



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Avon Products, Inc.
In millions, except share data

1 DESCRIPTION OF THE BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS

Avon Products, Inc. ("Avon" or "Company") is a global manufacturer and marketer of beauty and related products. The product categories include cosmetics, fragrance and toiletries; gift and decorative; apparel; and fashion jewelry and accessories. Avon's business is comprised of one industry segment, direct selling, which is conducted in North America, Latin America, the Pacific and Europe. Sales are made to the ultimate customers principally by independent Avon Representatives.

SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation > The consolidated financial statements include the accounts of Avon and its majority and wholly-owned subsidiaries. Intercompany balances and transactions are eliminated. 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.

Foreign Currency > The Company has operations in various countries around the world. Fluctuations in the value of foreign currencies cause U.S. dollar-translated amounts to change in comparison with previous periods. Accordingly, the Company 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.

Financial statements of foreign subsidiaries operating in other than highly inflationary economies are translated at year-end exchange rates for assets and liabilities and average exchange rates prevailing during the year for income and expense accounts. Translation adjustments of these subsidiaries are recorded within accumulated other comprehensive income.

For financial statements of subsidiaries operating in highly inflationary economies, nonmonetary assets (principally inventories and fixed assets) and the related expenses (principally cost of sales and depreciation) are translated at the respective historical exchange rates in effect when the assets were acquired or when the subsidiary was designated as operating in a highly inflationary economy. Monetary assets and liabilities are translated at year-end exchange rates. All other income and expense accounts are translated at average exchange rates prevailing during the year. Adjustments resulting from the translation of the financial statements of these subsidiaries are included in income.

Revenue Recognition > Avon recognizes revenue as shipments are made and title passes to independent Representatives, who are Avon's customers.

Cash and Equivalents > Cash equivalents are stated at cost plus accrued interest, which approximates fair value. Cash equivalents are highly liquid debt instruments with an original maturity of three months or less and consist of time deposits with a number of U.S. and non-U.S. commercial banks with high credit ratings. In accordance with Avon's policy, the maximum amount invested in any one bank is limited. Avon believes it is not exposed to any significant credit risk regarding cash and equivalents.

Inventories > Inventories are stated at the lower of cost or market. Cost is determined using the last-in, first-out ("LIFO") method for substantially all U.S. inventories, except apparel, and the first-in, first-out method for all other inventories.

Depreciation > Substantially all buildings, improvements and equipment are depreciated using the straight-line method over estimated useful lives. Estimated useful lives for buildings and improvements range from 20 to 45 years and equipment range from 3 to 15 years.

Other Assets > Systems development costs related to the development of major information and accounting systems are capitalized and amortized over the estimated useful life of the related project, not to exceed five years.

Stock Options > Compensation cost is recognized for fixed price options using the intrinsic value method. Under this method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock.

Financial Instruments > Derivative financial instruments are used by the Company in the management of its interest rate and foreign currency exposures and are accounted for on an accrual basis. Gains and losses resulting from effective hedges of existing assets, liabilities and firm commitments are deferred as other assets or liabilities and recognized when the offsetting gains and losses are recognized on the related hedged items. Income and expense are recorded in the same category as that arising from the related asset or liability being hedged. Items which do not qualify for hedge accounting are marked to market with the resulting gain or loss recognized in other (income) expense, net. Gains realized on termination of interest rate swap contracts are deferred and amortized over the remaining terms of the original swap agreements. Costs of interest rate cap contracts are amortized over the effective lives of the contracts if considered to be economic hedges; otherwise, they are marked to market.

The Company also uses financial instruments, principally forward contracts to purchase Avon common stock, to hedge certain employee benefit costs and the cost of the Company's share repurchase program. Contracts that require physical or net share settlement are initially measured at fair value with subsequent changes in fair value not recognized.

Research and Development > Research and development costs are expensed as incurred and aggregated in 1998 \$31.4 (1997 – \$29.9; 1996 – \$30.2).

Advertising > Advertising costs are expensed as incurred and aggregated in 1998 \$65.0 (1997 – \$64.5; 1996 – \$69.6).

Income Taxes > Deferred income taxes have been provided on items recognized for financial reporting purposes in different periods than for income tax purposes at future enacted rates.

U.S. income taxes have not been provided on approximately \$198.9 of undistributed income of subsidiaries that has been or is intended to be permanently reinvested outside the United States or is expected to be remitted free of U.S. income taxes. If such undistributed income was remitted, no substantial tax cost would be incurred.

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

For each of the three years ended December 31, the number of shares used in the computation of basic and diluted earnings per share are as follows:

	1998	1997	1996
Basic EPS			
Weighted-average shares	263.27	264.67	267.40
Incremental shares from conversion of:			
Stock options	2.68	2.33	1.86
Diluted EPS			
Adjusted weighted-average shares	265.95	267.00	269.26

Reclassifications > To conform to the 1998 presentation, certain reclassifications were made to the prior years' consolidated financial statements.

2 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, 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.

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, though 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 ("APB") 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 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.

3 INVENTORIES

Inventories at December 31 consisted of the following:

	1998	1997
Raw materials	\$ 140.6	\$ 147.4
Finished goods	397.8	417.4
Total	\$ 538.4	\$ 564.8

LIFO-based inventories at December 31, 1998 were \$135.3; (1997 - \$143.5) with the current estimated replacement cost exceeding the carrying value by approximately \$3.6 (1997 - \$15.2).

4 DEBT AND OTHER FINANCING

Debt at December 31 consisted of the following (see also Note 7 regarding financial instruments):

	1998	1997
Maturing within one year:		
Notes payable	\$ 53.9	\$ 29.4
Current portion of long-term debt	1.4	102.7
Total	\$ 55.3	\$ 132.1
Long-term debt:		
6.25% bonds, due 2018	\$ 100.0	\$ -
6.55% notes, due 2007	100.0	100.0
170 million 6-1/8% deutsche mark notes, due 1998 ⁽¹⁾	-	100.0
Other, payable to 2002 with interest from 7% to 31%	2.4	4.9
Less current portion	(1.4)	(102.7)
Total	\$ 201.0	\$ 102.2

(1) The deutsche mark notes ("Notes") were effectively converted into U.S. dollar debt through the use of a currency exchange swap contract which included both the principal and the interest. Reflected in the carrying value of the debt was a currency swap contract payable at December 31, 1997 of \$5.1.

Annual maturities of long-term debt for each of the next five years are: 1999 - \$1.4; 2000 - \$.6; 2001 - \$.2; 2002 - \$.1; and 2003 and beyond \$200.1.

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.

At December 31, 1998 and 1997, there were no borrowings outstanding under the credit facility.

The Company has bankers' acceptance facilities and uncommitted lines of credit available of \$65.0 (1997 – \$205.0) with various banks which have no compensating balances or fees. As of December 31, 1998 and 1997, there were no borrowings under either the bankers' acceptance facilities or uncommitted lines.

The maximum borrowings under these combined facilities during 1998 and 1997 were \$290.7 and \$409.3, respectively, and the annual average borrowings during each year were approximately \$205.7 and \$274.6, respectively, at average annual interest rates of approximately 4.8% and 5.2%, respectively.

At December 31, 1998 and 1997, international lines of credit totaled \$329.5 and \$295.8, respectively, of which \$53.9 and \$29.4 were outstanding, respectively. The maximum borrowings under these facilities during 1998 and 1997 were \$63.6 and \$38.8, respectively, and the annual average borrowings during each year were \$49.3 and \$33.8, respectively, at average annual interest rates of approximately 12.3% and 9.9%, respectively. Such lines have no compensating balances or fees.

At December 31, 1998 and 1997, Avon also has letters of credit outstanding totaling \$15.5 and \$15.5, respectively, which guarantee various insurance activities. In addition, Avon has outstanding letters of credit for various trade activities.

During 1998 and 1997, the Company entered into securities lending transactions resulting in the borrowing of securities which were subsequently sold for net proceeds approximating \$58.1 and \$58.6, respectively, used to repay commercial paper borrowings. The borrowed securities are due to the lender no later than December 29, 2000, but at the Company's option can be returned at any time. The obligations are included in other non-current liabilities on the balance sheet. The effective rates on the transactions are expected to be 5.5% and 6.5%, respectively.

5 COMPREHENSIVE INCOME

The following table reflects comprehensive income as of December 31:

	1998	1997	1996
Net income	\$270.0	\$338.8	\$317.9
Other comprehensive loss			
Change in equity due to foreign currency translation adjustments	(15.6)	(59.6)	(8.6)
Minimum pension liability adjustment	(15.4)	—	—
Comprehensive income	\$239.0	\$279.2	\$309.3

Accumulated other comprehensive income at December 31 consisted of the following:

	1998	1997
Foreign currency translation adjustments	\$ (285.9)	\$(270.3)
Minimum pension liability adjustments	(15.4)	—
Total	\$ (301.3)	\$(270.3)

6 INCOME TAXES

Deferred tax assets (liabilities) resulting from temporary differences in the recognition of income and expense for tax and financial reporting purposes at December 31 consisted of the following:

	1998	1997
Deferred tax assets:		
Postretirement benefits	\$ 82.0	\$ 69.3
Accrued expenses and reserves	58.7	44.0
Special and non-recurring charges	9.0	—
Employee benefit plans	54.5	40.0
Foreign operating loss carryforwards	29.1	32.5
Capital loss carryforwards	17.4	21.2
Postemployment benefits	11.0	10.6
All other	21.3	17.7
Valuation allowance	(46.9)	(55.7)
Total deferred tax assets	236.1	179.6
Deferred tax liabilities:		
Depreciation	(41.5)	(35.6)
Prepaid retirement plan costs	(55.2)	(52.4)
Capitalized interest	(10.6)	(13.5)
Unremitted foreign earnings	(17.4)	(12.0)
All other	(22.1)	(9.0)
Total deferred tax liabilities	(146.8)	(122.5)
Net deferred tax assets	\$ 89.3	\$ 57.1

Deferred tax assets (liabilities) at December 31 were classified as follows:

	1998	1997
Deferred tax assets:		
Prepaid expenses and other	\$ 86.9	\$ 76.5
Other assets	44.2	16.1
Total deferred tax assets	131.1	92.6
Deferred tax liabilities:		
Income taxes	(5.5)	(4.3)
Deferred income taxes	(36.3)	(31.2)
Total deferred tax liabilities	(41.8)	(35.5)
Net deferred tax assets	\$ 89.3	\$ 57.1

The valuation allowance primarily represents reserves for foreign operating loss and capital loss carryforwards. The basis used for recognition of deferred tax assets included the profitability of the operations and related deferred tax liabilities.

Income before taxes and minority interest for the years ended December 31 was as follows:

	1998	1997	1996
United States	\$ 74.2	\$ 153.6	\$ 171.3
Foreign	381.7	381.3	339.1
Total	\$ 455.9	\$ 534.9	\$ 510.4

The provision for income taxes for the years ended December 31 was as follows:

	1998	1997	1996
Federal:			
Current	\$ 16.7	\$ 5.4	\$ 30.9
Deferred	(10.4)	21.3	1.0
	6.3	26.7	31.9
Foreign:			
Current	176.2	169.7	152.4
Deferred	.9	(7.7)	(1.5)
	177.1	162.0	150.9
State and other:			
Current	10.9	4.8	8.8
Deferred	(3.5)	4.4	(.2)
	7.4	9.2	8.6
Total	\$190.8	\$197.9	\$191.4

The effective tax rate for the years ended December 31 was as follows:

	1998	1997	1996
Statutory federal rate	35.0%	35.0%	35.0%
State and local taxes, net of federal tax benefit	1.0	1.1	1.1
Tax-exempt operations	.8	(.5)	(.7)
Taxes on foreign income, including translation	9.5	5.3	6.3
Other	(4.4)	(3.9)	(4.2)
Effective tax rate	41.9%	37.0%	37.5%

During 1997, the Company reached final agreement with the Internal Revenue Service with respect to its examination of the Company's income tax returns for the years 1982 through 1989. As anticipated, payments, including related interest, made under this settlement were approximately \$42.4. Reserves previously had been provided by the Company related to the agreement.

In the fourth quarter of 1997, the Company recorded a benefit related to a value-added tax settlement in the United Kingdom totaling \$26.5, of which \$20.6 and \$5.9 have been reflected in other (income) expense, net and interest income, respectively.

At December 31, 1998, Avon had foreign operating loss carryforwards of approximately \$87.8. The loss carryforwards expiring between 1999 and 2006 were \$64.3 and the loss carryforwards which do not expire were \$23.5. Capital loss carryforwards, which expire between 1999 and 2001 and may be used to offset capital gains, if any, were approximately \$49.7 at December 31, 1998.

7 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk Management > The Company operates globally, with manufacturing and distribution facilities in various locations around the world. The Company may reduce its exposure to fluctuations in interest rates and foreign exchange rates by creating offsetting positions through the use of derivative financial instruments. The Company does not use derivative financial instruments for trading or speculative purposes, nor is the Company a party to leveraged derivatives.

The notional amount of forward exchange contracts and options is the amount of foreign currency bought or sold at maturity. The notional amount of interest rate swaps is the underlying principal amount used in determining the interest payments exchanged over the life of the swap. The notional amounts are not a direct measure of the Company's exposure through its use of derivatives.

Interest Rates > 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.

As discussed in Note 4, the Company 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 variable interest rate based on LIBOR.

Foreign Currencies > 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 (1997 – \$319.1) and option contracts with notional amounts totaling \$32.6 (1997 – \$80.0) to hedge foreign currency items. All except \$7.3 of these contracts have maturities prior to December 31, 1999. Additionally, the Company also held forward contracts with notional amounts totaling \$45.0 (1997 – \$44.2) which do not qualify as hedging transactions under the current accounting definitions and, accordingly, have been marked to market. The mark-to-market adjustments on these forward contracts at December 31, 1998 and 1997 were insignificant.

These forward and option contracts to purchase and sell foreign currencies, including cross-currency contracts to sell one foreign currency for another currency at December 31 are summarized below:

	1998		1997	
	Buy	Sell	Buy	Sell
Brazilian real	\$ —	\$ 45.0	\$ —	\$ —
British pound	37.9	57.7	29.1	56.5
Canadian dollar	—	39.1	—	30.8
Chinese renminbi	—	5.0	—	—
French franc	—	—	—	13.8
German mark	71.8	—	77.2	12.4
Indonesian rupiah	—	—	3.7	5.0
Irish punt	—	—	13.0	2.9
Italian lira	7.3	—	7.8	3.7
Japanese yen	1.5	67.3	12.0	53.3
Malaysian ringgit	—	—	—	6.0
Mexican peso	—	—	—	40.0
Philippine peso	—	—	—	15.0
Russian ruble	—	—	—	20.0
Spanish peseta	1.3	—	—	7.0
Taiwanese dollar	—	18.5	—	20.2
Thai baht	—	—	—	5.1
Other currencies	6.8	4.3	4.1	4.7
Total	\$ 126.6	\$ 236.9	\$ 146.9	\$ 296.4

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.

Credit and Market Risk > 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.

Fair Value of Financial Instruments > For purposes of the following disclosure, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. The aggregate fair value amounts presented are not intended to, and do not, represent the underlying fair value of Avon.

The methods and assumptions used to estimate fair value are as follows:

Grantor trust > The fair value of these investments, principally fixed income funds and equity securities, is based on the quoted market prices for issues listed on exchanges.

Debt maturing within one year and long-term debt and other financing > The fair value of all debt and other financing is estimated based on the quoted market prices for issues listed on exchanges.

Forward stock purchases and foreign exchange forward and option contracts > The fair value of forward and option contracts is estimated based on quoted market prices from banks.

Interest rate swap and currency swap agreements > The fair value of interest rate swap and currency swap agreements is estimated based on quotes from the market makers of these instruments and represents the estimated amounts that Avon would expect to receive or pay to terminate the agreements.

The asset and (liability) amounts recorded in the balance sheet (carrying amount) and the estimated fair values of financial instruments at December 31 consisted of the following:

	1998		1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and equivalents	\$ 105.6	\$ 105.6	\$ 141.9	\$ 141.9
Grantor trust	72.2	72.7	61.1	62.7
Debt maturing within one year	(55.3)	(55.3)	(127.0)	(127.6)
Long-term debt and other financing	(316.6)	(322.2)	(160.3)	(162.7)
Currency swap contract on long-term debt	—	—	(5.1)	(1.7)
Forward stock purchases and foreign exchange forward and option contracts	1.7	23.8	5.0	10.3
Interest rate swap receivable	.1	1.6	—	.1
Interest rate swap payable	—	—	(.7)	(2.2)

8 STOCK OPTION PLANS

A summary of the Company's stock option activity, weighted-average exercise price and related information for the years ended December 31 is as follows:

	1996		1997		1998	
	Shares (in 000's)	Weighted Average Price	Shares (in 000's)	Weighted Average Price	Shares (in 000's)	Weighted Average Price
Outstanding – beginning of year	4,818	\$14.23	5,750	\$16.28	7,070	\$22.29
Granted	1,788	19.81	2,860	30.68	1,664	32.40
Exercised	(846)	12.08	(1,426)	14.47	(1,412)	17.59
Forfeited	(10)	12.47	(114)	27.50	(195)	26.87
Outstanding – end of year	5,750	\$16.28	7,070	\$22.29	7,127	\$25.46
Options exercisable – end of year	1,150	\$13.02	1,360	\$15.27	2,943	\$18.74

Exercise prices for options outstanding as of December 31, 1998 consisted of 2,996,596 options at a price range of \$13 to \$23, 2,515,599 options at a price range of \$30 to \$32 and 1,614,678 options at a price range of \$31 to \$41, with weighted-average remaining contractual lives of approximately six years, seven years and nine years, respectively.

The 1993 Stock Incentive Plan ("1993 Plan") provides for several types of equity-based incentive compensation awards. Under the 1993 Plan, the maximum number of shares that may be awarded is 14,100,000 shares, of which no more than 8,000,000 shares may be used for restricted share and stock bonus grants. Awards, when made, may also be in the form of stock options, stock appreciation rights, dividend equivalent rights or performance unit awards. Stock options granted to officers and key employees shall be at a price no less than fair market value on the date the option is granted. During 1998, 1997 and 1996, restricted shares with aggregate value and vesting and related amortization periods were granted as follows: 1998 – 499,000 valued at \$16.0 vesting over one to three years; 1997 – 36,000 shares valued at \$1.2 vesting over one to three years; and 1996 – 78,000 shares valued at \$1.7 vesting over two to four years.

Effective January 1, 1997, the 1997 Long-Term Incentive Plan ("1997 LTIP") was authorized under the 1993 Plan. The 1997 LTIP provides for the grant of two forms of incentive awards, performance units for potential cash incentives and ten-year stock options. Performance units are earned over the three-year performance period (1997–1999), based on the degree of attainment of performance objectives. Options are awarded annually over the three-year performance period and vest in thirds over the three-year period following each option grant date. As discussed above, these options are granted at the fair market value on the date the option is granted.

Effective January 1, 1994, the 1994 Long-Term Incentive Plan ("1994 LTIP") was authorized under the 1993 Plan authorizing the grant of two forms of incentive awards, performance units for potential cash incentives and ten-year stock options. As of December 31, 1996, required performance goals under the 1994 LTIP were achieved and, accordingly, the cash incentives totaling \$31.0 were paid in early 1997.

Compensation expense under all plans in 1998 was \$17.8 (1997 – \$15.6; 1996 – \$14.7). The unamortized cost as of December 31, 1998 was \$10.5 (1997 – \$2.0). The accrued cost of the performance units in 1998 was \$24.1 (1997 – \$12.7).

The Company has adopted the disclosure provisions of FAS No. 123, but, as permitted by the statement, has continued to apply APB No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its employee stock option plans. Under APB No. 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

If the Company had elected to recognize compensation cost for the plans based on the fair value at the grant dates, consistent with the method prescribed by FAS No. 123, net income and earnings per share would have been the pro forma amounts indicated below:

	1998	1997	1996
Pro forma net income	\$263.0	\$332.5	\$314.9
Pro forma earnings per share:			
Basic	\$ 1.00	\$ 1.26	\$ 1.18
Diluted	\$.99	\$ 1.25	\$ 1.17

Pro forma information regarding net income and earnings per share is required by FAS No. 123, and has been determined as if the

Company had accounted for its employee stock options under the fair value method of FAS No. 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model which was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the expected stock price volatility. The weighted-average assumptions used for 1998 were the risk-free interest rate of approximately 5.5%; dividend yield of 2%; expected volatility of the market price of the Company's common stock of 25% to 30%; and a weighted-average expected life of the options of approximately five years. The weighted-average assumptions used for 1997 and 1996 were the risk-free interest rate of approximately 6.3% and 5.5%, respectively, dividend yield of 2% and 3%, respectively, expected volatility of the market price of the Company's common stock of 25% and 20%, respectively; and a weighted-average expected life of the options of approximately five and three years, respectively.

9 SHAREHOLDERS' EQUITY

Stock Split > On July 22, 1998, the Company declared a two-for-one stock split in the form of a 100% stock dividend which was distributed in September 1998 to shareholders of record as of the close of business on August 24, 1998. Accordingly, the stock split has been recognized by reclassifying the par value of the additional shares resulting from the split from retained earnings to common stock and treasury stock. The effect of this stock split was not retroactively reflected in the consolidated balance sheets and in the statements of changes in shareholders' equity for 1997 and prior periods. All references to the number of share and per share amounts elsewhere in the consolidated financial statements and related footnotes have been restated to reflect the effect of the split for all periods presented.

Share Rights Plan > Avon has a 1988 Share Rights Plan under which one right has been declared as a dividend for each outstanding share of its common stock. Each right, which is redeemable at \$.005 at any time at Avon's option, entitles the shareholder, among other things, to purchase one share of Avon common stock at a price equal to one-half of the then current market price, if certain events have occurred. The right is exercisable if, among other events, one party obtains a beneficial ownership of 20% or more of Avon's voting stock.

Dividends > On February 5, 1998, Avon increased the regular dividend on common shares to an annual rate of \$.68 per share with the first quarterly dividend at the rate of \$.17 per share having been paid on March 2, 1998.

On February 1, 1997, Avon increased the regular dividend on common shares to an annual rate of \$.63 per share, with the first quarterly dividend at the rate of \$.1575 per share having been paid on March 3, 1997.

On February 1, 1996, Avon increased the regular dividend on common shares to an annual rate of \$.58 per share, with the first quarterly dividend at the rate of \$.145 per share having been paid on March 1, 1996.

Stock Repurchase Programs > During 1994, Avon's Board authorized a stock repurchase program under which Avon would buy back up to 10% of its then outstanding common stock, or approximately 28.0 million shares. As of February 1997, when the plan ended, the cumulative number of shares repurchased was 25.3 million shares at a total cost of \$424.4 which are included in Treasury Stock. Under a new repurchase program, which began in February 1997, the Company repurchased approximately 6.7 million shares at a total cost of approximately \$217.2 as of December 31, 1998. Under this new program, the Company may buy back up to \$1,100.0 of its currently outstanding common stock through open market purchases over a period of up to five years.

Savings Plan > In 1998, Avon contributed 62,520 (1997 – 87,344) shares of treasury stock to an employees' savings plan and recognized expense for its fair value. In addition, during 1997, the Company contributed an additional 120,000 shares, for which the expense had been accrued at December 31, 1996. The expense recognized for the plan in 1998 was \$4.5 (1997 – \$2.6; 1996 – \$7.0).

Board of Directors Remuneration > Effective May 1, 1997, the Company discontinued the Board retirement plan, which was applicable only to non-management directors. Directors retiring after that date have had the actuarial value of their accrued retirement benefits converted to a one-time grant of common stock which is restricted as to transfer until retirement. Shares totaling 52,786 were issued to directors as a result of the discontinuance of the plan. As a replacement for such plan, effective on and after May 1, 1997, each non-management director is annually granted options to purchase 4,000 shares of common stock, at an exercise price based on the fair market price of the stock on the date of grant. The annual grant made in 1998 and 1997 consisted of a total of 36,000 and 40,000 options with an exercise price of \$41.31 and \$30.82, respectively.

Also effective as of May 1, 1997, the annual retainer paid to non-management directors was changed to consist of \$.025 cash plus an annual grant of shares having a value of \$.025 based on the average closing market price of the stock for the ten days preceding the date of grant. These shares are also restricted as to transfer until the director retires from the Board. The annual grant made in 1998 and 1997 consisted of a total of 5,472 and 8,520 shares, respectively.

10 EMPLOYEE BENEFIT PLANS

Retirement Plans > Avon and certain subsidiaries have contributory and noncontributory retirement plans for substantially all employees. Benefits under these plans are generally based on an employee's years of service and average compensation near retirement. Plans are funded on a current basis except where funding is not required. Plan assets consist primarily of equity securities, corporate and government bonds, commingled funds and investments in limited partnerships.

Effective July 1998, the defined benefit retirement plan covering U.S.-based employees was converted to a cash balance plan with benefits determined by compensation credits related to age and

service and interest credits based on individual account balances and prevailing interest rates. Additional amendments include an increased company matching contribution to the savings plan and a ten year transitional benefit arrangement for certain employees covered under the existing defined benefit retirement plan.

Postretirement Benefits > Avon provides health care, in excess of Medicare coverage, and life insurance benefits for the majority of employees who retire under Avon's retirement plans in the United States and certain foreign countries. The cost of such health care benefits is shared by Avon and its retirees.

The following provides a reconciliation of benefit obligations, plan assets and funded status of these plans:

	Pension Benefits		Postretirement Benefits	
	1998	1997	1998	1997
Change in benefit obligation:				
Beginning balance	\$(889.9)	\$(874.6)	\$(197.1)	\$(196.0)
Service cost	(35.4)	(35.2)	(3.3)	(3.0)
Interest cost	(64.5)	(63.1)	(13.0)	(13.0)
Actuarial (loss) gain	(83.0)	(35.9)	1.4	(5.6)
Benefits paid	84.9	61.8	10.2	20.5
Plan amendments	—	26.9	—	—
Other	(11.9)	30.2	—	—
Ending balance	(999.8)	(889.9)	(201.8)	(197.1)
Change in plan assets:				
Beginning balance	785.5	690.7	—	—
Actual return on plan assets	102.9	117.3	—	—
Company contributions	61.3	48.0	10.2	20.5
Plan participant contributions	1.5	1.2	—	—
Benefits paid	(84.9)	(61.8)	(10.2)	(20.5)
Other	(3.2)	(9.9)	—	—
Ending balance	863.1	785.5	—	—
Funded status of the plan	(136.7)	(104.4)	(201.8)	(197.1)
Unrecognized actuarial loss(gain)	139.3	99.3	(6.2)	(6.2)
Unrecognized prior service cost	(9.6)	(7.2)	—	—
Unrecognized net transition obligation(asset)	1.3	(3.0)	—	—
Prepaid (Accrued) benefit cost	(5.7)	(15.3)	(208.0)	(203.3)
Amount recognized in the statements:				
Prepaid benefit	138.0	115.2	—	—
Accrued liability	(143.7)	(130.5)	(208.0)	(203.3)
Additional minimum liability	(19.7)	(18.1)	—	—
Intangible asset	4.3	18.1	—	—
Accumulated other comprehensive income	15.4	—	—	—
	\$ (5.7)	\$ (15.3)	\$(208.0)	\$(203.3)

At December 31, 1998 and 1997, the weighted-average discount rates used in determining the pension benefit obligation were 6.7% and 7.0%, respectively. At December 31, 1998 and 1997, the weighted-average discount rates used in determining the postretirement benefit obligation were 7.0% and 7.2%, respectively.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension and postretirement benefit plans with accumulated benefit obligations in excess of plan assets were \$435.4, \$397.7, and \$30.7, respectively, as of December 31, 1998 and \$412.4, \$380.1, and \$31.8, respectively as of December 31, 1997.

Net periodic benefit cost for the years ended December 31 was determined as follows:

Pension Benefits:	1998	1997	1996
	Service cost	\$ 35.4	\$ 35.2
Interest cost	64.5	63.1	61.4
Expected return on plan assets	(64.0)	(58.9)	(58.9)
Amortization of transition (liability) asset	(6.8)	(6.8)	(6.6)
Amortization of prior service cost	(.4)	3.6	3.7
Amortization of actuarial losses (gains)	12.3	7.7	8.9
Settlements or curtailments	—	4.6	.3
Other	.3	—	1.0
Net periodic benefit cost	\$ 41.3	\$ 48.5	\$ 46.4

Postretirement Benefits:	1998	1997	1996
	Service cost	\$ 3.3	\$ 3.0
Interest cost	13.0	13.0	14.0
Expected return on plan assets	—	—	—
Amortization of transition (liability) asset	—	—	—
Amortization of prior service cost	—	—	—
Amortization of actuarial losses (gains)	—	—	—
Settlements or curtailments	—	—	—
Other	—	—	—
Net periodic benefit cost	\$ 16.3	\$ 16.0	\$ 17.3

The weighted-average assumptions used to determine the data for the years ended December 31 are as follows:

Pension Benefits:	1998	1997	1996
	Discount rate	7.1%	7.4%
Rate of compensation increase	4.0	4.7	4.5
Rate of return on assets	9.2	9.2	9.3
Postretirement Benefits:			
Discount rate	7.2%	7.7%	7.2%
Rate of compensation increase	4.5	4.5	4.5
Rate of return on assets	N/A	N/A	N/A

For 1998, the assumed rate of future increases in the per capita cost of health care benefits (the health care cost trend rate) was 8.1% for pre-65 claims (7.8% for post-65 claims) and will gradually decrease each year thereafter to 5.0% in 2005 and beyond. The healthcare cost trend rate assumption has a significant effect on the amounts reported. A one-percentage point change in the assumed health care cost trend rates would have the following effects:

(In millions)	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost components	2.4	2.0
Effect on postretirement benefit obligation	22.9	19.1

Supplemental Executive Retirement and Life Insurance Plans >

Avon has a Supplemental Executive Retirement Plan ("SERP") which is a defined benefit plan under which Avon will pay supplemental pension benefits to key executives in addition to amounts received under Avon's retirement plan. The annual cost of this plan has been included in the determination of the net periodic benefit cost shown above and in 1998 amounted to \$6.1 (1997 - \$5.5; 1996 - \$5.5). Such benefits will be paid from Avon's assets. The accumulated benefit obligation under this plan at December 31, 1998 was \$21.9 (1997 - \$22.8) and is primarily included in Employee Benefit Plans.

Avon also maintains a Supplemental Life Insurance Plan ("SLIP") under which additional death benefits ranging from \$.35 to \$2.0 are provided to certain active and retired officers. Avon has acquired corporate-owned life insurance policies to provide partial funding of the benefits. The cash surrender value of these policies at December 31, 1998 was \$22.4 (1997 - \$20.6) and is held in a grantor trust. During 1997, certain retirees elected to receive a cash distribution from the SLIP approximating \$10.0 which was funded by corporate-owned life insurance policies.

Avon has established a grantor trust to provide funding for the benefits payable under the SERP and SLIP. The trust is irrevocable and assets contributed to the trust can only be used to pay such benefits with certain exceptions. The assets held in the trust at December 31, 1998, amounted to \$94.5 (1997 - \$81.7), consisting of a fixed income portfolio, a managed portfolio of equity securities and corporate-owned life insurance policies. These assets are included in Other Assets.

Postemployment Benefits > Avon provides postemployment benefits which include salary continuation, severance benefits, disability benefits, continuation of health care benefits and life insurance coverage to former employees after employment but before retirement. At December 31, 1998, the accrued cost for postemployment benefits was \$33.5 (1997 - \$35.0) and is included in Employee Benefit Plans.

11 SEGMENT INFORMATION

The Company's reportable segments are based on geographic operations and include a North American business unit and International business units in Latin America, Pacific and Europe regions. The segments have similar business characteristics and each offers similar products through common customer access methods.

The accounting policies of the reportable segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements. The Company evaluates the performance of its operating segments based on operating profits or losses. Segment revenues reflect direct sales of products to representatives based on their geographic location. Intersegment sales and transfers are not significant. Each segment records direct expenses related to its employees and its operations. The Company does not allocate income taxes, foreign exchange gains or losses, or corporate overhead expenses to operating segments. Identifiable assets are primarily those directly used in the operations of each segment. "Other" assets include corporate cash, investments, deferred tax assets and certain intangibles.

Summarized financial information concerning the Company's reportable segments as of December 31, is shown in the following table. Net sales and operating profit by reportable segment are presented on page 31.

Identifiable Assets:

	1998	1997	1996
North America			
US	\$ 497.2	\$ 516.0	\$ 473.3
Other*	111.9	118.3	86.1
Total	609.1	634.3	559.4
International			
Latin America	530.8	481.4	461.7
Europe	390.1	361.9	376.4
Pacific	379.9	376.7	382.4
Total	1,300.8	1,220.0	1,220.5
Corporate and other	523.6	418.6	442.5
Total identifiable assets	\$2,433.5	\$2,272.9	\$2,222.4

Capital Expenditures:

	1998	1997	1996
North America			
US	\$ 32.1	\$ 24.0	\$ 19.9
Other*	11.7	5.2	2.8
Total	43.8	29.2	22.7
International			
Latin America	33.5	21.4	14.7
Europe	28.8	17.5	21.3
Pacific	28.1	41.2	28.0
Total	90.4	80.1	64.0
Corporate and Other	55.3	60.1	16.9
Total capital expenditures	\$ 189.5	\$ 169.4	\$ 103.6

Depreciation and Amortization:

	1998	1997	1996
North America			
US	\$ 19.2	\$ 17.9	\$ 16.0
Other*	2.4	2.2	1.9
Total	21.6	20.1	17.9
International			
Latin America	12.0	10.7	10.2
Europe	14.9	14.8	14.4
Pacific	11.2	15.3	13.0
Total	38.1	40.8	37.6
Corporate and Other	12.3	11.2	9.0
Total depreciation and amortization	\$ 72.0	\$ 72.1	\$ 64.5

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

The following table presents consolidated net sales by classes of principal products, as of December 31.

	1998	1997	1996
Cosmetics, fragrance and toiletries	\$3,181.6	\$3,093.9	\$2,946.8
Gift and decorative	1,050.6	1,049.7	934.1
Apparel	572.0	565.6	556.3
Fashion jewelry and accessories	408.5	370.2	377.0
Total net sales	\$5,212.7	\$5,079.4	\$4,814.2

Foreign Exchange > Financial statement translation of subsidiaries operating in highly inflationary economies and foreign currency transactions resulted in (gains) losses in 1998 netting to

(\$1.1) (1997 – \$2.2; 1996 – \$3.1), which are included in other (income) expense, net and income taxes. In addition, cost of sales and expenses include the unfavorable impact of the translation of inventories and prepaid expenses at historical rates in countries with highly inflationary economies in 1998 of \$15.8 (1997 – \$6.0; 1996 – \$12.6).

12 LEASES AND COMMITMENTS

Minimum rental commitments under noncancelable operating leases, primarily for equipment and office facilities at December 31, 1998, consisted of the following:

Year	
1999	\$ 65.5
2000	51.2
2001	38.4
2002	28.6
2003	22.9
Later years	230.1
Sublease rental income	(6.3)
Total	\$ 430.4

Rent expense in 1998 was \$84.7 (1997 – \$88.2; 1996 – \$89.7). Various construction and information systems projects were in progress at December 31, 1998 with an estimated cost to complete of approximately \$87.4.

13 SPECIAL AND NON-RECURRING CHARGES

In October 1997, the Company announced a worldwide business process redesign program to streamline operations and improve profitability through margin improvement and expense reductions. The special and non-recurring charges associated with this program totaled \$154.4 pretax (\$122.8 net of tax, or \$.46 per share on a basic and diluted basis) for the year ended December 31, 1998.

For the year ended December 31, 1998, special and non-recurring charges by business segment are as follows:

	Special Charges	Cost of Sales Charge	Total
North America	\$ 58.9	\$ 25.7	\$ 84.6
Latin America	2.3	4.0	6.3
Europe	14.2	4.0	18.2
Pacific	23.1	4.2	27.3
Corporate	18.0	—	18.0
Total	\$ 116.5	\$ 37.9	\$ 154.4

For the year ended December 31, 1998, special and non-recurring charges by category of expenditures are as follows:

	Special Charges	Cost of Sales Charge	Total
Employee severance costs	\$ 56.4	\$ —	\$ 56.4
Inventories	—	37.9	37.9
Write-down of assets to net realizable value	31.8	—	31.8
Field program buy-out	14.4	—	14.4
Other	13.9	—	13.9
Total	\$116.5	\$ 37.9	\$ 154.4

Employee severance costs are expenses, both domestic and international, associated with the realignment of the Company's global operations. The workforce will be reduced by approximately two thousand employees, or 7% of the total. Approximately one-half of the employees to be terminated relate to the facility closures. As of December 31, 1998, approximately 90% of the two thousand employees have been terminated.

Inventory-related charges represent losses to write down the carrying value of non-strategic inventory prior to disposal. These charges result from the closure of facilities, discontinuation of certain product lines, size-of-line reductions and a change in strategy for product dispositions.

The write-down of assets relates to the closure of a Far East buying office and manufacturing facilities in Puerto Rico and the Dominican Republic. As a result of ongoing government restrictions, the Company has also decided to close certain branches and a regional office in China. Also, write-downs include assets (primarily fixed and intangible assets) associated with the divestiture of the Discovery Toys business unit, which was effective January 15, 1999.

The field program buy-out represents costs to revamp the Company's representative recruitment program in the U.S.

"Other" category primarily represents lease and contract termination costs, litigation costs, and other costs associated with the facility closures.

The liability balance at December 31, 1998 is as follows:

	Special Charges	Cost of Sales Charge	Total
Provision	\$116.5	\$ 37.9	\$154.4
Cash expenditures:			
Severance	(43.6)	—	(43.6)
Field program buy-out	(12.6)	—	(12.6)
Other	(9.8)	—	(9.8)
Non-cash write-offs	(22.0)	(37.9)	(59.9)
Total	\$ 28.5	\$ —	\$ 28.5

The balance at December 31, 1998 relates primarily to employee severance costs that will be paid during 1999.

The Company expects to record additional charges in 1999 as plans are finalized.

14 CONTINGENCIES

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

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

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.

15 SUBSEQUENT EVENT

On February 4, 1999, Avon's Board approved an increase in the quarterly cash dividend to \$.18 per share from \$.17. The first dividend at the new rate will be paid on March 1, 1999 to shareholders of record on February 16, 1999. On an annualized basis, the new dividend rate will be \$.72 per share.

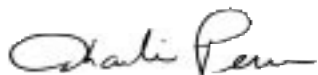
REPORT OF MANAGEMENT

The accompanying consolidated financial statements of Avon Products, Inc. have been prepared by management in conformity with generally accepted accounting principles and necessarily include amounts that are based on judgments and estimates. The audit report of PricewaterhouseCoopers LLP, independent accountants, on these financial statements is the result of their audits of these consolidated financial statements, which were performed in accordance with generally accepted auditing standards.

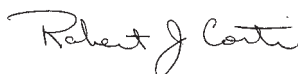
Avon maintains an internal control structure and related systems, policies and procedures designed to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with appropriate authorization and accounting records may be relied upon for the preparation of financial information. Avon also maintains an internal audit department that evaluates and formally reports to management on the adequacy and effectiveness of controls, policies and procedures.

The audit committee of the board of directors, comprised solely of outside directors, has an oversight role in the area of financial reporting and internal controls. This committee meets several times during the year with management, PricewaterhouseCoopers LLP and the internal auditors to monitor the proper discharge of each of their respective responsibilities. PricewaterhouseCoopers LLP and the internal auditors have free access to management and to the audit committee to discuss the results of their activities and the adequacy of controls.

It is management's opinion that Avon's policies and procedures, reinforced by the internal control structure, provide reasonable assurance that operations are managed in a responsible and professional manner with a commitment to the highest standard of business conduct.



Charles R. Perrin
Chief Executive Officer



Robert J. Corti
Executive Vice President,
Chief Financial Officer

REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders of Avon Products, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, changes in shareholders' equity and cash flows present fairly, in all material respects, the financial position of Avon Products, Inc. and its subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of Avon's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers L.L.P.

PricewaterhouseCoopers LLP
New York, New York
February 4, 1999

ELEVEN-YEAR REVIEW

Avon Products, Inc.

In millions, except per share and employee data	1998	1997	1996	1995
Income data				
Net sales	\$ 5,212.7	\$ 5,079.4	\$ 4,814.2	\$ 4,492.1
Operating profit	479.5	544.1	544.8	507.5
Interest expense	41.0	41.8	40.0	41.3
Income from continuing operations before taxes, minority interest and cumulative effect of accounting changes	455.9 ⁽³⁾	534.9	510.4	465.0
Income from continuing operations before minority interest and cumulative effect of accounting changes	265.1 ⁽³⁾	337.0	319.0	288.6
Income from continuing operations	270.0 ⁽³⁾	338.8	317.9	286.1
Income (loss) from discontinued operations, net	—	—	—	(29.6)
Cumulative effect of accounting changes, net	—	—	—	—
Net income (loss)	270.0 ⁽³⁾	338.8	317.9	256.5
Earnings (loss) per share – basic^{(1) (2)}				
Continuing operations	\$ 1.03 ⁽³⁾	\$ 1.28	\$ 1.19	\$ 1.05
Discontinued operations	—	—	—	(.11)
Cumulative effect of accounting changes	—	—	—	—
Net income (loss)	1.03 ⁽³⁾	1.28	1.19	.94
Earnings (loss) per share – diluted^{(1) (2)}				
Continuing operations	\$ 1.02 ⁽³⁾	\$ 1.27	\$ 1.18	\$ 1.05
Discontinued operations	—	—	—	(.11)
Cumulative effect of accounting changes	—	—	—	—
Net income (loss)	1.02 ⁽³⁾	1.27	1.18	.94
Cash dividends per share				
Common	\$.68	\$.63	\$.58	\$.53
Preferred	—	—	—	—
Balance sheet data				
Working capital	\$ 11.9	\$ (11.9)	\$ (41.7)	\$ (30.3)
Capital expenditures	189.5	169.4	103.6	72.7
Property, plant and equipment, net	669.9	611.0	566.6	537.8
Total assets	2,433.5	2,272.9	2,222.4	2,052.8
Debt maturing within one year	55.3	132.1	97.1	47.3
Long-term debt	201.0	102.2	104.5	114.2
Total debt	256.3	234.3	201.6	161.5
Shareholders' equity	285.1	285.0	241.7	192.7
Number of employees				
United States	8,000	8,100	7,800	8,000
International	25,900	26,900	25,900	23,800
Total employees	33,900	35,000	33,700	31,800

(1) Two-for-one stock splits were distributed in September 1998 and June 1996. All per share data in this report, unless indicated, have been restated to reflect the splits.

(2) Effective for the year ended 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.

(3) In 1998, Avon began a worldwide business process redesign program in order to streamline operations and recorded special and non-recurring charges of \$154.4 (\$122.8 net of tax, or \$.46 per share on a basic and diluted basis). Excluding the special and non-recurring charges, net income in 1998 increased 16% to \$392.8 from \$338.8.

(4) Effective January 1, 1994, Avon adopted Statement of Financial Accounting Standards ("FAS") No. 112, "Employers' Accounting for Postemployment Benefits", for all applicable operations, and FAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", for its foreign benefit plans. Effective January 1, 1993, Avon adopted FAS No. 106 for its U.S. retiree health care and life insurance benefit plans and FAS No. 109, "Accounting for Income Taxes". Effective January 1, 1988, Avon adopted FAS No. 96, "Accounting for Income Taxes".

	1994	1993	1992	1991	1990	1989	1988
	\$4,266.5	\$3,844.1	\$3,660.5	\$3,441.0	\$3,291.6	\$2,998.3	\$2,835.2
	495.6	433.2	345.2	434.7	413.3	372.6	317.6
	50.8	45.2	43.7	75.4	77.5	118.0	112.9
	433.8	394.6	290.0 ⁽⁵⁾	352.9	305.6	252.9	208.3
	270.3	243.8	169.4 ⁽⁵⁾	209.3	180.3	134.1	121.1
	264.8	236.9	164.2 ⁽⁵⁾	204.8	174.1	126.5	112.3
	(23.8)	2.7	10.8	(69.1)	21.2	(71.9)	(536.8)
	(45.2) ⁽⁴⁾	(107.5) ⁽⁴⁾	—	—	—	—	20.0 ⁽⁴⁾
	195.8	132.1	175.0 ⁽⁵⁾	135.7	195.3	54.6	(404.5)
	\$.94	\$.82	\$.57 ⁽⁵⁾	\$.65 ⁽⁶⁾	\$.61	\$.41 ⁽⁷⁾	\$.38 ⁽⁷⁾
	(.09)	.01	.04	(.24)	.09	(.33)	(2.16)
	(.16)	(.37)	—	—	—	—	.08
	.69	.46	.61 ⁽⁵⁾	.41 ⁽⁶⁾	.70	.08 ⁽⁷⁾	(1.70) ⁽⁷⁾
	\$.93	\$.82	\$.57 ⁽⁵⁾	\$.71 ⁽⁶⁾	\$.58	\$.40 ⁽⁷⁾	\$.38 ⁽⁷⁾
	(.08)	.01	.04	(.24)	.07	(.32)	(2.16)
	(.16)	(.37)	—	—	—	—	.08
	.69	.46	.61 ⁽⁵⁾	.47 ⁽⁶⁾	.65	.08 ⁽⁷⁾	(1.70) ⁽⁷⁾
	\$.48	\$.43	\$.38	\$ 1.10 ⁽⁸⁾	\$.25	\$.25	\$.38
	—	—	—	.253	.50	.50	.25
	\$ 9.3	\$ 23.1	\$ (99.5)	\$ (135.3)	\$ 71.6	\$ 56.3	\$ 51.0
	99.9	58.1	62.7	61.2	36.3	33.3	46.0
	528.4	476.2	476.7	468.5	467.2	472.5	529.1
	1,978.3	1,918.7	1,692.6	1,693.3	2,010.1	1,994.1	2,362.6
	61.2	70.4	37.3	143.8	207.1	151.7	205.6
	116.5	123.7	177.7	208.1	334.8	673.2	917.9
	177.7	194.1	215.0	351.9	541.9	824.9	1,123.5
	185.6	314.0	310.5	251.6	393.4	228.3	239.3
	7,900	8,000	8,700	9,200	9,500	9,400	9,700
	22,500	21,500	20,700	20,900	20,300	19,900	18,400
	30,400	29,500	29,400	30,100	29,800	29,300	28,100

(5) In 1992, Avon began the restructuring of its worldwide manufacturing and distribution facilities and recorded a provision of \$96.0 (\$64.4 after tax, or \$.22 per share on a basic and diluted basis). Income from continuing operations in 1993 increased 4% from \$228.6, or \$.79 per share on a basic and diluted basis, excluding the 1992 restructuring charge.

(6) For 1991, in management's opinion, per share amounts assuming dilution, even though the result is antidilutive, provide the most meaningful comparison of per share data because they show the full effect of the conversion of 72 preferred shares into approximately 51.84 common shares on June 3, 1991.

(7) In 1989 and 1988, the calculation of earnings per share was assumed to be antidilutive and, accordingly, earnings per share were not adjusted for the conversion of preferred shares into additional common shares.

(8) Includes special dividend of \$.75 paid in 1991.



AVON PRODUCTS, INC.

AVON LEADERSHIP TEAM

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Chief Executive Officer

Andrea Jung

President and Chief Operating Officer

Robert J. Corti

Executive Vice President and
Chief Financial Officer

Jose Ferreira, Jr.

Executive Vice President and
President, Europe, Asia and Africa

Jill Kanin-Lovers

Senior Vice President,
Human Resources

Susan J. Kropf

Executive Vice President and
President, North America

Fernando Lezama

Executive Vice President and
President, Latin America

Brian T. Martin

Senior Vice President,
Corporate Communications

Ward M. Miller, Jr.

Senior Vice President,
General Counsel and Secretary

John J. Wojie

Senior Vice President,
Global Business Operations

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Harriet Edelman

Senior Vice President,
Global Operations

Lynn Emmolo

Senior Vice President,
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Joseph A. Faranda

Vice President, Global Strategic
Planning and Marketing Research

Russell Hardin

Group Vice President,
Global Brand Imaging

Dennis Ling

Group Vice President, Finance and
Treasurer

Janice Marolda

Vice President and Controller

Carrol Murray-Negron

Vice President, Investor Relations

Janice Teal

Group Vice President and
Chief Scientific Officer

Kathleen Walas

Group Vice President,
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