed with the U.S. Securities and Exchange Commission. We undertake no obligation to update any such forward-looking statements.

Table of Contents

Avon Products, Inc.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from the information provided in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our 2007 Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, our principal executive and principal financial officers carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon their evaluation, the principal executive and principal financial officers concluded that our disclosure controls and procedures were effective at September 30, 2008, at the reasonable assurance level. Disclosure controls and procedures are designed to ensure that information relating to Avon (including our consolidated subsidiaries) required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and to ensure that information required to be disclosed is accumulated and communicated to management to allow timely decisions regarding disclosure.

Changes in Internal Control over Financial Reporting

Management has evaluated, with the participation of our principal executive and principal financial officers, whether any changes in our internal control over financial reporting that occurred during our last fiscal quarter have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has concluded that no such changes have occurred.

We are implementing an enterprise resource planning (ERP) system on a worldwide basis, which is expected to improve the efficiency of our supply chain and financial transaction processes. The implementation is expected to occur in phases over the next several years. The implementation of a worldwide ERP system will likely affect the processes that constitute our internal control over financial reporting and will require testing for effectiveness. Additional information regarding ERP is included in the Enterprise Resource Planning System section within MD&A.

We completed implementation in certain significant markets and will continue to roll-out the ERP system over the next several years. As with any new information technology application we implement, this application, along with the internal controls over financial reporting included in this process, were appropriately tested for effectiveness prior to the implementation in these countries. We concluded, as part of our evaluation described in the above paragraph, that the implementation of ERP in these countries has not materially affected our internal control over financial reporting.

Table of Contents

Avon Products, Inc.

PART II. OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

See Note 5, Contingencies, of the Notes to Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

An internal investigation of our China operations is being conducted.

We are voluntarily conducting an internal investigation of our China operations, focusing on compliance with the Foreign Corrupt Practices Act. The internal investigation, which is being conducted under the oversight of the Audit Committee, commenced in June 2008 after we received an allegation that certain travel, entertainment and other expenses may have been improperly incurred in connection with our China operations. We have voluntarily contacted the Securities and Exchange Commission and the United States Department of Justice to advise both agencies that an internal investigation is underway. Because the internal investigation is in its early stage, we cannot predict how the resulting consequences, if any, may impact our internal controls, business, results of operations or financial position.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) Repurchases

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs ⁽¹⁾ | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program |
|------------------|--|---------------------------------|---|---|
| 7/1/08 - 7/31/08 | 1,234,523 ⁽²⁾ | \$ 36.48 | 1,234,323 | \$ 1,821,939,000 |
| 8/1/08 - 8/31/08 | 8,242 ⁽³⁾ | 41.86 | 7,321 | 1,821,627,000 |
| 9/1/08 - 9/30/08 | 19,720 ⁽⁴⁾ | 38.19 | 2,317 | 1,821,526,000 |
| Total | 1,262,485 | | 1,243,961 | |

⁽¹⁾ All of the shares purchased during the third quarter as part of our \$2.0 billion share repurchase program, publicly announced on October 11, 2007, consists of (i) shares purchased in open-market transactions and (ii) shares purchased in private transactions from a broker in connection with the hedging of stock-based obligations under our Deferred Compensation Plan. The program commenced on December 17, 2007, and is scheduled to expire on December 17, 2012.

⁽²⁾ Includes share repurchases under our publicly announced programs and 200 shares that were repurchased by the Company in connection with employee elections to use shares to pay withholding taxes upon the vesting of their restricted stock units.

⁽³⁾ Includes share repurchases under our publicly announced programs and 921 shares that were repurchased by the Company in connection with employee elections to use shares to pay withholding taxes upon the vesting of their restricted stock units.

⁽⁴⁾

Edgar Filing: AVON PRODUCTS INC - Form 10-Q

Includes share repurchases under our publicly announced programs and 17,403 shares that were repurchased by the Company in connection with employee elections to use shares to pay withholding taxes upon the vesting of their restricted stock units.

ITEM 6. EXHIBITS

See Exhibit Index.

Table of Contents

Avon Products, Inc.

SIGNATURE

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.

Date: October 30, 2008

AVON PRODUCTS, INC.
(Registrant)

/s/ Simon N.R. Harford
Simon N.R. Harford
Group Vice President and Corporate Controller

Signed both on behalf of the registrant and as chief accounting officer.

Table of Contents

Avon Products, Inc.

EXHIBIT INDEX

- 10.1 Amendment No. 2 to Loan Agreement, dated August 21, 2008, by and between Avon Products, Inc. and the Bank of Tokyo-Mitsubishi UFJ, Ltd. (incorporated by reference to Exhibit 10.1 to Avon's Current Report on Form 8-K filed on August 26, 2008)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Vice Chairman, Chief Finance and Strategy Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Vice Chairman, Chief Finance and Strategy Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002