AVON PRODUCTS INC
Form 10-K
February 28, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[x] Annual Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2006

OR

[ ] Transition Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the transition period from to

Commission file number 1-4881

AVON PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

New York	13-0544597
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Address of principal executive offices)

(212) 282-5000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on

	which registered
Common stock (par value $.25)	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of voting and non-voting Common Stock (par value $.25) held by non-affiliates at June 30, 2006 (the last business day of our most recently completed second quarter) was $13.9 billion.

The number of shares of Common Stock (par value $.25) outstanding at January 31, 2007, was 441,081,231.

Documents Incorporated by Reference

Parts II and III Portions of the registrant s Proxy Statement relating to the 2007 Annual Meeting of Shareholders.

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

Statements in this report that are not historical facts or information are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as estimate, project, plan, believe, expect, anticipate, intend, planned, potential and similar expressions, or the negative of those expressions, may identify forward-looking statements. Such forward-looking statements are based on management s reasonable current assumptions and expectations. Such forward-looking statements involve risks, uncertainties and other factors, which may cause the actual results, levels of activity, performance or achievement of Avon to be materially different from any future results expressed or implied by such forward-looking statements, and there can be no assurance that actual results will not differ materially from management s expectations. Such factors include, among others, the following:

- our ability to implement the key initiatives of our global business strategy, including our multi-year restructuring initiatives, product mix and pricing strategies, enterprise resource planning, customer service initiatives, product line simplification, strategic sourcing initiative, zero overhead growth and cash management, tax, foreign currency hedging and risk management strategies;
- our ability to realize the anticipated benefits from our multi-year restructuring initiatives or other strategic initiatives on the time schedules or in the amounts that we expect, and our plans to invest these anticipated benefits ahead of future growth;
- the possibility of business disruption in connection with our multi-year restructuring initiatives or other strategic initiatives;
- our ability to realize sustainable growth from our investments in our brand and the direct selling channel;
- the costs associated with our product line simplification program;
- our ability to achieve growth objectives, particularly in our largest markets and new and emerging markets;
- our ability to successfully identify new business opportunities and acquisition candidates, and our ability to successfully integrate or manage any acquired business;
- the effect of political, legal and regulatory risks, as well as foreign exchange or other restrictions, imposed on us, our operations or our Representatives by governmental entities;
- our ability to successfully transition our business in China in connection with the resumption of direct selling in that market and our ability to operate using the direct selling model permitted in that market;
- the impact of substantial currency fluctuations on the results of our foreign operations;
- general economic and business conditions in our markets, including social, economic and political uncertainties in Latin America, Asia Pacific, Central and Eastern Europe and the Middle East;
- a general economic downturn, information technology systems outages, disruption in our supply chain or manufacturing and distribution operations, or other sudden disruption in business operations beyond our control as a result of events such as acts of terrorism or war, natural disasters, pandemic situations and large scale power outages;
- the risk of product or ingredient shortages resulting from our concentration of sourcing in fewer suppliers;
- the quality, safety and efficacy of our products;
- the success of our research and development activities;
- our ability to attract and retain key personnel and executives;
- competitive uncertainties in our markets, including competition from companies in the cosmetics, fragrances, skin care and toiletries industry, some of which are larger than we are and have greater resources;
- our ability to implement our Sales Leadership program globally, to generate Representative activity, to increase Representative productivity, to improve Internet-based tools for our Representatives, and to compete with other direct selling organizations to recruit, retain and service Representatives;
- the impact of the seasonal nature of our business, changes in market trends, purchasing habits of our consumers and changes in consumer preferences, particularly given the global nature of our business and the conduct of our business in primarily one channel;
- our ability to protect our intellectual property rights;
- the risk of an adverse outcome in our material pending and future litigations;
- our access to financing; and
- the impact of possible pension funding obligations and increased pension expense on our cash flow and results of operations.

We undertake no obligation to update any such forward-looking statements.

PART I

Dollars in Millions

ITEM 1. BUSINESS

General

We commenced operations in 1886 and were incorporated in the State of New York on January 27, 1916. We are a global manufacturer and marketer of beauty and related products. Our products fall into three product categories: Beauty, which consists of cosmetics, fragrances, skin care and toiletries (CFT); Beauty Plus, which consists of fashion jewelry, watches, apparel and accessories; and Beyond Beauty, which consists of home products and gift and decorative products. Sales from Health and Wellness products and *mark*., a global cosmetics brand that focuses on the market for young women, are included among these three categories based on product type.

Our business is conducted worldwide primarily in one channel, direct selling. Our reportable segments are based on geographic operations in six regions: North America; Latin America; Western Europe, Middle East & Africa; Central & Eastern Europe; Asia Pacific; and China. We also centrally manage Brand Marketing and Supply Chain organizations. Financial information relating to our reportable segments is included in the Segment Review section within Management s Discussion and Analysis of Financial Condition and Results of Operations on pages 18 through 33 of this 2006 Annual Report on Form 10-K, and in Note 11, Segment Information, on pages F-24 through F-26 of this 2006 Annual Report on Form 10-K. Information about geographic areas is included in Note 11, Segment Information, on pages F-24 through F-26 of this 2006 Annual Report on Form 10-K.

Strategic Initiatives

In November 2005, we launched a comprehensive, multi-year turnaround plan to restore sustainable growth. Our four-point turnaround plan includes:

- Committing to brand competitiveness by focusing research and development resources on product innovation and by increasing our advertising;
- Winning with commercial edge by more effectively utilizing pricing and promotion, expanding our Sales Leadership program and improving the attractiveness of our Representative earnings opportunity as needed;
- Elevating organizational effectiveness by redesigning our structure to eliminate layers of management in order to take full advantage of our global scale and size; and
- Transforming the cost structure so that our costs are aligned to our revenue growth and remain so.

We attacked our cost structure, primarily through delayering, and we have reinvested ahead of savings from this and other cost savings initiatives. Our initial investments have focused significantly on advertising and our direct selling channel, where we have increased investments in 2006.

We are also committed to increasing our spending on product and brand innovation. In 2006, we launched several new innovative products, including *Anew Clinical THERMAFIRM Face Lifting Cream*, *Anew Clinical EYE LIFT*, *superFULL mascara*, Avon *Solutions Ageless Results, Ultra Moisture Rich Metallic Lipstick,* Avon *Crystal Aura* fragrance, Avon *Blue Rush* fragrance and Derek Jeter *DRIVEN* fragrance. In 2007, we expect to implement a comprehensive strategy to reposition and rebrand our color line, including product innovation, upgrading packaging, a significant increase in advertising, improved merchandising and new brochure executions. We are forging alliances for our color line including alliances with a color make-up artist and an international fashion designer. In 2007, we also plan to launch a global integrated marketing campaign, called Hello Tomorrow, supporting both the brand and the direct selling channel. Additionally, we expect to continue to reallocate the time our research and development department spends toward innovation and away from promotional items.

We are also investing in our direct selling channel to improve the reward and effort equation for our Representatives (Representative Value Proposition). We have accelerated the roll out of our Sales Leadership program, which is described below, and have undertaken extensive analysis to better understand the drivers of value for our Representatives. In 2007, we will continue to look for ways to improve the earnings opportunity for Representatives through various means, including the following:

- Evaluating optimum commissions in select markets;
- Continuing to roll-out our Sales Leadership Program, which offers Representatives an enhanced career opportunity;
- Strategically examining fee structure and brochure costs to enhance Representative economics; and
- Recalibrating the frequency of campaigns to maximize Representative selling opportunities.

While the earnings and effort equation will be different within our global portfolio of businesses, we expect that web enablement will be a key element to reduce Representative effort worldwide. We will focus on improving Internet-based tools for our Representatives.

We have launched a product line simplification program (PLS), which includes an analysis of our product line to develop a smaller range of better performing, more profitable products. This program is designed to improve the shopping experience, our brand image and Representative experiences by reducing the number of SKU s overall, which is expected to have significant savings implications. Over time we expect this initiative will:

- Improve customer service;
- Reduce complexity and confusion of our offering to customers and Representatives;
- Simplify our product line for effectiveness and efficiency;
- Impact the new product development decision-making process;
- Improve life cycle management procedures;
- Improve inventory management; and
- Drive improved Supply Chain utilization.

Additionally, we are embarking on a strategic sourcing initiative (SSI) to reduce direct and indirect costs of materials, goods and services. Under this initiative, we will shift our purchasing strategy toward a global supplier orientation from one that is more local and component oriented. Beyond lower costs, our goal for this initiative is to improve asset management, service for Representatives and vendor relationships. We have also begun the implementation of a Sales and Operating Planning process that is intended to better align demand plans with our supply capabilities and provide us with earlier visibility to any potential supply issues.

We have begun to institutionalize a zero overhead growth methodology (ZOG) in which inflation is offset by improvements in productivity. These improvements in productivity will come primarily from previously announced initiatives such as our restructuring program, PLS and SSI.

Restructuring Initiatives

In connection with our four-point turnaround plan, in November 2005 we announced a multi-year restructuring plan. We expect to incur total restructuring charges and other costs to implement our restructuring initiatives in the range of $500.0 before taxes. Specific actions during 2005, 2006 and January 2007 for this phase of our restructuring initiatives included:

- organization realignment and downsizing in each region and global through a process called delayering, taking out layers to bring senior management closer to operations;
- the phased outsourcing of certain services, including certain key human resource and customer service processes, and the move of certain services from markets within Europe to lower cost shared service centers;
- the realignment of our North America distribution operations;
- the exit of certain unprofitable operations, including the closure of the Avon Salon & Spa, the closure of our operations in Indonesia, the exit of a product line in China and the exit of the *beComing* product line in the U.S.; and
- the reorganization of certain functions, primarily sales-related organizations.

Distribution

We presently have sales operations in 63 countries and territories, including the United States, and distribute our products in 51 more. Sales are made to the ultimate customer principally through a combination of direct selling and marketing by approximately 5.3 million active independent Avon Representatives, approximately 446,000 of whom are in the United States. Representatives are independent contractors, who are not employees of ours. Representatives generally purchase products at a discount from a published brochure price directly from us and sell them to their customers. Representatives are typically our customers and we generally have no arrangements with end users of our products beyond the Representative, except as described below. Generally, Representatives are invoiced for their orders and are responsible for payment to us, regardless of whether or not the Representative sells the products to an end user. No single Representative accounts for more than 10% of our net sales.

A Representative contacts customers directly, selling primarily through brochures, which highlight new products and special promotions for each sales campaign. A Representative may also use sales tools such as product samples, demonstration products and selling aids such as make-up color charts. Sales campaigns are generally for two-week duration in the United States and two-to-four week duration for most markets outside the United States. Generally, the Representative forwards an order for a campaign to us using the mail, the Internet, telephone, or fax. This order is processed and the products are assembled at a distribution center and delivered to the Representative usually through a combination of local and national delivery companies. Generally, the Representative then delivers the merchandise and collects payment from the customer for his or her own account. A Representative generally receives a refund of the full price the Representative paid for a product if the Representative chooses to return it.

We employ certain electronic order systems to increase Representative support, which allow a Representative to run her or his business more efficiently, and also allow us to improve our order-processing accuracy. For example, in many countries, Representatives can utilize the Internet to manage their business electronically, including order submission, order tracking, payment and two way communications with Avon. In addition, in the United States, Representatives can further build their own Avon business through personalized web pages developed in association with us, enabling them to sell a complete line of our products online. Self-paced online training also is available in certain markets, as well as up-to-the-minute news about Avon.

In the United States and selected other markets, we also market our products through consumer websites (*www.avon.com* in the U.S.). These sites provide a purchasing opportunity to consumers who choose not to purchase through a Representative.

In some markets, we use decentralized branches, satellite stores and independent retail operations to serve Representatives and other customers. Representatives come to a branch to place and pick up product orders for their customers. The branches also create visibility for Avon with consumers and help reinforce our beauty image. In certain markets, we provide opportunities to license Avon beauty centers and other retail-oriented opportunities to bring Avon to new customers in complementary ways to direct selling.

The recruiting or appointing and training of Representatives are the primary responsibilities of District Sales or Zone Managers and Sales Leadership Representatives. In most markets, District Sales or Zone Managers are employees of Avon and are paid a salary and a sales incentive based primarily on the increase over the prior year's sales by Representatives in their district, while in other markets, those responsibilities are handled by independent contractors. Personal contacts, including recommendations from current Representatives (including the Sales Leadership program), and local market advertising constitute the primary means of obtaining new Representatives. The Sales Leadership program is a multi-level compensation program which gives Representatives, known as Sales Leadership Representatives, the opportunity to obtain earnings from commissions based on sales made by Representatives they have recruited and trained, as well as from their own sales of Avon products. This program limits the number of levels on which commissions can be earned to three and continues to focus on individual product sales by Sales Leadership Representatives. Development of the Sales Leadership program throughout the world is one part of our long-term growth strategy. Because of the high rate of turnover among Representatives, which is a common characteristic of the direct-selling method, recruitment and training of new Representatives is continually necessary. As part of our four-point turnaround plan, we have initiatives underway to standardize global processes for prospecting, appointing, training and developing Representatives, as well as our direct selling executives.

As discussed previously, we are also investing in our direct selling channel in other ways to improve the reward and effort equation for our Representatives (Representative Value Proposition).

From time to time, local governments and others question the legal status of Representatives or impose burdens inconsistent with their status as independent contractors, often in regard to possible coverage under social benefit laws that would require us (and in most instances, the Representatives) to make regular contributions to government social benefit funds. Although we have generally been able to address these questions in a satisfactory manner, these questions can be raised again following regulatory changes in a jurisdiction or can be raised in additional jurisdictions. If there should be a final determination adverse to us in a country, the cost for future, and possibly past, contributions could be so substantial in the context of the volume and profitability of our business in that country that we would consider discontinuing operations in that country.

Promotion and Marketing

Sales promotion and sales development activities are directed at assisting Representatives, through sales aids such as brochures, product samples and demonstration products. In order to support the efforts of Representatives to reach new customers, specially designed sales aids, promotional pieces, customer flyers, television and print advertising are used. In addition, we seek to motivate our Representatives through the use of special incentive programs that reward superior sales performance. Periodic sales meetings with Representatives are conducted by the District Sales Managers or Zone Managers. The meetings are designed to keep Representatives abreast of product line changes, explain sales techniques and provide recognition for sales performance.

A number of merchandising techniques are used, including the introduction of new products, the use of combination offers, the use of trial sizes and samples, and the promotion of products packaged as gift items. In general, for each sales campaign, a distinctive brochure is published in which new products are introduced and selected items are offered as special promotions or are given particular prominence in the brochure. A key current priority for our merchandising is to expand the use of pricing and promotional models to enable a deeper, fact-based understanding of the role and impact of pricing within our product portfolio.

As previously discussed, we significantly increased spending on advertising during 2006. We have also increased our investments in upgrading the quality and size of our brochure in many markets. We expect this to be an ongoing investment to strengthen our beauty image worldwide and drive sales positively. Channel elements, such as high Representative activity and brochure distribution, are important as well.

From time to time, various regulations or laws have been proposed or adopted that would, in general, restrict the frequency, duration or volume of sales resulting from new product introductions, special promotions or other special price offers. We expect our pricing flexibility and broad product lines to mitigate any effect of these regulations.

Competitive Conditions

We face competition from various products and product lines both domestically and internationally. Worldwide, we compete against products sold directly to consumers by other direct-selling and direct sales companies and through the Internet, and against products sold through the mass market and prestige retail channels.

Our principal competitors in the CFT industry are large and well-known cosmetics and fragrances companies that manufacture and sell broad product lines through various types of retail establishments. There are many other companies that compete in more narrow CFT product lines sold through retail establishments.

We have many competitors in the gift and decorative products and apparel industries globally, including retail establishments, gift shops and specialty retailers, and direct-mail companies specializing in these products.

Our principal competition in the fashion jewelry industry consists of a few large companies and many small companies that sell fashion jewelry through retail establishments.

The CFT, gift and decorative products, apparel and fashion jewelry industries are highly competitive. However, the number of competitors and degree of competition that we face in the CFT, gift and decorative products, apparel and fashion jewelry industries varies widely from country to country.

We believe that the personalized customer service offered by our Representatives; the high quality, attractive designs and prices of our products; the high level of new and innovative products; our easily recognized brand name and our guarantee of satisfaction are significant factors in establishing and maintaining our competitive position.

International Operations

Our international operations are conducted primarily through subsidiaries in 62 countries and territories outside the U.S. In addition to these 62 countries and territories, our products are distributed in 51 other countries through distributorships.

Our international operations are subject to risks inherent in conducting business abroad, including, but not limited to, the risk of adverse currency fluctuations, currency remittance restrictions and unfavorable social, economic and political conditions.

See the sections Risk Factors Our ability to conduct business, particularly in international markets, may be affected by political, legal and regulatory risks and Risk Factors We are subject to other risks related to our international operations, including exposure to foreign currency fluctuations in Item 1A on page 10 of this 2006 Annual Report on Form 10-K.

Manufacturing

We manufacture and package almost all of our CFT products. Raw materials, consisting chiefly of essential oils, chemicals, containers and packaging components, are purchased for our CFT products from various suppliers. Almost all of our non-CFT products are purchased from various suppliers. Additionally, we produce the brochures that are used by the Representatives to sell our products. The loss of any one supplier would not have a material impact on our ability to source raw materials for our CFT products or paper for the brochures or our non-CFT products. Packages, consisting of containers and packaging components, are designed by our staff of artists and designers.

The design and development of new CFT products are affected by the cost and availability of materials such as glass, plastics and chemicals. We believe that we can continue to obtain sufficient raw materials and supplies to manufacture and produce our CFT products.

As described previously, we are embarking on our SSI initiative to reduce direct and indirect costs of materials, goods and services. Under this initiative, we will shift our purchasing strategy toward a global supplier orientation from one that is more local and component oriented.

We are implementing an Enterprise Resource Planning (ERP) system on a worldwide basis, which is expected to improve the efficiency of our supply chain and financial transaction processes. The implementation is expected to occur in phases over the next several years. We began implementing the ERP system in Europe during 2005, and will continue to roll-out the ERP system throughout Europe over the next several years. We will begin implementation in North America in the first quarter of 2007.

See Item 2, Properties, for additional information regarding the location of our principal manufacturing facilities.

Product Categories

Each of our three product categories account for 10% or more of consolidated net sales. The following is the percentage of net sales by product category for the years ended December 31:

	2006	2005	2004
Beauty	70%	69%	69%
Beauty Plus	19%	19%	18%
Beyond Beauty	11%	12%	13%

Trademarks and Patents

Our business is not materially dependent on the existence of third party patent, trademark or other third party intellectual property rights, and we are not a party to any ongoing material licenses, franchises or concessions. We do seek to protect our key proprietary technologies by aggressively pursuing comprehensive patent coverage in major markets. We protect our Avon name and other major proprietary trademarks through registration of these trademarks in the markets where we sell our products, monitoring the markets for misuses of such trademarks by others, and by taking appropriate steps to stop any infringing activities.

Seasonal Nature of Business

Our sales and earnings have a marked seasonal pattern characteristic of many companies selling CFT, gift and decorative products, apparel, and fashion jewelry. Holiday sales cause a sales peak in the fourth quarter of the year; however, the sales volume of holiday gift items is, by its nature, difficult to forecast. Fourth quarter revenue was approximately 30% of total revenue in 2006 and 2005, and fourth quarter operating profit was approximately 37% and 26% of total operating profit in 2006 and 2005, respectively. The fourth quarter operating profit comparison between 2006 and 2005 was impacted by costs to implement our restructuring initiatives and PLS program. In 2005, cost to implement of $56.5 was all recorded in the fourth quarter whereas only $43.6 of full-year 2006 cost to implement of $228.8 was recorded in the fourth quarter of 2006. The fourth quarter of 2006 also includes costs of $41.6 of full-year 2006 costs of $81.4 related to our PLS program.

Research and Product Development Activities

New products are essential to growth in the highly competitive cosmetics industry. Our research and development department s efforts are significant to developing new products, including formulating effective beauty treatments relevant to women's needs, and redesigning or reformulating existing products. To increase our brand competitiveness, we have increased our focus on new technology and product innovation to deliver first-to-market products that deliver visible consumer benefits.

Our research and development facility is located in Suffern, NY. A team of researchers and technicians apply the disciplines of science to the practical aspects of bringing products to market around the world. Relationships with dermatologists and other specialists enhance our ability to deliver new formulas and ingredients to market. Additionally, we have satellite research facilities located in Brazil, China, Japan, Mexico and Poland.

In 2006, our most significant product launches included *ANEW Clinical THERMAFIRM Face Lifting Cream, ANEW Clinical EYE LIFT*, superFULL Mascara, Avon *Solutions Ageless Results*, *Ultra Moisture Rich Metallic Lipstick*, Avon *Crystal Aura* fragrance, Avon *Blue Rush* fragrance, and Derek Jeter *DRIVEN* fragrance.

The amounts incurred on research activities relating to the development of new products and the improvement of existing products were $65.8 in 2006, $64.2 in 2005, and $63.1 in 2004. This research included the activities of product research and development and package design and development. Most of these activities were related to the development of CFT products.

Environmental Matters

In general, compliance with environmental regulations impacting our global operations has not had, and is not anticipated to have, any material adverse effect upon the capital expenditures, financial position or competitive position of Avon.

Employees

At December 31, 2006 and 2005, we employed approximately 40,300 and 43,000 full-time equivalent employees, respectively. Of these, approximately 6,600 and 7,300, respectively, were employed in the United States and 33,700 and 35,700, respectively, in other countries.

Website Access to Reports

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, are and have been throughout 2006, available without charge on our investor website (*www.avoninvestor.com*) as soon as reasonably practicable after they are filed with or furnished to the Securities and Exchange Commission (the SEC). We also make available on our website the charters of our Board Committees, our Corporate Governance Guidelines and our Code of Business Conduct and Ethics. Copies of these SEC reports and other documents are also available, without charge, from Investor Relations, Avon Products, Inc., 1345 Avenue of the Americas, New York, NY 10105-0196 or by sending an email to investor.relations@avon.com or by calling (212) 282-5623. Information on our website does not constitute part of this report. Additionally, our filings with the SEC may be read and copied at the SEC Public Reference Room at 100 F Street, N.E. Room 1580 Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. These filings are also available on the SEC s website at *www.sec.gov* free of charge as soon as reasonably practicable after we have filed or furnished the above referenced reports.

ITEM 1A. RISK FACTORS

You should carefully consider each of the following risks associated with an investment in our publicly traded securities and all of the other information in this 2006 Annual Report on Form 10-K. Our business may also be adversely affected by risks and uncertainties not presently known to us or that we currently believe to be immaterial. If any of the events contemplated by the following discussion of risks should occur, our business, *prospects, financial condition and results of operations may suffer.*

Our success depends on our ability to execute fully our global business strategy.

Our ability to implement the key initiatives of our global business strategy is dependent upon a number of factors, including our ability to:

- implement our multi-year restructuring initiatives and achieve anticipated benefits from these initiatives;
- increase our beauty sales and market share, and strengthen our brand image;
- realize anticipated cost savings and reinvest such savings effectively in consumer-oriented investments and other aspects of our business;
- implement appropriate product mix and pricing strategies including our product line simplification program;
- implement enterprise resource planning and our strategic sourcing initiative, and realize efficiencies across our supply chain, marketing processes, sales model and organizational structure;
- implement cash management, tax, foreign currency hedging and risk management strategies;
- implement our Sales Leadership program globally, recruit Representatives, enhance the Representative experience and increase their productivity through investments in the direct selling channel; and
- reach new consumers through a combination of new brands, new businesses, new channels and pursuit of strategic opportunities such as acquisitions, joint ventures and strategic alliances with other companies.

There can be no assurance that any of these initiatives will be successfully and fully executed within the planned time periods.

We may experience difficulties, delays or unexpected costs in completing our multi-year turnaround plan, including achieving the anticipated benefits of our multi-year restructuring initiatives.

In November 2005, we announced a multi-year turnaround plan as part of a major drive to fuel revenue growth and expand profit margins, while increasing consumer investments. As part of the turnaround plan, restructuring initiatives include: enhancement of organizational effectiveness, implementation of a global manufacturing strategy through facilities realignment, additional supply chain efficiencies in the areas of procurement and distribution and streamlining of transactional and other services through outsourcing and moves to low-cost countries. We may not realize, in full or in part, the anticipated benefits from one or more of these initiatives, and other events and circumstances, such as difficulties, delays or unexpected costs, may occur which could result in our not realizing all or any of the anticipated benefits. If we are unable to realize these benefits, our ability to continue to fund planned advertising, market intelligence, consumer research and product innovation initiatives may be adversely affected. In addition, our plans to invest these benefits ahead of future growth means that such costs will be incurred whether or not we realize these benefits. Finally, the costs of implementing the restructuring plan are expected to be in the range of $500 million before taxes, a significant portion of which has not yet been incurred.

We are also subject to the risk of business disruption in connection with our multi-year restructuring initiatives, which could have a material adverse effect on our business, financial condition and operating results.

There can be no assurance that we will be able to achieve our growth objectives.

There can be no assurance that we will be able to achieve profitable growth in the future. In developed markets, such as the United States, we seek to achieve growth in line with that of the overall beauty market, while in developing and emerging markets we have higher growth targets. Our growth overall is also subject to the strengths and weakness of our individual markets, including our international markets. Our ability to increase revenue and earnings depends on numerous factors, and there can be no assurance that our current or future business strategies will lead to such increases.

Our business is conducted worldwide primarily in one channel, direct selling.

Our business is conducted worldwide, primarily in the direct selling channel. Sales are made to the ultimate consumer principally through 5.3 million independent Representatives worldwide. There is a high rate of turnover among Representatives, which is a common characteristic of the direct selling business. As a result, in order to maintain our business and grow our business in the future, we need to retain and recruit Representatives on a continuing basis. If consumers change their purchasing habits, such as by reducing purchases of beauty and related products from Representatives or buying beauty and related products in channels other than in direct selling, this could reduce our sales and have a material adverse effect on our business, financial condition and results of operations. If our competitors establish greater market share in the direct selling channel, our business, financial condition and operating results may be adversely affected. Furthermore, if any government bans or severely restricts our business method of direct selling, our business, financial condition and operating results may be adversely affected.

Our ability to conduct business, particularly in international markets, may be affected by political, legal and regulatory risks.

Our ability to capitalize on growth in new international markets and to maintain the current level of operations in our existing international markets is exposed to risks associated with our international operations, including:

- the possibility that a foreign government might ban or severely restrict our business method of direct selling, or that local civil unrest, political instability or changes in diplomatic or trade relationships might disrupt our operations in an international market;
- the possibility that a government authority might impose legal, tax or other financial burdens on our Representatives, as direct sellers, or on Avon, due, for example, to the structure of our operations in various markets; and
- the possibility that a government authority might challenge the status of our Representatives as independent contractors or impose employment or social taxes on our Representatives.

For example, in 1998, the Chinese government banned direct selling but, subsequently in April 2005, the Chinese government granted approval for us to proceed with a limited test of direct selling in certain areas. The Chinese government later issued direct selling regulations in late 2005, and we were granted a direct selling license by China s Ministry of Commerce in late February 2006, which has allowed us to commence direct selling under such regulations. However, there can be no assurance that these and other regulations and approvals will not be rescinded, restricted or otherwise altered, which may have a material adverse effect on our direct selling business in China. There can be no assurance that we will be able to successfully transition our business in China in connection with the resumption of direct selling in that market and successfully operate using the direct selling model currently in place or that may be subsequently permitted in that market, or that we will experience growth in that or other emerging markets. The introduction of new channels in our business, such as the direct selling channel in China, may also negatively impact existing sales. We may encounter similar political, legal and regulatory risks in Central and Eastern Europe, Latin America, Asia Pacific, and the Middle East and Africa.

We are also subject to changes in other foreign laws, rules, regulations or policies, such as restrictions on trade, import and export license requirements, tariffs and taxes. In addition, we face legal and regulatory risks in the United States and, in particular, cannot predict with certainty the outcome of various contingencies or the impact that pending or future legislative and regulatory changes may have on our business in the future.

We are subject to other risks related to our international operations, including exposure to foreign currency fluctuations.

We operate globally, through operations in various locations around the world, and derive approximately 75% of our consolidated revenue from our operations outside of the U.S. One risk associated with our international operations is the possibility that a foreign government may impose new currency remittance restrictions. Another risk associated with our international operations is that the functional currency for most of our international operations is the applicable local currency. Although we implement foreign currency hedging and risk management strategies to reduce our exposure to fluctuations in earnings and cash flows associated with changes in foreign exchange rates, there can be no assurance that foreign currency fluctuations will not have a material adverse effect on our business, results of operations and financial condition.

Third party suppliers provide, among other things, the raw materials used to manufacture our CFT products, and the loss of these suppliers or a disruption or interruption in the supply chain may adversely affect our business.

We manufacture and package almost all of our CFT products. Raw materials, consisting chiefly of essential oils, chemicals, containers and packaging components, are purchased from various third party suppliers for our CFT products. Almost all of our non-CFT products are purchased from various suppliers. Additionally, we produce the brochures that are used by Representatives to sell Avon products. The loss of multiple suppliers or a significant disruption or interruption in the supply chain could have a material adverse effect on the manufacturing and packaging of our CFT products, the purchasing of our non-CFT products or the production of our brochures. This risk may be exacerbated by our recently announced strategic sourcing initiative, which is expected to shift our purchasing strategy toward a global supplier orientation. Furthermore, increases in the costs of raw materials may adversely affect our profit margins if we are unable to pass along any higher costs in the form of price increases or otherwise achieve cost efficiencies in manufacturing and distribution.

The loss of or a disruption in our manufacturing and distribution operations could adversely affect our business.

Our principal properties consist of worldwide manufacturing facilities for the production of CFT products, distribution centers where offices are located and where finished merchandise is packed and shipped to Representatives in fulfillment of their

orders, and one principal research and development facility. Therefore, as a company engaged in manufacturing, distribution and research and development on a global scale, we are subject to the risks inherent in such activities, including industrial accidents, environmental events, strikes and other labor disputes, disruptions in logistics or information systems, loss or impairment of key manufacturing sites, product quality control, safety, licensing requirements and other regulatory issues, as well as natural disasters, acts of terrorism and other external factors over which we have no control. The loss of, or damage to, any of our facilities or centers could have a material adverse effect on our business, results of operations and financial condition.

A general economic downturn or sudden disruption in business conditions may affect consumer purchases of discretionary items, including beauty and related products, which could adversely affect our business.

Consumer spending is generally affected by a number of factors, including general economic conditions, inflation, interest rates, energy costs, and consumer confidence generally, all of which are beyond our control. Consumer purchases of discretionary items tend to decline during recessionary periods, when disposable income is lower, and may impact sales of our products. In addition, sudden disruptions in business conditions as a result of a terrorist attack similar to the events of September 11, 2001, including further attacks, retaliation and the threat of further attacks or retaliation, war, adverse weather conditions or other natural disasters, such as Hurricane Katrina, pandemic situations or large scale power outages can have a short or, sometimes, long-term impact on consumer spending. A downturn in the economies in which we sell our products or a sudden disruption of business conditions in those economies could adversely affect our sales.

Our success depends, in part, on the quality and safety of our products.

Our success depends, in part, on the quality and safety of our products. If our products are found to be defective or unsafe, or if they otherwise fail to meet our Representatives or end customers standards, our relationship with our Representatives or end customers could suffer, we could need to recall some of our products, our reputation could be diminished, and we could lose market share and/or become subject to liability claims, any of which could result in a material adverse effect on our business, results of operations and financial condition.

Our information technology systems may be susceptible to disruptions.

We employ information technology systems to support our business, including systems to support financial reporting, an Enterprise Resource Planning (ERP) system which we are implementing on a worldwide basis, and an internal communication and data transfer network. We also employ information technology systems to support Representatives in many of our markets, including electronic order collection and invoicing systems and on-line training. We have Internet sites in many of our markets, including business-to-business sites to support Representatives. We have recently announced initiatives to increase our reliance on employing information technology systems to support our Representatives, as well as initiatives, as part of our multi-year restructuring program, to outsource certain services, including the provision of global human resources information technology systems to our employees. Any of these systems may be susceptible to outages due to fire, floods, power loss, telecommunications failures, break-ins and similar events. Despite the implementation of network security measures, our systems may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with these systems. The occurrence of these or other events could disrupt our information technology systems and adversely affect our operation.

Any future acquisitions may expose us to additional risks.

We continuously review acquisition prospects that would complement our current product offerings, increase the size and geographic scope of our operations or otherwise offer growth and operating efficiency opportunities. The financing for any of these acquisitions could dilute the interests of our stockholders, result in an increase in our indebtedness or both. Acquisitions may entail numerous risks, including:

- difficulties in assimilating acquired operations or products, including the loss of key employees from acquired businesses and disruption to our direct selling channel;
- diversion of management s attention from our core business;
- adverse effects on existing business relationships with suppliers and customers; and
- risks of entering markets in which we have limited or no prior experience.

Our failure to successfully complete the integration of any acquired business could have a material adverse effect on our business, financial condition and operating results. In addition, there can be no assurance that we will be able to identify suitable acquisition candidates or consummate acquisitions on favorable terms.

Our success depends, in part, on our key personnel.

Our success depends, in part, on our ability to retain our key personnel, including our executive officers and senior management team. The unexpected loss of one or more of our key employees could adversely affect our business. Our success also depends, in part, on our continuing ability to identify, hire, train and retain other highly qualified personnel. Competition for these employees can be intense. We may not be able to attract, assimilate or retain qualified personnel in the future, and our failure to do so could adversely affect our business. This risk may be exacerbated by the uncertainties associated with our multi-year restructuring initiatives.

We face significant competition.

We face competition from competing products in each of our lines of business, in both the domestic and international markets. We compete against products sold directly to consumers by other direct-selling and direct sales companies and through the Internet, and against products sold through the mass market and prestige retail channels.

Our principal competitors in the CFT industry are large and well-known cosmetics and fragrances companies that manufacture and sell broad product lines through various types of retail establishments. There are many other companies that compete in more narrow CFT product lines sold through retail establishments. This industry is highly competitive, and some of our principal competitors in the CFT industry are larger than we are and have greater resources than we do. Competitive activities on their part could cause our sales to suffer. We have many competitors in the highly competitive gift and decorative products and apparel industries globally, including retail establishments, principally department stores, gift shops and specialty retailers, and direct-mail companies specializing in these products. Our principal competition in the highly competitive fashion jewelry industry consists of a few large companies and many small companies that sell fashion jewelry through retail establishments. However, the number of competitors and degree of competition that we face in the CFT, gift and decorative products, apparel and fashion jewelry industries varies widely from country to country. There are a number of direct-selling companies that sell product lines similar to ours, some of which also have worldwide operations and compete with us globally.

If our advertising, promotional, merchandising or other marketing strategies are not successful, if we are unable to deliver new products that represent technological breakthroughs, if we do not successfully manage the timing of new product introductions or the profitability of these efforts, or if for other reasons our Representatives or end customers perceive competitors   products as having greater appeal, then our sales and financial results may suffer.

We are also subject to significant competition for the recruitment of Representatives from other direct selling or network marketing organizations, including those that market personal care products, dietary and nutritional supplements and weight management products. As a result, it is continually necessary to recruit and retain new Representatives and if we are unable to do so our business will be adversely affected.

Our ability to anticipate and respond to market trends and changes in consumer preferences could affect our financial results.

Our continued success depends on our ability to anticipate, gauge and react in a timely and effective manner to changes in consumer spending patterns and preferences for beauty and related products. We must continually work to develop, produce and market new products, maintain and enhance the recognition of our brands, achieve a favorable mix of products, and refine our approach as to how and where we market and sell our products. While we devote considerable effort and resources to shape, analyze and respond to consumer preferences, consumer spending patterns and preferences cannot be predicted with certainty and can change rapidly. If we are unable to anticipate and respond to trends in the market for beauty and related products and changing consumer demands, our financial results will suffer. This risk may be exacerbated by our product line simplification program, which will lead to significant changes to our product offerings.

Furthermore, material shifts or decreases in market demand for our products, including as a result of changes in consumer spending patterns and preferences, could result in us carrying inventory that cannot be sold at anticipated prices or increased product returns by our Representatives. Failure to maintain proper inventory levels or increased product returns by our Representatives could result in a material adverse effect on our business, results of operations and financial condition.

If we are unable to protect our intellectual property rights, specifically patents and trademarks, our ability to compete could be negatively impacted.

The market for our products depends to a significant extent upon the value associated with our patents and trademarks. We own the material patents and trademarks used in connection with the marketing and distribution of our major products both in the United States and in other countries where such products are principally sold. Although most of our material intellectual property is registered in the United States and in certain foreign countries in which we operate, there can be no assurance with respect to the rights associated with such intellectual property in

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those countries. In addition, the laws of certain foreign countries, including many emerging markets, such as China, may not protect our intellectual property rights to the same extent as the laws of the United States. The costs required to protect our patents and trademarks may be substantial.

We are involved, and may become involved in the future, in legal proceedings that, if adversely adjudicated or settled, could adversely affect our financial results.

We are and may, in the future, become party to litigation, including, for example, claims relating to our customer service or advertisings, or alleging violation of the federal securities or ERISA laws and/or state law. In general, litigation claims can be expensive and time consuming to bring or defend against and could result in settlements or damages that could significantly affect financial results. We are currently vigorously contesting certain of these litigation claims. However, it is not possible to predict the final resolution of the litigation to which we currently are or may in the future become party to, and the impact of certain of these matters on our business, results of operations and financial condition could be material.

Significant changes in pension fund investment performance or assumptions relating to pension costs may have a material effect on the valuation of pension obligations, the funded status of pension plans and our pension cost.

Our funding policy for pension plans is to accumulate plan assets that, over the long run, will approximate the present value of projected benefit obligations. Our pension cost is materially affected by the discount rate used to measure pension obligations, the level of plan assets available to fund those obligations at the measurement date and the expected long-term rate of return on plan assets. Significant changes in investment performance or a change in the portfolio mix of invested assets can result in corresponding increases and decreases in the valuation of plan assets, particularly equity securities, or in a change of the expected rate of return on plan assets. A change in the discount rate would result in a significant increase or decrease in the valuation of pension obligations, affecting the reported funded status of our pension plans as well as the net periodic pension cost in the following fiscal years. Similarly, changes in the expected return on plan assets can result in significant changes in the net periodic pension cost of the following fiscal years. During the fiscal year ended December 31, 2006, we contributed approximately $160.0 to the plans.

The market price of our common stock could be subject to fluctuations as a result of many factors.

Factors that could affect the trading price of our common stock include the following:

- variations in operating results;
- economic conditions and volatility in the financial markets;
- announcements or significant developments with respect to beauty and related products or the beauty industry in general;
- actual or anticipated variations in our quarterly or annual financial results;
- governmental policies and regulations;
- estimates of our future performance or that of our competitors or our industries;
- general economic, political, and market conditions; and
- factors relating to competitors.

The trading price of our common stock has been, and could in the future continue to be, subject to significant fluctuations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our principal properties worldwide consist of manufacturing facilities for the production of CFT products, distribution centers where offices are located and where finished merchandise is packed and shipped to Representatives in fulfillment of their orders, and one principal research and development facility. The domestic manufacturing facilities are located in Morton Grove, IL and Springdale, OH. The domestic distribution centers are located in Atlanta, GA; Glenview, IL; Newark, DE; and Pasadena, CA. The research and development facility is located in Suffern, NY. We also lease office space in two locations in New York City and own property in Rye, NY, for our executive and administrative offices.

Other principal properties outside the U.S measuring 50,000 square feet or more include the following:

three distribution centers for primary use in North America operations (other than in the United States);
five manufacturing facilities, ten distribution centers and one administrative office in Latin America;
three manufacturing facilities in Europe, primarily servicing Western Europe, Middle East & Africa and Central and Eastern Europe;

- four distribution centers and two administrative offices in Western Europe, Middle East & Africa;
- one distribution center and two administrative offices in Central & Eastern Europe;
- two manufacturing facilities, four distribution centers, and three administrative offices in Asia Pacific; and
- one manufacturing facility and twelve distribution centers in China.

Of all the properties listed above, 30 are owned and the remaining 33 are leased. Many of our properties are used for a combination of manufacturing, distribution and administration. These properties are included in the above listing based on primary usage.

We consider all of these properties to be in good repair, to adequately meet our needs and to operate at reasonable levels of productive capacity. In January 2007, we announced plans to restructure our North America distribution operations. This initiative includes the building of a state-of-the-art distribution center in the U.S. Midwest, a location to be determined, that will open in 2009. We will phase-out our current distribution branches in Newark, DE and Glenview, IL with the closures expected to be completed by mid-2009 and mid-2010, respectively.

ITEM 3. LEGAL PROCEEDINGS

Reference is made to Note 14, Contingencies, on pages F-28 through F-30 of this 2006 Annual Report on Form 10-K.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

PART II

ITEM 5. MARKET FOR THE REGISTRANTS COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Avon s Common stock

Avon s Common Stock is listed on the New York Stock Exchange and trades under the AVP ticker symbol. At December 31, 2006, there were approximately 19,092 record holders of Avon s Common Stock. We believe that there are many additional shareholders who are not shareholders of record but who beneficially own and vote shares through nominee holders such as brokers and benefit plan trustees. High and low market prices and dividends per share of Avon s Common Stock, in dollars, for 2006 and 2005 were as follows:

	2006			2005		
Quarter	High	Low	Dividends Declared and Paid	High	Low	Dividends Declared and Paid
First	$ 32.43					