

ESTEE LAUDER COMPANIES INC  
Form 10-K  
August 28, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 30, 2007

OR

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**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**

(State or other jurisdiction of incorporation or organization)

**11-2408943**

(IRS Employer Identification No.)

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

**10153**  
(Zip Code)

Registrant's telephone number, including area code **212-572-4200**

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

Title of each class

Name of each exchange  
on which registered

Class A Common Stock, \$.01 par value

New York Stock Exchange

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

None

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of the registrant's voting common equity held by non-affiliates of the registrant was approximately \$4.61 billion at December 31, 2006 (the last business day of the registrant's most recently completed second quarter).\*

At August 17, 2007, 112,467,544 shares of the registrant's Class A Common Stock, \$.01 par value, and 81,804,761 shares of the registrant's Class B Common Stock, \$.01 par value, were outstanding.

**Documents Incorporated by Reference**

**Document**

**Where Incorporated**

Proxy Statement for Annual Meeting of Stockholders to be held November 9, 2007

Part III

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\* Calculated by excluding all shares held by executive officers and directors of registrant and certain trusts without conceding that all such persons are affiliates of registrant for purposes of the Federal securities laws.

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THE ESTÉE LAUDER COMPANIES INC.

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*Forward-Looking Statements and Risk Factors*

*This Annual Report on Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such 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, we cannot assure that actual results will not differ materially from our expectations. Factors that could cause actual results to differ from expectations are described herein; in particular, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Information. In addition, there is a discussion of risks associated with an investment in our securities. See Item 1A. Risk Factors.*

**PART I**

**Item 1. Business.**

The Estée Lauder Companies Inc., founded in 1946 by Estée and Joseph Lauder, is one of the world's leading manufacturers and marketers of quality skin care, makeup, fragrance and hair care products. Our products are sold in over 135 countries and territories under the following well-recognized brand names: Estée Lauder, Aramis, Clinique, Prescriptives, Lab Series, Origins, M A C, Bobbi Brown, La Mer, Aveda, Jo Malone, Bumble and bumble, Darphin, American Beauty, Flirt!, Good Skin and Grassroots. We are also the global licensee for fragrances and cosmetics sold under the Tommy Hilfiger, Donna Karan, Michael Kors, Sean John, Missoni, Daisy Fuentes and Tom Ford brand names. Each brand is distinctly positioned within the market for beauty products.

We are a pioneer in the cosmetics industry and believe we are a leader in the industry due to the global recognition of our brand names, our leadership in product innovation, our strong market position in key geographic markets and the consistently high quality of our products. We sell our prestige products principally through limited distribution channels to complement the images associated with our brands. These channels, encompassing over 20,000 points of sale, consist primarily of upscale department stores, specialty retailers, upscale perfumeries and pharmacies and prestige salons and spas. In addition, our products are sold in freestanding company-owned stores and spas, our own and authorized retailer websites, stores on cruise ships, television direct marketing, in-flight and duty-free shops and certain fragrances are sold in self-select outlets. We believe that our strategy of pursuing limited distribution strengthens our relationships with retailers, enables our brands to be among the best selling product lines at the stores and heightens the aspirational quality of our brands.

We sell American Beauty, Flirt!, Good Skin, Grassroots and fragrances by Daisy Fuentes at Kohl's Department Stores in the United States. In fiscal 2006, we signed an exclusive agreement to create fragrances and related products to be sold to Coach, Inc., the first fragrance of which became available in Spring 2007 at Coach retail stores in the United States. In July 2007, we acquired Ojon Corporation, which markets and sells Ojon hair care and skin care products primarily through direct response television and specialty stores.

In April 2006, we completed the sale of certain assets and operations of our reporting unit that marketed and sold Stila brand products, which was originally acquired in August 1999. As of June 30, 2007, we terminated the Gloss.com joint venture in which we formerly owned a controlling majority interest.

We have been controlled by the Lauder family since the founding of our company. Members of the Lauder family, some of whom are directors, executive officers and/or employees, beneficially own, directly or indirectly, as of August 17, 2007, shares of Class A Common Stock and Class B Common Stock having approximately 89.1% of the outstanding voting power of the Common Stock.

Unless the context requires otherwise, references to we, us, our and the Company refer to The Estée Lauder Companies Inc. and its subsidiaries.

**Products**

**Skin Care** - Our broad range of skin care products addresses various skin care needs for women and men. These products include moisturizers, creams, lotions, cleansers, sun screens and self-tanning products, a number of which are developed for use on particular areas of the body, such as the face or the hands or around the eyes. Skin care products accounted for approximately 37% of our net sales in fiscal 2007.

**Makeup** - We manufacture, market and sell a full array of makeup products, including lipsticks, lip glosses, mascaras, foundations, eyeshadows, nail polishes and powders. Many of the products are offered in an extensive array of shades

and colors. We also sell related items such as compacts, brushes and other makeup tools. Makeup products accounted for approximately 39% of our net sales in fiscal 2007.

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**Fragrance** - We offer a variety of fragrance products for women and men. The fragrances are sold in various forms, including eau de parfum sprays and colognes, as well as lotions, powders, creams and soaps that are based on a particular fragrance. Fragrance products accounted for approximately 19% of our net sales in fiscal 2007.

**Hair Care** - Hair care products are offered mainly in salons and in freestanding retail stores and include hair color and styling products, shampoos, conditioners and finishing sprays. In fiscal 2007, hair care products accounted for approximately 5% of our net sales.

Given the personal nature of our products and the wide array of consumer preferences and tastes, as well as competition for the attention of consumers, our strategy has been to market and promote our products through distinctive brands seeking to address broad preferences and tastes. Each brand has a single global image that is promoted with consistent logos, packaging and advertising designed to enhance its image and differentiate it from other brands.

**Estée Lauder** - Estée Lauder brand products, which have been sold since 1946, are positioned as luxurious, classic and aspirational. We believe that Estée Lauder brand products are technologically advanced and innovative and have a worldwide reputation for excellence. The broad product line principally consists of skin care, makeup and fragrance products that are presented in high quality packaging.

**Aramis and Designer Fragrances** - Our Aramis and Designer Fragrances division creates and markets fragrance and skin care products, including the following brand names:

- **Aramis** - We pioneered the marketing of prestige men's fragrance, grooming and skin care products with the introduction of Aramis products in 1964.
- **Lab Series** - Lab Series Skincare for Men, introduced by the Aramis and Designer Fragrances division in 1987, offers a full range of products for cleansing, shaving, treatment and body that are especially formulated to answer the unique needs of men's skin.
- **Tommy Hilfiger** - We have an exclusive global license arrangement to develop and market a line of men's and women's fragrances and cosmetics under the Tommy Hilfiger brand name. We launched the line in 1995 with a men's fragrance, *tommy*. Today, we manufacture and sell a variety of fragrances and ancillary products for men and women.
- **Donna Karan Cosmetics** - In November 1997, we obtained the exclusive global license to develop, market and distribute a line of fragrances and other cosmetics under the Donna Karan New York and DKNY brand names, including certain products that were originally sold by The Donna Karan Company. We launched the first DKNY women's fragrance in fiscal 2000 and the first DKNY men's fragrance in fiscal 2001. Under this license, fragrances have been expanded to include extensive lines of companion bath and body products.
- **Michael Kors** - In May 2003, we entered into a license agreement for fragrances and beauty products under the Michael Kors brand name and purchased certain related rights and inventory from another party. The fragrances, as well as ancillary bath and body products, are sold in department stores, specialty stores, at freestanding Michael Kors boutiques and over the Internet.
- **Sean John Fragrances** - In 2005, we entered into an exclusive license agreement to develop fragrances and other beauty products under the Sean John brand name. Sean "Diddy" Combs played an active role in creating the signature scent, *Unforgivable*. The *Unforgivable* fragrance and ancillary products are primarily available at select department and specialty stores as well as travel retail outlets around the world.

- **Missoni** - In 2006, we launched fragrance and ancillary products under our exclusive global licensing agreement with Milan-based fashion house, Missoni. Missoni products are sold in select distribution channels worldwide.

In addition to the foregoing brands, we manufacture and sell Kiton and Toni Gard products as a licensee. During fiscal 2007, we entered into a license agreement with Ford Motor Company to manufacture and sell a fragrance using the name Mustang.

**Clinique** - First introduced in 1968, Clinique skin care and makeup products are all allergy tested and 100% fragrance free and have been designed to address individual skin types and needs. The products are based on the research and related expertise of leading dermatologists. Clinique skin care products are generally marketed as part of the 3-Step System: Cleanse, Exfoliate, Moisturize. Clinique also offers fragrances and a line of hair care products.

**Prescriptives** - We developed and introduced Prescriptives in 1979. Prescriptives is positioned as a color authority with an advanced collection of highly individualized products primarily addressing the makeup and skin care needs of contemporary women with active lifestyles. The products are characterized by simple concepts, minimalist design and an innovative image and, through a system of color application and extensive range of makeup shades, accommodate a diverse group of consumers.

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**Origins** - Origins was introduced in 1990. It is positioned as a plant-based line of skin care, makeup and aromatherapy products that combine time-tested botanical ingredients with modern science to promote total well-being. Origins sells its products at our freestanding Origins stores and through stores-within-stores (which are designed to replicate the Origins store environment within a department store), at traditional retail counters, in perfumeries and directly to consumers over the Internet. Origins also has a license agreement to develop and sell products using the name of Dr. Andrew Weil.

**M A C** - M A C products comprise a broad line of color-oriented, professional cosmetics and professional makeup tools targeting makeup artists and fashion-conscious consumers. The products are sold through a limited number of department and specialty stores, at freestanding M A C stores and directly to consumers over the Internet. We acquired the companies behind M A C in three stages: in December 1994, March 1997 and February 1998.

**Bobbi Brown** - In October 1995, we acquired the Bobbi Brown line of color cosmetics, professional makeup brushes and skin care products. Bobbi Brown products are manufactured to our specifications, primarily by third parties, and sold through a limited number of department and specialty stores and directly to consumers over the Internet.

**La Mer** - La Mer products primarily consist of moisturizing creams, lotions, cleansers, toners and other skin care products. The line, which is available in very limited distribution in the United States and certain other countries, is an extension of the initial Crème de la Mer product that we acquired in 1995.

**Aveda** - We acquired the Aveda business in December 1997 and have since acquired selected Aveda distributors and retail stores. Aveda, a prestige hair care leader, is a manufacturer and marketer of plant-based hair care, skin care, makeup and fragrance products. We sell Aveda products to third-party distributors and prestige salons and spas, cosmetology schools, certain non-U.S. department stores and specialty retailers and directly to consumers at our own freestanding Aveda Experience Centers and certain Aveda Institutes.

**Jo Malone** - We acquired London-based Jo Malone Limited in October 1999. Jo Malone is known for its prestige skin care, fragrance and hair care products showcased at its flagship store in London. Products are also available through a company catalogue, at freestanding stores and at a very limited group of specialty stores, primarily in the United States, Canada and the United Kingdom.

**Bumble and bumble** - In June 2000, we acquired a controlling majority equity interest in Bumble and Bumble Products, LLC, a marketer and distributor of quality hair care products, and Bumble and Bumble, LLC, the operator of a premier hair salon in New York City (collectively Bumble and bumble ). Bumble and bumble styling and other hair care products are distributed to top-tier salons and select specialty stores. In fiscal 2004, we opened a second wholly-owned salon and a training and education center. In fiscal 2007, we acquired the remaining equity interest in Bumble and bumble.

**Darphin** - In April 2003, we acquired Laboratoires Darphin, the Paris-based company dedicated to the development, manufacture and marketing of prestige skin care and makeup products which are distributed through high-end independent pharmacies and specialty stores.

**BeautyBank** - BeautyBank is our entrepreneurial think tank division whose mission is to develop brands for consumers shopping outside of the traditional department store channel on a worldwide basis. Brands developed under the BeautyBank umbrella include:

- **American Beauty** - Launched in 2004, the luxurious makeup and advanced skin care line celebrates the beauty of American style. These products, which are sold in the United States at Kohl's Department Stores and Kohls.com, have been developed to meet the needs of the modern American woman, with a straightforward makeup

and skin care appeal.

- **Flirt!** - Launched in 2004 and sold in the United States at Kohl's Department Stores and Kohls.com, this makeup line is all about experimenting with color, pop culture and trends; you can Flirt! with the possibilities.
- **Good Skin** - Launched in 2004 and sold in the United States at Kohl's Department Stores and Kohls.com, this line of skin care products was created with the expertise of a dermatologist. This line is color-coded for ease of use. *good skin, easy to choose, easy to use, doctor formulated for you.*
- **Grassroots** - Introduced in 2005 and sold in the United States at Kohl's Department Stores and Kohls.com, Grassroots offers a range of wholesome, naturally-sourced products to help care for you and your family. This line's seven product categories include face, body, hair, post-pregnancy, babies, kids and pets.
- **Daisy Fuentes** - In early fiscal 2007, we launched Dianoche, the first fragrance under our license agreement with Daisy Fuentes. Dianoche holds two scents that connect in a single bottle and is available exclusively at Kohl's Department Stores nationwide or online at Kohls.com.

**Tom Ford** - In 2006, we entered into a license agreement to develop fragrances and other beauty products under the Tom Ford brand name. In fiscal 2007, we introduced Tom Ford Black Orchid, his first signature fragrance.

Our core brands are Estée Lauder, Aramis and Designer Fragrances, Clinique, Prescriptives and Origins. M A C and Bobbi Brown are our makeup artist brands.

## Distribution

We sell our products principally through limited distribution channels to complement the images associated with our brands. These channels include more than 20,000 points of sale in over 135 countries and territories and consist primarily of upscale department stores, specialty retailers, upscale perfumeries and pharmacies and prestige salons and spas. In addition, our products are sold in freestanding company-owned stores and spas, our own and authorized retailer websites, stores on cruise ships, television direct marketing, in-flight and duty-free shops and certain fragrances are sold in self-select outlets.

We maintain a dedicated sales force which sells to our retail accounts in North America and in the major overseas markets, such as Western Europe and Japan. We have wholly-owned operations in over 35 countries, and controlling interests in joint ventures that operate in four other countries, through which we market, sell and distribute our products. In certain countries, we sell our products through selected local distributors under contractual arrangements designed to protect the image and position of the brands. In addition, we sell certain products in select domestic and international military locations. For information regarding our net sales and long-lived assets by geographic region, see Note 17 of Notes to Consolidated Financial Statements, which is incorporated herein by reference. Our net sales in the United States in fiscal 2007, 2006 and 2005 were \$3,224.5 million, \$3,141.4 million and \$3,094.5 million, respectively. Our long-lived assets in the United States at June 30, 2007, 2006 and 2005 were \$520.1 million, \$452.7 million and \$425.5 million, respectively.

We sell Aveda products principally to independent salons and spas, cosmetology schools, third-party distributors and specialty retailers and directly to consumers at our own freestanding Aveda Experience Centers and certain Aveda Institutes. There are currently about 7,200 points of sale, primarily in the United States, that sell Aveda products. Bumble and bumble products are principally sold to more than 2,500 independent salons, primarily in the United States. Darphin products are principally sold through high-end independent pharmacies, principally in Europe, representing approximately 3,700 points of sale.

As part of our strategy to diversify our distribution, we have been selectively expanding the number of single-brand, freestanding stores that we operate. The Origins, Aveda and M A C brands are the primary focus for this method of distribution. At this time, we operate 505 single-brand, freestanding stores worldwide, the majority of which are in the United States, and expect that number to increase moderately over the next several years. We also operate 86 multi-brand stores.

We sell American Beauty, Flirt!, Good Skin, Grassroots and Dianoche, by Daisy Fuentes in approximately 800 Kohl's Department Stores in the United States.

We sell some of our products directly to consumers over the Internet through our own websites: Estée Lauder, Clinique, Lab Series, Prescriptives, Origins, M A C, Bobbi Brown, La Mer, Aveda, Jo Malone and Darphin.

As is customary in the cosmetics industry, our practice is to accept returns of our products from retailers if properly requested, authorized and approved. In accepting returns, we typically provide a credit to the retailer against sales and accounts receivable from that retailer on a dollar-for-dollar basis. In recognition of this practice, and in accordance with U.S. generally accepted accounting principles, we report revenues on a net sales basis, which reflects the amount of actual returns received and an amount established for anticipated returns. As a percentage of gross sales, returns were 4.2%, 5.0% and 4.6% in fiscal 2007, 2006 and 2005, respectively.

## Customers

Our strategy is to build strong strategic relationships with selected retailers globally. Senior management works with executives of our major retail accounts on a regular basis and we believe we are viewed as an important supplier to these customers. During fiscal 2006, Federated Department Stores, Inc. acquired The May Department Stores Company, resulting in the merger of our previous two largest customers (collectively Macy's, Inc.). As of and for the fiscal years ended June 30, 2007 and 2006, Macy's, Inc. accounted for 12% and 14%, respectively, of our accounts receivable and 14% and 16%, respectively, of our consolidated net sales. In fiscal 2005, no single customer accounted for more than 10% of consolidated net sales.

## Marketing

Our marketing strategy is built around our vision statement: Bringing the Best to Everyone We Touch. Mrs. Estée Lauder formulated this marketing philosophy to provide high-quality service and products as the foundation for a solid and loyal consumer base.



Our marketing efforts focus principally on promoting the quality and benefits of our products. Each of our brands is distinctively positioned, has a single global image, and is promoted with consistent logos, packaging and advertising designed to enhance its image and differentiate it from other brands. We regularly advertise our products on television and radio, in upscale magazines and newspapers and through direct mail and photo displays at international airports. In addition, our products receive extensive editorial coverage in prestige publications and other media worldwide. Promotional activities and in-store displays are designed to introduce existing consumers to different products in the line and to attract new consumers. Our marketing efforts also benefit from cooperative advertising programs with retailers, some of which are supported by coordinated promotions, such as purchase with purchase and gift with purchase. Our marketing and sales executives spend considerable time in the field meeting with consumers and key retailers and consulting with sales representatives at the points of sale. These include Estée Lauder Beauty Advisors, Clinique Consultants, Aramis Selling Specialists, Prescriptives Analysts, Origins Guides and M A C Makeup Artists. At in-store counters, sales representatives offer personal demonstrations to market individual products as well as to provide education on basic skin care and makeup application. We conduct extensive sampling programs and we pioneered gift with purchase as a sampling program. We believe that the quality and perceived benefits of sample products have been effective inducements to purchases by new and existing consumers.

Starting with the launch of the Clinique website in 1996, we have used the Internet to educate and inform consumers about certain of our brands. Currently, we have sixteen single-brand marketing sites, eleven of which have e-commerce capabilities.

Most of our creative marketing work is done by in-house creative teams. The creative staff designs and produces the sales materials, advertisements and packaging for all products in each brand.

Global net advertising, merchandising, sampling and promotional expenditures were \$1,916.3 million, \$1,793.1 million and \$1,793.7 million for fiscal 2007, 2006 and 2005, respectively. These amounts include revenues and expenses relating to purchase with purchase and gift with purchase promotions that are reflected in net sales and cost of sales.

#### **Information Systems**

Information systems support business processes including product development, marketing, sales, order processing, production, distribution and finance. Of the many systems currently being utilized, the most significant to our business needs are: (i) a centralized data repository of essential attributes for each of the products we offer, or plan to offer, which enables us to globally manufacture and market products of consistent quality; (ii) a sales analysis system to track weekly sales at the stock keeping unit (SKU) level at most significant retail sales locations (i.e., sell-through data), increasing our understanding of consumer preferences and enabling us to coordinate more effectively our product development, manufacturing and marketing strategies; (iii) an automated replenishment system with many of our key domestic customers, allowing us to replenish inventories for individual points of sale automatically, with minimal paperwork; and (iv) an inventory management system to provide us with a global view of finished goods availability relative to actual requirements, facilitating inventory control and distribution for both existing product lines and new product launches.

We expect that these systems will continue to provide pertinent inventory and sales data in the short term. However, as part of our long-term effort to enhance these systems and increase productivity, we are implementing our Strategic Modernization Initiative ( SMI ), which includes an enterprise-wide global program that we expect will deliver a single set of integrated data, processes and technologies, which would be scalable and used to standardize business processes across brands, operating units and sales affiliates. The initial implementation of SMI at our Aveda operating unit occurred in May 2007 and we believe it is operating effectively. We anticipate SMI implementation will continue at additional locations in fiscal 2008, with the majority of our locations to be implemented through fiscal 2010.

#### **Research and Development**

We believe that we are an industry leader in the development of new products. Marketing, product development and packaging groups work with our research and development group to identify shifts in consumer preferences, develop new products and improve, redesign or reformulate existing products. In addition, research and development personnel work closely with quality assurance and manufacturing personnel on a worldwide basis to provide ongoing technical assistance and know-how, to ensure consistent global standards for our products and to deliver products with attributes that fulfill consumer expectations. The research and development group has long-standing working relationships with several U.S. and international medical and educational facilities, which supplement internal capabilities. Members of the group are also responsible for regulatory compliance matters.

We do not conduct animal testing on our products or ingredients, nor ask others to test on our behalf, except when required by law. We evaluate our finished products in clinical tests on volunteer panels.

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We maintain ongoing research and development programs at our facilities in Melville, New York; Oevel, Belgium; Petersfield, U.K.; Tokyo, Japan; Markham, Ontario; Blaine, Minnesota; Shanghai, China; and Colombes, France. As of June 30, 2007, we had approximately 450 employees engaged in research and development. Research and development expenditures, which are included in advertising, merchandising and sampling expenditures, totaled \$74.4 million, \$72.0 million and \$72.3 million in fiscal 2007, 2006 and 2005, respectively.

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### **Manufacturing, Warehousing and Raw Materials**

We manufacture skin care, makeup, fragrance and hair care products in the United States, Belgium, Switzerland, the United Kingdom, Canada and France. We continue to streamline our manufacturing processes and identify sourcing opportunities to improve innovation, increase efficiencies and reduce costs. Our major manufacturing facilities operate as focus plants that primarily manufacture one type of product (e.g., lipsticks) for all of the principal brands. Our plants are modern and our manufacturing processes are substantially automated. While we believe that our manufacturing facilities are sufficient to meet current and reasonably anticipated manufacturing requirements, we continue to identify opportunities to make significant improvements in capacity and productivity. To capitalize on innovation and other supply benefits, we continue to utilize third parties on a global basis for finished goods production, including an increased volume in Asia/Pacific to support our international growth.

We have established a global distribution network designed to meet the changing demands of our customers while maintaining service levels. We are continuously evaluating and restructuring this physical distribution network. We have begun to establish regional inventory centers strategically positioned throughout the world in order to facilitate timely delivery of our products to our customers.

The principal raw materials used in the manufacture of our products are essential oils, alcohol and specialty chemicals. We also purchase packaging components that are manufactured to our design specifications. Procurement of materials for all manufacturing facilities is generally made on a global basis through our Global Supplier Relations department. In recent years, we made a concentrated effort in supplier rationalization with the specific objective of reducing costs, increasing innovation and improving quality. In addition, we continue to focus on supply sourcing within the region of manufacture to allow for improved supply chain efficiencies. As a result of sourcing initiatives, there is increased dependency on certain suppliers, but we believe that these suppliers have adequate resources and facilities to overcome any unforeseen interruption of supply. We are continually benchmarking the performance of the supply chain and will add or delete suppliers based upon the changing needs of the business. In the past, we have been able to obtain an adequate supply of essential raw materials and currently believe we have adequate sources of supply for virtually all components of our products.&#16