

REVIEW OF OPERATIONS

AMERICAS REGION

1997	In millions	% Change from 1996
Net Sales	\$ 1,753	+9%
Pretax Income	\$ 311	+6%

Sales in the Americas Region in 1997 grew 9% to \$1.8 billion as the region for the first time became Avon's largest operating business unit. Excluding the impact of foreign currencies, sales rose 14% as Mexico, Argentina, Chile and Venezuela each delivered double-digit sales gains and solid growth in pretax income.

Avon Mexico had another outstanding year, with sales rising 27% (32% in local currency) to \$378 million, on top of the 22% sales gain in 1996. Global brands like *Anew* and *Avon Color*, supported by aggressive product sampling, brand advertising, field recruiting and incentive programs, helped increase both the number of orders and the size of the average order. Also, units were up 11%, and the number of active Representatives climbed 10%.

Pretax income in Mexico increased 36% in 1997 to over \$100 million, making Avon Mexico the first international company to surpass that level in the corporation's history. The strong pretax profit performance reflects the sales gains as well as a favorable operating expense ratio. Avon Mexico also invested in upgrading computer programs and equipment to improve shipping and distribution services to Representatives.

In Argentina, sales rose 10% despite the impact of high unemployment on consumer spending. The second half of the year was especially strong as a "New Customer Crusade" program helped boost customer transactions by 24% in the fourth quarter and 23% for the full year. Both units sold and the number of active Representatives rose for the full year despite heavy competition, especially from new market entries.

Global brands such as *Avon Color*, *Anew* and *Far Away* contributed to the sales growth in Argentina. For example, the Spring 1997 launch of *Millennia* resulted in sales of 2.3 units per Representative during the introductory campaign and was the second best fragrance launch in Avon Argentina's history. The customer base grew by 35% during the same campaign.

Avon Chile achieved a 20% sales gain in 1997 along with double-digit gains in all business indicators. A focus on global beauty brands like *Millennia*, plus aggressive marketing and sales, further increased Avon Chile's market penetration and customer growth. Profits were up significantly in Chile versus the prior year. Avon Venezuela rebounded strongly over 1996 results with sales climbing 21%. Excluding exchange, sales rose 45%, driven by a higher average order size. The markets of Central America and the Dominican Republic also delivered sales increases, generated by increases in units sold and growth in the number of active Representatives.

In Brazil, sales declined in the single digits due to competitive and economic pressures, including reduced consumer spending. Moreover, aggressive marketing programs in the high-volume fourth quarter did not deliver the expected sales gains. Pretax income fell significantly in 1997 due to the sales decline and a narrowing of gross margin as consumers shifted to lower-priced products. Also, margin was negatively impacted during the year by approximately \$15 million for actions taken to reduce inventory levels.

Avon Brazil responded by substantially increasing consumer sampling programs, especially in support of higher-margin global brands. The company also accelerated recruiting, retention and training programs to stabilize the Representative base in a volatile economic environment. One program, for example, generated 141,000 new Representative appointments in the fourth quarter, or an average of 68 new appointments per sales zone. Avon Brazil has improved its inventory position considerably and is working to reduce manufacturing and materials costs, with improved performance expected in 1998.



Moments (Brazil)

AVON U.S.

1997	In millions	% Change from 1996
Net Sales	\$ 1,733	+ 4%
Pretax Income	\$ 220	-3%

Nineteen ninety-seven was a challenging year for Avon U.S., with sales up 4% and pretax profits down 3%. Excluding Discovery Toys, a direct seller of educational products for children which Avon acquired in January 1997, sales rose 1% and pretax income declined 2%.

Avon U.S., excluding Discovery Toys, started the year with decreases in the number of active Representatives and units due to a change in late 1996 in the discount policy on demonstration products for low-producing Representatives. As a result, the number of active Representatives fell 3% and units dropped 2% in the first quarter of 1997.

Although recovery took longer than anticipated, by year-end the number of active Representatives increased year-over-year by 1% to 445,000. Also, units for the full year had risen in the single digits. Importantly, the number of Avon's top-selling President's Club Representatives increased 2% for the year, and the number of low-producing Representatives dropped almost 10%.

Pretax income in the U.S. in 1997 was impacted by increased spending through the first half of the year on pricing strategies and field incentives designed to boost sales. Increased investments in advertising and promotions, plus costs associated with the centralization of returned goods and call center operations, also affected pretax income.

Avon's beauty business in the U.S. grew by 6% in 1997 as sales of global brands climbed 13% and grew to account for 51% of CFT sales. Skin Care was especially strong as the launches of the renovated, technologically advanced *Anew* line and *Avon Skin Care* generated a 26% gain in skin care sales for the year. Sales of *Avon Color* increased for the third consecutive year based on strong sales in the lip and nail segments. Fragrance sales were soft due to the disappointing results of *Starring* and a soft fragrance industry overall.

Personal Care rose 14% with the launch of *Avon Techniques*, a breakthrough performance line of shampoos, conditioners and styling products. Specialty bath products and a line of *Barbie*® toiletries for girls also contributed to the strong personal care performance. Gifts also increased in 1997 due to the continued success of the seasonal *Barbie*® dolls and the *Mattel* line of toys.

In apparel, sales of *Avon Style* decreased in 1997 due to lower casualwear and demo sales in the first half of the year. However, a strong fourth quarter performance in the sleepwear and childrenswear categories helped to offset this decrease.

Accessories climbed significantly due to sales gains in organizer handbags and licensed products such as watches.

Jewelry, however, was down for the year, and Avon U.S. is implementing plans to upgrade quality and design to increase customer demand.

Avon U.S. continued to explore innovative strategies to reach new customers and enhance its beauty image. For example, the direct mail catalogue test of *Avon Beauty & Fashion by Mail* attracted incremental new customers who are spending more on beauty than traditional customers. Avon's newly renovated worldwide web site, www.avon.com, attracted over 1 million visitors last year. Moreover, Avon's 1997 advertising campaign, "*Dare to change your mind about Avon*," invited consumers to take another look at the company through print and television ads that showcased Avon's improved beauty image and breakthrough skin care products.

Avon U.S. also initiated programs in 1997 to streamline its business and provide improved service to Representatives and customers. For example, the company opened its telephone call center in Springdale in the fall. Beginning in 1999, the new call center will save between \$3–\$5 million dollars annually. The company's consolidated returned goods center, also in Springdale, became fully operational in 1997. Avon U.S. also announced plans to close the Far East Buying Office, effective in March 1998. This office had provided sourcing and logistics support for gifts, home, jewelry and accessories products for the U.S. business. These functions now will be outsourced and will provide greater access to unique products, help reduce overhead, and improve gross margins.



Techniques

REVIEW OF OPERATIONS

PACIFIC REGION

1997	In millions	% Change from 1996
Net Sales	\$ 782	+ 4%
Pretax Income	\$ 56	- 24%

Sales in the Pacific Region in 1997 rose 4%. Excluding the effect of foreign exchange, sales climbed 14% as all markets except Thailand grew in local currency terms. Also, every market except Japan and New Zealand delivered double-digit local currency sales increases. In addition, leading business indicators gained as well: units grew 18%; orders rose 31%; the number of customers served increased 43%; and the number of active Representatives climbed 30%.

Pretax income for the region declined due to the impact of the currency devaluations, and also due to profit pressures in Japan. For the full year, the currency devaluations reduced pretax income for the region by approximately \$7 million. Excluding Japan, pretax income increased 17%.

In the Philippines, sales in 1997 climbed 12%, and 25% in local currency terms. Aggressive customer growth programs increased units by 22% and customers served by 59%. Recruiting and retention programs increased the number of active Representatives by more than 100%. Avon Philippines enjoyed continuing success with its teen apparel line, and also expanded its teen CFT line with a *Teen Color* makeup collection.

Avon Taiwan had a banner year in 1997, with sales climbing 36% (43% in local currency). Units, customers, and active Representatives each increased dramatically over last year. The introduction of a new sales strategy, coupled with a retail access initiative, generated the gains. Avon Taiwan also boosted its market penetration through Avon showrooms and opportunities for selling in a well-known retail chain.

In Malaysia, sales grew 12% (24% excluding currency), with strong double-digit increases in key business indicators. Avon Malaysia expanded its system of franchised beauty boutiques to 145, which contributed to a 54% increase in customer transactions. Avon Indonesia increased sales by 19% in local currency terms due to double-digit gains in customer transactions and orders.

Sales in Avon Japan in 1997 declined in dollars, but grew 3% in local currency, despite weakened consumer spending and intense competition, especially from discount outlets. The local currency sales increase was the first in four years as a new multiple order system and enhanced recruiting, retention and customer growth programs helped increase units by 33% and customers served by 57%. The number of active Representatives also grew significantly.

Pretax income, however, declined in Japan in 1997 due to heavy investments in the customer growth strategies, including

a 20% reduction in prices early in the year to make products more competitive in the marketplace. Also, a shift in the sales mix to lower-margin non-CFT products contributed to the pretax income decline.

Management in Japan is restructuring the business to operate more efficiently and to reduce overhead costs. For example, several improvements in the ordering process helped to reduce product delivery to one or two days, and an ongoing early retirement program reduced regular staff levels by 5%. Avon Japan expects to deliver improved profitability in 1998.

In China, sales in 1997 rose 13% to \$77 million, but pretax income fell due to higher expenses associated with a planned branch expansion. The Chinese government has been conducting a lengthy recertification program of all direct selling companies. As a result, the company was not able to open new branches during the year, although most of the existing 76 branches were relicensed. Management in China is reviewing a variety of options for modifying our direct selling system for possible implementation in the future.

In the established markets of Australia and New Zealand, sales and pretax income continued to grow following the turnaround of 1996. Avon India completed its first year of operations in 1997 with one branch in New Delhi.



Fashion Makeup Group (Japan)

EUROPE REGION

1997	In millions	% Change from 1996
Net Sales	\$ 812	+ 4%
Pretax Income	\$ 99	+82%

Sales in the Europe Region in 1997 increased 4% due to strong growth in the U.K., the four countries of Central Europe, and in Russia. In local currencies, sales rose 11%, and every country in the region except Germany generated local currency sales gains. Overall, units across the region increased 13% and the number of active Representatives was up 12%.

Pretax income climbed 82% due to improved gross margins in the U.K., ongoing expense reduction throughout the region, and a \$26.5 million gain from the settlement of a Value-Added Tax (VAT) claim in the U.K. in the fourth quarter. Excluding the VAT, pretax income in Europe was up 34%.

Avon U.K. in 1997 generated a 15% sales gain and a substantial increase in pretax income due to an improved mix of higher-margin products. An intensified focus on global brands, customer sampling and image enhancements, especially through advertising and the Avon sales brochure, helped boost sales of products such as *Avon Color*, *Anew* and *Avon Skin Care*. Global brands in the U.K. last year grew to comprise 37% of the company's CFT revenues.

Global fragrances such as *Far Away* and *Rare Gold* enabled Avon U.K. to continue its dominance of the country's fragrance market. Avon U.K. last year boosted consumer sampling of fragrances via micro-encapsulation of product on brochure pages. As a result, 35% of customers purchased an Avon fragrance in 1997, versus 24% in 1996. Suncare products like *Bronze*, and continuing success of personal care products such as *Naturals*, *Avon Spa*, *Footworks* and *Advance*, also contributed to the sales growth.

The four countries of Central Europe – Poland, Hungary, Slovakia and the Czech Republic – delivered another outstanding year in 1997. Sales advanced 19% (43% excluding exchange) on double-digit increases in units, customers and the number of active Representatives. Sales of global brands climbed 50%, driven by the launch of *Avon Skin Care* and continuing gains with *Avon Color*. Brand image advertising, aggressive recruitment and training programs, and consumer events all contributed to the increases. Avon also entered the Eastern European markets of Romania, Ukraine and Croatia during the latter half of the year.

Avon Russia continued its dramatic growth as the most successful market entry in Avon's history. Sales in 1997 almost doubled to \$56 million. The number of active Representatives more than doubled to 44,000 due to aggressive recruiting and Representative support programs. The company also expanded eastward to major cities across European Russia.

In addition, Avon Russia opened an image-enhancing sales center for Representatives in Moscow, and began exploring fixed access strategies to accelerate market penetration. The company also installed new assembly lines to increase manufacturing capacity and invested in system upgrades to support the market's rapid sales growth. Avon Russia was highly profitable for the year.

In Germany, higher unemployment, weak consumer spending, and a shift to lower-priced products depressed sales and all key business indicators. Management enacted programs to increase market coverage, strengthen Avon's image and generate customer growth.

Avon Italy increased sales by almost 7% in local currency on strong unit growth. Pretax income climbed 79% due to effective expense controls, organizational and logistical efficiency initiatives, and the continuing conversion of compensation for the sales force from fixed to variable.

In Spain, sales were up 8% in local currency and pretax income increased 26% as the company's focus on winning more customers generated continuing growth. Avon Portugal increased sales by 12% in local currency, along with double-digit gains in units and customers served. In France, a party plan test and a Representative segmentation strategy were enacted to enhance access for new customers. Pretax income was up dramatically due to ongoing expense controls.



Bronze (U.K.)