

AVON PRODUCTS INC
Form 10-Q
October 27, 2011
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UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

T Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2011

OR

£ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission file number 1-4881

AVON PRODUCTS, INC.
(Exact name of registrant as specified in its charter)

New York 13-0544597
(State or other jurisdiction of (I.R.S. Employer
Incorporation or organization) Identification No.)
1345 Avenue of the Americas, New York, N.Y. 10105-0196
(Address of principal executive offices) (Zip code)

(212) 282-5000

(Telephone Number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of Common Stock (par value \$0.25) outstanding at September 30, 2011 was 430,774,694

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AVON PRODUCTS, INC.
 CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited)

| In millions, except per share data | Three Months Ended | | |
|--|-----------------------|-----------------------|---|
| | September 30, 2011 | September 30, 2010 | |
| Net sales | \$2,706.7 | \$2,580.1 | |
| Other revenue | 55.7 | 32.3 | |
| Total revenue | 2,762.4 | 2,612.4 | |
| Costs, expenses and other: | | | |
| Cost of sales | 998.3 | 933.0 | |
| Selling, general and administrative expenses | 1,485.5 | 1,420.1 | |
| Operating profit | 278.6 | 259.3 | |
| Interest expense | 22.9 | 21.2 | |
| Interest income | (4.6 |) (1.7 |) |
| Other expense, net | 19.0 | 3.7 | |
| Total other expenses | 37.3 | 23.2 | |
| Income from continuing operations, before taxes | 241.3 | 236.1 | |
| Income taxes | (76.1 |) (68.9 |) |
| Income from continuing operations, net of tax | 165.2 | 167.2 | |
| Discontinued operations, net of tax | — | 0.3 | |
| Net income | 165.2 | 167.5 | |
| Net income attributable to noncontrolling interest | (1.0 |) (0.8 |) |
| Net income attributable to Avon | \$164.2 | \$166.7 | |
| Earnings per share: | | | |
| Basic from continuing operations | \$0.38 | \$0.38 | |
| Basic from discontinued operations | \$— | \$— | |
| Basic attributable to Avon | \$0.38 | \$0.39 | |
| Diluted from continuing operations | \$0.38 | \$0.38 | |
| Diluted from discontinued operations | \$— | \$— | |
| Diluted attributable to Avon | \$0.38 | \$0.38 | |
| Cash dividends per common share | \$0.23 | \$0.22 | |

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| In millions, except per share data | Nine Months Ended | | |
|--|-----------------------|-----------------------|---|
| | September 30, 2011 | September 30, 2010 | |
| Net sales | \$8,114.1 | \$7,593.5 | |
| Other revenue | 133.8 | 93.7 | |
| Total revenue | 8,247.9 | 7,687.2 | |
| Costs, expenses and other: | | | |
| Cost of sales | 2,966.1 | 2,829.8 | |
| Selling, general and administrative expenses | 4,440.1 | 4,140.2 | |
| Operating profit | 841.7 | 717.2 | |
| Interest expense | 69.5 | 63.3 | |
| Interest income | (13.3 |) (10.0 |) |
| Other expense, net | 25.6 | 52.4 | |
| Total other expenses | 81.8 | 105.7 | |
| Income from continuing operations, before taxes | 759.9 | 611.5 | |
| Income taxes | (233.8 |) (236.6 |) |
| Income from continuing operations, net of tax | 526.1 | 374.9 | |
| Discontinued operations, net of tax | (8.6 |) 5.1 | |
| Net income | 517.5 | 380.0 | |
| Net income attributable to noncontrolling interest | (3.5 |) (3.2 |) |
| Net income attributable to Avon | \$514.0 | \$376.8 | |
| Earnings per share: | | | |
| Basic from continuing operations | \$1.20 | \$0.86 | |
| Basic from discontinued operations | \$(0.02 |) \$0.01 | |
| Basic attributable to Avon | \$1.18 | \$0.87 | |
| Diluted from continuing operations | \$1.20 | \$0.86 | |
| Diluted from discontinued operations | \$(0.02 |) \$0.01 | |
| Diluted attributable to Avon | \$1.18 | \$0.87 | |
| Cash dividends per common share | \$0.69 | \$0.66 | |

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

| In millions | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$988.2 | \$1,179.9 |
| Accounts receivable, net | 783.2 | 826.3 |
| Inventories | 1,361.2 | 1,152.9 |
| Prepaid expenses and other | 1,008.6 | 1,025.2 |
| Total current assets | \$4,141.2 | \$4,184.3 |
| Property, plant and equipment, at cost | 2,706.1 | 2,750.9 |
| Less accumulated depreciation | (1,139.1 |) (1,123.5 |
| Property, plant and equipment, net | 1,567.0 | 1,627.4 |
| Goodwill | 674.1 | 675.1 |
| Other intangible assets, net | 351.1 | 368.3 |
| Other assets | 1,146.0 | 1,018.6 |
| Total assets | \$7,879.4 | \$7,873.7 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Debt maturing within one year | \$785.7 | \$727.6 |
| Accounts payable | 808.0 | 809.8 |
| Accrued compensation | 217.8 | 293.2 |
| Other accrued liabilities | 729.0 | 771.6 |
| Sales and taxes other than income | 202.8 | 207.6 |
| Income taxes | 128.7 | 146.5 |
| Total current liabilities | 2,872.0 | 2,956.3 |
| Long-term debt | 2,464.8 | 2,408.6 |
| Employee benefit plans | 476.0 | 561.3 |
| Long-term income taxes | 83.8 | 128.9 |
| Other liabilities | 139.1 | 146.0 |
| Total liabilities | \$6,035.7 | \$6,201.1 |
| Contingencies (Note 5) | | |
| Shareholders' Equity | | |
| Common stock | \$187.3 | \$186.6 |
| Additional paid-in capital | 2,075.9 | 2,024.2 |
| Retained earnings | 4,825.7 | 4,610.8 |
| Accumulated other comprehensive loss | (694.1 |) (605.8 |
| Treasury stock, at cost | (4,565.5 |) (4,559.3 |
| Total Avon shareholders' equity | 1,829.3 | 1,656.5 |
| Noncontrolling interest | 14.4 | 16.1 |
| Total shareholders' equity | \$1,843.7 | \$1,672.6 |
| Total liabilities and shareholders' equity | \$7,879.4 | \$7,873.7 |

The accompanying notes are an integral part of these statements.

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

| In millions | Nine Months Ended | |
|---|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 |
| Cash Flows from Operating Activities | | |
| Net income | \$517.5 | \$380.0 |
| Discontinued operations, net of tax | 8.6 | (5.1) |
| Income from continuing operations | \$526.1 | \$374.9 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 173.7 | 136.5 |
| Provision for doubtful accounts | 187.0 | 160.7 |
| Provision for obsolescence | 79.0 | 76.2 |
| Share-based compensation | 33.8 | 46.2 |
| Deferred income taxes | (94.4) | (54.6) |
| Charge for Venezuelan monetary assets and liabilities | — | 46.1 |
| Other | 54.8 | 32.7 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (178.8) | (183.0) |
| Inventories | (338.1) | (318.7) |
| Prepaid expenses and other | 4.3 | (40.5) |
| Accounts payable and accrued liabilities | (68.7) | 146.0 |
| Income and other taxes | (30.0) | (96.7) |
| Noncurrent assets and liabilities | (114.5) | (14.3) |
| Net cash provided by operating activities of continuing operations | 234.2 | 311.5 |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (197.4) | (216.7) |
| Disposal of assets | 11.7 | 11.7 |
| Purchases of investments | (28.6) | (1.6) |
| Proceeds from sale of investments | 33.6 | 9.6 |
| Acquisitions and other investing activities | — | (795.2) |
| Net cash used by investing activities of continuing operations | (180.7) | (992.2) |
| Cash Flows from Financing Activities* | | |
| Cash dividends | (302.2) | (287.5) |
| Debt, net (maturities of three months or less) | 566.1 | 529.3 |
| Proceeds from debt | 62.8 | 5.5 |
| Repayment of debt | (580.6) | (18.4) |
| Proceeds from exercise of stock options | 15.9 | 18.7 |
| Excess tax benefit realized from share-based compensation | 1.7 | 2.8 |
| Repurchase of common stock | (6.8) | (11.3) |
| Net cash (used) provided by financing activities of continuing operations | (243.1) | 239.1 |
| Cash Flows from Discontinued Operations | | |
| Net cash provided by operating activities of discontinued operations | — | 10.9 |
| Net cash used by investing activities of discontinued operations | (1.2) | (0.3) |
| Net cash used by financing activities of discontinued operations | — | (0.2) |
| Net cash (used) provided by Discontinued Operations | (1.2) | 10.4 |

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| In millions | Nine Months Ended | |
|---|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 |
| Effect of exchange rate changes on cash and equivalents | (0.9 |) (38.9 |
| Net decrease in cash and equivalents | (191.7 |) (470.1 |
| Cash and equivalents at beginning of year (1) | \$1,179.9 | \$1,311.6 |
| Cash and equivalents at end of period (2) | \$988.2 | \$841.5 |

* Non-cash financing activities in 2011 and 2010 included the change in fair market value of interest-rate swap agreements of \$59.2 and \$125.8, respectively.

(1) Includes cash and cash equivalents of discontinued operations of \$13.5 at January 1, 2010.

(2) Includes cash and cash equivalents of discontinued operations of \$15.5 at September 30, 2010.

The accompanying notes are an integral part of these statements.

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

1. ACCOUNTING POLICIES

Basis of Presentation

We prepare our unaudited interim consolidated financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”). We consistently applied the accounting policies described in our 2010 Annual Report on Form 10-K (“2010 Form 10-K”) in preparing these unaudited financial statements. In our opinion, we made all adjustments of a normal recurring nature that are necessary for a fair statement of the results for the interim periods. Results for interim periods are not necessarily indicative of results for a full year. You should read these unaudited interim consolidated financial statements in conjunction with our consolidated financial statements contained in our 2010 Form 10-K. When used in these notes, the terms “Avon,” “Company,” “we” or “us” mean Avon Products, Inc.

For interim consolidated financial statement purposes, our tax provision is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. We also provide for accruals under our various employee benefit plans for each quarter based on one quarter of the estimated annual expense.

We have revised some immaterial amounts in the Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 for comparative purposes. We reclassified \$5.5 from Noncurrent assets and liabilities to Proceeds from sale of investments.

New Accounting Standards Implemented

In January 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2010-06, Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends FASB Codification Topic 820, Fair Value Measurements and Disclosures, to require additional disclosures regarding fair value measurements. Effective January 1, 2011, ASU 2010-06 required additional disclosures regarding activity in Level 3 Fair Value measurements. This disclosure requirement did not have an impact on our interim Fair Value disclosures.

New Accounting Standards to be Implemented

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. ASU 2011-04 provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 will be effective for Avon as of January 1, 2012 and will be applied prospectively. Avon is currently evaluating the impact of adopting ASU 2011-04, but currently believes there will be no significant impact on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires entities to present items of net income and other comprehensive income either in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive, statements of net income and other comprehensive income. ASU 2011-05 will be effective as of January 1, 2012 for Avon and is not expected to have a significant impact on our financial statements, other than presentation.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment. ASU 2011-08 provides entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. This standard is not expected to have a significant impact on our

financial statements.

Out-of-Period Items

During 2011, the Company determined that the net after tax gain on sale of Avon Products Company Limited (“Avon Japan”), reported in our financial statements for the year ended December 31, 2010, should have been reported as a net after tax loss of \$3, to correctly include all balances relating to Avon Japan that were previously included in Accumulated Other Comprehensive Income (“AOCI”). In addition, in the first quarter of 2011 the Company released a liability relating to a previously owned health care business, which should have been released in a prior period, resulting in a \$4 increase in net income. The results of these businesses were originally reported within discontinued operations upon disposition. The net impact of these two items decreased net income for the first quarter of 2011 by \$9. We evaluated these adjustments in relation to the nine-month period, which is when they were corrected, as well as the periods in which they originated and concluded that these adjustments are immaterial to both the consolidated quarterly and annual financial statements for all periods.

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

2. EARNINGS PER SHARE AND SHARE REPURCHASES

We compute earnings per share using the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities. Our participating securities are our grants of restricted stock and restricted stock units which contain non-forfeitable rights to dividend equivalents.

| (Shares in millions) | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|----------|-----------------------|----------|
| | September 30, 2011 | 2010 | September 30, 2011 | 2010 |
| Numerator from continuing operations | | | | |
| Income from continuing operations less amounts attributable to noncontrolling interests | \$ 164.2 | \$ 166.3 | \$ 522.6 | \$ 371.5 |
| Less: Earnings allocated to participating securities | (1.4 |) (1.3 |) (4.4 |) (2.8 |
| Income from continuing operations allocated to common shareholders | 162.8 | 165.0 | 518.2 | 368.7 |
| Numerator from discontinued operations | | | | |
| Income (loss) from discontinued operations plus/less amounts attributable to noncontrolling interests | \$— | \$0.5 | \$(8.6 |) \$5.4 |
| Less: Earnings allocated to participating securities | — | — | — | — |
| Income (loss) allocated to common shareholders | — | 0.5 | (8.6 |) 5.4 |
| Numerator attributable to Avon | | | | |
| Income attributable to Avon less amounts attributable to noncontrolling interests | \$ 164.2 | \$ 166.8 | \$ 514.0 | \$ 376.9 |
| Less: Earnings allocated to participating securities | (1.4 |) (1.3 |) (4.4 |) (2.8 |
| Income allocated to common shareholders | 162.8 | 165.5 | 509.6 | 374.1 |
| Denominator: | | | | |
| Basic EPS weighted-average shares outstanding | 430.73 | 429.07 | 430.33 | 428.53 |
| Diluted effect of assumed conversion of stock options | 3.23 | 3.30 | 3.21 | 3.31 |
| Diluted EPS adjusted weighted-average shares outstanding | 433.96 | 432.37 | 433.54 | 431.84 |
| Earnings per Common Share from continuing operations: | | | | |
| Basic | \$0.38 | \$0.38 | \$1.20 | \$0.86 |
| Diluted | \$0.38 | \$0.38 | \$1.20 | \$0.86 |
| Income (loss) per Common Share from discontinued operations: | | | | |
| Basic | \$— | \$— | \$(0.02 |) \$0.01 |
| Diluted | \$— | \$— | \$(0.02 |) \$0.01 |
| Earnings per Common Share attributable to Avon: | | | | |
| Basic | \$0.38 | \$0.39 | \$1.18 | \$0.87 |
| Diluted | \$0.38 | \$0.38 | \$1.18 | \$0.87 |

At September 30, 2011 and 2010, we did not include stock options to purchase 19.3 million shares and 18.4 million shares of Avon common stock, respectively, in the calculations of diluted earnings per share because their inclusion would have been anti-dilutive.

We purchased approximately 0.3 million shares of Avon common stock for \$6.8 during the first nine months of 2011, as compared to approximately 0.4 million shares of Avon common stock for \$11.3 during the first nine months of 2010 under our previously announced share repurchase program and through acquisition of stock from employees in connection with tax payments upon vesting of restricted stock units.

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

3. INVENTORIES

| Components of Inventories | September 30, 2011 | December 31, 2010 |
|---------------------------|-----------------------|----------------------|
| Raw materials | \$401.4 | \$371.6 |
| Finished goods | 959.8 | 781.3 |
| Total | \$1,361.2 | \$1,152.9 |

4. EMPLOYEE BENEFIT PLANS

| Net Periodic Benefit Costs | Three Months Ended September 30, Pension Benefits | | | | | |
|---|--|---------|----------------|---------|-------------------------|----------|
| | U.S. Plans | | Non-U.S. Plans | | Postretirement Benefits | |
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Service cost | \$3.1 | \$2.7 | \$3.6 | \$3.7 | \$0.5 | \$0.5 |
| Interest cost | 8.2 | 8.0 | 9.9 | 9.8 | 1.5 | 1.8 |
| Expected return on plan assets | (9.0 |) (8.3 |) (10.5 |) (9.4 |) (0.6 |) (0.6 |
| Amortization of prior service credit | — | (0.1 |) (0.5 |) (0.3 |) (4.0 |) (4.3 |
| Amortization of transition asset/(obligation) | — | — | 0.1 | — | — | — |
| Amortization of actuarial losses | 10.8 | 8.7 | 3.2 | 3.3 | 0.7 | 0.9 |
| Net periodic benefit costs | \$13.1 | \$11.0 | \$5.8 | \$7.1 | \$(1.9 |) \$(1.7 |
| Net Periodic Benefit Costs | Nine Months Ended September 30, Pension Benefits | | | | | |
| | U.S. Plans | | Non-U.S. Plans | | Postretirement Benefits | |
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Service cost | \$9.7 | \$9.0 | \$11.9 | \$11.0 | \$1.5 | \$1.9 |
| Interest cost | 24.4 | 23.9 | 30.3 | 29.5 | 4.9 | 5.5 |
| Expected return on plan assets | (27.2 |) (25.0 |) (31.3 |) (28.2 |) (1.6 |) (1.8 |
| Amortization of prior service credit | (0.2 |) (0.3 |) (1.1 |) (0.9 |) (12.0 |) (12.9 |
| Amortization of transition asset/(obligation) | — | — | 0.1 | — | — | — |
| Amortization of actuarial losses | 34.6 | 26.3 | 10.3 | 10.1 | 2.5 | 2.9 |
| Net periodic benefit costs | \$41.3 | \$33.9 | \$20.2 | \$21.5 | \$(4.7 |) \$(4.4 |

We previously disclosed in our financial statements for the year ended December 31, 2010, that we expected to contribute approximately \$90 to \$100 and \$40 to \$45 to our U.S. and non-U.S. pension and postretirement plans, respectively, in 2011. As of September 30, 2011, we made approximately \$89 and \$8 of contributions to the U.S. and non-U.S. pension and postretirement plans, respectively. We anticipate contributing approximately \$1 to \$11 and \$32 to \$37 to fund our U.S. and non-U.S. pension and postretirement plans, respectively, during the remainder of 2011. Our funding requirements may be impacted by regulations or interpretations thereof.

5. CONTINGENCIES

In 2002, our Brazilian subsidiary received an excise tax assessment from the Brazilian tax authorities for alleged tax deficiencies during the years 1997-1998 asserting that the establishment in 1995 of separate manufacturing and distribution companies in that country was done without a valid business purpose and that Avon Brazil did not observe minimum pricing rules to define the taxable basis of excise tax. The structure adopted in 1995 is comparable to that used by many other companies in Brazil. We believe that our Brazilian corporate structure is appropriate, both operationally and legally, and that the 2002 assessment is unfounded. This matter is being vigorously contested and in the opinion of our outside counsel, the likelihood that the assessment ultimately will be upheld is remote. Management believes that the likelihood that the assessment

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

will have a material impact on our consolidated financial position, results of operations or cash flows is correspondingly remote. Other similar excise tax assessments involving different periods have been canceled and officially closed in our favor by the second administrative level.

In October 2010, the 2002 assessment was upheld at the first administrative level at an amount reduced to \$35 from \$82, including penalties and accruing interest, at the exchange rate on September 30, 2011. We have appealed this decision to the second administrative level. In the event that the 2002 assessment is upheld at the third and last administrative level, it may be necessary for us to provide security to pursue further appeals, which, depending on the circumstances, may result in a charge to income. It is not possible to make a reasonable estimate of the amount or range of expense that could result from an unfavorable outcome in respect of this or any additional assessments that may be issued for subsequent periods.

As previously reported, we have engaged outside counsel to conduct an internal investigation and compliance reviews focused on compliance with the Foreign Corrupt Practices Act (“FCPA”) and related U.S. and foreign laws in China and additional countries. The internal investigation, which is being conducted under the oversight of our Audit Committee, began in June 2008. As we reported in October 2008, we voluntarily contacted the United States Securities and Exchange Commission and the United States Department of Justice to advise both agencies of our internal investigation. We are continuing to cooperate with both agencies and inquiries by them, including but not limited to, signing tolling agreements, translating and producing documents and assisting with interviews.

As previously reported in July 2009, in connection with the internal investigation, we commenced compliance reviews regarding the FCPA and related U.S. and foreign laws in additional countries in order to evaluate our compliance efforts. We are conducting these compliance reviews in a number of other countries selected to represent each of the Company's international geographic segments. The internal investigation and compliance reviews are focused on reviewing certain expenses and books and records processes, including, but not limited to, travel, entertainment, gifts, use of third party vendors and consultants and related due diligence, joint ventures and acquisitions, and payments to third-party agents and others, in connection with our business dealings, directly or indirectly, with foreign governments and their employees. In connection with the ongoing internal investigation and compliance reviews, certain personnel actions have been taken and additional personnel actions may be taken in the future. For additional information, see Note 5 to our consolidated financial statements contained in our Form 10-Q for the quarter ended March 31, 2011 and “Risk Factors” contained in our Form 10-K for the year ended December 31, 2010. The internal investigation and compliance reviews of these matters are ongoing, and we continue to cooperate with both agencies with respect to these matters. In connection with the internal investigation and compliance reviews, we continue to enhance our ethics and compliance program, including our policies and procedures, FCPA compliance-related training, FCPA third party due diligence program and other compliance-related resources.

On October 26, 2011, the Company received a subpoena from the United States Securities and Exchange Commission (“SEC”) requesting documents and information in connection with a Regulation FD investigation of the Company's contacts and communications with certain financial analysts and other representatives of the financial community during 2010 and 2011. The Company was also advised that a formal order of investigation was issued by the SEC relating to the FCPA matters described above and the Regulation FD matters that are referenced in the subpoena. The Company intends to cooperate fully with the SEC's investigation.

At this point we are unable to predict the duration, scope, developments in, results of, or consequences of the internal investigation and compliance reviews and the SEC's investigation.

Beginning in July and August 2010, several derivative actions were filed against certain present or former officers and/or directors of the Company that allege breach of fiduciary duty, and, in certain complaints, abuse of control, waste of corporate assets, unjust enrichment and/or proxy disclosure violations, relating to the Company's compliance with the FCPA. The relief sought in one or more of the derivative complaints includes certain declaratory and equitable relief, restitution, unspecified damages, exemplary damages and interest. The Company is named as a nominal defendant. These actions include three consolidated federal court actions (Murray C. White, derivatively on behalf of Avon Products, Inc. v. Andrea Jung, et al. and Avon Products, Inc. as nominal defendant (filed in the United States District Court for the Southern District of New York, 10-CV-5560); County of York Employees Retirement Plan, derivatively on behalf of Avon Products, Inc. v. W. Don Cornwell, et al. and Avon Products, Inc. as nominal defendant (originally filed in the New York Supreme Court, New York County, Index No. 651065/2010 and now refiled in the United States District Court for the Southern District of New York, 10-CIV-5933); and IBEW Local 1919 Pension Fund, derivatively on behalf of Avon Products, Inc. v. W. Don Cornwell, et al. and Avon Products, Inc. as nominal defendant (filed in the United States District Court for the Southern District of New York, 10-CIV-6256)) and two state court actions (Carol J. Parker, derivatively on behalf of Avon Products, Inc. v. W. Don Cornwell, et al. and Avon

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AVON PRODUCTS, INC.

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Products, Inc. as nominal defendant (filed in the New York Supreme Court, Nassau County, Index No. 600570/2010) and Lynne Schwartz, derivatively on behalf of Avon Products, Inc. v. Andrea Jung et al. and Avon Products, Inc. as nominal defendant (filed in the New York Supreme Court, New York County, Index No. 651304/2010)). On May 12, 2011, plaintiffs in the consolidated federal court actions (White v. Jung, et al.) filed a consolidated complaint that alleges breach of fiduciary duty, unjust enrichment and proxy disclosure violations, relating to the Company's compliance with the FCPA, including the adequacy of the Company's internal controls. On June 13, 2011, defendants moved to dismiss the consolidated federal court actions. On September 6, 2011, in light of plaintiffs' expressed intention to further amend their complaint, the Court denied defendants' motion without prejudice as moot. We are unable to predict the outcome of these matters.

On July 6, 2011, a purported shareholder's class action complaint (City of Brockton Retirement System v. Avon Products, Inc., et al., No. 11-CIV-4665) was filed in the United States District Court for the Southern District of New York against certain present or former officers and/or directors of the Company. The complaint is brought on behalf of a purported class consisting of all persons or entities who either (1) were Avon shareholders as of the close of business on March 17, 2011, March 17, 2010, March 18, 2009, March 14, 2008, or March 15, 2007 and therefore were eligible to vote proxies or (2) purchased or otherwise acquired shares of Avon's common stock from July 31, 2006 through and including May 24, 2011. The complaint asserts violations of Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934 based on allegedly false or misleading statements and omissions with respect to, among other things, the Company's compliance with the FCPA, including the adequacy of the Company's internal controls. On September 29, 2011, the Court appointed LBBW Asset Management Investmentgesellschaft mbH and SGSS Deutschland Kapitalanlagegesellschaft mbH as lead plaintiffs and Motley Rice LLC as lead counsel. In light of, among other things, the early stage of the litigation, we are unable to predict the outcome of this matter and are unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome.

Various other lawsuits and claims, arising in the ordinary course of business or related to businesses previously sold, are pending or threatened against Avon. In management's opinion, based on its review of the information available at this time, the total cost of resolving such other contingencies at September 30, 2011, should not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

6. COMPREHENSIVE (LOSS) INCOME

| Components of Comprehensive (Loss) Income | Three Months Ended | | Nine Months Ended | |
|---|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net income | \$ 165.2 | \$ 167.5 | \$ 517.5 | \$ 380.0 |
| Foreign currency translation adjustments | (276.9 |) 145.6 | (111.3 |) 67.5 |
| Change in unrealized gains from available-for-sale securities | — | (0.1 |) — | — |
| Change in derivative losses on cash flow hedges | 0.9 | 1.0 | 2.9 | 3.0 |
| Change in derivative gains on net investment hedge | (2.1 |) — | (2.1 |) — |
| Adjustments for amortization of net actuarial loss, prior service cost, and transition obligation, net of taxes | 7.1 | 7.6 | 22.2 | 19.0 |
| Comprehensive (loss) income | (105.8 |) 321.6 | 429.2 | 469.5 |
| Less: comprehensive (loss) income attributable to noncontrolling interest | 0.5 | 0.7 | (1.6 |) (3.2 |

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| | | | | |
|--|----------|-----------|---------|---------|
| Comprehensive (loss) income attributable to Avon | \$(105.3 |) \$322.3 | \$427.6 | \$466.3 |
|--|----------|-----------|---------|---------|

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

7. SEGMENT INFORMATION

In conjunction with management changes, beginning in the first quarter of 2011, the results of Asia Pacific and China were managed as a single operating segment. Accordingly, 2011 and 2010 Asia Pacific amounts include the results of China.

Summarized financial information concerning our reportable segments was as follows:

| | Three Months Ended September 30, | | 2010 | |
|--------------------------------------|----------------------------------|-------------------------|-----------|-------------------------|
| | 2011 | Operating Profit (Loss) | Revenue | Operating Profit (Loss) |
| Latin America | \$1,340.2 | \$168.2 | \$1,206.8 | \$186.3 |
| North America | 492.9 | 4.4 | 531.1 | 30.1 |
| Central & Eastern Europe | 332.3 | 55.4 | 310.8 | 49.9 |
| Western Europe, Middle East & Africa | 363.2 | 50.4 | 332.1 | 33.4 |
| Asia Pacific | 233.8 | 20.8 | 231.6 | 17.8 |
| Total from operations | \$2,762.4 | \$299.2 | \$2,612.4 | \$317.5 |
| Global and other | — | (20.6) | — | (58.2) |
| Total | \$2,762.4 | \$278.6 | \$2,612.4 | \$259.3 |
| | Nine Months Ended September 30, | | 2010 | |
| | 2011 | Operating Profit (Loss) | Revenue | Operating Profit (Loss) |
| Latin America | \$3,819.8 | \$502.3 | \$3,314.9 | \$414.9 |
| North America | 1,513.6 | 57.0 | 1,599.6 | 110.0 |
| Central & Eastern Europe | 1,119.2 | 205.7 | 1,077.0 | 198.1 |
| Western Europe, Middle East & Africa | 1,107.8 | 136.1 | 984.5 | 115.0 |
| Asia Pacific | 687.5 | 57.3 | 711.2 | 51.0 |
| Total from operations | \$8,247.9 | \$958.4 | \$7,687.2 | \$889.0 |
| Global and other | — | (116.7) | — | (171.8) |
| Total | \$8,247.9 | \$841.7 | \$7,687.2 | \$717.2 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------|----------------------------------|-----------|---------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Beauty ⁽¹⁾ | \$2,006.8 | \$1,861.3 | \$5,920.9 | \$5,484.7 |
| Fashion ⁽²⁾ | 454.6 | 471.1 | 1,453.7 | 1,387.0 |
| Home ⁽³⁾ | 245.3 | 247.7 | 739.5 | 721.8 |
| Net sales | \$2,706.7 | \$2,580.1 | \$8,114.1 | \$7,593.5 |
| Other revenue ⁽⁴⁾ | 55.7 | 32.3 | 133.8 | 93.7 |
| Total revenue | \$2,762.4 | \$2,612.4 | \$8,247.9 | \$7,687.2 |

(1)Beauty includes color cosmetics, fragrances, skin care and personal care.

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- (2) Fashion includes jewelry, watches, apparel, footwear, accessories and children's products.
- (3) Home includes gift and decorative products, housewares, entertainment and leisure products and nutritional products.
- (4) Other revenue primarily includes shipping and handling and order processing fees billed to Representatives. Sales from Health and Wellness products and mark. are included among these categories based on product type.

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8. SUPPLEMENTAL BALANCE SHEET INFORMATION

At September 30, 2011 and December 31, 2010, prepaid expenses and other included the following:

| Components of Prepaid Expenses and Other | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| Deferred tax assets | \$344.4 | \$347.4 |
| Receivables other than trade | 150.0 | 145.9 |
| Prepaid taxes and tax refunds receivable | 228.0 | 247.1 |
| Prepaid brochure costs, paper and other literature | 139.2 | 121.4 |
| Short-term investments | 13.5 | 17.1 |
| Property held for sale | 12.8 | 12.8 |
| Interest-rate swap agreements (Notes 11 and 12) | 7.0 | 20.9 |
| Other | 113.7 | 112.6 |
| Prepaid expenses and other | \$1,008.6 | \$1,025.2 |

At September 30, 2011 and December 31, 2010, other assets included the following:

| Components of Other Assets | September 30, 2011 | December 31, 2010 |
|---|-----------------------|----------------------|
| Deferred tax assets | \$587.6 | \$544.3 |
| Investments | 47.5 | 47.6 |
| Deferred software | 166.2 | 140.6 |
| Interest-rate swap agreements (Notes 11 and 12) | 162.1 | 103.9 |
| Other | 182.6 | 182.2 |
| Other assets | \$1,146.0 | \$1,018.6 |

9. RESTRUCTURING INITIATIVES

2005 Restructuring Program

In November 2005, we announced a multi-year turnaround plan to restore sustainable growth. As part of our turnaround plan, we launched a restructuring program in late 2005 (the "2005 Restructuring Program"). The 2005 Restructuring Program initiatives include:

- enhancement of organizational effectiveness, including efforts to flatten the organization and bring senior management closer to consumers through a substantial organization downsizing;
- implementation of a global manufacturing strategy through facilities realignment;
- implementation of additional supply chain efficiencies in distribution; and
- streamlining of transactional and other services through outsourcing and moves to lower-cost countries.

We have approved and announced all of the initiatives that are part of our 2005 Restructuring Program. We expect to record total restructuring charges and other costs to implement restructuring initiatives of approximately \$510 before taxes. We have recorded total costs to implement, net of adjustments, of \$515.7 (\$2.0 in the first nine months of 2011, \$3.2 in 2010, \$20.1 in 2009, \$59.3 in 2008, \$157.5 in 2007, \$217.1 in 2006, and \$56.5 in 2005) for actions associated with our restructuring initiatives. We will incur other costs to implement restructuring initiatives such as other professional services and accelerated depreciation. These future costs are expected to be more than offset by gains on the sales of properties exited due to restructuring initiatives.

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Restructuring Charges – First, Second, and Third Quarters of 2011

During the three and nine months ended September 30, 2011, we recorded total costs to implement of \$0.5 and \$2.0, respectively, associated with previously approved initiatives that are part of our 2005 Restructuring Program, and the costs consisted of the following:

net charge of \$0.3 and \$0.3, respectively, primarily for employee-related costs offset by adjustments to the reserve; implementation costs of \$0.0 and \$1.1, respectively, for professional service fees, primarily associated with our initiatives to outsource certain finance processes and realign certain distribution operations; and accelerated depreciation of \$0.2 and \$0.6, respectively, associated with our initiatives to realign certain distribution operations.

Total costs to implement were recorded in selling, general and administrative expenses for the three and nine months ended September 30, 2011.

Restructuring Charges – First, Second, and Third Quarters of 2010

During the three and nine months ended September 30, 2010, we recorded total costs to implement of \$0.9 and \$2.4, respectively, associated with previously approved initiatives that are part of our 2005 Restructuring Program, and the costs consisted of the following:

net benefits of \$0.7 and \$3.8, respectively, primarily for adjustments to the reserves for employee-related costs; implementation costs of \$1.6 and \$4.9, respectively, for professional service fees, primarily associated with our initiatives to outsource certain finance processes and realign certain distribution operations; and accelerated depreciation of \$0.1 and \$1.3, respectively, associated with our initiatives to realign certain distribution operations.

Of the total costs to implement, \$0.8 and \$2.3, respectively, were recorded in selling, general and administrative expenses for the three and nine months ended September 30, 2010, and \$0.1 and \$0.1, respectively, were recorded in cost of sales for the three and nine months ended September 30, 2010.

The liability balances for the initiatives under the 2005 Restructuring Program are shown below:

| | Employee- Related Costs | Inventory Write-offs | Contract Terminations/ Other | Total |
|----------------------------|-------------------------------|-------------------------|------------------------------------|--------|
| Balance December 31, 2010 | \$20.6 | \$(0.2) | \$0.1 | \$20.5 |
| 2011 Charges | 1.5 | — | — | 1.5 |
| Adjustments | (1.2) |) — | — | (1.2) |
| Cash payments | (4.8) |) — | (0.1) | (4.9) |
| Foreign exchange | (0.7) |) — | — | (0.7) |
| Balance September 30, 2011 | \$15.4 | \$(0.2) | \$— | \$15.2 |

The following table presents the restructuring charges incurred to date, net of adjustments, under our 2005 Restructuring Program, along with the charges expected to be incurred under the plan:

| | Employee- Related Costs | Asset Write-offs | Inventory Write-offs | Currency Translation Adjustment Write-offs | Contract Terminations/ Other | Total |
|--|-------------------------------|---------------------|-------------------------|---|------------------------------------|---------|
| Charges incurred to date | \$332.8 | \$10.8 | \$7.2 | \$11.6 | \$8.6 | \$371.0 |
| Charges to be incurred on approved initiatives | 1.3 | — | — | — | — | 1.3 |

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| | | | | | | |
|------------------------|---------|--------|-------|--------|-------|---------|
| Total expected charges | \$334.1 | \$10.8 | \$7.2 | \$11.6 | \$8.6 | \$372.3 |
|------------------------|---------|--------|-------|--------|-------|---------|

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

The charges, net of adjustments, of initiatives under the 2005 Restructuring Program by reportable business segment were as follows:

| | Latin America | North America | Central & Eastern Europe | Western Europe, Middle East & Africa | Asia Pacific | Corporate | Total |
|--|------------------|------------------|--------------------------------|---|-----------------|-----------|---------|
| 2005 | \$3.5 | \$6.9 | \$1.0 | \$11.7 | \$22.4 | \$6.1 | \$51.6 |
| 2006 | 34.6 | 61.8 | 6.9 | 45.1 | 14.2 | 29.5 | 192.1 |
| 2007 | 14.9 | 7.0 | 4.7 | 65.1 | 4.9 | 12.7 | 109.3 |
| 2008 | 1.9 | (1.1) |) 1.7 | 19.0 | (0.7) |) (3.0) |) 17.8 |
| 2009 | 1.4 | (0.1) |) (0.7) |) (4.4) |) 11.4 | (2.9) |) 4.7 |
| 2010 | 2.1 | (0.1) |) (0.1) |) (3.9) |) (2.3) |) (0.5) |) (4.8) |
| First Quarter 2011 | (0.6) |) (0.3) |) — | — | — | — | (0.9) |
| Second Quarter 2011 | 0.7 | 0.4 | — | 0.1 | — | (0.3) |) 0.9 |
| Third Quarter 2011 | 0.4 | — | (0.1) |) — | — | — | 0.3 |
| Charges recorded to date | 58.9 | 74.5 | 13.4 | 132.7 | 49.9 | 41.6 | 371.0 |
| Charges to be incurred on approved initiatives | 1.3 | — | — | — | — | — | 1.3 |
| Total expected charges | \$60.2 | \$74.5 | \$13.4 | \$132.7 | \$49.9 | \$41.6 | \$372.3 |

As noted previously, we expect to record total costs to implement of approximately \$510 before taxes for all restructuring initiatives under the 2005 Restructuring Program, including restructuring charges and other costs to implement. The amounts shown in the tables above as charges recorded to date relate to initiatives that have been approved and recorded in the financial statements as the costs are probable and estimable. The amounts shown in the tables above as total expected charges represent charges recorded to date plus charges yet to be recorded for approved initiatives as the relevant accounting criteria for recording an expense have not yet been met. In addition to the charges included in the tables above, we will incur other costs to implement restructuring initiatives such as other professional services and accelerated depreciation. These future costs are expected to be more than offset by gains on the sales of properties exited due to restructuring initiatives.

2009 Restructuring Program

In February 2009, we announced a new restructuring program (the “2009 Restructuring Program”) which targets increasing levels of efficiency and organizational effectiveness across the Company’s global operations. The 2009 Restructuring Program initiatives include:

- restructuring the Company’s global supply chain operations;
- realigning certain local business support functions to a more regional basis to drive increased efficiencies; and
- streamlining transaction related services, including selective outsourcing; and reorganizing certain other functions.

We have approved and announced all of the initiatives that are part of our 2009 Restructuring Program. We expect to record total restructuring charges and other costs to implement restructuring initiatives in the range of \$300 to \$310 before taxes over the next several years, with implementation to be completed by 2012-2013. We have recorded total costs to implement, net of adjustments, of \$257.6 (\$29.3 in the first nine months of 2011, \$77.5 in 2010, and \$150.8 in 2009), for actions associated with our restructuring initiatives.

Restructuring Charges – First, Second, and Third Quarters of 2011

During the three and nine months ended September 30, 2011, we recorded total costs to implement of \$4.1 and \$29.3, respectively, associated with previously approved initiatives that are part of our 2009 Restructuring Program, and the

costs consisted of the following:

net benefits of \$4.9 for the three-month period related to adjustments to the reserves for employee-related costs, including severance, and a net charge of \$3.5 for the nine-month period related to contract termination costs, offset by adjustments to the reserves for employee-related costs, including severance;

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implementation costs of \$5.5 and \$22.6, respectively, for professional service fees, primarily associated with our initiatives to realign certain support functions to a more regional basis and realignment of certain manufacturing facilities; and

accelerated depreciation of \$3.5 and \$8.7, respectively, associated with our initiatives to realign some distribution operations and close some manufacturing operations, offset by a gain of \$5.5 in the first quarter of 2011 due to the sale of land and a building in Germany.

Of the total costs to implement, \$0.6 and \$21.1, respectively, were recorded in selling, general and administrative expenses for the three and nine months ended September 30, 2011, and \$3.5 and \$8.2, respectively, were recorded in cost of sales for the three and nine months ended September 30, 2011.

Restructuring Charges – First, Second, and Third Quarters of 2010

During the three and nine months ended September 30, 2010, we recorded total costs to implement of \$6.1 and \$20.2, respectively, associated with previously approved initiatives that are part of our 2009 Restructuring Program, and the costs consisted of the following:

net benefit of \$0.5 and charge \$0.5, respectively, primarily for adjustments to the reserves for employee-related costs; implementation costs of \$4.4 and \$12.2, respectively, for professional service fees, primarily associated with our initiatives to realign certain support functions to a more regional basis and realignment of certain manufacturing facilities; and

accelerated depreciation of \$2.2 and \$7.5, respectively, associated with our initiatives to realign some distribution operations and close some manufacturing operations.

Of the total costs to implement, \$3.9 and \$13.3, respectively, were recorded in selling, general and administrative expenses for the three and nine months ended September 30, 2010, and \$2.2 and \$6.9, respectively, were recorded in cost of sales for the three and nine months ended September 30, 2010.

The liability balances for the initiatives under the 2009 Restructuring Program are shown below:

| | Employee- Related Costs | Contract Terminations/ Other | Total |
|----------------------------|-------------------------------|------------------------------------|---------|
| Balance December 31, 2010 | \$115.3 | \$0.1 | \$115.4 |
| 2011 Charges | 3.0 | 12.8 | 15.8 |
| Adjustments | (12.3 |) — | (12.3 |
| Cash payments | (27.1 |) (12.6 |) (39.7 |
| Foreign exchange | 0.9 | — | 0.9 |
| Balance September 30, 2011 | \$79.8 | \$0.3 | \$80.1 |

The following table presents the restructuring charges incurred to date, net of adjustments, under our 2009 Restructuring Program, along with the charges expected to be incurred under the plan:

| | Employee- Related Costs | Contract Terminations | Total |
|--|----------------------------|--------------------------|---------|
| Charges incurred to date | \$160.8 | \$14.4 | \$175.2 |
| Charges to be incurred on approved initiatives | 1.7 | 0.8 | 2.5 |
| Total expected charges | \$162.5 | \$15.2 | \$177.7 |

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The charges of initiatives approved to date under the 2009 Restructuring Program by reportable business segment were as follows:

| | Latin America | North America | Central & Eastern Europe | Western Europe, Middle East & Africa | Asia Pacific | Corporate | Total |
|--|------------------|------------------|--------------------------------|---|-----------------|-----------|----------|
| 2009 | 17.8 | 26.8 | 25.8 | 31.8 | 8.5 | 14.9 | \$125.6 |
| 2010 | 11.5 | 17.9 | 0.4 | 2.8 | 2.0 | 11.5 | 46.1 |
| First Quarter 2011 | (2.2 |) 5.6 | 0.2 | 1.0 | (0.5 |) 6.4 | 10.5 |
| Second Quarter 2011 | (0.1 |) (0.3 |) 0.2 | 1.2 | (0.1 |) (3.0 |) (2.1 |
| Third Quarter 2011 | (2.6 |) (0.4 |) 0.4 | (0.2 |) — | (2.1 |) \$(4.9 |
| Charges recorded to date | 24.4 | 49.6 | 27.0 | 36.6 | 9.9 | 27.7 | \$175.2 |
| Charges to be incurred on approved initiatives | 0.2 | (0.6 |) 1.7 | 1.3 | (0.1 |) — | 2.5 |
| Total expected charges on approved initiatives | \$24.6 | \$49.0 | \$28.7 | \$37.9 | \$9.8 | \$27.7 | \$177.7 |

As noted previously, we expect to record total costs to implement in the range of \$300 to \$310 million before taxes for all restructuring initiatives under the 2009 Restructuring Program, including restructuring charges and other costs to implement. The amounts shown in the table above as charges recorded to date relate to initiatives that have been approved and recorded in the financial statements as the costs are probable and estimable. The amounts shown in the table above as total expected charges on approved initiatives represents charges recorded to date plus charges yet to be recorded for approved initiatives as the relevant accounting criteria for recording an expense have not yet been met. In addition to the charges included in the table above, we will incur other costs to implement restructuring initiatives such as consulting, other professional services, and accelerated depreciation.

10. GOODWILL AND INTANGIBLE ASSETS

Goodwill

| | Latin America | North America | Central & Eastern Europe | Western Europe, Middle East & Africa | Asia Pacific | Total |
|-------------------------------|------------------|------------------|--------------------------------|--|-----------------|---------|
| Balance at December 31, 2010 | \$113.5 | \$314.7 | \$8.4 | \$158.5 | \$80.0 | \$675.1 |
| Adjustments | — | — | — | (2.8 |) — | (2.8 |
| Foreign exchange | (0.1 |) — | (0.6 |) (0.4 |) 2.9 | 1.8 |
| Balance at September 30, 2011 | \$113.4 | \$314.7 | \$7.8 | \$155.3 | \$82.9 | \$674.1 |

In July 2010, we acquired substantially all the assets and liabilities of Silpada Designs, Inc. (“Silpada”), for approximately \$650 in cash, plus a potential additional payment in early 2015 based on the achievement of earnings growth of the Silpada North America business during the periods between 2012 through 2014. Silpada is included within our North America segment. The purchase price allocation resulted in goodwill of \$314.7, indefinite-lived trademarks of \$150.0 and customer relationships of \$172.8. The customer relationships have an average 10-year useful life. At the date of the acquisition, a liability of approximately \$26 was recorded associated with this potential

additional consideration (“contingent consideration”), based on a valuation of the estimated fair value of the liability after probability-weighting and discounting various potential payments. At December 31, 2010, we estimated that the estimated fair value of the contingent consideration liability was \$11. At September 30, 2011, we estimated that the potential additional payment associated with the contingent consideration could range from \$0 to approximately \$15 and that the estimated fair value of the contingent consideration liability was \$4.2. The change in the fair value of the contingent consideration was recorded within selling, general and administrative expenses and was primarily due to a decrease in estimates of the ultimate consideration.

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In the second quarter of 2011, due to the impact of rising silver prices and a decline in revenues relative to our internal forecasts, we completed an interim analysis of the fair value of goodwill and indefinite-lived intangibles impairment assessment related to Silpada. The asset impairment analyses performed for goodwill and indefinite-lived intangibles require several estimates including future cash flows, growth rates and the selection of discount rates. The estimation of fair value utilizing discounted expected future cash flows includes numerous uncertainties which require our significant judgment when making assumptions of expected growth rates and the selection of discount rates as well as assumptions regarding general economic and business conditions, among other factors. Key assumptions used in measuring the fair value of Silpada included the discount rate (based on the weighted-average cost of capital), revenue growth, silver prices, and Representative growth and activity rates. The fair value of Silpada for the goodwill impairment assessment was determined using an income approach, which focuses on the income producing capability of a reporting unit based on a prospective analysis of the business that is discounted at a risk adjusted rate. Based upon our interim assessment, Silpada's estimated fair value exceeded its carrying value by 13% as of June 30, 2011. The interim impairment review of the Silpada trademarks during the second quarter of 2011 used a risk-adjusted discounted cash flow model and the relief-from-royalty method. The royalty rate used was based on a consideration of market rates. Based on the discounted cash flow model, we determined the fair value of the Silpada trademarks exceeded their carrying value by a small amount. As a result of the asset impairment analyses performed for goodwill and indefinite-lived trademarks related to Silpada, no adjustments were necessary as of June 30, 2011. We have considered whether any circumstances exist that would more likely than not reduce Silpada's fair value below its carrying value and an interim impairment analysis was not considered necessary as of September 30, 2011. During the fourth quarter of 2011, we will be performing our annual impairment analysis of our reporting units, including Silpada. A decline in expected future cash flows and growth rates or a change in the risk-adjusted discount rate used to fair value expected future cash flows may result in an impairment charge for the goodwill and/or the indefinite-lived trademarks.

Intangible assets

| | September 30, 2011 | | December 31, 2010 | |
|-----------------------------|--------------------|--------------------------|-------------------|--------------------------|
| | Gross Amount | Accumulated Amortization | Gross Amount | Accumulated Amortization |
| Amortized Intangible Assets | | | | |
| Customer relationships | \$222.2 | \$(58.6) | \$221.9 | \$(45.6) |
| Licensing agreements | 58.7 | (49.1) | 58.5 | (46.1) |
| Noncompete agreements | 8.2 | (7.0) | 8.2 | (6.8) |
| Trademarks | 6.6 | (3.5) | 6.6 | (1.8) |
| Indefinite Lived Trademarks | 173.6 | — | 173.4 | — |
| Total | \$469.3 | \$(118.2) | \$468.6 | \$(100.3) |

Estimated Amortization Expense:

| | |
|------|--------|
| 2011 | \$23.6 |
| 2012 | 23.6 |
| 2013 | 21.4 |
| 2014 | 20.6 |
| 2015 | 20.0 |

Aggregate amortization expense during the three and nine months ended September 30, 2011 was \$5.2 and \$17.6, respectively, compared to \$8.4 and \$10.7 for the same periods of 2010.

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(Dollars in millions, except per share data)

11. FAIR VALUE

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2011:

| | Level 1 | Level 2 | Total |
|------------------------------------|---------|---------|---------|
| Assets: | | | |
| Available-for-sale securities | \$1.6 | \$— | \$1.6 |
| Interest-rate swap agreements | — | 169.1 | 169.1 |
| Foreign exchange forward contracts | — | 3.3 | 3.3 |
| Total | \$1.6 | \$172.4 | \$174.0 |
| Liabilities: | | | |
| Interest-rate swap agreements | \$— | \$9.0 | \$9.0 |
| Foreign exchange forward contracts | — | 19.4 | 19.4 |
| Total | \$— | \$28.4 | \$28.4 |

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of December 31, 2010:

| | Level 1 | Level 2 | Total |
|------------------------------------|---------|---------|---------|
| Assets: | | | |
| Available-for-sale securities | \$1.8 | \$— | \$1.8 |
| Interest-rate swap agreements | — | 124.8 | 124.8 |
| Foreign exchange forward contracts | — | 11.1 | 11.1 |
| Total | \$1.8 | \$135.9 | \$137.7 |
| Liabilities: | | | |
| Interest-rate swap agreements | \$— | \$9.9 | \$9.9 |
| Foreign exchange forward contracts | — | 4.3 | 4.3 |
| Total | \$— | \$14.2 | \$14.2 |

Fair Value of Financial Instruments

The net asset (liability) amounts recorded in the balance sheet (carrying amount) and the estimated fair values of financial instruments at September 30, 2011 and December 31, 2010, respectively, consisted of the following:

| | 2011 | | 2010 | |
|---|-----------------|------------|-----------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents | \$988.2 | \$988.2 | \$1,179.9 | \$1,179.9 |
| Available-for-sale securities | 1.6 | 1.6 | 1.8 | 1.8 |
| Grantor trust cash and cash equivalents | 1.9 | 1.9 | 1.1 | 1.1 |
| Short term investments | 13.5 | 13.5 | 17.1 | 17.1 |
| Cash surrender value of supplemental life insurance | 45.6 | 45.6 | 44.7 | 44.7 |
| Debt maturing within one year | 785.7 | 785.7 | 727.6 | 727.6 |
| Long-term debt, net of related discount or premium | 2,464.8 | 2,462.6 | 2,408.6 | 2,502.4 |

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| | | | | |
|------------------------------------|-------|---------|-------|-------|
| Foreign exchange forward contracts | (16.1 |) (16.1 |) 6.8 | 6.8 |
| Interest-rate swap agreements | 160.1 | 160.1 | 114.9 | 114.9 |

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

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

Cash and cash equivalents, Grantor trust cash and cash equivalents, and Short term investments - Given the short term nature of these financial instruments, the stated cost approximates fair value.

Available-for-sale securities - The fair values of these investments were the quoted market prices for issues listed on securities exchanges.

Cash surrender value of supplemental life insurance - The fair value is equal to the cash surrender value of the life insurance policy.

Debt maturing within one year and long-term debt - The fair values of all debt and other financing were determined based on quoted market prices.

Foreign exchange forward contracts - The fair values of forward contracts were primarily based on quoted forward foreign exchange prices at the reporting date.

Interest-rate swap agreements - The fair values of interest-rate swap agreements were estimated based on LIBOR yield curves at the reporting date.

12. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Derivatives are recognized on the balance sheet at their fair values. The following table presents the fair value of derivative instruments outstanding at September 30, 2011:

| | Asset Balance Sheet Classification | Fair Value | Liability Balance Sheet Classification | Fair Value |
|--|--|---------------|--|---------------|
| Derivatives designated as hedges: | | | | |
| Interest-rate swap agreements | Other assets/ prepaid expenses and other | \$160.2 | Other liabilities/ other accrued liabilities | \$— |
| Foreign exchange forward contracts | Prepaid expenses and other | 2.1 | Accounts payable | — |
| Total derivatives designated as hedges | | \$162.3 | | \$— |
| Derivatives not designated as hedges: | | | | |
| Interest-rate swap agreements | Other assets/ prepaid expenses and other | \$8.9 | Other liabilities/ other accrued liabilities | \$9.0 |
| Foreign exchange forward contracts | Prepaid expenses and other | 1.2 | Accounts payable | 19.4 |
| Total derivatives not designated as hedges | | \$10.1 | | \$28.4 |
| Total derivatives | | \$172.4 | | \$28.4 |

The following table presents the fair value of derivative instruments outstanding at December 31, 2010:

| | Asset Balance Sheet Classification | Fair Value | Liability Balance Sheet Classification | Fair Value |
|---------------------------------------|--|---------------|--|---------------|
| Derivatives designated as hedges: | | | | |
| Interest-rate swap agreements | Other assets/ prepaid expenses and other | \$114.9 | Other liabilities/ other accrued liabilities | \$— |
| Derivatives not designated as hedges: | | | | |
| Interest-rate swap agreements | | \$9.9 | | \$9.9 |

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| | Other assets/ prepaid expenses and other | | Other liabilities/ other accrued liabilities | |
|--|--|---------|--|--------|
| Foreign exchange forward contracts | Prepaid expenses and other | 11.1 | Accounts payable | 4.3 |
| Total derivatives not designated as hedges | | \$21.0 | | \$14.2 |
| Total derivatives | | \$135.9 | | \$14.2 |

When we become a party to a derivative instrument, we designate the instrument as a fair value hedge, a cash flow hedge, a net investment hedge, or a non-hedge.

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AVON PRODUCTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share data)

We assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. The ineffective portion of a derivative's gain or loss, if any, is recorded in earnings in other expense, net on the Consolidated Statements of Income. When we determine that a derivative is not highly effective as a hedge, hedge accounting is discontinued. When it is probable that a hedged forecasted transaction will not occur, we discontinue hedge accounting for the affected portion of the forecasted transaction, and reclassify gains or losses that were accumulated in AOCI to earnings.

Interest Rate Risk

We use interest rate swaps to manage our interest rate exposure. The interest rate swaps are used to either convert our fixed rate borrowing to a variable interest rate or to unwind an existing variable interest rate swap on a fixed rate borrowing. At September 30, 2011 and December 31, 2010, we held interest-rate swap agreements that effectively converted approximately 74% of our outstanding long-term, fixed-rate borrowings to a variable interest rate based on LIBOR. Our total exposure to floating interest rates at September 30, 2011 and December 31, 2010 was approximately 82% and 81%, respectively.

At September 30, 2011, we had interest-rate swap agreements designated as fair value hedges of fixed-rate debt, with notional amounts totaling \$1,725. During the three and nine months ended September 30, 2011, we recorded a net gain of \$48.8 and \$59.2, respectively, in interest expense for these interest-rate swap agreements designated as fair value hedges. The gain on these interest-rate swap agreements was offset by an equal and offsetting loss in interest expense on our fixed-rate debt. During the three and nine months ended September 30, 2010, we recorded a net gain of \$43.0 and \$125.8 in interest expense for these interest-rate swap agreements designated as fair value hedges. The gain on these interest-rate swap agreements was offset by an equal and offsetting loss in interest expense on our fixed-rate debt.

At times, we may de-designate the hedging relationship of a receive-fixed/pay-variable interest-rate swap agreement. In these cases, we enter into receive-variable/pay-fixed interest-rate swap agreements that are designed to offset the gain or loss on the de-designated contract. At September 30, 2011, we had interest-rate swap agreements that were not designated as hedges with notional amounts totaling \$250. During the three and nine months ended September 30, 2011, we recorded a net loss of \$0.1 in other expense, net associated with these undesignated interest-rate swap agreements. During the three and nine months ended September 30, 2010, we recorded a net gain of \$0.1 and less than \$0.1, respectively, in other expense, net associated with these undesignated interest-rate swap agreements.

Foreign Currency Risk

The primary currencies for which we have net underlying foreign currency exchange rate exposures are the Argentine peso, Brazilian real, British pound, Canadian dollar, Chinese renminbi, Colombian peso, the euro, Mexican peso, Philippine peso, Polish zloty, Russian ruble, Turkish lira, Ukrainian hryvnia and Venezuelan bolivar. We use foreign exchange forward contracts to manage a portion of our foreign currency exchange rate exposures. At September 30, 2011, we had outstanding foreign exchange forward contracts with notional amounts totaling approximately \$364.4 for the euro, the Mexican peso, the British pound, the Peruvian new sol, the Russian ruble, the Hungarian forint, the Canadian dollar, the Romanian leu, the Czech Republic koruna, and the New Zealand dollar.

We also use foreign exchange forward contracts to manage foreign currency exposure of intercompany loans. These contracts are not designated as hedges. The change in fair value of these contracts is immediately recognized in earnings and substantially offsets the foreign currency impact recognized in earnings relating to the intercompany loans. During the three and nine months ended September 30, 2011, we recorded a loss of \$11.7 and a gain of \$8.8, respectively, in other expense, net related to these undesignated foreign exchange forward contracts. During the three and nine months ended September 30, 2011, we recorded a gain of \$13.0 and a loss of \$3.9, respectively, related to the intercompany loans, caused by changes in foreign currency exchange rates. During the three and nine months ended September 30, 2010, we recorded a gain of \$12.2 and \$0.1, respectively, in other expense, net related to these

undesignated foreign exchange forward contracts. During the three and nine months ended September 30, 2010, we recorded a loss of \$10.9 and a gain of \$2.8, respectively, related to the intercompany loans, caused by changes in foreign currency exchange rates.

We also used a foreign exchange forward contract to hedge a portion of the net assets of a foreign subsidiary, which was effective as a hedge. A gain of \$2.1 on the foreign exchange forward contract was recorded in AOCI for the three and nine months ended September 30, 2011.

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AVON PRODUCTS, INC.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

OVERVIEW

We are a global manufacturer and marketer of beauty and related products. Our business is conducted worldwide, primarily in the direct selling channel. We presently have sales operations in 64 countries and territories, including the U.S., and distribute products in 41 more. Our reportable segments are based on geographic operations in five regions: Latin America; North America; Central & Eastern Europe; Western Europe, Middle East & Africa; and Asia Pacific. We have centralized operations for Global Brand Marketing, Global Sales and Global Supply Chain. Our product categories are Beauty, Fashion and Home. Beauty consists of color cosmetics, fragrances, skin care and personal care. Fashion consists of jewelry, watches, apparel, footwear, accessories and children's products. Home consists of gift and decorative products, housewares, entertainment and leisure products and nutritional products. Sales are made to the ultimate consumer principally through direct selling by approximately 6.5 million active independent Representatives, who are independent contractors and not our employees. The success of our business is highly dependent on recruiting, retaining and servicing our Representatives. During 2010, approximately 83% of our consolidated revenue was derived from operations outside the U.S.

During the first nine months of 2011, revenues increased 7%, impacted by favorable foreign exchange. Constant \$ revenues increased 2%. Sales of products in the Beauty category increased 8%, partially due to favorable foreign exchange. On a Constant \$ basis, sales of products in the Beauty category increased 3% due to a 4% increase in net per unit partially offset by a 1% decrease in units. Active Representatives were flat. See the "Segment Review" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations for additional information related to changes in revenue by segment.

The implementation of an Enterprise Resource Planning system in Brazil significantly impacted results for the third quarter of 2011. Increased macro-economic volatility, including softer consumer sentiment, also pressured results in the quarter.

We are implementing restructuring initiatives under our 2005 and 2009 Restructuring Programs. For a description of these restructuring initiatives, please refer to Item 7 of our 2010 Annual Report on Form 10-K ("2010 Form 10-K"). With regards to the 2005 Restructuring Program, we expect to achieve annualized savings of approximately \$415 once all initiatives are fully implemented by 2011-2012. With regards to the 2009 Restructuring Program, we remain on track with our expectations included in the 2010 Form 10-K. See Note 9, Restructuring Initiatives, of the Notes to Consolidated Financial Statements for more information on our restructuring programs.

We continue to experience increases in labor and commodity costs, including oil, silver and cotton, which our pricing strategies are helping to offset the resulting product cost increases.

Beginning in the first quarter of 2011, the results of Asia Pacific and China were managed as a single operating segment, referred to as Asia Pacific. Accordingly, 2011 and 2010 amounts include the results of China in the Asia Pacific segment. In December 2010, we completed the sale of our subsidiary in Japan, which has been reflected as discontinued operations for all periods.

NEW ACCOUNTING STANDARDS

Information relating to new accounting standards is included in Note 1, Accounting Policies, of the Notes to Consolidated Financial Statements.

RESULTS OF OPERATIONS—THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AS COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010

Non- GAAP Financial Measures

To supplement our financial results presented in accordance with generally accepted accounting principles in the United States ("GAAP"), we disclose operating results that have been adjusted to exclude the impact of changes due to

the translation of foreign currencies into U.S. dollars. We refer to these adjusted growth rates as Constant \$ growth, which is a non- GAAP financial measure. We believe this measure provides investors an additional perspective on trends. To exclude the impact of changes due to the translation of foreign currencies into U.S. dollars, we calculate current year results and prior year results at a constant exchange rate. Currency impact is determined as the difference between actual growth rates and constant currency growth rates.

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AVON PRODUCTS, INC.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

We present gross margin, selling, general and administrative expenses as a percentage of revenue, operating profit, operating margin and effective tax rate on a non-GAAP basis. The discussion of our segments presents operating profit and operating margin on a non-GAAP basis. We have provided a quantitative reconciliation of the difference between the non-GAAP financial measure and the financial measure calculated and reported in accordance with GAAP. These non-GAAP measures should not be considered in isolation, or as a substitute for, or superior to, financial measures calculated in accordance with GAAP. The Company uses the non-GAAP financial measures to evaluate its operating performance and believes that it is meaningful for investors to be made aware of, on a period-to-period basis, the impacts of 1) costs to implement (“CTI”) restructuring initiatives and 2) costs and charges related to Venezuela being designated as a highly inflationary economy and the subsequent devaluation of its currency (“Venezuelan special items”). The Company believes investors find the non-GAAP information helpful in understanding the ongoing performance of operations separate from items that may have a disproportionate positive or negative impact on the Company’s financial results in any particular period. The Venezuelan special items include the impact on the Statement of Income caused by the devaluation of the Venezuelan currency on monetary assets and liabilities, such as cash, receivables and payables; deferred tax assets and liabilities; and nonmonetary assets, such as inventory and prepaid expenses. For nonmonetary assets, the Venezuelan special items include the earnings impact caused by the difference between the historical cost of the assets at the previous official exchange rate of 2.15 and the revised official exchange rate of 4.30. See Note 9, Restructuring Initiatives and the Latin America segment review below for more information on these items.

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AVON PRODUCTS, INC.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

Consolidated

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | | | |
|--|----------------------------------|-----------|----------------|---------------------------------|-----------|----------------|---|--|
| | 2011 | 2010 | %/Point Change | 2011 | 2010 | %/Point Change | | |
| Total revenue | \$2,762.4 | \$2,612.4 | 6 | % \$8,247.9 | \$7,687.2 | 7 | % | |
| Cost of sales | 998.3 | 933.0 | 7 | % 2,966.1 | 2,829.8 | 5 | % | |
| Selling, general and administrative expenses | 1,485.5 | 1,420.1 | 5 | % 4,440.1 | 4,140.2 | 7 | % | |
| Operating profit | 278.6 | 259.3 | 7 | % 841.7 | 717.2 | 17 | % | |
| Interest expense | 22.9 | 21.2 | 8 | % 69.5 | 63.3 | 10 | % | |
| Interest income | (4.6) | (1.7) | 171 | % (13.3) | (10.0) | 33 | % | |
| Other expense, net | 19.0 | 3.7 | * | 25.6 | 52.4 | * | | |
| Net income attributable to Avon | 164.2 | 166.7 | (1) | % 514.0 | 376.8 | 36 | % | |
| Diluted earnings per share attributable to Avon | 0.38 | 0.38 | — | % 1.18 | 0.87 | 36 | % | |
| Advertising expenses ⁽¹⁾ | 76.4 | 114.9 | (34) | % 240.3 | 308.5 | (22) | % | |
| Gross margin | 63.9 | % 64.3 | % (0.4) | 64.0 | % 63.2 | % 0.8 | | |
| CTI restructuring | 0.1 | 0.1 | — | 0.1 | 0.1 | — | | |
| Venezuelan special items | — | 0.3 | (0.3) | — | 0.9 | (0.9) | | |
| Adjusted Non-GAAP gross margin | 64.0 | % 64.6 | % (0.6) | 64.1 | % 64.2 | % (0.1) | | |
| Selling, general and administrative expenses as a % of total revenue | 53.8 | % 54.4 | % (0.6) | 53.8 | % 53.9 | % (0.1) | | |
| CTI restructuring | — | (0.2) | 0.2 | (0.3) | (0.2) | (0.1) | | |
| Venezuelan special items | — | — | — | — | (0.1) | 0.1 | | |
| Adjusted Non-GAAP selling, general and administrative expenses as a % of total revenue | 53.7 | % 54.2 | % (0.5) | 53.6 | % 53.5 | % 0.1 | | |
| Operating profit | \$278.6 | \$259.3 | 7 | % \$841.7 | \$717.2 | 17 | % | |
| CTI restructuring | 4.6 | 6.9 | | 31.3 | 22.5 | | | |
| Venezuelan special items | — | 7.0 | | — | 79.5 | | | |
| Adjusted Non-GAAP operating profit | \$283.2 | \$273.2 | 4 | % \$873.0 | \$819.2 | 7 | % | |
| Operating margin | 10.1 | % 9.9 | % 0.2 | 10.2 | % 9.3 | % 0.9 | | |
| CTI restructuring | 0.2 | 0.3 | (0.1) | 0.4 | 0.3 | 0.1 | | |
| Venezuelan special items | — | 0.3 | (0.3) | — | 1.0 | (1.0) | | |
| Adjusted Non-GAAP operating margin | 10.3 | % 10.5 | % (0.2) | 10.6 | % 10.7 | % (0.1) | | |

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| | | | | | | | |
|--------------------------------------|------|--------|-------|-------|--------|--------|----|
| Effective tax rate | 31.5 | % 29.2 | % 2.3 | 30.8 | % 38.7 | % (7.9 |) |
| CTI restructuring | — | 0.4 | (0.4 |) 0.2 | 0.2 | — | |
| Venezuelan special items | — | (0.9 |) 0.9 | — | (8.4 |) 8.4 | |
| Adjusted Non-GAAP effective tax rate | 31.5 | % 28.8 | % 2.7 | 31.0 | % 30.6 | % 0.4 | |
| Units sold | | | (5 |)% | | (3 |)% |
| Active Representatives | | | — | % | | — | % |

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AVON PRODUCTS, INC.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

Amounts in the table above may not necessarily sum because the computations are made independently.

* calculation not meaningful

(1) Advertising expenses are included within selling, general and administrative expenses.

Revenue

Total revenue increased 6% in the three months ended September 30, 2011, with favorable foreign exchange contributing 5 percentage points to the revenue increase. Constant \$ revenue increased 1%. The acquisition of Silpada Designs, Inc. ("Silpada") contributed less than 1 point to revenue growth. Active Representatives were flat.

On a category basis, the increase in revenue for the three months ended September 30, 2011, was primarily driven by an increase of 8% in Beauty sales, with increases in all sub-categories of Beauty. Within the Beauty category, fragrance increased 12%, color cosmetics increased 9%, personal care increased 6%, and skincare increased 2%. Fashion sales decreased 4% and Home sales decreased 1%. On a Constant \$ basis, the Beauty category increased 3%. Within the Beauty category, on a Constant \$ basis, sales of fragrance increased 9%, sales of color cosmetics increased 4%, and personal care increased 2%, while sales of skincare decreased 3%. Constant \$ sales of Fashion decreased 7%. We acquired Silpada Designs, Inc. ("Silpada") at the end of July 2010. Inclusion of Silpada's results for July 2011 benefited the Fashion Constant \$ growth rate by 3 points, as the similar period's results was not included in our 2010 financial results ("unmatched period"). Constant \$ sales of Home decreased 5%.

Total revenue increased 7% in the nine months ended September 30, 2011, with favorable foreign exchange contributing 5 percentage points to the revenue increase. Constant \$ revenue increased 2%. Acquisitions of Liz Earle Beauty Co. Limited ("Liz Earle") and Silpada contributed approximately 1 point to revenue growth. Active Representatives were flat.

On a category basis, the increase in revenue for the nine months ended September 30, 2011, was primarily driven by an increase of 8% in Beauty sales, with increases in all sub-categories of Beauty. Within the Beauty category, fragrance increased 11%, personal care increased 9%, color cosmetics increased 8%, and skincare increased 4%. Fashion sales increased 5% and Home sales increased 2%. On a Constant \$ basis, the Beauty category increased 3%. Within the Beauty category on a Constant \$ basis, sales of fragrance increased 6%, personal care increased 3%, color cosmetics increased 2%, and skincare decreased 1%. Skincare Constant \$ growth rates benefited by 1 point from the Liz Earle acquisition. Constant \$ sales of Fashion increased 1%, as inclusion of Silpada's unmatched period of January through July during 2011 contributed 7 points to the growth rate. Constant \$ sales of Home decreased 3%.

Gross Margin

Gross margin decreased by 40 basis points in the three months ended September 30, 2011 primarily due to higher product costs. Gross margin increased 80 basis points in the nine months ended September 30, 2011, primarily due to the negative impact of the Venezuelan special items in the first nine months of 2010. Adjusted non-GAAP gross margin declined 60 and 10 basis points during the three- and nine-month periods ended September 30, 2011, respectively, as the negative impact of rising product costs was partially offset by pricing benefits and favorable foreign currency.

Selling, General and Administrative Expenses

Selling, general and administrative expenses as a percentage of revenue for the three- and nine-month periods ended September 30, 2011 decreased 60 basis points and 10 basis points, respectively, compared to the same periods of 2010, while Adjusted Non-GAAP selling, general, and administrative expenses as a percentage of revenue decreased 50 basis points and increased 10 basis points, respectively, as lower advertising was partially offset by increased

investment in the Representative Value Proposition ("RVP"). We invested approximately \$34 and \$86 incrementally in our RVP in the three and nine months ended September 30, 2011, respectively, by continued implementation of our Sales Leadership program and higher incentives. Selling, general and administrative expenses during the three and nine-months ended September 30, 2011, benefited from lower expenses associated with employee incentive compensation plans.

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

Other Expense

Interest expense increased by 8% and 10% in the three and nine months ended September 30, 2011, respectively, primarily due to higher outstanding debt balances. At September 30, 2011, we held interest-rate swap agreements that effectively converted approximately 74% of our outstanding long-term, fixed-rate borrowings to a variable interest rate based on LIBOR.

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AVON PRODUCTS, INC.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

Interest income increased by 171% and 33% in the three and nine months ended September 30, 2011, respectively, due to higher interest rates and average cash balances.

Other expense, net increased during the three months ended September 30, 2011 due to higher foreign exchange losses. Other expense, net decreased in the nine months ended September 30, 2011, primarily due to a \$46.1 negative impact in 2010 from the devaluation of the Venezuelan currency on monetary assets and liabilities in conjunction with highly inflationary accounting which occurred in the first quarter of 2010, partially offset by higher foreign exchange losses in 2011. Refer to the Latin America segment review for a further discussion of the Venezuelan currency.

Effective Tax Rate

The effective tax rates for the three and nine months ended September 30, 2011 were 31.5% and 30.8% respectively, compared to 29.2% and 38.7% for the three and nine months ended September 30, 2010, respectively. The three and nine months ended September 30, 2010 tax rates were negatively impacted by 0.9 and 8.4 points, respectively, due to the devaluation of the Venezuelan currency in conjunction with highly inflationary accounting discussed further within the Latin America segment review. Additionally, the tax rates for the three months ended September 30, 2011 and 2010 included tax benefits from audit settlements, which favorably impacted the tax rates by 2.4 and 5.6 points, respectively. The rates for the nine months ended September 30, 2011 and 2010 included tax benefits from audit settlements and statute expirations, which favorably impacted the tax rates by 3.5 and 2.9 points, respectively.

Segment Review

Latin America

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|------------------------------------|----------------------------------|-------------|----------------|---------|---------------------------------|----------------|---------|-------------|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| | US\$ | Constant \$ | %/Point Change | US\$ | Constant \$ | %/Point Change | US\$ | Constant \$ |
| Total revenue | \$1,340.2 | \$1,206.8 | 11 % | 6 % | \$3,819.8 | \$3,314.9 | 15 % | 9 % |
| Operating profit | 168.2 | 186.3 | (10 %) | (17 %) | 502.3 | 414.9 | 21 % | (6 %) |
| CTI restructuring | (2.1) | 2.3 | | | (3.3) | 7.0 | | |
| Venezuelan special items | — | 7.0 | | | — | 79.5 | | |
| Adjusted Non-GAAP operating profit | 166.1 | 195.6 | (15 %) | (19 %) | 499.0 | 501.4 | — % | (8 %) |
| Operating margin | 12.6 % | 15.4 % | (2.8 %) | (3.5 %) | 13.1 % | 12.5 % | 0.6 % | (2.0 %) |
| CTI restructuring | (0.2) | 0.2 | | | (0.1) | 0.2 | | |
| Venezuelan special items | — | 0.6 | | | — | 2.4 | | |
| Adjusted Non-GAAP operating margin | 12.4 % | 16.2 % | (3.8 %) | (3.9 %) | 13.1 % | 15.1 % | (2.0 %) | (2.3 %) |
| Units sold | | | | | (4 %) | | | 1 % |
| Active Representatives | | | | | 3 % | | | 3 % |

Total revenue for the three- and nine-month periods ended September 30, 2011, increased due to favorable foreign exchange, higher average order, and growth in Active Representatives, driven by continued investments in RVP. Average order benefited from the favorable impacts of pricing. Revenue for the three months ended September 30, 2011, grew 5% in Brazil and 17% in Mexico, with benefits from favorable foreign exchange. Constant \$ revenue for the three months ended September 30, 2011, declined 3% in Brazil and grew 12% in Mexico, along with continued growth from most other markets. During the nine months ended September 30, 2011, revenue grew 11% in Brazil and 22% in Mexico, with benefits from favorable foreign exchange. Constant \$ revenue for the nine months ended September 30, 2011, benefited from continued growth in most markets, with growth of 1% in Brazil and 15% in Mexico. In Venezuela, revenue and Constant \$ revenue for the three and nine months ended September 30, 2011 grew 22% and 24%, respectively. Additional information regarding our Venezuela operations is discussed in more detail below.

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AVON PRODUCTS, INC.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

Brazil's performance for the three- and nine-month periods ended September 30, 2011, continued to be pressured by lower than normal service levels. In addition, in the third quarter of 2011, we implemented an Enterprise Resource Planning ("ERP") system in Brazil which further impacted service levels, which in turn has negatively impacted average order and Active Representative and revenue growth during 2011. We also saw greater impact to our results from increased competition in Brazil. While the implementation of the ERP system and transformation of the related processes may negatively impact service levels in the short-term, we expect the ERP system to help improve our service reliability over the long-term.

Constant \$ revenue growth in Mexico for the three and nine months ended September 30, 2011, was driven by an increase in Active Representatives and a higher average order. Revenue growth for the three and nine months ended September 30, 2011, in Venezuela was the result of a higher average order primarily due to increased prices, partially as a result of inflation.

The decrease in Adjusted Non-GAAP operating margin for the three and nine months ended September 30, 2011, was driven by a sharp decline in Brazil's operating margin, caused by business disruptions and resulting investments in that market, as well as inflationary pressure on costs. Additionally, the region's operating margin for both the three- and nine-month periods was negatively impacted by higher bad debt expense and higher distribution costs due to the transition to new facilities in Brazil and Colombia. Operating margin for the three and nine months ended September 30, 2010, in Latin America was negatively impacted by the devaluation of the Venezuelan currency in conjunction with highly inflationary accounting as discussed further below.

Effective January 1, 2010, we began to account for Venezuela as a highly inflationary economy. Effective January 11, 2010, the Venezuelan government devalued its currency and moved to a two-tier exchange structure. The official exchange rate moved from 2.15 to 2.60 for essential goods and to 4.30 for nonessential goods and services. Effective December 30, 2010, the Venezuelan government eliminated the 2.60 rate which had been available for the import of essential goods. Substantially all of the imports of our subsidiary in Venezuela ("Avon Venezuela") fall into the nonessential classification.

As a result of the change in the official rate to 4.30 in conjunction with accounting for our operations in Venezuela under highly inflationary accounting guidelines, during the first quarter of 2010, we recorded net charges of \$46.1 in "Other expense, net" and \$12.7 in "income taxes", for a total after-tax charge of \$58.8, reflecting the write-down of monetary assets and liabilities and deferred tax benefits. Additionally, certain nonmonetary assets must continue to be carried at U.S. historic dollar cost subsequent to the devaluation. Therefore, the historic U.S. dollar costs impacted the income statement during 2010 at a disproportionate rate as they had not been devalued based on the new exchange rates. As a result of using the U. S. historic dollar cost basis of nonmonetary assets, such as inventory, acquired prior to the devaluation, operating profit during the three and nine months ended September 30, 2010 was negatively impacted by \$33.8 and \$73.2, respectively, for the difference between the historical cost at the previous official exchange rate of 2.15 and the current official exchange rate of 4.30. Assuming no further devaluations, in 2011, there will be an immaterial impact on operating profit from the 2010 Venezuelan currency devaluations.

Currency restrictions enacted by the Venezuelan government in 2003 have impacted the ability of Avon Venezuela to obtain foreign currency at the official rate to pay for imported products. Since 2003, Avon Venezuela had been obtaining its foreign currency needs beyond the amounts that could be obtained at official rates through non-government sources where the exchange rates were less favorable than the official rate ("parallel market"). In late May 2010, the Venezuelan government took control over the previously freely-traded parallel market. Trading in the parallel market was suspended for several weeks in May and June and reopened as a regulated ("SITME") market in early June 2010. The government has imposed volume restrictions on trading activity, limiting an entity's activity to a maximum of \$0.35 per month. The current limit is below the monthly foreign exchange requirements of our

Venezuelan operations and, unless these restrictions are modified, may have a negative impact on Avon Venezuela's future operations. There is no assurance that the Company will be able to recover the higher cost of obtaining foreign currency in the SITME market as compared to the official rate through operating activities, such as increased pricing or cost reductions in other areas.

At September 30, 2011, we had a net asset position of \$188 associated with our operations in Venezuela, which included cash balances of approximately \$170 of which approximately \$165 was denominated in bolívars remeasured at the September 30, 2011 official exchange rate and approximately \$5 was denominated in U.S. dollars. Of the \$188 net asset position, approximately \$164 was associated with bolívar-denominated monetary net assets and deferred income taxes. Additionally, during the first nine months of 2011 Avon Venezuela's revenue and operating profit represented approximately 4% of Avon's consolidated revenue and 5% of Avon's consolidated operating profit.

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AVON PRODUCTS, INC.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in millions, except per share data)

During the first nine months of 2011, the exchange rate in the SITME market ranged within 5 to 6 Bolívares to the U.S. Dollar. To illustrate our sensitivity to potential future changes in the official exchange rate in Venezuela, if the official exchange rate was further devalued as of September 30, 2011, to a rate of \$5.7 Bolívares to the U.S. dollar, which was approximately the rate on September 30, 2011, in the SITME market, or an approximate 25% devaluation, our results would be negatively impacted as follows:

As a result of the use of a further devalued exchange rate for the remeasurement of Avon Venezuela's revenues and profits, Avon's annualized consolidated revenues would likely be negatively impacted by approximately 1% and annualized consolidated operating profit would likely be negatively impacted by approximately 2% prospectively, assuming no operational improvements occurred to offset the negative impact of a further devaluation.

Avon's consolidated operating profit during the first twelve months following the devaluation in this example would likely be negatively impacted by approximately 4%, assuming no offsetting operational improvements. The larger negative impact on operating profit during the first twelve months as compared to the prospective impact is caused by costs of nonmonetary assets being carried at historic dollar cost in accordance with the requirement to account for Venezuela as a highly inflationary economy while revenue would be remeasured at the further devalued rate.

We would likely incur an immediate charge of approximately \$31 (\$29 in "Other expenses, net" and \$2 in "Income taxes") associated with the \$164 of Bolívar-denominated monetary net assets and deferred income taxes.

For the three and nine months ended September 30, 2011, costs associated with acquiring goods that required settlement