

FINANCIAL SECTION

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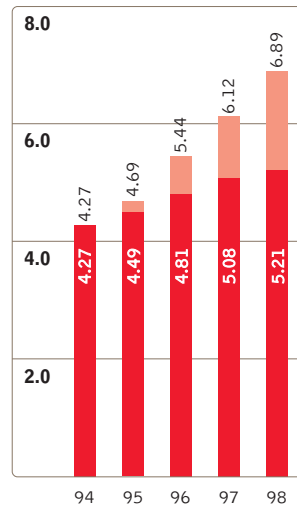
60 Eleven-Year Review

Sales – Constant vs.

Actual U.S. Dollars

\$ In billions

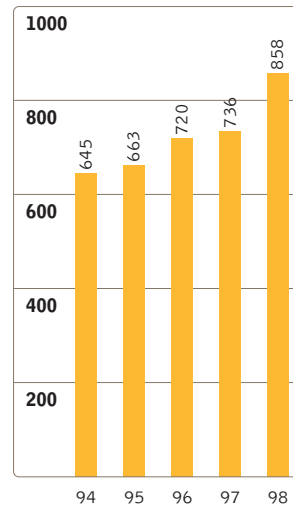
Base year = 1994



● Sales, Actual U.S. Dollars
● Sales, Constant U.S. Dollars
(excludes currency translation)

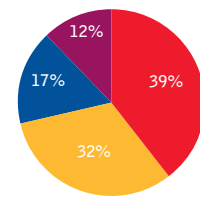
Business Unit Operating Profit

\$ In millions

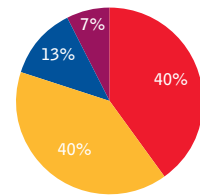


1998 Results by Geographic Region

Net Sales



Business Unit Operating Profit



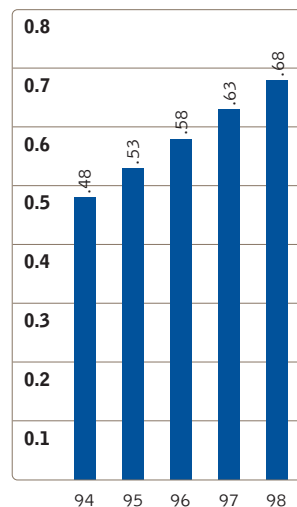
● North America
● Latin America
● Europe
● Pacific

Dividends Paid

Per Common Share

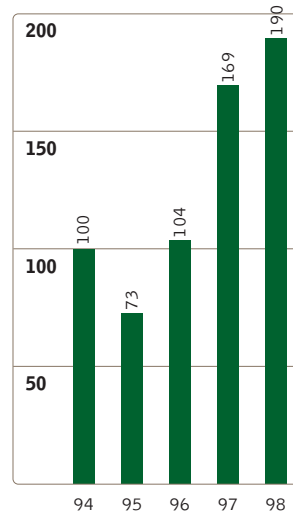
In dollars

Restated for two-for-one stock
splits in 1998 and 1996



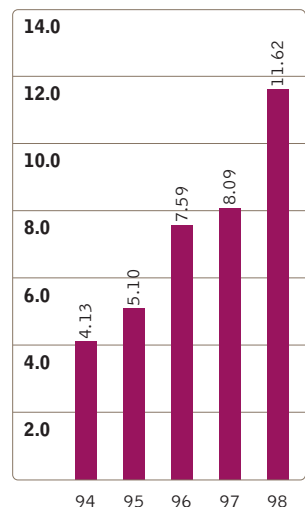
Capital Expenditures

\$ In millions



Year-End Market Capitalization

\$ In billions





MANAGEMENT'S DISCUSSION AND ANALYSIS

Avon Products, Inc.
Dollars in millions, except share data

The following discussion of the results of operations and financial condition of Avon Products, Inc. ("Avon" or "Company") should be read in conjunction with the information contained in the Consolidated Financial Statements and Notes thereto. These statements have been prepared in conformity with generally accepted accounting principles and require management to make estimates and assumptions that affect amounts reported and disclosed in the financial statements and related notes. Actual results could differ from these estimates.

All share and per share data included in this report have been restated to reflect two-for-one stock splits distributed in September 1998 and June 1996.

FORWARD-LOOKING STATEMENT

Certain statements in this report which are not historical facts or information are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including, but not limited to, the information set forth herein. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, levels of activity, performance or achievement of the Company, or industry results, to be materially different from any future results, levels of activity, performance or achievement expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions; the ability of the Company to implement its business strategy; the Company's access to financing and its management of foreign currency risks; the Company's ability to successfully identify new business opportunities; the Company's ability to attract and retain key executives; the Company's ability to achieve anticipated cost savings and profitability targets; the impact of substantial currency exchange devaluations in the Company's principal foreign markets; 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. 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.

RESULTS OF OPERATIONS

Consolidated > Net income in 1998 was \$270.0 compared with \$338.8 in 1997. Basic and diluted earnings per share in 1998 were \$1.03 and \$1.02, respectively, compared with \$1.28 and \$1.27, respectively, in 1997.

Special and non-recurring charges were recorded in the first and third quarters of 1998 for the Company's previously announced business process redesign program. These charges totaled \$154.4 pretax, which reduced net income by \$122.8 after tax, or \$.46 per share on a basic and diluted basis. See Note 13 of the Notes to Consolidated Financial Statements for further discussion of this program. Before the charges, net income for the year ended December 31, 1998 of \$392.8 increased 16% over 1997. Earnings per share before the charges of \$1.49 and \$1.48 on a basic and diluted basis, respectively, increased 16% and 17%, respectively, from the comparable period in 1997. The 1997 results include the favorable settlement of a value-added tax claim in the United Kingdom equal to approximately \$26.5 on a pretax basis. The \$26.5 gain represents a \$20.6 settlement of disputed value-added tax charges from prior years, which is included in other (income) expense, net and \$5.9 of interest which is included in interest income. The net effect of this gain was to increase 1997 net income by \$16.7 and both basic and diluted earnings per share by \$.06. Net income for 1996 was \$317.9 and basic and diluted earnings per share were \$1.19 and \$1.18, respectively.

Excluding the charges, operating profit was \$633.9, or 17% over 1997 due to higher sales and an improved gross margin, partially offset by a higher operating expense ratio in 1998. Excluding the impact of foreign exchange, operating profit increased 27% over 1997. The improvement in operating profit combined with a favorable foreign exchange impact was partially mitigated by the 1997 value-added tax settlement in the United Kingdom. As a result, pretax income, before the charges, rose \$75.4, or 14%, over 1997. Net income was also impacted by a lower effective tax rate in 1998 and by favorable minority interest due mainly to the results in China.

On a consolidated basis, Avon's net sales of \$5.21 billion increased 3% from \$5.08 billion in 1997. Sales in North America increased 5% to \$2.06 billion primarily due to a 5% increase in the U.S. attributable mainly to a higher average order size. International sales increased 1% to \$3.15 billion from \$3.11 billion due to strong growth in Latin America, most significantly in Brazil, Mexico, Argentina and Venezuela, as well as in Europe reflecting improvements in the United Kingdom and Poland. These increases

were partially offset by sales declines in the Pacific, most significantly in Japan, China and the Philippines. Excluding the impact of foreign exchange, consolidated net sales rose 9% over the prior year. In 1997, consolidated net sales of \$5.08 billion increased 6% from \$4.81 billion in 1996. International sales increased 7% to \$3.11 billion from \$2.92 billion in 1996 due to strong growth in Latin America, most significantly in Mexico, Argentina, Chile and Venezuela, and in the United Kingdom, Russia, Central Europe and the Pacific Rim, primarily Taiwan and the Philippines. These improvements were partially offset by sales declines in Germany, Brazil and Japan. Sales in North America increased 4% to \$1.97 billion primarily due to the 1997 acquisition of Discovery Toys and an increase in the U.S. average order size partially offset by a decrease in the number of Representative orders. Excluding the impact of foreign currency exchange, 1997 consolidated net sales rose 10% over 1996.

Cost of sales as a percentage of sales was 39.4% in 1998, compared with 40.4% in 1997. The 1998 cost of sales includes \$37.9 of a non-recurring charge for inventory write-downs related to the Company's business process redesign program. The charge relates to the closure of facilities, discontinuation of certain product lines, size-of-line reductions and a change in strategy for product dispositions. See Note 13 of the Notes to Consolidated Financial Statements for further discussion of these charges. Excluding the charge, cost of sales as a percentage of sales was 38.7%, a 1.7 point improvement from 1997. This improvement was primarily due to a higher margin in Brazil, reflecting actions taken in 1997 to reduce inventory levels combined with cost reduction programs in 1998. Additionally, the gross margin in Venezuela improved as a result of pricing strategies and business redesign efforts. Japan's gross margin improved as a result of cost reduction initiatives, and the U.S. improved its margin through pricing strategies, cost improvements and reduced clearance activity in the non-cosmetics, fragrance and toiletries categories. In 1997, cost of sales as a percentage of sales was 40.4%, compared with 39.9% in 1996. The decline in gross margin was primarily due to unfavorable cost ratios in Japan, resulting from an aggressive pricing strategy and a shift in sales mix to lower-margin items, and in Brazil, reflecting a consumer shift towards lower-priced products as well as actions taken to reduce inventory levels. These declines were partially offset by a margin improvement in the United Kingdom due to a shift in sales mix to higher-margin items.

Marketing, distribution and administrative expenses of \$2.56 billion increased \$79.4, or 3%, from 1997 and increased as a percentage of sales to 49.2% from 48.9% in 1997. Increased operating expenses in the U.S. were attributable primarily to the sales growth. Operating expenses grew in Brazil in 1998 due to higher sales and increased marketing programs. Mexico's operating expenses were higher in 1998 reflecting sales growth driven by increased incentive programs and higher brochure costs to support the growth in Representatives. These increases were partially offset by lower

expenses in the Pacific due to lower sales and the impact of currency devaluations. The overall increase in the expense ratio was due to higher expense ratios in Mexico due to increased marketing and promotional expenses associated with new product launches, in Venezuela due to increased administrative expenses as a result of the implementation of a new labor law, in Argentina due to increased marketing expenses and in China reflecting the shutdown of sales operations for most of the second quarter of 1998. In 1997, marketing, distribution and administrative expenses of \$2.48 billion increased \$136.1, or 6%, from 1996 and increased slightly as a percentage of sales to 48.9% from 48.8% in 1996. The increase in operating expenses was attributed to markets which had experienced strong sales growth, including Mexico, the United Kingdom, Russia, Taiwan and Venezuela. Operating expenses in the U.S. increased due to higher strategic spending in advertising and promotional support for new launches, the national rollout of Avon Home and costs associated with the centralization of certain operational areas. In addition, operating expenses in China were higher due to expenses incurred in preparation for the planned opening of 24 new branches during 1997 which were not put into operation because of new government recertification requirements on direct selling activities. These increases were partially offset by lower expenses in Germany due mainly to the impact of a stronger U.S. dollar in 1997.

Special charges of \$116.5 were recorded in 1998 for the Company's business process redesign program. These charges are primarily related to employee severance benefits and facility rationalizations in Puerto Rico, the Dominican Republic, Hong Kong and China as well as asset write-downs associated with the divestiture of the Discovery Toys business unit. See Note 13 of the Notes to Consolidated Financial Statements for further discussion of these charges.

Interest expense in 1998 of \$41.0 was \$.8 favorable to prior year due to lower cost of borrowings. Interest expense in 1997 of \$41.8 increased \$1.8 compared to 1996 primarily due to increased domestic debt levels partially offset by lower average debt outstanding in Brazil in 1997.

Interest income in 1998 of \$15.9 decreased \$.8 compared to 1997 primarily due to the interest portion of the 1997 favorable value-added tax settlement in the United Kingdom, partially offset by a Mexico tax refund claim, as well as higher interest rates and increased average short-term investments in Brazil in 1998. Interest income in 1997 of \$16.7 increased \$2.2 compared to 1996 due to the interest portion of the value-added tax settlement in the United Kingdom partially offset by lower interest rates in Brazil and lower cash investment levels in the U.S.

Other (income) expense, net, was \$14.4 unfavorable to 1997. Excluding the 1997 value-added tax settlement in the United Kingdom, other (income) expense, net was \$6.2 favorable primarily due to favorable foreign exchange. In 1997, other (income) expense, net, was \$24.8 favorable to 1996 due to the \$20.6 portion of the value-added tax settlement in the United Kingdom as well as lower foreign exchange losses in 1997.

Income taxes were \$190.8 in 1998 and the effective tax rate was 41.9% compared with \$197.9 and an effective tax rate of 37.0% in 1997. Excluding the effect of the special and non-recurring charges, income taxes were \$222.4 and the effective tax rate was 36.4%. The 36.4% effective tax rate was lower in 1998 due to the mix of earnings and income tax rates of the international

subsidiaries. In 1997, the effective tax rate was 37.0% compared with 37.5% in 1996. The effective tax rate was lower in 1997 due to the mix of earnings and income tax rates of international subsidiaries.

Inflation in the United States has remained at a relatively low level during the last three years and has not had a major effect on Avon's results of operations. Many countries in which Avon has operations have experienced higher rates of inflation than the United States. Mexico, Venezuela and Russia experienced high cumulative rates of inflation over the three-year period 1996 through 1998. However, Mexico will be converted to non-hyperinflationary status beginning January 1, 1999 due to reduced cumulative inflation rates during the past three years.

Below is an analysis of the key factors affecting net sales and operating profit by reportable segment for each of the years in the three-year period ended December 31, 1998.

Years ended December 31	1998		1997		1996	
	Net Sales	Operating Profit	Net Sales	Operating Profit	Net Sales	Operating Profit
North America:						
U.S.	\$1,774.0	\$ 302.8	\$1,696.7	\$ 261.8	\$ 1,672.5	\$ 267.4
Other	287.6	40.2	275.4	35.1	224.3	34.4
Total	2,061.6	343.0	1,972.1	296.9	1,896.8	301.8
International*						
Latin America	1,665.1	344.4	1,513.3	280.0	1,385.6	273.3
Pacific	623.3	62.5	782.4	67.0	751.1	77.0
Europe	862.7	108.5	811.6	91.7	780.7	67.4
Total	3,151.1	515.4	3,107.3	438.7	2,917.4	417.7
Total from operations	\$5,212.7	858.4	\$5,079.4	735.6	\$ 4,814.2	719.5
Global expenses		(224.5)		(191.5)		(174.7)
Special and non-recurring charges		(154.4)		—		—
Operating profit		\$ 479.5		\$ 544.1		\$ 544.8

* Excludes Canada, Dominican Republic and Puerto Rico which are now included in North America.

Note: 1997 and 1996 data have been restated to reflect the Company's segments on an operating profit basis. See Note 11 of the Notes to the Consolidated Financial Statements for further details.

North America > Sales in North America increased 5% to \$2.06 billion and operating profit increased 16% to \$343.0 in 1998. The U.S. business, which represents almost 90% of the North American segment, reported sales and operating profit growth of 5% and 16%, respectively. Sales growth in the U.S. reflected a 4% increase in the average order size coupled with a 1% increase in the number of Representative orders. The sales improvement resulted from increases in fashion jewelry and accessories, cosmetics, fragrance and toiletries ("CFT") and home entertainment categories partially offset by a decline in the gift and decorative category. Sales of fashion jewelry and accessories rose significantly over the prior year, primarily in the accessories segment, with the success of such products as organizer handbags, the *Home Run Hero* watch introduced in the fourth quarter and increased sales of licensed products, including *Winnie the Pooh* carryalls and sports watches. Growth in the CFT category was driven by successful launches of *Rare Rubies*, *Anew Retinol Hand Complex*, and the *Diane Von Furstenberg* fragrance, *Forest Lily*. In addition, the success of Avon's transfer resistant technology lipstick and Avon Color's Spring Shade Collection combined with continued growth of the *Avon Techniques* hair care and *Skin-So-Soft* lines contributed to the growth in CFT. Higher sales in the home entertainment category were driven by the launch of a collection of inspirational and religious products, as well as an increase in the sales of demonstration products purchased by Representatives. These increases were partially offset by a decline in the gift and decorative category resulting from the phasing out of the Avon Home line and lower sales of *Barbie* and holiday products in 1998. The improvement in U.S. operating profit was mainly a result of the above sales increase combined with a favorable gross margin driven by cost improvements, revised pricing strategies and reduced clearance activity.

In 1997, North American sales increased 4% to \$1.97 billion and operating profit decreased 2% to \$296.9. Sales in the U.S. segment rose 1% to \$1.70 billion and operating profit decreased 2% to \$261.8. The 1% sales growth reflected a 3% increase in average order size partially offset by a 2% decrease in the number of Representative orders. Units sold in the U.S. increased 4% over 1996. The U.S. sales improvement resulted from increases in the CFT and gift and decorative categories partially offset by declines in apparel. The growth in the CFT category was driven by the launches of *Anew Retinol Recovery Complex* and *Avon Techniques* hair care line in addition to the first quarter 1997 product introductions in the specialty bath segment, such as *California Bath* and the *Soft and Sensual* line extension of the *Skin-So-Soft* brand. Additionally, the renovated *Anew* launch in early 1997 contributed to higher CFT sales. The continued success of the seasonal *Barbie* dolls, the launch of Avon Home and the success of the Mattel line of toys led to the increase in gift and decorative sales. Apparel sales were lower in 1997 due to the success of the Olympic Games collection in 1996 and lower sales of demonstration products in the first two quarters of 1997. The decrease in operating profit resulted

from a lower gross margin and a higher operating expense ratio. The decline in gross margin was due to strategic price investments in CFT products aimed at energizing customer sales and the addition of Avon Home, a lower-margin new business. The unfavorable operating expense ratio was driven by higher expenses related to advertising and promotional support for new products, costs associated with the centralization of the returned goods and call center operations and increased field incentives designed to drive sales. In addition, operational costs associated with higher returned goods processing in 1997 contributed to the unfavorable expense ratio.

International > International sales increased 1% to \$3.15 billion and operating profit increased 17% to \$515.4 from \$438.7 in 1997. The sales growth resulted from strong growth in Latin America, particularly in Brazil, Mexico, Argentina and Venezuela, as well as in Europe reflecting improvements in the United Kingdom and Poland. These results were significantly offset by sales declines in the Pacific, most significantly in Japan, China and the Philippines. Excluding the impact of foreign currency exchange, international sales rose 11% and operating profit increased 30% over 1997.

In Latin America, sales increased 10% to \$1.67 billion and operating profit increased 23%, or \$64.4, to \$344.4 in 1998. The sales improvement resulted from strong growth in Brazil and, to a lesser extent, Mexico, Argentina and Venezuela. Brazil's growth in sales was driven by attractive pricing and successful new product launches, which resulted in strong double-digit increases in units and orders in 1998. Additionally, the number of active Representatives rose 31% from 1997. Mexico's sales increase was driven by successful new product launches including *Anew Night Force*, *Yessamin* fragrance and *Women of Earth*, as well as increases in the apparel and home line extensions which offered superior design and promotions in 1998. Argentina and Venezuela reported strong increases in units, orders and customers served. Excluding the impact of foreign currency exchange, sales in Latin America rose 19% over 1997. The increase in the region's operating profit was primarily due to favorable results in Brazil attributable to the strong sales increase and an improved gross margin and operating expense ratio. Brazil's gross margin improvement resulted from actions taken in 1997 to reduce inventory levels as well as better vendor negotiations and continued cost reduction programs in 1998. The favorable operating expense ratio was driven by the strong sales increase. Operating profit improvements in Mexico due to the sales increase, and in Venezuela due to pricing strategies and business redesign efforts, contributed to the region's growth in operating profit. Excluding the impact of foreign currency exchange, operating profit in Latin America increased 34% over the prior year.

In the Pacific Region, sales decreased 20% to \$623.3 in 1998 and operating profit decreased 7% to \$62.5 from \$67.0 in 1997. The decline in sales resulted from decreases in every major market, most significantly in Japan, China and the Philippines. The Asian currency and economic crisis which began in mid-1997 continued throughout 1998 and negatively impacted results in the Pacific. The general economic environment is poor with low consumer confidence and reduced spending. Excluding the impact of foreign currency exchange, sales decreased 3%, a 17 point differential from U.S. dollar reported results. In addition, selling activities in China were suspended for most of the second quarter of 1998 due to governmental restrictions on direct-selling companies. As of the beginning of June, the Company received Chinese governmental approval to resume operations as a wholesale and retail business and became operational again in mid-June. The Company converted its branches into retail outlets to serve customers and received approval to utilize sales promoters, much like Representatives, to promote product sales in China. Despite the above difficulties, most markets showed growth in active Representatives and number of customers served resulting from a strong focus on active recruitment to expand the Representative base throughout the region. The Philippines posted double-digit increases in orders, customers served and active Representatives. Local currency sales in the Philippines increased 10% over the prior year. The decrease in the region's operating profit resulted primarily from declines discussed above. Despite the sales decline, Japan's operating profit increased significantly over the prior year as a result of improvements in gross margin and operating expense ratio. Japan's margin improvements resulted from cost reduction strategies and the elimination of many lower-margin products in 1998. Additionally, business process redesign efforts have resulted in lower operating expenses. Excluding the impact of foreign currency exchange, operating profit in the Pacific increased 19% from 1997.

In the Europe Region, sales increased 6% to \$862.7 and operating profit increased \$16.8, or 18%, to \$108.5 in 1998. The sales increase was primarily due to growth in the United Kingdom resulting from a higher average order size in 1998. The United Kingdom continues to focus on developing the core business through Representatives, growth in orders and customers as well as brand awareness and image enhancement. In addition, Poland's sales increased significantly from 1997 as a result of dramatic growth in active Representatives and all business fundamentals including units, orders and customers served. These improvements were partially offset by sales shortfalls in Russia attributable to the devaluation of the Russian ruble in August 1998. Average orders have declined significantly in Russia due to low consumer purchasing power. In response to this situation, several actions have been taken by local management including pricing flexibility to maintain

and build market share and reduce credit sales, as well as a tightening of expense controls. Geographic expansion into new cities has also been deferred. The devaluation negatively affected Russia's U.S. dollar results in 1998. Excluding the impact of foreign currency exchange, sales in Europe and Russia increased 10% and 26%, respectively, from prior year. The increase in the region's operating profit was due to the overall sales increase combined with an improved operating margin in the United Kingdom. A shift in sales mix to higher-margin items contributed to a gross margin improvement, and continued active expense management led to a favorable operating expense ratio in the United Kingdom. These increases were partially offset by operating profit declines in Russia mainly due to the devaluation of the ruble discussed above. Excluding the impact of foreign currency exchange, operating profit in Europe increased 25% over 1997.

In 1997, international sales increased 7% to \$3.11 billion and operating profit increased 5% to \$438.7. The sales increase reflected strong growth in Latin America, particularly in Mexico, Argentina, Chile and Venezuela, and in the United Kingdom, Russia, Central Europe and the Pacific Rim, most significantly in Taiwan and the Philippines. These improvements were partially offset by sales declines in Germany, Brazil and Japan, discussed below. Excluding the impact of foreign currency exchange, international sales grew 13% over 1996.

In Latin America, 1997 sales increased 9% to \$1.51 billion and operating profit increased 2%, or \$6.7, to \$280.0 from \$273.3 in 1996. The sales improvement was driven by tremendous growth in Mexico reflecting strong increases in the number of orders, average order size and active Representatives primarily due to customer growth initiatives. These initiatives included incentive programs focused on retention, increased sampling on breakthrough products such as *Anew Vitamin C*, increased advertising and an emphasis on market penetration in metropolitan areas. The sales increase in the region also reflected significant unit growth in Argentina and Chile and an increased average order size in Venezuela. In addition, Central American markets posted strong sales increases in 1997 attributable to growth in units and active Representatives. These improvements were partially offset by a significant sales decline in Brazil. In 1997, consumers in Brazil experienced a tightening of credit which limited their purchasing ability resulting in declines in units sold and active Representatives. To improve Representative count, aggressive retention and achievement programs were implemented including incentives and premiums to improve activity and order size. Excluding the impact of foreign currency exchange, sales in Latin America were up 15% over 1996. The increase in the region's operating profit was primarily due to favorable results in

Mexico reflecting the strong sales increase, described above, combined with a favorable operating expense ratio. In addition, operating profits were higher in Argentina and Chile due mainly to the sales growth. These improvements were partially offset by a lower operating profit in Brazil due to a significant gross margin decline and an unfavorable operating expense ratio. The gross margin decline resulted from a shift in consumer preferences towards lower-priced products and margin investments relating to inventory reduction efforts. The unfavorable operating expense ratio in Brazil was driven by the sales decline. Actions were taken in Brazil to reduce manufacturing and customer service costs, negotiate better terms and costs with vendors and introduce more global products with a higher price and improved margin.

In the Pacific Region, 1997 sales increased 4% to \$782.4 and operating profit decreased 13% to \$67.0 from \$77.0 in 1996. The increase in sales was driven by operational improvements in the Pacific Rim, most significantly in Taiwan and the Philippines. Growth in units, customers served and active Representatives was significant in both Taiwan and the Philippines. Taiwan's sales performance was the strongest in the region resulting from successful merchandising campaigns, product launches supported by strong advertising and promotional activities, including the introduction of *Lighten Up Undereye Treatment* and effective field sales programs in 1997. The sales growth in the Philippines was driven by successful new and extended CFT lines, a new line of children's apparel and an additional service center in 1997. These improvements were partially offset by a significant sales decline in Japan due primarily to an unfavorable exchange impact of a stronger U.S. dollar in 1997 and a reduction in the average order size. Excluding the impact of foreign currency exchange, sales in the Pacific were up 14%. The decrease in the region's operating profit resulted from declines in Japan and, to a lesser extent, in China. The gross margin in Japan declined significantly as a result of strategic pricing programs as well as a shift in sales mix to lower-margin non-CFT items. The competitive environment remained intense in Japan with the continued relaxation of import restrictions and the accelerated growth in discount outlets. As a result, prices were adjusted in early 1997 to make products more competitive in the marketplace. Efforts were focused on restructuring the business in Japan for improved profitability, including innovative recruiting programs, enhanced advertising campaigns and new systems focused on improving customer access. Despite sales growth in China, operating profits declined due to the government licensing revalidation process of all direct selling companies. As a result, no new branches were opened in 1997, but the expense base associated with the planned expansions negatively impacted China's operating profit. The region's operating profit was also negatively impacted by currency devaluations throughout Southeast Asia.

Several currencies in the Pacific Rim devalued significantly during 1997. The Thai baht devalued by 57%, the Philippine peso by 34%, the Malaysian ringgit by 39% and the Indonesian rupiah by 61%. These devaluations lowered pretax income by approximately \$7.0 for the full year. In response to this situation, several actions were taken by local management, including cost negotiations with vendors and a focus on growing the Representative base. In terms of size, these markets represented approximately 5% of Avon's consolidated net sales in 1997.

In the Europe Region, 1997 sales increased 4% to \$811.6 and operating profit increased \$24.3, or 36%, to \$91.7. The sales increase was primarily due to strong growth in the United Kingdom resulting from an increased average order size, unit growth and a favorable exchange rate impact. The sales growth in the United Kingdom was also attributable to a focus on improving market share through brand and image enhancement. Customers were spending more in 1997 as a function of the improvement in image and the quality of the Avon brochure. The European sales improvement was also driven by unit and active Representative growth in Russia and in Central Europe, primarily Poland. Russia continued to exceed expectations as the most successful startup market in Avon's history. Russia's success was attributable to a strong Representative structure, geographic expansion into new cities, installation of new assembly lines which increased capacity and investment in system upgrades to support the sales growth. These improvements were partially offset by sales shortfalls in Germany resulting from an unfavorable exchange impact of a stronger U.S. dollar in 1997 and a weak economic environment which led to lower consumer spending and higher unemployment. Excluding the impact of foreign currency exchange, sales in Europe increased 11% over 1996. The increase in operating profit was mainly due to the overall sales increase and an improved gross margin in the United Kingdom resulting from a favorable product mix of higher-margin items in 1997. Additionally, the continued effect of expense reduction efforts in Europe contributed to a lower operating expense ratio.

See Foreign Operations section under Liquidity and Capital Resources for additional discussion.

Global Expenses > Global expenses were \$224.5 in 1998 compared with \$191.5 in 1997. The \$33.0 increase reflected increased expenses in 1998 associated with information technology system and global marketing initiatives and higher expenses for incentive compensation programs primarily due to the improved operating results in 1998. In 1997, global expenses were \$16.8 unfavorable compared with 1996 primarily due to process redesign and system initiatives.

Accounting Changes > Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards ("FAS") No. 130, "Reporting Comprehensive Income". This statement establishes standards for the reporting and presentation of comprehensive income and its components in a full set of financial statements. As shown in the statements of changes in shareholders' equity and Note 5 of the Notes to Consolidated Financial Statements, comprehensive income includes all changes in equity during a period, except those resulting from investments by and distributions to the Company's stockholders. As this standard only requires additional information in the financial statements, it does not affect the Company's results of operations or financial position.

Effective January 1, 1998, the Company adopted FAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", which changes the way the Company reports information about its operating segments. The information for 1997 and 1996 has been restated from that previously reported in order to conform with the current year's presentation. FAS No. 131 requires a new basis, entitled the management approach, for determining reportable segments. This approach is based on the way management organizes segments within a company for making operating decisions and assessing performance. FAS No. 131 also establishes standards for supplemental disclosure about products and services, geographical areas and major customers. Segment results for the three years ended December 31, 1998 are presented in Note 11 of the Notes to Consolidated Financial Statements.

Effective January 1, 1998, the Company adopted FAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits". FAS No. 132 standardizes the disclosure requirements for pensions and other postretirement benefits, although it does not impact the measurement or recognition of those benefits. There was no impact on the Company's results of operations or financial position in adopting this statement. Prior years' information has been restated to conform with the requirements of FAS No. 132.

Effective January 1, 1998, the Company adopted AICPA Statement of Position ("SOP") No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". SOP No. 98-1 requires certain costs in connection with developing or obtaining internally used software to be capitalized that previously would have been expensed as incurred. The adoption of SOP No. 98-1 did not have a material impact on the Company's results of operations, financial position or cash flows.

Effective December 31, 1997, the Company adopted FAS No. 128, "Earnings per Share". FAS No. 128 establishes standards for computing and presenting earnings per share ("EPS") and replaces the presentation of previously disclosed EPS with both basic and diluted EPS. Based upon the Company's capitalization structure,

the EPS amounts calculated in accordance with FAS No. 128 approximated the Company's EPS amounts in accordance with Accounting Principles Board Opinion No. 15, "Earnings per Share". All prior period EPS data have been restated in accordance with FAS No. 128.

Effective January 1, 1996, the Company adopted the fair value disclosure requirements of FAS No. 123, "Accounting for Stock-Based Compensation". As permitted by the statement, the Company did not change the method of accounting for its employee stock compensation plans. See Note 8 of the Notes to Consolidated Financial Statements for the fair value disclosures required under FAS No. 123.

Recent Pronouncements > In June 1998, the Financial Accounting Standards Board issued FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". FAS No. 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999 (January 1, 2000 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 will be 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 instruments 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 results of operations or financial position.

Contingencies > Although Avon has completed its divestiture of all discontinued operations, various lawsuits and claims (asserted and unasserted) are pending or threatened against Avon. The Company is also involved in a number of proceedings arising out of the federal Superfund law and similar state laws. In some instances, Avon, along with other companies, has been designated as a potentially responsible party which may be liable for costs associated with these various hazardous waste sites. 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 December 31, 1998 should not have a material adverse impact on Avon's consolidated financial position, results of operations or cash flows.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows > Net cash provided by continuing operations was \$324.4 in 1998 compared to \$315.5 in 1997. The 1998 increase principally reflects, among other things, a lower working capital level partially offset by lower adjusted net income. The lower funding of working capital included the 1997 settlement of tax issues in the U.S. A more detailed analysis of the individual items contributing to the 1998 and 1997 amounts is included in the Consolidated Statements of Cash Flows.

There was no cash used by discontinued operations in 1998 and 1997, compared to \$38.2 in 1996. The \$38.2 cash used in 1996 primarily reflected final payment of a settlement reached with a discontinued operation, Mallinckrodt, in December 1995.

Excluding changes in debt and other financing activities, net cash usage of \$117.6 in 1998 was \$19.7 favorable compared to net cash usage of \$137.3 in 1997. During 1998 and 1997, the Company received net proceeds of approximately \$58.1 and \$58.6, respectively, under securities lending transactions which were used to repay domestic commercial paper borrowings and are included in the cash flows as other financing activities. See Note 4 of the Notes to Consolidated Financial Statements for further discussion of these transactions. The \$19.7 variance reflects a favorable exchange rate impact on cash and higher cash provided by continuing operations. These sources were partially offset by higher capital expenditures and increased dividend payouts in 1998. In 1997, excluding changes in debt and other financing activities, there was a net increase in cash usage of \$130.7. This variance reflected lower cash provided by continuing operations, higher capital expenditures and an unfavorable exchange rate impact on cash. These uses were partially offset by the unfavorable impact of discontinued operations reflected in 1996 cash flows and lower repurchases of common stock in 1997. For the period 1994 through 1998, 32.1 million shares of common stock have been purchased for approximately \$641.5 under the stock repurchase programs. See Note 9 of the Notes to

Consolidated Financial Statements for further details of the stock repurchase programs.

Working Capital > At December 31, 1998, current assets exceeded current liabilities by \$11.9 while at the end of 1997, current liabilities exceeded current assets by \$11.9. This increase of \$23.8 is primarily due to lower net debt (debt less cash and equivalents) which resulted from the repayment of \$100.0 reclassified as short-term debt in 1997 on the 6-1/8% deutsche mark notes and lower accounts payable. In addition, higher receivables, partially offset by lower inventory levels, as discussed in the Inventories section, and higher accrued compensation resulting from increased incentive compensation expense in 1998 also contributed to the variance.

Avon's liquidity results from its ability to generate significant cash flows from operations and its ample unused borrowing capacity. Avon's credit agreements do not contain any provisions or requirements with respect to working capital.

Capital Resources > Total debt of \$256.3 at December 31, 1998 increased \$22.0 from \$234.3 at December 31, 1997, compared with an increase of \$32.7 from December 31, 1996. In addition, at December 31, 1998 and 1997, other non-current liabilities included approximately \$112.4 and \$58.1, respectively, related to securities lending activities. See Note 4 of the Notes to Consolidated Financial Statements for further discussion of these activities. During 1998 and 1997, cash flows from continuing operations and other financing activities combined with cash on hand and higher debt levels were used for dividends, repurchase of common stock and capital expenditures. During 1996, cash flows from continuing operations and higher debt levels, partially offset by higher cash and equivalents, were used for dividends, the stock repurchase program, capital expenditures, a payment made related to discontinued operations and the purchase of a company in South Africa.

At December 31, 1998, debt maturing within one year consists of borrowings from banks of \$53.9 and the current maturities of long-term debt of \$1.4. Management believes that cash from operations and available sources of financing are adequate to meet anticipated requirements for working capital, dividends, capital expenditures, the stock repurchase program and other cash needs.

In May 1998, Avon issued \$100.0 of bonds embedded with option features (the "bonds") to pay down commercial paper borrowings. The bonds have a twenty-year maturity; however, after five years, the bonds, at the holder's option, can be sold back to the Company at par or can be called at par by the underwriter and resold to investors as fifteen-year debt. The coupon rate on the bonds is 6.25% for the first five years, but will be refinanced at market rates if the bonds are called in year five.

In connection with the bond issuance, Avon entered into a five-year interest rate swap contract with a notional amount of \$50.0 to effectively convert fixed interest on a portion of the bonds to a variable interest rate, based on LIBOR.

During 1997, the Company issued \$100.0 of 6.55% notes, due August 1, 2007 to pay down commercial paper borrowings.

During 1996, the Company entered into an agreement, which expires in 2001, with various banks to amend and restate the five-year, \$600.0 revolving credit and competitive advance facility agreement. Within this facility, the Company is able to borrow, on an uncommitted basis, various foreign currencies. The new agreement and the prior agreement are referred to, collectively, as the credit facility.

The credit facility is primarily to be used to finance working capital, provide support for the issuance of commercial paper and support the stock repurchase program. At the Company's option, the interest rate on borrowings under the credit facility is based on LIBOR, prime or federal fund rates. The credit facility has an annual facility fee of \$.4. The credit facility contains a covenant for interest coverage, as defined. The Company is in compliance with this covenant. There were no borrowings outstanding at December 31, 1998 and 1997.

The Company has uncommitted lines of credit available of \$65.0 with various banks which have no compensating balances or fees. As of December 31, 1998 and 1997, there were no borrowings under lines of credit or bankers' acceptance facilities. In addition, as of December 31, 1998 and 1997, there were international lines of credit totaling \$329.5 and \$295.8, respectively, of which \$53.9 and \$29.4 were outstanding, respectively. There were no compensating balances or fees under these facilities.

Inventories > Avon's products are marketed during twelve to twenty-six individual sales campaigns each year. Each campaign is conducted using a brochure offering a wide assortment of products, many of which change from campaign to campaign. It is necessary for Avon to maintain relatively high inventory levels as a result of the nature of its business, including the number of campaigns conducted annually and the large number of products marketed. Avon's operations have a seasonal pattern characteristic of many companies selling CFT, fashion jewelry and accessories, gift and decorative items and apparel. Christmas sales cause a peak in the fourth quarter which results in the build up of inventory at the end of the third quarter. Inventory levels are then sharply reduced by the end of the

fourth quarter. Inventories of \$538.4 at December 31, 1998 were \$26.4 lower than 1997 due mainly to reduced inventory levels in the U.S. The decrease in the U.S. results from improvements in CFT related to the implementation of supply chain initiatives which resulted in reduced cycle times, reorder quantity and overstocking as well as lower component prices. In addition, write-downs in fashion jewelry and accessories and apparel associated with the Company's business process redesign program contributed to the decrease. See Note 13 of the Notes to Consolidated Financial Statements for further discussion of the business process redesign program. It is Avon's objective to continue to manage purchases and inventory levels maintaining the focus of operating the business at efficient inventory levels. However, the addition or expansion of product lines such as apparel, jewelry and impulse gift items, products that are subject to changing fashion trends and consumer tastes, as well as planned expansion in high growth markets, may cause the inventory levels to grow periodically.

Capital Expenditures > Capital expenditures during 1998 were \$189.5 (1997 - \$169.4). These expenditures were made for capacity expansion in high growth markets, maintenance of worldwide facilities, contemporization and replacement of information systems, supply chain initiatives in the U.S. and for shipping and other customer service improvements, primarily in the United Kingdom and Brazil. Numerous construction and information systems projects were in progress at December 31, 1998 with an estimated cost to complete of approximately \$87.4. Capital expenditures in 1999 are currently expected to be in the range of \$200.0 - \$220.0. These expenditures will include improvements on existing facilities, continued investments for capacity expansion in high growth markets, facility modernization, information systems and equipment replacement projects.

Foreign Operations > The Company derived approximately 60% of its 1998 consolidated net sales and consolidated operating profit from operations from its subsidiaries outside of North America. In addition, as of December 31, 1998, these subsidiaries comprised approximately 53% of the Company's consolidated total assets.

Avon's operations in many countries utilize numerous currencies. Avon has significant net assets in Brazil, the United Kingdom, Japan, Argentina, Germany and the Philippines. Changes in the value of these countries' currencies relative to the U.S. dollar result in direct charges or credits to equity. Effective January 1, 1997, Mexico was designated as a country with a highly inflationary economy due to the cumulative inflation rates over the three year period 1994-1997. However, Mexico will be converted to non-hyper inflationary status effective January 1, 1999 due to reduced cumulative inflation rates over the past three years.

The Russian ruble devalued significantly in August 1998. In response to this situation, several actions have been taken by local management including pricing flexibility to maintain and build market share, the reduction of credit sales as well as a tightening of expense controls. The devaluation negatively affected Russia's U.S. dollar results in 1998. In terms of size, Russia's 1998 net sales represented approximately 1% of Avon's consolidated net sales. Avon's results continue to be negatively impacted by the Asian currency and economic crisis which began in mid-1997.

On April 21, 1998, the Chinese government issued a directive banning all direct selling in China resulting in the shutdown of the Company's sales operations for most of the second quarter. As of the beginning of June, the Company received Chinese governmental approval to resume operations as a wholesale and retail business and became operational again on June 15, 1998. The Company converted its 75 branches into retail outlets to serve customers. During the end of the second quarter of 1998, Avon received government approval to utilize sales promoters, much like Representatives, to promote product sales in China.

Avon's well diversified global portfolio of businesses has demonstrated that the effects of weak economies and currency fluctuations in certain countries may be offset by strong results in others. Fluctuations in the value of foreign currencies cause U.S. dollar-translated amounts to change in comparison with previous periods. Accordingly, Avon cannot project in any meaningful way the possible effect of such fluctuations upon translated amounts or future earnings. This is due to the large number of currencies involved, the constantly changing exposure in these currencies, the complexity of intercompany relationships, the hedging activity entered into in an attempt to minimize certain of the effects of exchange rate changes where economically feasible and the fact that all foreign currencies do not react in the same manner against the U.S. dollar.

Certain of the Company's financial instruments, which are discussed below under Risk Management Strategies and Market Rate Sensitive Instruments and in Note 7 of the Notes to the Consolidated Financial Statements, are used to hedge various amounts relating to certain international subsidiaries. However, the Company's foreign currency hedging activities are not significant when compared to the Company's international financial position or results of operations.

Some foreign subsidiaries rely primarily on borrowings from local commercial banks to fund working capital needs created by their highly seasonal sales pattern. From time to time, when tax and other considerations dictate, Avon will finance subsidiary working capital needs or borrow foreign currencies. At December 31, 1998, the total indebtedness of foreign subsidiaries was \$55.6.

It is Avon's policy to remit all the available cash (cash in excess of working capital requirements, having no legal restrictions and not considered permanently reinvested) of foreign subsidiaries as rapidly as is practical. During 1998, these subsidiaries remitted, net of taxes, \$340.2 in dividends and royalties. This sum is a substantial portion of the 1998 consolidated net earnings of Avon's foreign subsidiaries.

Risk Management Strategies and Market Rate Sensitive

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

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 and intercompany foreign currency transactions. The Company regularly monitors its foreign currency exposures and ensures that hedge contract amounts do not exceed the amounts of the underlying exposures.

At December 31, 1998, the Company held foreign currency forward contracts with notional amounts totaling \$285.9 and option contracts with notional amounts totaling \$32.6 to hedge foreign currency items. Only \$7.3 of these contracts have maturities after December 31, 1999. Also outstanding in 1998 were foreign currency forward contracts totaling \$45.0 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 December 31, 1998 was insignificant.

At December 31, 1998, the Company has entered into forward contracts to purchase approximately 3,469,200 shares of Avon common stock at an average price of \$36.31 per share at December 31, 1998. The contracts mature over the next three 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.

Non-performance of the counterparties to the balance of all the currency and interest rate swap agreements would not result in a significant write off at December 31, 1998. Each agreement provides for the right of offset between counterparties to the agreement. In addition, Avon may be exposed to market risk on its foreign exchange and interest rate swap agreements as a result of changes in foreign exchange and interest rates. The market risk related to the foreign exchange agreements should be substantially offset by changes in the valuation of the underlying items being hedged.

The Company is exposed to changes in financial market conditions in the normal course of its operations primarily due to international businesses and transactions denominated in foreign currencies and the use of various financial instruments to fund ongoing activities.

Various derivative and non-derivative financial instruments held by the Company are sensitive to changes in interest rates. These financial instruments are either discussed above or in Notes 4 and 7 of the Notes to Consolidated Financial Statements. Interest rate changes would result in gains or losses in the fair value of debt and other financing instruments held by the Company. Based on the outstanding balance of all instruments at December 31, 1998, a hypothetical 50 basis point increase or decrease in interest rates prevailing at this date, sustained for one year, would not represent a material potential loss in fair value, earnings or cash flows. This potential loss was calculated based on discounted cash flow analyses using interest rates comparable to the Company's current cost of debt. In 1998, the Company did not experience a material loss in fair value, earnings or cash flows associated with changes in interest rates.

The Company also engages in various hedging activities in order to reduce potential losses due to foreign currency risks. Consistent with the nature of the economic hedge of such foreign exchange contracts, any unrealized gain or loss would be offset by corresponding decreases or increases, respectively, of the underlying instrument or transaction being hedged. These financial instruments are discussed above and in Note 7 of the Notes to Consolidated Financial Statements. Based on the Company's foreign exchange

contracts at December 31, 1998, the impact of a 10% appreciation or 10% depreciation of the U.S. dollar against the Company's foreign exchange contracts would not represent a material potential loss in fair value, earnings or cash flows. This potential loss does not consider the underlying foreign currency transaction or translation exposures of the Company. The hypothetical impact was calculated on the combined option and forward positions using forward rates at December 31, 1998 adjusted for an assumed 10% appreciation or 10% depreciation of the U.S. dollar against the foreign contracts. The impact of payoffs on option contracts is not significant to this calculation. Additionally, any foreign currency risk associated with the foreign denominated debt instrument was assumed to be offset by a related currency exchange swap contract. In 1998, foreign exchange losses associated with the Company's foreign exchange contracts did not represent a material loss in fair value, earnings or cash flows.

As of December 31, 1998, the primary currencies for which the Company has net underlying foreign currency exchange rate exposure are the U.S. dollar versus the Argentine peso, Brazilian real, British pound, Canadian dollar, German mark, Japanese yen and the Mexican peso. The Company is also exposed to other South American and Asian currencies.

The Company does not hedge its foreign currency exposure in a manner that would entirely eliminate the effect of changes in foreign exchange rates on the Company's consolidated financial position, results of operations and cash flows. The impact of a 10% appreciation or 10% depreciation of the U.S. dollar against the Company's net underlying foreign currency transaction and translation exposures could be significant.

OTHER INFORMATION

On October 23, 1997, the Company announced that it raised its long-term growth targets for sales and earnings per share and that it expects to record special charges in connection with a major business process redesign program. Commencing in 1998, the long-term target for sales growth has been raised to 8-10% compounded annually, and its target for earnings per share growth has been raised to 16-18% annually. Previously, the Company targeted long-term sales growth of 6-8% and long-term earnings per share growth of 13-15%. The higher targets come largely as a result of initiatives currently underway and others under review intended to reduce costs by up to \$400.0 a year by 2000, with \$200.0 of the savings being reinvested concurrently in advertising and marketing programs to boost sales. In the first quarter of 1998, the Company recorded \$108.4 pretax of such one-time charges (\$84.2 after tax, or \$.32 per share on a basic and diluted basis) in connection with the business process redesign program. Slightly more than half of

the total pretax charges in the first quarter were to be cash related with payments in 1998 and 1999. In the third quarter of 1998, the Company recorded additional special charges for business redesign efforts totaling \$46.0 pretax (\$38.6 after tax, or \$.14 per share on a basic and diluted basis). Approximately 70% of the third quarter pretax charges were to be cash related with payments in 1998 and 1999. At December 31, 1998, the remaining liability balance was \$28.5 and relates primarily to severance costs that will be paid during 1999. The Company expects to record the balance of one-time charges in 1999.

EURO

A single currency called the euro was introduced in Europe on January 1, 1999. Eleven of the fifteen member countries of the European Union adopted the euro as their common legal currency on that date. Fixed conversion rates between these participating countries' existing currencies (the "legacy currencies") and the euro were established as of that date. The legacy currencies are scheduled to remain legal tender as denominations of the euro until June 30, 2002. 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, and legacy currencies will be withdrawn from circulation.

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 UPDATE

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

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

Project Plan > The Company's Year 2000 project plan is divided into four major sections, including: Infrastructure, Application 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 completed all phases through remediation and has progressed to the validation testing phase. All Infrastructure activities are expected to be completed by June 1999.

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, is ongoing and is anticipated to be completed by June 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 May 1999. Follow-up reviews will also be scheduled for the remainder of 1999.

The Embedded Systems section includes all hardware, software and associated embedded computer chips that are utilized in operating and maintaining the internal functions of the Company's facilities, i.e. climate control systems. The Company has elected to employ a regional-based strategy for addressing Year 2000 compliance of its embedded systems. Avon U.S. operations have substantially completed the remediation of embedded systems and anticipate all repair and testing to be completed by March 1999. From an international standpoint, the Company is in the process of inventorying material items that are not Year 2000 compliant and expects the assessment phase to be completed by July 1999, with all remediation testing scheduled to be completed by year-end 1999.

Costs > The total estimated cost associated with achieving worldwide Year 2000 compliance will be approximately \$29.4, of which \$17.0 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 will be developed in detail during 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 "Forward-Looking Statement".

RESULTS OF OPERATIONS BY QUARTER

Avon Products, Inc.

All share and per share data shown below have been restated to reflect two-for-one stock splits which were distributed in September 1998 and June 1996.

In millions, except per share data	First	Second	Third	Fourth	Year
1998					
Net sales	\$1,183.4	\$1,247.2	\$1,233.2	\$1,548.9	\$5,212.7
Gross profit*	680.3	781.6	755.0	942.8	3,159.7
Special charges	70.5	—	46.0	—	116.5
Operating (loss) profit	(16.3)	178.6	82.7	234.5	479.5
(Loss)income before taxes and minority interest	(26.6)	173.6	76.5	232.4	455.9
(Loss)income before minority interest	(32.7)	109.7	39.8	148.3	265.1
Net (loss)income	\$ (31.0)	\$ 111.4	\$ 41.5	\$ 148.1	\$ 270.0
(Loss)earnings per share:					
Basic	\$ (.12)	\$.42	\$.16	\$.56	\$ 1.03 ⁽¹⁾
Diluted	\$ (.12)	\$.42	\$.16	\$.56	\$ 1.02 ⁽¹⁾

*First quarter includes a one-time charge of \$37.9 for inventory write-downs.

1997					
Net sales	\$1,087.6	\$1,225.0	\$1,249.4	\$1,517.4	\$5,079.4
Gross profit	646.0	748.9	732.2	901.3	3,028.4
Operating profit	73.1	157.0	117.5	196.5	544.1
Income before taxes and minority interest	63.0	150.5	107.9	213.5	534.9
Income before minority interest	39.7	94.8	68.0	134.5	337.0
Net income	\$ 41.3	\$ 95.2	\$ 68.6	\$ 133.7	\$ 338.8
Earnings per share:					
Basic	\$.16	\$.36	\$.26	\$.51	\$ 1.28 ⁽¹⁾
Diluted	\$.15	\$.36	\$.26	\$.50	\$ 1.27 ⁽¹⁾

(1) The sum of per share amounts for the quarters does not necessarily equal that for the year because the computations are made independently.

MARKET PRICES PER SHARE OF COMMON STOCK BY QUARTER

Quarter	1998		1997	
	High	Low	High	Low
First	\$40.63	\$28.00	\$31.81	\$26.06
Second	44.50	36.94	37.00	25.31
Third	44.31	25.00	39.00	29.25
Fourth	46.25	25.75	38.38	27.75

Avon common stock is listed on the New York Stock Exchange. At December 31, 1998, there were 23,375 shareholders of record. The Company believes that there are over 60,000 additional shareholders who are not "shareholders of record" but who beneficially own and vote shares through nominee holders such as brokers, benefit plan trustees, etc. Dividends of \$.68 per share, or \$.17 per share each quarter, were declared and paid in 1998. Dividends of \$.63 per share, or \$.1575 per share each quarter, were declared and paid in 1997.

CONSOLIDATED STATEMENTS OF INCOME

Avon Products, Inc.

In millions, except per share data

Years ended December 31

	1998	1997	1996
Net sales	\$5,212.7	\$5,079.4	\$4,814.2
Costs, expenses and other:			
Cost of sales**	2,053.0	2,051.0	1,921.2
Marketing, distribution and administrative expenses	2,563.7	2,484.3	2,348.2
Special charges	116.5	—	—
Operating profit	479.5	544.1	544.8
Interest expense	41.0	41.8	40.0
Interest income	(15.9)	(16.7)	(14.5)
Other (income) expense, net	(1.5)	(15.9)	8.9
Total other expenses	23.6	9.2	34.4
Income before taxes and minority interest	455.9	534.9	510.4
Income taxes	190.8	197.9	191.4
Income before minority interest	265.1	337.0	319.0
Minority interest	4.9	1.8	(1.1)
Net income	\$ 270.0	\$ 338.8	\$ 317.9
Earnings per share:			
Basic	\$ 1.03	\$ 1.28*	\$ 1.19*
Diluted	\$ 1.02	\$ 1.27*	\$ 1.18*

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

**1998 includes a one-time charge of \$37.9 for inventory write-downs.

The accompanying notes are an integral part of these statements.

CONSOLIDATED BALANCE SHEETS

Avon Products, Inc.

In millions, except share data

December 31	1998	1997
Assets		
Current assets		
Cash, including cash equivalents of \$59.7 and \$60.0	\$ 105.6	\$ 141.9
Accounts receivable (less allowance for doubtful accounts of \$49.0 and \$35.5)	492.6	444.8
Inventories	538.4	564.8
Prepaid expenses and other	204.8	192.5
Total current assets	\$1,341.4	\$1,344.0
Property, plant and equipment, at cost		
Land	51.4	48.6
Buildings and improvements	613.0	567.0
Equipment	728.4	666.0
	1,392.8	1,281.6
Less accumulated depreciation	722.9	670.6
	669.9	611.0
Other assets	422.2	317.9
Total assets	\$2,433.5	\$2,272.9
Liabilities and Shareholders' Equity		
Current liabilities		
Debt maturing within one year	\$ 55.3	\$ 132.1
Accounts payable	416.9	476.0
Accrued compensation	161.3	111.3
Other accrued liabilities	308.2	268.9
Sales and taxes other than income	106.2	101.0
Income taxes	281.6	266.6
Total current liabilities	\$1,329.5	\$1,355.9
Long-term debt	201.0	102.2
Employee benefit plans	390.0	367.6
Deferred income taxes	36.3	31.2
Other liabilities (including minority interest of \$36.1 and \$37.5)	191.6	131.0
Commitments and contingencies (Note 14)		
Shareholders' equity		
Common stock, par value \$.25 – authorized: 400,000,000 shares; issued 351,314,366 and 174,711,173 shares	87.8	43.7
Additional paid-in capital	780.0	733.1
Retained earnings	719.1	660.9
Accumulated other comprehensive income	(301.3)	(270.3)
Treasury stock, at cost – 88,793,640 and 42,897,463 shares	(1,000.5)	(882.4)
Total shareholders' equity	285.1	285.0
Total liabilities and shareholders' equity	\$2,433.5	\$2,272.9

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Avon Products, Inc.

In millions

Years ended December 31

	1998	1997	1996
Cash flows from operating activities			
Net income	\$ 270.0	\$ 338.8	\$ 317.9
Adjustments to reconcile income to net cash provided by continuing operations:			
Depreciation and amortization	72.0	72.1	64.5
Provision for doubtful accounts	91.3	80.8	79.0
Translation gains	(7.2)	(1)	(2)
Deferred income taxes	(13.0)	18.0	(7)
Special charges	88.5	—	—
Other	3.9	9.4	9.9
Changes in assets and liabilities:			
Accounts receivable	(157.6)	(121.4)	(125.5)
Inventories	(17.2)	(67.5)	(65.4)
Prepaid expenses and other	(4.0)	6.7	13.7
Accounts payable and accrued liabilities	13.0	42.9	97.8
Income and other taxes	19.5	(56.1)	57.7
Noncurrent assets and liabilities	(34.8)	(8.1)	(23.6)
Net cash provided by continuing operations	324.4	315.5	425.1
Net cash used by discontinued operations	—	—	(38.2)
Net cash provided by operating activities	324.4	315.5	386.9
Cash flows from investing activities			
Capital expenditures	(189.5)	(169.4)	(103.6)
Disposal of assets	5.8	3.3	3.3
Acquisitions of subsidiary stock and other investing activities	1.4	(9.0)	(6.3)
Net cash used by investing activities	(182.3)	(175.1)	(106.6)
Cash flows from financing activities			
Cash dividends	(180.6)	(168.3)	(158.1)
Debt, net (maturities of three months or less)	(96.1)	(39.8)	17.8
Proceeds from short-term debt	54.7	25.7	37.5
Retirement of short-term debt	(34.9)	(49.0)	(14.1)
Proceeds from long-term debt	100.1	100.0	—
Retirement of long-term debt	(.6)	(.8)	(1.5)
Proceeds from exercise of stock options, net of taxes	24.0	20.6	10.0
Repurchase of common stock	(107.8)	(110.8)	(127.8)
Other financing activities	58.1	58.6	—
Net cash used by financing activities	(183.1)	(163.8)	(236.2)
Effect of exchange rate changes on cash and equivalents	4.7	(19.2)	(11.0)
Net (decrease)increase in cash and equivalents	(36.3)	(42.6)	33.1
Cash and equivalents at beginning of year	141.9	184.5	151.4
Cash and equivalents at end of year	\$ 105.6	\$ 141.9	\$ 184.5
Cash paid for			
Interest	\$ 39.2	\$ 36.0	\$ 35.2
Income taxes, net of refunds received	188.5	215.8	158.9

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Avon Products, Inc.

In millions, except share data	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
	Shares	Amount					
Balance at December 31, 1995	173,498,112	\$ 43.4	\$ 672.9	\$ 325.8	\$ (202.1)	\$ (647.3)	\$ 192.7
Comprehensive income:							
Net income				317.9			317.9
Foreign currency translation adjustments					(8.6)		(8.6)
Total comprehensive income							309.3
Dividends – \$1.16 per share				(154.9)			(154.9)
Exercise of stock options, including tax benefits	423,267	.1	15.6				15.7
Grant, cancellation and amortization of restricted stock	36,000		2.7				2.7
Repurchase of common stock						(127.8)	(127.8)
Benefit plan contributions			2.4			1.6	4.0
Balance at December 31, 1996	173,957,379	43.5	693.6	488.8	(210.7)	(773.5)	241.7
Comprehensive income:							
Net income				338.8			338.8
Foreign currency translation adjustments					(59.6)		(59.6)
Total comprehensive income							279.2
Dividends – \$1.26 per share				(166.7)			(166.7)
Exercise of stock options, including tax benefits	713,298	.2	30.3				30.5
Grant, cancellation and amortization of restricted stock	40,496		4.6				4.6
Repurchase of common stock						(110.8)	(110.8)
Benefit plan contributions			4.6			1.9	6.5
Balance at December 31, 1997	174,711,173	43.7	733.1	660.9	(270.3)	(882.4)	285.0
Comprehensive income:							
Net income				270.0			270.0
Foreign currency translation adjustments					(15.6)		(15.6)
Minimum pension liability adjustment					(15.4)		(15.4)
Total comprehensive income							239.0
Dividends – \$.68 per share				(178.9)			(178.9)
Two-for-one stock split effected in the form of a stock dividend from retained earnings (Note 9)	175,419,475	43.9		(32.9)		(11.0)	—
Exercise of stock options, including tax benefits	916,102	.2	38.2				38.4
Grant, cancellation and amortization of restricted stock	267,616		7.1				7.1
Repurchase of common stock						(107.8)	(107.8)
Benefit plan contributions			1.6			.7	2.3
Balance at December 31, 1998	351,314,366	\$ 87.8	\$ 780.0	\$ 719.1	\$ (301.3)	\$ (1,000.5)	\$ 285.1

The accompanying notes are an integral part of these statements.