

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

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

FORM 10-Q/A

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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

For the quarterly period ended June 30, 1999

OR

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

For the transition period from \_\_\_ to \_\_\_

Commission file number 1-4881

AVON PRODUCTS, INC.

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

New York

13-0544597

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

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

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

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

(212) 282-5000

-----  
(Telephone Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

The number of shares of Common Stock (par value \$.25) outstanding at July 31, 1999 was 260,792,530.

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### Introductory Note--Restatements

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

The accompanying financial statements have been restated to reflect the restatements discussed above as well as the accounting changes outlined in Note 2. No attempt has been made in this Form 10-Q/A to modify or update any disclosures except as required to reflect the results of the restatements discussed above and any changes made to prior period financial information for

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which a Form 10-Q/A was not filed.

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PART I. FINANCIAL INFORMATION

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

	Three months ended June 30	
	1999	1998
	(Restated Note 2) -----	
	----- (unaudited)	
Net sales.....	\$1,258.1	\$1,247.2
Other revenue.....	9.1	8.8
	-----	-----
Total revenue.....	1,267.2	1,256.0
Costs, expenses and other:		
Cost of sales.....	451.7	465.6
Marketing, distribution and administrative expenses.....	622.8	613.5
	-----	-----
Operating profit .....	192.7	176.9
Interest expense.....	8.9	8.2
Interest income.....	(2.2)	(5.9)
Other expense, net.....	.7	1.0
	-----	-----
Total other expenses.....	7.4	3.3
	-----	-----
Income before taxes and minority interest..	185.3	173.6
Income taxes.....	66.6	63.9
	-----	-----
Income before minority interest.....	118.7	109.7
Minority interest.....	.8	1.7
	-----	-----
Net income.....	\$ 119.5	\$ 111.4
	=====	=====
Earnings per share:		
Basic .....	\$ .46	\$ .42*
	=====	=====
Diluted.....	\$ .45	\$ .42*
	=====	=====

\*Restated to reflect a two-for-one stock split distributed in September 1998.

The accompanying notes are an integral part of these statements.

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

	Six months ended June 30	
	1999	1998
	(Restated Note 2) -----	
	----- (unaudited)	
Net sales.....	\$2,471.9	\$2,430.6
Other revenue.....	18.3	17.6
	-----	-----
Total revenue.....	2,490.2	2,448.2
Costs, expenses and other:		
Cost of sales**.....	959.9	968.7
Marketing, distribution and administrative expenses.....	1,273.7	1,249.8
Special charge.....	90.4	70.5
Asset impairment charge.....	38.1	-
	-----	-----
Operating profit.....	128.1	159.2
Interest expense.....	17.9	16.3
Interest income.....	(5.4)	(8.2)
Other (income)expense, net.....	(7.1)	4.1
	-----	-----
Total other expenses.....	5.4	12.2
	-----	-----
Income before taxes and minority interest..	122.7	147.0
Income taxes.....	68.7	70.0
	-----	-----
Income before minority interest.....	54.0	77.0
Minority interest.....	2.6	3.4
	-----	-----
Net income.....	\$ 56.6	\$ 80.4
	=====	=====
Earnings per share:		
Basic .....	\$ .22	\$ .31*
	=====	=====
Diluted.....	\$ .21	\$ .30*
	=====	=====

\*Restated to reflect a two-for-one stock split distributed in September 1998.

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

The accompanying notes are an integral part of these statements.

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

	June 30 1999 (Restated Note 2)	December 31 1998
	-----	-----
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and equivalents.....	\$ 73.8	\$ 105.6
Accounts receivable.....	471.4	492.6
Inventories.....	535.4	538.4
Prepaid expenses and other.....	202.0	204.8
	-----	-----
Total current assets.....	1,282.6	1,341.4
	-----	-----
Property, plant and equipment, at cost..	1,373.6	1,392.8
Less accumulated depreciation.....	710.8	722.9
	-----	-----
	662.8	669.9
	-----	-----
Other assets.....	411.8	422.2
	-----	-----
Total assets.....	\$2,357.2	\$2,433.5
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Debt maturing within one year.....	\$ 312.5	\$ 55.3
Accounts payable.....	286.1	416.9
Accrued compensation.....	131.9	161.3
Other accrued liabilities.....	332.7	308.2
Sales and other taxes.....	91.4	106.2
Income taxes.....	284.6	281.6
	-----	-----
Total current liabilities.....	1,439.2	1,329.5
	-----	-----
Long-term debt.....	204.5	201.0
Employee benefit plans.....	385.7	390.0
Deferred income taxes.....	37.8	36.3
Other liabilities.....	183.5	191.6
Shareholders' equity:		
Common stock.....	88.1	87.8
Additional paid-in capital.....	804.3	780.0
Retained earnings.....	681.6	719.1
Accumulated comprehensive income.....	(341.5)	(301.3)
Treasury stock, at cost.....	(1,126.0)	(1,000.5)
	-----	-----
Total shareholders' equity.....	106.5	285.1
	-----	-----
Total liabilities and shareholders' equity	\$2,357.2	\$2,433.5
	=====	=====

The accompanying notes are an integral part of these statements.

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

	Six months ended June 30	
	1999	1998
	(Restated Note 2) -----	
	----- (unaudited)	
Cash flows from operating activities:		
Net income.....	\$ 56.6	\$ 80.4
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Special and non-recurring charges.....	93.1	81.9
Asset impairment charge.....	38.1	-
Depreciation and amortization.....	39.5	34.0
Provision for doubtful accounts.....	43.6	43.0
Translation gains.....	(.7)	(.4)
Deferred income taxes.....	(18.4)	(11.0)
Amortization of debt discount.....	(3.3)	
Other.....	2.0	2.5
Changes in assets and liabilities:		
Accounts receivable.....	(58.5)	(79.7)
Inventories.....	(67.6)	(75.5)
Prepaid expenses and other.....	(1.9)	(19.8)
Accounts payable and accrued liabilities.....	(120.7)	(107.1)
Income and other taxes.....	(2.7)	(1.1)
Noncurrent assets and liabilities.....	8.4	(13.3)
	-----	-----
Net cash provided(used)by operating activities..	7.5	(66.1)
	-----	-----
Cash flows from investing activities:		
Capital expenditures.....	(69.1)	(73.8)
Disposal of assets.....	5.2	5.8
Other investing activities.....	(15.3)	(.4)
	-----	-----
Net cash used by investing activities.....	(79.2)	(68.4)
	-----	-----
Cash flows from financing activities:		
Cash dividends.....	(95.7)	(91.0)
Debt, net (maturities of three months or less).	254.8	163.9
Proceeds from short-term debt.....	22.1	46.7
Retirement of short-term debt.....	(19.5)	(103.6)
Proceeds from long-term debt.....	-	100.0
Retirement of long-term debt.....	(.2)	(.4)
Repurchase of common stock.....	(125.5)	(48.7)
Proceeds from exercise of stock options.....	21.4	12.3
	-----	-----
Net cash provided by financing activities.....	57.4	79.2
	-----	-----
Effect of exchange rate changes on cash and equivalents.....	(17.5)	1.4
	-----	-----
Net decrease in cash and equivalents.....	(31.8)	(53.9)
Cash and equivalents beginning of period.....	105.6	141.9
	-----	-----

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Cash and equivalents end of period.....	\$ 73.8	\$ 88.0
	=====	=====

The accompanying notes are an integral part of these statements.

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

#### 1. ACCOUNTING POLICIES

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

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

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

#### 2. RESTATEMENTS AND ACCOUNTING CHANGES

##### Restatements

In connection with the settlement of a previously disclosed investigation by the Securities and Exchange Commission relating to the write off of an order management software system known as the "FIRST" project, Avon has restated its Consolidated Financial Statements as of December 31, 2001, 2000 and 1999 and

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for the years then ended and for each of the fiscal quarters ended March 31, 1999 through March 31, 2002. See Introductory Note-Restatements and Note 10 of the Notes to Consolidated Financial Statements, "Asset Impairment Charge".

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

The principal adjustments comprising the restatements are as follows:

- o Reclassification of \$14.8 of pre-tax charges recorded in the first quarter of 1999 related to the write off of a portion of the FIRST project, out of the "Special charges" line and into the "Asset impairment charge" line;
- o An additional Asset impairment charge of \$23.3 pretax in the first quarter of 1999 to reflect the write off of all capitalized costs associated with the FIRST project as of March 31, 1999;

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

- o Reversal of the third quarter 2001 Asset impairment charge of \$23.9 pretax related to the abandonment of the FIRST project; and
- o Restatement of all other activity related to the FIRST project, consisting of costs incurred and capitalized subsequent to March 31, 1999 and amortization, recorded from the second quarter of 1999 through the first quarter of 2002.

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

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

	Consolidated Statements of Operations		
	Three Months ended June 30, 1999		Six Months ended Jun
	As Reported(1)	As Restated(2)	As Reported(1)
	-----	-----	-----
Marketing, distribution and administrative expenses	\$ 619.7	\$ 622.8	\$1,270.6
Special charges	-	-	105.2
Asset impairment charge	-	-	-
Operating profit	195.8	192.7	154.5
Income before taxes and minority Interest	188.4	185.3	149.1
Income taxes	67.8	66.6	79.2



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Income before minority interest	120.6	118.7	69.9
Net income	121.4	119.5	72.5
Earnings per share:			
Basic	\$ .46	\$ .46	\$ .28
Diluted	\$ .46	\$ .45	\$ .27

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

	As Reported(3)	As Restated(2)
Property, plant and equipment, at cost	\$1,376.3	\$1,373.6
Other assets	424.5	411.8
Total assets	2,372.6	2,357.2
Other accrued liabilities	332.2	332.7
Total current liabilities	1,438.7	1,439.2
Retained earnings	697.5	681.6
Total liabilities and shareholder's equity	2,372.6	2,357.2

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

#### Accounting Changes

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

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

- o Accounting changes made to reported 1999 financial information as a result of the adoption of Emerging Issues Task Force ("EITF") 00-10, "Accounting for Shipping and Handling Fees and Costs". The adoption of EITF 00-10 resulted in increases in Marketing, distribution and administrative expenses and Other Revenue of \$9.1 and \$18.3 for the three and six months ending June 30, 1999, respectively, and \$8.8 and \$17.6 for the three and six months ending June 30, 1998, respectively. The adoption of this EITF had no impact on Net income or Earnings per share.
- o Reclassifications made to reported financial information to conform with the 1999 full year presentation.

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

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

	Six months ended June 30	
	1999	1998
Interest.....	\$19.5	\$18.9
Income taxes, net of refunds received....	73.1	82.0

#### 4. EARNINGS PER SHARE

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

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

	Three Months ended June 30		Six Months ended June 30	
	1999	1998*	1999	1998*
Basic EPS				
Weighted-average shares	261.54	263.55	261.77	263.56
Incremental shares from assumed conversion of stock options	3.47	3.16	3.09	2.76
Diluted EPS				
Adjusted weighted- average shares	265.01	266.71	264.86	266.32

\*Restated to reflect a two-for-one stock split distributed in September 1998.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in millions, except share data)

The Company purchased approximately 2,756,500 shares of common stock for \$125.5 during the first six months of 1999, as compared to approximately 1,432,300 shares of common stock for \$48.7 during the first six months of 1998, under a previously announced share repurchase program.

#### 5. INVENTORIES

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	June 30 1999	December 31 1998
	----	----
Raw materials.....	\$163.1	\$140.6
Finished goods.....	372.3	397.8
	-----	-----
	\$535.4	\$538.4
	=====	=====

### 6. DIVIDENDS

Cash dividends paid per share of common stock were \$.18 and \$.36 for the three and six months ended June 30, 1999, respectively, and \$.17 and \$.34 for the corresponding 1998 period. On February 4, 1999, the Company increased the annual dividend rate to \$.72 from \$.68.

### 7. CONTINGENCIES

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

In 1991, a class action suit was initiated against Avon on behalf of certain classes of holders of Avon's Preferred Equity-Redemption Cumulative Stock ("PERCS"). This lawsuit alleges various contract and securities law claims relating to the PERCS (which were fully redeemed that year). Avon has rejected the assertions in this case, believes it has meritorious defenses to the claims and is vigorously contesting this lawsuit. A trial has been preliminary scheduled to commence as early as December 1999.

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

### 8. COMPREHENSIVE INCOME

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

	Three Months ended June 30		Six Months ended June 30	
	-----	-----	-----	-----
	1999	1998	1999	1998
	----	----	----	----
Net Income	\$119.5	\$111.4	\$ 56.6	\$ 80.4
Other comprehensive income (loss):				
Change in equity due to foreign currency translation and transaction adjustments	1.4	(13.8)	(40.2)	(17.7)
	-----	-----	-----	-----
Comprehensive income	\$120.9	\$ 97.6	\$ 16.4	\$ 62.7
	=====	=====	=====	=====

### 9. SPECIAL AND NON-RECURRING CHARGES

In October 1997, the Company announced a worldwide business process

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redesign program in order to streamline operations and improve profitability, through margin improvement and expense reductions. The special and non-recurring charges associated with this program totaled \$154.4 pretax (\$122.8 net of tax, or \$.46 per share on a basic and diluted basis) for the year ended December 31, 1998.

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

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

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

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

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

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

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

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

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

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

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

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

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

	Special Charge -----	Cost of Sales Charge -----	Total -----
Balance at December 31, 1998	\$ 28.5	\$ -	\$ 28.5
Provision	90.4	46.0	136.4
Cash expenditures	(43.3)		(43.3)
Non-cash write offs	(24.5)	(46.0)	(70.5)
	-----	-----	-----
Balance at June 30, 1999	\$ 51.1 =====	\$ - =====	\$ 51.1 =====

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

### 10. ASSET IMPAIRMENT CHARGE

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

The decision to abandon the FIRST project was based on various factors, including project management and implementation issues and costs, costs for ongoing support, and changes in Avon business strategies.

The FIRST project, and the Special charge reported by Avon in the first quarter of 1999 that included the write off of \$14.8 in pre-tax costs associated with FIRST, were the subject of a formal investigation by the SEC commenced in August 2000. Avon has settled that matter with the SEC and, as

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part of that settlement, has restated its financial statements to reflect the additional write off as of March 31, 1999 of all capitalized costs (\$23.3 pretax, and \$14.0 after tax) associated with the FIRST project as of that date for a total first quarter write off of \$38.1 pretax (\$24.0 after tax). Avon has also reversed the charge recorded in the third quarter of 2001, and has restated all other FIRST-related activity recorded during 1999-2002.

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

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

### 11. SEGMENT INFORMATION

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

	Three Months Ended June 30			
	1999		1998	
	Net Sales	Operating Profit	Net Sales	Operating Profit
	-----	-----	-----	-----
North America:				
U.S.	\$ 430.0	\$ 91.0	\$ 414.7	\$ 81.7
Other*	61.5	9.6	66.9	9.9
	-----	-----	-----	-----
Total	491.5	100.6	481.6	91.6
	-----	-----	-----	-----
International:				
Latin America	400.7	92.5	414.0	86.4
Pacific	169.2	22.8	145.5	11.0
Europe	196.7	31.8	206.1	28.9
	-----	-----	-----	-----
Total	766.6	147.1	765.6	126.3
	-----	-----	-----	-----
Total from operations	\$1,258.1	\$ 247.7	\$1,247.2	\$ 217.9
	-----	-----	-----	-----
Global expenses		(55.0)		(41.0)
		-----		-----
Operating profit		\$ 192.7		\$ 176.9
		=====		=====

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

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

	Six Months Ended June 30			
	1999		1998	
	Net Sales	Operating Profit	Net Sales	Operating Profit
North America:				
U.S.	\$ 858.8	\$ 168.5	\$ 819.0	\$ 150.5
Other*	124.0	19.6	127.0	15.5
Total	982.8	188.1	946.0	166.0
International:				
Latin America	770.8	154.6	788.3	145.2
Pacific	326.5	36.4	297.7	21.0
Europe	391.8	45.8	398.6	44.0
Total	1,489.1	236.8	1,484.6	210.2
Total from operations	\$2,471.9	\$ 424.9	\$2,430.6	\$ 376.2
Global expenses		(122.3)		(108.6)
Special and non-recurring charges		(136.4)		(108.4)
Asset impairment charge		(38.1)		-
Operating profit		\$ 128.1		\$ 159.2

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

### 12. OTHER FINANCING ACTIVITIES

At June 30, 1999, the Company had entered into forward contracts to purchase approximately 2,608,200 shares of Avon common stock at an average rate of \$36.67 per share as of June 30, 1999. The contracts mature over the next 2-1/2 years and provide for physical or net settlement to the Company. Accordingly, no adjustment for subsequent changes in fair value has been recognized.

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

All share and per share data in this report have been restated to reflect a two-for-one stock split distributed in September 1998.

#### Results of Operations

##### Consolidated

Consolidated net sales for the second quarter and six-month period of 1999 increased 1% and 2%, respectively, over the same periods of 1998. The sales growth was due to increases in North America primarily in the U.S. and Pacific; while sales declined in Latin America and Europe versus the prior year. Excluding the impact of foreign currency exchange, consolidated net sales rose 9% and 10% in the second quarter and six-month period of 1999, respectively, over the comparable periods of the prior year.

Cost of sales as a percentage of net sales increased 1.4 percentage points in the second quarter and 1.1 percentage points in the six-month period of 1999 compared to the same periods of 1998. The cost of sales for the six months ended June 30, 1999 and 1998 include one-time charges of \$46.0 and \$37.9, respectively, for inventory write-downs related to the Company's BPR program. See Note 9 for further detail. Excluding these charges, the gross margin increased 1.3 points on a June year-to-date basis. The higher gross margin resulted from improvements in all regions, most significantly in the U.S, Brazil, Japan, the United Kingdom, Germany and Central Europe.

Marketing, distribution and administrative expenses increased \$9.3 (2%) and \$23.9 (2%) in the second quarter and six-month period of 1999, respectively, over the same periods of 1998 primarily due to increases in the U.S. and Mexico as well as higher global expenses, partially offset by lower expenses in Brazil. Marketing, distribution, and administrative expenses increased as a percentage of Total revenue to 49.1% in the second quarter of 1999 from 48.8% in 1998. Second quarter 1999 expense ratio improvements in Brazil and Central Europe were more than offset by unfavorable expense ratios throughout remaining major markets in Latin America, the United Kingdom, Germany, and Japan.

The six months ended 1999 and 1998 results include special charges of \$90.4 and \$70.5, respectively, which were recorded in the first quarter of 1999 and 1998 for the Company's BPR program. These charges are primarily related to employee severance benefits worldwide, as well as facility reorganizations. See Note 9 for further detail.

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

Interest expense increased to \$8.9 in the second quarter of 1999 as compared with \$8.2 in 1998, and to \$17.9 in the first half of 1999 compared with \$16.3 in 1998. Interest income decreased \$3.7 and \$2.8 in the second quarter and six-month period of 1999, respectively, compared to prior year due to a Mexico tax refund claim in June 1998.

Other expense (income), net of \$.7 in the second quarter of 1999 decreased slightly and other income of \$7.1 for the six-month period of 1999 was \$11.2 favorable over the six-month period of 1998 due primarily to favorable net foreign exchange resulting from gains on Brazilian currency forward contracts.



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AVON PRODUCTS, INC.  
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The effective tax rate for the second quarter 1999 was 35.9% versus 36.8% for the second quarter 1998 due to the earnings mix and tax rates of international subsidiaries. Excluding the special and non-recurring charges, the effective tax rate was 36.1% in the first half of 1999 compared to 33.7% in the first half of 1998.

Minority interest decreased \$.9 and \$.8 in the second quarter and six-month period of 1999, respectively, compared to 1998, primarily due to lower losses in Japan in 1999.

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

### North America

Net sales grew 2% and 4% in the second quarter and six-month period of 1999, respectively, over the same periods in 1998. The U.S. business, which represents almost 90% of the North American segment, reported sales growth of 4% in the second quarter and 5% in the first half of 1999 driven by a higher average order size. The U.S. sales improvement resulted from strong growth in the fashion jewelry and accessories and home entertainment categories, partially offset by declines in apparel. The growth in fashion jewelry and accessories was driven by strong sales of sterling silver items as well as the introduction of licensed luggage, American Tourister, and excellent performance in watches and handbags. The improvement in home entertainment resulted from increased sales of inspirational and religious products. Apparel sales decreased due to underperformance on new product introductions and demonstration products, partially offset by successes in casual wear and sleepwear. Sales of cosmetics, fragrance and toiletries ("CFT") decreased 2% in the second quarter due to the underperformance of the new Skin-So-Soft Bug Guard launch which failed to match the strength of last year's new product launch. Gift and decorative sales were level in the second quarter of 1999 compared with second quarter of 1998.

However, successful holiday promotions, including a strong Easter program and entry into the Blues Clues children's market contributed to a double-digit increase in the gift and decorative category for the first half of 1999.

Operating profit in North America increased 10% and 13% in the second quarter and first half of 1999, respectively, compared with the same periods in 1998. This improvement is primarily attributable to a higher gross margin in the U.S. due to supply chain cost improvements and pricing and product category management. Operating expenses in North America increased in line with the sales increase.

### International

Sales growth in the second quarter of 1999 in the Pacific region (16%) was offset by sales declines in Latin America (-3%) and Europe (-5%). For the first half of 1999, the sales improvement in the Pacific (10%) was also offset by sales declines in Latin America (-2%) and in Europe (-2%). However, excluding the effect of foreign currency exchange, sales increased 13% during both the second quarter and first half of 1999.

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The sales improvement in the Pacific region for both the second quarter and first half of 1999 was driven by double digit increases in units, customers served and active Representatives in the Philippines and Taiwan. Japan's sales increased as well due to favorable currency impact. Local currency sales in Japan decreased due to a lower average order size. Excluding the effect of foreign currency exchange, sales

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in the Pacific increased 10% and 5% in the second quarter and first half of 1999, respectively. The sales decline in Latin America resulted from significant decreases in Brazil as a result of the real devaluation, and in Argentina and Chile as a result of weak economic conditions. Local currency sales and units were up over 20% in Brazil for the second quarter and first half of 1999. Active Representatives in Brazil were also up double-digits driven by recruiting and retention strategies in place including strong training and incentive programs. Excluding the impact of exchange, sales in Latin America increased 16% and 19% in the second quarter and first half of 1999, respectively. In Europe, sales were down in Russia due to the ruble devaluation in August 1998 and the continued economic crisis. Additionally, sales decreased in most markets in Western Europe, mainly in Germany due to a weak economic environment and in Italy and France due to unit declines. These declines were partially offset by improvements in the United Kingdom due to a higher average order size and increased franchise and distributorship sales in 1999, and in Central Europe, primarily Poland, due to dramatic increases in units, customers served and active Representatives. Excluding the impact of exchange, Europe sales grew 8% in both the second quarter and first half of 1999.

International operating profit increased 16% and 13% in the second quarter and six-month period of 1999, respectively, compared to the same periods in 1998.

Operating profit growth in the Pacific of 107% and 73% in the second quarter and first half of 1999, respectively, resulted from U.S. dollar sales growth in nearly all markets and operating margin improvements, most significantly in Japan and China. Japan's gross margin improved due to product cost savings initiatives in CFT and improved sourcing decisions for non-CFT as well as a business-wide product profitability screening process that led to the elimination of many low-margin products. Additionally, business process redesign ("BPR") efforts continue to generate significant savings across all expense areas in Japan. China's improvement in 1999 reflects the suspension of operations for most of the second quarter of 1998 due to governmental restrictions on direct-selling companies. Philippines and Taiwan also reported strong increases in operating profit driven primarily by the sales growth, discussed above. As a result, the operating margin in the Pacific was up 5.9 points and 4.1 points for the second quarter and first half of 1999, respectively, over prior year.

In Latin America, operating profit improvements of 7% in the second quarter and 6% in the first half of 1999 were driven by increases in Brazil and Mexico. Aggressive cost reduction efforts combined with strict expense

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management contributed to Brazil's double-digit improvement in operating profit. Mexico's improvement resulted mainly from the sales increase, partially offset by increased advertising expense in 1999. These improvements were partially offset by operating profit declines in Argentina and Chile due to the sales shortfalls and weak economic conditions.

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

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Operating profit in Europe increased 10% and 4% in the second quarter and six-month period, respectively. This improvement was driven by increases in the United Kingdom, Central Europe and Italy. The United Kingdom continues to focus on developing the business through optimization of the most profitable sales mix through brand awareness, image enhancement and expense control. The United Kingdom, Central Europe and Italy reported significant growth in operating margins due to higher gross margins which resulted from a continuing focus on pricing strategies and improved profitability of non-CFT categories. These improvements were partially offset by declines in Russia resulting from the ruble devaluation during the second half of 1998. Management in Russia will continue to manage expenses tightly and seek to increase market share and improve margins through pricing flexibility and tight expense management.

### Global Expenses

Global expenses increased 34% and 13% in the second quarter and first half of 1999, respectively, over the same periods in 1998 primarily due to increased investments in global marketing, research and development and information technology systems, as well as costs related to the work on the Company's new strategic initiatives.

### Liquidity and Capital Resources

#### Cash Flows

Excluding changes in debt, there was a net decrease in cash of \$289.0 in the first half of 1999 compared with a decrease of \$260.5 in the comparable period of 1998. The \$28.5 variance primarily reflects increased repurchases of common stock, an unfavorable effect of foreign currency exchange and increased cash used for investing activities due to the acquisition of the remaining interest in a manufacturing facility in Poland. These uses of cash were partially offset by lower net cash used by operations reflecting a favorable consolidated working capital level and higher net income (adjusted for the non-cash portion of the special charges).

During the first half of 1999, the Company purchased approximately 2,756,500 shares of common stock for \$125.5 compared with \$48.7 spent for the repurchase

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of approximately 1,432,300 shares during the comparable period in 1998.

### Capital Resources

Total debt increased \$260.7 to \$517.0 from \$256.3 at December 31, 1998, principally due to normal seasonal working capital requirements during the first half of 1999 and to support the continuing stock buyback program. Total debt of \$517.0 at June 30, 1999 was \$77.5 higher than total debt of \$439.5 at June 30, 1998 due to increased share repurchases. In addition, at June 30, 1999 and December 31, 1998, other non-current liabilities included approximately \$109.4 and \$112.4, respectively, related to securities lending activities.

At June 30, 1999, there were no borrowings under the amended and restated revolving credit and competitive advance facility agreement. This agreement is also used to support the Company's commercial paper borrowings of which \$244.7 was outstanding at June 30, 1999.

At June 30, 1999, there were \$10.0 of borrowings outstanding under uncommitted lines of credit.

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

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

### Working Capital

As of June 30, 1999, current liabilities exceeded current assets by \$156.6, while at December 31, 1998 current assets exceeded current liabilities by \$11.9. The increase of current liabilities over current assets was primarily due to the increase in net debt (debt less cash and equivalents), as discussed in the Debt section, and other accrued liabilities, mainly due to the accrual for special and non-recurring charges, partially offset by a decrease in accounts payable and accrued compensation due to the payment of 1998 incentive programs.

Although current liabilities exceeded current assets at June 30, 1999, management believes this is due to the Company's direct selling business format which results in lower receivable and working capital levels as well as the Company's practice of repurchasing shares with available cash. Avon's liquidity results from its ability to generate significant cash flows from operations and its ample unused borrowing capacity. Actions that would eliminate the working capital deficit are not anticipated at this time. Avon's credit agreements do not contain any provisions or requirements with respect to working capital.

### Financial Instruments and Risk Management Strategies

The Company operates globally, with manufacturing and distribution facilities in various locations around the world. The Company may reduce its exposure to fluctuations in interest rates and foreign exchange rates by creating offsetting positions through the use of derivative financial

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instruments. The Company currently does not use derivative financial instruments for trading or speculative purposes, nor is the Company a party to leveraged derivatives.

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

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

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

At June 30, 1999, the Company held foreign currency forward contracts with notional amounts totaling \$315.6 and option contracts with notional amounts totaling \$3.7 to hedge foreign currency items. Only \$9.0 of these contracts have maturities after 1999. Also outstanding at June 30, 1999 were foreign contracts totaling \$35.0 which do not qualify as hedging transactions under the current accounting definitions and accordingly, have been marked to market. The mark-to-market adjustment at June 30, 1999 was insignificant. The

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Company's risk of loss on the options in the future is limited to premiums paid, which are insignificant.

At June 30, 1999, the Company has entered into forward contracts to purchase approximately 2,608,200 shares of Avon common stock at an average rate of \$36.67 per share as of June 30, 1999. The contracts mature over the next 2-1/2 years and provide for physical or net share settlement to the Company. Accordingly, no adjustment for subsequent changes in fair value has been recognized.

The Company attempts to minimize its credit exposure to counterparties by entering into interest rate swap and cap contracts only with major international financial institutions with "A" or higher credit ratings as issued by Standard & Poor's Corporation. The Company's foreign currency and interest rate derivatives are comprised of over-the-counter forward contracts or options with major international financial institutions. Although the Company's theoretical credit risk is the replacement cost at the then estimated fair value of these instruments, management believes that the risk of incurring losses is remote and that such losses, if any, would not be material.

Other Information

Euro

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

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

Year 2000

General

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

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The Company commenced its worldwide Year 2000 initiative in early 1996. The Company has developed a comprehensive project plan as a means for ensuring that all information technology ("IT") systems, including applications, operating systems, mainframe, mid range and client server platforms, all non-information technology ("Non-IT") systems, including embedded applications and equipment and key third parties are Year 2000 compliant by December 31, 1999. The Company has identified high risk applications that are critical to its business, recognizing the fact that timely compliance of these systems is crucial, and, therefore, has designed its programs to address these systems first. Furthermore, the Company has established a project team to identify and address the Company's Year 2000 risks and issues in an attempt to ensure the integrity and reliability of the Company's information systems and business processes.

Project Plan

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The Company's Year 2000 project plan is divided into four major sections, including: Infrastructure, Application Softwares, Validation of Third Party Compliance and Embedded Systems. The project has five phases, which are common to all sections: 1) identifying, inventorying and prioritizing Year 2000 items; 2) assessing Year 2000 compliance of identified items and related potential risks in circumstances of non-compliance of these items; 3) remediating, replacing or upgrading, as appropriate, material items that are determined not to be Year 2000 compliant; 4) validation testing of material items to ensure compliance; and 5) contingency planning and implementation.

The Company utilizes internal resources and outside consultants to renovate and test its IT and Non-IT systems for Year 2000 compliance. None of the Company's other information technology projects have been deferred due to the implementation of the Year 2000 project.

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

The Applications Software section includes the conversion of both in-house developed and vendor-supplied software applications. In-house developed software that is not Year 2000 compliant has undergone remediation of its application, whereas non-compliant vendor provided software has been upgraded or replaced, where available by the supplier. This section's testing phase, which includes procedures for independent validation and verification of code has been completed. Currently, the Company is verifying the integrity of internal and external system interfaces. This activity is scheduled to be completed by September 1999.

Validation of Third Party Compliance includes the process of recognizing, prioritizing and communicating with key suppliers and service providers with whom the Company has a direct and significant relationship and are believed to be critical to its business operations. Identification of significant vendors has been completed and a strategy has been initiated in an attempt to reasonably ascertain their progress in addressing the Year 2000 issue. The Company has distributed comprehensive questionnaires to key suppliers, and, with the guidance of outside consultants, is in the process of conducting detailed assessments of the responses received. The validation of third party compliance is expected to be completed by August 1999. Follow-up reviews will also be scheduled for the remainder of 1999.

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The Embedded Systems section includes all hardware, software and associated embedded computer chips that are utilized in operating and maintaining the internal functions of the Company's facilities, i.e. climate control systems. The Company has elected to employ a regional-based strategy for addressing Year 2000 compliance of its embedded systems. Avon U.S. operations have completed the remediation and testing of embedded systems. From an international standpoint, the Company has completed the assessment and remediation phases and is currently testing critical equipment. Testing is scheduled to be completed by September 1999.

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### Costs

The total estimated cost associated with achieving worldwide Year 2000 compliance will be approximately \$32.7, of which \$25.0 has been spent to date. Replacement costs and costs associated with the validation of third party compliance are included in these figures. The Company does not separately track the internal costs incurred for the Year 2000 project, those costs primarily being related to payroll costs for the Company's information systems group. The Company's policy is to expense as incurred information system maintenance and modification costs and to capitalize costs related to system replacement. The costs of the Company's Year 2000 compliance efforts are being funded through operating cash flows.

### Risks

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

### Contingency Plans

Development of contingency plans is in progress and are scheduled to be completed by September 1999. Once established, contingency plans and related cost estimates will be continually modified, if necessary, as additional information becomes available.

### Disclaimer

Readers are cautioned that forward-looking statements contained in the Year 2000 Update should be read in conjunction with the Company's disclosure under the heading "CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" on page 24.

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

Certain statements in this report which are not historical facts or information are forward-looking statements, including, but not limited to, the information set forth in "Other Information" herein. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, levels of activity, performance or achievement of the Company, or industry results, to be materially different from any future results, levels of activity, performance or achievement expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions; the



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ability of the Company to implement its business strategy; the Company's access to financing and its management of foreign currency risks; the Company's ability to successfully identify new business opportunities; the Company's ability to attract and retain key executives; the Company's ability to achieve anticipated cost savings and profitability targets; changes in the industry; competition; the effect of regulatory and legal restrictions imposed by foreign governments; the effect of regulatory and legal proceedings and other factors discussed in Item 1 of the Company's Form 10-K/A. As a result of the foregoing and other factors, no assurance can be given as to the future results and achievements of the Company. Neither the Company nor any other person assumes responsibility for the accuracy and completeness of these statements.

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AVON PRODUCTS, INC.  
PART II. OTHER INFORMATION

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

(a) Exhibits

There are no exhibits.

(b) Reports on Form 8-K.

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

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SIGNATURES

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

AVON PRODUCTS, INC.

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(Registrant)

Date: August 12, 2002

By /s/ JANICE MAROLDA

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Janice Marolda  
Vice President,  
Controller  
Principal Accounting Officer

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

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