ESTEE LAUDER COMPANIES INC
Form 10-Q
May 05, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549-1004

FORM 10-Q

(Mark One)

x	**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
	For the quarterly period ended March 31, 2009
	OR
o	**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
	For the transition period from to
	Commission file number: 1-14064

The Estée Lauder Companies Inc.

(Exact name of registrant as specified in its charter)

Delaware	**11-2408943**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

767 Fifth Avenue, New York, New York	**10153**
(Address of principal executive offices)	(Zip Code)

212-572-4200

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

At April 27, 2009, 118,623,473 shares of the registrant s Class A Common Stock, $.01 par value, and 78,067,261 shares of the registrant s Class B Common Stock, $.01 par value, were outstanding.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements.***

THE ESTÉE LAUDER COMPANIES INC.

CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Three Months Ended March 31		Nine Months Ended March 31	
	2009	2008	2009	2008
	(In millions, except per share data)			
Net Sales	$ 1,696.5	$ 1,879.8	$ 5,641.0	$ 5,898.7
Cost of sales	446.4	471.9	1,454.5	1,506.2
Gross Profit	1,250.1	1,407.9	4,186.5	4,392.5
Operating expenses:				
Selling, general and administrative	1,159.0	1,247.4	3,732.2	3,783.4
Restructuring and other special charges	6.2	(0.7)	6.6	(0.5)
Other intangible asset impairments	14.6		14.6	
	1,179.8	1,246.7	3,753.4	3,782.9
Operating Income	70.3	161.2	433.1	609.6
Interest expense, net	20.6	16.1	55.5	52.8
Earnings before Income Taxes and Minority Interest	49.7	145.1	377.6	556.8
Provision for income taxes	21.4	53.7	138.4	197.7
Minority interest, net of tax	(1.1)	(1.3)	(2.9)	(5.5)
Net Earnings	$ 27.2	$ 90.1	$ 236.3	$ 353.6
Net earnings per common share:				
Basic	$ .14	$ .47	$ 1.20	$ 1.83
Diluted	.14	.46	1.19	1.80
Weighted average common shares outstanding:				
Basic	196.7	193.9	196.2	193.8
Diluted	197.2	196.6	197.8	196.8
Cash dividends declared per share	$	$	$ .55	$ .55

See notes to consolidated financial statements.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

CONSOLIDATED BALANCE SHEETS

	March 31 2009 (Unaudited)	June 30 2008
	($ in millions)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 640.6	$ 401.7
Accounts receivable, net	1,031.6	1,038.8
Inventory and promotional merchandise, net	820.3	987.2
Prepaid expenses and other current assets	403.5	359.5
Total current assets	2,896.0	2,787.2
Property, Plant and Equipment, net	1,010.1	1,043.1
Other Assets		
Investments, at cost or market value	20.6	24.1
Goodwill	735.5	708.9
Other intangible assets, net	172.9	191.9
Other assets	283.7	256.0
Total other assets	1,212.7	1,180.9
Total assets	$ 5,118.8	$ 5,011.2
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Short-term debt	$ 140.7	$ 118.7
Accounts payable	276.4	361.7
Accrued income taxes	10.7	151.2
Other accrued liabilities	1,014.7	1,067.6
Total current liabilities	1,442.5	1,699.2
Noncurrent Liabilities		
Long-term debt	1,403.3	1,078.2
Other noncurrent liabilities	596.1	554.0
Total noncurrent liabilities	1,999.4	1,632.2
Contingencies (Note 9)		
Minority Interest	25.6	26.6
Stockholders Equity		
Common stock, $.01 par value; 650,000,000 shares Class A authorized; shares issued: 183,917,950 at March 31, 2009 and 180,754,534 at June 30, 2008; 240,000,000 shares Class B authorized; shares issued and outstanding: 78,067,261 at March 31, 2009 and June 30, 2008	2.6	2.6
Paid-in capital	1,136.7	979.0
Retained earnings	3,212.9	3,085.1
Accumulated other comprehensive income (loss)	(114.7)	110.8
	4,237.5	4,177.5

Less: Treasury stock, at cost; 65,294,477 Class A shares at March 31, 2009 and 63,914,699 Class A shares at June 30, 2008		(2,586.2)		(2,524.3)
Total stockholders equity		1,651.3		1,653.2
Total liabilities and stockholders equity	$	5,118.8	$	5,011.2

See notes to consolidated financial statements.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended March 31 2009	Nine Months Ended March 31 2008
	(In millions)	
Cash Flows from Operating Activities		
Net earnings	$ 236.3	$ 353.6
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	191.8	184.5
Deferred income taxes	(15.9)	(80.1)
Minority interest, net of tax	2.9	5.5
Non-cash stock-based compensation	42.6	40.8
Excess tax benefits from stock-based compensation arrangements	(1.4)	(0.6)
Loss on disposal of property, plant and equipment	8.1	5.3
Other intangible asset impairments	14.6	
Other non-cash items	1.2	2.0
Changes in operating assets and liabilities:		
Increase in accounts receivable, net	(113.0)	(189.9)
Decrease (increase) in inventory and promotional merchandise, net	76.6	(18.8)
Increase in other assets, net	(69.5)	(48.7)
Decrease in accounts payable	(55.6)	(1.7)
Increase (decrease) in accrued income taxes	(37.4)	128.1
Increase in other liabilities	25.4	138.5
Net cash flows provided by operating activities	306.7	518.5
Cash Flows from Investing Activities		
Capital expenditures	(215.9)	(250.3)
Acquisition of businesses and other intangible assets, net of cash acquired	(64.5)	(120.4)
Proceeds from the disposition of long-term investments	0.9	
Purchases of long-term investments	(0.4)	(0.4)
Net cash flows used for investing activities	(279.9)	(371.1)
Cash Flows from Financing Activities		
Increase in short-term debt, net	15.7	131.0
Proceeds from issuance of long-term debt, net	297.7	
Repayments and redemptions of long-term debt	(9.1)	(4.3)
Net proceeds from stock-based compensation transactions	109.5	70.9
Excess tax benefits from stock-based compensation arrangements	1.4	0.6
Payments to acquire treasury stock	(62.6)	(93.6)
Dividends paid to stockholders	(108.4)	(106.6)
Net cash flows provided by (used for) financing activities	244.2	(2.0)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(32.1)	10.9
Net Increase in Cash and Cash Equivalents	238.9	156.3
Cash and Cash Equivalents at Beginning of Period	401.7	253.7

Cash and Cash Equivalents at End of Period	$	640.6	$	410.0

See notes to consolidated financial statements.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1   SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of The Estée Lauder Companies Inc. and its subsidiaries (collectively, the   Company). All significant intercompany balances and transactions have been eliminated.

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP   ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments of a normal recurring nature considered necessary for a fair presentation have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the full fiscal year. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company   s Annual Report on Form 10-K for the year ended June 30, 2008.

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

Management Estimates

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses reported in those financial statements. Actual results could differ from those estimates and assumptions. Certain significant accounting policies that contain subjective management estimates and assumptions include those related to revenue recognition, concentration of credit risk, inventory, pension and other post-retirement benefit costs, goodwill and other intangible assets, income taxes and derivatives. Descriptions of these and other significant accounting policies are discussed in the Company   s Annual Report on Form 10-K for the year ended June 30, 2008.

Currency Translation and Transactions

All assets and liabilities of foreign subsidiaries and affiliates are translated at period-end rates of exchange, while revenue and expenses are translated at weighted-average rates of exchange for the period. Unrealized translation gains or losses are reported as cumulative translation adjustments through other comprehensive income (loss). Such adjustments amounted to $38.5 million of unrealized translation losses, net of tax, and $47.4 million of unrealized translation gains, net of tax, during the three months ended March 31, 2009 and 2008, respectively, and $247.2 million of unrealized translation losses, net of tax, and $95.2 million of unrealized translation gains, net of tax, during the nine months ended March 31, 2009 and 2008, respectively. The accompanying consolidated statements of earnings include net exchange (losses) gains on foreign currency transactions of $(5.2) million and $3.9 million during the three months ended March 31, 2009 and 2008, respectively, and $(31.3) million and $5.4 million during the nine months ended March 31, 2009 and 2008, respectively.

Accounts Receivable

Accounts receivable is stated net of the allowance for doubtful accounts and customer deductions of $39.5 million and $26.3 million as of March 31, 2009 and June 30, 2008, respectively.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Manufacturing overhead is allocated to the cost of inventory based on the normal production capacity. Unallocated overhead during periods of abnormally low production levels are recognized as cost of sales in the period in which they are incurred. 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.

The components of inventory and promotional merchandise, net were as follows:

	March 31 2009 (Unaudited)	June 30 2008
	(In millions)	
Raw materials	$ 201.0	$ 205.4
Work in process	34.4	56.8
Finished goods	404.9	494.7
Promotional merchandise	180.0	230.3
	$ 820.3	$ 987.2

Property, Plant and Equipment

Property, plant and equipment consists of:

	March 31 2009 (Unaudited)	June 30 2008
	(In millions)	
Assets (Useful Life)		

Land	$	14.2	$	14.9
Buildings and improvements (10 to 40 years)		177.3		183.5
Machinery and equipment (3 to 10 years)		1,038.2		1,008.9
Furniture and fixtures (5 to 10 years)		88.3		95.6
Leasehold improvements		1,091.9		1,090.7
		2,409.9		2,393.6
Less accumulated depreciation and amortization		1,399.8		1,350.5
	$	1,010.1	$	1,043.1

The cost of assets related to projects in progress of $129.2 million and $129.0 million as of March 31, 2009 and June 30, 2008, respectively, is included in their respective asset categories in the table above. Depreciation and amortization of property, plant and equipment was $61.7 million and $59.8 million during the three months ended March 31, 2009 and 2008, respectively, and $181.0 million and $171.2 million during the nine months ended March 31, 2009 and 2008, respectively.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Income Taxes

As of March 31, 2009 and June 30, 2008, the gross amount of unrecognized tax benefits, exclusive of interest and penalties, totaled $216.1 million and $199.0 million, respectively. The increase of $17.1 million principally resulted from tax positions taken during a prior period for which ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was $122.7 million. The total interest and penalties accrued related to unrecognized tax benefits during the three and nine months ended March 31, 2009 in the accompanying consolidated statements of earnings was $7.1 million and $12.5 million, respectively. The total gross accrued interest and penalties in the accompanying consolidated balance sheets at March 31, 2009 and June 30, 2008 was $63.2 million and $54.0 million, respectively. On the basis of the information available as of March 31, 2009, it is reasonably possible that a reduction in a range of $30 million to $60 million of unrecognized tax benefits may occur within 12 months as a result of projected resolutions of global tax examinations and controversies.

Recently Adopted Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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).

In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13. This FSP amends SFAS No. 157 to exclude certain leasing transactions accounted for under previously existing accounting guidance. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination, regardless of whether those assets and liabilities are related to leases.

In February 2008, the FASB issued FSP No. FAS 157-2, Effective Date for FASB Statement No. 157 (FSP No. FAS 157-2). This FSP permits the delayed application of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, as defined in this FSP, except for those that are recognized or disclosed at fair value in the financial statements at least annually, until the beginning of the Company s fiscal 2010. As of July 1, 2008, the Company adopted SFAS No. 157 (see Note 7), with the exception of its application to nonfinancial assets and nonfinancial liabilities, which the Company will defer in accordance with FSP No. FAS 157-2 until the beginning of fiscal 2010. Nonfinancial assets and nonfinancial liabilities principally consist of intangible assets acquired through business combinations, long-lived assets when assessing potential impairment, and liabilities associated with restructuring activities. The Company is currently evaluating the impact of the provisions for such nonfinancial assets and nonfinancial liabilities on its consolidated financial statements.

In October 2008, the FASB issued FSP No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP No. FAS 157-3), which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate following the guidance in SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154). However, the disclosure provisions in SFAS No. 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. The Company adopted SFAS No. 157 beginning in its fiscal 2009 first quarter. As part of this adoption, the Company evaluated the fair value measurements of its financial assets and liabilities and determined that these instruments are valued in active markets. As such, the guidance in this FSP did not impact the Company s consolidated financial statements.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO 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 became effective for the Company as of July 1, 2008. As the Company did not elect the fair value option for its financial instruments (other than those already measured at fair value in accordance with SFAS No. 157), the adoption of this standard did not have an impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 requires companies to provide qualitative disclosures about their objectives and strategies for using derivative instruments, quantitative disclosures of the fair values of, and gains and losses on, these derivative instruments in a tabular format, as well as more information about liquidity by requiring disclosure of a derivative contract s credit-risk-related contingent features. SFAS No. 161 also requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. The Company adopted this disclosure-only standard beginning in its fiscal 2009 third quarter (see Note 6).

Recently Issued Accounting Standards

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, principally to require publicly traded companies to provide disclosures about fair value of financial instruments in interim financial information. The adoption of this disclosure-only guidance will not have an impact on the Company s consolidated financial results and is effective beginning with its fiscal 2010 interim period ending September 30, 2009.

In April 2009, the FASB issued FSP No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP No. FAS 157-4). This FSP provides additional guidance for estimating fair value in accordance with SFAS No. 157 when there has been a significant decrease in market activity for a financial asset. An entity is required to base its conclusion about whether a transaction was distressed on the weight of the evidence presented. This FSP also re-affirms that the objective of fair value, when the market for an asset is not active, is the price that would be received to sell the asset in an orderly market (as opposed to a distressed or forced transaction). Additional enhanced disclosures are also required in accordance with this FSP. FSP No. FAS 157-4 must be applied prospectively and is effective for interim and annual periods ending after June 15, 2009. The Company determined that its financial assets are currently valued in active markets. As such, the guidance in this FSP is not anticipated to impact the Company s consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably determined. If the fair value of such assets or liabilities cannot be reasonably determined, then they would generally be recognized in accordance with SFAS No. 5, Accounting for Contingencies and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss an interpretation of FASB Statement No. 5. This FSP also amends the subsequent accounting for assets and liabilities arising from contingencies in a business combination and certain other disclosure requirements. This FSP is effective for assets or liabilities arising from contingencies in business combinations that are consummated on or after July 1, 2009.

In December 2008, the FASB issued FSP No. FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets (FSP No. FAS 132(R)-1) to require employers to provide additional disclosures about plan assets of a defined benefit pension or other post-retirement plan. These disclosures should principally include information detailing investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets and an understanding of significant concentrations of risk within plan assets. While earlier application of the provisions of this FSP is permitted, the disclosures required by this FSP shall be provided for fiscal years ending after December 15, 2009 (or the Company s fiscal 2010, the anticipated period of adoption). Upon initial application, the provisions of this FSP are not required for earlier periods that are presented for comparative purposes.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In November 2008, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 08-7, Accounting for Defensive Intangible Assets (EITF No. 08-7). Defensive intangible assets are assets acquired in a business combination that the acquirer (a) does not intend to use or (b) intends to use in a way other than the assets highest and best use as determined by an evaluation of market participant assumptions. While defensive intangible assets are not being actively used, they are likely contributing to an increase in the value of other assets owned by the acquiring entity. EITF No. 08-7 will require defensive intangible assets to be accounted for as separate units of accounting at the time of acquisition and the useful life of such assets would be based on the period over which the assets will directly or indirectly affect the entity s cash flows. This Issue would be applied prospectively for defensive intangible assets acquired on or after the beginning of the Company s fiscal 2010, in order to coincide with the effective date of SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)).

In November 2008, the FASB ratified the consensus reached on EITF Issue No. 08-6, Accounting for Equity Method Investment Considerations (EITF No. 08-6). EITF No. 08-6 addresses questions about the potential effect of SFAS No. 141(R) and SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51 (SFAS No. 160) on equity-method accounting. The primary issues include how the initial carrying value of an equity method investment should be determined, how to account for any subsequent purchases and sales of additional ownership interests, and whether the investor must separately assess its underlying share of the investee s indefinite-lived intangible assets for impairment. The effective date of EITF No. 08-6 coincides with that of SFAS No. 141(R) and SFAS No. 160 and is to be applied on a prospective basis beginning in the Company s fiscal 2010. Early adoption is not permitted for entities that previously adopted an alternate accounting policy.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP No. FAS 142-3). This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). This FSP also adds certain disclosures to those already prescribed in SFAS No. 142. FSP No. FAS 142-3 becomes effective for fiscal years, and interim periods within those fiscal years, beginning in the Company s fiscal 2010. The guidance for determining useful lives must be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements must be applied prospectively to all intangible assets recognized as of the effective date.

In December 2007, the FASB issued SFAS No. 141(R). SFAS No. 141(R) replaces SFAS No. 141, Business Combinations, however, it retains the fundamental requirements of the former Statement that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. SFAS No. 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. Among other requirements, SFAS No. 141(R) requires the acquiring entity in a business combination to recognize the identifiable assets acquired, liabilities assumed and any noncontrolling interest in the acquiree at their acquisition-date fair values, with limited exceptions; acquisition-related costs generally will be expensed as incurred. SFAS No. 141(R) requires certain financial statement disclosures to enable users to evaluate and understand the nature and financial effects of the business combination. SFAS No. 141(R) must be applied prospectively to business combinations that are consummated on or after July 1, 2009.

In December 2007, the FASB issued SFAS No. 160 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Among other requirements, SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is to be reported as a separate component of equity in the consolidated financial statements. SFAS No. 160 also requires consolidated net income to include the amounts attributable to both the parent and the noncontrolling interest and to disclose those amounts on the face of the consolidated statement of income. SFAS No. 160 must be applied prospectively for fiscal years, and interim periods within those fiscal years, beginning in the Company s fiscal 2010, except for the presentation and disclosure requirements, which will be applied retrospectively for all periods presented.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2007, the FASB ratified the consensus reached on EITF Issue No. 07-1, Collaborative Arrangements, (EITF No. 07-1). This Issue addresses accounting for collaborative arrangement activities that are conducted without the creation of a separate legal entity for the arrangement. Revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators pursuant to the guidance in EITF Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, and other applicable accounting literature. Payments to or from collaborators should be presented in the income statement based on the nature of the arrangement, the nature of the company s business and whether the payments are within the scope of other accounting literature. Other detailed information related to the collaborative arrangement is also required to be disclosed. The requirements under this Issue must be applied to collaborative arrangements in existence at the beginning of the Company s fiscal 2010 using a modified version of retrospective application. The Company is currently not a party to significant collaborative arrangement activities, as defined by EITF No. 07-1.

NOTE 2 GOODWILL AND OTHER INTANGIBLE ASSETS

The Company follows the provisions of 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 indefinite-lived intangibles are no longer amortized.

The Company tests goodwill for impairment at the reporting unit level, which is one level below its operating segments. The Company identifies its reporting units by assessing whether the components of its operating segments constitute businesses for which discrete financial information is available and management of each reporting unit regularly reviews the operating results of those components. 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. The impairment test for indefinite-lived intangible assets encompasses calculating a fair value of an indefinite-lived intangible asset and comparing the fair value to its carrying value. If the carrying value exceeds the fair value, impairment is recorded.

To determine fair value of the reporting unit, the Company generally uses an equal weighting of the income and market approaches. The Company believes both approaches are equally relevant and the most reliable indications of fair value because the fair value of product or service companies is more dependent on the ability to generate earnings than on the value of the assets used in the production process. Under the market approach, the Company utilizes information from comparable publicly traded companies with similar operating and investment characteristics as the reporting units, which creates valuation multiples that are applied to the operating performance of the reporting unit being tested, to value the reporting unit. Under the income approach, the Company determines fair value using a discounted cash flow method, estimating future cash flows of each reporting unit, as well as terminal value, and discounting such cash flows at a rate of return that reflects the relative risk of the cash flows. The key estimates and factors used in these two approaches include, but are not limited to, revenue growth rates and profit margins based on internal forecasts, terminal value, the weighted-average cost of capital used to discount future cash flows and comparable market multiples. To determine fair value of other indefinite-lived intangible assets, the Company uses an income approach, the relief-from-royalty method. This method assumes that, in lieu of ownership, a third party would be willing to a pay a royalty in order to obtain the rights to use the comparable asset. Other indefinite-lived intangible assets fair values require significant judgments in determining both the assets estimated cash flows as well as the appropriate discount and royalty rates applied to those cash flows to determine fair value. Changes in such estimates or the application of alternative assumptions could produce significantly different results.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company believes the recent decline in stock price, which impacts market capitalization, primarily reflects the reaction of the equity markets to the recessionary economy, rather than a fundamental change in the business operations. In light of the recent decline in stock price, the Company reviewed the impact of the aggregate change in market capitalization on the fair value of its reporting units with goodwill and such review indicated that all reporting units, except for the Darphin reporting unit, continued to have fair value in excess of carrying value.

During the third quarter of fiscal 2009, the Company concluded that the Darphin reporting unit met certain indicators triggering an interim impairment review of goodwill and trademarks. Those indicators included a decline in recent operating activities, restructuring activities, revisions in internal forecasts and an application of the Company s continued decline in market capitalization to this reporting unit. The Company performed an interim impairment test for goodwill and trademarks as of March 31, 2009 on this reporting unit. The Company concluded that the carrying value of the Darphin trademark exceeded its estimated fair value and as a result recognized an impairment charge of $12.3 million at the exchange rate at March 31, 2009. This charge was reflected in the skin care product category and in the Europe, the Middle East & Africa region. After adjusting the carrying value of the trademark, the Company completed step one of the impairment analysis for goodwill and concluded that the fair value of the Darphin reporting unit was in excess of its carrying value including goodwill.

During the third quarter of fiscal 2009, the Company reviewed its other intangible assets for events or changes in circumstances that indicate the carrying amount of such assets may not be recoverable. Pursuant to this review, the Company identified a fragrance license agreement intangible asset which was tested for impairment based upon a history of operating losses in excess of projections and revisions in internal forecasts. The Company determined that the intangible asset was impaired and therefore recorded an asset impairment charge of $2.3 million in the fragrance product category and in the Americas region.

As the duration and magnitude of the volatility of the current economic conditions remain uncertain, the Company will continue to monitor and evaluate the potential impact on the business and on the annual impairment testing in the fourth quarter of the current fiscal year. Accordingly, it is possible that the Company would recognize an impairment charge in the future with respect to goodwill and/or other intangible assets.

NOTE 3 ACQUISITION OF BUSINESSES

During fiscal 2009, the Company acquired Applied Genetics Incorporated Dermatics, a manufacturer of cosmetics ingredients. The purchase price, paid at closing, was funded by cash provided by operations. In addition, the Company acquired businesses engaged in the wholesale distribution and retail sale of Aveda products. These activities were predominantly related to the Company s skin care and hair care businesses and resulted in increases to goodwill of $36.4 million and other intangible assets of $17.9 million as of March 31, 2009, pending final valuation.

The aggregate purchase price for these transactions, net of acquired cash, which includes acquisition costs, was $58.4 million at March 31, 2009. 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 and as of the prior-year period have not been presented as the impact on the Company s consolidated financial results would not have been material.

NOTE 4 RESTRUCTURING AND OTHER SPECIAL CHARGES

In February 2009, the Company announced the implementation of a multi-faceted cost savings program (the Program) to position it to achieve long-term profitable growth. The Company anticipates the Program will result in related restructuring and other special charges over the next few fiscal years totaling between $350 million and $450 million before taxes. The Program includes organizational resizing and regional realignments which principally reflects the reduction of the workforce by approximately 2,000 employees.

During fiscal 2009, the Company approved cost savings initiatives to resize the organization, reorganize certain functions, exit unprofitable operations and outsource certain services. For the three and nine months ended March 31, 2009, aggregate expenses of $7.0 million and $10.3 million, respectively, were recorded as Restructuring and other special charges related to the Program in the accompanying consolidated statements of earnings. These charges primarily reflected employee-related costs, asset write-offs, contract terminations and other special charges.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present the restructuring charges incurred for the three and nine months ended March 31, 2009 under the Program. Substantially all of these charges are expected to result in cash expenditures, with a majority of the cash payments expected to be made through fiscal 2010.

	Three Months Ended March 31, 2009		Nine Months Ended March 31, 2009	
	(Unaudited) (In millions)			
Employee-related costs	$	4.3	$	5.5
Asset write-offs		0.1		0.1
Contract terminations		0.1		0.1
Other exit costs		0.1		0.1
Total restructuring charges	$	4.6	$	5.8

The total amount of restructuring charges expected to be incurred in connection with these initiatives, plus other initiatives approved through April 16, 2009, include approximately $28 million for employee-related costs, approximately $4 million in asset write-offs and approximately $5 million of contract terminations and other exit costs.

The related liability balances and activity for these restructuring charges are shown below.

	Employee-Related Costs	Asset Write-offs	Contract Terminations	Other	Total