ESTEE LAUDER COMPANIES INC
Form 10-Q
October 28, 2008
Table of Contents

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549-1004**

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# 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 September 30, 2008**

**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 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 October 22, 2008, 118,304,468 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**

| | Page |
|---|---|
| **Part I. Financial Information** | |
| Item 1. Financial Statements | |
| Consolidated Statements of Earnings Three Months Ended September 30, 2008 and 2007 | 2 |
| Consolidated Balance Sheets September 30, 2008 and June 30, 2008 | 3 |
| Consolidated Statements of Cash Flows Three Months Ended September 30, 2008 and 2007 | 4 |
| Notes to Consolidated Financial Statements | 5 |
| Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations | 18 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 29 |
| Item 4. Controls and Procedures | 29 |
| **Part II. Other Information** | |
| Item 1. Legal Proceedings | 30 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 30 |
| Item 6. Exhibits | 31 |
| **Signatures** | 32 |

Table of Contents

**PART I. FINANCIAL INFORMATION**

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

**THE ESTÉE LAUDER COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF EARNINGS**

**(Unaudited)**

| | Three Months Ended September 30 | |
|---|---|---|
| | **2008** | **2007** |
| | **(In millions, except per share data)** | |
| **Net Sales** | $ 1,903.5 | $ 1,710.1 |
| Cost of sales | 500.1 | 455.8 |
| **Gross Profit** | 1,403.4 | 1,254.3 |
| Operating expenses: | | |
| Selling, general and administrative | 1,310.8 | 1,176.1 |
| Special charges related to cost savings initiative | 0.1 | 0.3 |
| | 1,310.9 | 1,176.4 |
| **Operating Income** | 92.5 | 77.9 |
| Interest expense, net | 15.3 | 18.4 |
| **Earnings before Income Taxes and Minority Interest** | 77.2 | 59.5 |
| Provision for income taxes | 27.6 | 21.1 |
| Minority interest, net of tax | 1.5 | 0.7 |
| **Net Earnings** | $ 51.1 | $ 39.1 |
| Net earnings per common share: | | |
| Basic | $ .26 | $ .20 |
| Diluted | .26 | .20 |
| Weighted-average common shares outstanding: | | |
| Basic | 195.3 | 194.0 |
| Diluted | 198.8 | 197.2 |

See notes to consolidated financial statements.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**CONSOLIDATED BALANCE SHEETS**

| | September 30 2008 (Unaudited) | June 30 2008 |
|---|---|---|
| | ($ in millions) | |
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 328.8 | $ 401.7 |
| Accounts receivable, net | 1,164.9 | 1,038.8 |
| Inventory and promotional merchandise, net | 1,048.4 | 987.2 |
| Prepaid expenses and other current assets | 364.1 | 359.5 |
| **Total current assets** | 2,906.2 | 2,787.2 |
| **Property, Plant and Equipment, net** | 1,042.6 | 1,043.1 |
| **Other Assets** | | |
| Investments, at cost or market value | 22.5 | 24.1 |
| Goodwill and other intangible assets, net | 944.5 | 900.8 |
| Other assets, net | 265.9 | 256.0 |
| **Total other assets** | 1,232.9 | 1,180.9 |
| **Total assets** | $ 5,181.7 | $ 5,011.2 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| **Current Liabilities** | | |
| Short-term debt | $ 349.9 | $ 118.7 |
| Accounts payable | 331.5 | 361.7 |
| Accrued income taxes | 101.2 | 151.2 |
| Other accrued liabilities | 1,041.5 | 1,067.6 |
| **Total current liabilities** | 1,824.1 | 1,699.2 |
| **Noncurrent Liabilities** | | |
| Long-term debt | 1,082.0 | 1,078.2 |
| Other noncurrent liabilities | 536.1 | 554.0 |
| **Total noncurrent liabilities** | 1,618.1 | 1,632.2 |
| **Minority Interest** | 23.1 | 26.6 |
| **Stockholders Equity** | | |
| Common stock, $.01 par value; 650,000,000 shares Class A authorized; shares issued: 183,452,573 at September 30, 2008 and 180,754,534 at June 30, 2008; 240,000,000 shares Class B authorized; shares issued and outstanding: 78,067,261 at September 30, 2008 and June 30, 2008 | 2.6 | 2.6 |
| Paid-in capital | 1,118.3 | 979.0 |
| Retained earnings | 3,136.2 | 3,085.1 |
| Accumulated other comprehensive income | 40.3 | 110.8 |
| | 4,297.4 | 4,177.5 |
| Less: Treasury stock, at cost; 65,148,305 Class A shares at September 30, 2008 and 63,914,699 Class A shares at June 30, 2008 | (2,581.0) | (2,524.3) |
| **Total stockholders equity** | 1,716.4 | 1,653.2 |

| | | |
|---|---|---|
| **Total liabilities and stockholders equity** | $ 5,181.7 | $ 5,011.2 |

See notes to consolidated financial statements.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Three Months Ended September 30 | |
|---|---|---|
| | **2008** | **2007** |
| | **(In millions)** | |
| **Cash Flows from Operating Activities** | | |
| Net earnings | $ 51.1 | $ 39.1 |
| Adjustments to reconcile net earnings to net cash flows from operating activities: | | |
| Depreciation and amortization | 62.6 | 59.0 |
| Deferred income taxes | (7.1) | (6.4) |
| Minority interest, net of tax | (1.5) | (0.7) |
| Non-cash stock-based compensation | 22.6 | 18.9 |
| Excess tax benefits from stock-based compensation arrangements | (1.4) | |
| Loss on disposal of fixed assets | 4.0 | 2.4 |
| Other non-cash items | 0.8 | 0.2 |
| Changes in operating assets and liabilities: | | |
| Increase in accounts receivable, net | (177.6) | (174.6) |
| Increase in inventory and promotional merchandise, net | (96.8) | (84.9) |
| Increase in other assets, net | (23.0) | (12.1) |
| Decrease in accounts payable | (18.6) | (11.5) |
| Decrease in accrued income taxes | (25.2) | (11.5) |
| Increase in other liabilities | 13.9 | 49.3 |
| **Net cash flows used for operating activities** | (196.2) | (132.8) |
| | | |
| **Cash Flows from Investing Activities** | | |
| Capital expenditures | (75.9) | (78.5) |
| Acquisition of businesses and other intangible assets, net of cash acquired | (63.5) | (116.4) |
| 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** | (138.9) | (195.3) |
| | | |
| **Cash Flows from Financing Activities** | | |
| Increase in short-term debt, net | 220.3 | 335.5 |
| Repayments and redemptions of long-term debt | (3.1) | (1.3) |
| Net proceeds from stock-based compensation transactions | 109.3 | 2.7 |
| Excess tax benefits from stock-based compensation arrangements | 1.4 | |
| Payments to acquire treasury stock | (57.0) | (54.4) |
| Dividends paid to stockholders | (0.1) | |
| **Net cash flows provided by financing activities** | 270.8 | 282.5 |
| | | |
| Effect of Exchange Rate Changes on Cash and Cash Equivalents | (8.6) | 3.3 |
| | | |
| **Net Decrease in Cash and Cash Equivalents** | (72.9) | (42.3) |
| **Cash and Cash Equivalents at Beginning of Period** | 401.7 | 253.7 |
| **Cash and Cash Equivalents at End of Period** | $ 328.8 | $ 211.4 |

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 necessary for a fair presentation are of a normal and recurring nature and 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 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. The Company s most significant 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 and derivatives. Descriptions of these 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. Such adjustments amounted to $84.0 million of unrealized translation losses and $30.7 million of unrealized translation gains during the three months ended September 30, 2008 and 2007, respectively. The accompanying consolidated statements of earnings include net exchange (losses) gains on foreign currency transactions of $(19.9) million and $1.0 million during the three months ended September 30, 2008 and 2007, respectively.

***Accounts Receivable***

Accounts receivable is stated net of the allowance for doubtful accounts and customer deductions of $30.9 million and $26.3 million as of September 30, 2008 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. 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.

| | September 30 2008 (Unaudited) | June 30 2008 |
|---|---|---|
| | (In millions) | |
| Inventory and promotional merchandise, net consists of: | | |
| Raw materials | $ 212.7 | $ 205.4 |
| Work in process | 47.7 | 56.8 |
| Finished goods | 561.4 | 494.7 |
| Promotional merchandise | 226.6 | 230.3 |
| | $ 1,048.4 | $ 987.2 |

***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 $137.4 million and $129.0 million as of September 30, 2008 and June 30, 2008, 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. 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.

| | September 30 2008 (Unaudited) | June 30 2008 |
|---|---|---|
| | (In millions) | |
| **Assets (Useful Life)** | | |
| Land | $ 14.6 | $ 14.9 |

| | | | | |
|---|---|---|---|---|
| Buildings and improvements (10 to 40 years) | | 180.0 | | 183.5 |
| Machinery and equipment (3 to 10 years) | | 1,017.7 | | 1,008.9 |
| Furniture and fixtures (5 to 10 years) | | 93.4 | | 95.6 |
| Leasehold improvements | | 1,096.0 | | 1,090.7 |
| | | 2,401.7 | | 2,393.6 |
| Less accumulated depreciation and amortization | | 1,359.1 | | 1,350.5 |
| | $ | 1,042.6 | $ | 1,043.1 |

Depreciation and amortization of property, plant and equipment was $59.3 million and $54.0 million during the three months ended September 30, 2008 and 2007, 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.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***Goodwill and Other Intangible Assets***

During the first quarter of fiscal 2009, the Company acquired Applied Genetics Incorporated Dermatics ( AGI ), a manufacturer of cosmetics ingredients (see Note 2). The Company also acquired businesses engaged in the wholesale distribution and retail sale of Aveda products. These activities resulted in an increase to goodwill and other intangible assets of $53.8 million as of September 30, 2008.

***Income Taxes***

As of September 30, 2008 and June 30, 2008, the gross amount of unrecognized tax benefits, exclusive of interest and penalties, totaled $196.8 million and $199.0 million, respectively. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was $115.3 million. The total interest and penalties accrued related to unrecognized tax benefits during the three months ended September 30, 2008 in the accompanying consolidated statement of earnings was $2.7 million. The total gross accrued interest and penalties in the accompanying consolidated balance sheets at September 30, 2008 and June 30, 2008 was $55.6 million and $54.0 million, respectively. On the basis of the information available as of September 30, 2008, 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 4), 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. The Company is currently evaluating the impact of adopting SFAS No. 157 at the beginning of fiscal 2010 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.

***Recently Issued Accounting Standards***

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ( 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, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 ( 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.

In December 2007, the FASB ratified the consensus reached on Emerging Issues Task Force ( EITF ) Issue No. 07-1, Collaborative Arrangements, ( EITF No. 07-1 ). This EITF 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 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 EITF 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 collaborative arrangement activities, as defined by EITF

No. 07-1.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO 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 and gains and losses of 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 is currently evaluating the disclosure requirements of SFAS No. 161. The adoption of this disclosure-only standard will not have an impact on the Company s consolidated financial results. SFAS No. 161 becomes effective for the March 2009 interim consolidated financial statements.

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 June 2008, the FASB issued FSP No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. Early application of this FSP is prohibited. The Company does not issue share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents.

**NOTE 2 ACQUISITION OF BUSINESSES**

During the first quarter of fiscal 2009, the Company acquired AGI, a manufacturer of cosmetics ingredients. The initial 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.

The aggregate purchase price for these transactions, which includes acquisition costs, was $57.7 million at September 30, 2008. 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 3 DEBT**

During the first quarter of fiscal 2009, the Company issued additional commercial paper, which is being used for general corporate purposes. As of September 30, 2008 and June 30, 2008, outstanding commercial paper was $299.7 million and $83.9 million, respectively.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 4 FAIR VALUE MEASUREMENTS

The Company adopted the provisions of SFAS No. 157 for financial assets and liabilities as of July 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the Company s consolidated financial statements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires the entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

SFAS No. 157 describes three levels of inputs that may be used to measure fair value:

Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Inputs reflect management s best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instruments valuation.

The following table presents the Company s hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2008:

| (In millions) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| **Assets:** | | | | |
| Foreign currency forward and option contracts | $ | $ 14.2 | $ | $ 14.2 |
| Interest rate swap contracts | | 14.1 | | 14.1 |
| Available-for-sale securities | 14.7 | | | 14.7 |
| Total | 14.7 | 28.3 | | 43.0 |
| | | | | |
| **Liabilities:** | | | | |
| Foreign currency forward contracts | $ | $ 3.8 | $ | $ 3.8 |

*Foreign Currency Forward and Option Contracts* - The fair values of the Company s foreign currency forward and option contracts were valued using pricing models, with all significant inputs derived from or corroborated by observable market data such as yield curves, currency spot and forward rates and currency volatilities.

*Interest Rate Swap Contracts* - The fair values of the Company s outstanding interest rate swap contracts were determined based on non-binding offers from the counterparties that are corroborated by observable market data.

*Available-For-Sale Securities* - Available-for-sale securities are generally comprised of mutual funds and are valued using quoted market prices on an active exchange.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 5 PENSION 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. The Company also maintains a domestic post-retirement benefit plan which provides certain medical and dental benefits to eligible employees. Descriptions of these plans are discussed in the Company s Annual Report on Form 10-K for the year ended June 30, 2008.

The components of net periodic benefit cost for the three months ended September 30, 2008 and 2007 consisted of the following:

| (Unaudited) (In millions) | Pension Plans U.S. 2008 | Pension Plans U.S. 2007 | Pension Plans International 2008 | Pension Plans International 2007 | Other than Pension Plans Post-retirement 2008 | Other than Pension Plans Post-retirement 2007 |
|---|---|---|---|---|---|---|
| Service cost | $ 5.2 | $ 4.9 | $ 4.4 | $ 3.9 | $ 1.0 | $ 1.0 |
| Interest cost | 7.0 | 6.6 | 5.1 | 3.5 | 1.8 | 1.6 |
| Expected return on plan assets | (8.3) | (7.9) | (5.3) | (3.6) | | |
| Amortization of: | | | | | | |
| Prior service cost | 0.2 | 0.2 | 0.7 | 0.1 | | |
| Actuarial loss | 0.4 | 0.4 | 0.2 | 1.5 | | 0.1 |
| Net periodic benefit cost | $ 4.5 | $ 4.2 | $ 5.1 | $ 5.4 | $ 2.8 | $ 2.7 |

The Company previously disclosed in its consolidated financial statements for the fiscal year ended June 30, 2008 that it expected to make cash contributions totaling approximately $15 million to its trust based, noncontributory qualified defined benefit pension plan ( U.S. Qualified Plan ) and approximately $46 million to its international defined benefit pension plans during the fiscal year ending June 30, 2009. During the first quarter of fiscal 2009, the Company made a discretionary contribution to the U.S. Qualified Plan of $5.0 million and does not currently anticipate further discretionary contributions for the remainder of the fiscal year. In addition, as of September 30, 2008, the expected contributions to the international defined benefit pension plans are currently anticipated to be approximately $44 million for the fiscal year ending June 30, 2009.

## NOTE 6 COMMON STOCK

During the three months ended September 30, 2008, the Company purchased approximately 1.2 million shares of its Class A Common Stock for $57.0 million.

**NOTE 7 STOCK PROGRAMS**

As of September 30, 2008, 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 33,194,400 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 September 30, 2008, approximately 4,052,100 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 September 30, 2008 include stock options, performance share units ( PSU ), restricted stock units ( RSU ) and share units.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Total net 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 during the three months ended September 30, 2008 and 2007 was $22.6 million and $18.9 million, respectively. As of September 30, 2008, the total unrecognized compensation cost related to nonvested stock-based awards was $72.1 million and the related weighted-average period over which it is expected to be recognized is approximately 2.2 years.

**Stock Options**

A summary of the Company s stock option programs as of September 30, 2008 and changes during the three months then ended, is presented below:

| (Unaudited) (Shares in thousands) | Shares | Weighted-Average Exercise Price Per Share | Aggregate Intrinsic Value(1) (in millions) | Weighted-Average Contractual Life Remaining in Years |
|---|---|---|---|---|
| Outstanding at June 30, 2008 | 20,307.2 | $ 42.53 | | |
| Granted at fair value | 1,745.4 | 52.83 | | |
| Exercised | (2,626.7) | 41.69 | | |
| Expired | (28.5) | 46.54 | | |
| Forfeited | (17.2) | 41.22 | | |
| Outstanding at September 30, 2008 | 19,380.2 | 43.57 | $ 138.6 | 4.5 |
| | | | | |
| Exercisable at September 30, 2008 | 14,593.9 | 43.08 | $ 110.2 | 3.0 |

(1) The intrinsic value of a stock option is the amount by which the 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 the three months ended September 30, 2008 and 2007 was $17.47 and $14.34, respectively. The total intrinsic value of stock options exercised during the three months ended September 30, 2008 and 2007 was $24.7 million and $0.7 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:

| | Three Months Ended September 30 | |
|---|---|---|
| **(Unaudited)** | **2008** | **2007** |
| Weighted-average expected stock-price volatility | 28% | 24% |
| Weighted-average expected option life | 8 years | 8 years |
| Average risk-free interest rate | 3.4% | 4.5% |
| Average dividend yield | 1.2% | 1.2% |

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Performance Share Units**

During the three months ended September 30, 2008, the Company granted 131,000 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, 2011 and subject to the continued employment of the grantees. Settlement will be made pursuant to a range of opportunities relative to the net sales and diluted net earnings per common 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. In September 2008, 78,400 shares of the Company s Class A Common Stock were issued and related accrued dividends were paid, relative to the target goals set at the time of issuance, in settlement of 96,600 PSUs which vested as of June 30, 2008.

The following is a summary of the status of the Company s PSUs as of September 30, 2008 and activity during the three months then ended:

| (Unaudited) (Shares in thousands) | Shares | Weighted-Average Grant Date Fair Value Per Share |
|---|---|---|
| Nonvested at June 30, 2008 | 189.3 | $ 41.05 |
| Granted | 131.0 | 52.83 |
| Vested | | |
| Forfeited | | |
| Nonvested at September 30, 2008 | 320.3 | 45.87 |

**Restricted Stock Units**

The Company granted approximately 617,200 RSUs during the three months ended September 30, 2008. At the time of grant, 343,500 were scheduled to vest on November 2, 2009, 178,700 on November 1, 2010 and 95,000 on October 31, 2011, all subject to the continued employment or retirement of the grantees. Certain RSUs granted in fiscal 2009 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 2009 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 September 30, 2008 and activity during the three months then ended:

| (Unaudited) (Shares in thousands) | Shares | Weighted-Average Grant Date Fair Value Per Share |
|---|---|---|
| Nonvested at June 30, 2008 | 814.0 | $ 40.85 |
| Granted | 617.2 | 52.40 |
| Vested | | |
| Forfeited | (10.9) | 40.94 |
| Nonvested at September 30, 2008 | 1,420.3 | 45.87 |

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**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 September 30, 2008 and activity during the three months then ended:

| (Unaudited) (Shares in thousands) | Shares | Weighted-Average Grant Date Fair Value Per Share |
|---|---|---|
| Outstanding at June 30, 2008 | 18.1 | $ 39.21 |
| Granted | | |
| Dividend equivalents | | |
| Converted | | |
| Outstanding at September 30, 2008 | 18.1 | 39.21 |

**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 share 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 $0.3 million and $0.1 million as compensation expense to reflect additional deferrals and the change in the market value for the three months ended September 30, 2008 and 2007, respectively.

**NOTE 8 NET EARNINGS PER COMMON SHARE**

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.

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

| | | Three Months Ended September 30 | |
|---|---|---|---|
| | | 2008 | 2007 |
| | | (Unaudited) (In millions, except per share data) | |
| **Numerator:** | | | |
| Net earnings | | $ 51.1 | $ 39.1 |
| | | | |
| **Denominator:** | | | |
| Weighted-average common shares outstanding | Basic | 195.3 | 194.0 |
| Effect of dilutive stock options | | 2.9 | 2.7 |
| Effect of restricted stock units | | 0.6 | 0.5 |
| Weighted-average common shares outstanding | Diluted | 198.8 | 197.2 |
| | | | |
| **Net earnings per common share:** | | | |
| Basic | | $ .26 | $ .20 |
| Diluted | | .26 | .20 |

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

As of September 30, 2008 and 2007, outstanding options to purchase 7.4 million and 10.1 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 September 30, 2008 and 2007, 0.3 million of PSUs 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 7.

**NOTE 9 COMPREHENSIVE INCOME (LOSS)**

The components of accumulated other comprehensive income ( OCI ) included in the accompanying consolidated balance sheets consist of net unrealized investment gain (loss), net gain (loss) on derivative instruments designated and qualifying as cash-flow hedging instruments, net actuarial gain (loss) and prior service costs or credits associated with pension and other post-retirement benefits, and cumulative translation adjustments as of the end of each period.

Comprehensive income (loss) and its components, net of tax, are as follows:

| | Three Months Ended September 30 | |
|---|---|---|
| | 2008 | 2007 |
| | (Unaudited) (In millions) | |
| Net earnings | $ 51.1 | $ 39.1 |
| Other comprehensive income (loss): | | |
| Net unrealized investment gain (loss) | (0.1) | (0.2) |
| Net derivative instruments gain (loss) | 8.7 | (0.9) |
| Amounts included in net periodic benefit cost, net | 4.9 | 1.3 |
| Translation adjustments | (84.0) | 30.7 |
| | | |
| Other comprehensive income (loss) | (70.5) | 30.9 |
| | | |
| Comprehensive income (loss) | $ (19.4) | $ 70.0 |

The accumulated net gain (loss) on derivative instruments consists of the following:

| | Three Months Ended September 30 | |
|---|---|---|
| | 2008 | 2007 |

| | | (Unaudited) (In millions) | | |
|---|---|---|---|---|
| OCI-derivative instruments, beginning of period | $ | 7.9 | $ | 8.2 |
| Gain (loss) on derivative instruments | | 13.1 | | (1.4) |
| Reclassification to earnings of net (gain) loss during the period | | 0.3 | | |
| Adjustment for deferred income taxes | | (4.7) | | 0.5 |
| | | | | |
| Net derivative instruments gain (loss) | | 8.7 | | (0.9) |
| | | | | |
| OCI-derivative instruments, end of period | $ | 16.6 | $ | 7.3 |

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Of the $16.6 million, net of tax, derivative instrument gain recorded in OCI at September 30, 2008, $8.9 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. Also included in the net derivative instrument gain recorded in OCI was $8.3 million in gains, net of tax, related to foreign currency forward and option contracts, which the Company will reclassify to earnings during the next nine months. Partially offsetting these gains 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.

At the end of the prior period, the $7.3 million, net of tax, derivative instrument gain recorded in OCI included $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 $1.1 million in losses, net of tax, related to foreign currency forward contracts, which were subsequently reclassified to earnings.

**NOTE 10 STATEMENT OF CASH FLOWS**

Supplemental cash flow information for the three months ended September 30, 2008 and 2007 were as follows:

| | 2008 | 2007 |
|---|---|---|
| | (Unaudited) (In millions) | |
| Cash | | |
| Cash paid during the period for interest | $ 11.9 | $ 10.9 |
| Cash paid during the period for income taxes | $ 59.8 | $ 38.1 |
| | | |
| Non-cash investing and financing activities | | |
| Long-term debt issued upon acquisition of business | $ | $ 23.8 |
| Liabilities incurred for acquisitions | $ 1.4 | $ 3.6 |
| Incremental tax benefit from the exercise of stock options | $ (7.8) | $ (0.2) |
| Capital lease obligations incurred | $ 14.0 | $ 0.2 |
| Interest rate swap derivative mark to market | $ 3.3 | $ 9.0 |

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 11 SEGMENT DATA AND RELATED INFORMATION**

Reportable operating segments 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. Although the Company does business in one operating segment, beauty products, management also evaluates performance on a product category basis. Performance is measured based upon net sales and operating income. Operating income represents earnings before income taxes, minority interest and net interest expense. The accounting policies for the Company s reportable segment are substantially the same as those for the consolidated financial statements, as described in the segment data and related information footnote included in the Company s Annual Report on Form 10-K for the year ended June 30, 2008. 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. There has been no significant variance in the total or long-lived asset value associated with the Company s segment data since June 30, 2008.

| | Three Months Ended September 30 | |
|---|---|---|
| | 2008 | 2007 |
| | (Unaudited) (In millions) | |
| **PRODUCT CATEGORY DATA** | | |
| **Net Sales:** | | |
| Skin Care | $ 716.8 | $ 619.5 |
| Makeup | 742.9 | 663.1 |
| Fragrance | 327.8 | 313.0 |
| Hair Care | 98.8 | 102.6 |
| Other | 17.2 | 11.9 |
| | $ 1,903.5 | $ 1,710.1 |
| **Operating Income (Loss):** | | |
| Skin Care | $ 43.5 | $ 35.8 |
| Makeup | 54.4 | 41.1 |
| Fragrance | (5.5) | (5.0) |
| Hair Care | (1.0) | 7.4 |
| Other | 1.2 | (1.1) |
| Special charges related to cost savings initiative | (0.1) | (0.3) |
| | 92.5 | 77.9 |
| Reconciliation: | | |
| Interest expense, net | 15.3 | 18.4 |
| Earnings before income taxes and minority interest | $ 77.2 | $ 59.5 |
| | | |
| **GEOGRAPHIC DATA** | | |
| **Net Sales:** | | |
| The Americas | $ 939.0 | $ 898.9 |
| Europe, the Middle East & Africa | 641.5 | 551.2 |
| Asia/Pacific | 323.0 | 260.0 |

| | | | | |
|---|---|---|---|---|
| | $ | 1,903.5 | $ | 1,710.1 |
| **Operating Income (Loss):** | | | | |
| The Americas | $ | 56.5 | $ | 52.4 |
| Europe, the Middle East & Africa | | 7.6 | | 9.0 |
| Asia/Pacific | | 28.5 | | 16.8 |
| Special charges related to cost savings initiative | | (0.1) | | (0.3) |
| | $ | 92.5 | $ | 77.9 |

Table of Contents

## THE ESTÉE LAUDER COMPANIES INC.

**Item 2.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

**RESULTS OF OPERATIONS**

We manufacture, market and sell beauty products including those in the skin care, makeup, fragrance and hair care categories which are distributed in over 140 countries and territories. The following is a comparative summary of operating results for the three months ended September 30, 2008 and 2007, and reflects the basis of presentation described in Note 1 of Notes to Consolidated Financial Statements *Summary of Significant Accounting Policies* for all periods presented. Sales of products and services that do not meet our definition of skin care, makeup, fragrance or hair care have been included in the other category.

| | Three Months Ended September 30 | |
|---|---|---|
| | 2008 | 2007 |
| | (In millions) | |
| **NET SALES** | | |
| **By Region:** | | |
| The Americas | $ 939.0 | $ 898.9 |
| Europe, the Middle East & Africa | 641.5 | 551.2 |
| Asia/Pacific | 323.0 | 260.0 |
| | $ 1,903.5 | $ 1,710.1 |
| | | |
| **By Product Category:** | | |
| Skin Care | $ 716.8 | $ 619.5 |
| Makeup | 742.9 | 663.1 |
| Fragrance | 327.8 | 313.0 |
| Hair Care | 98.8 | 102.6 |
| Other | 17.2 | 11.9 |
| | $ 1,903.5 | $ 1,710.1 |
| **OPERATING INCOME (LOSS)** | | |
| **By Region:** | | |
| The Americas | $ 56.5 | $ 52.4 |
| Europe, the Middle East & Africa | 7.6 | 9.0 |
| Asia/Pacific | 28.5 | 16.8 |
| Special charges related to cost savings initiative | (0.1) | (0.3) |
| | $ 92.5 | $ 77.9 |
| | | |
| **By Product Category:** | | |
| Skin Care | $ 43.5 | $ 35.8 |
| Makeup | 54.4 | 41.1 |
| Fragrance | (5.5) | (5.0) |
| Hair Care | (1.0) | 7.4 |
| Other | 1.2 | (1.1) |
| Special charges related to cost savings initiative | (0.1) | (0.3) |
| | $ 92.5 | $ 77.9 |

18

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

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

| | Three Months Ended September 30 | |
|---|---|---|
| | **2008** | **2007** |
| Net sales | 100.0% | 100.0% |
| Cost of sales | 26.3 | 26.7 |
| Gross profit | 73.7 | 73.3 |
| | | |
| Operating expenses: | | |
| Selling, general and administrative | 68.9 | 68.8 |
| Special charges related to cost savings initiative | | |
| | 68.9 | 68.8 |
| | | |
| Operating income | 4.8 | 4.5 |
| Interest expense, net | 0.8 | 1.0 |
| | | |
| Earnings before income taxes and minority interest | 4.0 | 3.5 |
| Provision for income taxes | 1.4 | 1.2 |
| Minority interest, net of tax | 0.1 | |
| | | |
| Net earnings | 2.7% | 2.3% |

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.

The recent challenges and uncertainties in the economies of certain key countries, including the United States, are likely to impact consumer demand, which may have an adverse impact on the financial strength of our customers that are retailers. These will likely affect our future net sales and operating results. We are reviewing our plans and taking actions to mitigate the impact of these conditions. Our future net sales and operating results may also be impacted by changes in foreign currency exchange rates. The dramatic strengthening of the U.S. dollar subsequent to September 30, 2008 will likely have a negative impact on our results during the fiscal second quarter. If the current exchange rates persist or the U.S. dollar continues to strengthen, there will be an adverse impact on our results for the full fiscal year.

***First Quarter Fiscal 2009 as Compared with First Quarter Fiscal 2008***

**NET SALES**

Net sales increased 11%, or $193.4 million, to $1,903.5 million, primarily led by net sales growth in our skin care and makeup product categories. Our fragrance product category experienced modest net sales growth while hair care net sales declined slightly. Net sales grew in every geographic region, led by Asia/Pacific and Europe, the Middle East & Africa. Excluding the impact of foreign currency translation, net sales increased 10%.

***Product Categories***

***Skin Care***

Net sales of skin care products increased 16%, or $97.3 million, to $716.8 million. The recent launches of Perfectionist [CP+] Wrinkle Lifting Serum and Cyber White EX from Estée Lauder and Moisture Surge Extended Thirst Relief, Superdefense SPF 25 Age Defense Moisturizer, Even Better Skin Tone Corrector and Redness Solutions from Clinique contributed incremental sales of approximately $68 million, combined. Net sales increases from products in Clinique s 3-Step Skin Care System, as well as Advanced Night Repair and Resilience Lift Extreme Ultra Firming products from Estée Lauder, totaled approximately $28 million. These improvements were partially offset by approximately $22 million of lower sales from other existing products in the Perfectionist line from Estée Lauder and Moisture Surge and Superdefense lines from Clinique. Excluding the impact of foreign currency translation, skin care net sales increased 14%.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

***Makeup***

Makeup net sales increased 12%, or $79.8 million, to $742.9 million reflecting increases from our makeup artist brands of approximately $38 million, particularly driven by strong growth internationally. The recent launches of High Impact Lip Colour SPF 15 and reformulated Superfit Makeup from Clinique and Estée Lauder Signature Blush and Sumptuous Bold Volume Lifting Mascara from Estée Lauder contributed incremental sales of approximately $44 million, combined. This growth was partially offset by approximately $15 million of lower sales of existing Superfit Makeup products and Superbalm Moisturizing Gloss from Clinique and Estée Lauder Signature Silky Eyeshadow Duo from Estée Lauder. Excluding the impact of foreign currency translation, makeup net sales increased 11%.

***Fragrance***

Net sales of fragrance products increased 5%, or $14.8 million, to $327.8 million. The recent launches of Estée Lauder Sensuous and DKNY Delicious Night collectively contributed approximately $31 million to the category. Higher net sales of approximately $8 million of various Tom Ford and Jo Malone fragrances also contributed to the increase. Partially offsetting the growth in this category were lower sales of Sean John Unforgivable, Estée Lauder *pleasures*, DKNY Be Delicious and DKNY Red Delicious Women of approximately $28 million, collectively. While current year sales levels compared favorably to the prior-year period, we anticipate continued challenges due to competitive pressures in this product category, primarily in the United States. Excluding the impact of foreign currency translation, fragrance net sales increased 3%.

***Hair Care***

Hair care net sales decreased 4%, or $3.8 million, to $98.8 million. Net sales from Bumble and bumble declined primarily as a result of the conclusion of its hotel amenities program in the third quarter of fiscal 2008 and, to a lesser extent, a softer salon retail environment in the United States. These declines were partially offset by higher sales from Aveda, primarily as a result of the launch of Dry Remedy Shampoo and Conditioner and the acquisition of an independent distributor in Australia. Excluding the impact of foreign currency translation, hair care net sales decreased 4%.

***Geographic Regions***

Net sales in the Americas increased 4%, or $40.1 million to $939.0 million. Higher net sales from certain of our core brands, as well as our makeup artist brands, in the United States contributed approximately $19 million to the increase. Net sales growth in Latin America and Canada contributed an additional $13 million to the increase. We believe that current economic conditions in this region, particularly in the department store channel, as well as competitive pressures, have negatively impacted certain of our businesses.

In Europe, the Middle East & Africa, net sales increased 16%, or $90.3 million, to $641.5 million. Net sales increases of approximately $61 million were driven by our travel retail business, Russia, the United Kingdom, Germany and Italy, as well as in the Middle East, which converted from a distributor market to an affiliate in the prior year. The performance in these countries primarily reflected net sales growth in our makeup artist brands and certain of our core brands. While net sales increased in virtually all countries in the region, net sales growth rates are anticipated to slow in certain key countries due to current economic conditions. Excluding the impact of foreign currency translation, net sales in Europe, the Middle East & Africa increased 14%.

Net sales in Asia/Pacific increased 24%, or $63.0 million, to $323.0 million, reflecting growth in all countries in the region. This increase reflected higher net sales of approximately $55 million in China, Japan, Hong Kong, Korea and Australia. Despite the softening of certain retail environments in this region, most brands delivered double-digit net sales growth. Excluding the impact of foreign currency translation, Asia/Pacific net sales increased 21%.

We believe the economic conditions that are currently having a negative impact on the global economy will likely have an adverse impact on our future financial performance. We cannot predict with certainty the magnitude of the impact or how it will vary across each of our geographic regions.

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

Table of Contents



**COST OF SALES**

Cost of sales as a percentage of total net sales decreased to 26.3% as compared with 26.7% in the prior-year period. 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 30 basis points and a positive effect of exchange rates of approximately 20 basis points. Partially offsetting these improvements was an increase in obsolescence charges of approximately 50 basis points.

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 increased to 68.9% of net sales as compared with 68.8% of net sales in the prior-year period. Company-wide cost containment and contingency plan efforts to maintain expenses in line with our business needs resulted in an operating expense margin improvement of approximately 140 basis points. These initiatives were offset by net losses from foreign exchange transactions of approximately 110 basis points and incremental costs of global information technology systems and infrastructure of approximately 50 basis points.

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.

**OPERATING RESULTS**

Operating income increased 19%, or $14.6 million, to $92.5 million as compared with the prior-year period. Operating margin improved to 4.8% of net sales as compared with 4.5% in the prior-year period, reflecting the increase in our gross margin partially offset by the increase in our operating expense margin, as previously discussed.

***Product Categories***

Makeup operating income increased 32%, or $13.3 million, to $54.4 million, primarily reflecting improved results from certain of our core brands and from our makeup artist brands. Skin care operating income increased 22%, or $7.7 million, to $43.5 million, primarily reflecting improved results from certain of our core brands driven by increased net sales from new launches. Fragrance operating results declined 10%, or $0.5 million, primarily reflecting lower net sales of designer fragrance products, partially offset by favorable results related to launches of new Estée Lauder fragrances. Hair care operating results declined over 100%, or $8.4 million, primarily reflecting lower sales of Bumble and bumble products due to the conclusion of its hotel amenities program and an increase in selling and marketing expenses related to the positioning of the Ojon brand for future growth.

***Geographic Regions***

Operating income in the Americas increased 8%, or $4.1 million, to $56.5 million, driven by higher sales from certain of our core brands and our makeup artist brands, coupled with cost containment and contingency plan efforts. These favorable results were partially offset by difficulties experienced by our hair care brands in the United States and incremental costs of information technology systems and infrastructure as previously discussed.

In Europe, the Middle East & Africa, operating income decreased 16%, or $1.4 million, to $7.6 million. This decrease reflected lower results of approximately $20 million in Russia, Spain and France, inclusive of additional provisions for receivables and inventory. Partially offsetting these decreases were improved results from our travel retail business, the United Kingdom and Germany of approximately $19 million, collectively.

In Asia/Pacific, operating income increased 70%, or $11.7 million, to $28.5 million, primarily reflecting improved results in Japan, Korea, Hong Kong and China of approximately $10 million, collectively. Partially offsetting these improvements were lower results in Taiwan and New Zealand of approximately $1 million, combined.

Table of Contents

THE ESTÉE LAUDER COMPANIES INC.

**INTEREST EXPENSE, NET**

Net interest expense was $15.3 million as compared with $18.4 million in the prior-year period. This decrease primarily resulted from lower average borrowing rates and lower average balances of outstanding commercial paper.

**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 income taxes, tax rates in foreign jurisdictions and certain nondeductible expenses. Our effective tax rate will change from quarter to quarter based on recurring and non-recurring factors including, but not limited to, the geographical mix of earnings, enacted tax legislation, state and local income taxes, tax audit settlements and the interaction of various global tax strategies. In addition, changes in judgment from the evaluation of new information resulting in the recognition, derecognition or remeasurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

The effective rate for income taxes for the three months ended September 30, 2008 was 35.8% as compared with 35.5% in the prior-year period. The increase in the effective income tax rate of 30 basis points was primarily attributable to a net increase in the gross amount of unrecognized tax benefits and related interest accruals.

**FINANCIAL CONDITION**

**LIQUIDITY AND CAPITAL RESOURCES**

Our principal sources of funds historically have been cash flows from operations, borrowings pursuant to our commercial paper program, 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 September 30, 2008, we had cash and cash equivalents of $328.8 million compared with $401.7 million at June 30, 2008.

At September 30, 2008, 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 |
| 5.75% Senior Notes, due October 15, 2033 ( 2033 Senior Notes(2)) | | 197.5 | | | | 197.5 |
| 5.55% Senior Notes, due May 15, 2017 ( 2017 Senior Notes(3)) | | 313.7 | | | | 313.7 |
| 6.00% Senior Notes, due January 15, 2012 ( 2012 Senior Notes(4)) | | 242.5 | | | | 242.5 |
| $13.5 million promissory note due August 31, 2012 (5) | | 15.6 | | | | 15.6 |
| $7.0 million promissory note due July 31, 2009 (6) | | | | 8.0 | | 8.0 |
| Commercial paper maturing through November 2008 (2.16% average interest rate) | | | | 299.7 | | 299.7 |
| Turkish lira overdraft facility | | | | 17.7 | | 17.7 |
| Other borrowings | | 16.5 | | 24.5 | | 41.0 |
| | $ | 1,082.0 | $ | 349.9 | $ | 1,431.9 |

(1) Consists of $300.0 million principal and unamortized debt discount of $3.8 million.
(2) Consists of $200.0 million principal and unamortized debt discount of $2.5 million.
(3) Consists of $300.0 million principal, unamortized debt discount of $0.4 million and a $14.1 million adjustment to reflect the fair value of outstanding interest rate swaps.
(4) Consists of $250.0 million principal, unamortized debt discount of $0.4 million and a $7.1 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.
(5) Consists of $13.5 million face value and unamortized premium of $2.1 million.
(6) Consists of $7.0 million face value, capitalized interest of $0.7 million and unamortized premium of $0.3 million.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

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 September 30, 2008, we had $299.7 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 $207.1 million in additional uncommitted credit facilities, of which $31.3 million was used as of September 30, 2008.

We have an undrawn $750.0 million senior unsecured revolving credit facility that expires on April 26, 2012. This facility may be used primarily to provide credit support for our commercial paper program, to repurchase shares of our common stock and for general corporate purposes. Up to the equivalent of $250 million of the credit 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 ½% 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 September 30, 2008, we were in compliance with all related financial and other restrictive covenants, including limitations on indebtedness and liens.

As part of the purchase price related to the July 2007 acquisition of Ojon Corporation, we have (i) an outstanding promissory note due July 31, 2009 with a notional value of $7.0 million and capitalized interest of $0.7 million (present value of $8.0 million at September 30, 2008), bearing interest at 10.00% due at maturity and (ii) an outstanding promissory note due August 31, 2012 with a notional amount of $13.5 million (present value of $15.6 million at September 30, 2008), bearing interest at 10.00% payable annually on July 31. The notes due in 2009 and 2012 were recorded in the accompanying consolidated balance sheet at present value using effective rates of 5.11% and 5.42%, respectively.

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 September 30, 2008, 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 30.0 million Turkish lira. The interest rate applicable to each such credit shall be up to a maximum of 175 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 September 30, 2008 of 21.9 million Turkish lira ($17.7 million at the exchange rate at September 30, 2008) is classified as short-term debt in our consolidated balance sheet.

We have a 3.0 billion Japanese 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 outstanding balance at September 30, 2008 of 200.0 million Japanese yen ($1.9 million at the exchange rate at September 30, 2008) is classified as short-term debt in our consolidated balance sheet.

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 45% at September 30, 2008 and 42% at June 30, 2008.

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.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

***Cash Flows***

Net cash used for operating activities was $196.2 million during the three months ended September 30, 2008 as compared with net cash used of $132.8 million in the prior-year period. The change in operating cash outflows in the first quarter of this fiscal year, as compared with the first quarter of the prior fiscal year, was primarily impacted by the timing of payments and costs related to accrued advertising merchandising and sampling activities and employee compensation as well as an increase in pension contributions in support of required funding obligations of a particular affiliate related to a previously disclosed plan amendment. The increase in the use of cash also reflected higher payments for income taxes and higher global inventory levels to support our previously forecasted sales activity.

Net cash used for investing activities was $138.9 million during the three months ended September 30, 2008 compared with $195.3 million in the prior-year period. Investing activities during the fiscal 2009 quarter primarily reflected cash payments related to counters and leasehold improvements, global information technology systems and infrastructure, as well as the acquisitions of Applied Genetics Incorporated Dermatics and businesses engaged in the wholesale distribution and retail sale of Aveda products. Additional cash used for investing activities in the prior-year period was related to the purchases of Ojon Corporation and an Aveda distributor.

Net cash provided by financing activities was $270.8 million during the three months ended September 30, 2008 compared with $282.5 million in the prior-year period. This change primarily reflected less proceeds from the issuance of commercial paper, partially offset by an increase in proceeds from employee stock transactions.

***Share Repurchase Program***

We are authorized by the Board of Directors to repurchase up to 88.0 million shares of Class A Common Stock in the open market or in privately negotiated transactions, depending on market conditions and other factors. As of September 30, 2008, the cumulative total of acquired shares pursuant to the authorization was 65.3 million, reducing the remaining authorized share repurchase balance to 22.7 million. During the three months ended September 30, 2008, we purchased approximately 1.2 million shares pursuant to the authorization for $55.3 million as outlined in the following table:

| Period | Total Number of Shares Purchased | | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Number of Shares that May Yet Be Purchased Under the Program(1) |
|---|---|---|---|---|---|
| July 2008 | 674,700 | $ | 43.79 | 674,700 | 23,266,841 |
| August 2008 | 198,700 | $ | 44.50 | 198,700 | 23,068,141 |
| September 2008 | 367,261(2) | $ | 50.70 | 333,709 | 22,734,432 |
| | 1,240,661 | $ | 45.95 | 1,207,109 | 22,734,432 |

(1) The initial program covering the repurchase of 8.0 million shares was announced in September 1998 and increased by 20.0 million shares each in November 2007, February 2007 and May 2005 and 10.0 million shares in both May 2004 and October 2002.

(2) Includes shares that were repurchased by the Company in connection with shares withheld to satisfy tax obligations upon the settlement of performance share units earned as of June 30, 2008.

***Commitments, Contingencies and Contractual Obligations***

Since June 30, 2008 we made additional commitments pursuant to employment agreements. These commitments will result in an increase to our contractual obligations previously disclosed in our Annual Report on Form 10-K for periods beyond fiscal 2009. Unconditional purchase obligations related to these agreements are expected to increase approximately $6 million in fiscal 2010 and 2011.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

***Derivative Financial Instruments and Hedging Activities***

There have been no significant changes to our derivative financial instruments and hedging activities as discussed in our Annual Report on Form 10-K for the year ended June 30, 2008.

***Foreign Exchange Risk Management***

We enter into foreign currency forward 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. The majority of foreign currency forward contracts is denominated in currencies of major industrial countries and is with large financial institutions rated as investment grade by a major rating agency. We also enter into foreign currency option contracts to hedge anticipated transactions where there is a high probability that anticipated exposures will materialize. The foreign currency forward and option contracts entered into to hedge anticipated transactions have been designated as cash-flow hedges. Hedge effectiveness of foreign currency forward 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 foreign currency forward and 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 September 30, 2008, 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 2009. 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 September 30, 2008, we had foreign currency forward contracts and option contracts in the amount of $1,082.3 million and $51.9 million, respectively. The foreign currencies included in foreign currency forward contracts (notional value stated in U.S. dollars) are principally the Euro ($234.8 million), Swiss franc ($189.9 million), British pound ($170.8 million), Canadian dollar ($111.6 million), Australian dollar ($70.2 million), Russian ruble ($65.7 million) and Hong Kong dollar ($51.2 million). The foreign currencies included in foreign currency option contracts (notional value stated in U.S. dollars) are principally the Canadian dollar ($30.0 million) and the South Korean won ($17.9 million).

***Interest Rate Risk Management***

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

We have 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 September 30, 2008, these fair-value hedges were highly effective, in all material respects.

***Market Risk***

Using the value-at-risk model, as discussed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008, our average value-at-risk, calculated for the most recent twelve months, is $13.7 million related to our foreign currency forward and option contracts. As of September 30, 2008, our average value-at-risk related to our interest rate contracts for the twelve month period for which these contracts were outstanding was $23.4 million. There have been no significant changes in market risk since June 30, 2008 that would have a material effect on our calculated value-at-risk exposure, as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

***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.

***CRITICAL ACCOUNTING POLICIES***

As disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008, the discussion and analysis of our financial condition and results of operations 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 and assumptions. 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 and derivatives. Since June 30, 2008, there have been no significant changes to the assumptions and estimates related to our critical accounting policies.

**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 our fiscal 2010. As of July 1, 2008, we adopted SFAS No. 157, with the exception of its application to nonfinancial assets and nonfinancial liabilities, which we will defer in accordance with FSP No. FAS 157-2. We are currently evaluating the impact of adopting SFAS No. 157 at the beginning of fiscal 2010 for such nonfinancial assets and nonfinancial liabilities on our 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. We adopted SFAS No. 157 beginning in our fiscal 2009 first quarter. As part of this adoption, we evaluated the fair value measurements of our financial assets and liabilities and determined that these instruments are valued in active markets. As such, the guidance in this FSP did not impact our consolidated financial statements.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

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 us as of July 1, 2008. As we did not elect the fair value option for our financial instruments (other than those already measured at fair value in accordance with SFAS No. 157) or other assets and liabilities, the adoption of this standard did not have an impact on our consolidated financial statements.

**RECENTLY ISSUED ACCOUNTING STANDARDS**

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ( 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, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 ( 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 our fiscal 2010, except for the presentation and disclosure requirements, which will be applied retrospectively for all periods presented.

In December 2007, the FASB ratified the consensus reached on Emerging Issues Task Force ( EITF ) Issue No. 07-1, Collaborative Arrangements, ( EITF No. 07-1 ). This EITF 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 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 EITF must be applied to collaborative arrangements in existence at the beginning of our fiscal 2010 using a modified version of retrospective application. We are currently not a party to collaborative arrangement activities, as defined by EITF No. 07-1.

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 and gains and losses of 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 adoption of this disclosure-only standard will not have an impact on our consolidated financial results. SFAS No. 161 becomes effective for the March 2009 interim consolidated financial statements.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

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 June 2008, the FASB issued FSP No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. Early application of this FSP is prohibited. We do not issue share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents.

**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 a 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;

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

(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 the volatility in the global credit and equity markets, 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, suppliers or other contract counterparties, our operations, the cost and availability of capital which we may need for new equipment, facilities or acquisitions, the returns that we are able to generate on our pension assets and the resulting impact on funding obligations, 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 or maintain 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 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 the Annual Report on Form 10-K for the fiscal year ended June 30, 2008.

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

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk.***

The information required by this item is set forth in Item 2 of this Quarterly Report on Form 10-Q under the caption Liquidity and Capital Resources - Market Risk and is incorporated herein by reference.

**Item 4.** ***Controls and Procedures.***

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. The Chief Executive Officer and the Chief Financial Officer, with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of September 30, 2008 and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

As part of our Strategic Modernization Initiative, we anticipate the continued migration of our operations to SAP, with the majority of our business being implemented through fiscal 2012. Based on management s evaluation, the necessary steps have been taken to monitor and maintain appropriate internal control over financial reporting during this period.

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the first quarter of fiscal 2009 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1.** ***Legal Proceedings.***

We are involved, from time to time, in litigation and other legal proceedings incidental to our business. Management believes that the outcome of current litigation and legal proceedings will not have a material adverse effect upon our results of operations or financial condition. However, management s assessment of our 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 us not presently known to us 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.

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. We have accrued an amount which we believe would be necessary to resolve our share of this matter. If settlement discussions are not successful, we intend 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 our consolidated financial condition.

**Item 2.** ***Unregistered Sales of Equity Securities and Use of Proceeds.***

**Sales of Unregistered Securities**

Shares of Class B Common Stock may be converted immediately into Class A Common Stock on a one-for-one basis by the holder and are automatically converted into Class A Common Stock on a one-for-one basis upon transfer to a person or entity that is not a Permitted Transferee or soon after a record date for a meeting of stockholders where the outstanding Class B Common Stock constitutes less than 10% of the outstanding shares of Common Stock of the Company. There is no cash or other consideration paid by the holder converting the shares and, accordingly, there is no cash or other consideration received by the Company. The shares of Class A Common Stock issued by the Company in such conversions are exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 3(a)(9) thereof.

During the three months ended September 30, 2008, no holders of Class B Common Stock converted such shares into Class A Common Stock.

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

**Share Repurchase Program**

Information required by this item is set forth in Part I Item 2 of this Quarterly Report on Form 10-Q under the caption Liquidity and Capital Resources Share Repurchase Program and is incorporated herein by reference.

**Item 6.** ***Exhibits.***

| Exhibit Number | Description |
|---|---|
| 10.1 | Form of Stock Option Agreement under The Estée Lauder Companies Inc. Amended and Restated Fiscal 2002 Share Incentive Plan (including Form of Notice of Grant). |
| 10.2 | Form of Performance Share Unit Award Agreement under The Estée Lauder Companies Inc. Amended and Restated Fiscal 2002 Share Incentive Plan (including Form of Notice of Grant). |
| 10.3 | Form of Restricted Stock Unit Agreement under The Estée Lauder Companies Inc. Amended and Restated Fiscal 2002 Share Incentive Plan for Executive Officers (including Form of Notice of Grant). |
| 10.4 | Form of Restricted Stock Unit Agreement under The Estée Lauder Companies Inc. Amended and Restated Fiscal 2002 Share Incentive Plan for Employees other than Executive Officers (including Form of Notice of Grant). |
| 10.5 | Employment Agreement dated as of July 1, 2007 between the Company and John Demsey. |
| 10.6 | Employment Agreement dated as of July 1, 2008 between the Company and Cedric Prouvé. |
| 31.1 | Certification pursuant to Rule 13a-14(a) (CEO). |
| 31.2 | Certification pursuant to Rule 13a-14(a) (CFO). |
| 32.1 | Certification pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CEO). (furnished) |
| 32.2 | Certification pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CFO). (furnished) |

Exhibit is a management contract or compensatory plan or arrangement.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**THE ESTÉE LAUDER COMPANIES INC.**

Date: October 28, 2008

By: /s/RICHARD W. KUNES
Richard W. Kunes
Executive Vice President
and Chief Financial Officer
(Principal Financial and
Accounting Officer)

Table of Contents

**THE ESTÉE LAUDER COMPANIES INC.**

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