

Allen, mit denen wir zu tun haben, nur das Beste zu bieten

BRINGING THE BEST TO EVERYONE WE TOUCH

Llevándole lo mejor a todos los que nos rodean

将最美好的感受带给与我们接触的每一个人

ДАРИТЬ САМОЕ ЛУЧШЕЕ ВСЕМ, С КЕМ МЫ СОПРИКАСАЕМСЯ

Apporter le Meilleur à Tout ce que Nous Touchons

触れ合う一人ひとりに最高のものを

THE ESTÉE LAUDER
COMPANIES INC.
2007
ANNUAL REPORT

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CoNtEnts

THE ESTÉE LAUDER COMPANIES INC.

The Estée Lauder Companies Inc. is one of the world's leading manufacturers and marketers of quality skin care, makeup, fragrance and hair care products. The Company's products are sold in over 135 countries and territories under well-recognized brand names, including Estée Lauder, Aramis, Clinique, Prescriptives, Lab Series Skincare for Men, Origins, Tommy Hilfiger, M·A·C, Kiton, Bobbi Brown, La Mer, Donna Karan, Aveda, Jo Malone, Bumble and bumble, Michael Kors, Darphin, American Beauty, Flirt!, Good Skin, Grassroots, Sean John Fragrances, Missoni, Daisy Fuentes, Tom Ford, Mustang and Coach.



THE AMERICAS—The Company was founded by Estée Lauder in 1946 in New York City. In Fiscal 2007, the Americas region represented 51% of net sales and 45% of operating income.



EUROPE, THE MIDDLE EAST & AFRICA—Our first international door opened in 1960 in London. In Fiscal 2007, Europe, the Middle East & Africa represented 35% of net sales and 43% of operating income. This region includes results from our travel retail business.



ASIA/PACIFIC—We established a presence in Hong Kong in 1961. In Fiscal 2007, the Asia/Pacific region represented 14% of net sales and 12% of operating income.





POP CULTURE of BEAUTY

ESTÉE LAUDER

Introduced in 1946. Sold in more than 135 countries and territories. Technologically advanced and high-performance products with a reputation for innovation, sophistication and superior quality. Select products: Advanced Night Repair, Advanced Night Repair Concentrate, Perfectionist [CP+] Correcting Serum for Lines/Wrinkles/Age Spots, Re-Nutriv Ultimate Lifting Crème, Resilience Lift Extreme Ultra Firming Crème SPF 15, Resilience Lift Extreme Ultra Firming Makeup SPF 15, Private Collection Tuberose Gardenia, Estée Lauder *pleasures*, Pure White Linen, Beautiful, Beautiful Love, Nutritious Vita-Mineral Radiance Essence, Projectionist High Definition Volume Mascara and Pure Color Lipstick.

ARAMIS

Introduced in 1964. Sold in more than 120 countries and territories. A pioneer in the marketing of prestige men's fragrance, grooming and skin care products. Select products: Aramis Classic fragrance, Aramis 24 Hour Antiperspirant Spray, Aramis 24 Hour High Performance Deodorant Stick and Aramis Invigorating Body Shampoo.

CLINIQUE

Introduced in 1968. Sold in more than 135 countries and territories. A leading skin care and makeup authority, Clinique develops allergy-tested, fragrance-free products based on the research of guiding dermatologists. Select products: 3-Step Skin Care System, Continuous Rescue Antioxidant Moisturizer, Fresh Bloom Allover Colour, Repairwear Intensive Night Cream and Lotion, Superdefense Triple Action Moisturizer SPF 25, Moisture Surge, Turnaround Concentrate, High Impact Mascara, Super City Block Oil-Free Daily Face Protector SPF 40, Clinique Happy and Skin Supplies for Men.

PRESCRIPTIVES

Introduced in 1979. Sold in seven countries. Prescriptives' signature services include the ultra-personalized artistry of Custom Blend Makeup and Colorprinting. Prescriptives focuses on delivering exact match foundations, color cosmetics and skin care. Select products: Flawless Skin Total Protection Makeup, Super Line Preventor Xtreme, Virtual Skin Super Natural Finish Makeup, Anti-AGE Advanced Protection Lotion SPF 25, ★magic by Prescriptives Liquid Powder and Lash Envy Volumizing Mascara.

LAB SERIES SKINCARE FOR MEN

Introduced in 1987. Sold in more than 55 countries and territories. A global leader and authority in men's skin care, Lab Series Skincare For Men is solely dedicated to men and their skin's unique needs. The elite team of doctors, scientists and skin care specialists of the Lab Series Research Center have developed high-performance, technologically advanced skin care, hair and shaving essentials to keep men looking healthy, comfortable and well-groomed. Select products: Maximum Comfort Shave Cream, Triple Benefit Post-Shave Remedy, Root Power Treatment Shampoo, Oil Control Daily Hydrator and Age Rescue Face Lotion.

ORIGINS

Introduced in 1990. Sold in more than 30 countries and territories. The mission at Origins is to promote beauty and wellness through good-for-you products and feel-good experiences. Origins celebrates the connection between Mother Nature and Human Nature. Select products: Peace of Mind On-the-spot relief, Dr. Andrew Weil for Origins Plantidote Mega-Mushroom Face Serum, Dr. Andrew Weil for Origins Plantidote Mega-Mushroom Supplement, Modern Friction Nature's gentle dermabrasion, A Perfect World White tea skin guardian, Modern Fusion, Smileage Plus Liptint, Ain't Misbehavin Lightweight hair spray, Hair Dresser Smooth Styling cream and Youthtopia Skin firming cream with Rhodiola.

TOMMY HILFIGER TOILETRIES

Exclusive global license agreement signed in 1993. Sold in more than 120 countries and territories. Tommy Hilfiger Toiletries produces fragrances and body products that reflect the All-American lifestyle themes of designer Tommy Hilfiger. Select products: tommy, tommy girl, tommy summer, tommy girl summer, tommy 10 and tommy girl 10.

M·A·C

Majority interest acquired in 1994; acquisition completed in 1998. Sold in more than 60 countries and territories. A broad line of color cosmetics, makeup tools, skin care, foundations, fragrances and accessories targeting professional makeup artists and fashion-forward consumers. M·A·C: All races, All sexes, All ages. Select products: Fluidline eyeliner, Studio Touch-Up Stick, Mineralize Eye Shadow, Tendertone Lip Balm SPF 12, Slimshine Lipstick, Lipglass, Lustreglass, Viva Glam and Turquatic fragrance.

KITON

Exclusive global license agreement signed in 1995. Sold in more than 10 countries and territories. Kiton is a fragrance that is the very essence of fashion, elegance, discreet masculinity and of the highest quality pedigree. Introduced in March 2007, Kiton Black is a couture version of the original fragrance that reflects a man's personal style and impeccable taste. Select products: Kiton and Kiton Black.

LA MER

Acquired in 1995. Sold in more than 40 countries and territories. La Mer represents supreme luxury and serious treatment. Crème de la Mer, one of the most innovative and sought-after moisturizers, was conceived by Dr. Max Huber, an aerospace physicist, after an experiment exploded resulting in severe chemical burns to his face. Twelve years later, he perfected Crème de la Mer. Since then, it has evolved into what can only be described as a legend. La Mer has expanded from the original, best-selling Crème de la Mer into a complete range of facial skin care and body products. Select products: The Eye Balm, The Lifting Face Serum and The Radiant Infusion.

BOBBI BROWN

Acquired in 1995. Sold in select retailers in more than 35 countries and territories. An exclusive beauty line developed by celebrated makeup artist Bobbi Brown with a focus on service and teaching women to be their own makeup artists. Professional line includes color cosmetics, skin care, professional makeup brushes and tools, accessories and fragrance. Select products: Luminous Moisturizing Foundation, Creamy Concealer Kit, Shimmer Brick Compact, Long-Wear Gel Eyeliner, Long-Wear Cream Shadow, Lip Color, Hydrating Eye Cream, Extra line of skin care, Bobbi Brown *beach* fragrance and related products.

DONNA KARAN COSMETICS

Exclusive global license agreement signed in 1997. Sold in more than 120 countries and territories. Luxury fragrance, bath and body collections that reflect the quality, style and innovation identified with designer Donna Karan. Select products: Donna Karan Cashmere Mist, Donna Karan Gold, Donna Karan Black Cashmere, Donna Karan Essence, Donna Karan New York, DKNY Be Delicious and DKNY Red Delicious Women, DKNY Be Delicious and DKNY Red Delicious Men, DKNY The Fragrance for Women and DKNY The Fragrance for Men.

AVEDA

Acquired in 1997. Sold in more than 25 countries and territories. Premium professional and consumer hair care, styling, professional hair color, skin, body, spa, aroma, makeup and lifestyle products based on The Art and Science of Pure Flower and Plant Essences that fulfill the brand's mission of environmental leadership and responsibility. Select products: Damage Remedy hair care collection, Color Conserve Strengthening Treatment, Shampure Shampoo and Conditioner, Be Curly Shampoo and Curl Control, Smooth Infusion Shampoo and Conditioner, Outer Peace Foaming Cleanser and Inner Light Liquid Foundation SPF 12.

JO MALONE

Acquired in 1999. Available in more than 10 countries. British fragrance house Jo Malone is an iconic lifestyle collection for the bath, body and home. Exclusive, modern and unique—the world of Jo Malone embodies the spirit of its London heritage. From the refined, unexpected scents to the signature cream and black packaging, the timeless luxury of Jo Malone appeals to discerning women and men around the world. Jo Malone favorites include: Lime Basil & Mandarin Cologne and Home Candle, Orange Blossom Cologne, Pomegranate Noir Cologne, Grapefruit Home Candle, Blue Agava and Cacao Cologne and Vitamin E Nourishing Hand Treatment.

BUMBLE AND BUMBLE

Majority interest acquired in 2000; full purchase completed in September 2006. Sold in more than 15 countries and territories. A New York-based hair care and education company with two salons that creates high-quality hair care and styling products distributed through other top-tier salons and select prestige retailers. Bb. University provides business and design education to the Bumble and bumble network of independent salons. Select products include: Gentle Shampoo, Super Rich Conditioner, Crème de Coco Shampoo and Conditioner, Thickening Spray, Brilliantine, Styling and Tonic Lotions, Sumo Tech moulding compound, Grooming Creme, Surf Spray, Bb. Shine Spray and Hair Powder, which comes in five custom colors.

MICHAEL KORS BEAUTY

Exclusive global license agreement signed and certain assets acquired in 2003. Sold in more than 20 countries and territories. The designer's signature scent, Michael Kors, is a modern interpretation of the classic Tuberose. Select products include: A Modern Perfume, a chic Eau de Toilette and innovative Leg Shine. Since the launch of Island Michael Kors in 2005, the designer has introduced limited-edition island destination fragrances including Island Michael Kors Fiji (2006) and Island Michael Kors Hawaii (2007).

DARPHIN

Acquired in 2003. Sold in more than 50 countries and territories. A well-established, Paris-based brand offering prestige skin care, makeup and spa-inspired body products created from the finest plant extracts and botanical aromas. Sold in independent European pharmacies and spas. Select products: Tangerine Aromatic Care, Arovita C Line Response Firming Serum, Stimulskin Plus Eye Contour Cream, Predermine Cream, Aromatic Purifying Balm, Denblan whitening toothpaste and Volume Shampoo.

AMERICAN BEAUTY

Introduced in 2004. Sold in the United States. American Beauty is a luxurious cosmetics, skin care and fragrance brand that celebrates the beauty of American style. American Beauty is available at Kohl's Department Stores nationwide and online at kohls.com. Select products: Wonderful Perfume Spray, Beauty Boost Overnight Radiance Cream, All is Forgiven Skin Repair Concentrate, Luxury for Lids Eyeshadow Duo and Enduring Beauty Longwear Lipcolor.

FLIRT!

Introduced in 2004. Sold in the United States. FLIRT! is a makeup line with more than 250 shades to play with that is creatively driven by pop culture and celebrity guest creators. Products are housed in innovative, color-matched packaging for easy shade selection. FLIRT! is available at Kohl's Department Stores nationwide and online at kohls.com. Select products: Dreamy Eyes Eyeshadow, Plushious Liquid Velvet Lipcolor, Far Out Lengthening Mascara and Flirtatious! Perfume Spray.

GOOD SKIN

Introduced in 2004. Sold in the United States. Good Skin is a dermatologist-formulated, fragrance-free skin care brand with simple, color-coded packages that allow for self-diagnosis by skin concern. Good Skin is available at Kohl's Department Stores nationwide and online at kohls.com. Select products: Tri-Aktiline Instant Deep Wrinkle Filler, All Bright 2 Step Facial Peel Pads, Microcrystal Skin Refinisher, Instant Lightening Eye Cream, All Firm Rebuilding Serum, All Calm Moisture Cream and All Firm Makeup.

GRASSROOTS

Introduced in 2005. Sold in the United States. Grassroots is a line of naturally-sourced products blended from pure essential oils. Grassroots has product categories for face, body, hair, post-pregnancy, babies and even pets. Grassroots is available at Kohl's Department Stores nationwide and online at kohls.com. Select products: Happily Ever After Scent, Happily Ever After Moisture Cream SPF 15, While You Were Sleeping Overnight Moisture Lotion, In Perfect Condition Deeply Moisturizing Conditioner, Time To Shine Shampoo and Conditioner, and In Good Hands Comforting Hand Cream.

SEAN JOHN FRAGRANCES

Exclusive global license agreement signed in 2005. Sold more than 25 countries and territories. Unforgivable is a premium luxury fragrance that catapulted to immediate success in the United States and around the world. Along with its bath and body collection, Unforgivable reflects the impeccable taste, sophistication, style and belief that “life without passion is Unforgivable” epitomized by multi-media mogul Sean “Diddy” Combs. Select products: Unforgivable, Unforgivable Multi-Platinum, ancillary products including Shower Gel, Deodorant Stick, After Shave and After Shave Balm.

MISSONI PROFUMI

Exclusive global licensing agreement with Missoni signed in 2005. Sold in North America, Australia, Italy, the United Kingdom, Russia, Greece and South Africa. Missoni, the Milan-based fashion house, is celebrated for its vibrant knitwear and engaging graphic designs. After more than 50 years in the fashion business, the Italian knitwear company launched Missoni, an Italian fragrance for women, in Spring 2006, followed by its second fragrance, Missoni acqua in Summer 2007. Select products: Missoni Eau de Parfum, Eau de Toilette, Parfum, Body Lotion and Shower Gel, Face Highlighter Compact and Missoni acqua Eau de Toilette and Body Lotion.

DAISY FUENTES

Introduced in 2006. Sold in the United States. Daisy Fuentes launched with Dianoche Eau de Parfum, her first fragrance. Dianoche offers a fragrance package with two different fragrances in one bottle. A warm and alluring daytime fragrance is complemented by a sexy and mysterious fragrance for night. Dianoche was followed by Daisy’s second fragrance, So Luxurious, launched in July 2007. Daisy Fuentes is available at Kohl’s Department Stores nationwide and online at kohls.com. Other select products: Dianoche Body Shimmer All-Over Moisturizing Lotion and Dianoche Firming Body Cream.

TOM FORD BEAUTY

Exclusive global license agreement signed in 2005. Sold in 16 countries and select travel retail locations. In November 2006, Tom Ford introduced Tom Ford Black Orchid, his first women’s fragrance and the first entry in the Tom Ford Beauty collection. Tom Ford Black Orchid evokes the timeless luxury and worldly glamour reminiscent of classic fragrances from the most elegant fragrance houses. Following the launch of his first scent, Tom Ford also introduced Private Blend, an exclusive line of 12 unisex fragrances, as well as an ancillary collection to complement the Black Orchid scent. Select products: Tom Ford Black Orchid Eau de Parfum, Tom Ford Black Orchid Perfume, Private Blend Collection, Tom Ford Black Orchid Ancillary Collection including Luminous Hair Perfume, Hydrating Emulsion, Cleansing Oil and Finishing Oil.

MUSTANG

Exclusive license agreement signed in 2006. Sold in the United States and Canada. The Mustang fragrance exemplifies the allure of the Mustang man: bold, daring and legendary. Mustang infuses a blend of warm ingredients, including amber, cedar wood and patchouli, into a dynamic signature scent. Select products: Mustang Cologne Spray and After-Shave.

COACH

Introduced in 2007, the first fragrance from Coach embodies the many personalities of the Coach woman, timeless, chic and sophisticated. The Coach fragrance is available exclusively at Coach-based boutiques nationwide. Select products: 1.7 oz Perfume Spray, Purse Spray and Solid Perfume.

Dear Fellow Stockholders:

I am particularly proud of our Company's performance in Fiscal Year 2007.

Our results speak for themselves. Our sales were over \$7 billion, breaking all previous records. We achieved respectable growth in the difficult U.S. market and delivered spectacular results in many international markets, particularly China and Russia. We are growing quickly and gaining market share in many countries around the world.

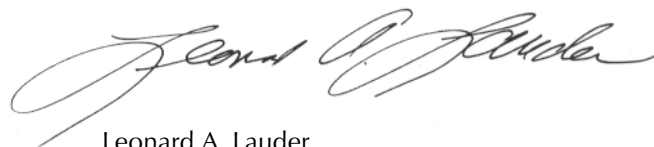
In March of this year, we held a conference for investors and analysts. They were given an in-depth look at our strategy and had an opportunity to interact with many of our senior managers. The participants responded positively to our plans and were impressed with our people.

Of course, we face many challenges and overall market conditions are uncertain. What encourages me is the way our management team is responding. In tough times, we don't run for cover. We are investing in overseas markets, which will give us a broader and better base of business. We are committed to the highest quality and are upgrading our infrastructure. We are always on the watch for the best brands and the best talent. Simply, we are investing today for the success of our business tomorrow.

As William Lauder, our President and Chief Executive Officer, says in his letter to you, our goal is to "remain the preeminent leader in global prestige cosmetics." We have grand ambitions—all of which are achievable.

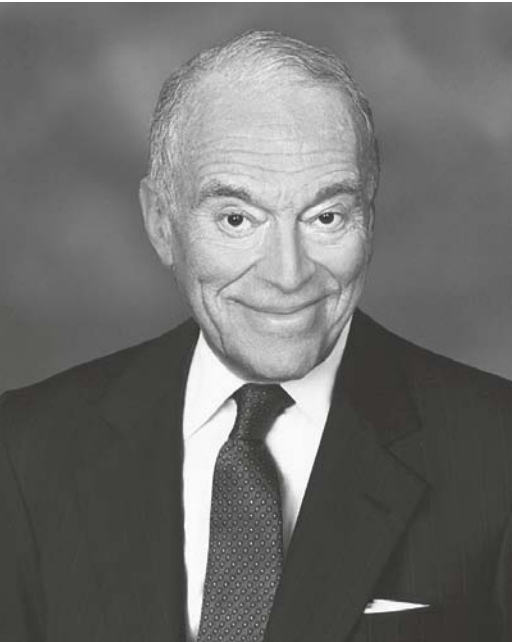
I look forward to writing to you next year to report on our progress and to thank you for your continued support and trust.

Sincerely,



Leonard A. Lauder

Chairman



LEONARD A. LAUDER

Chairman's
MESSAGE

Dear Fellow Stockholders:

Leading People. Leading Growth.

These days, being the President and CEO of an expanding international company requires the leadership skills of a conductor, the persuasive abilities of a great communicator and the street smarts of a small corner merchant. Each brings talents that are important to leading people to growth.

At The Estée Lauder Companies, our single focus is to remain the preeminent leader in global prestige cosmetics. To do that means nurturing three key assets—great brands, great people and great ideas.

This year, sales from our international business again surpassed that of the United States. Most of our 27 brands can be found for sale in international markets, and we will continue to launch them in new markets where appropriate. To meet the demands of an evolving global marketplace, our affiliate networks must be managed by the best talent in the industry.

Like a conductor, my job is to assess the demands of the upcoming performance, match the right people to the right positions and provide the leadership that lets them perform to the best of their abilities. Half of our 35 international affiliates are led by a General Manager who has been in that position three years or less. As Benjamin Franklin once said, “To change is difficult. Not to change is fatal.” It is imperative for us to continue to nurture new talent with fresh thinking to successfully engage in the dynamics of a global business.

Persuasive communication is essential to strong leadership. Communicating our strategy creates transparency and trust. Our five strategic imperatives:

- Optimize our brand portfolio
- Strengthen our product categories
- Strengthen and expand our geographic presence
- Diversify and strengthen our channels of distribution
- Achieve operational and cost excellence

are well known to our management and our key stockholders, alike.

This year, we held conferences around the world to communicate our direction for growth to the financial and supplier communities.

We have also initiated a more proactive approach to communicating with our 28,500 employees worldwide to foster high engagement in their jobs. More robust daily reporting on our corporate Intranet, more frequent personal appearances by our senior management teams and CEO Roundtables are just some of the ways we regularly communicate our values to employees.



WILLIAM P. LAUDER

A better-informed and engaged employee is a more productive employee. We strive to keep their passion alive through professional development. More than 2,000 people attended at least one of the 40-plus training courses we provide during the year for all levels of employees.

Communicating our citizenship values and the impact we have on the communities we touch is as important to us as our economic reporting. We produced our first Corporate Social Responsibility report, *The Beauty of Sustainability*. To view the report, please go to www.elcompanies.com. We value our reputation and are eager to share the commitment we have to *Bringing the Best To Everyone We Touch* on all levels. Every year, our Breast Cancer Awareness Campaign raises millions of dollars for The Breast Cancer Research Foundation. This year, 13 of our brands participated in October Breast Cancer Awareness events.

We need the sharp, keen instincts of a small merchant to stay close to our consumers. Constant listening and observing how they shop remain key touchstones. To ensure that our brands remain fresh in the consumer's mind, we pursue innovation at all levels—from new formulas to the latest technology and the most environmentally friendly packaging—keeping the new product excitement high. We have research centers in Asia, Europe, Canada and the United States that focus on the specific needs of the many faces of global beauty.

The global prestige cosmetics business is a \$37 billion sector. Every year, hundreds of new brands are launched to lure shoppers and compete for their attention. The Estée Lauder Companies is built on the success of its 27 unique brands. This year, four new brands joined our portfolio—Daisy Fuentes with two fragrances at Kohl's, Tom Ford Beauty, Coach and Mustang. Each represents a new approach to reaching the consumer. Tom Ford joins La Mer, Jo Malone and Estée Lauder Re-Nutriv in defining the ultraluxe niche. Coach is our first foray into creating a fragrance exclusively for distribution in the highly successful Coach free-standing fashion stores. Mustang, a collaboration with the Ford Motor Company, interprets the iconic image of the famed Mustang car in a fragrance targeted to the mid-tier retail channel.

As has been the pattern in other years, more than one-third of our revenues come from products that have been launched in the last three years.

M·A·C and Bobbi Brown continue to color our world with outstanding launches in the makeup-artist category, like the best-selling M·A·C Plushglass and Bobbi Brown Long-Wear Cream Shadow. Clinique's consumer tells us she trusts a brand with authority and depends on the brand's expertise at counter. The newly re-vamped Clinique 3-Step Skin Care System reflects the Clinique loyalist's preferences and is a global best seller.

at the estée lauder companies,
our single focus is to remain
the preeminent leader in global
prestige cosmetics.

The just-launched Private Collection Tuberose Gardenia, designed by Aerin Lauder for Estée Lauder, focuses on the aspirational and elegant heritage that is so much a part of the brand's roots. Unforgivable by Sean John is a best seller in the men's lifestyle fragrance arena. Aveda and Bumble and bumble are leading the prestige salon business—each in its own way. As men become more interested in treatment and grooming products, Lab Series Skincare for Men and Clinique Skin Supplies for Men are both poised to capture a larger share of this growing category.

Not only do we focus on what our consumers want, but also on where they shop for prestige beauty. We operate more than 450 free-standing stores for brands including Origins, M·A·C, Jo Malone and Aveda. Sales from our online division grew by more than 25% in Fiscal 2007. In addition to our own sites, our brands are also sold on select retailer sites. Many of our brands are expanding their e-commerce to global markets as consumers around the world use the Internet for shopping.

This year, Bobbi Brown's appearance on QVC became the direct-TV shopping channel's most successful beauty launch in 20 years—selling more product in one hour than any other guest. Sales benefits overflowed from TV to retail counters and on bobbibrowncosmetics.com, as shoppers looked for more from this great brand.

We continue to support our North American department store business through the current wave of consolidations. In Fiscal 2007, Origins entered the dynamic European pharmacy channel, and Darphin has pursued the international spa channel. We are rapidly expanding in the potentially lucrative Chinese market and now have eight brands in China, with the Estée Lauder brand the most widely available in 32 cities.

we need the sharp, keen instincts of a small merchant to stay close to our consumers.

Travel retail has proven to be a vital shopping venue. In spite of the potential challenges at the beginning of the year, travel for business and pleasure grew, as did the retail opportunity within airports and duty-free shops. Our travel retail business responded to the demand with exclusive product offerings that met the unique needs of travelers. We now have 11 brands available in airports and duty-free shops around the world. In Fiscal 2007, sales from our travel retail business grew 16%. Our retail strategies in this arena are setting a new standard for how some of our brands touch consumers. The beautiful Jo Malone store at Heathrow airport in London is a model for the brand's global expansion.

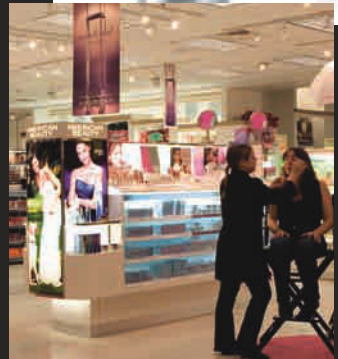
Finally, global growth would not be feasible without the infrastructure to support our concept-to-market product cycles. We are gaining momentum with our Strategic Modernization Initiative. We successfully launched SAP at Aveda in May 2007. We anticipate that the majority of the SAP transformation will take place through Fiscal 2010, at which point we expect to benefit from the full impact of more than \$80 million in savings annually.

I would like to take this moment to thank our Board of Directors for their guidance and support; our Chairman, Leonard Lauder, for providing us with his ongoing wisdom and experience; our management for their dedication and leadership; and all of the employees of The Estée Lauder Companies for their continued passion, drive and commitment to growth.

Sincerely,



William P. Lauder
President and
Chief Executive Officer





ESTÉE LAUDER

Debajo de la piel que ve, está la piel que desea. Réveléla ya. Sin tratamientos con láser. Nuevo. Idealist Pro MicroZing Skin Refinisher

El tratamiento de renovación de la piel con láser puede ser un alternativa para mejorar el aspecto, lo mismo sucede con el. Necesitamos revelar la piel que está debajo de la piel que ve. Necesitamos revelar la piel que está debajo de la piel que ve. Necesitamos revelar la piel que está debajo de la piel que ve.

Más suave, más elástica, perfectamente sin puntos.

Formulado con el nuevo péptido HEMA, nuestra tecnología patentada. Combina el ácido hialurónico y el ácido glicólico para suavizar la superficie de la piel, ayudando a reducir las líneas de expresión y a iluminar la piel.

Más suave, más elástica y luminosa.

Resulta en un aspecto más suave y luminoso que la piel que ve. Necesitamos revelar la piel que está debajo de la piel que ve. Necesitamos revelar la piel que está debajo de la piel que ve. Necesitamos revelar la piel que está debajo de la piel que ve.

Está en la piel que está debajo de la piel que ve. Necesitamos revelar la piel que está debajo de la piel que ve.



PRESCRIPTIVES

Have you been Colorprinted? The service that lets your foundation choose you.

to learn more about Colorprinting, visit www.prescriptives.com or call 1-800-850-8500.

THE NEW ESSENCE

DONNA KARAN GOLD

THE LIGHT OF A WOMAN

OuR bRAnds oUr cHaNNels OuR wOrld



AVEDA

the art and science of plant flower and plant essences

smooth infusion™

smooths and softens hair up to 60%*

Sleek hair styles start with new Smooth Infusion™ Shampoo and Conditioner. Our exclusive plant infusion blend creates a smooth new surface on hair, making it more manageable and easier to style. A hydrolyzed wheat protein complex helps protect hair from heat styling. The smoothest move! Find Aveda toll-free at 866.824.5549 or aveda.com.

*When you use Shampoo and Conditioner together. ©2008 Aveda.

fraGrAnCE





TRENDSPOOT: LIFESTYLE FRAGRANCES INFUSE THE AIR

Soft and sexy; light and floral; elegant and crisp; warm and luxurious; bold and woody, or fruity and fresh... no matter what the moment calls for, today's fragrances are helping to set the mood. A fragrance is as individual and personal as the intimate pulse points it touches. It is the memory that lingers in the room and ignites the senses. Each year, more than 300 new prestige fragrances are introduced.

For The Estée Lauder Companies, where we have a long heritage of creating fragrances that endure and mature into classics, the fragrance category has evolved from personal fragrances for men and women to lifestyle fragrances, aromatherapy fragrances and accessory fragrances that are an integral part of any personal signature. Four of our women's fragrances rank among the top 12 fragrances in U.S. prestige department stores. Classics like Beautiful, Estée Lauder *pleasures* and Clinique Happy endure year after year. Pure White Linen brought a fresh new air to the classic White Linen line from Estée Lauder, attracting a new generation of devotees.

A classic with a cult following, Calyx by Prescriptives celebrates 25 years of being a much-loved fragrance. Tommy Girl 10 celebrates the brand's 10th anniversary with a lush and voluptuous fresh floral fragrance that incorporates notes hand-picked from the American designscape.



Launching new fragrances is as much of an art as creating the fragrance itself. Category breaker Sean John Unforgivable launched with a dramatically different marketing campaign in 2006 and went on to capture a 2007 FiFi Award as Fragrance of the Year in Men's Luxe Category, as well as a 2007 Cosmetic Executive Women CEW Award for Best Men's Launch of 2006. No longer limited to the fragrance bar, Unforgivable has found a place alongside Sean John's stylish menswear and accessories, making it available to a new generation of style-conscious men.

Our portfolio of fragrance brands expanded this year with four new additions. Coach launched a new fragrance for exclusive distribution in its free-standing stores. Designed to reflect the classic elegance of its renowned leather goods and accessories, the fragrance has the true smell of success. Mustang, a new fragrance that brings to life the spirit of the iconic sports car, exemplifies the allure of the Mustang man—bold, daring and legendary. Daisy Fuentes launched her fragrance line at Kohl's with Dianoché Eau de Parfum, followed by So Luxurious.

Tom Ford Beauty unveiled its first fragrance line with an ultraluxe note. Black Orchid, a sensuous and daring fragrance made from the rare black orchid, is sold in limited distribution in U.S. specialty stores, Tom Ford's new Madison Avenue boutique, in limited doors in Europe and in select travel retail locations. From the far corners of the Earth comes Tom Ford's Private Blend Collection, a breathtaking line of 12 highly individual fragrances made from a rare and exotic blend of ingredients. Tom Ford for Men is a new, innovative take on the classic woods category, with an original and distinctive combination of ingredients, some never before used in fragrance.



DKNY Be Delicious continues to be a global favorite. A best seller in travel retail, DKNY Red Delicious is the newest addition. The new Donna Karan Gold collection reflects the designer's passion for design and fragrance in a sensuous new scent inspired by the light of a woman. We are pleased to congratulate Donna Karan on her FiFi Hall of Fame Award from the Fragrance Foundation this year.

Jo Malone fragrances and candles strike a chord synonymous with chic. The brand's philosophy of layering fragrances from your body to your room to the menu for tonight's dinner party elevates the role of fragrance to a new level. New to the line this year is the Latin-inspired Blue Agava and Cacao with notes of blue agava and cardamom. Pomegranate Noir is a sultry fragrance for men and women. It received a prestigious FiFi Award from the U.K. for Best New Fragrance in Limited Distribution for Men and was also recognized by the British Society of Perfumers with the 2006 McCorkey Award for Best Female Fragrance. Jo Malone arrived on the fashionably chic and elegant avenues of Cannes this year with its first free-standing store in France.

Aerin Lauder debuted her luxurious new fragrance, Private Collection Tuberose Gardenia, an homage to the aspirational elegance that the Estée Lauder brand has always represented.

There's a new scent in the air at Missoni Profumi with the introduction of acqua, a luxe scent drenched in "la bella vita" and inspired by the crystal blue waters of the Mediterranean Sea. Island Michael Kors Hawaii is the third Island fragrance from the designer, who bottled his passion for a jet-set lifestyle and exotic travels around the globe with his first destination fragrance, Island Michael Kors, in 2005.

Our commitment to the fragrance category is strong. With more than 50% of our fragrance sales embedded within our core brands, we look to optimize the benefits of our strong, classic line-up and continue to look for ways to create newness.



TRENDSPOT: MAKEUP...NATURALLY

Nothing says “me” more than a woman’s touch with makeup. For many, makeup is the ultimate form of self-expression. This year, the U.S. prestige makeup category took the lead over prestige skin care and fragrance. Our M·A·C artists create 22 million consumer experiences a year, selling 35 eye shadows and 21 lip glosses per minute in the United States, alone. M·A·C is number one in lip gloss, pressed powder and eye shadow in U.S. department stores.

The makeup artist brands are keeping a younger audience attracted and involved in the playfulness of the category. Bobbi Brown’s philosophy to help a woman feel her prettiest and most confident is resonating with women around the world. The “mystique” of Bobbi Brown has made the brand an international best seller—especially in the celebrity-driven Asian markets. Bobbi Brown recently unveiled *Bobbi Brown Living Beauty*, her fourth book, which is dedicated to redefining beauty for women over 40.

When it comes to being playful, M·A·C goes right to the source. M·A·C teamed up with Barbie this year to produce the limited edition *Barbie Loves M·A·C* collection. With its bright candy pinks, buttercup yellows and warm greens, it was the largest color collection in the history of M·A·C. The brand’s first micro-site, barbielovesmac.com, launched the collection.



MAKEUP



Foundation fosters loyalty among women and is often the gateway to a woman's makeup table for our brands. Estée Lauder Doublewear Long Lasting Foundation with 20 shades that promise 15-hour power is the top-selling liquid foundation for the brand in many international markets. Bobbi Brown Luminous Foundation, the brand's first liquid foundation launch in five years, is now the number-one foundation in Korea, selling 2.5 times as much as the next foundation in the region. Custom Blend Makeup from Prescriptives provides an exact match for every skin tone utilizing Prescriptives' Colorprinting analysis for women of all races and shades. Custom Blend Makeup was joined this year by Custom Concealer, an under-eye cream that brings the concept of customization to a new level by giving women the option to select multiple benefits, optics, moisturization and coverage.

One out of every three foundations sold in North American department stores is a Clinique foundation. Best-selling Clinique Perfectly Real Foundation boasts 26 shades geared to every skin tone from very fair to moderately fair to medium to olive dark. Micro-mirrored technology optically resurfaces skin to create a naturally perfect look.

Flirty eyes have it this year, as the wink and blink sector grew aggressively. Projectionist High Definition Volume Mascara from Estée Lauder promises lashes with 2.5 times the volume in a non-clumping, long-wearing formula. Clinique High Definition Lashes Mascara combines the latest in technology with a brush that combs, then brushes lashes for maximum volume. New Lash Envy Volumizing Mascara from Prescriptives frames eyes with voluptuous, luscious lashes delivered by the brand's signature elegant, ergonomically-designed silver wand. Flirt! Far Out Lengthening Mascara, with its innovative molded brush, exceeded expectations as it quickly achieved best-seller status for Kohl's. M·A·C LiquidLast Eyeliner was the top eye launch in U.S. department stores.

Lip plumpers designed for the perfect pout are boosting the lips category. Sales of lip plumpers surged 287% in the United States between 2001 and 2006. Clinique Full Potential Lips Plump and Shine is a super gloss that instantly creates a fuller, lusher, more kissable look, making lips appear smoother and more defined over time.



Plushglass, the lip plumper from M·A·C, moisturizes, soothes and visibly plumps the lips to make them look luxuriously healthy and well-conditioned. Vitamin E adds environmental protection.

Understanding what is important to our consumers extends beyond our product innovation. Our brands not only make our consumers look good...they help them feel good. One hundred percent of the selling prices of M·A·C Viva Glam, the lipstick created to raise money for the M·A·C AIDS FUND, and Lipglass is donated to the M·A·C AIDS Fund. Since the Fund was established in 1994, M·A·C Cosmetics has raised more than \$100 million to support organizations working with underserved regions and communities worldwide that provide programs, services and care for people infected and affected by HIV/AIDS. In Fiscal 2007, the M·A·C AIDS Fund distributed over \$16 million in grants globally and continued to set funding trends by addressing emerging issues in HIV prevention.

Bobbi Brown partnered with QVC to make a \$25,000 donation to Dress for Success, an organization with which she has long been associated.

Origins is committed to promoting beauty and wellness through good-for-you-products and feel-good experiences. As part of this commitment, Origins teams up with a different not-for-profit organization annually, during holiday time, to help save animals from extinction and harm. A one-of-a-kind plush animal is created for Origins and sold alongside its makeup and skin care products. Proceeds from the sale are given to the designated charity.

SKiN CARE





TRENDSPOT: FACE TIME WITH ULTRALUXE

In skin care, the future is today. Ultraluxe, high-performance treatment products are quickly becoming the newest antidote for the latest wrinkle as consumers look for alternatives to in-office procedures. Products that promise to plump, lift, firm, hydrate, contour, de-crease, erase and rescue women from the visible signs of aging are quickly gaining traction at the counter. Advanced technology is giving rise to a new generation of ultraluxe beauty where no ingredient is too luxurious or costly.

Mrs. Estée Lauder launched Advanced Night Repair, the original prestige anti-aging product, 25 years ago. Today, Advanced Night Repair is still as vivacious as the day it was launched, ranking as one of the top-selling anti-aging products in the world. The new Advanced Night Repair Concentrate received the U.K. *Marie Claire* Prix d'Excellence award in 2007.

The proven performance of luxurious Re-Nutriv, where innovation meets indulgence, drove powerhouse growth around the world for this Estée Lauder favorite. Re-Nutriv's manifesto is to find the most effective anti-aging ingredients for its line of prestige serums, creams and lotions.

When it comes to luxe, La Mer is the crème of choice for A-list celebrities. The brand has expanded the core line of Crème de la Mer to include Gel de la Mer, a moisturizing gel cream designed for skin that needs moisturizing



with a lighter touch. New Radiant Infusion and Radiant Facial from La Mer are high-potency, next-generation infusions that deliver extreme radiance, clarity, pore-minimizing and tone.

Dermatologist-recommended continues to drive consumer confidence. Clinique, the first skin care brand developed with dermatologists, is often the last stop before the dermatologist and the first stop after the dermatologist. In North America, two out of every five skin care products sold in department stores are Clinique products.

Clinique celebrates its heritage with its award-winning 3-Step line of skin care basics. New Liquid Facial Soap joins Dramatically Different Moisturizing Lotion and Clarifying Lotion as the number-one choices for cleansing and moisturizing among U.S. department store shoppers. Gentle Cleansing Acne Treatments provide a clear promise to acne sufferers worldwide. Vitamins and antioxidants for your skin? Continuous Rescue from Clinique provides a daily dose that helps skin fight the abusive effects of an aggressive environment.

Prescriptives focuses on aging concerns of women with Super Line Preventor Xtreme Intense Environmental Protection from Prescriptives. A potent cocktail of antioxidants that diminishes the appearance of lines and wrinkles by up to 54%, this anti-aging treatment takes defense against environmental assaults to a new level.

Concerns about the environment are giving rise to non-traditional alternatives for skin care products. Aveda developed Outer Peace acne treatments at the Himalayan Institute of Medicine with two Indian doctors who combined the first naturally-derived salicylic acid with botanicals for proven results in treating ongoing acne.

Health and beauty come together at Origins with Dr. Andrew Weil for Origins. The foremost authority in integrative health care believes there is no beauty without good health. His best-selling Origins products include the Plantidote Mega-Mushroom program, designed to optimize skin's health. Also new from Origins are Youthtopia Skin firming cream with Rhodiola and Skin firming lotion with Rhodiola. These patent-pending



formulas trace their roots to an ancient Siberian plant. They help empower skin to rebound from damaging stress, retrieve its youthful buoyancy and reduce the look of lines and wrinkles.

Tri-Aktiline Instant Deep Wrinkle Filler is the newest in anti-aging from Good Skin. In this one groundbreaking complex, three technologically advanced agents help eliminate the appearance of wrinkles, frown lines, brow lines and under-eye lines on contact.

European pharmacies are a growing channel for skin care. This year, both Origins and Darphin are breaking fresh ground in this dynamic channel. The luxurious new Arovita C collection from Darphin was created for the new, younger generation of French women who want to take proactive measures to fight early signs of aging.

Men's skin care choices continue to expand beyond grooming. Lab Series Skincare for Men received two Grooming Awards from *Men's Health* magazine for Instant Moisture Eye Gel and Oil Control Daily Hydrator.

Enhanced R&D facilities in Japan provide a leading edge for developing products targeted to the unique needs of Asian skin. Nutritious by Estée Lauder, a pomegranate-based skin care solution, targets the younger Asian woman who is seeking healthy, radiant skin. The formula quickly became a top seller in Korea, Japan and Taiwan.

Finally, emerging markets such as Russia, China and Eastern Europe, where luxury skin care is the fastest growing segment, are driving growth for both Estée Lauder and Clinique. In emerging markets such as Brazil, Latin women have a long love affair with looking young. This year, our business in Latin America has excelled as the economies in these markets continue to grow.



TRENDSPOT: PRESTIGE HAIR SHINES WITH HEALTH

From flowing waves and precision razor cuts to dramatic color, finding exactly the right hairdressers and products is top of mind for consumers. Their quest has gotten easier as prestige salons reposition themselves as “beauty destinations,” offering equal access to the world’s best hair designs and products.

The robust global health of the hair care category drives double-digit growth for our brands and their salon partners. Of the top 200 fastest-growing salons in the United States, 142 carry Aveda and/or Bumble and bumble—94 of those selling Aveda exclusively. Both brands are highly respected for their product innovation, artistic inspiration and professional education.

Aveda continues to build loyalty with the new Be Curly line, a four-step curl-perfecting system. In addition to the brand’s successful Curl Enhancer, there is an award-winning new Shampoo and accompanying Conditioner and Curl Control. Formulated to reduce frizz and define texture, the range has increased the brand’s popularity with its growing Hispanic following.

Also gaining traction are new Smooth Infusion Shampoo and Conditioner, which incorporate plant-based ingredients to smooth and soften hair up to 60 percent with daily use. To help lock in color and shine between salon appointments, the brand is offering Color Conserve Strengthening Treatment. The Aveda Men Pure-Formance Hair Care line adds muscle to this high-potential market with products that target men’s concerns.



hair care



International markets are fertile ground for hair care growth. Aveda has launched in Spain and is expanding in Japan with the opening of its Osaka flagship. Its online business is also thriving, along with its new, secure Professional Connections area and site for students and teachers. About 3.5 million people visited aveda.com in 2007.

Education for hairdressers remains an Aveda hallmark. The brand's 42 Concept Schools prepare students for cosmetology licensing, while its Institutes and Advanced Academies teach seasoned pros new tricks. A new curriculum reinforces the brand's commitment to men. Salon owners and managers who have completed the three courses offered by Aveda's Business College report sales growth of up to 110 percent.

The Aveda mission—to care for the world we live in—resonates with consumers and salon professionals, alike. The brand is the largest corporate customer for wind energy in Minnesota, offsetting 100 percent of the electricity used at its distribution center and main manufacturing plant with its purchases of wind energy credits. During Earth Month 2007, Aveda and its salons raised over \$1.8 million to support making clean water a human right. The brand also works with the United Nations to foster sustainable development partnerships between indigenous communities and business.

Bumble and bumble continues to gain momentum as the premier salon-inspired, salon-based brand in prestige distribution. It leverages its reputation for high-quality hairdressing with products such as the best-selling Gentle Shampoo, Super Rich Conditioner and Grooming Crème. These are complemented with specialist collections like Curl Conscious and the Bb. Treatment range.

Bumble and bumble connects with consumers and professionals effectively. Close ties to the world's best-known fashion designers generate buzz for the brand through fashion shows and photo shoots. Demonstrations

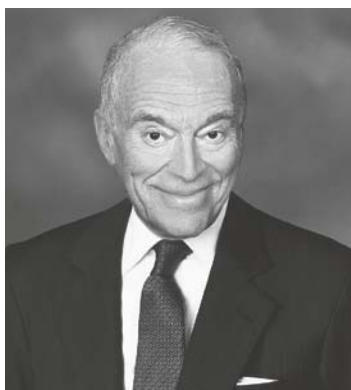


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at trade events and breakthrough educational programs forge lasting connections with salon professionals. The brand connects with owners, managers and stylists online via its Network Educator Certification website and goes live to hairdressers at Bb. University programs at its New York City flagship and in London. Solid growth in the United Kingdom is setting the stage for expansion in Europe.

For the first time, hair color classes led by award-winning colorist Victoria Hunter have introduced Bumble and bumble to hair colorists, whose high-ticket services boost salon income. Also new is “Bumble on Tour,” multi-city road shows for salon customers with lead educators and star stylists such as Jimmy Paul and Laurent Phillipon.

Looking beyond the salon channel, our online sites for Aveda, Bumble and bumble, Clinique and Origins continue to attract visitors. The staff at our Aveda and Origins retail stores give detailed recommendations on cleansing, conditioning, styling and treatment to consumers. Among Origins’ latest offerings are Ain’t Misbehavin Lightweight hair spray and Hair Dresser Smooth styling cream. We are targeting men at department stores with Lab Series Root Power Treatment Shampoo and Clinique Skin Supplies for Men Hair Maximizing Serum. Darphin’s Volume Shampoo with Gleditschia brings high-end hair care to the pharmacy channel, while Grassroots Time to Shine Shampoo and Conditioner attracts consumers to Kohl’s across the United States.



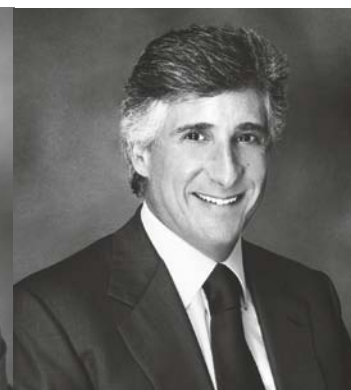
LEONARD A. LAUDER³
Chairman
The Estée Lauder Companies Inc.



CHARLENE BARSHEFSKY³
Senior International Partner
Wilmer Cutler Pickering Hale
and Dorr LLP



ROSE MARIE BRAVO, CBE^{2,4}
Former Vice Chairman
Burberry Group Plc.



PAUL J. FRIBOURG¹
Chairman
Chief Executive Officer
ContiGroup Companies, Inc.



MELLODY HOBSON¹
President
Ariel Capital Management, LLC



IRVINE O. HOCKADAY, JR.¹
Retired President and
Chief Executive Officer
Hallmark Cards, Inc.



AERIN LAUDER
Senior Vice President
Creative Director
Estée Lauder



RONALD S. LAUDER
Chairman
Clinique Laboratories, LLC



WILLIAM P. LAUDER
President
Chief Executive Officer
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RICHARD D. PARSONS^{2,3}
Chairman
Chief Executive Officer
Time Warner Inc.



LYNN FORESTER
DE ROTHSCHILD^{2,3,4}
Chief Executive
EL Rothschild LLC



BARRY S. STERNLICHT¹
President
Chief Executive Officer
Starwood Capital Group

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- 2. Member of Compensation Committee
- 3. Member of Nominating and Board Affairs Committee
- 4. Member of Stock Plan Subcommittee

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Executive Vice President
Global Operations

PATRICK BOUSQUET-CHAVANNE
Group President

DANIEL J. BRESTLE
Chief Operating Officer

EVELYN H. LAUDER
Senior Corporate Vice President

ROGER CARACAPPA
Executive Vice President
Global Packaging,
Quality Assurance,
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Design and Merchandising

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Clinique Laboratories, LLC

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General Counsel

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Global Research and Development

CEDRIC PROUVÉ
Group President

RICHARD W. KUNES
Executive Vice President
Chief Financial Officer

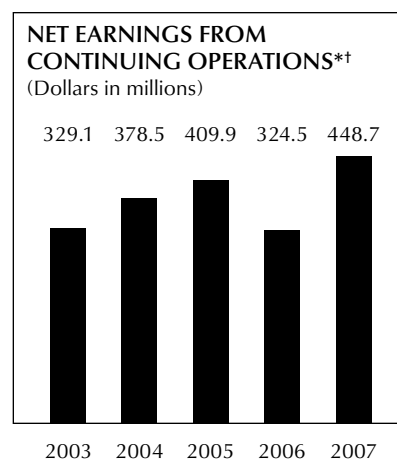
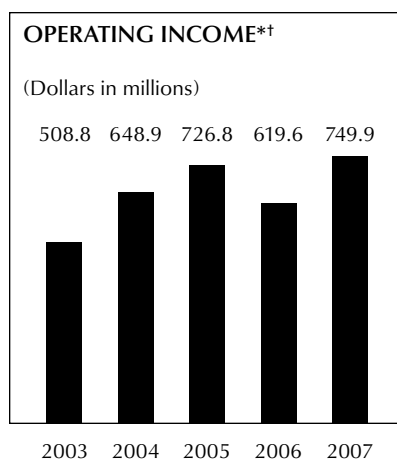
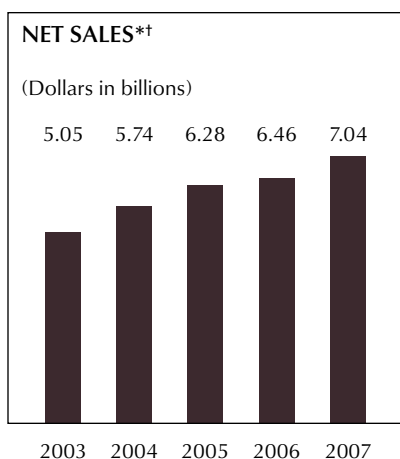
PHILIP SHEARER
Group President

SALLY SUSMAN
Executive Vice President
Global Communications

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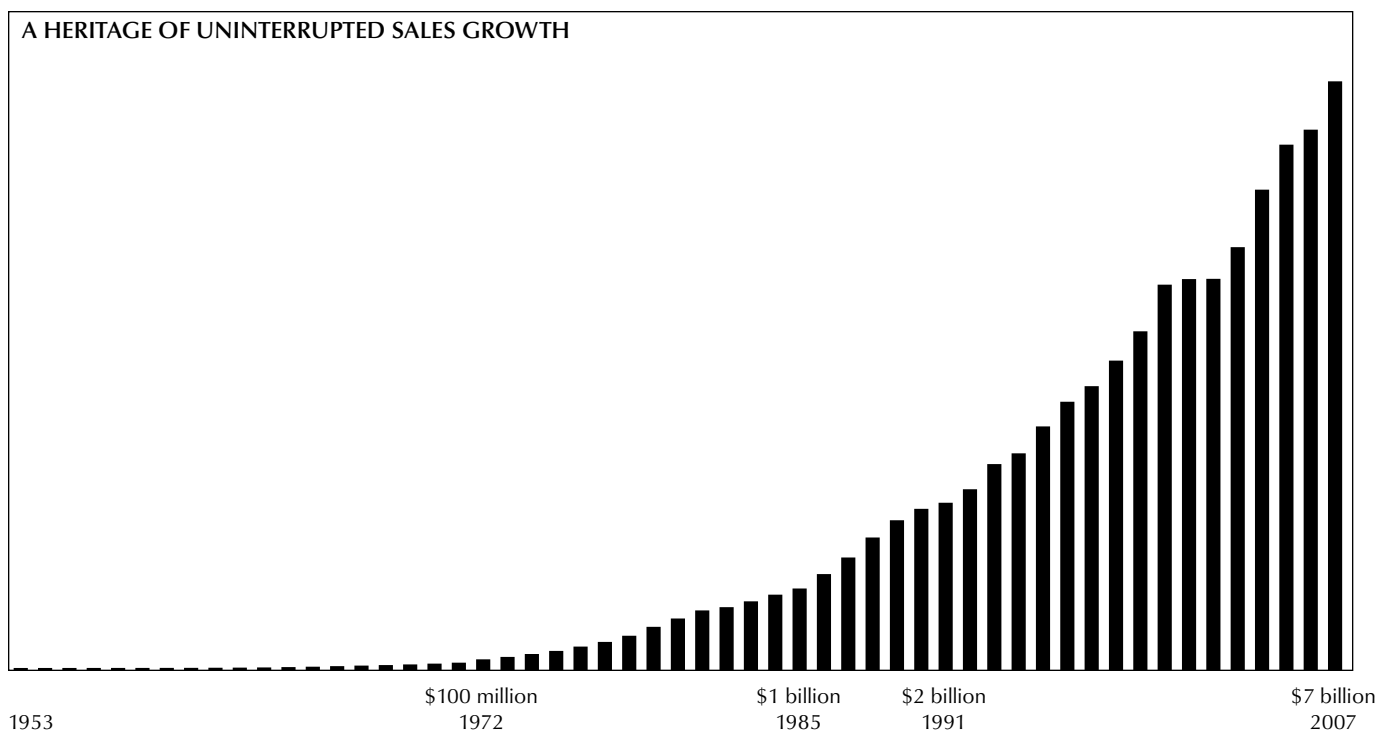
FINANCIAL HIGHLIGHTS

FOR THE FISCAL YEAR ENDED JUNE 30 (Dollars in millions, except per share data)	2006	Percent Change
Net Sales [†]	\$6,463.8	9%
Operating Income ^{*†}	619.6	21%
Net Earnings from Continuing Operations ^{*†}	324.5	38%
Net Earnings Per Common Share from Continuing Operations—Diluted ^{*†}	1.49	45%
Total Assets	\$3,784.1	9%
Stockholders' Equity	1,622.3	(26%)



* Refer to Selected Financial Data and related footnotes on page 33.

† In April 2006, we completed the sale of certain assets and operations of the reporting unit that marketed and sold Stila brand products. In February 2004, we sold the assets and operations of our former reporting unit that sold jane brand products. As a result, statements of earnings information for all periods presented has been restated to reflect those reporting units as discontinued operations.



SELECTED FINANCIAL DATA

The table below summarizes selected financial information. For further information, refer to the audited consolidated financial statements and the notes thereto beginning on page 55 of this report.

YEAR ENDED OR AT JUNE 30	2007	2006 ^(a)	2005 ^(b)	2004	2003 ^(c)
(In millions, except per share data)					
STATEMENT OF EARNINGS DATA:					
Net sales	\$7,037.5	\$6,463.8	\$6,280.0	\$5,741.5	\$5,049.8
Gross profit	5,262.7	4,777.2	4,677.2	4,277.2	3,736.5
Operating income	749.9	619.6	726.8	648.9	508.8
Interest expense, net ^(d)	38.9	23.8	13.9	27.1	8.1
Earnings before income taxes, minority interest, discontinued operations and accounting change	711.0	595.8	712.9	621.8	500.7
Provision for income taxes	255.2	259.7	293.7	234.4	164.9
Minority interest, net of tax	(7.1)	(11.6)	(9.3)	(8.9)	(6.7)
Net earnings from continuing operations	448.7	324.5	409.9	378.5	329.1
Discontinued operations, net of tax ^(e)	0.5	(80.3)	(3.8)	(36.4)	(9.3)
Net earnings	449.2	244.2	406.1	342.1	319.8
Preferred stock dividends ^(d)	—	—	—	—	23.4
Net earnings attributable to common stock	449.2	244.2	406.1	342.1	296.4
CASH FLOW DATA:					
Net cash flows provided by operating activities	\$ 661.6	\$ 709.8	\$ 478.1	\$ 673.0	\$ 558.6
Net cash flows used for investing activities	(373.8)	(303.2)	(237.0)	(213.7)	(198.0)
Net cash flows used for financing activities	(411.6)	(594.6)	(300.4)	(216.0)	(555.0)
PER SHARE DATA:					
Net earnings per common share from continuing operations ^(e) :					
Basic	\$ 2.20	\$ 1.51	\$ 1.82	\$ 1.66	\$ 1.31
Diluted	\$ 2.16	\$ 1.49	\$ 1.80	\$ 1.64	\$ 1.30
Net earnings per common share:					
Basic	\$ 2.20	\$ 1.14	\$ 1.80	\$ 1.50	\$ 1.27
Diluted	\$ 2.16	\$ 1.12	\$ 1.78	\$ 1.48	\$ 1.26
Weighted average common shares outstanding ^(g) :					
Basic	204.3	215.0	225.3	228.2	232.6
Diluted	207.8	217.4	228.6	231.6	234.7
Cash dividends declared per common share	\$.50	\$.40	\$.40	\$.30	\$.20
BALANCE SHEET DATA:					
Working capital	\$ 738.7	\$ 738.7	\$ 804.9	\$ 877.2	\$ 791.3
Total assets	4,125.7	3,784.1	3,885.8	3,708.1	3,349.9
Total debt ^{(d), (f)}	1,088.5	521.5	714.7	535.3	291.4
Redeemable preferred stock ^(d)	—	—	—	—	360.0
Stockholders' equity ^(g)	1,199.0	1,622.3	1,692.8	1,733.5	1,423.6

(a) Fiscal 2006 results included \$93.0 million, after-tax, or \$.43 per diluted share in special charges related to our cost savings initiative and tax-related matters. Included in the charges was an operating expense charge of \$92.1 million, equal to \$.27 per diluted common share related to the cost savings initiative. The results also included a special tax charge related to a settlement with the Internal Revenue Service regarding an examination of our consolidated Federal income tax returns for fiscal years 1998 through 2001, and represents the aggregate earnings impact of the settlement through fiscal 2006. The settlement resulted in an increase to our fiscal 2006 income tax provision and a corresponding decrease in fiscal 2006 net earnings of approximately \$46 million, or approximately \$.21 per diluted common share. During the fourth quarter of fiscal 2006, we completed the repatriation of foreign earnings through intercompany dividends under the provisions of the American Jobs Creation Act of 2004 (the "AJCA"). In connection with the repatriation, we updated the computation of the related aggregate tax impact, resulting in a favorable adjustment of approximately \$11 million, or approximately \$.05 per diluted common share, to our initial tax charge of \$35 million recorded in fiscal 2005. The tax settlement, coupled with the AJCA favorable tax adjustment, resulted in a net increase to our fiscal 2006 income tax provision and a corresponding decrease in fiscal 2006 net earnings of approximately \$35 million, or approximately \$.16 per diluted common share.

(b) In the fourth quarter of fiscal 2005, we announced plans to repatriate approximately \$690 million of foreign earnings in fiscal year 2006, which included \$500 million of extraordinary intercompany dividends under the provisions of the AJCA. This action resulted in an aggregate tax charge of approximately \$35 million in our fiscal year ended June 30, 2005, which included an incremental tax charge of approximately \$28 million, equal to \$.12 per diluted share.

(c) Fiscal 2003 included a special charge related to the proposed settlement of a legal action of \$13.5 million, after-tax, or \$.06 per diluted common share.

(d) During fiscal 2004, there was an increase of approximately \$17.4 million in interest expense, net and a corresponding decrease in preferred stock dividends as a result of the adoption of Statement of Financial Accounting Standards ("SFAS") No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." Additionally, in connection with this pronouncement, redeemable preferred stock was reclassified as a component of total debt subsequent to June 30, 2003 and all subsequent applicable periods.

(e) In April 2006, we completed the sale of certain assets and operations of the reporting unit that marketed and sold Stila brand products. In February 2004, we sold the assets and operations of our former reporting unit that sold Jane brand products. As a result, all consolidated statements of earnings information in the consolidated financial statements and footnotes for all periods presented has been restated for comparative purposes to reflect those reporting units as discontinued operations.

(f) In May 2007, we issued and sold \$300.0 million of 5.55% Senior Notes due May 15, 2017 and \$300.0 million of 6.00% Senior Notes, due May 15, 2037 in a public offering. We used the net proceeds of this offering to repay long-term commercial paper, which was used to fund our accelerated stock repurchase program, and to pay transaction fees and expenses related to this offering.

(g) During fiscal 2007, we repurchased 22,461,642 shares of our outstanding common stock, of which 15,960,842 shares were purchased for \$750.0 million through an accelerated stock repurchase program with a financial counterparty.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition at June 30, 2007 and our results of operations for the three fiscal years ended June 30, 2007 are based upon our consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be subjective and complex, and consequently actual results could differ from those estimates. Our most critical accounting policies relate to revenue recognition, concentration of credit risk, inventory, pension and other post-retirement benefit costs, goodwill and other intangible assets, income taxes, derivatives and stock-based compensation.

Management of the Company has discussed the selection of significant accounting policies and the effect of estimates with the Audit Committee of the Company's Board of Directors.

REVENUE RECOGNITION

Revenues from merchandise sales are recognized upon transfer of ownership, including passage of title to the customer and transfer of the risk of loss related to those goods. In the Americas region, sales are generally recognized at the time the product is shipped to the customer and in the Europe, Middle East & Africa and Asia/Pacific regions sales are generally recognized based upon the customer's receipt. In certain circumstances, transfer of title takes place at the point of sale, for example, at our retail stores. Sales at our retail stores and online are recognized in accordance with a 4-4-5 retail calendar.

Revenues are reported on a net sales basis, which is computed by deducting from gross sales the amount of actual product returns received, discounts, incentive arrangements with retailers and an amount established for anticipated product returns. Our practice is to accept product returns from retailers only if properly requested, authorized and approved. In accepting returns, we typically provide a credit to the retailer against accounts receivable from that retailer. As a percentage of gross sales, returns were 4.2%, 5.0% and 4.6% in fiscal 2007, 2006 and 2005, respectively.

Our sales return accrual is a subjective critical estimate that has a direct impact on reported net sales. This accrual is calculated based on a history of actual returns, estimated

future returns and information provided by authorized retailers regarding their inventory levels. Consideration of these factors results in an accrual for anticipated sales returns that reflects increases or decreases related to seasonal fluctuations. Experience has shown a relationship between retailer inventory levels and sales returns in the subsequent period, as well as a consistent pattern of returns due to the seasonal nature of our business. In addition, as necessary, specific accruals may be established for significant future known or anticipated events. The types of known or anticipated events that we have considered, and will continue to consider, include, but are not limited to, the financial condition of our customers, store closings by retailers, changes in the retail environment and our decision to continue or support new and existing products.

CONCENTRATION OF CREDIT RISK

An entity is vulnerable to concentration of credit risk if it is exposed to risks of loss greater than it would have if it mitigated its risks through diversification of customers. The significance of such credit risk depends on the extent and nature of the concentration.

During fiscal 2006, Federated Department Stores, Inc. acquired The May Department Stores Company, resulting in the merger of our previous two largest customers (collectively "Macy's, Inc."). This customer sells products primarily within North America and accounted for \$958.8 million, or 14%, and \$1,005.8 million, or 16%, of our consolidated net sales in fiscal 2007 and 2006, respectively. This customer accounted for \$105.3 million, or 12%, and \$105.4 million, or 14%, of our accounts receivable at June 30, 2007 and 2006, respectively. Although management believes that this customer and our other major customers are sound and creditworthy, a severe adverse impact on their business operations could have a corresponding material adverse effect on our net sales, cash flows and/or financial condition.

In the ordinary course of business, we have established an allowance for doubtful accounts and customer deductions in the amount of \$23.3 million and \$27.1 million as of June 30, 2007 and 2006, respectively. Our allowance for doubtful accounts is a subjective critical estimate that has a direct impact on reported net earnings. The allowance for doubtful accounts was reduced by \$18.2 million, \$12.0 million and \$12.6 million for customer deductions and write-offs in fiscal 2007, 2006 and 2005, respectively, and increased by \$14.4 million, \$10.2 million and \$11.4 million for additional provisions in fiscal 2007, 2006 and

2005, respectively. This reserve is based upon the evaluation of accounts receivable aging, specific exposures and historical trends.

INVENTORY

We state our inventory at the lower of cost or fair market value, with cost being determined on the first-in, first-out (FIFO) method. We believe FIFO most closely matches the flow of our products from manufacture through sale. The reported net value of our inventory includes saleable products, promotional products, raw materials and componentry and work in process that will be sold or used in future periods. Inventory cost includes raw materials, direct labor and overhead.

We also record an inventory obsolescence reserve, which represents the difference between the cost of the inventory and its estimated realizable value, based on various product sales projections. This reserve is calculated using an estimated obsolescence percentage applied to the inventory based on age, historical trends and requirements to support forecasted sales. In addition, and as necessary, we may establish specific reserves for future known or anticipated events.

PENSION AND OTHER POST-RETIREMENT BENEFIT COSTS

We offer the following benefits to some or all of our employees: a domestic trust-based noncontributory qualified defined benefit pension plan (“U.S. Qualified Plan”) and an unfunded, non-qualified domestic non-contributory pension plan to provide benefits in excess of statutory limitations (collectively with the U.S. Qualified Plan, the “Domestic Plans”); a domestic contributory defined contribution plan; international pension plans, which vary by country, consisting of both defined benefit and defined contribution pension plans; deferred compensation arrangements; and certain other post-retirement benefit plans.

The amounts needed to fund future payouts under these plans are subject to numerous assumptions and variables. Certain significant variables require us to make assumptions that are within our control such as an anticipated discount rate, expected rate of return on plan assets and future compensation levels. We evaluate these assumptions with our actuarial advisors and we believe they are within accepted industry ranges, although an increase or decrease in the assumptions or economic events outside our control could have a direct impact on reported net earnings.

The pre-retirement discount rate for each plan used for determining future net periodic benefit cost is based on a review of highly rated long-term bonds. For fiscal 2007, we used a pre-retirement discount rate for our Domestic Plans of 6.25% and varying rates on our international plans of between 2.25% and 6.25%. The pre-retirement rate for our Domestic Plans is based on a bond portfolio that includes only long-term bonds with an Aa rating, or equivalent, from a major rating agency. We believe the timing and amount of cash flows related to the bonds included in this portfolio is expected to match the estimated defined benefit payment streams of our Domestic Plans. For fiscal 2007, we used an expected return on plan assets of 7.75% for our U.S. Qualified Plan and varying rates of between 2.75% and 7.25% for our international plans. In determining the long-term rate of return for a plan, we consider the historical rates of return, the nature of the plan’s investments and an expectation for the plan’s investment strategies. The U.S. Qualified Plan asset allocation as of June 30, 2007 was approximately 49% equity investments, 31% fixed income investments and 20% other investments. The asset allocation of our combined international plans as of June 30, 2007 was approximately 55% equity investments, 29% fixed income investments and 16% other investments. The difference between actual and expected returns on plan assets is accumulated and amortized over future periods and, therefore, affects our recorded obligations and recognized expenses in such future periods. For fiscal 2007, our pension plans had actual returns on assets of \$80.1 million as compared with expected returns on assets of \$42.5 million, which resulted in a net deferred gain of \$37.6 million.

A 25 basis-point change in the discount rate or the expected rate of return on plan assets would have had the following effect on fiscal 2007 pension expense:

	25 Basis-Point Increase	25 Basis-Point Decrease
(In millions)		
Discount rate	\$(2.5)	\$2.7
Expected return on assets	\$(1.5)	\$1.5

Our post-retirement plans are comprised of health care plans that could be impacted by health care cost trend rates, which may have a significant effect on the amounts reported. A one-percentage-point change in assumed health care cost trend rates for fiscal 2007 would have had the following effects:

(In millions)	One-Percentage- Point Increase	One-Percentage- Point Decrease
Effect on total service and interest costs	\$ 1.5	\$ (1.3)
Effect on post-retirement benefit obligations	\$12.1	\$(10.8)

For fiscal 2008, we are using a pre-retirement discount rate for the Domestic Plans of 6.25% and varying rates for our international plans of between 2.25% and 6.25%. We are using an expected return on plan assets of 7.75% for the U.S. Qualified Plan and varying rates for our international pension plans of between 3.00% and 6.75%. The net change in these assumptions from those used in fiscal 2007 will result in a decrease in pension expense of approximately \$2.0 million in fiscal 2008. We will continue to monitor the market conditions relative to these assumptions and adjust them accordingly.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is calculated as the excess of the cost of purchased businesses over the fair value of their underlying net assets. Other intangible assets principally consist of purchased royalty rights and trademarks. Goodwill and other intangible assets that have an indefinite life are not amortized.

On an annual basis, or more frequently if certain events or circumstances warrant, we test goodwill and other indefinite-lived intangible assets for impairment. To determine the fair value of these intangible assets, there are many assumptions and estimates used that directly impact the results of the testing. We have the ability to influence the outcome and ultimate results based on the assumptions and estimates we choose. To mitigate undue influence, we use industry accepted valuation models and set criteria that are reviewed and approved by various levels of management and, in certain instances, we engage third-party valuation specialists to advise us.

INCOME TAXES

We account for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," as amended. This statement establishes financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. It requires an asset and liability approach for financial accounting and reporting of income taxes.

As of June 30, 2007, we have current net deferred tax assets of \$124.0 million and non-current net deferred tax liabilities of \$16.6 million. The net deferred tax assets assume sufficient future earnings for their realization, as well as the continued application of currently anticipated tax rates. Included in net deferred tax assets is a valuation allowance of approximately \$5.5 million for deferred tax assets, where management believes it is more likely than not that the deferred tax assets will not be realized in the relevant jurisdiction. Based on our assessments, no additional valuation allowance is required. If we determine that a deferred tax asset will not be realizable, an adjustment to the deferred tax asset will result in a reduction of earnings at that time.

We provide tax reserves for Federal, state, local and international exposures relating to periods subject to audit. The development of reserves for these exposures requires judgments about tax issues, potential outcomes and timing, and is a subjective critical estimate. Although the outcome relating to these exposures is uncertain, in management's opinion adequate provisions for income taxes have been made for estimable potential liabilities emanating from these exposures. In certain circumstances, the ultimate outcome of exposures and risks involves significant uncertainties which render them inestimable. If actual outcomes differ materially from these estimates, including those that cannot be quantified, they could have a material impact on our results of operations, as we experienced in the fourth quarter of fiscal 2006 (see "Results of Operations, Fiscal 2006 as Compared with Fiscal 2005—Provision for Income Taxes").

DERIVATIVES

We account for derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. This statement also requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet and that they be measured at fair value.

We currently use derivative financial instruments to hedge certain anticipated transactions and interest rates, as well as receivables and payables denominated in foreign currencies. We do not utilize derivatives for trading or speculative purposes. Hedge effectiveness is documented, assessed and monitored by employees who are qualified to make such assessments and monitor the

instruments. Variables that are external to us such as social, political and economic risks may have an impact on our hedging program and the results thereof. For a discussion on the quantitative impact of market risks related to our derivative financial instruments, refer to *"Liquidity and Capital Resources—Market Risk."*

STOCK-BASED COMPENSATION

We are required to record the fair value of stock-based compensation awards as an expense in accordance with SFAS No. 123(R), "Share-Based Payment," as amended. In order to determine the fair value of stock options on the date of grant, we apply the Black-Scholes option-pricing model. Inherent in this model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions that are based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a greater level of judgment which makes them critical accounting estimates.

We use an expected stock-price volatility assumption that is a combination of both current and historical implied volatilities of the underlying stock which are obtained from public data sources. This approach is used as a predictor of future realized and implied volatilities and is directly related to stock option valuation. For stock option grants issued during the fiscal year ended June 30, 2007, we used a weighted-average expected stock-price volatility of 24% based upon the implied volatility at the time of issuance.

With regard to the weighted-average option life assumption, we consider the exercise behavior of past grants and model the pattern of aggregate exercises. Patterns are determined based on specific criteria of the aggregate pool of optionees including the reaction to vesting, realizable value, long-run exercise propensity, pent-up demand, stock run-up effect and short-time-to-maturity effect. For stock option grants issued during the fiscal year ended June 30, 2007, we used a weighted-average expected option life assumption of approximately 8 years.

While we believe the above critical estimates are based on outcomes that are reasonably likely to occur, if we were to increase or decrease the expected option life by one year and simultaneously increase or decrease the expected volatility by 100 basis points, recognized compensation expense would have changed approximately \$2.0 million in either direction for the fiscal year ended June 30, 2007.

QUANTITATIVE ANALYSIS

During the three-year period ended June 30, 2007, there have not been material changes in the assumptions underlying these critical accounting policies, nor to the related significant estimates. With the exception of our tax settlement with the Internal Revenue Service in the fourth quarter of fiscal 2006, which finalized the ultimate liability for exposures which were previously inestimable (see *"Results of Operations, Fiscal 2006 as Compared with Fiscal 2005—Provision for Income Taxes"*), the results of our business underlying these assumptions have not differed significantly from our expectations.

While we believe that the estimates that we have made are proper and the related results of operations for the period are presented fairly in all material respects, other assumptions could reasonably be justified that would change the amount of reported net sales, cost of sales, operating expenses or our provision for income taxes as they relate to the provisions for anticipated sales returns, allowance for doubtful accounts, inventory obsolescence reserve and income taxes. For fiscal 2007, had these estimates been changed simultaneously by 2.5% in either direction, our reported gross profit would have increased or decreased by approximately \$4.7 million, operating expenses would have changed by approximately \$0.6 million and the provision for income taxes would have increased or decreased by approximately \$1.4 million. The collective impact of these changes on operating income, net earnings and net earnings per diluted common share would be an increase or decrease of approximately \$5.3 million, \$6.7 million and \$.03, respectively.

RESULTS OF OPERATIONS

OVERVIEW

We manufacture, market and sell skin care, makeup, fragrance and hair care products which are distributed in over 135 countries and territories. We believe that the best way to increase stockholder value is to provide our customers and consumers with the products and services that they have come to expect from us in the most efficient and profitable manner. With this goal in mind, we have developed a long-term strategy based on the following five imperatives:

1. Optimize brand portfolio
2. Strengthen product categories
3. Strengthen and expand geographic presence
4. Diversify and strengthen distribution channels
5. Achieve operational and cost excellence

In fiscal 2007, we continued to find ways to strengthen our core brands and product categories, maximize high-growth brands, incubate and develop next generation brands and divest non-strategic brands. Net sales from Estée Lauder and Clinique grew on a global basis, fueled by strong demand overseas. Our faster growing M·A·C, Bobbi Brown, La Mer, Jo Malone and Aveda brands continued to grow in virtually all regions and we acquired the remaining equity interest in Bumble and bumble. Sean John Unforgivable continued to be a success at retail in North America and we rolled out the brand in certain international markets during fiscal 2007. We launched products under the Tom Ford brand name in North America and Europe and entered into a license agreement with Ford Motor Company to create a fragrance using the name Mustang. In July 2007, we acquired the Ojon Corporation, a privately held hair care and skin care company based in Canada. In August 2007, we sold Rodan + Fields back to its founders.

The majority of our net sales continue to be generated outside the United States. Around the globe, we generated growth in sales and profits in our travel retail business and increased our presence in China and Russia. We also acquired a distributor in Turkey and established an affiliate in Brazil.

In alternative distribution channels, we continued to grow our online business in North America, where products from most of our brands are available at Company-owned websites. However, in order to streamline this business, we terminated our majority-owned Gloss.com joint venture. In addition, we recently expanded the online business into the United Kingdom, Australia and France. Certain of our products are now available at specialty retailers such as Sephora, ULTA, and Shoppers Drug Mart. We made strategic investments to establish the platform upon which we intend to build our pharmacy channel business in Europe. Origins has recently expanded into the French pharmacy channel. We also began to expand the number of Company-owned Jo Malone retail stores in Europe, including the brand's first French store in Cannes.

We continued to make progress on our Strategic Modernization Initiative ("SMI"). In May 2007, our Aveda operating unit began using SAP software, a critical part of SMI. We anticipate SMI implementation will continue at additional locations in fiscal 2008, with the majority of our locations to be implemented through fiscal 2010.

Despite the rise in energy and raw material costs, we were able to improve our overall cost of goods margin by negotiating new contracts with suppliers and achieving significant savings by sourcing from Asia. We also reduced the number of our global manufacturing and distribution facilities by increasing the use of third-parties to control shipping and warehousing costs. In addition, we improved speed to market of new SKUs and expanded our hub warehouse concept, which allows us to take components on a just-in-time basis.

During fiscal 2007, we also faced challenges, many of which we expect to be ongoing in fiscal 2008. For instance, we continue to see challenges for certain of our core brands due in part to the consolidation and changes taking place among retailers and the decline in effectiveness of gift-with-purchase promotions. In addition, the fragrance business model continues to be a challenge, with even the most successful launches having difficulty becoming profitable. Efforts to expand geographically are complicated by increasing regulatory issues and cultural barriers.

As we continue to implement our strategic imperatives, we expect to make selective investments, embark on new business endeavors, and pursue initiatives that we believe will have long-term benefits. The timing, impact and magnitude of any particular actions, such as an acquisition to strengthen our product categories and/or diversify our distribution channels, are subject to numerous factors and cannot be predicted.

The following table is a comparative summary of operating results from continuing operations for fiscal 2007, 2006 and 2005 and reflects the basis of presentation described in Note 2 and Note 17 to the Notes to Consolidated Financial Statements for all periods presented. Products and services that do not meet our definition of skin care, makeup, fragrance and hair care have been included in the "other" category.

YEAR ENDED JUNE 30	2007	2006	2005
(In millions)			
NET SALES			
By Region:			
The Americas	\$3,560.9	\$3,446.4	\$3,351.1
Europe, the Middle East & Africa	2,493.4	2,147.7	2,109.1
Asia/Pacific	983.2	869.7	819.8
	\$7,037.5	\$6,463.8	\$6,280.0
By Product Category:			
Skin Care	\$2,601.0	\$2,400.8	\$2,352.1
Makeup	2,712.7	2,504.2	2,366.8
Fragrance	1,308.6	1,213.3	1,260.6
Hair Care	377.1	318.7	273.9
Other	38.1	26.8	26.6
	\$7,037.5	\$6,463.8	\$6,280.0
OPERATING INCOME			
By Region:			
The Americas	\$ 336.4	\$ 344.1	\$ 366.2
Europe, the Middle East & Africa	321.4	297.5	305.3
Asia/Pacific	93.2	70.1	55.3
Special charges related to cost savings initiative*	(1.1)	(92.1)	—
	\$ 749.9	\$ 619.6	\$ 726.8
By Product Category:			
Skin Care	\$ 341.5	\$ 346.4	\$ 365.8
Makeup	339.3	329.4	301.1
Fragrance	28.1	7.7	35.8
Hair Care	42.5	26.5	22.8
Other	(0.4)	1.7	1.3
Special charges related to cost savings initiative*	(1.1)	(92.1)	—
	\$ 749.9	\$ 619.6	\$ 726.8

The following table presents certain consolidated earnings data as a percentage of net sales:

YEAR ENDED JUNE 30	2007	2006	2005
Net sales	100.0%	100.0%	100.0%
Cost of sales	25.2	26.1	25.5
Gross profit	74.8	73.9	74.5
Operating expenses:			
Selling, general and administrative	64.1	62.9	62.9
Special charges related to cost savings initiative	—	1.4	—
	64.1	64.3	62.9
Operating income	10.7	9.6	11.6
Interest expense, net	0.6	0.4	0.2
Earnings before income taxes, minority interest and discontinued operations	10.1	9.2	11.4
Provision for income taxes	3.6	4.0	4.7
Minority interest, net of tax	(0.1)	(0.2)	(0.2)
Net earnings from continuing operations	6.4	5.0	6.5
Discontinued operations, net of tax	—	(1.2)	(0.1)
Net earnings	6.4%	3.8%	6.4%

*Refer to the following discussion in "Fiscal 2006 as Compared with Fiscal 2005—Operating Expenses" for further information regarding these charges.

In order to meet the demands of consumers, we continually introduce new products, support new and established products through advertising, sampling and merchandising and phase out existing products that no longer meet the needs of our consumers. The economics of developing, producing, launching and supporting products influence our sales and operating performance each period. The introduction of new products may have some cannibalizing effect on sales of existing products, which we take into account in our business planning.

FISCAL 2007 AS COMPARED WITH FISCAL 2006

NET SALES

Net sales increased 9%, or \$573.7 million, to \$7,037.5 million, reflecting net sales growth in all product categories and geographic regions. The increases in our skin care, makeup and fragrance product categories were led by Europe, the Middle East & Africa while the increase in hair care net sales was predominantly in the Americas. Excluding the impact of foreign currency translation, net sales increased 7%.

Product Categories

Skin Care Net sales of skin care products increased 8%, or \$200.2 million, to \$2,601.0 million. Most of this growth was fueled by new product launches which made their most significant impact in our Europe, the Middle East & Africa and Asia/Pacific regions. The recent launches of Advanced Night Repair Concentrate Recovery Boosting Treatment and Idealist Refinisher from Estée Lauder, and Repairwear Lift Firming Night Cream, Continuous Rescue Antioxidant Moisturizer, All About Eyes Rich and Repairwear Contour Firming Formula from Clinique contributed incremental sales of approximately \$95 million, combined. Net sales increases from our fast-growing La Mer brand, Resilience Lift Extreme Ultra Firming products and other existing Advanced Night Repair products from Estée Lauder, along with products in the Clinique 3-Step Skin Care System and Superdefense from Clinique, totaled approximately \$97 million. These improvements were partially offset by approximately \$35 million of lower sales from certain other Resilience Lift products and Perfectionist [CP+] from Estée Lauder. Excluding the impact of foreign currency translation, skin care net sales increased 6%.

Makeup Makeup net sales increased 8%, or \$208.5 million, to \$2,712.7 million, reflecting growth from our makeup artist brands of approximately \$191 million. This increase was supported by new points of distribution and new product launches as well as M·A·C Viva Glam lip products, the proceeds of which are donated to

AIDS-related charities. Higher sales of Double Wear Foundation and the recent launch of Resilience Lift Extreme Ultra Firming Makeup SPF 15 by Estée Lauder contributed approximately \$56 million to the growth in this product category. Lower sales of approximately \$35 million of Pure Color Gloss and Individualist Natural Finish Makeup by Estée Lauder, and Repairwear Anti-Aging Makeup SPF 15 by Clinique partially offset this growth. Excluding the impact of foreign currency translation, makeup net sales increased 6%.

Fragrance Net sales of fragrance products increased 8%, or \$95.3 million, to \$1,308.6 million, primarily driven by incremental international sales from newer fragrance offerings. DKNY Red Delicious, Pure White Linen from Estée Lauder, Sean John Unforgivable, DKNY Red Delicious Men and Donna Karan Gold collectively contributed approximately \$128 million to the category. Lower sales of approximately \$67 million of True Star and True Star Men by Tommy Hilfiger, and Estée Lauder *pleasures* partially offset the growth in this product category. While current year sales levels compared favorably to the prior year, we anticipate continued challenges in this product category due in part to competitive dynamics, particularly in the United States. Excluding the impact of foreign currency translation, fragrance net sales increased 5%.

Hair Care Hair care net sales increased 18%, or \$58.4 million, to \$377.1 million, primarily due to sales growth from Aveda and Bumble and bumble products. Aveda net sales increases were primarily due to sales of professional color products, the recent launch of Be Curly shampoo and conditioner and the acquisition of an independent distributor. Bumble and bumble sales benefited from a new hotel amenities program, sales growth in its existing salon distribution and new points of distribution. Excluding the impact of foreign currency translation, hair care net sales increased 17%.

Geographic Regions

Net sales in the Americas increased 3%, or \$114.5 million, to \$3,560.9 million. The increase was led by growth in the United States of approximately \$152 million from our makeup artist brands, our hair care business, our internet distribution, and the recent launch of the Unforgivable fragrance by Sean John. Partially offsetting this growth was approximately \$90 million related to weaknesses in our core brands as a result of competitive pressures and retailer consolidations. Net sales growth in Canada, Latin America and Mexico contributed an additional \$31 million to the increase. The prior year results reflected an incremental provision of approximately \$16 million for returns

that were anticipated at that time as a result of then-announced store closings from retailer consolidations.

In Europe, the Middle East & Africa, net sales increased 16%, or \$345.7 million, to \$2,493.4 million, including an exchange rate benefit due to the weakening of the U.S. dollar of approximately \$122 million. The growth in the region reflected higher net sales of approximately \$260 million in the United Kingdom, our travel retail business, Russia, Germany and Spain, with all benefiting from an improving retail environment, and in Turkey, where we acquired a distributor. On a local currency basis, net sales in Europe, the Middle East & Africa increased 10%.

Net sales in Asia/Pacific increased 13%, or \$113.5 million, to \$983.2 million. The growth in this region reflected higher net sales of approximately \$86 million in Korea, China, Hong Kong and Australia. These markets benefited from an improved economy across the region while China's growth in net sales primarily reflected our continuing strategic expansion in this country. We also experienced modest sales growth in Japan, our largest market in this region. Excluding the impact of foreign currency translation, Asia/Pacific net sales increased 11%.

We strategically stagger our new product launches by geographic market, which may account for differences in regional sales growth.

COST OF SALES

Cost of sales as a percentage of total net sales decreased to 25.2% as compared with 26.1% in the prior year. Cost of sales as a percentage of net sales reflected a favorable change in the mix of our business of approximately 40 basis points, a decrease in the level and timing of promotional activities of approximately 20 basis points, the effect of exchange rate translation of approximately 20 basis points and a decrease in obsolescence charges of approximately 10 basis points. Certain of these items reflect savings achieved during the current period from our cost savings initiative, which commenced during fiscal 2006.

Since certain promotional activities are a component of sales or cost of sales and the timing and level of promotions vary with our promotional calendar, we have experienced, and expect to continue to experience, fluctuations in the cost of sales percentage. In addition, future cost of sales mix may be impacted by the inclusion of new brands which have margin and product cost structures different from those of our existing brands.

OPERATING EXPENSES

Operating expenses improved to 64.1% of net sales as compared with 64.3% of net sales in the prior year. During the prior year, we recorded a \$92.1 million charge to

operating expenses related to the implementation of our cost savings initiative that negatively impacted our operating expense margin by approximately 140 basis points. Partially offsetting this improvement was an increase of approximately 50 basis points in selling, general and administrative expenses reflecting higher demonstration, field selling and training costs in support of our business. In fiscal 2007, our operating expense margin was negatively impacted by approximately 40 basis points resulting from expenses related to our pharmacy channel for organizational costs, costs to streamline the distribution of goods, and the impairment of goodwill and other intangible assets. An increase in costs incurred related to the implementation of our Strategic Modernization Initiative and higher stock-based compensation expenses lowered our operating expense margin by approximately 20 additional basis points, combined. Overall operating expenses reflected savings achieved during the current period from our cost savings initiative, which commenced during fiscal 2006.

Changes in advertising, merchandising and sampling spending result from the type, timing and level of activities related to product launches and rollouts, as well as the markets being emphasized.

OPERATING RESULTS

Due to the growth in net sales and the decreases in our cost of sales and operating expense margins as previously discussed, operating income increased 21%, or \$130.3 million, to \$749.9 million as compared with the prior year. Operating margins were 10.7% of net sales as compared with 9.6% in the prior year, which was negatively impacted by 1.4% of net sales as a result of the special charge related to our cost savings initiative.

The following discussions of Operating Results by *Product Categories and Geographic Regions* exclude the impact of special charges related to our cost savings initiative of \$1.1 million and \$92.1 million for the fiscal years ended June 30, 2007 and 2006, respectively. We believe the following analysis of operating results better reflects the manner in which we conduct and view our business. See Note 17 of Notes to Consolidated Financial Statements—*Segment Data and Related Information*.

Product Categories

Fragrance operating results increased over 100%, or \$20.4 million, to \$28.1 million, as profits from higher international net sales and lower spending at certain of our core brands in the United States more than offset spending behind new and developing brands. Hair care operating results grew 60%, or \$16.0 million, to \$42.5 million as the increase in net sales outpaced increased spending in

support of new distribution points and product launches. Operating results increased 3%, or \$9.9 million, to \$339.3 million in makeup, primarily as a result of higher net sales and profits from our makeup artist brands, which more than offset challenges among certain core brands. Skin care operating results decreased 1%, or \$4.9 million, to \$341.5 million. The results in this product category were negatively impacted in fiscal 2007 by charges related to our pharmacy channel. We recorded approximately \$30 million for organizational costs, costs to streamline the distribution of goods, and the impairment of goodwill and other intangible assets. In addition, improvements in international skin care results were partially offset by challenges in certain core brands in the United States.

Geographic Regions

Operating income in the Americas decreased 2%, or \$7.7 million, to \$336.4 million, reflecting spending behind strategic initiatives at our core brands, retailer consolidation and costs to develop new brands in the United States. Operating income growth from our makeup artist brands, hair care business and our internet distribution partially offset these results.

In Europe, the Middle East & Africa, operating income increased 8%, or \$23.9 million, to \$321.4 million primarily due to higher results of approximately \$49 million from our travel retail business, the United Kingdom, Russia and Germany. Lower results from France partially offset these improvements by approximately \$10 million. The current year operating results in France reflected the rebalancing of inventory levels at certain retailers as well as strategic investment spending behind the field sales force. During the current year, the region was negatively impacted by the charges discussed above related to our pharmacy channel, partially offset by modest combined operating income growth from the remaining affiliates in this region.

In Asia/Pacific, operating income increased 33%, or \$23.1 million, to \$93.2 million. This increase reflected improved results of approximately \$23 million in Hong Kong, China, Australia and Korea.

INTEREST EXPENSE, NET

Net interest expense was \$38.9 million as compared with \$23.8 million in the prior year. This change primarily resulted from higher average debt balances, primarily associated with the funding of our accelerated share repurchase program, and higher average interest rates. Also contributing to the increase was reduced interest income generated from lower average investment balances internationally, partially offset by higher average investment rates. These increases were partially offset by

the capitalization of interest expense on internally developed software in connection with the upgrade of our information systems.

PROVISION FOR INCOME TAXES

The provision for income taxes represents Federal, foreign, state and local income taxes. The effective rate differs from statutory rates due to the effect of state and local taxes, tax rates in foreign jurisdictions and certain nondeductible expenses. Our effective tax rate will change from quarter to quarter based on non-recurring and recurring factors including, but not limited to, the geographical mix of earnings, enacted tax legislation, state and local taxes, tax audit settlements and the interaction of various global tax strategies. The effective rate for income taxes for the year ended June 30, 2007 was 35.9% as compared with 43.6% in the prior year. The decrease in the effective income tax rate was primarily attributable to the prior year effect of the IRS tax settlement of approximately 770 basis points.

DISCONTINUED OPERATIONS

On September 30, 2005, we committed to a plan to sell and on April 10, 2006, we completed the sale of certain assets and operations of our reporting unit that marketed and sold Stila brand products. For the fiscal year ended June 30, 2007, \$0.5 million, net of tax, of operating income was reflected as discontinued operations, reflecting the conclusion of transitional distribution services provided to the purchaser. The prior year charge of \$80.3 million, net of tax, reflected the then-anticipated loss on the sale of the business of \$69.9 million, net of tax, and the operating loss of \$10.4 million, net of tax.

NET EARNINGS

Net earnings as compared with the prior fiscal year increased \$205.0 million to \$449.2 million and diluted net earnings per common share improved 93% from \$1.12 to \$2.16. Net earnings from continuing operations as compared with the prior fiscal year increased by \$124.2 million, or 38%, to \$448.7 million and diluted net earnings per common share from continuing operations increased 45% from \$1.49 to \$2.16.

FISCAL 2006 AS COMPARED WITH FISCAL 2005

NET SALES

Net sales increased 3%, or \$183.8 million, to \$6,463.8 million due to growth in our makeup, skin care and hair care product categories, which was partially offset by lower sales in our fragrance product category. The net increase reflected sales growth in all geographic regions.

Excluding the impact of foreign currency translation, net sales increased 4%.

Product Categories

Skin Care Net sales of skin care products increased 2%, or \$48.7 million, to \$2,400.8 million primarily due to new product launches. The fiscal 2006 launches of Resilience Lift Extreme Ultra Firming Creams and Re-Nutriv Ultimate Lifting Serum by Estée Lauder, and Turnaround Concentrate Visible Skin Renewer and Turnaround 15-Minute Facial by Clinique generated incremental sales of approximately \$123 million, combined. Perfectionist [CP+] by Estée Lauder and products in Clinique's 3-Step Skin Care System, bolstered by the introduction of Liquid Facial Soap, contributed approximately \$78 million to the increase. These improvements were offset by approximately \$157 million of decreases in sales of existing products in certain of our core brands as well as declines in our BeautyBank brands, which completed their initial rollout during fiscal 2005. Excluding the impact of foreign currency translation, skin care net sales increased 3%.

Makeup Makeup net sales increased 6%, or \$137.4 million, to \$2,504.2 million reflecting growth from our makeup artist brands of approximately \$179 million. This growth was partially offset by approximately \$72 million of lower sales from certain existing products, reflecting challenges experienced by certain of our core brands, and declines in our BeautyBank brands, which completed their initial rollout during fiscal 2005. Excluding the impact of foreign currency translation, makeup net sales increased 7%.

Fragrance Net sales of fragrance products decreased 4%, or \$47.3 million, to \$1,213.3 million as we continued to be challenged in this product category, particularly in the Americas region. Estée Lauder Beyond Paradise and various fragrances from Clinique and Tommy Hilfiger generated approximately \$106 million of lower sales. Also contributing to the decrease were lower sales of approximately \$28 million of True Star by Tommy Hilfiger and Lauder Beyond Paradise Men by Estée Lauder as we anniversaried the initial shipments of those products in fiscal 2005. These decreases were partially offset by the fiscal 2006 launches of True Star Men by Tommy Hilfiger and Unforgivable by Sean John, which collectively contributed approximately \$49 million to the category, and higher sales of approximately \$47 million of DKNY Be Delicious and Estée Lauder *pleasures*. Excluding the impact of foreign currency translation, fragrance net sales decreased 2%.

Hair Care Hair care net sales increased 16%, or \$44.8 million, to \$318.7 million, primarily due to sales growth from Bumble and bumble and Aveda products. Bumble and bumble sales benefited from sales growth due to new points of distribution, increases in sales of core products and the launches of Shine and Powder products. Aveda net sales increases benefited from the fiscal 2006 launch of Damage Remedy hair care products, strong demand for color products and from the acquisition of a distributor. Excluding the impact of foreign currency translation, hair care net sales increased 17%.

Geographic Regions

Net sales in the Americas increased 3%, or \$95.3 million, to \$3,446.4 million. The increase was led by growth in the United States of approximately \$190 million from our makeup artist and hair care brands, our internet distribution, and the introduction of the Unforgivable fragrance by Sean John. Partially offsetting this growth was approximately \$122 million related to weaknesses in certain of our core brands as a result of challenges from competitive pressures and business disruptions at certain key retailers, and lower sales from our BeautyBank brands, which completed their initial rollout during fiscal 2005. Net sales growth in Canada, Latin America and Mexico contributed an additional \$48 million to the increase.

In Europe, the Middle East & Africa, net sales increased 2%, or \$38.6 million, to \$2,147.7 million, reflecting higher net sales of approximately \$64 million from our travel retail and distributor businesses, Russia and the United Kingdom, with all benefiting from the success of the DKNY Be Delicious franchise and the sale of M·A·C products. These increases were partially offset by decreases of approximately \$26 million in Spain and Italy. Spain's net sales were adversely affected by changes to our distribution policy and a difficult retail environment. Net sales in Italy were negatively impacted by changes to our distribution policy and, to a lesser extent, the balancing of inventory levels at its retailers. On a local currency basis, net sales in Europe, the Middle East & Africa increased 5%.

Net sales in Asia/Pacific increased 6%, or \$49.9 million, to \$869.7 million. Strategic growth in China combined with positive results in Korea and Hong Kong, contributed approximately \$57 million to sales growth in this region. These increases were partially offset by decreases in Japan and Australia of approximately \$18 million. Japan's results were negatively impacted due to the strengthening of the U.S. dollar against the Japanese yen. The decrease in Australia reflected slower sell-through in a difficult retail environment, particularly in the fragrance category, as

well as the balancing of inventory levels at a major retailer. On a local currency basis, net sales in Asia/Pacific increased 7%.

We strategically stagger our new product launches by geographic market, which may account for differences in regional sales growth.

COST OF SALES

Cost of sales as a percentage of total net sales increased to 26.1% as compared with 25.5% in fiscal 2005. This change reflected an increase in obsolescence charges of approximately 40 basis points, the net change in the mix of our business within our geographic regions and product categories of approximately 20 basis points, a charge related to unutilized tooling of approximately 10 basis points and 20 basis points related to commodity material prices. Partially offsetting these increases were favorable changes in promotional activities of approximately 30 basis points. The higher price of oil resulted in price increases in certain oil-based chemicals, which had a slight adverse effect on our cost of sales margin.

Since certain promotional activities are a component of net sales or cost of sales and the timing and level of promotions vary with our promotional calendar, we have experienced fluctuations in the cost of sales percentage.

OPERATING EXPENSES

Operating expenses increased to 64.3% of net sales as compared with 62.9% of net sales in fiscal 2005. The fiscal 2006 operating expense margin was negatively impacted by charges related to the implementation of our cost savings initiative of approximately \$92.1 million or approximately 140 basis points, costs related to stock-based compensation as a result of the fiscal 2006 adoption of SFAS No. 123(R) of approximately 60 basis points, and the estimated impact of both the merger of Federated Department Stores, Inc. and The May Department Stores Company and the hurricanes that affected the southern United States of approximately 40 basis points. Partially

offsetting these incremental costs were operating expense margin improvements of approximately 90 basis points primarily resulting from net sales growth in brands and channels with lower advertising, merchandising and sampling cost structures as well as an overall reduction in this type of spending. Overall operating expenses reflected savings achieved during fiscal 2006 from our cost savings initiative.

Changes in advertising, sampling and merchandising spending result from the type, timing and level of activities related to product launches and rollouts, as well as the markets being emphasized.

During fiscal 2006, we recorded special charges associated with a cost savings initiative that was designed to support our long-term financial objectives. As part of this multi-faceted initiative, we identified savings opportunities that include streamlined processes and organizational changes. The principal component of the initiative was a voluntary separation program offered primarily to North America-based employees. During the fourth quarter of fiscal 2006, involuntary separations were communicated to certain employees. Under this initiative, we incurred expenses related to one-time termination benefits for 494 employees, of which 28 were involuntary, which benefits were based principally upon years of service.

In addition, we identified other cost savings opportunities to improve efficiencies in our distribution network and product offerings and to eliminate other nonessential costs. These charges primarily related to employee severance for facilities that are closing, contract cancellations, counter and door closings and product returns.

For the year ended June 30, 2006, aggregate expenses of \$92.1 million were recorded as special charges related to the cost savings initiative in the accompanying consolidated statement of earnings.

The following table summarizes the costs and expected savings associated with our cost savings initiative, which impacted, and will continue to impact, our operating expenses and cost of sales:

	Fiscal 2006 expense	Fiscal 2006 payments	Accrued at June 30, 2006	Fiscal 2006 savings
(In millions)				
Employee separation expenses	\$75.9	\$20.7	\$55.2	\$17.5
Facility closures and product/ distribution rationalization	12.5	—	12.5	11.7
Advertising and promotional effectiveness	3.7	2.5	1.2	9.8
	\$92.1	\$23.2	\$68.9	\$39.0

OPERATING RESULTS

Operating income decreased 15%, or \$107.2 million, to \$619.6 million. Operating margin was 9.6% of net sales in fiscal 2006 as compared with 11.6% in fiscal 2005. These results were negatively impacted by the effects of special charges related to our cost savings initiative of \$92.1 million, or 1.4% of net sales. In addition to the special charges, net sales growth was more than offset by the increases in our cost of sales and operating expense margins as previously discussed.

The following discussions of Operating Results by *Product Categories and Geographic Regions* exclude the impact of special charges related to the implementation of our cost savings initiative. We believe the following analysis of operating results better reflects the manner in which we conduct and view our business.

Product Categories

Operating income declined 79%, or \$28.1 million, to \$7.7 million in the fragrance product category reflecting lower sales and, to a lesser extent, expenses incurred related to development of new products and brands, partially offset by a shift in spending in certain of our core brands to other product categories. Skin care operating income decreased 5%, or \$19.4 million, to \$346.4 million primarily reflecting lower than anticipated net sales in certain of our core brands. Operating income increased 9%, or \$28.3 million, to \$329.4 million in the makeup product category primarily reflecting sales growth from our makeup artist brands, partially offset by declines in certain of our core brands. Hair care operating income increased 16%, or \$3.7 million, to \$26.5 million reflecting worldwide sales growth. In fiscal 2006, the merger of Federated Department Stores, Inc. and The May Department Stores Company had a negative impact on the operating results of our skin care, makeup and fragrance product categories, while incremental operating expenses associated with new accounting rules for stock-based compensation negatively impacted all of our product categories.

Geographic Regions

Operating income in the Americas decreased 6%, or \$22.1 million, to \$344.1 million, primarily reflecting challenges experienced by certain of our core brands, due in part to competitive pressures and retailer consolidations, and incremental operating expenses of approximately \$33 million associated with new accounting rules for stock-based compensation. The ongoing success of our makeup artist and hair care brands and our internet distribution partially offset these challenges.

In Europe, the Middle East & Africa, operating income decreased 3%, or \$7.8 million, to \$297.5 million. This

decrease was primarily due to lower results in Spain, Benelux (Belgium, the Netherlands and Luxembourg) and Italy of approximately \$20 million, collectively. These decreases were partially offset by improvements of approximately \$12 million in France, our travel retail business and Central Europe (Hungary, Poland and Czech Republic).

In Asia/Pacific, operating income increased 27%, or \$14.8 million, to \$70.1 million. This increase reflects improved results of approximately \$16 million in Korea, Japan and China, partially offset by lower results in Taiwan and Thailand of approximately \$4 million, collectively. As China is an emerging market for us, we have invested, and plan to continue to invest, in new brand expansion and business opportunities there.

INTEREST EXPENSE, NET

Net interest expense was \$23.8 million as compared with \$13.9 million in fiscal 2005. The increase in net interest expense was primarily due to higher average interest rates and, to a lesser extent, higher average debt balances due to outstanding commercial paper during the year. The increased expense was partially offset by increased interest income related to higher investment interest rates.

PROVISION FOR INCOME TAXES

The provision for income taxes represents Federal, foreign, state and local income taxes. The effective rate for income taxes for fiscal 2006 was 43.6% as compared with 41.2% in fiscal 2005. The effective rate differs from statutory rates due to the effect of state and local taxes, tax rates in foreign jurisdictions and certain nondeductible expenses. The Company's effective tax rate will change from year to year based on non-recurring and recurring factors including, but not limited to, the geographic mix of earnings, enacted tax legislation, state and local taxes, tax audit findings and settlements and the interaction of various global tax strategies.

On July 13, 2006, we announced a settlement with the Internal Revenue Service ("IRS") regarding its examination of our consolidated Federal income tax returns for the fiscal years ended June 30, 1998 through June 30, 2001. The settlement resolves previously disclosed issues raised during the IRS's examination, including transfer pricing and foreign tax credit computations. The settlement of these issues resulted in a tax charge of approximately \$46 million in the fourth quarter of fiscal 2006 and represents the aggregate earnings impact of the settlement through fiscal 2006. In addition, during the fourth quarter of fiscal 2006, we completed the repatriation of foreign earnings

through intercompany dividends as required under the provisions of the American Jobs Creation Act of 2004 (the "AJCA"). In connection with the repatriation, we updated the computation of the related aggregate tax impact, resulting in a favorable adjustment of approximately \$11 million. The tax settlement, coupled with the AJCA favorable tax adjustment, resulted in a net increase to our fiscal 2006 income tax provision of approximately \$35 million.

The increase in the effective income tax rate was attributable to the tax settlement charge of approximately 770 basis points, an increase of approximately 60 basis points resulting from our foreign operations and an increase in nondeductible expenses of approximately 30 basis points. These increases were partially offset by the net reduction in the incremental tax charge relative to the repatriation of foreign earnings pursuant to the AJCA of approximately 570 basis points, as well as a reduction of approximately 50 basis points for miscellaneous items.

DISCONTINUED OPERATIONS

On April 10, 2006 (the "Effective Date"), we completed the sale of certain assets and operations of the reporting unit that marketed and sold Stila brand products to Stila Corp. (the "Purchaser"), an affiliate of Sun Capital Partners, Inc., for consideration of \$23.0 million. The sale price included cash of \$9.3 million, a promissory note with a notional value of \$13.3 million and a fair value of \$11.0 million and convertible preferred stock with an aggregate liquidation preference of \$5.0 million and a fair value of \$2.7 million. As additional consideration for the purchased assets, and subject to the terms and conditions of the sale agreement, the Purchaser will pay us an amount equal to two percent of the annual net sales of the acquired business during the period commencing on the Effective Date and ending August 20, 2019. We will use these proceeds to satisfy our commitment under the 1999 agreement pursuant to which we originally purchased the Stila business. The Purchaser immediately assumed responsibility for all decisions regarding the operations of the Stila business and we agreed to divest ourselves of continuing involvement in the Stila business, except as described below.

In fiscal 2006, we recorded charges of \$80.3 million (net of \$43.3 million tax benefit) to discontinued operations, which reflected the loss on the disposition of the business of \$69.9 million, net of tax, and adjustments to the fair value of assets sold, the costs to dispose of those

assets not acquired by the Purchaser and other costs in connection with the sale. The charges also included the operating losses of \$10.4 million, net of tax, for the fiscal year ended June 30, 2006. Net sales associated with the discontinued operations were \$45.1 million for the fiscal year ended June 30, 2006. All statements of earnings information for previous years has been restated for comparative purposes, including the restatement of the makeup product category and each of the geographic regions presented in Note 17 of Notes to Consolidated Financial Statements—*Segment Data and Related Information*.

In order to facilitate the transition of the Stila business to the Purchaser, we agreed to provide certain information systems, accounting and other back office services to the Purchaser in exchange for monthly service fees designed to recover the estimated costs of providing these transition services. We also agreed with the Purchaser to provide certain distribution and online services. In both cases, the services concluded in fiscal 2007. In addition, we agreed to manufacture and sell to the Purchaser a limited range of products for a period of up to four months following the Effective Date and, in the case of one product, of up to two years.

NET EARNINGS

Net earnings as compared with fiscal 2005 declined \$161.9 million or 40% to \$244.2 million and diluted net earnings per common share decreased 37% from \$1.78 to \$1.12. Net earnings from continuing operations as compared with fiscal 2005 decreased by \$85.4 million, or 21%, to \$324.5 million and diluted net earnings per common share from continuing operations decreased 17% from \$1.80 to \$1.49.

FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of funds historically have been cash flows from operations and borrowings under commercial paper, borrowings from the issuance of long-term debt and committed and uncommitted credit lines provided by banks and other lenders in the United States and abroad. At June 30, 2007, we had cash and cash equivalents of \$253.7 million compared with \$368.6 million at June 30, 2006.

At June 30, 2007, our outstanding borrowings were as follows:

	Long-term Debt	Short-term Debt	Total Debt
(\$ in millions)			
6.00% Senior Notes, due May 15, 2037 ("2037 Senior Notes") ⁽¹⁾	\$ 296.2	\$ —	\$ 296.2
5.55% Senior Notes, due May 15, 2017 ("2017 Senior Notes") ⁽²⁾	290.9	—	290.9
6.00% Senior Notes, due January 15, 2012 ("2012 Senior Notes") ⁽³⁾	239.7	—	239.7
5.75% Senior Notes, due October 15, 2033 ("2033 Senior Notes") ⁽⁴⁾	197.4	—	197.4
Commercial paper maturing through July 2007 (5.40% average interest rate)	—	26.5	26.5
12.3 million Turkish lira overdraft borrowing facility	—	9.4	9.4
Other borrowings	3.9	24.5	28.4
	\$1,028.1	\$60.4	\$1,088.5

(1) Consists of \$300.0 million principal and unamortized debt discount of \$3.8 million.

(2) Consists of \$300.0 million principal, unamortized debt discount of \$0.5 million and an \$8.6 million adjustment to reflect the fair value of outstanding interest rate swaps.

(3) Consists of \$250.0 million principal, unamortized debt discount of \$0.5 million and a \$9.8 million adjustment to reflect the remaining termination value of an interest rate swap that is being amortized to interest expense over the life of the debt.

(4) Consists of \$200.0 million principal and unamortized debt discount of \$2.6 million.

We have a \$750.0 million commercial paper program under which we may issue commercial paper in the United States. Our commercial paper is currently rated A-1 by Standard & Poor's and P-1 by Moody's. Our long-term credit ratings are A with a stable outlook by Standard & Poor's and A2 with a stable outlook by Moody's. At June 30, 2007, we had \$26.5 million of commercial paper outstanding, which we may refinance on a periodic basis as it matures at then-prevailing market interest rates. We also have \$178.9 million in additional uncommitted credit facilities, of which \$28.9 million was used as of June 30, 2007.

Effective April 2007, we entered into a \$750.0 million senior unsecured revolving credit facility, expiring on April 26, 2012, primarily to provide credit support for our commercial paper program, to repurchase shares of our common stock and for general corporate purposes. The new facility replaced our prior, undrawn \$600.0 million senior unsecured revolving credit facility, which had been effective since May 27, 2005. Up to the equivalent of \$250 million of the current facility is available for multi-currency loans. The interest rate on borrowings under the credit facility is based on LIBOR or on the higher of prime, which is the rate of interest publicly announced by the administrative agent, or 1/2% plus the Federal funds rate. We incurred costs of approximately \$0.3 million to establish the facility which will be amortized over the term of the facility. The credit facility has an annual fee of \$0.4 million, payable quarterly, based on our current credit ratings. As of June 30, 2007, we were in compliance with all related financial and other restrictive covenants, including limitations on indebtedness and liens.

In May 2007, we issued and sold the 2017 Senior Notes and the 2037 Senior Notes in a public offering. The 2017 Senior Notes were priced at 99.845% with a yield of

5.570% and the 2037 Senior Notes were priced at 98.722% with a yield of 6.093%. Interest payments on both notes are required to be made semi-annually on May 15 and November 15, commencing November 15, 2007. We used the net proceeds of this offering to repay long-term commercial paper, which was used to fund our accelerated stock repurchase program, and to pay transaction fees and expenses related to this offering.

We have a fixed rate promissory note agreement with a financial institution pursuant to which we may borrow up to \$150.0 million in the form of loan participation notes through one of our subsidiaries in Europe. The interest rate on borrowings under this agreement is at an all-in fixed rate determined by the lender and agreed to by us at the date of each borrowing. At June 30, 2007, no borrowings were outstanding under this agreement. Debt issuance costs incurred related to this agreement were de minimis.

We have an overdraft borrowing agreement with a financial institution pursuant to which our subsidiary in Turkey may be credited to satisfy outstanding negative daily balances arising from its business operations. The total balance outstanding at any time shall not exceed 20.0 million Turkish lira. The interest rate applicable to each such credit shall be 40 basis points per annum above the spot rate charged by the lender or the lender's floating call rate agreed to by us at each borrowing. There were no debt issuance costs incurred related to this agreement. The outstanding balance at June 30, 2007 (\$9.4 million at the exchange rate at June 30, 2007) is classified as short-term debt in our consolidated balance sheet.

We have a 3.0 billion yen revolving credit facility that expires on March 24, 2009. The interest rate on borrowings under the credit facility is based on TIBOR (Tokyo Interbank Offered Rate) and a 10 basis point facility fee is

incurred on the undrawn balance. At June 30, 2007, no borrowings were outstanding under this facility.

Our business is seasonal in nature and, accordingly, our working capital needs vary. From time to time, we may enter into investing and financing transactions that require additional funding. To the extent that these needs exceed cash from operations, we could, subject to market conditions, issue commercial paper, issue long-term debt securities or borrow under our revolving credit facilities.

Total debt as a percent of total capitalization was 48% at June 30, 2007 and 24% at June 30, 2006.

The effects of inflation have not been significant to our overall operating results in recent years. Generally, we have been able to introduce new products at higher selling prices or increase selling prices sufficiently to offset cost increases, which have been moderate.

Based on past performance and current expectations, we believe that cash on hand, cash generated from operations, available credit lines and access to credit markets will be adequate to support currently planned business operations, information systems enhancements, capital expenditures, stock repurchases, commitments and other contractual obligations on both a near-term and long-term basis.

Cash Flows

Net cash provided by operating activities was \$661.6 million, \$709.8 million and \$478.1 million in fiscal 2007, 2006 and 2005, respectively. The net decrease in operating cash flows from fiscal 2006 to fiscal 2007 reflected higher domestic and international inventory levels primarily driven by growth in new and emerging international markets, increased regulatory requirements and the building of safety stock for the recent implementation of SAP as part of our Strategic Modernization Initiative at our Aveda manufacturing facility. In addition, the decrease in operating cash flows reflected higher accounts receivable balances, primarily related to significant sales growth from our international operations. Cash flows were also impacted by cash payments made during fiscal 2007 related to our fiscal 2006 cost savings initiative. Partially offsetting the decrease was an improvement in net earnings from continuing operations.

The net increase in operating cash flows for fiscal 2006 as compared with fiscal 2005 primarily reflected favorable changes in certain working capital accounts, partially offset by a decrease in net earnings from continuing operations. Net accounts receivable balances decreased primarily reflecting higher collections domestically during fiscal 2006. Inventory levels remained constant at June 30, 2006 as compared to June 30, 2005 due to our efforts to better manage our inventory. Increases in other accrued

liabilities primarily reflected higher advertising, merchandising and sampling accruals compared to fiscal 2005, as well as significant deferred compensation and supplemental pension payments made to retired executives in fiscal 2005. Additional increases in other accrued liabilities and other noncurrent liabilities reflected accrued employee separation benefits related to the Company's fiscal 2006 cost savings initiative.

Net cash used for investing activities was \$373.8 million, \$303.2 million and \$237.0 million in fiscal 2007, 2006 and 2005. The increase in cash flows used for investing activities as compared with fiscal 2006 primarily reflected capital expenditures, which reflected our continuing company-wide initiative to upgrade our information systems, store improvements and counter construction. Fiscal 2007 investing activities also reflected the purchase of the remaining equity interest in Bumble and Bumble Products, LLC and Bumble and Bumble, LLC, as well as the acquisition of businesses engaged in the wholesale distribution and retail sale of our products in the United States and other countries. The increase in cash flows used for investing activities during fiscal 2006 primarily reflected the cash payment related to the Jo Malone Limited earn-out provision and, to a lesser extent, Aveda distributor acquisitions. Capital expenditures also increased in fiscal 2006 primarily reflecting our continued company-wide initiative to upgrade our information systems, which was initiated in fiscal 2005. Fiscal 2005 capital expenditures reflected those costs related to our information systems as well as the investment in leasehold improvements for our corporate offices.

Cash used for financing activities was \$411.6 million, \$594.6 million and \$300.4 million in fiscal 2007, 2006 and 2005, respectively. Net cash flows related to short-term and long-term borrowings increased approximately \$722.1 million from the prior year. An increase in proceeds from employee stock transactions of approximately \$87 million also contributed to the improvement. Partially offsetting these improvements were increases in treasury stock repurchases of approximately \$604 million and an increase of approximately \$18 million in dividends paid to stockholders. During fiscal 2006, in addition to common stock repurchases and dividend payments, cash flows used for financing activities reflected the repayment of short-term commercial paper that was outstanding at June 30, 2005 and the October 2005 redemption of the remaining 2015 Preferred Stock. These outflows were partially offset by short-term borrowings under our loan participation note program. The 3.0 billion yen term loan outstanding at the end of fiscal 2005 was refinanced by borrowings under the new 3.0 billion yen revolving

credit facility that we entered into in March 2006. The net cash used for financing activities in fiscal 2005 primarily reflected common stock repurchases and dividend payments, partially offset by the issuance of short-term commercial paper to fund working capital needs and the receipt of proceeds from employee stock option transactions.

Dividends

On October 25, 2006, the Board of Directors declared an annual dividend of \$.50 per share on our Class A and Class B Common Stock, of which an aggregate of \$103.6 million was paid on December 27, 2006 to stockholders of record at the close of business on December 8, 2006. The annual common stock dividend declared during fiscal 2006 was \$.40 per share, of which an aggregate of \$85.4 million was paid on December 28, 2005 to stockholders of record at the close of business on December 9, 2005. Dividends on the 2015 Preferred Stock were \$0.5 million for fiscal 2006 and were characterized as interest expense in the accompanying consolidated statement of earnings. 2015 Preferred Stock was redeemed in October 2005.

Pension Plan Funding and Expense

We maintain pension plans covering substantially all of our full-time employees for our U.S. operations and a majority of our international operations. Several plans provide pension benefits based primarily on years of service and employees' earnings. In the United States, we maintain a trust-based, noncontributory qualified defined benefit pension plan ("U.S. Qualified Plan"). Additionally, we have an unfunded, non-qualified domestic noncontributory pension plan to provide benefits in excess of statutory limitations. Our international pension plans are comprised of defined benefit and defined contribution plans.

Several factors influence our annual funding requirements. For the U.S. Qualified Plan, our funding policy consists of annual contributions at a rate that provides for future plan benefits and maintains appropriate funded percentages. Such contribution is not less than the minimum required by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and subsequent pension legislation, and is not more than the maximum amount deductible for income tax purposes. For each international plan, our funding policies are determined by local laws and regulations. In addition, amounts necessary to fund future obligations under these plans could vary depending on estimated assumptions (as detailed in "*Critical Accounting Policies and Estimates*"). The effect of our pension plan funding on future operating results will depend on economic conditions, employee demo-

graphics, mortality rates, the number of participants electing to take lump-sum distributions, investment performance and funding decisions.

For fiscal 2007 and 2006, there was no minimum contribution to the U.S. Qualified Plan required by ERISA. During the first quarter of fiscal 2007, the Pension Protection Act of 2006 was adopted into law in the United States. Certain provisions of this law changed the calculation related to the maximum contribution amount deductible for income tax purposes. As a result of these provisions, we made discretionary contributions totaling \$20.0 million to the U.S. Qualified Plan during fiscal 2007. We did not make any cash contributions pursuant to the plan during fiscal 2006. During fiscal 2008, we expect to make cash contributions totaling \$20.0 million to the U.S. Qualified Plan.

For fiscal 2007 and 2006, we made benefit payments under our non-qualified domestic noncontributory pension plan of \$5.3 million and \$7.4 million, respectively. We expect to make benefit payments under this plan during fiscal 2008 of \$11.7 million. For fiscal 2007 and 2006, we made cash contributions to our international defined benefit pension plans of \$24.0 million and \$25.7 million, respectively. We expect to make contributions under these plans during fiscal 2008 of \$21.0 million.

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans, an amendment of FASB Statements No. 87, 106, and 132(R)" ("SFAS No. 158"). SFAS No. 158 requires employers to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income to report the funded status of defined benefit pension and other postretirement benefit plans. Previous standards required employers to disclose the complete funded status of its plans only in the notes to the financial statements. Changes in the funded status of these plans will be recognized as they occur through other comprehensive income. Additional minimum liability adjustments are no longer recognized upon adoption of SFAS No. 158. As of June 30, 2007, we prospectively adopted the balance sheet recognition provisions of SFAS No. 158. Additionally, SFAS No. 158 requires employers to measure plan assets and obligations at their year-end balance sheet date. Our principal pension and post-retirement benefit plans are measured as of June 30; therefore, the measurement provisions of SFAS No. 158 did not affect our existing valuation practices. The adoption of SFAS No. 158 did not impact the consolidated statements of earnings or our financial debt covenant. As of June 30, 2007, we recognized other assets of \$128.0

million, other accrued liabilities of \$19.0 million and other noncurrent liabilities of \$237.3 million on our consolidated balance sheet representing the funded status of our pension and post-retirement plans.

Prior to the adoption of SFAS No. 158, we recognized a liability on our balance sheet for each pension plan if the fair market value of the assets of that plan was less than the accumulated benefit obligation and, accordingly, a benefit or a charge was recorded in accumulated other comprehensive income in shareholders' equity for the change in such liability. During fiscal 2006, we recorded a benefit, net of deferred tax, of \$29.9 million.

Contractual Obligations

The following table summarizes scheduled maturities of our contractual obligations for which cash flows are fixed and determinable as of June 30, 2007:

	Total	Payments Due in Fiscal					Thereafter
		2008	2009	2010	2011	2012	
(In millions)							
Debt service ⁽¹⁾	\$2,198.7	\$ 122.4	\$ 63.6	\$ 62.6	\$ 61.9	\$304.4	\$1,583.8
Operating lease commitments ⁽²⁾	1,240.6	166.3	156.6	139.8	118.9	103.3	555.7
Unconditional purchase obligations ⁽³⁾	1,553.0	1,046.1	132.5	99.9	63.9	36.9	173.7
Total contractual obligations	\$4,992.3	\$1,334.8	\$352.7	\$302.3	\$244.7	\$444.6	\$2,313.2

(1) Includes long-term and short-term debt and the related projected interest costs, and to a lesser extent, capital lease commitments. Refer to Note 8 of Notes to Consolidated Financial Statements.

(2) Refer to Note 14 of Notes to Consolidated Financial Statements.

(3) Unconditional purchase obligations primarily include inventory commitments, estimated future earn-out payments, estimated royalty payments pursuant to license agreements, advertising commitments, capital improvement commitments, planned funding of pension and other post-retirement benefit obligations, commitments pursuant to executive compensation arrangements and obligations related to our cost savings initiative. Future earn-out payments and future royalty and advertising commitments were estimated based on planned future sales for the term that was in effect at June 30, 2007, without consideration for potential renewal periods.

Derivative Financial Instruments and Hedging Activities

We address certain financial exposures through a controlled program of risk management that includes the use of derivative financial instruments. We primarily enter into foreign currency forward exchange contracts and foreign currency options to reduce the effects of fluctuating foreign currency exchange rates. We also enter into interest rate derivative contracts to manage the effects of fluctuating interest rates. We categorize these instruments as entered into for purposes other than trading.

For each derivative contract entered into where we look to obtain special hedge accounting treatment, we formally document the relationship between the hedging instrument and hedged item, as well as its risk-management objective and strategy for undertaking the hedge, the nature of the risk being hedged, how the hedging instruments' effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives

Commitments and Contingencies

Certain of our business acquisition agreements include "earn-out" provisions. These provisions generally require that we pay to the seller or sellers of the business additional amounts based on the performance of the acquired business. Since the size of each payment depends upon performance of the acquired business, we do not expect that such payments will have a material adverse impact on our future results of operations or financial condition.

For additional contingencies, refer to "Legal Proceedings" in Note 14 of Notes to Consolidated Financial Statements.

that are designated as fair-value, cash-flow, or foreign-currency hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also formally 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. If it is determined that a derivative is not highly effective, then we will be required to discontinue hedge accounting with respect to that derivative prospectively.

Foreign Exchange Risk Management

We enter into forward exchange contracts to hedge anticipated transactions, as well as receivables and payables denominated in foreign currencies, for periods consistent with our identified exposures. The purpose of the hedging activities is to minimize the effect of foreign exchange rate movements on our costs and on the cash flows that we receive from foreign subsidiaries. Almost all foreign currency contracts are denominated in currencies of major

industrial countries and are with large financial institutions rated as strong investment grade by a major rating agency. We also may enter into foreign currency options to hedge anticipated transactions where there is a high probability that anticipated exposures will materialize. The forward exchange contracts and foreign currency options entered into to hedge anticipated transactions have been designated as cash-flow hedges. Hedge effectiveness of forward exchange contracts is based on a hypothetical derivative methodology and excludes the portion of fair value attributable to the spot-forward difference which is recorded in current-period earnings. Hedge effectiveness of foreign currency option contracts is based on a dollar offset methodology. The ineffective portion of both forward exchange and foreign currency option contracts is recorded in current-period earnings. For hedge contracts that are no longer deemed highly effective, hedge accounting is discontinued and gains and losses accumulated in other comprehensive income are reclassified to earnings when the underlying forecasted transaction occurs. If it is probable that the forecasted transaction will no longer occur, then any gains or losses accumulated in other comprehensive income are reclassified to current-period earnings. As of June 30, 2007, these cash-flow hedges were highly effective, in all material respects.

As a matter of policy, we only enter into contracts with counterparties that have at least an "A" (or equivalent) credit rating. The counterparties to these contracts are major financial institutions. We do not have significant exposure to any one counterparty. Our exposure to credit loss in the event of nonperformance by any of the counterparties is limited to only the recognized, but not realized, gains attributable to the contracts. Management believes risk of default under these hedging contracts is remote and in any event would not be material to the consolidated financial results. The contracts have varying maturities through the end of June 2008. Costs associated with entering into such contracts have not been material to our consolidated financial results. We do not utilize derivative financial instruments for trading or speculative purposes.

At June 30, 2007, we had foreign currency contracts in the form of forward exchange contracts in the amount of \$862.0 million. The foreign currencies included in forward exchange contracts (notional value stated in U.S. dollars) are principally the British pound (\$148.1 million), Canadian dollar (\$140.3 million), Euro (\$124.1 million), Swiss franc (\$113.1 million), Australian dollar (\$79.3 million), Japanese yen (\$42.6 million) and South Korean won (\$33.6 million). As of June 30, 2007, all of our previously outstanding option contracts have matured.

Interest Rate Risk Management

We enter into interest rate derivative contracts to manage the exposure to fluctuations of interest rates on our funded and unfunded indebtedness for periods consistent with the identified exposures. All interest rate derivative contracts are with large financial institutions rated as strong investment grade by a major rating agency.

In April 2007, we terminated an interest rate swap agreement with a notional amount of \$250.0 million to effectively convert fixed rate interest on the 2012 Senior Notes to variable interest rates based on six-month LIBOR. This instrument, which was designated as a fair-value hedge and classified as a liability, had a termination fair value of \$11.1 million at cash settlement, which included \$0.9 million of accrued interest payable to the counterparty. Hedge accounting treatment was discontinued prospectively and the offsetting adjustment to the carrying amount of the related debt will be amortized to interest expense over the remaining life of the debt.

In April 2007, in connection with the anticipated issuance of debt, we entered into a series of forward-starting interest rate swap agreements on a notional amount totaling \$210.0 million at a weighted average all-in rate of 5.45%. These forward-starting swap agreements, designated as cash-flow hedges, were used to hedge the exposure to a possible rise in interest rates prior to the May 2007 issuance of debt. The agreements were settled upon the issuance of the 2037 Senior Notes and we recognized a loss in other comprehensive income of \$0.9 million that will be amortized to interest expense over the 30-year life of the 2037 Senior Notes.

In April 2007, we entered into interest rate swap agreements with a notional amount totaling \$250.0 million to effectively convert the fixed rate interest on our 2017 Senior Notes to variable interest rates based on six-month LIBOR. The interest rate swaps were designated as fair-value hedges. As of June 30, 2007, these fair-value hedges were highly effective, in all material respects.

Market Risk

We use a value-at-risk model to assess the market risk of our derivative financial instruments. Value-at-risk represents the potential losses for an instrument or portfolio from adverse changes in market factors for a specified time period and confidence level. We estimate value-at-risk across all of our derivative financial instruments using a model with historical volatilities and correlations calculated over the past 250-day period. The measured value-at-risk, calculated as an average, for the twelve months ended June 30, 2007 related to our foreign exchange contracts and our interest rate contracts was \$10.2 million and \$7.5 million, respectively. The model estimates were

made assuming normal market conditions and a 95 percent confidence level. We used a statistical simulation model that valued our derivative financial instruments against one thousand randomly generated market price paths.

Our calculated value-at-risk exposure represents an estimate of reasonably possible net losses that would be recognized on our portfolio of derivative financial instruments assuming hypothetical movements in future market rates and is not necessarily indicative of actual results, which may or may not occur. It does not represent the maximum possible loss or any expected loss that may occur, since actual future gains and losses will differ from those estimated, based upon actual fluctuations in market rates, operating exposures, and the timing thereof, and changes in our portfolio of derivative financial instruments during the year.

We believe, however, that any such loss incurred would be offset by the effects of market rate movements on the respective underlying transactions for which the derivative financial instrument was intended.

OFF-BALANCE SHEET ARRANGEMENTS

We do not maintain any off-balance sheet arrangements, transactions, obligations or other relationships with unconsolidated entities that would be expected to have a material current or future effect upon our financial condition or results of operations.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2006, the FASB issued FASB Interpretation Number ("FIN") 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a two-step evaluation process for tax positions taken, or expected to be taken, in a tax return. The first step is recognition and the second is measurement. For recognition, an enterprise judgmentally determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold it is measured and recognized in the financial statements as the largest amount of tax benefit that is greater than 50% likely of being realized. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements.

Tax positions that meet the more-likely-than-not recognition threshold at the effective date of FIN 48 may be recognized or, continue to be recognized, upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. FIN 48 will apply to fiscal years beginning after December 15, 2006, with earlier adoption permitted. In May 2007, the FASB issued FASB Staff Position ("FSP") No. FIN 48-1, "Definition of Settlement in FASB Interpretation No. 48, an amendment of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes" ("FSP No. FIN 48-1"). FSP No. FIN 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits.

The provisions of FIN 48 became effective for us on July 1, 2007. While we are continuing to evaluate the impact of the interpretation on the consolidated financial statements, we expect the cumulative effect of adoption to reduce opening retained earnings by approximately \$10 million to \$20 million with a corresponding increase to reserves for uncertain tax positions.

In September 2006, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157") to clarify the definition of fair value, establish a framework for measuring fair value and expand the disclosures on fair value measurements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). SFAS No. 157 becomes effective for us in our fiscal year ending June 30, 2009. We are currently evaluating the impact of the provisions of SFAS No. 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159") to permit all entities to choose to elect, at specified election dates, to measure

eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. We are currently evaluating the impact of the provisions of SFAS No. 159 on our consolidated financial statements, if any, when it becomes effective for the fiscal year ending June 30, 2009.

FORWARD-LOOKING INFORMATION

We and our representatives from time to time make written or oral forward-looking statements, including statements contained in this and other filings with the Securities and Exchange Commission, in our press releases and in our reports to stockholders. The words and phrases “will likely result,” “expect,” “believe,” “planned,” “may,” “should,” “could,” “anticipate,” “estimate,” “project,” “intend,” “forecast” or similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, without limitation, our expectations regarding sales, earnings or other future financial performance and liquidity, product introductions, entry into new geographic regions, information systems initiatives, new methods of sale and future operations or operating results. Although we believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, actual results may differ materially from our expectations. Factors that could cause actual results to differ from expectations include, without limitation:

- (1) increased competitive activity from companies in the skin care, makeup, fragrance and hair care businesses, some of which have greater resources than we do;
- (2) our ability to develop, produce and market new products on which future operating results may depend and to successfully address challenges in our core brands, including gift with purchase, and in our fragrance business;
- (3) consolidations, restructurings, bankruptcies and reorganizations in the retail industry causing a decrease in the number of stores that sell our products, an increase in the ownership concentration within the retail industry, ownership of retailers by our competitors or ownership of competitors by our customers that are retailers;

- (4) destocking by retailers;
- (5) the success, or changes in timing or scope, of new product launches and the success, or changes in the timing or the scope, of advertising, sampling and merchandising programs;
- (6) shifts in the preferences of consumers as to where and how they shop for the types of products and services we sell;
- (7) social, political and economic risks to our foreign or domestic manufacturing, distribution and retail operations, including changes in foreign investment and trade policies and regulations of the host countries and of the United States;
- (8) changes in the laws, regulations and policies (including the interpretations and enforcement thereof) that affect, or will affect, our business, including those relating to our products, changes in accounting standards, tax laws and regulations, trade rules and customs regulations, and the outcome and expense of legal or regulatory proceedings, and any action we may take as a result;
- (9) foreign currency fluctuations affecting our results of operations and the value of our foreign assets, the relative prices at which we and our foreign competitors sell products in the same markets and our operating and manufacturing costs outside of the United States;
- (10) changes in global or local conditions, including those due to natural or man-made disasters, real or perceived epidemics, or energy costs, that could affect consumer purchasing, the willingness or ability of consumers to travel and/or purchase our products while traveling, the financial strength of our customers or suppliers, our operations, the cost and availability of capital which we may need for new equipment, facilities or acquisitions, the cost and availability of raw materials and the assumptions underlying our critical accounting estimates;
- (11) shipment delays, depletion of inventory and increased production costs resulting from disruptions of operations at any of the facilities that manufacture nearly all of our supply of a particular type of product (i.e., focus factories) or at our distribution or inventory centers, including disruptions that may be caused by the implementation of SAP as part of our Strategic Modernization Initiative;
- (12) real estate rates and availability, which may affect our ability to increase the number of retail locations at which we sell our products and the costs associated with our other facilities;

(13) changes in product mix to products which are less profitable;

(14) our ability to acquire, develop or implement new information and distribution technologies, on a timely basis and within our cost estimates;

(15) our ability to capitalize on opportunities for improved efficiency, such as publicly-announced cost-savings initiatives and the success of Stila under new ownership, and to integrate acquired businesses and realize value therefrom;

(16) consequences attributable to the events that are currently taking place in the Middle East, including terrorist attacks, retaliation and the threat of further attacks or retaliation;

(17) the timing and impact of acquisitions and divestitures, which depend on willing sellers and buyers, respectively; and

(18) additional factors as described in our filings with the Securities and Exchange Commission, including this Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

We assume no responsibility to update forward-looking statements made herein or otherwise.

CONSOLIDATED STATEMENTS OF EARNINGS

YEAR ENDED JUNE 30	2007	2006	2005
(In millions, except per share data)			
Net Sales	\$7,037.5	\$6,463.8	\$6,280.0
Cost of sales	1,774.8	1,686.6	1,602.8
Gross Profit	5,262.7	4,777.2	4,677.2
Operating expenses:			
Selling, general and administrative	4,511.7	4,065.5	3,950.4
Special charges related to cost savings initiative	1.1	92.1	—
	4,512.8	4,157.6	3,950.4
Operating Income	749.9	619.6	726.8
Interest expense, net	38.9	23.8	13.9
Earnings before Income Taxes, Minority Interest and Discontinued Operations	711.0	595.8	712.9
Provision for income taxes	255.2	259.7	293.7
Minority interest, net of tax	(7.1)	(11.6)	(9.3)
Net Earnings from Continuing Operations	448.7	324.5	409.9
Discontinued operations, net of tax	0.5	(80.3)	(3.8)
Net Earnings	\$ 449.2	\$ 244.2	\$ 406.1
Basic net earnings per common share:			
Net earnings from continuing operations	\$ 2.20	\$ 1.51	\$ 1.82
Discontinued operations, net of tax	.00	(.37)	(.02)
Net earnings	\$ 2.20	\$ 1.14	\$ 1.80
Diluted net earnings per common share:			
Net earnings from continuing operations	\$ 2.16	\$ 1.49	\$ 1.80
Discontinued operations, net of tax	.00	(.37)	(.02)
Net earnings	\$ 2.16	\$ 1.12	\$ 1.78
Weighted average common shares outstanding:			
Basic	204.3	215.0	225.3
Diluted	207.8	217.4	228.6
Cash dividends declared per share	\$.50	\$.40	\$.40

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

JUNE 30	2007	2006
(\$ in millions)		
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 253.7	\$ 368.6
Accounts receivable, net	860.5	771.2
Inventory and promotional merchandise, net	855.8	766.3
Prepaid expenses and other current assets	269.4	270.8
Total current assets	2,239.4	2,176.9
Property, Plant and Equipment, net	880.8	758.0
Other Assets		
Investments, at cost or market value	22.2	13.4
Goodwill	651.3	635.8
Other intangible assets, net	113.4	77.0
Other assets, net	218.6	123.0
Total other assets	1,005.5	849.2
Total assets	\$ 4,125.7	\$ 3,784.1
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Short-term debt	\$ 60.4	\$ 89.7
Accounts payable	314.7	264.5
Accrued income taxes	161.7	135.5
Other accrued liabilities	963.9	948.5
Total current liabilities	1,500.7	1,438.2
Noncurrent Liabilities		
Long-term debt	1,028.1	431.8
Other noncurrent liabilities	376.6	266.4
Total noncurrent liabilities	1,404.7	698.2
Commitments and Contingencies (Note 14)		
Minority Interest	21.3	25.4
Stockholders' Equity		
Common stock, \$.01 par value; 650,000,000 shares Class A authorized; shares issued: 173,365,104 at June 30, 2007 and 164,837,563 at June 30, 2006; 240,000,000 shares Class B authorized; shares issued and outstanding: 81,804,761 at June 30, 2007 and 85,305,915 at June 30, 2006	2.6	2.5
Paid-in capital	801.7	581.0
Retained earnings	2,731.5	2,361.9
Accumulated other comprehensive income	54.7	64.7
	3,590.5	3,010.1
Less: Treasury stock, at cost; 60,841,674 Class A shares at June 30, 2007 and 38,382,458 Class A shares at June 30, 2006	(2,391.5)	(1,387.8)
Total stockholders' equity	1,199.0	1,622.3
Total liabilities and stockholders' equity	\$ 4,125.7	\$ 3,784.1

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME

YEAR ENDED JUNE 30	2007	2006	2005
(In millions)			
STOCKHOLDERS' EQUITY			
Common stock, beginning of year	\$ 2.5	\$ 2.5	\$ 2.4
Stock-based compensation programs	0.1	—	0.1
Common stock, end of year	2.6	2.5	2.5
Paid-in capital, beginning of year	581.0	465.2	382.3
Stock-based compensation programs	220.7	115.8	82.9
Paid-in capital, end of year	801.7	581.0	465.2
Retained earnings, beginning of year	2,361.9	2,203.2	1,887.2
Cumulative effect of adjustments resulting from adoption of SAB No. 108, net of tax (Note 3)	24.2	—	—
Adjusted retained earnings, beginning of year	2,386.1	2,203.2	1,887.2
Common stock dividends	(103.8)	(85.5)	(90.1)
Net earnings for the year	449.2	244.2	406.1
Retained earnings, end of year	2,731.5	2,361.9	2,203.2
Accumulated other comprehensive income, beginning of year	64.7	9.4	10.5
Other comprehensive income (loss)	47.3	55.3	(1.1)
Adjustment to initially apply FASB Statement No. 158, net of tax (Note 10)	(57.3)	—	—
Accumulated other comprehensive income, end of year	54.7	64.7	9.4
Treasury stock, beginning of year	(1,387.8)	(987.5)	(548.9)
Acquisition of treasury stock, net of issuances	(1,003.7)	(400.3)	(438.6)
Treasury stock, end of year	(2,391.5)	(1,387.8)	(987.5)
Total stockholders' equity	\$ 1,199.0	\$ 1,622.3	\$ 1,692.8
COMPREHENSIVE INCOME			
Net earnings	\$ 449.2	\$ 244.2	\$ 406.1
Other comprehensive income (loss):			
Net unrealized investment gains (losses), net of tax	0.3	0.1	0.3
Net derivative instrument gains (losses), net of tax	(2.1)	(1.7)	1.8
Net minimum pension liability adjustments, net of tax	(4.0)	29.9	(11.4)
Translation adjustments	53.1	27.0	8.2
Other comprehensive income (loss)	47.3	55.3	(1.1)
Total comprehensive income	\$ 496.5	\$ 299.5	\$ 405.0

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEAR ENDED JUNE 30	2007	2006	2005
(In millions)			
Cash Flows from Operating Activities			
Net earnings	\$ 449.2	\$ 244.2	\$ 406.1
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	207.2	198.4	196.7
Deferred income taxes	9.9	(74.3)	104.9
Minority interest, net of tax	7.1	11.6	9.3
Non-cash stock-based compensation	43.3	35.9	(1.2)
Excess tax benefits from stock-based compensation arrangements	(9.4)	(6.7)	—
Loss on disposal of fixed assets	13.4	13.2	9.8
Discontinued operations, net of tax	(0.5)	80.3	—
Other non-cash items	11.8	0.8	1.1
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable, net	(68.0)	14.6	(106.6)
Decrease (increase) in inventory and promotional merchandise, net	(70.8)	1.9	(105.1)
Decrease (increase) in other assets	(26.3)	7.0	6.0
Increase (decrease) in accounts payable	46.4	9.1	(23.9)
Increase in accrued income taxes	44.9	63.5	21.0
Increase (decrease) in other accrued liabilities	13.1	66.2	(47.5)
Increase (decrease) in other noncurrent liabilities	(4.0)	61.6	8.6
Net cash flows provided by operating activities of continuing operations	667.3	727.3	479.2
Net cash flows used for operating activities of discontinued operations	(5.7)	(17.5)	(1.1)
Net cash flows provided by operating activities	661.6	709.8	478.1
Cash Flows from Investing Activities			
Capital expenditures	(312.1)	(260.6)	(229.6)
Capital expenditures of discontinued operations	—	(0.6)	—
Acquisition of businesses, net of cash acquired	(61.2)	(51.7)	(7.1)
Proceeds from divestitures	—	9.3	—
Proceeds from disposition of long-term investments	—	0.5	—
Purchases of long-term investments	(0.5)	(0.1)	(0.3)
Net cash flows used for investing activities	(373.8)	(303.2)	(237.0)
Cash Flows from Financing Activities			
Increase (decrease) in short-term debt, net	(31.6)	(82.0)	158.6
Proceeds from issuance of long-term debt, net	590.6	—	—
Proceeds from the net settlement of interest rate derivatives	(11.1)	—	—
Repayments and redemptions of long-term debt	(5.6)	(97.8)	(2.5)
Net proceeds from employee stock transactions	154.1	67.3	80.6
Excess tax benefits from stock-based compensation arrangements	9.4	6.7	—
Payments to acquire treasury stock	(1,004.3)	(400.5)	(438.6)
Dividends paid to stockholders	(103.6)	(85.4)	(90.1)
Distributions made to minority holders of consolidated subsidiaries	(9.5)	(2.9)	(8.4)
Net cash flows used for financing activities	(411.6)	(594.6)	(300.4)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	8.9	3.3	1.0
Net Decrease in Cash and Cash Equivalents	(114.9)	(184.7)	(58.3)
Cash and Cash Equivalents at Beginning of Year	368.6	553.3	611.6
Cash and Cash Equivalents at End of Year	\$ 253.7	\$ 368.6	\$ 553.3
Supplemental disclosures of cash flow information (Note 16)			
Cash paid during the year for:			
Interest	\$ 44.6	\$ 33.8	\$ 23.1
Income Taxes	\$ 199.6	\$ 256.9	\$ 164.4

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—DESCRIPTION OF BUSINESS

The Estée Lauder Companies Inc. manufactures, markets and sells skin care, makeup, fragrance and hair care products around the world. Products are marketed under the following brand names: Estée Lauder, Aramis, Clinique, Prescriptives, Lab Series, Origins, M·A·C, Bobbi Brown, La Mer, Aveda, Jo Malone, Bumble and bumble, Darphin, American Beauty, Flirt!, Good Skin™ and Grassroots. The Estée Lauder Companies Inc. is also the global licensee of the Tommy Hilfiger, Donna Karan, Michael Kors, Sean John, Missoni, Daisy Fuentes and Tom Ford brand names for fragrances and cosmetics.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of The Estée Lauder Companies Inc. and its subsidiaries (collectively, the “Company”) as continuing operations, with the exception of the operating

results of its reporting unit that marketed and sold Stila brand products, which have been reflected as discontinued operations for fiscal 2007, 2006 and 2005 (see Note 4). All significant intercompany balances and transactions have been eliminated.

Certain amounts in the consolidated financial statements of prior years have been reclassified to conform to current year presentation for comparative purposes.

Net Earnings Per Common Share

For the years ended June 30, 2007, 2006 and 2005, net earnings per common share (“basic EPS”) is computed by dividing net earnings by the weighted average number of common shares outstanding and contingently issuable shares (which satisfy certain conditions). Net earnings per common share assuming dilution (“diluted EPS”) is computed by reflecting potential dilution from stock-based awards and contingently issuable shares.

A reconciliation between the numerators and denominators of the basic and diluted EPS computations is as follows:

YEAR ENDED JUNE 30	2007	2006	2005
(In millions, except per share data)			
Numerator:			
Net earnings from continuing operations	\$448.7	\$324.5	\$409.9
Discontinued operations, net of tax	0.5	(80.3)	(3.8)
Net earnings attributable to common stock	\$449.2	\$244.2	\$406.1
Denominator:			
Weighted average common shares outstanding—Basic	204.3	215.0	225.3
Effect of dilutive stock options	3.2	2.4	3.3
Effect of restricted share units	0.2	0.0	—
Effect of contingently issuable shares pursuant to accelerated share repurchase program	0.1	—	—
Weighted average common shares outstanding—Diluted	207.8	217.4	228.6
Basic net earnings per common share:			
Net earnings from continuing operations	\$ 2.20	\$ 1.51	\$ 1.82
Discontinued operations, net of tax	.00	(.37)	(.02)
Net earnings	\$ 2.20	\$ 1.14	\$ 1.80
Diluted net earnings per common share:			
Net earnings from continuing operations	\$ 2.16	\$ 1.49	\$ 1.80
Discontinued operations, net of tax	.00	(.37)	(.02)
Net earnings	\$ 2.16	\$ 1.12	\$ 1.78

As of June 30, 2007, 2006 and 2005, outstanding options to purchase 6.0 million, 13.6 million and 12.5 million shares, respectively, of Class A Common Stock were not included in the computation of diluted EPS because their inclusion would be anti-dilutive. As of June 30, 2007 and 2006, 0.2 million and 0.1 million, respectively, of performance share units have been excluded from the calculation of diluted EPS because the number of shares ultimately issued is contingent on the achievement of

certain performance targets of the Company, as discussed in Note 13—Stock Programs.

Cash and Cash Equivalents

Cash and cash equivalents include \$51.3 million and \$66.2 million of short-term time deposits at June 30, 2007 and 2006, respectively. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable is stated net of the allowance for doubtful accounts and customer deductions of \$23.3 million and \$27.1 million as of June 30, 2007 and 2006, respectively.

Currency Translation and Transactions

All assets and liabilities of foreign subsidiaries and affiliates are translated at year-end rates of exchange, while revenue and expenses are translated at weighted average rates of exchange for the year. Unrealized translation gains or losses are reported as cumulative translation adjustments through other comprehensive income. Such adjustments amounted to \$53.1 million, \$27.0 million and \$8.2 million of unrealized translation gains in fiscal 2007, 2006 and 2005, respectively.

The Company enters into foreign currency forward exchange contracts and foreign currency options to hedge foreign currency transactions for periods consistent with its identified exposures. Accordingly, the Company categorizes these instruments as entered into for purposes other than trading.

The accompanying consolidated statements of earnings include net exchange gains (losses) of \$(0.6) million, \$4.0 million and \$(15.8) million in fiscal 2007, 2006 and 2005, respectively.

Inventory and Promotional Merchandise

Inventory and promotional merchandise only includes inventory considered saleable or usable in future periods, and is stated at the lower of cost or fair-market value, with cost being determined on the first-in, first-out method. Cost components include raw materials, componentry, direct labor and overhead (e.g., indirect labor, utilities, depreciation, purchasing, receiving, inspection and warehousing) as well as inbound freight. Promotional merchandise is charged to expense at the time the merchandise is shipped to the Company's customers. Included in inventory and promotional merchandise is an inventory obsolescence reserve, which represents the difference between the cost of the inventory and its estimated realizable value, based on various product sales projections. This reserve is calculated using an estimated obsolescence percentage applied to the inventory based on age, historical trends and requirements to support forecasted sales. In addition, and as necessary, specific reserves for future known or anticipated events may be established.

JUNE 30	2007	2006
(In millions)		
Inventory and promotional merchandise consists of:		
Raw materials	\$179.5	\$151.0
Work in process	49.2	44.2
Finished goods	431.3	407.1
Promotional merchandise	195.8	164.0
	\$855.8	\$766.3

Property, Plant and Equipment

Property, plant and equipment, including leasehold and other improvements that extend an asset's useful life or productive capabilities, are carried at cost less accumulated depreciation and amortization. The cost of assets related to projects in progress of \$72.1 million and \$91.9 million as of June 30, 2007 and June 30, 2006, respectively, is included in their respective asset categories in the table below. For financial statement purposes, depreciation is provided principally on the straight-line method over the estimated useful lives of the assets ranging from 3 to 40 years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lives of the respective leases or the expected useful lives of those improvements.

JUNE 30	2007	2006
(In millions)		
Asset (Useful Life)		
Land	\$ 14.4	\$ 13.7
Buildings and improvements (10 to 40 years)	167.5	161.7
Machinery and equipment (3 to 10 years)	905.0	803.0
Furniture and fixtures (5 to 10 years)	108.2	108.2
Leasehold improvements	917.2	790.8
	2,112.3	1,877.4
Less accumulated depreciation and amortization	1,231.5	1,119.4
	\$ 880.8	\$ 758.0

Depreciation and amortization of property, plant and equipment was \$198.1 million, \$189.9 million and \$186.3 million in fiscal 2007, 2006 and 2005, respectively. Depreciation and amortization related to the Company's manufacturing process is included in cost of sales and all other depreciation and amortization is included in selling, general and administrative expenses in the accompanying consolidated statements of earnings.

Goodwill and Other Intangible Assets

The Company follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 141,

“Business Combinations” (“SFAS No. 141”) and SFAS No. 142, “Goodwill and Other Intangible Assets” (“SFAS No. 142”). These statements establish financial accounting and reporting standards for acquired goodwill and other intangible assets. Specifically, the standards address how acquired intangible assets should be accounted for both at the time of acquisition and after they have been recognized in the financial statements. In accordance with SFAS No. 142, intangible assets, including purchased goodwill, must be evaluated for impairment. Those intangible assets that will continue to be classified as goodwill or as other intangibles with indefinite lives are no longer amortized.

In accordance with SFAS No. 142, the impairment testing is performed in two steps: (i) the Company determines impairment by comparing the fair value of a reporting unit with its carrying value, and (ii) if there is an impairment, the Company measures the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. To determine fair value, the Company relies on three valuation models: guideline public companies, acquisition analysis and discounted cash flow. For goodwill valuation purposes only, the revised fair value of a reporting unit is allocated to the assets and liabilities of the business unit to arrive at an implied fair value of goodwill, based upon known facts and circumstances, as if the acquisition occurred at that time.

During fiscal 2007, the Company purchased the remaining minority equity interest in the Bumble and bumble business, recorded additional goodwill related to payments made in prior years in connection with the acquisition of the Bobbi Brown brand (see Note 3—Staff Accounting Bulletin No. 108), and acquired businesses engaged in the wholesale distribution and retail sale of the Company’s products in the United States and other countries. The combined results of these activities increased goodwill by \$20.4 million and other intangible assets by \$47.0 million. Also during fiscal 2007, as a result of the Company’s annual impairment testing, the Company determined that the carrying values of its goodwill and intangible assets related to the Darphin and Rodan + Fields brands exceeded their respective fair values. As such, the Company reduced its goodwill by \$7.3 million and other intangible assets by \$4.3 million, which are reported in selling, general and administrative expenses in the accompanying consolidated statements of earnings.

During fiscal 2006, the Company sold certain assets and operations of its reporting unit that marketed and sold Stila brand products. In conjunction with the sale, the Company reduced its goodwill by \$91.3 million, which is reported as a component of discontinued operations in the accompanying consolidated statements of earnings.

Goodwill

The Company assigns goodwill of a reporting unit to the product category in which that reporting unit predominantly operates at the time of its acquisition. The change in the carrying amount of goodwill, including the effect of foreign exchange rates is as follows:

YEAR ENDED OR AT JUNE 30	2005	Additions	Reductions	2006	Additions	Reductions	2007
(In millions)							
Skin Care	\$ 19.0	\$1.3	\$ —	\$ 20.3	\$ 1.3	\$7.3	\$ 14.3
Makeup	318.6	—	91.3	227.3	18.5	—	245.8
Fragrance	55.2	—	1.3	53.9	0.6	—	54.5
Hair Care	327.8	6.5	—	334.3	2.4	—	336.7
Total	\$720.6	\$7.8	\$92.6	\$635.8	\$22.8	\$7.3	\$651.3

Other Intangible Assets

Other intangible assets include trademarks and patents, as well as license agreements and other intangible assets resulting from or related to businesses purchased by the Company. Indefinite lived assets (e.g., trademarks) are not subject to amortization and are evaluated annually for impairment or more frequently if certain events or circumstances indicate a potential impairment. Indefinite lived assets of \$70.5 million and \$30.3 million at June 30, 2007 and 2006, respectively, are classified as “Trademarks and other” in the table below. Patents are amortized on a

straight-line basis over the shorter of the legal term or the useful life of the patent, approximately 20 years. Other intangible assets (e.g., non-compete agreements, customer lists) are amortized on a straight-line basis over their expected period of benefit, approximately 2 years to 10 years. Intangible assets related to license agreements are amortized on a straight-line basis over their useful lives based on the term of the respective agreement, currently approximately 10 years to 16 years, and are subject to impairment testing if certain events or circumstances indicate a potential impairment.

Other intangible assets consist of the following:

JUNE 30, 2007	Gross Carrying Value	Accumulated Amortization	Total Net Book Value	JUNE 30, 2006	Gross Carrying Value	Accumulated Amortization	Total Net Book Value
(In millions)				(In millions)			
License agreements	\$ 42.9	\$ 23.8	\$ 19.1	License agreements	\$ 42.9	\$ 19.7	\$23.2
Trademarks and other	191.2	97.3	93.9	Trademarks and other	148.6	95.0	53.6
Patents	0.6	0.2	0.4	Patents	0.5	0.3	0.2
Total	\$234.7	\$121.3	\$113.4	Total	\$192.0	\$115.0	\$77.0

The aggregate amortization expense related to amortizable intangible assets for the years ended June 30, 2007, 2006 and 2005 was \$6.3 million, \$5.5 million and \$4.6 million, respectively. The estimated aggregate amortization expense for each of the next five fiscal years is as follows:

ESTIMATED EXPENSE IN FISCAL	2008	2009	2010	2011	2012
(In millions)					
Aggregate amortization expense	\$6.2	\$4.8	\$4.7	\$3.9	\$3.5

Long-Lived Assets

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets in question may not be recoverable. An impairment would be recorded in circumstances where undiscounted cash flows expected to be generated by an asset are less than the carrying value of that asset.

Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income ("OCI") included in the accompanying consolidated balance sheets consist of the following:

YEAR ENDED JUNE 30	2007	2006	2005
(In millions)			
Net unrealized investment gains, beginning of year	\$ 0.5	\$ 0.4	\$ 0.1
Unrealized investment gains	0.5	0.1	0.5
Provision for deferred income taxes	(0.2)	—	(0.2)
Net unrealized investment gains, end of year	0.8	0.5	0.4
Net derivative instruments, beginning of year	10.3	12.0	10.2
Gain (loss) on derivative instruments	(7.4)	5.2	(9.1)
Benefit (provision) for deferred income taxes on derivative instruments	2.5	(1.7)	3.0
Reclassification to earnings during the year	4.2	(8.3)	11.8
Benefit (provision) for deferred income taxes on reclassification	(1.4)	3.1	(3.9)
Net derivative instruments, end of year	8.2	10.3	12.0
Net minimum pension liability adjustments, beginning of year	(6.1)	(36.0)	(24.6)
Minimum pension liability adjustments	(6.7)	41.4	(15.5)
Benefit (provision) for deferred income taxes	2.7	(11.5)	4.1
Adjustment to initially apply SFAS No. 158, net of tax	10.1	—	—
Net minimum pension liability adjustments, end of year	—	(6.1)	(36.0)
Cumulative translation adjustments, beginning of year	60.0	33.0	24.8
Translation adjustments	53.1	27.0	8.2
Cumulative translation adjustments, end of year	113.1	60.0	33.0
Adjustment to initially apply SFAS No. 158	(98.7)	—	—
Benefit for deferred income taxes	31.3	—	—
Adjustment to initially apply SFAS No. 158, net of tax	(67.4)	—	—
Accumulated other comprehensive income	\$ 54.7	\$ 64.7	\$ 9.4

Of the \$8.2 million, net of tax, derivative instrument gain recorded in OCI at June 30, 2007, \$9.0 million, net of tax, related to the October 2003 gain from the settlement of the treasury lock agreements upon the issuance of the Company's 5.75% Senior Notes due October 2033, which will be reclassified to earnings as an offset to interest expense over the life of the debt. Partially offsetting this gain was \$0.6 million, net of tax, related to a loss from the settlement of a series of forward-starting interest rate swap agreements upon the issuance of the Company's 6.00% Senior Notes due May 2037, which will be reclassified to earnings as an addition to interest expense over the life of the debt. Also partially offsetting the net derivative instrument gain recorded in OCI was \$0.2 million in losses, net of tax, related to forward contracts which the Company will reclassify to earnings during the next twelve months.

Revenue Recognition

Revenues from merchandise sales are recognized upon transfer of ownership, including passage of title to the customer and transfer of the risk of loss related to those goods. In the Americas region, sales are generally recognized at the time the product is shipped to the customer and in the Europe, Middle East & Africa and Asia/Pacific regions sales are generally recognized based upon the customer's receipt. In certain circumstances, transfer of title takes place at the point of sale, for example, at the Company's retail stores. Sales at the Company's retail stores and online are recognized in accordance with a 4-4-5 retail calendar.

Revenues are reported on a net sales basis, which is computed by deducting from gross sales the amount of actual product returns received, discounts, incentive arrangements with retailers and an amount established for anticipated product returns. The Company's practice is to accept product returns from retailers only if properly requested, authorized and approved. In accepting returns, the Company typically provides a credit to the retailer against accounts receivable from that retailer. As a percentage of gross sales, returns were 4.2%, 5.0% and 4.6% in fiscal 2007, 2006 and 2005, respectively.

Payments to Customers

The Company is subject to the provisions of Emerging Issues Task Force ("EITF") Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)." In accordance with this guidance, the Company has recorded the revenues generated from purchase with purchase promotions as sales and the costs of its purchase with purchase and gift with purchase promotions as cost of sales. Certain other incentive arrangements require the payment of a fee to customers based on their attainment of

pre-established sales levels. These fees have been recorded as a reduction of net sales in the accompanying consolidated statements of earnings and were not material to the results of operations in any period presented.

The Company enters into transactions related to advertising, product promotions and demonstrations, some of which involve cooperative relationships with customers. These activities may be arranged either with unrelated third parties or in conjunction with the customer. The Company's share of the cost of these transactions (regardless of to whom they were paid) are reflected in selling, general and administrative expenses in the accompanying consolidated statements of earnings and were approximately \$978 million, \$912 million and \$898 million in fiscal 2007, 2006 and 2005, respectively.

Advertising and Promotion

Costs associated with advertising are expensed during the year as incurred. Global net advertising and promotion expenses, which primarily consist of television, radio, print media, product development and promotional expenses, such as products used as sales incentives, were \$1,916.3 million, \$1,793.1 million and \$1,793.7 million in fiscal 2007, 2006 and 2005, respectively. These amounts include activities relating to purchase with purchase and gift with purchase promotions that are reflected in net sales and cost of sales.

Advertising, merchandising and sampling expenses included in operating expenses were \$1,715.3 million, \$1,586.3 million and \$1,577.1 million in fiscal 2007, 2006 and 2005, respectively.

Research and Development

Research and development costs are included in advertising, merchandising and sampling and amounted to \$74.4 million, \$72.0 million and \$72.3 million in fiscal 2007, 2006 and 2005, respectively. Research and development costs are expensed as incurred.

Operating Leases

The Company recognizes rent expense from operating leases with periods of free and scheduled rent increases on a straight-line basis over the applicable lease term. The Company considers lease renewals in the useful life of its leasehold improvements when such renewals are reasonably assured. From time to time, the Company may receive capital improvement funding from its lessors. These amounts are recorded as deferred liabilities and amortized over the remaining lease term as a reduction of rent expense.

License Arrangements

The Company's license agreements provide the Company with worldwide rights to manufacture, market and sell

beauty and beauty-related products (or particular categories thereof) using the licensors' trademarks. The licenses typically have an initial term of approximately 3 years to 11 years, and are renewable subject to the Company's compliance with the license agreement provisions. The remaining terms, including the potential renewal periods, range from approximately 1 year to 23 years. Under each license, the Company is required to pay royalties to the licensor, at least annually, based on net sales to third parties.

Most of the Company's licenses were entered into to create new business. In some cases, the Company acquired, or entered into, a license where the licensor or another licensee was operating a pre-existing beauty products business. In those cases, intangible assets are capitalized and amortized over their useful lives based on the terms of the agreement and are subject to impairment testing if certain events or circumstances indicate a potential impairment.

Stock-Based Compensation

As of June 30, 2007, the Company had established a number of share incentive programs as discussed in more detail in Note 13 — Stock Programs. Prior to fiscal 2006, the Company applied the intrinsic value method as outlined in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), and related interpretations in accounting for stock options and share units granted under these programs. Under the intrinsic value method, no compensation expense was recognized if the exercise price of the Company's employee stock options equaled the market price of the underlying stock on the date of the grant. Accordingly, no compensation cost was recognized in the accompanying consolidated statements of earnings prior to fiscal year 2006 on stock options granted to employees, since all options granted under the Company's share incentive programs had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective July 1, 2005, the Company adopted SFAS No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"). This statement replaced SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and superseded APB No. 25. SFAS No. 123(R) requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. This statement was adopted using the modified prospective method of application, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior years' financial statements have not been restated. Under this method, in addition to reflecting compensation expense

for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in pro-forma disclosures in prior years. SFAS No. 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

Concentration of Credit Risk

The Company is a worldwide manufacturer, marketer and distributor of skin care, makeup, fragrance and hair care products. Domestic and international sales are made primarily to department stores, perfumeries and specialty retailers. The Company grants credit to all qualified customers and does not believe it is exposed significantly to any undue concentration of credit risk.

During fiscal 2006, Federated Department Stores, Inc. acquired The May Department Stores Company, resulting in the merger of the Company's previous two largest customers (collectively "Macy's, Inc."). This customer sells products primarily within North America and accounted for \$958.8 million, or 14%, and \$1,005.8 million, or 16%, of the Company's consolidated net sales in fiscal 2007 and 2006, respectively. This customer accounted for \$105.3 million, or 12%, and \$105.4 million, or 14%, of the Company's accounts receivable at June 30, 2007 and 2006, respectively. No single customer accounted for more than 10% of the Company's net sales or accounts receivable during fiscal 2005.

Management Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements. Actual results could differ from those estimates and assumptions.

Derivative Financial Instruments

The Company accounts for derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," ("SFAS No. 133") as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 also requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet and that they be measured at fair value.

Recently Issued Accounting Standards

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation Number ("FIN") 48,

“Accounting for Uncertainty in Income Taxes” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes.” FIN 48 prescribes a two-step evaluation process for tax positions taken, or expected to be taken, in a tax return. The first step is recognition and the second is measurement. For recognition, an enterprise judgmentally determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold it is measured and recognized in the financial statements as the largest amount of tax benefit that is greater than 50% likely of being realized. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements.

Tax positions that meet the more-likely-than-not recognition threshold at the effective date of FIN 48 may be recognized or, continue to be recognized, upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. FIN 48 will apply to fiscal years beginning after December 15, 2006, with earlier adoption permitted. In May 2007, the FASB issued FASB Staff Position (“FSP”) No. FIN 48-1, “Definition of Settlement in FASB Interpretation No. 48, an amendment of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes” (“FSP No. FIN 48-1”). FSP No. FIN 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits.

The provisions of FIN 48 became effective for the Company on July 1, 2007. While the Company is continuing to evaluate the impact of the interpretation on the consolidated financial statements, the Company expects the cumulative effect of adoption to reduce opening retained earnings by approximately \$10 million to \$20 million with a corresponding increase to reserves for uncertain tax positions.

In September 2006, the FASB issued Statement of Financial Accounting Standard (“SFAS”) No. 157, “Fair Value Measurements” (“SFAS No. 157”) to clarify the definition of fair value, establish a framework for measuring fair value and expand the disclosures on fair value measurements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market

participants at the measurement date (an exit price). SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity’s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). SFAS No. 157 becomes effective for the Company in its fiscal year ending June 30, 2009. The Company is currently evaluating the impact of the provisions of SFAS No. 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities,” (“SFAS No. 159”) to permit all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The Company is currently evaluating the impact of the provisions of SFAS No. 159 on its consolidated financial statements, if any, when it becomes effective for the fiscal year ending June 30, 2009.

NOTE 3—STAFF ACCOUNTING BULLETIN NO. 108 In September 2006, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin (“SAB”) No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB No. 108”), which sets forth the SEC Staff’s views on the proper methods for quantifying errors when there were uncorrected errors in a prior year. Under SAB No. 108, companies should evaluate a misstatement that existed in prior years based on its impact on the current year income statement (the “rollover” approach), as well as the cumulative effect of correcting such misstatements in the current year’s ending balance sheet (the “iron curtain” approach), or collectively, the “dual” approach. In prior years, the Company utilized the “rollover” approach to evaluate

uncorrected misstatements and believes the conclusions reached regarding its quantitative and qualitative assessments of materiality of such items, both individually and in the aggregate, were appropriate.

SAB No. 108 became effective for the Company's fiscal year ended June 30, 2007. In accordance with the transition guidance set forth in SAB No. 108, the Company elected to record a one-time cumulative effect adjustment to opening retained earnings to correct errors in certain balance sheet accounts that arose in prior years, which previously had been considered immaterial using the "rollover" approach.

Since the fiscal 1996 acquisition of the Bobbi Brown brand, the Company made payments to the sellers based on a percentage of Bobbi Brown sales internationally, which should have been capitalized as goodwill in accordance with SFAS No. 141, "Business Combinations," as amended. These payments were previously recorded as selling, general and administrative expenses in the consolidated statements of earnings. As such, goodwill increased by \$10.5 million and opening retained earnings increased by \$6.7 million, net of tax, in the accompanying fiscal 2007 consolidated balance sheet.

In connection with the Company's defined benefit pension obligations, certain liability amounts were incorrectly reflected on the balance sheet in years prior to fiscal 2002, the majority of which related to benefit plans for the Company's international operations. As such, other noncurrent liabilities decreased by \$8.7 million and opening retained earnings increased by \$5.0 million, net of tax, in the accompanying fiscal 2007 consolidated balance sheet.

Beginning in years prior to fiscal 2003, inventory valuation was impacted by the incorrect application of profit in ending inventory partially offset by the overstatement of inventory obsolescence reserves, culminating in the current year net decrease to inventory of \$2.5 million and opening retained earnings decrease of \$2.0 million, net of tax, in the accompanying fiscal 2007 consolidated balance sheet.

In years prior to fiscal 2004, the Company overstated certain accrued liability positions. As such, other accrued liabilities decreased by \$19.1 million and opening retained earnings increased by \$14.5 million, net of tax, in the accompanying fiscal 2007 consolidated balance sheet.

NOTE 4—ACQUISITION AND DIVESTITURE OF BUSINESSES AND LICENSE ARRANGEMENTS

During fiscal 2007, the Company purchased the remaining minority equity interests in Bumble and Bumble Products, LLC and Bumble and Bumble, LLC, which have

been accounted for as indefinite lived intangible assets in the accompanying consolidated balance sheet.

On April 10, 2006 (the "Effective Date"), the Company completed the sale of certain assets and operations of the reporting unit that marketed and sold Stila brand products to Stila Corp. (the "Purchaser"), an affiliate of Sun Capital Partners, Inc., for consideration of \$23.0 million. The sale price included cash of \$9.3 million, a promissory note with a notional value of \$13.3 million and a fair value of \$11.0 million and convertible preferred stock with an aggregate liquidation preference of \$5.0 million and a fair value of \$2.7 million. As additional consideration for the purchased assets, and subject to the terms and conditions of the sale agreement, the Purchaser will pay the Company an amount equal to two percent of the annual net sales of the acquired business during the period commencing on the Effective Date and ending August 20, 2019. The Company will use these proceeds to satisfy its commitment under the 1999 agreement pursuant to which it originally purchased the Stila business. The Purchaser immediately assumed responsibility for all decisions regarding the operations of the Stila business and the Company agreed to divest itself of continuing involvement in the Stila business, except as described below.

In fiscal 2006, the Company recorded charges of \$80.3 million (net of \$43.3 million tax benefit) to discontinued operations, which reflected the loss on the disposition of the business of \$69.9 million, net of tax, and adjustments to the fair value of assets sold, the costs to dispose of those assets not acquired by the Purchaser and other costs in connection with the sale. The charges also include the operating losses of \$10.4 million, net of tax, for fiscal year ended June 30, 2006. Net sales associated with the discontinued operations were \$45.1 million for the fiscal year ended June 30, 2006. All statement of earnings information for fiscal 2005 has been restated for comparative purposes, including the restatement of the makeup product category and each of the geographic regions presented in Note 17—Segment Data and Related Information.

In order to facilitate the transition of the Stila business to the Purchaser, the Company agreed to provide certain information systems, accounting and other back office services to the Purchaser in exchange for monthly service fees designed to recover the estimated costs of providing these transition services. The Company also agreed with the Purchaser to provide certain distribution and online services. In both cases, the services concluded in fiscal 2007.

In fiscal 2006, the Company settled its obligation, recorded as goodwill at June 30, 2005, related to an earn-out provision in the Company's fiscal 2000 acquisition of Jo Malone Limited.

In fiscal 2005, the Company acquired a majority equity interest in its former distributor in Portugal. The aggregate payments made to acquire the distributor were funded by cash provided by operations and did not have a material effect on the Company's results of operations or financial condition. In addition, the Company assumed debt and other long-term obligations of 4.6 million Euros associated with the acquisition (approximately \$5.6 million at acquisition date exchange rates). The debt is payable semi-annually through February 2008 at a variable interest rate.

At various times during fiscal 2007, 2006 and 2005, the Company also acquired businesses engaged in the wholesale distribution and retail sale of the Company's products in the United States and other countries.

The aggregate cost for these activities, which includes purchase price, earn-out payments and acquisition costs, was \$61.2 million, \$51.7 million, and \$7.1 million in fiscal 2007, 2006 and 2005, respectively, and each transaction was accounted for using the purchase method of accounting. Accordingly, the results of operations for each of the acquired businesses are included in the accompanying consolidated financial statements commencing with its date of original acquisition. Pro forma results of operations, as if each of such businesses had been acquired as of the beginning of the year of acquisition, have not been presented, as the impact on the Company's consolidated financial results would not have been material.

In fiscal 2007, the Company signed an exclusive agreement to create fragrances and related products to be sold to Coach Inc., which are available at Coach retail stores in the United States. In May 2007, the Company entered into a license agreement with Ford Motor Company to create a fragrance using the name Mustang. Since fiscal 2006, the Company developed and sold fragrance products pursuant to a license agreement with Daisy Fuentes. Since fiscal 2005, the Company developed and sold products under license agreements for Sean John (announced in May 2004), Tom Ford (announced in April 2005) and Missoni (announced in May 2005) and an Origins license agreement to develop and sell products using the name of Dr. Andrew Weil (announced in October 2004).

Certain license agreements may require minimum royalty payments, incremental royalties based on net sales

levels and minimum spending on advertising and promotional activities. Royalty expenses are accrued in the period in which net sales are earned while advertising and promotional expenses are accrued at the time these costs are incurred.

NOTE 5 – COST SAVINGS INITIATIVE

During fiscal 2006, the Company recorded special charges associated with a cost savings initiative that was designed to support its long-term financial objectives. As part of this multi-faceted initiative, the Company had identified savings opportunities that include streamlined processes and organizational changes. The principal component of the initiative was a voluntary separation program offered primarily to North America-based employees. During the fourth quarter of fiscal 2006, involuntary separations were communicated to certain employees. Under this initiative, the Company incurred expenses related to one-time termination benefits for 494 employees, of which 28 were involuntary, which benefits were based principally upon years of service. Employees designated for separation under the cost savings initiative have been separated as of June 30, 2007.

In addition, the Company identified other cost savings opportunities to improve efficiencies in the Company's distribution network and product offerings and to eliminate other nonessential costs. These charges primarily related to employee severance for facilities that are closing, contract cancellations, counter and door closings and product returns.

For the years ended June 30, 2007 and 2006, aggregate expenses of \$1.1 million and \$92.1 million, respectively, were recorded as special charges related to the cost savings initiative in the accompanying consolidated statements of earnings. The fiscal 2007 charges were primarily related to facility closings. At June 30, 2007 and 2006, \$15.4 million and \$40.7 million, respectively, and \$7.5 million and \$28.2 million, respectively, related to the cost savings initiative were recorded in other accrued liabilities and other noncurrent liabilities, respectively, in the accompanying consolidated balance sheet.

The following table summarizes the cost savings initiative, which impacted the Company's operating expenses and cost of sales:

	Fiscal 2006 expense	Fiscal 2006 payments	Accrued at June 30, 2006	Fiscal 2007 expense	Fiscal 2007 payments	Accrued at June 30, 2007
(In millions)						
Employee separation expenses	\$75.9	\$20.7	\$55.2	\$0.3	\$34.2	\$21.3
Facility closures and product/distribution rationalization	12.5	—	12.5	0.8	11.7	1.6
Advertising and promotional effectiveness	3.7	2.5	1.2	—	1.2	—
	\$92.1	\$23.2	\$68.9	\$1.1	\$47.1	\$22.9

NOTE 6 – INCOME TAXES

The provision for income taxes is comprised of the following:

YEAR ENDED JUNE 30	2007	2006	2005
(In millions)			
Current:			
Federal	\$ 66.6	\$164.3	\$ 53.8
Foreign	166.7	158.2	129.2
State and local	12.0	11.5	8.0
	245.3	334.0	191.0
Deferred:			
Federal	11.3	(73.7)	86.5
Foreign	(4.8)	(0.3)	10.7
State and local	3.4	(0.3)	5.5
	9.9	(74.3)	102.7
	\$255.2	\$259.7	\$293.7

A reconciliation between the provision for income taxes computed by applying the statutory Federal income tax rate to earnings before income taxes and minority interest and the actual provision for income taxes is as follows:

YEAR ENDED JUNE 30	2007	2006	2005
(\$ in millions)			
Provision for income taxes at statutory rate	\$248.9	\$208.5	\$249.8
Increase (decrease) due to:			
State and local income taxes, net of Federal tax benefit	11.2	9.7	11.8
Effect of foreign operations	(0.5)	7.0	4.3
IRS tax settlement	—	46.0	—
AJCA incremental dividend	(5.7)	(10.9)	27.5
Preferred stock dividends not deductible for U.S. tax purposes	—	0.2	0.3
Other nondeductible expenses	3.4	3.4	2.0
Tax credits	(3.0)	(2.2)	(2.6)
Other, net	0.9	(2.0)	0.6
Provision for income taxes	\$255.2	\$259.7	\$293.7
Effective tax rate	35.9%	43.6%	41.2%

Significant components of the Company's deferred income tax assets and liabilities as of June 30, 2007 and 2006 were as follows:

	2007	2006
(In millions)		
Deferred tax assets:		
Compensation related expenses	\$ 75.5	\$ 69.8
Inventory obsolescence and other inventory related reserves	55.6	54.0
Retirement benefit obligations	31.6	8.2
Various accruals not currently deductible	78.1	72.4
Net operating loss and credit carryforwards	3.4	7.2
Other differences between tax and financial statement values	16.1	7.6
	260.3	219.2
Valuation allowance for deferred tax assets	(5.5)	(6.5)
Total deferred tax assets	254.8	212.7
Deferred tax liabilities:		
Depreciation and amortization	(142.6)	(111.1)
Other differences between tax and financial statement values	(4.8)	(5.7)
Total deferred tax liabilities	(147.4)	(116.8)
Total net deferred tax assets	\$ 107.4	\$ 95.9

As of June 30, 2007 and 2006, the Company had current net deferred tax assets of \$124.0 million and \$139.1 million, respectively, which are included in prepaid expenses and other current assets in the accompanying consolidated balance sheets. In addition, the Company had non-current net deferred tax liabilities of \$16.6 million and \$43.2 million as of June 30, 2007 and June 30, 2006, respectively, which are included in other noncurrent liabilities in the accompanying consolidated balance sheets.

On July 13, 2006, the Company announced a settlement with the Internal Revenue Service (“IRS”) regarding its examination of the Company’s consolidated Federal income tax returns for the fiscal years ended June 30, 1998 through June 30, 2001. The settlement resolves previously disclosed issues raised during the IRS’s examination, including transfer pricing and foreign tax credit computations. The settlement of these issues resulted in a tax charge of approximately \$46 million in the fourth quarter of fiscal 2006 and represents the aggregate earnings impact of the settlement through fiscal 2006. In addition, during the fourth quarter of fiscal 2006, the Company completed the repatriation of foreign earnings through intercompany dividends as required under the provisions of the American Jobs Creation Act of 2004 (the “AJCA”). In connection with the repatriation, the Company updated the computation of the related aggregate tax impact, resulting in a favorable adjustment of approximately \$11 million. The tax settlement, coupled with the AJCA favorable tax adjustment, resulted in a net increase to the Company’s fiscal 2006 income tax provision of approximately \$35 million.

Federal income and foreign withholding taxes have not been provided on approximately \$539 million of undistributed earnings of international subsidiaries at June 30, 2007. The Company intends to reinvest these earnings in its foreign operations indefinitely, except where it is able to repatriate these earnings to the United States without material incremental tax provision. As of June 30, 2006 and 2005, the Company had not provided federal income and foreign withholding taxes on approximately \$336 million and \$90 million, respectively, of undistributed earnings of international subsidiaries.

As of June 30, 2007 and 2006, certain international subsidiaries had tax loss carryforwards for local tax purposes of approximately \$11 million and \$23 million, respectively. With the exception of \$6.4 million of losses with an indefinite carryforward period as of June 30, 2007, these losses expire at various dates through fiscal 2022.

Deferred tax assets, net of valuation allowances, in the amount of \$1.2 million and \$0.7 million as of June 30, 2007 and 2006, respectively, have been recorded to reflect the tax benefits of the losses not utilized to date.

A full valuation allowance has been provided for those deferred tax assets for which, in the opinion of management, it is more likely than not that the deferred tax assets will not be realized.

Earnings before income taxes and minority interest include amounts contributed by the Company’s international operations of approximately \$696 million, \$603 million and \$583 million for fiscal 2007, 2006 and 2005, respectively. Some of these earnings are taxed in the United States.

Earnings from the Company’s global operations are subject to tax in various jurisdictions both within and outside the United States. The Company is routinely audited in these jurisdictions and these reviews can involve complex issues that may require an extended period of time for resolution. The Company’s U.S. Federal income tax returns have been examined and settled through fiscal 2001.

The Company is currently under examination by the Internal Revenue Service for fiscal years 2002 through 2005. In addition, the Company has ongoing audits in various state and local jurisdictions, as well as audits in various foreign jurisdictions.

The Company provides tax reserves for Federal, state, local and international exposures relating to periods subject to audit. The development of reserves for these exposures requires judgments about tax issues, potential outcomes and timing, and is a subjective critical estimate. Although the outcome related to these exposures is uncertain, in management’s opinion, adequate provisions for income taxes have been made for estimable potential liabilities emanating from these exposures. In certain circumstances, the ultimate outcome of exposures and risks involve significant uncertainties which render them inestimable. If actual outcomes differ materially from these estimates, including those that cannot be quantified, they could have a material impact on the Company’s results of operations.

The Company has been notified of a disallowance of tax deductions claimed by its subsidiary in Spain for the fiscal years 1999 through 2002. As a result, the subsidiary was reassessed corporate income tax of approximately \$3 million for this period. An appeal against this reassessment was filed with the Chief Tax Inspector. On July 18, 2005,

the final assessment made by the Chief Tax Inspector was received, confirming the reassessment made by the tax auditors. During fiscal 2006, an appeal against this final assessment was filed with the Madrid Regional Economic Administrative Tribunal. While no assurance can be given as to the outcome in respect of this assessment, either during the administrative appeals process or in the Spanish courts, management believes that the subsidiary should ultimately be successful in its defense against the assessment. Accordingly, no tax reserve has been established for this potential exposure.

NOTE 8—DEBT

The Company's short-term and long-term debt and available financing consist of the following:

	Debt at June 30		Available financing at June 30			
			Committed		Uncommitted	
	2007	2006	2007	2006	2007	2006
(\$ in millions)						
6.00% Senior Notes, due May 15, 2037 ("2037 Senior Notes")	\$ 296.2	\$ —	\$ —	\$ —	\$ —	\$ —
5.55% Senior Notes, due May 15, 2017 ("2017 Senior Notes")	290.9	—	—	—	—	—
6.00% Senior Notes, due January 15, 2012 ("2012 Senior Notes")	239.7	230.0	—	—	—	—
5.75% Senior Notes, due October 15, 2033 ("2033 Senior Notes")	197.4	197.4	—	—	—	—
Commercial paper	26.5	—	—	—	723.5	750.0
Turkish lira overdraft borrowing facility	9.4	—	—	—	—	—
Loan participation notes	—	38.0	—	—	150.0	112.0
Japanese yen revolving credit facility	—	26.2	24.3	—	—	—
Other long-term borrowings	3.9	4.4	—	—	—	—
Other short-term borrowings	24.5	25.5	—	—	150.0	129.3
Revolving credit facility	—	—	750.0	600.0	—	—
	1,088.5	521.5	\$774.3	\$600.0	\$1,023.5	\$991.3
Less short-term debt including current maturities	(60.4)	(89.7)				
	\$1,028.1	\$431.8				

As of June 30, 2007, the Company had outstanding \$296.2 million of 2037 Senior Notes consisting of \$300.0 million principal and unamortized debt discount of \$3.8 million. The 2037 Senior Notes, when issued in May 2007, were priced at 98.722% with a yield of 6.093%. Interest payments are required to be made semi-annually on May 15 and November 15. In April 2007, in anticipation of the issuance of the 2037 Senior Notes, the Company entered into a series of forward-starting interest rate swap agreements on a notional amount totaling \$210.0 million at a weighted average all-in rate of 5.45%. The forward-starting interest rate swap agreements were settled upon the issuance of the new debt and the Company recognized a loss in other comprehensive income of \$0.9 million that will be amortized to interest expense over the life of the 2037 Senior Notes. As a result of the forward-

NOTE 7—OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of the following:

JUNE 30	2007	2006
(In millions)		
Advertising, merchandising and sampling	\$324.7	\$334.5
Employee compensation	281.0	260.5
Special charges related to cost savings initiative	15.4	40.7
Other	342.8	312.8
	\$963.9	\$948.5

starting interest rate swap agreements, the debt discount and debt issuance costs, the effective interest rate on the 2037 Senior Notes will be 6.181% over the life of the debt.

As of June 30, 2007, the Company had outstanding \$290.9 million of 2017 Senior Notes consisting of \$300.0 million principal, an unamortized debt discount of \$0.5 million, and an \$8.6 million adjustment to reflect the fair value of an outstanding interest rate swap. The 2017 Senior Notes, when issued in May 2007, were priced at 99.845% with a yield of 5.570%. Interest payments are required to be made semi-annually on May 15 and November 15. In April 2007, the Company entered into an interest rate swap agreement with a notional amount of \$250.0 million to effectively convert the fixed

rate interest on its outstanding 2017 Senior Notes to variable interest rates based on six-month LIBOR.

As of June 30, 2007, the Company had outstanding \$239.7 million of 2012 Senior Notes consisting of \$250.0 million principal, an unamortized debt discount of \$0.5 million, and a \$9.8 million adjustment to reflect the remaining termination value of an interest rate swap. The 2012 Senior Notes, when issued in January 2002, were priced at 99.538% with a yield of 6.062%. Interest payments are required to be made semi-annually on January 15 and July 15. In May 2003, the Company entered into an interest rate swap agreement with a notional amount of \$250.0 million to effectively convert the fixed rate interest on its outstanding 2012 Senior Notes to variable interest rates based on six-month LIBOR. In April 2007, the Company terminated this interest rate swap. The instrument, which was classified as a liability, had a fair value of \$11.1 million at cash settlement, which included \$0.9 million of accrued interest payable to the counterparty. Hedge accounting treatment was discontinued prospectively and the offsetting adjustment to the carrying amount of the related debt will be amortized to interest expense over the remaining life of the debt.

As of June 30, 2007, the Company had outstanding \$197.4 million of 2033 Senior Notes consisting of \$200.0 million principal and unamortized debt discount of \$2.6 million. The 2033 Senior Notes, when issued in September 2003, were priced at 98.645% with a yield of 5.846%. Interest payments are required to be made semi-annually on April 15 and October 15. In May 2003, in anticipation of the issuance of the 5.75% Senior Notes, the Company entered into a series of treasury lock agreements on a notional amount totaling \$195.0 million at a weighted average all-in rate of 4.53%. The treasury lock agreements were settled upon the issuance of the new debt and the Company received a payment of \$15.0 million that will be amortized against interest expense over the life of the 2033 Senior Notes. As a result of the treasury lock agreements, the debt discount and debt issuance costs, the effective interest rate on the 2033 Senior Notes will be 5.395% over the life of the debt.

In October 2006, the Company entered into an overdraft borrowing agreement with a financial institution pursuant to which its subsidiary in Turkey may be credited to satisfy outstanding negative daily balances arising from its business operations. The total balance outstanding at any time shall not exceed 20.0 million Turkish lira. The interest rate applicable to each such credit shall be 40 basis points per annum above the spot rate charged by the lender or the lender's floating call rate agreed to by the Company at each borrowing. There were no debt issuance costs incurred related to this agreement. The

outstanding balance at June 30, 2007 (\$9.4 million at the exchange rate at June 30, 2007) is classified as short-term debt on the Company's consolidated balance sheet.

In March 2006, the Company entered into a 3.0 billion yen revolving credit facility that expires on March 24, 2009. The interest rate on borrowings under the credit facility is based on TIBOR (Tokyo Interbank Offered Rate) and a 10 basis point facility fee is incurred on the undrawn balance. The Company borrowed 3.0 billion yen under the new facility on March 28, 2006 to repay the previously outstanding 1.45% Japan term loan that matured on that date. At June 30, 2007, the Company did not have any borrowings outstanding under this facility.

In May 2006, the Company entered into a fixed rate promissory note agreement with a financial institution for the primary purpose of funding cash dividend repatriations from certain of its international affiliates to the United States as permitted by the AJCA. Under the agreement, the Company may borrow up to \$150.0 million in the form of loan participation notes through one of the Company's subsidiaries in Europe. The interest rate on borrowings under this agreement will be an all-in fixed rate determined by the lender and agreed to by the Company at the date of each borrowing. Debt issuance costs incurred related to this agreement were de minimis. At June 30, 2007, the Company did not have any borrowings outstanding under this agreement.

The Company has a \$750.0 million commercial paper program under which it may issue commercial paper in the United States. The Company's commercial paper is currently rated A-1 by Standard & Poor's and P-1 by Moody's. The Company's long-term credit ratings are A with a stable outlook by Standard & Poor's and A2 with a stable outlook by Moody's. At June 30, 2007, the Company had \$26.5 million of commercial paper outstanding, due at various dates through July 2007 at an average interest rate of 5.40%, which may be refinanced on a periodic basis as it matures at then-prevailing market interest rates.

Effective April 2007, the Company entered into a \$750.0 million senior unsecured revolving credit facility, expiring on April 26, 2012, primarily to provide credit support for its commercial paper program, to repurchase shares of its common stock and for general corporate purposes. The new facility replaced the Company's prior, undrawn \$600.0 million senior unsecured revolving credit facility, which was effective since May 27, 2005. Up to the equivalent of \$250 million of the facility is available for multi-currency loans. The interest rate on borrowings under the credit facility is based on LIBOR or on the higher of prime, which is the rate of interest publicly announced by the administrative agent, or 1/2% plus the

Federal funds rate. The Company incurred costs of approximately \$0.3 million to establish the facility which will be amortized over the term of the facility. The credit facility has an annual fee of \$0.4 million, payable quarterly, based on the Company's current credit ratings. The credit facility contains various covenants, including one financial covenant which requires the Company's interest expense coverage ratio (as defined in the facility) at the last day of each fiscal quarter to be greater than 3.0:1.0. As of June 30, 2007, the Company was in compliance with this financial covenant. There are no other conditions where the lender's commitments may be withdrawn, other than certain events of default, as defined in the facility, which are customary for facilities of this type.

The Company maintains uncommitted credit facilities in various regions throughout the world. Interest rate terms for these facilities vary by region and reflect prevailing market rates for companies with strong credit ratings. During fiscal 2007 and 2006, the monthly average amount outstanding was approximately \$20.0 million and \$22.8 million, respectively, and the annualized monthly weighted average interest rate incurred was approximately 5.96% and 5.56%, respectively.

Refer to Note 14—Commitments and Contingencies for the Company's projected debt service payments over the next five fiscal years.

NOTE 9—FINANCIAL INSTRUMENTS

Derivative Financial Instruments

The Company addresses certain financial exposures through a controlled program of risk management that includes the use of derivative financial instruments. The Company primarily enters into foreign currency forward exchange contracts and foreign currency options to reduce the effects of fluctuating foreign currency exchange rates. The Company, if necessary, enters into interest rate derivatives to manage the effects of interest rate movements on the Company's aggregate liability portfolio. The Company categorizes these instruments as entered into for purposes other than trading.

All derivatives are recognized at their fair value and are included in prepaid expenses and other current assets or other accrued liabilities in the accompanying balance sheets. The associated gains and losses on these derivatives are recorded in cost of goods sold and selling, general and administrative expenses in the accompanying statements of earnings. On the date the derivative contract is entered into, the Company designates the derivative as (i) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair-value" hedge), (ii) a hedge of a forecasted transaction or of the variability of cash flows to be received or

paid related to a recognized asset or liability ("cash-flow" hedge), (iii) a foreign-currency fair-value or cash-flow hedge ("foreign-currency" hedge), (iv) a hedge of a net investment in a foreign operation, or (v) other. Changes in the fair value of a derivative that is highly effective as (and that is designated and qualifies as) a fair-value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), are recorded in current-period earnings. Changes in the fair value of a derivative that is highly effective as (and that is designated and qualifies as) a cash-flow hedge are recorded in other comprehensive income, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). Changes in the fair value of derivatives that are highly effective as (and that are designated and qualify as) foreign-currency hedges are recorded in either current-period earnings or other comprehensive income, depending on whether the hedge transaction is a fair-value hedge (e.g., a hedge of a firm commitment that is to be settled in a foreign currency) or a cash-flow hedge (e.g., a foreign-currency-denominated forecasted transaction). If, however, a derivative is used as a hedge of a net investment in a foreign operation, its changes in fair value, to the extent effective as a hedge, are recorded in accumulated other comprehensive income within equity. Furthermore, changes in the fair value of other derivative instruments are reported in current-period earnings.

For each derivative contract entered into where the Company looks to obtain special hedge accounting treatment, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking the hedge transaction, the nature of the risk being hedged, how the hedging instruments' effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as fair-value, cash-flow, or foreign-currency hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, 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. If it is determined that a derivative is not highly effective, or that it has ceased to be a highly effective hedge, the Company will be required to discontinue hedge accounting with respect to that derivative prospectively.

Foreign Exchange Risk Management

The Company enters into forward exchange contracts to hedge anticipated transactions, as well as receivables and payables denominated in foreign currencies, for periods consistent with the Company's identified exposures. The purpose of the hedging activities is to minimize the effect of foreign exchange rate movements on costs and on the cash flows that the Company receives from foreign subsidiaries. Almost all foreign currency contracts are denominated in currencies of major industrial countries and are with large financial institutions rated as strong investment grade by a major rating agency. The Company also enters into foreign currency options to hedge anticipated transactions where there is a high probability that anticipated exposures will materialize. The forward exchange contracts and foreign currency options entered into to hedge anticipated transactions have been designated as cash-flow hedges. Hedge effectiveness of forward exchange contracts is based on a hypothetical derivative methodology and excludes the portion of fair value attributable to the spot-forward difference which is recorded in current-period earnings. Hedge effectiveness of foreign currency option contracts is based on a dollar offset methodology. The ineffective portion of both forward exchange and foreign currency option contracts is recorded in current-period earnings. For hedge contracts that are no longer deemed highly effective, hedge accounting is discontinued and gains and losses accumulated in other comprehensive income are reclassified to earnings when the underlying forecasted transaction occurs. If it is probable that the forecasted transaction will no longer occur, then any gains or losses accumulated in other comprehensive income are reclassified to current-period earnings. As of June 30, 2007, these cash-flow hedges were highly effective, in all material respects.

As a matter of policy, the Company only enters into contracts with counterparties that have at least an "A" (or equivalent) credit rating. The counterparties to these contracts are major financial institutions. The Company does not have significant exposure to any one counterparty. Exposure to credit loss in the event of nonperformance by any of the counterparties is limited to only the recognized, but not realized, gains attributable to the contracts. Management believes risk of loss under these hedging contracts is remote and in any event would not be material to the Company's consolidated financial results. The contracts have varying maturities through the end of June 2008. Costs associated with entering into such contracts have not been material to the Company's consolidated financial results. The Company does not utilize derivative financial instruments for trading or speculative purposes.

At June 30, 2007, the Company had foreign currency contracts in the form of forward exchange contracts in the amount of \$862.0 million. The foreign currencies included in forward exchange contracts (notional value stated in U.S. dollars) are principally the British pound (\$148.1 million), Canadian dollar (\$140.3 million), Euro (\$124.1 million), Swiss franc (\$113.1 million), Australian dollar (\$79.3 million), Japanese yen (\$42.6 million) and South Korean won (\$33.6 million). As of June 30, 2007, all of the Company's previously outstanding option contracts have matured.

At June 30, 2006, the Company had foreign currency contracts in the form of forward exchange contracts and option contracts in the amount of \$782.6 million and \$130.2 million, respectively. The foreign currencies included in forward exchange contracts (notional value stated in U.S. dollars) are principally the Euro (\$238.5 million), Swiss franc (\$98.5 million), British pound (\$92.4 million), Canadian dollar (\$71.7 million), Japanese yen (\$50.6 million), Australian dollar (\$50.5 million) and South Korean won (\$33.1 million). The foreign currencies included in the option contracts (notional value stated in U.S. dollars) are principally the Japanese yen (\$32.0 million), Euro (\$27.7 million), Canadian dollar (\$22.8 million), Swiss franc (\$14.8 million) and South Korean won (\$13.4 million).

Interest Rate Risk Management

The Company enters into interest rate derivative contracts to manage the exposure to fluctuations of interest rates on its funded and unfunded indebtedness for periods consistent with the identified exposures. All interest rate derivative contracts are with large financial institutions rated as strong investment grade by a major rating agency.

In April 2007, the Company entered into interest rate swap agreements with a notional amount totaling \$250.0 million to effectively convert the fixed rate interest on its 2017 Senior Notes to variable interest rates based on six-month LIBOR. The interest rate swaps were designated as fair-value hedges. As of June 30, 2007, these fair-value hedges were highly effective in all material respects.

In April 2007, the Company terminated an interest-rate swap agreement with a notional amount of \$250.0 million to effectively convert fixed rate interest on its 2012 Senior Notes to variable interest rates based on six-month LIBOR. This instrument was classified as a liability and had a termination fair value of \$11.1 million at cash settlement, which included \$0.9 million of accrued interest payable to the counterparty. Hedge accounting treatment was discontinued prospectively and the offsetting adjustment to the carrying amount of the related debt will be amortized to interest expense over the remaining life of the debt.

Information regarding the Company's interest rate swap agreements is presented in the following table:

	YEAR ENDED OR AT JUNE 30, 2007			YEAR ENDED OR AT JUNE 30, 2006		
	Notional Amount	Weighted Average		Notional Amount	Weighted Average	
		Pay Rate	Receive Rate		Pay Rate	Receive Rate
(\$ in millions)						
Interest rate swaps on 2017 Senior Notes	\$250.0	5.70%	5.55%	\$ —	—	—
Interest rate swap on 2012 Senior Notes	\$ —	—	—	\$250.0	6.22%	6.00%

Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents:

The carrying amount approximates fair value, primarily because of the short maturity of cash equivalent instruments.

Short-term and long-term debt:

The fair value of the Company's debt was estimated based on the current rates offered to the Company for debt with the same remaining maturities. To a lesser extent, debt also includes capital lease obligations for which the carrying amount approximates the fair value.

Foreign exchange and interest rate contracts:

The fair value of forwards, swaps and options is the estimated amount the Company would receive or pay to terminate the agreements.

The estimated fair values of the Company's financial instruments are as follows:

	JUNE 30, 2007		JUNE 30, 2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(In millions)				
Nonderivatives				
Cash and cash equivalents	\$ 253.7	\$ 253.7	\$368.6	\$368.6
Short-term and long-term debt	1,088.5	1,082.0	521.5	533.2
Derivatives				
Forward exchange contracts	(0.4)	(0.4)	2.0	2.0
Foreign currency option contracts	—	—	1.2	1.2
Interest rate swap contracts	(8.6)	(8.6)	(19.4)	(19.4)

NOTE 10—PENSION, DEFERRED COMPENSATION AND POST-RETIREMENT BENEFIT PLANS

The Company maintains pension plans covering substantially all of its full-time employees for its U.S. operations and a majority of its international operations. Several plans provide pension benefits based primarily on years of service and employees' earnings. In certain instances, the Company adjusts benefits in connection with international employee transfers.

Retirement Growth Account Plan (U.S.)

The Retirement Growth Account Plan is a trust-based, noncontributory qualified defined benefit pension plan. The Company's funding policy consists of an annual contribution at a rate that provides for future plan benefits and maintains appropriate funded percentages. Such

contribution is not less than the minimum required by the Employee Retirement Income Security Act of 1974, as amended, ("ERISA") and subsequent pension legislation and is not more than the maximum amount deductible for income tax purposes.

Restoration Plan (U.S.)

The Company also has an unfunded, non-qualified domestic noncontributory pension Restoration Plan to provide benefits in excess of Internal Revenue Code limitations.

International Pension Plans

The Company maintains International Pension Plans, the most significant of which are defined benefit pension plans. The Company's funding policies for these plans are determined by local laws and regulations.

Post-retirement Benefits

The Company maintains a domestic post-retirement benefit plan which provides certain medical and dental benefits to eligible employees. Employees hired after January 1, 2002 are not eligible for retiree medical benefits when they retire. Certain retired employees who are receiving monthly pension benefits are eligible for participation in the plan. Contributions required and benefits received by retirees and eligible family members are dependent on the age of the retiree. It is the Company's practice to fund these benefits as incurred.

Certain of the Company's international subsidiaries and affiliates have post-retirement plans, although most participants are covered by government-sponsored or administered programs.

Plan Summaries

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and

Other Postretirement Plans, an amendment of FASB Statements No. 87, 106, and 132(R)" ("SFAS No. 158"). SFAS No. 158 requires employers to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income to report the funded status of defined benefit pension and other post-retirement benefit plans. Previous standards required employers to disclose the complete funded status of its plans only in the notes to the consolidated financial statements. Changes in the funded status of these plans will be recognized as they occur through other comprehensive income. Additional minimum liability adjustments are no longer recognized upon adoption of SFAS No. 158. As of June 30, 2007, the Company prospectively adopted the balance sheet recognition provisions of SFAS No. 158. The incremental effect of applying SFAS No. 158 on individual line items in the Company's consolidated balance sheet is summarized below:

	Before Application of SFAS No. 158	Minimum Liability Adjustment	SFAS No. 158 Adjustments	After Application of SFAS No. 158
(In millions)				
Other assets, net	\$274.7	\$ —	\$(56.1)	\$218.6
Other accrued liabilities	944.9	—	19.0	963.9
Other noncurrent liabilities	369.0	(16.0)	23.6	376.6
Accumulated other comprehensive income	137.4	16.0	(98.7)	54.7

Additionally, SFAS No. 158 requires employers to measure plan assets and obligations at their year-end balance sheet date. The Company's principal pension and post-retirement benefit plans are measured as of June 30; therefore, the measurement provisions of SFAS No. 158 did not affect the Company's existing valuation practices. The adoption of SFAS No. 158 did not impact the consolidated statements of earnings or the Company's financial debt covenant.

Amounts recognized in accumulated other comprehensive income as of June 30, 2007 are as follows:

	Pension Plans		Other than Pension Plans	Total
	U.S.	International	Post-retirement	
(In millions)				
Prior service cost (credit)	\$ 5.2	\$ 1.7	\$ (0.1)	\$ 6.8
Net actuarial loss	48.2	33.6	10.1	91.9
Total amounts recognized in accumulated other comprehensive income	\$53.4	\$35.3	\$10.0	\$98.7

Amounts in accumulated other comprehensive income expected to be amortized as components of net periodic benefit cost during fiscal 2008 are as follows:

	Pension Plans		Other than Pension Plans
	U.S.	International	Post-retirement
(In millions)			
Prior service cost	\$0.6	\$0.3	\$ —
Net actuarial loss	1.7	7.5	0.1

The significant components of the above mentioned plans as of and for the years ended June 30 are summarized as follows:

	Pension Plans				Other than Pension Plans	
	U.S.		International		Post-retirement	
	2007	2006	2007	2006	2007	2006
(In millions)						
Change in benefit obligation:						
Benefit obligation at beginning of year	\$417.5	\$423.2	\$284.3	\$255.5	\$ 101.8	\$ 92.6
Service cost	18.4	21.5	16.2	16.2	4.1	5.1
Interest cost	25.0	21.2	12.8	10.8	5.9	5.6
Plan participant contributions	—	—	1.5	1.3	0.3	0.4
Actuarial loss (gain)	4.4	(28.2)	(10.2)	(7.1)	(4.0)	(10.5)
Foreign currency exchange rate impact	—	—	11.9	6.9	0.7	(0.1)
Benefits, expenses, taxes and premiums paid	(24.8)	(20.2)	(20.3)	(16.5)	(3.5)	(3.2)
Plan amendments	—	—	—	—	—	—
Special termination benefits	—	—	1.6	0.3	—	—
Acquisitions, divestitures, adjustments	—	—	(1.7)	18.2	—	11.9
Settlements and curtailments	—	—	(1.3)	(1.3)	—	—
Benefit obligation at end of year	\$440.5	\$417.5	\$294.8	\$284.3	\$ 105.3	\$ 101.8
Change in plan assets:						
Fair value of plan assets at beginning of year	\$376.0	\$353.3	\$242.1	\$187.2	\$ —	\$ —
Actual return on plan assets	54.0	35.5	26.1	28.9	—	—
Foreign currency exchange rate impact	—	—	9.7	4.7	—	—
Employer contributions	25.3	7.4	24.0	25.7	3.2	2.8
Plan participant contributions	—	—	1.5	1.3	0.3	0.4
Settlements and curtailments	—	—	(1.3)	—	—	—
Acquisitions, divestitures, adjustments	—	—	—	10.8	—	—
Benefits, expenses, taxes and premiums paid from plan assets	(24.8)	(20.2)	(20.3)	(16.5)	(3.5)	(3.2)
Fair value of plan assets at end of year	\$430.5	\$376.0	\$281.8	\$242.1	\$ —	\$ —
Funded status	\$ (10.0)	\$ (41.5)	\$ (13.0)	\$ (42.2)	\$ (105.3)	\$ (101.8)
Unrecognized net actuarial loss		70.8		61.2		14.3
Unrecognized prior service cost		5.8		1.8		(0.1)
Unrecognized net transition obligation		—		—		—
Prepaid (accrued) benefit cost		\$ 35.1		\$ 20.8		\$ (87.6)
Amounts recognized in the Balance Sheet consist of:						
Other assets, net	\$ 79.2		\$ 48.8		\$ —	
Other accrued liabilities	(11.3)		(4.6)		(3.1)	
Other noncurrent liabilities	(77.9)		(57.2)		(102.2)	
Funded status	(10.0)		(13.0)		(105.3)	
Accumulated other comprehensive income	53.4		35.3		10.0	
Net amount recognized	\$ 43.4		\$ 22.3		\$ (95.3)	
Prepaid benefit cost		\$ 88.3		\$ 78.0		\$ —
Accrued benefit liability		(61.9)		(58.6)		(87.6)
Intangible asset		0.5		0.3		—
Minimum pension liability		8.2		1.1		—
Net amount recognized		\$ 35.1		\$ 20.8		\$ (87.6)

	Pension Plans						Other than Pension Plans		
	U.S.			International			Post-retirement		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
(\$ in millions)									
Components of net periodic benefit cost:									
Service cost, net	\$ 18.4	\$ 21.5	\$ 19.3	\$ 16.2	\$ 16.2	\$ 11.3	\$ 4.1	\$ 5.1	\$ 3.5
Interest cost	25.0	21.2	21.2	12.8	10.8	9.8	5.9	5.6	4.2
Expected return on assets	(28.7)	(24.9)	(24.1)	(13.8)	(12.1)	(11.2)	—	—	—
Amortization of:									
Transition (asset) obligation	—	—	—	0.1	0.1	—	—	—	—
Prior service cost	0.6	0.8	0.5	0.3	0.2	1.2	—	—	—
Actuarial loss (gain)	1.7	6.1	4.6	7.8	8.3	4.0	0.2	1.3	0.2
Acquisitions, divestitures, adjustments	—	—	—	(1.7)	—	—	—	—	—
Special termination benefits	—	—	—	1.6	0.3	2.0	—	—	—
Settlements and curtailments	—	—	—	0.5	(0.7)	—	—	—	—
Net periodic benefit cost	\$ 17.0	\$ 24.7	\$ 21.5	\$ 23.8	\$ 23.1	\$ 17.1	\$10.2	\$12.0	\$7.9
Weighted-average assumptions used to determine benefit obligations at June 30:									
Pre-retirement discount rate	6.25%	6.25%	5.25%	2.25–6.25%	2.25–6.25%	1.75–5.25%	5.50–6.25%	5.75–6.25%	5.25%
Post-retirement discount rate	5.25%	5.25%	4.75%	2.25–5.75%	2.25–5.75%	1.75–5.25%	5.50–6.25%	5.75–6.25%	5.25%
Rate of compensation increase	3.00–9.50%	3.00–9.50%	3.00–9.50%	1.75–5.00%	1.75–5.00%	1.75–4.50%	N/A	N/A	N/A
Weighted-average assumptions used to determine net periodic benefit cost for the year ending June 30:									
Pre-retirement discount rate	6.25%	5.25%	6.00%	2.25–6.25%	1.75–5.50%	2.25–6.00%	5.75–6.25%	5.25%	6.00%
Post-retirement discount rate	5.25%	4.75%	5.00%	2.25–5.75%	1.75–5.50%	2.25–6.00%	5.75–6.25%	5.25%	6.00%
Expected return on assets	7.75%	7.75%	7.75%	2.75–7.25%	2.75–7.50%	3.25–7.50%	N/A	N/A	N/A
Rate of compensation increase	3.00–9.50%	3.00–9.50%	3.00–9.50%	1.75–5.00%	1.75–5.00%	1.75–4.00%	N/A	N/A	N/A

In determining the long-term rate of return for a plan, the Company considers the historical rates of return, the nature of the plan's investments and an expectation for the plan's investment strategies.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The assumed weighted-average health care cost trend rate for the coming year is 9.66% while the ultimate trend rate of 4.50% is expected to be reached in fiscal 2015. A one-percentage-point change in assumed health care cost trend rates for fiscal 2007 would have had the following effects:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
(In millions)		
Effect on total service and interest costs	\$ 1.5	\$ (1.3)
Effect on post-retirement benefit obligations	\$12.1	\$(10.8)

The projected benefit obligation, accumulated benefit obligation, fair value of plan assets and the other comprehensive (income) loss due to change in minimum liability recognition for the Company's pension plans at June 30 are as follows:

	Pension Plans					
	Retirement Growth Account		Restoration		International	
	2007	2006	2007	2006	2007	2006
(In millions)						
Projected benefit obligation	\$351.2	\$336.4	\$89.3	\$81.1	\$294.8	\$284.3
Accumulated benefit obligation	299.4	284.7	71.8	61.9	255.1	245.7
Fair value of plan assets	430.5	376.0	—	—	281.8	242.1
Other comprehensive (income) loss due to change in minimum liability recognition:						
Increase (decrease) in additional minimum liability		\$ —		\$ 8.2		\$ (50.0)
(Increase) decrease in intangible asset		—		—		0.4
Other comprehensive (income) loss		\$ —		\$ 8.2		\$ (49.6)

International pension plans with accumulated benefit obligations in excess of the plans' assets had aggregate projected benefit obligations of \$96.4 million and \$86.8 million, aggregate accumulated benefit obligations of \$81.2 million and \$73.2 million and aggregate fair value of plan assets of \$35.3 million and \$31.7 million at June 30, 2007 and 2006, respectively.

	Pension Plans		Other than Pension Plans
	U.S.	International	Post-retirement
(In millions)			
Expected Cash Flows:			
Expected employer contributions for year ending June 30, 2008	\$ 20.0	\$21.0	N/A
Expected benefit payments for year ending June 30,			
2008	42.3	17.4	\$3.6
2009	28.2	14.6	4.0
2010	28.5	13.6	4.5
2011	31.5	17.3	5.2
2012	30.9	17.3	5.9
Years 2013 – 2017	199.1	91.8	39.4
Plan Assets:			
Actual asset allocation at June 30, 2007			
Equity	49%	55%	N/A
Fixed income	31%	29%	N/A
Other	20%	16%	N/A
	100%	100%	N/A
Target asset allocation			
Equity	44%	56%	N/A
Fixed income	34%	28%	N/A
Other	22%	16%	N/A
	100%	100%	N/A

The target asset allocation policy was set to maximize returns with consideration to the long-term nature of the obligations and maintaining a lower level of overall volatility through the allocation to fixed income. During the year, the asset allocation is reviewed for adherence to the target policy and is rebalanced periodically towards the target weights.

401(k) Savings Plan (U.S.)

The Company's 401(k) Savings Plan ("Savings Plan") is a contributory defined contribution plan covering substantially all regular U.S. employees who have completed the hours and service requirements, as defined by the plan document. Regular full-time employees are eligible to participate in the Savings Plan on the first day of the second month following their date of hire. During fiscal 2007, the Savings Plan was enhanced to accelerate new regular full-time employee eligibility, to increase the rate of Company contributions and to provide an automatic enrollment feature. The Savings Plan is subject to the applicable provisions of ERISA. The Company matches a portion of the participant's contributions after one year of service under a predetermined formula based on the participant's contribution level. The Company's contributions were approximately \$13.7 million, \$10.6 million and \$9.8 million for the fiscal years ended June 30, 2007, 2006 and 2005, respectively. Shares of the Company's Class A Common Stock are not an investment option in the Savings Plan and the Company does not use such shares to match participants' contributions.

Deferred Compensation

The Company accrues for deferred compensation and interest thereon, and for the increase in the value of share units pursuant to agreements with certain key executives and outside directors. The amounts included in the accompanying consolidated balance sheets under these plans were \$69.6 million and \$71.0 million as of June 30, 2007 and 2006. The expense for fiscal 2007, 2006 and 2005 was \$8.5 million, \$11.6 million and \$10.2 million, respectively.

NOTE 11 – POST-EMPLOYMENT BENEFITS OTHER THAN TO RETIREES

The Company provides certain post-employment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. These benefits include health care coverage and severance benefits. The cost of providing these benefits is accrued and any incremental benefits were not material to the Company's consolidated financial results.

NOTE 12 – COMMON STOCK

As of June 30, 2007, the Company's authorized common stock consists of 650 million shares of Class A Common Stock, par value \$.01 per share, and 240 million shares of Class B Common Stock, par value \$.01 per share. Class B Common Stock is convertible into Class A Common Stock, in whole or in part, at any time and from time to time at the option of the holder, on the basis of one share

of Class A Common Stock for each share of Class B Common Stock converted. Holders of the Company's Class A Common Stock are entitled to one vote per share and holders of the Company's Class B Common Stock are entitled to ten votes per share.

Information about the Company's common stock outstanding is as follows:

	Class A	Class B
(Shares in thousands)		
Balance at June 30, 2004	134,514.1	93,012.9
Acquisition of treasury stock	(10,720.0)	—
Conversion of Class B to Class A	5,372.0	(5,372.0)
Stock-based compensation	3,497.3	—
Balance at June 30, 2005	132,663.4	87,640.9
Acquisition of treasury stock	(11,216.3)	—
Conversion of Class B to Class A	2,335.0	(2,335.0)
Stock-based compensation	2,673.0	—
Balance at June 30, 2006	126,455.1	85,305.9
Acquisition of treasury stock	(22,477.6)	—
Conversion of Class B to Class A	3,501.1	(3,501.1)
Stock-based compensation	5,044.8	—
Balance at June 30, 2007	112,523.4	81,804.8

On September 18, 1998, the Company's Board of Directors authorized a share repurchase program to repurchase a total of up to 8.0 million shares of Class A Common Stock in the open market or in privately negotiated transactions, depending on market conditions and other factors. The Board of Directors authorized the repurchase of up to 10.0 million additional shares of Class A Common Stock in both October 2002 and May 2004, and an additional 20.0 million in both May 2005 and February 2007, increasing the total authorization under the share repurchase program to 68.0 million shares. As of June 30, 2007, approximately 61.1 million shares have been purchased under this program.

In May 2005, the Company purchased 1,872,000 shares of Class A Common Stock from a related party for \$73.5 million. The repurchase was part of the program described in the previous paragraph.

Accelerated Share Repurchase Program

In March 2007, the Company repurchased approximately 15,960,800 shares of its outstanding Class A Common Stock for \$750.0 million through an accelerated share repurchase program with a financial counterparty. These shares were accounted for as treasury stock, carried at cost, and reflected as a reduction to stockholders' equity. The financial counterparty is expected to purchase shares for its own account in the open market over a period ending no later than October 2007. At the end of that period, the Company will receive or pay a price adjustment based on the volume weighted average price

of the Company's shares traded during the period ("VWAP"). For the purpose of limiting the price adjustment, approximately 10,640,500 shares purchased are subject to a cap, which sets a maximum price for these shares. For the shares subject to the cap, the maximum price adjustment the Company could pay is equal to \$80.6 million. The cap is not carried on the accompanying consolidated balance sheet as an asset or liability because it is a component of a transaction involving the Company's equity securities and can potentially be settled by the issuance of the Company's common stock or a cash payment at the Company's discretion. If share settlement is elected by the Company, the number of shares it could potentially issue at the end of the repurchase period cannot currently be determined since the number will be dependent upon the amount, if any, that the Company might owe as a price adjustment, divided by the market price of its common stock on the settlement date. The maximum number of shares potentially issuable is 25,000,000.

The following table provides information as of June 30, 2007 regarding the accelerated share repurchase program:

	Maturity— October 2007
(In millions, except share and per share data)	
Shares subject to cap	10,640,500
Cap price per share	\$54.57
Maximum potential price adjustment subject to cap	\$ 80.6
Shares not subject to cap	5,320,300
Estimated interim price adjustment at June 30, 2007	\$ 8.5
Estimated impact of a \$1 change in the VWAP	\$ 16.0

Subsequent to June 30, 2007, the financial counterparty informed the Company that it had completed its obligation pursuant to the accelerated share repurchase program (see Note 19—Unaudited Subsequent Events).

NOTE 13—STOCK PROGRAMS

As of June 30, 2007, the Company has three active equity compensation plans which include the Amended and Restated Fiscal 2002 Share Incentive Plan, the Fiscal 1999 Share Incentive Plan and the Non-Employee Director Share Incentive Plan (collectively, the "Plans"). These Plans currently provide for the issuance of 32,894,400 shares, which consist of shares originally provided for and shares transferred to the Plans from a previous plan and employment agreement, to be granted in the form of stock-based awards to key employees, consultants and non-employee directors of the Company. As of June 30, 2007, approximately 8,532,300 shares of Class A Common Stock were reserved and available to be granted pursuant to these Plans. The Company may satisfy the obligation of

its stock-based compensation awards with either new or treasury shares. The Company's stock compensation awards outstanding at June 30, 2007 include stock options, performance share units ("PSU"), restricted stock units ("RSU") and share units.

Stock-based compensation expense is attributable to the granting of, and the remaining requisite service periods of, stock options, PSUs, RSUs and share units. Compensation expense attributable to net stock-based compensation for fiscal 2007 and 2006 was \$43.2 million (\$28.3 million after tax) and \$35.7 million (\$23.4 million after tax), respectively, or \$.14 and \$.11 for both basic and diluted net earnings per common share, respectively. As of June 30, 2007 and 2006, the total unrecognized compensation cost related to nonvested stock-based awards was \$30.4 million and \$26.3 million, respectively, and the related weighted-average period over which it is expected to be recognized is approximately 1.8 years and 2.2 years, respectively.

Prior to the Company's adoption of SFAS No. 123(R) in fiscal 2006, SFAS No. 123 required that the Company provide pro forma information regarding net earnings and net earnings per common share as if compensation cost for the Company's stock-based awards had been determined in accordance with the fair value method prescribed therein. The Company had previously adopted the disclosure portion of SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," requiring quarterly SFAS No. 123 pro forma disclosure. The pro forma charge for compensation cost related to stock-based awards granted was recognized over the service period. For stock options, the service period represents the period of time between the date of grant and the date each option becomes exercisable without consideration of acceleration provisions (e.g., retirement, change of control, etc.).

The following table illustrates the effect on net earnings per common share as if the fair value method had been applied to all outstanding awards for fiscal 2005:

YEAR ENDED JUNE 30, 2005	
(In millions, except per share data)	
Net earnings, as reported	\$406.1
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	21.8
Pro forma net earnings	\$384.3
Earnings per common share:	
Net earnings per common share—Basic, as reported	\$ 1.80
Net earnings per common share—Basic, pro forma	\$ 1.71
Net earnings per common share—Diluted, as reported	\$ 1.78
Net earnings per common share—Diluted, pro forma	\$ 1.67

Stock Options

A summary of the Company's stock option programs as of June 30, 2007 and changes during the fiscal year then ended is presented below:

	Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value ⁽¹⁾ (in millions)	Weighted-Average Contractual Life Remaining in Years
(Shares in thousands)				
Outstanding at June 30, 2006	26,215.7	\$39.53		
Granted at fair value	1,684.3	39.68		
Exercised	(5,001.9)	30.93		
Expired	(202.6)	42.50		
Forfeited	(123.5)	39.32		
Outstanding at June 30, 2007	22,572.0	41.42	\$129.8	4.4
Exercisable at June 30, 2007	18,747.6	41.89	\$105.4	3.6

(1) The intrinsic value of a stock option is the amount by which the current market value of the underlying stock exceeds the exercise price of the option.

The exercise period for all stock options generally may not exceed ten years from the date of grant. Stock option grants to individuals generally become exercisable in three substantively equal tranches over a service period of up to four years. The Company attributes the value of option awards on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

The per-share weighted-average grant date fair value of stock options granted during fiscal 2007, 2006 and 2005 was \$13.69, \$11.87 and \$16.45, respectively. The total intrinsic value of stock options exercised during fiscal 2007, 2006 and 2005 was \$72.3 million, \$38.0 million and \$73.2 million, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

YEAR ENDED JUNE 30	2007	2006	2005
Weighted-average expected stock-price volatility	24%	23%	32%
Weighted-average expected option life	8 years	8 years	7 years
Average risk-free interest rate	4.7%	4.3%	3.9%
Average dividend yield	1.2%	.9%	.7%

Performance Share Units

During fiscal 2007, the Company issued 119,000 PSUs, which will be settled in stock subject to the achievement of the Company's net sales and net earnings per share goals for the three years ending June 30, 2009. Settlement will be made pursuant to a range of opportunities relative to the net sales and net earnings per share targets of the Company and, as such, the compensation cost of the PSU is subject to adjustment based upon the attainability of these target goals. No settlement will occur for

results below the applicable minimum threshold and additional shares shall be issued if performance exceeds the targeted performance goals. PSUs are accompanied by dividend equivalent rights that will be payable in cash upon settlement of the PSU. These awards are subject to the provisions of the agreement under which the PSUs are granted. The PSUs were valued at the closing market value of the Company's Class A Common Stock on the date of grant and generally vest at the end of the performance period.

The following is a summary of the status of the Company's PSUs as of June 30, 2007 and activity during the fiscal year then ended:

	Shares	Weighted-Average Grant Date Fair Value
(Shares in thousands)		
Nonvested at June 30, 2006	111.1	\$35.00
Granted	119.0	39.56
Vested	—	—
Forfeited	—	—
Nonvested at June 30, 2007	230.1	\$37.36

Restricted Stock Units

The Company granted approximately 603,100 RSUs during fiscal 2007, of which 332,800 are scheduled to vest on October 31, 2007, 173,500 on October 31, 2008 and 96,800 on November 2, 2009, all subject to the continued employment or retirement of the grantees. Certain RSUs granted in fiscal 2007 are accompanied by dividend equivalent rights that will be payable in cash upon settlement of the RSU and, as such, were valued at the closing market value of the Company's Class A Common Stock on the date of grant. Other RSUs granted in fiscal 2007 are not accompanied by dividend equivalent rights and, as such, were valued at the closing market value of the Company's Class A Common Stock on the date of grant

less the discounted present value of the dividends expected to be paid on the shares during the vesting period.

The following is a summary of the status of the Company's RSUs as of June 30, 2007 and activity during the fiscal year then ended:

	Shares	Weighted-Average Grant Date Fair Value
(Shares in thousands)		
Nonvested at June 30, 2006	111.1	\$35.00
Granted	603.1	39.21
Vested	(37.0)	35.00
Forfeited	(17.8)	39.27
Nonvested at June 30, 2007	659.4	\$38.74

Share Units

The Company grants share units to certain non-employee directors under the Non-Employee Director Share Incentive Plan. The share units are convertible into shares of Class A Common Stock as provided for in that plan. Share units are accompanied by dividend equivalent rights that are converted to additional share units when such

dividends are declared. The following is a summary of the status of the Company's share units as of June 30, 2007 and activity during the fiscal year then ended:

	Shares	Weighted-Average Grant Date Fair Value
(Shares in thousands)		
Outstanding at June 30, 2006	13.1	\$36.79
Granted	4.3	40.35
Dividend equivalents	0.2	41.25
Converted	(3.8)	37.98
Outstanding at June 30, 2007	13.8	\$37.65

Cash Units

Certain non-employee directors defer cash compensation in the form of cash payout share units, which are not subject to the Plans. These cash units are classified as liabilities and, as such, their fair value is adjusted to reflect the current market value of the Company's Class A Common Stock. The Company recorded \$0.8 million, \$0.5 million and \$0.1 million as compensation expense to reflect additional deferrals and the change in the market value for fiscal 2007, 2006 and 2005, respectively.

NOTE 14—COMMITMENTS AND CONTINGENCIES

Contractual Obligations

The following table summarizes scheduled maturities of the Company's contractual obligations for which cash flows are fixed and determinable as of June 30, 2007:

	Total	Payments Due in Fiscal					Thereafter
		2008	2009	2010	2011	2012	
(In millions)							
Debt service ⁽¹⁾	\$2,198.7	\$ 122.4	\$ 63.6	\$ 62.6	\$ 61.9	\$304.4	\$1,583.8
Operating lease commitments ⁽²⁾	1,240.6	166.3	156.6	139.8	118.9	103.3	555.7
Unconditional purchase obligations ⁽³⁾	1,553.0	1,046.1	132.5	99.9	63.9	36.9	173.7
Total contractual obligations	\$4,992.3	\$1,334.8	\$352.7	\$302.3	\$244.7	\$444.6	\$2,313.2

(1) Includes long-term and short-term debt and the related projected interest costs, and to a lesser extent, capital lease commitments. Refer to Note 8—Debt.

(2) Total rental expense included in the accompanying consolidated statements of earnings was \$201.6 million in fiscal 2007, \$182.9 million in fiscal 2006 and \$179.5 million in fiscal 2005.

(3) Unconditional purchase obligations primarily include inventory commitments, estimated future earn-out payments, estimated royalty payments pursuant to license agreements, advertising commitments, capital improvement commitments, planned funding of pension and other post-retirement benefit obligations, commitments pursuant to executive compensation arrangements and obligations related to the Company's cost savings initiative. Future earn-out payments and future royalty and advertising commitments were estimated based on planned future sales for the term that was in effect at June 30, 2007, without consideration for potential renewal periods.

Legal Proceedings

The Company is involved, from time to time, in litigation and other legal proceedings incidental to its business. Management believes that the outcome of current litigation and legal proceedings will not have a material adverse effect upon the Company's results of operations or financial condition. However, management's assessment of the Company's current litigation and other legal proceedings could change in light of the discovery of facts with respect to legal actions or other proceedings pending against the

Company not presently known to the Company or determinations by judges, juries or other finders of fact which are not in accord with management's evaluation of the possible liability or outcome of such litigation or proceedings.

On March 30, 2005, the United States District Court for the Northern District of California entered into a Final Judgment approving the settlement agreement the Company entered into in July 2003 with the plaintiffs, the other Manufacturer Defendants (as defined below) and

the Department Store Defendants (as defined below) in a consolidated class action lawsuit that had been pending in the Superior Court of the State of California in Marin County since 1998. On April 29, 2005, notices of appeal were filed by representatives of two members of the purported class of consumers. One of those appeals has since been withdrawn. If the appeal is resolved satisfactorily, the Final Judgment will result in the plaintiffs' claims being dismissed, with prejudice, in their entirety in both the Federal and California actions. There has been no finding or admission of any wrongdoing by the Company in this lawsuit. The Company entered into the settlement agreement solely to avoid protracted and costly litigation. In connection with the settlement agreement, the defendants, including the Company, will provide consumers with certain free products and pay the plaintiffs' attorneys' fees. To meet its obligations under the settlement, the Company took a special pre-tax charge of \$22.0 million, or \$13.5 million after-tax, equal to \$.06 per diluted common share in the fourth quarter of fiscal 2003. At June 30, 2007, the remaining accrual balance was \$16.3 million. The charge did not have a material adverse effect on the Company's consolidated financial condition. In the Federal action, the plaintiffs, purporting to represent a class of all U.S. residents who purchased prestige cosmetics products at retail for personal use from eight department stores groups that sold such products in the United States (the "Department Store Defendants"), alleged that the Department Store Defendants, the Company and eight other manufacturers of cosmetics (the "Manufacturer Defendants") conspired to fix and maintain retail prices and to limit the supply of prestige cosmetics products sold by the Department Store Defendants in violation of state and Federal laws. The plaintiffs sought, among other things, treble damages, equitable relief, attorneys' fees, interest and costs.

In 1999, the Office of the Attorney General of the State of New York (the "State") notified the Company and ten other entities that they had been identified as potentially responsible parties ("PRPs") with respect to the Blydenburgh landfill in Islip, New York. Each PRP may be jointly and severally liable for the costs of investigation and cleanup, which the State estimated in 2006 to be approximately \$19.7 million for all PRPs. In 2001, the State sued other PRPs (including Hickey's Carting, Inc., Dennis C. Hickey and Maria Hickey, collectively the "Hickey Parties"), in the U.S. District Court for the Eastern District of New York to recover such costs in connection with the site, and in September 2002, the Hickey Parties brought contribution actions against the Company and other Blydenburgh PRPs. These contribution actions seek to

recover, among other things, any damages for which the Hickey Parties are found liable in the State's lawsuit against them, and related costs and expenses, including attorneys' fees. In June 2004, the State added the Company and other PRPs as defendants in its pending case against the Hickey Parties. In April 2006, the Company and other defendants added numerous other parties to the case as third-party defendants. The Company and certain other PRPs have engaged in settlement discussions which to date have been unsuccessful. Settlement negotiations with the new third-party defendants, the State, the Company and other defendants began in July 2006. The Company has accrued an amount which it believes would be necessary to resolve its share of this matter. If settlement discussions are not successful, the Company intends to vigorously defend the pending claims. While no assurance can be given as to the ultimate outcome, management believes that the resolution of the Blydenburgh matters will not have a material adverse effect on the Company's consolidated financial condition.

On March 30, 2006, a purported securities class action complaint captioned Thomas S. Shin, et al. v. The Estée Lauder Companies Inc., et al., was filed against the Company and certain of its officers and directors (collectively the "Defendants") in the United States District Court for the Southern District of New York. The complaint alleged that the Defendants made statements during the period April 28, 2005 to October 25, 2005 in press releases, the Company's public filings and during conference calls with analysts that were materially false and misleading and that artificially inflated the price of the Company's stock. The complaint alleged claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The complaint also asserted that during the class period, certain executive officers and the trust for the benefit of a director sold shares of the Company's Class A Common Stock at artificially inflated prices. Three additional purported securities class action complaints were subsequently filed in the United States District Court for the Southern District of New York containing similar allegations. On July 10, 2006, the Court consolidated these actions under the caption *In re: Estée Lauder Companies Securities Litigation*, appointed lead plaintiff, and approved the selection of lead counsel. A consolidated amended complaint addressing the same issues as the original complaint was filed on September 8, 2006. The Defendants filed a motion to dismiss the amended complaint on November 7, 2006. On May 21, 2007, the Court granted the motion to dismiss and gave plaintiff until June 4, 2007 to file an amended complaint. The plaintiff did not file an amended complaint by the deadline.

On April 10, 2006, a shareholder derivative action complaint captioned Miriam Loveman v. Leonard A. Lauder, et al., was filed against certain of the Company's officers and all of its directors as of that date (collectively the "Derivative Action Defendants") in the United States District Court for the Southern District of New York. The complaint alleged that the Derivative Action Defendants breached their fiduciary duties to the Company based on the same alleged course of conduct identified in the complaint described above. On May 2, 2007, the judge granted the Derivative Action Defendants' motion to dismiss because the plaintiff failed to satisfy the requirement under Delaware law that she make a demand on the Board of Directors to pursue litigation on behalf of the Company prior to initiating the litigation herself. The plaintiff has not taken any further action with respect to this matter.

NOTE 15 – NET UNREALIZED INVESTMENT GAINS
Under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"), available-for-sale securities are recorded at market value. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a component of stockholders' equity until realized. The Company's investments subject to the provisions of SFAS No. 115 are treated as available-for-sale and, accordingly, the applicable investments have been adjusted to market value with a corresponding adjustment, net of tax, to net unrealized investment gains in accumulated other comprehensive income. Included in accumulated other comprehensive income was an unrealized investment gain (net of deferred taxes) of \$0.8 million and \$0.5 million at June 30, 2007 and 2006, respectively.

NOTE 16 – STATEMENT OF CASH FLOWS
Supplemental cash flow information related to certain non-cash investing and financing transactions for fiscal 2007, 2006 and 2005 is as follows:

	2007	2006	2005
(In millions)			
Incremental tax benefit from the exercise of stock options	\$16.0	\$ 6.4	\$19.7
Change in liability associated with acquisition of business	\$ 2.1	\$(36.1)	\$38.2
Capital lease obligations incurred	\$ 5.1	\$ 1.5	\$10.9
Accrued dividend equivalents	\$ 0.2	\$ 0.1	\$ —
Interest rate swap derivative mark to market	\$ 0.6	\$(16.5)	\$ 9.6

NOTE 17 – SEGMENT DATA AND RELATED INFORMATION

Reportable operating segments, as defined by SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," include components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker (the "Chief Executive") in deciding how to allocate resources and in assessing performance. As a result of the similarities in the manufacturing, marketing and distribution processes for all of the Company's products, much of the information provided in the consolidated financial statements is similar to, or the same as, that reviewed on a regular basis by the Chief Executive. Although the Company operates in one business segment, beauty products, management also evaluates performance on a product category basis.

While the Company's results of operations are also reviewed on a consolidated basis, the Chief Executive reviews data segmented on a basis that facilitates comparison to industry statistics. Accordingly, net sales, depreciation and amortization, and operating income are available with respect to the manufacture and distribution of skin care, makeup, fragrance, hair care and other products. These product categories meet the FASB's definition of operating segments and, accordingly, additional financial data are provided below. The "other" segment includes the sales and related results of ancillary products and services that do not fit the definition of skin care, makeup, fragrance and hair care.

The Company evaluates segment performance based upon operating income, which represents earnings before income taxes, minority interest, net interest expense and discontinued operations. The accounting policies for each of the reportable segments are the same as those described in the summary of significant accounting policies, except for depreciation and amortization charges, which are allocated, primarily, based upon net sales. The assets and liabilities of the Company are managed centrally and are reported internally in the same manner as the consolidated financial statements; thus, no additional information is produced for the Chief Executive or included herein.

YEAR ENDED OR AT JUNE 30	2007	2006	2005
(In millions)			
PRODUCT CATEGORY DATA			
Net Sales:			
Skin Care	\$2,601.0	\$2,400.8	\$2,352.1
Makeup	2,712.7	2,504.2	2,366.8
Fragrance	1,308.6	1,213.3	1,260.6
Hair Care	377.1	318.7	273.9
Other	38.1	26.8	26.6
	\$7,037.5	\$6,463.8	\$6,280.0
Depreciation and Amortization:			
Skin Care	\$ 75.4	\$ 71.1	\$ 70.6
Makeup	84.6	81.3	78.1
Fragrance	36.7	35.4	38.5
Hair Care	9.3	9.8	7.8
Other	1.2	0.8	0.8
	\$ 207.2	\$ 198.4	\$ 195.8
Operating Income (Loss):			
Skin Care	\$ 341.5	\$ 346.4	\$ 365.8
Makeup	339.3	329.4	301.1
Fragrance	28.1	7.7	35.8
Hair Care	42.5	26.5	22.8
Other	(0.4)	1.7	1.3
Special charges related to cost savings initiative	(1.1)	(92.1)	—
	749.9	619.6	726.8
Reconciliation:			
Interest expense, net	(38.9)	(23.8)	(13.9)
Earnings before income taxes, minority interest and discontinued operations	\$ 711.0	\$ 595.8	\$ 712.9
GEOGRAPHIC DATA			
Net Sales:			
The Americas	\$3,560.9	\$3,446.4	\$3,351.1
Europe, the Middle East & Africa	2,493.4	2,147.7	2,109.1
Asia/Pacific	983.2	869.7	819.8
	\$7,037.5	\$6,463.8	\$6,280.0
Operating Income (Loss):			
The Americas	\$ 336.4	\$ 344.1	\$ 366.2
Europe, the Middle East & Africa	321.4	297.5	305.3
Asia/Pacific	93.2	70.1	55.3
Special charges related to cost savings initiative	(1.1)	(92.1)	—
	\$ 749.9	\$ 619.6	\$ 726.8
Total Assets:			
The Americas	\$2,534.5	\$2,305.9	\$2,149.8
Europe, the Middle East & Africa	1,268.1	1,175.0	1,432.6
Asia/Pacific	323.1	303.2	303.4
	\$4,125.7	\$3,784.1	\$3,885.8
Long-Lived Assets (property, plant and equipment, net):			
The Americas	\$ 580.1	\$ 500.5	\$ 463.1
Europe, the Middle East & Africa	250.7	213.2	192.9
Asia/Pacific	50.0	44.3	38.2
	\$ 880.8	\$ 758.0	\$ 694.2

NOTE 18—UNAUDITED QUARTERLY FINANCIAL DATA

The following summarizes the unaudited quarterly operating results of the Company for the years ended June 30, 2007 and 2006:

	Quarter Ended				Total Year
	September 30	December 31	March 31	June 30	
(In millions, except per share data)					
Fiscal 2007					
Net sales	\$1,593.5	\$1,991.1	\$1,690.5	\$1,762.4	\$7,037.5
Gross profit	1,165.4	1,492.1	1,264.5	1,340.7	5,262.7
Operating income	99.9	332.4	156.7	160.9	749.9
Net earnings from continuing operations	58.0	208.5	93.8	88.4	448.7
Net earnings	58.3	208.4	93.9	88.6	449.2
Net earnings per common share from continuing operations:					
Basic	.28	1.00	.46	.46	2.20
Diluted	.27	.99	.45	.45	2.16
Net earnings per common share:					
Basic	.28	1.00	.46	.46	2.20
Diluted	.27	.99	.45	.45	2.16
Fiscal 2006^{(a)(b)}					
Net sales	\$1,497.1	\$1,783.9	\$1,578.2	\$1,604.6	\$6,463.8
Gross profit	1,077.6	1,325.4	1,166.7	1,207.5	4,777.2
Operating income	105.1	250.7	116.3	147.5	619.6
Net earnings from continuing operations	61.8	150.4	63.2	49.1	324.5
Net earnings	58.5	81.7	59.5	44.5	244.2
Net earnings per common share from continuing operations:					
Basic	.28	.70	.30	.23	1.51
Diluted	.28	.70	.29	.23	1.49
Net earnings per common share:					
Basic	.26	.38	.28	.21	1.14
Diluted	.26	.38	.28	.21	1.12

(a) Fiscal 2006 results included \$93.0 million, after-tax, or \$.43 per diluted share in special charges related to the Company's cost savings initiative and tax-related matters. Included in the charges was an operating expense charge of \$92.1 million, equal to \$.27 per diluted common share related to the cost savings initiative. The results also included a special tax charge related to a settlement with the IRS regarding an examination of the Company's consolidated Federal income tax returns for fiscal years 1998 through 2001, and represents the aggregate earnings impact of the settlement through fiscal 2006. The settlement resulted in an increase to the Company's fiscal 2006 income tax provision and a corresponding decrease in fiscal 2006 net earnings of approximately \$46 million, or approximately \$.21 per diluted common share. During the fourth quarter of fiscal 2006, the Company completed the repatriation of foreign earnings through intercompany dividends under the provisions of the AJCA. In connection with the repatriation, the Company updated the computation of the related aggregate tax impact, resulting in a favorable adjustment of approximately \$11 million, or approximately \$.05 per diluted common share, to the Company's initial tax charge of \$35 million recorded in fiscal 2005. The tax settlement, coupled with the AJCA favorable tax adjustment, resulted in a net increase to the Company's fiscal 2006 income tax provision and a corresponding decrease in fiscal 2006 net earnings of approximately \$35 million, or approximately \$.16 per diluted common share.

(b) In April 2006, the Company completed the sale of certain assets and operations of the reporting unit that marketed and sold Stila brand products.

NOTE 19—UNAUDITED SUBSEQUENT EVENTS

In July 2007, the Company acquired Ojon Corporation, which markets and sells Ojon hair care and skin care products primarily through direct response television and specialty stores. In August 2007, the Company sold Rodan + Fields back to its founders.

In August 2007, pursuant to the Company's accelerated share repurchase program (see Note 12—Common Stock), the financial counterparty informed the Company that it had completed its obligations under the agreement. The per-share price paid by the Company at inception of the program exceeded the final VWAP. Accordingly, the Company received 97,417 shares of its common stock from the financial counterparty as a price adjustment and final settlement, which was recorded as treasury stock and additional paid-in capital in the consolidated balance sheet.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of The Estée Lauder Companies Inc. (including its subsidiaries) (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) of the Securities Exchange Act of 1934, as amended).

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision of and with the participation of the Chief Executive Officer and the Chief Financial Officer, the Company's management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework and criteria established in *Internal Control—Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, the Company's management has concluded that, as of June 30, 2007, the Company's internal control over financial reporting was effective.

KPMG LLP, the independent registered public accounting firm that audits the Company's consolidated financial statements has issued its attestation report on management's assessment of internal control over financial reporting. That attestation report follows this report.



William P. Lauder
President and Chief Executive Officer



Richard W. Kunes
Executive Vice President and Chief Financial Officer

August 27, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON
INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders
The Estée Lauder Companies Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that The Estée Lauder Companies Inc. maintained effective internal control over financial reporting as of June 30, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Estée Lauder Companies Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that The Estée Lauder Companies Inc. maintained effective internal control over financial reporting as of June 30, 2007, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, The Estée Lauder Companies Inc. maintained, in all material respects, effective internal control over financial reporting as of June 30, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of The Estée Lauder Companies Inc. and subsidiaries as of June 30, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended June 30, 2007, and our report dated August 27, 2007 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

New York, New York
August 27, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
The Estée Lauder Companies Inc.:

We have audited the accompanying consolidated balance sheets of The Estée Lauder Companies Inc. and subsidiaries as of June 30, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended June 30, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Estée Lauder Companies Inc. and subsidiaries as of June 30, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in the notes to the consolidated financial statements, effective July 1, 2005, the Company adopted Statement of Financial Accounting Standard No. 123(R), "Share-Based Payment." Also, as discussed in the notes to the consolidated financial statements, effective July 1, 2006, the Company changed their method for quantifying errors based on SEC Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," and effective June 30, 2007, the Company adopted Statement of Financial Accounting Standard No. 158, "Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans—An Amendment of FASB Statements No. 87, 88, 106, and 132(R)."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of The Estée Lauder Companies Inc.'s internal control over financial reporting as of June 30, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated August 27, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

New York, New York
August 27, 2007

STOCKHOLDER INFORMATION

Company Headquarters

The Estée Lauder Companies Inc.
767 Fifth Avenue, New York, New York 10153
212-572-4200

Stockholder Information

Stockholders may access Company information, including a summary of the latest financial results, 24 hours a day, by dialing our toll-free information line, 800-308-2334. News releases issued in the last 12 months are available online at www.elcompanies.com.

Investor Inquiries

We welcome inquiries from investors, securities analysts and other members of the professional financial community. Please contact the Investor Relations Department in writing at the Company's headquarters or by telephone at 212-572-4384.

Annual Report on Form 10-K

If you would like a copy of the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, please call the toll-free information line, 800-308-2334, or write to the Investor Relations Department at the Company's headquarters. Our 10-K is also available on our website at www.elcompanies.com. The most recent certifications by our Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits to our Form 10-K. We have also filed with the New York Stock Exchange the most recent Annual CEO Certification as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.

Common Stock Information

The Class A Common Stock of The Estée Lauder Companies Inc. is listed on the New York Stock Exchange with the symbol EL.

Quarterly Per Share Market Prices

Fiscal 2007 Quarter Ended	Market Price of Common Stock		
	High	Low	Close
September 30	\$41.15	\$34.88	\$40.33
December 31	43.60	39.05	40.82
March 31	50.12	39.52	48.85
June 30	52.31	44.67	45.51

Dividends

Dividends on the common stock are expected to be paid annually following the declaration by the Board of Directors. The last annual dividend was \$.50 per share and was paid in December 2006.

Annual Meeting

The Company's Annual Meeting of Stockholders will be held on Friday, November 9, 2007, at 10:00 a.m. at:
Jumeirah Essex House
160 Central Park South
New York, New York 10019

Attendance at the Annual Meeting will require an admission ticket.

Stockholder Services

Mellon Investor Services is the Company's transfer agent and registrar. Please contact Mellon directly with all inquiries and requests to:

- Change the name, address, or ownership of stock;
- Replace lost certificates or dividend checks;
- Obtain information about dividend reinvestment, direct stock purchase or direct deposit of dividends.

Mellon Investor Services LLC
P.O. Box 358015
Pittsburgh, PA 15252-8015
800-851-9677
www.melloninvestor.com

Trademarks

The Estée Lauder Companies Inc. and its subsidiaries own numerous trademarks. Those appearing in the text of this report include: 3-Step Skin Care System, A Perfect World, Advanced Night Repair, Age Rescue, Ain't Misbehavin, All Bright, All Calm, All Firm, All is Forgiven, American Beauty, Anti-Age Advanced Protection Lotion, Aramis, Arovita C, Aveda, Bb Big Shine, Bb Creme de Coco, Be Curly, Beauty Boost, Beautiful, Beyond Long, Big Flirt, Bobbi Brown, Bobbi Brown beach, Bobbi Brown Extra, Brilliantine, Bumble and bumble, Calyx, Clinique, Clinique Happy, Color Conserve, Colorprint, Continuous Rescue, Crème de La Mer, Custom Blend, Damage Remedy, Darphin, Denblan, Double Wear, Dramatically Different, Dreamy Eyes, Enduring Beauty, Estée Lauder, Estée Lauder *pleasures*, Far Out, Flawless Skin, Flirt!, Flirtatious!, Fluidline, Fresh Bloom, Full Potential, Gel de La Mer, Good Skin, Grassroots, Hair Dresser, Happily Ever After, High Definition Lashes, High Impact, In Good Hands, In Perfect Condition, Inner Light, Instant Lightening, Instant Moisture, Jo Malone, La Mer, Lab Series Skincare for Men, Lash Envy, Lipglass, LiquidLast, Long-Wear Cream Shadow, Luminous Moisturizing Foundation, Lustreglass, Luxury for Lids, M·A·C, ★magic By Prescriptives, Maximum Comfort, MicroCrystal Skin Refinisher, Mineralize, Modern Fusion, Moisture Surge, Nite-trition, Nutritious, Oil Control Daily Hydrator, Origins, Origins Natural Resources, Outer Peace, Peace of Mind, Perfectionist,

Perfectly Real, Plantidote, Plushglass, Plushious, Pomegranate Noir, Predermine, Prescriptives, Private Collection Tuberose Gardenia, Projectionist, Pure Abundance, Pure Color, Pure-Formance, Pure White Linen, Radiant Facial, Radiant Infusion, Re-Creation, Re-Nutriv, Repairwear, Resilience Lift, Root Power, Shampure, Shimmer Brick, Skin Supplies for Men, Slimshine, Smileage, Smooth Infusion, Stimulskin, Studio Moisture Fix, Studio Touch-up Stick, Sumo Tech, Super City Block, Super Line Preventor Xtreme, Superdefense, Surf Spray, Tendertones, Time to Shine, Tri-Aktiline, Triple Benefit, Turnaround, Turquatic, Virtual Skin, Viva Glam, While You Were Sleeping, Wonderful, Youth Dew, Youth Dew Amber Nude, Youthtopia.

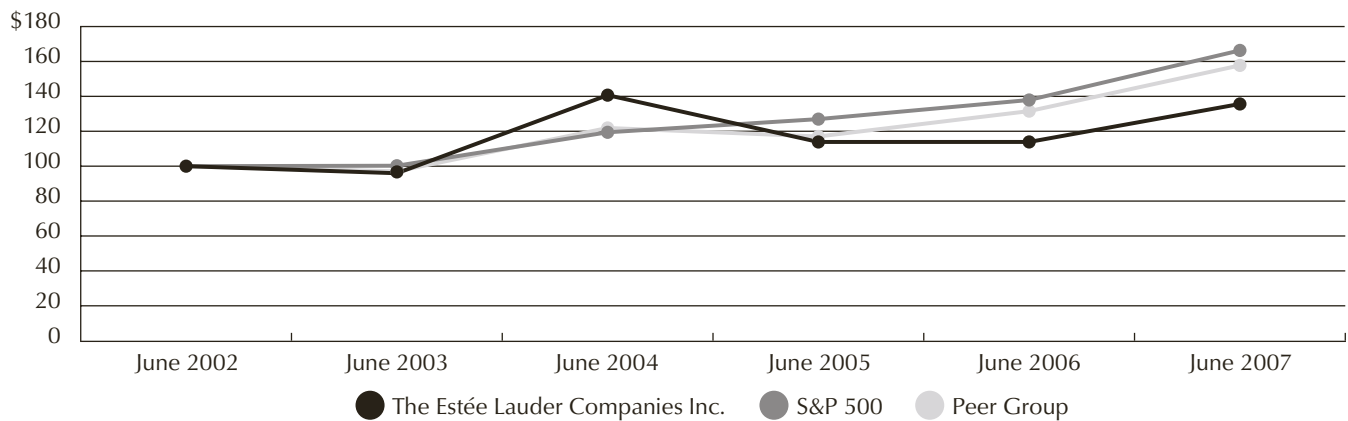
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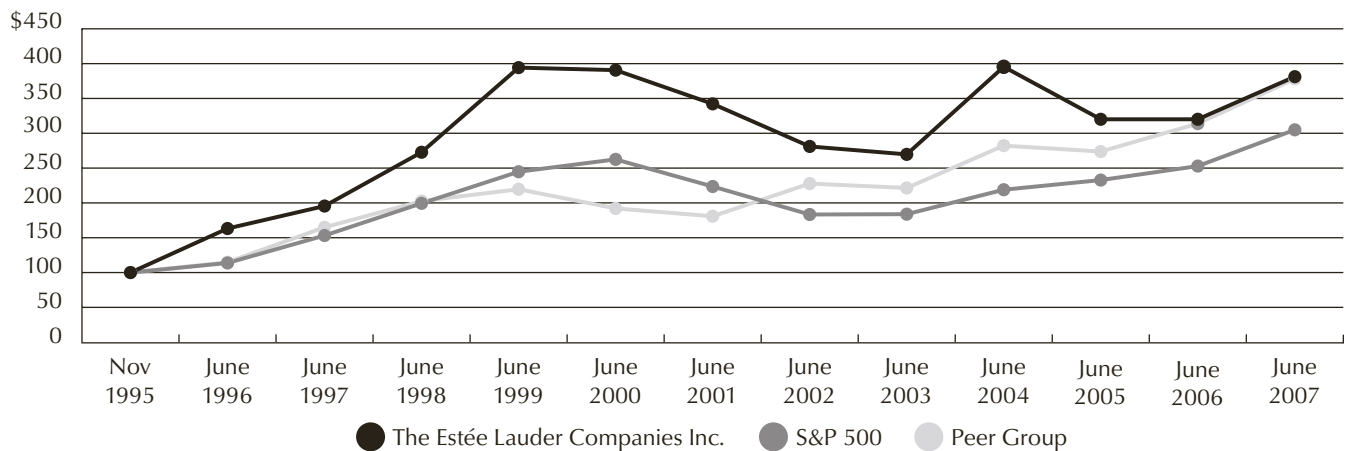
Performance Graphs

The following graphs compare the cumulative five- and twelve-year total stockholder return (stock price appreciation plus dividends) on the Company's Class A Common Stock with the cumulative total return of the S&P 500 Index and a market weighted index of publicly traded peers. The returns are calculated by assuming an investment of \$100 in the Class A Common Stock and in each index on June 30, 2002, for the five-year graph, and November 16, 1995 (the Company's initial public offering date) for the twelve-year graph. The publicly traded companies included in the peer group are: Avon Products, Inc., Groupe Clarins S.A., L'Oreal S.A., LVMH Moët Hennessy Louis Vuitton S.A., The Procter & Gamble Company, Shiseido Company, Ltd. and Unilever N.A.

Cumulative five-year total stockholder return



Cumulative twelve-year total stockholder return



**THE ESTÉE LAUDER COMPANIES INC. ANNUAL REPORT
ENVIRONMENTAL FIGURES**

The Estée Lauder Companies Inc. Annual Report is printed on recycled paper that contains 100% post-consumer recycled (PCR) fiber. This recycled paper is made from fiber sourced from well-managed forests and other controlled wood sources and is independently certified by SmartWood, a program of the Rainforest Alliance, to the Forest Stewardship Council (FSC) standards.

587.18 trees preserved for the future	1695.55 lbs. waterborne waste not created
249,421 gallons wastewater flow saved	27,598 lbs. solid waste not generated
54,339 lbs. net greenhouse gases prevented	415,922,000 BTUs energy not consumed

SAVINGS FROM THE USE OF EMISSION-FREE WIND-GENERATED ELECTRICITY:

28,234 lbs. air emissions not generated

DISPLACES THIS AMOUNT OF FOSSIL FUEL:

12 barrels crude oil unused

THIS AMOUNT OF WIND-GENERATED ELECTRICITY IS EQUIVALENT TO:

Taking 2 cars off the road for one year or planting 1,908 trees

Sandy Alexander Inc., an ISO 14001:2004 certified printer with Forest Stewardship Council (FSC) Chain of Custody Certification, printed this report with the use of Green-e certified renewable wind energy resulting in nearly zero greenhouse gas (GHG) emissions.

SAVINGS DERIVED FROM USING 100% ELECTRICITY FROM GREEN-E CERTIFIED RENEWABLE WIND ENERGY SOURCES FOR THE PRINTING OF THE ESTÉE LAUDER COMPANIES INC. ANNUAL REPORT:

10,668.51 lbs. air emissions of greenhouse gases not generated (CO₂, SO₂ and NO_x), a major contributor to global warming.

SAVINGS DERIVED FROM WIND-GENERATED ELECTRICITY IS EQUIVALENT TO:

9,172.35 miles not driven in an automobile or 719.18 trees being planted



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