

COMBINING EVERYONE'S ENERGIES WITH A FORCEFUL BUSINESS MODEL TO FUEL A POWERFUL GROWTH DRIVE

2006 was another year of strong economic growth for L'Oréal.

The return to dynamic growth, the quality of our operating performance, and the strong increase in both profitability and cash flow have again proved the strength and relevance of the L'Oréal business model developed by Sir Lindsay Owen-Jones.

High growth in the worldwide cosmetics market

Market growth accelerated in 2006, demonstrating the robust health of our businesses. Growth slowed in North America, but is moving forward again in Western Europe and has accelerated further in the rest of the world.

The continuing increase in scale of the new markets should generate its own momentum, moving world market growth up a gear. In our estimation, the gradual rise in household income in these countries should mean that each year some 70 million consumers will be able to buy our products for the first time.

This is an exceptional opportunity for L'Oréal because in each area we have an ideal portfolio of diversified and complementary brands to penetrate and conquer these new markets. The process of fully globalising our brands is only just beginning.

L'Oréal keeps on growing faster than the market

Once again this year we have seen our sales growth outstrip the market. Like-for-like growth accelerated to +5.8%, edging closer to our long-term growth target range of +6% to +8% a year. Growth based on published figures reached +8.7%, the highest figure since 2000. This added an extra 1.257 billion euros to our 2005 sales, thus increasing our share of the world market from 15% to 15.6%: a very significant rise. All our Divisions strengthened their positions in their respective markets.

The key event was the regeneration of our growth in Western Europe, driven by market share gains in several categories, such as haircare, facial skincare and perfumes. In North America, our sales were affected by restructuring in two distribution channels out of three. 2006 was, however, a source of great satisfaction: L'ORÉAL PARIS rose to third position in make-up and Fructis by GARNIER took second place in the American haircare market, only four years after its launch.

Another historic development was the move of the Rest of the World Zone into second position, ahead of North America. This zone contributed 60% of the group's sales growth. Its growing importance provides dynamic stimulus for L'Oréal's overall sales growth.

Our growth in this zone was strong, driven by spectacular growth in Eastern Europe and in Latin America. In Asia, the breakthrough in China continued. In India, we are ensuring that all our brands tap into the sharp acceleration of this market.

And finally in Japan, although sales edged down slightly, we had some good success stories, showing that even in a difficult and competitive market we can succeed if our product offering is strong and matches local preferences.

The group's growth engine is firing on all six cylinders

Overall, the L'Oréal engine was more efficient—firing on all six cylinders—which meant we could accelerate our growth compared with 2005.

The first cylinder is **technological innovation**: the development by L'Oréal's laboratories of Pro-Xylane™, a revolutionary anti-ageing compound made using green chemistry techniques, is a milestone in the history of anti-ageing skincare.

Introduced into the group's core brands, it gives them a major technological advantage in conquering the "seniors" market. This market is our number one strategic opportunity in developed countries (and features strongly in this Annual Report).

The creation of major products: the international roll-out of blockbusters launched this year will bolster growth in 2007 and beyond.

The enhancement of the value of our products: this has clearly increased in comparison with the last two years.

The power of our brands was strengthened in 2006, with two remarkable breakthroughs in particular: GARNIER sales topped the 2 billion euro mark and GIORGIO ARMANI has been transformed into a global beauty brand, with the target of becoming a major world player in the luxury market over the next few years.

The globalisation of our brands: we have completed our global coverage through new subsidiaries, such as in the Ukraine and Vietnam, and in the largest market in the world, the United States, where we have launched our VICHY brand.

Acquisitions: 2006 was a highly eventful year in this respect with the signing of the Diesel licence agreement enabling us to build up a powerful fragrance business, and with the acquisition of Laboratoires Sanoflore, giving us a foothold in organic cosmetics, a segment which is set to grow strongly worldwide. However, the most important acquisition was The Body Shop, which added to L'Oréal's portfolio a powerful and fully complementary international cosmetics brand with a promising future.



“The growth engine was more efficient and was firing on all six cylinders.”

Another year of strong growth in our results

The trend of our results in 2006 shows the virtue and strength of our business model: in structural terms, the results' trends are very healthy and of remarkably good quality.

2006 was a vintage year in terms of gross profit improvement, thanks to our constant efforts to enhance product value and optimise purchasing and industrial productivity.

The Research and Development budget, an absolute priority for L'Oréal, advanced slightly more rapidly than like-for-like sales.

Advertising and promotion expenses increased to support our core brands and step up advertising expenditure in emerging markets. Lastly, sales, general and administrative expenses again fell (excluding The Body Shop), reflecting the improved efficiency of our organisational structures.

Confidence for the future

We are looking forward to 2007 with confidence and optimism. The strengths behind the quality of the 2006 results will again feature this year. They should enable us to continue the growth cycle, which is spiralling upwards, demonstrating the success of the L'Oréal business model.

Economic success, which is shared with all the company's employees, is essential. But this is not our only goal. Our second aim is to make L'Oréal a model for individual self-fulfilment. Bonded by a common passion for adventure, and a strong and deeply human corporate culture, L'Oréal is a community of talents to which all individuals contribute their creativity, enthusiasm and commitment. It is a community in which we strive for each individual to be able, in return, to obtain the means for his or her professional and personal fulfilment.

“ Making L'Oréal a top performer and one of the world's most respected companies. ”

Overall, the group's operating profit increased by +12.1%. The very even distribution of profitable growth across the Divisions and Zones reflects the solidity of our business model and is extremely promising. Our stake in Sanofi-Aventis again made a strong contribution, with dividends up by +26.7%. Net profit excluding non-recurrent items after minority interests advanced by +11.9% and EPS grew strongly by +14.7%, in part as a result of the accretive effect of share buybacks.

2006 was also a very good year in cash flow terms. On this front too, all the indications are that we shall be able to continue to increase cash flow regularly, which is an essential part of our economic performance.

Our third goal is to make L'Oréal an exemplary company in terms of sustainable development, which is exactly what the leader in beauty care should be. We are already firmly committed to this aim, and we want to go even further, so that L'Oréal fully lives up to its principle to be a good world citizen.

I know I can count on the remarkable commitment and motivation of L'Oréal's teams, who put all their enthusiasm into meeting every kind of beauty need, ensuring the excellence of our products and making L'Oréal not only a top performer but also one of the world's most respected companies.

Jean-Paul Agon
Chief Executive Officer of L'Oréal