PEDEVCO CORP
Form 10-Q
August 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

¨ 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: 000-53725

PEDEVCO CORP.
(Exact name of registrant as specified in its charter)

Blast Energy Services, Inc.
(Former name of registrant as specified in its charter)

Texas	22-3755993
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

4125 Blackhawk Plaza Circle, Suite 201
Danville, California 94506
(Address of Principal Executive Offices)

(855) 733-2685
(Registrant's Telephone Number, Including Area Code)

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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, and 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 ¨ Accelerated filer ¨
Non-accelerated filer ¨ Smaller reporting company x

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes x No ¨

As of August 14, 2012, the Registrant will have 19,339,379 shares of the Registrant's common stock, $0.001 par value per share, issued and outstanding, including 10,268 approved but unissued shares arising from the class action settlement from 2005.

On July 27, 2012, the Registrant completed a merger ("Merger") between Blast Acquisition Corp., a wholly-owned Nevada subsidiary of the Registrant ("MergerCo"), and Pacific Energy Development Corp., a privately-held Nevada corporation ("PEDCO"). As a result of the Merger, the operations and assets of PEDCO became the operations and assets of the Registrant (provided that the Registrant maintained its prior pre-Merger operations and assets). However, as the Merger closed after the date of the financial statements set forth herein, the disclosures and financial statements below relate (except as otherwise provided) to the Registrant's pre-merger operations and assets. For more information regarding PEDCO, including its business, plan of operations, and risk factors regarding its operations readers are encouraged to review the Registrant's Definitive Schedule 14A Proxy Statement filed with the Securities and Exchange Commission on July 3, 2012 (the "Proxy Statement") and the Amended Report on Form 8-K filed with the Securities and Exchange Commission on August 8, 2012.

Unless otherwise indicated or the context otherwise requires, the terms "Company," "we," "us," and "our" refer to PEDEVCO Corp. and its subsidiaries before giving effect to the Merger.

PEDEVCO CORP.

For the Three and Six Months Ended June 30, 2012

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

PEDEVCO CORP.
(FORMERLY BLAST ENERGY SERVICES, INC.)
CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash	$2,186	$19,428
Accounts receivable, net	15,088	16,507
Prepaid expenses and other current assets	39,399	30,472
Total current assets	56,673	66,407
Oil and gas properties – full cost method		
Proved oil and gas properties	1,210,877	1,216,277
Unproved oil and gas properties	696,178	696,178
Less: accumulated depletion	(532,914)	(493,186)
Total oil and gas properties	1,374,141	1,419,269
Equipment, net	366,089	396,754
Total assets	$1,796,903	$1,882,430
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$23,144	$84,196
Accrued expenses	614,318	632,349
Accrued expenses - related parties	9,745	367,763
Note payable - related parties	6,150	106,150
Advances from PEDCO	488,330	87,000
Notes payable - net of discount of $158,018 and $11,944, respectively	1,376,783	1,185,731
Total current liabilities	2,518,470	2,463,189
Long term liabilities:		
Notes payable - related party	-	1,120,000
Asset retirement obligations	41,712	44,160
Total liabilities	2,560,182	3,627,349
Commitments and contingencies	-	-
Stockholders' deficit:		
Series A Preferred Stock, $.001 par value, 25,000,000 shares authorized; 6,000,000 shares issued and outstanding	6,000	6,000
Series B Preferred Stock, $.001 par value, 1 share authorized; 1 share issued and outstanding, respectively	-	-
Common Stock, $.001 par value, 200,000,000 shares authorized; 1,368,201 and 637,731 shares issued and outstanding	1,368	638

Additional paid-in capital	78,095,435	76,459,912
Accumulated deficit	(78,866,082)	(78,211,469)
Total stockholders' deficit	(763,279)	(1,744,919)
Total liabilities and stockholders' deficit	$1,796,903	$1,882,430

See accompanying notes to unaudited consolidated financial statements.

PEDEVCO CORP.
(FORMERLY BLAST ENERGY SERVICES, INC.)
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Six Months Ended June 30, 2012 and 2011
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues	$108,375	$136,543	$226,589	$243,070
Cost of revenues				
Services	-	1,378	-	6,880
Lease operating costs	56,725	65,199	124,078	135,573
Total cost of revenues	56,725	66,577	124,078	142,453
Operating expenses:				
Selling, general and administrative expense	203,296	270,060	394,277	696,574
Depreciation, depletion and amortization	37,221	36,587	73,345	71,503
Total operating expenses	240,517	306,647	467,622	768,077
Operating loss	(188,867)	(236,681)	(365,111)	(667,460)
Other income (expense)				
Gain on settlement of accrued liabilities	62,030	-	62,030	-
Interest expense	(162,141)	(254,300)	(351,532)	(368,075)
Total other expense	(100,111)	(254,300)	(289,502)	(368,075)
Loss from continuing operations	(288,978)	(490,981)	(654,613)	(1,035,535)
Loss from discontinued operations	-	-	-	(3,686)
Net loss	$(288,978)	$(490,981)	$(654,613)	$(1,039,221)
Preferred dividends	59,836	59,836	119,672	119,014
Net loss attributable to common shareholders	$(348,814)	$(550,817)	$(774,285)	$(1,158,235)
Net loss per common share - Basic and diluted:				
Continuing operations	$(0.38)	$(0.86)	$(0.99)	$(1.83)
Discontinued operations	-	-	-	(0.01)
	$(0.38)	$(0.86)	$(0.99)	$(1.84)
Weighted average common shares outstanding:				
Basic and diluted	923,567	637,731	782,220	631,139

See accompanying notes to unaudited consolidated financial statements.

PEDEVCO CORP.
(FORMERLY BLAST ENERGY SERVICES, INC.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2012 and 2011
(unaudited)

	2012	2011
Cash Flows From Operating Activities:		
Net loss	$(654,613)	$(1,039,221)
Loss from discontinued operations	-	3,686
Loss from continuing operations	(654,613)	(1,035,535)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, depletion and amortization - oil and gas	73,345	71,504
Amortization of discount and financing costs	190,754	235,714
Gain on settlement of accrued liabilities	(62,030)	-
Stock-based compensation	-	216,675
Loss on disposal of equipment	-	1,315
Changes in:		
Accounts receivable	1,419	58,160
Prepaid expenses and other current assets	24,174	48,912
Accounts payable	(61,052)	36,858
Accrued expenses	43,999	167,986
Accrued expense – related parties	58,235	47,745
Net cash used in operating activities	(385,769)	(150,666)
Cash Flows From Investing Activities:		
Proceeds from sale of fixed assets	-	11,200
Cash paid for oil and gas properties	-	(1,890,489)
Net cash used in investing activities	-	(1,879,289)
Cash Flows From Financing Activities:		
Payments on short term debt	(32,803)	(305,423)
Borrowings on short term debt, net of financing costs	-	2,153,009
Cash paid for deferred financing costs	-	(135,548)
Advances from PEDCO	401,330	-
Proceeds from warrants exercised	-	7,500
Net cash provided by financing activities	368,527	1,719,538
Net cash used in discontinued operating activities	-	(3,686)
Net change in cash	(17,242)	(314,103)
Cash at beginning of period	19,428	373,470
Cash at end of period	$2,186	$59,367
Cash paid for:		
Interest	$105,646	$63,599
Income taxes	-	-
Non-cash investing and financing transactions:		
Note payable issued to finance insurance	53,893	65,373

Shares issued for accrued expenses	1,636,253	249,000

See accompanying notes to unaudited consolidated financial statements.

PEDEVCO CORP.
(FORMERLY BLAST ENERGY SERVICES, INC.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited interim financial statements of PEDEVCO CORP., formerly Blast Energy Services, Inc. ("PEDEVCO" or the "Company"), have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the rules of the Securities and Exchange Commission ("SEC") and should be read in conjunction with the audited financial statements and notes thereto contained in the Company's latest Annual Report filed with the SEC on Form 10-K. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements that would substantially duplicate disclosures contained in the audited financial statements for the most recent fiscal year, as reported in the Form 10-K, have been omitted.

The Company's consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

NOTE 2 – DESCRIPTION OF BUSINESS

Business. Prior to the closing of the Merger (described below) the Company was primarily seeking to become an independent oil and gas producer with additional revenue potential from its applied fluid jetting ("AFJ") technology. The Company planned to grow operations, initially through the acquisition of oil producing properties, and then eventually through the acquisition of oil and gas properties where its applied fluid jetting process could be used to increase field production volumes and, therefore, the value of the properties in which it owns an interest.

As a part of this shift in strategy, in September 2010, with an effective date of October 1, 2010, the Company completed the acquisition of oil and gas interests in the North Sugar Valley Field located in Matagorda County, Texas, and in October 2010, the Company entered into a Letter of Intent with Solimar Energy LLC as described in Note 7 below. The Company also determined that the Satellite Services business was no longer a strategic part of the Company's future and steps were taken to divest this business unit further discussed in Note 14.

On January 13, 2012, the Company entered into an Agreement and Plan of Reorganization with Blast Acquisition Corp., a newly formed wholly-owned Nevada subsidiary of the Company ("MergerCo"), and Pacific Energy Development Corp., a privately-held Nevada corporation ("PEDCO"), pursuant to which MergerCo was to be merged with and into PEDCO, with PEDCO being the surviving entity and becoming a wholly-owned subsidiary of the Company, in a transaction structured to qualify as a tax-free reorganization (the "Merger"). The Merger closed on July 27, 2012.

In connection with the Merger in July 2012, we subsequently issued former security holders of PEDCO 17,917,261 shares of common stock, 19,716,676 shares of new Series A Preferred Stock (as defined below), warrants to purchase an aggregate of (1) 100,000 shares of common stock with an exercise price of $0.08 per share; (2) 500,000 shares of common stock with an exercise price of $1.25 per share; (3) 500,000 shares of common stock with an exercise price of $1.50 per share; (4) 20,000 shares of common stock with an exercise price of $0.75 per share, to former common stock warrant holders of PEDCO; and (5) 692,584 shares of new Series A Convertible Preferred Stock with an exercise price of $0.75 per share to former Series A Convertible Preferred Stock warrant holders of PEDCO; and options to purchase an aggregate of 470,000 shares of common stock with an exercise price of $0.08 per share;

365,000 shares of common stock with an exercise price of $0.10 per share; and 3,400,000 shares of the Company's common stock with an exercise price of $0.17 per share, to former option holders of PEDCO.

Additionally, on or around July 27, 2012, the Company filed an Amended and Restated Certificate of Formation with the Secretary of State of Texas, which among other things, changed the Company's name to PEDEVCO Corp., converted all of the Company's outstanding shares of preferred stock into common stock on a one-for-one basis, and effected a reverse split of the Company's issued and outstanding shares on a basis of 1:112, with any fractional shares rounded up on a per shareholder basis. As a result, the Company's shares of issued and outstanding common stock decreased from 153,238,555 shares to 1,411,850 shares. All shares and per share amounts used throughout this report have been retroactively restated for the impact of the reverse split. The Amended and Restated Certificate of Formation also increased the Company's authorized capital stock subsequent to the reverse split from 180,000,000 shares of common stock to 200,000,000 shares of common stock and from 20,000,000 shares of preferred stock to 100,000,000 shares of preferred stock. Finally, on July 27, 2012, the Company filed an Amended and Restated Series A Convertible Preferred designation with the Secretary of State of Texas.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Use of Estimates in Financial Statement Preparation. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as certain financial statement disclosures. While management believes that the estimates and assumptions used in the preparation of the financial statements are appropriate, actual results could differ from these estimates. Significant estimates include those with respect to the amount of recoverable oil and gas reserves, the fair value of financial instruments, oil and gas depletion, asset retirement obligations and stock based compensation.

Revenue Recognition. All revenue is recognized when persuasive evidence of an arrangement exists, the service or sale is complete, the price is fixed or determinable and collectability is reasonably assured. Revenue is derived from the sale of crude oil and down hole services. Revenue from crude oil sales is recognized when the crude oil is delivered to the purchaser and collectability is reasonably assured. Revenue from services is recognized when the service is delivered or completed and collection is reasonably assured. The Company follows the “sales method” of accounting for oil and natural gas revenue, so it recognizes revenue on all natural gas or crude oil sold to purchasers, regardless of whether the sales are proportionate to its ownership in the property. A receivable or liability is recognized only to the extent that the Company has an imbalance on a specific property greater than its share of the expected remaining proved reserves. If collection is uncertain, revenue is recognized when cash is collected. We recognize reimbursements received from third parties for out-of-pocket expenses incurred as service revenues and account for out-of-pocket expenses as direct costs.

Cash Equivalents. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Allowance for Doubtful Accounts. The Company does not require collateral from its customers with respect to accounts receivable, but performs periodic credit evaluations of such customer’s financial condition. The Company determines any required allowance by considering a number of factors including length of time accounts receivable are past due and the Company’s previous loss history. The Company provides reserves for accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. As of June 30, 2012 and December 31, 2011, the Company determined that no allowance for doubtful accounts was required.

Equipment. Equipment is stated at cost less accumulated depreciation and amortization. Maintenance and repairs are charged to expense as incurred. Renewals and betterments which extend the life or improve existing equipment are capitalized. Upon disposition or retirement of equipment, the cost and related accumulated depreciation are removed and any resulting gain or loss is reflected in operations. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which are 3 to 10 years.

Oil and Gas Properties, Full Cost Method. The Company uses the full cost method of accounting for oil and gas producing activities. Costs to acquire mineral interests in oil and gas properties, to drill and equip exploratory wells used to find proved reserves, and to drill and equip development wells, including directly related overhead costs, and related asset retirement costs are capitalized.

Under this method, all costs, including internal costs directly related to acquisition, exploration and development activities, if any, are capitalized as oil and gas property costs on a field by field basis. Sales of oil and gas properties or interests therein are credited against capitalized costs in the full cost pool. Properties not subject to amortization

consist of exploration and development costs which are evaluated on a property-by-property basis. Amortization of these unproved property costs begins when the properties become proved or their values become impaired. The Company will assess the probability of realization of unproved properties, if any, on at least an annual basis or when there has been an indication that impairment in value may have occurred. Impairment of unproved properties is assessed based on management's intention with regard to future exploration and development of individually significant properties and the ability of the Company to obtain funds to finance such exploration and development. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized. Costs of oil and gas properties are amortized using the units of production method.

Ceiling Test. In applying the full cost method, the Company performs an impairment test (ceiling test) at each reporting date, whereby the carrying value of oil and gas property and equipment is compared to the "estimated present value" of its proved reserves, discounted at a 10% interest rate of future net revenues based on current operating conditions at the end of the period and the average, first day of the month price received for oil and gas production over the preceding 12 month period, plus the cost of properties not being amortized, plus the lower of cost or fair market value of unproved properties included in costs being amortized, less the income tax effects related to book and tax basis differences of the properties.

Impairment of Long-Lived Assets. The Company reviews the carrying value of its long-lived assets (other than oil and gas properties, which are subject to a quarterly ceiling test impairment analysis) annually or whenever events or changes in circumstances indicate that the historical cost-carrying value of an asset may no longer be appropriate. The Company assesses recoverability of the carrying value of the asset by estimating the future net undiscounted cash flows expected to result from the asset, including eventual disposition. If the future net undiscounted cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and estimated fair value.

Accounting for Asset Retirement Obligations. If a reasonable estimate of the fair value of an obligation to perform site reclamation, dismantle facilities or plug and abandon wells can be made, the Company will record a liability (an asset retirement obligation or ARO) on its consolidated balance sheet and capitalize the present value of the asset retirement cost in oil and gas properties in the period in which the retirement obligation is incurred. In general, the amount of an ARO and the costs capitalized will be equal to the estimated future cost to satisfy the abandonment obligation assuming the normal operation of the asset, using current prices that are escalated by an assumed inflation factor up to the estimated settlement date, which is then discounted back to the date that the abandonment obligation was incurred using an assumed cost of funds for the Company. After recording these amounts, the ARO will be accreted to its future estimated value using the same assumed cost of funds and the capitalized costs are depreciated on a unit-of-production basis within the related full cost pool. Both the accretion and the depreciation will be included in depreciation, depletion and amortization expense on our consolidated statements of operations.

Fair Value of Financial Instruments. The carrying amount of the Company's cash, accounts receivables, accounts payables, and accrued expenses approximates their estimated fair values due to the short-term maturities of those financial instruments. Management believes the fair value of the promissory notes entered into in connection with the funding arrangement for the Guijarral Hills Exploitation Project approximates the fair value due to the short-term nature of the instruments.

Income Taxes. The Company utilizes the asset and liability method in accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for operating loss and tax credit carry-forwards and for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that the value of such assets will be realized.

Stock-Based Compensation. Pursuant to the provisions of FASB ASC 718, Compensation – Stock Compensation, which establishes accounting for equity instruments exchanged for employee service, we utilize the Black-Scholes option pricing model to estimate the fair value of employee stock option awards at the date of grant, which requires the input of highly subjective assumptions, including expected volatility and expected life. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. These assumptions are subjective and generally require significant analysis and judgment to develop. When estimating fair value, some of the assumptions will be based on, or determined from, external data and other assumptions may be

derived from our historical experience with stock-based payment arrangements. The appropriate weight to place on historical experience is a matter of judgment, based on relevant facts and circumstances.

The Company estimates volatility by considering the historical stock volatility. The Company has opted to use the simplified method for estimating expected term, which is generally equal to the midpoint between the vesting period and the contractual term.

Earnings or Loss per Share. Basic earnings per share equal net earnings or loss divided by weighted average common shares outstanding during the period. Diluted earnings per share include the impact on dilution from all contingently issuable shares, including options, warrants and convertible securities. The common stock equivalents from contingent shares are determined by the treasury stock method. The Company incurred a net loss for the six month periods ended June 30, 2012 and 2011 and therefore, basic and diluted earnings per share for those periods are the same as all potential common equivalent shares would be anti-dilutive.

Recently Issued Accounting Pronouncements. There were various accounting standards and interpretations issued during 2012 and 2011, none of which are expected to have a material impact on the Company's financial position, operations or cash flows.

Subsequent Events. We evaluated all transactions from June 30, 2012 through the financial statement issuance date for the subsequent event disclosure.

NOTE 4 - MERGER AGREEMENT – PACIFIC ENERGY DEVELOPMENT CORP.

On January 13, 2012, the Company entered into an Agreement and Plan of Reorganization (the "Merger Agreement") with Blast Acquisition Corp., a newly formed wholly-owned Nevada subsidiary of the Company ("MergerCo"), and Pacific Energy Development Corp., a privately-held Nevada corporation ("PEDCO"), pursuant to which MergerCo was to merge with and into PEDCO, with PEDCO being the surviving entity and becoming a wholly-owned subsidiary of the Company, in a transaction structured to qualify as a tax-free reorganization (the "Merger"). Pursuant to the Merger Agreement, prior to the effective time of the Merger (the "Effective Time"), the Company was required to amend its Certificate of Formation and Designation to: (i) convert all outstanding shares of the Company's Series A Convertible Preferred Stock and Series B Preferred Stock into common stock of the Company on a one to one basis, and immediately thereafter, (ii) effectuate a reverse stock split, with the end result being that the Company would not have more than 2,400,000 shares of common stock issued and outstanding on a fully-diluted basis prior to the Merger (the "Shares Limit"), which include the converted preferred stock, converted debt securities (as described below), and all options and warrants issued but not exercised (the "Reverse Split" and the "Amendment"). Furthermore, in connection with the Reverse Split and the Amendment, the Company agreed to change its name to "PEDEVCO Corp.", and amend its Certificate of Formation and Designation, so that the Company shall have an authorized capitalization consisting of 300,000,000 shares of capital stock post-Reverse Split, which shall consist of 200,000,000 shares of common stock, $0.001 par value per share ("Common Stock"); and 100,000,000 authorized shares of Preferred Stock, including (a) 25,000,000 authorized shares of Series A Convertible Preferred Stock, $0.001 par value per share ("new Series A Preferred Stock"), which shares shall be designated in connection with the amendment to the Certificate of Formation and Designation and which shall amend and replace the currently designated Series A and Series B Preferred Stock designations, and have such terms and conditions as described in the Form of Amended and Restated Certificate of Formation and Designation.

In addition, prior to the closing of the Merger, PEDCO agreed to advance certain transaction-related fees and expenses to the Company.

The Merger closed on July 27, 2012, at which time MergerCo merged into PEDCO, with the stockholders of PEDCO receiving one (1) share of the Company's post-Reverse Split Common Stock or new Series A Preferred Stock, as applicable, for each share of PEDCO Common Stock or PEDCO Series A Convertible Preferred Stock then held by the PEDCO shareholders and all outstanding warrants and options of PEDCO at the Effective Time being assumed by the Company. As a result of the Merger, the stockholders of PEDCO received approximately 95% of the issued and

outstanding capital stock of the Company in the Merger.

BMC Debt Conversion

In connection with the Merger Agreement, on January 13, 2012, the Company entered into a Debt Conversion Agreement (the “BMC Debt Conversion Agreement”) with Berg McAfee Companies, LLC (“BMC”), and Clyde Berg, (“Berg”). The Company had previously entered into: (1) a Secured Promissory Note Agreement, dated February 27, 2008, as amended on January 5, 2011 with BMC in the aggregate principal amount of $1,120,000 (the "BMC Note"); and (2) a Promissory Note, dated May 19, 2011, with Berg in the aggregate principal amount of $100,000 (the "Berg Note" and collectively with the BMC Note, the “Notes”).

The BMC Debt Conversion Agreement modified the Notes to provide that all principal and accrued interest under the Notes shall be converted into shares of the Company's Common Stock at a conversion price of $2.24 per share (the "Conversion"). On May 29, 2012, BMC and Berg entered into a "First Amendment to the Voting Agreement and Debt Conversion Agreement" (the "Amendment"). On June 26, 2012, the outstanding principal under the Notes, consisting of $1,120,000 under the BMC Note and $100,000 under the Berg Note and accrued interest of $416,253, comprised of $388,553 under the BMC Note and $27,700 under the Berg Note was converted into 730,470 shares of the Company's Common Stock.

Debt Modifications

In connection with the Merger, on January 13, 2012, the Company entered into the Amendment to Note Purchase Agreement (the "Note Purchase Amendment"), and on May 29, 2012, the Company entered into the Second Amendment to First Tranche Promissory Note and the Second Amendment to the Second Tranche Promissory Note (collectively, the "Second Amendments to the Promissory Notes"), with the Lender in connection with the Company's debt obligations under certain secured notes with the Lender. The Note Purchase Amendment and the Second Amendments to the Promissory Notes amended the Note Purchase Agreement, dated February 24, 2011 (the "Note Purchase Agreement") primarily in order (i) to grant consent to the Merger Agreement, (ii) to waive, solely with respect to the Company post-Merger, certain loan covenants and restrictions as they relate to the assets of PEDCO and the operations of the Company post-Merger, (iii) to waive the Lender's right of first refusal to provide additional funding to the Company; and (iv) to provide for the conversion of up to 50% of the loan amounts outstanding to the Lender in the original principal amount of $2,522,111, of which approximately $1,306,078 was owed as of the date of the parties entry into the Note Purchase Amendment, into shares of the Company's Common Stock at $0.75 per share at the option of Lender at any time after June 9, 2012, provided that the Company in its sole discretion may waive the 50% conversion limitation. The conversion rights described above are subject to the Lender being prohibited from converting any portion of the outstanding notes which would cause it to beneficially own more than 4.99% of the Company's then outstanding shares of common stock, subject to the Lender's right to increase such limit to up to 9.99% of the Company's outstanding shares with 61 days prior written notice to the Company.

The Promissory Notes issued in connection with the Note Purchase Amendment were amended to provide an extension of the maturity date of such Promissory Notes, which were due February 2, 2012 under the terms of the original notes, to the earlier of (i) thirty (30) days after the termination of the Merger Agreement, if the Merger Agreement is terminated before June 1, 2012, (ii) August 1, 2012, or (iii) the date all obligations and indebtedness under such Promissory Notes are accelerated in accordance with the terms and conditions of such Promissory Notes. Furthermore, commencing February 2, 2012, the interest amount on the Promissory Notes was increased from 10% to 18% per annum, and the new interest rate includes both the principal amount and the Exit Fee payable below, and as further described under the Promissory Notes. Lastly, the Exit Fee, which is 12% of the repayment amount, was increased by an aggregate of $15,000 for the Promissory Notes and was expensed by the Company at modification.

The Company is currently working with Centurion on payment terms including extending the maturity date and converting a portion of the outstanding loan balance to the Company's common stock.

Other Debt Conversions

In connection with the Merger, the Company further approved the conversion of certain other outstanding debt obligations of the Company at $2.24 per share. As of June 30, 2012, these debt obligations include: $335,500 of accrued compensation due to the members of Board of Directors, $6,150 of short term loans from members of the Board of Directors, and $225,958 of accrued salaries and vacation pay owed to the Company's employees for a total amount of $567,608. These amounts will convert at $2.24 per share under debt conversion agreements ("Debt Conversion Agreements") into approximately 253,396 shares of the Company's Common Stock shortly after the date of

this filing. Additionally, in May 2012, in a settlement amongst the principals for Trident, the placement fee owed by the Company was reduced from $119,990 to $47,960 and Trident agreed to convert the remaining amount due at $2.24 per share into approximately 21,411 shares of the Company's Common Stock upon completion of the Merger.

Advances from PEDCO

For the twelve month period ended December 31, 2011, the Company received $87,000 in advances from PEDCO to fund the merger transaction-related fees and expenses. During the six month period ended June 30, 2012, the Company received an additional $401,330 in advances from PEDCO for the same purpose resulting in a total advance as of June 30, 2012 of $488,330. The advances were non-interest bearing and will be eliminated as the result of completion of merger.

NOTE 5 - EQUIPMENT

Equipment consists of the following as of June 30, 2012 and December 31, 2011:

Description	Life		June 30, 2012		December 31, 2011
Computer equipment	3 years	$	-0-	$	7,987
Tractor	4 years		15,518		15,518
Service Trailer	5 years		4,784		4,784
AFJ Rig	10 years		712,133		712,133
Equipment			732,435		740,422
Less: Accumulated depreciation			(366,346)		(343,668)
Equipment, net		$	366,089	$	396,754

During the six months ended June 30, 2012, we evaluated the carrying value of the AFJ rig and, based upon our analysis, no impairment was warranted.

NOTE 6 – OIL AND GAS PROPERTIES

Guijarral Hills Exploitation Project

In October 2010, the Company entered into a letter of intent with Solimar Energy LLC (“Solimar”), which provides the Company the right to participate in a field extension drilling project to exploit an undeveloped acreage position in the Guijarral Hills Field located in the San Joaquin basin of central California. Solimar is a wholly-owned subsidiary of Solimar Energy Limited, a publicly-traded company on the Australia Stock Exchange based in Melbourne, Australia. Pursuant to the letter of intent, the Company paid Solimar a non-refundable fee of $100,000 in return for the exclusive right for a period of 90 days to execute a definitive agreement.

In February 2011, the Company entered into a farmout agreement with Solimar, whereby the Company will participate in the Guijarral Hills project on a promoted basis of 66-2/3 percent (%) of the costs to drill and complete the initial planned exploratory well. After the drilling of the initial well, the Company will earn a 50% working interest, with a net revenue interest of 38% in the entire project’s acreage position and will be required to contribute on an equal heads up basis (i.e., 50% of all costs) on any additional wells that may be drilled in the project.

In March 2011, the Solimar Energy 76-33 well in the Guijarral Hills Field reached its total drilling depth of 10,550 feet. In May 2011, Solimar commenced completion operations, by perforating and flow testing three potentially hydrocarbon bearing sands encountered in the drilling process. However, the zones tested did not result in an oil producing well.

On December 22, 2011, the Company entered into a Modification Agreement ("Modification Agreement") with Solimar. The Modification Agreement amended certain existing agreements, including the Guijarral Hills Farmout Agreement and the related Guijarral Hills Joint Operating Agreement ("JOA") with Solimar, which provided the Company the right to participate in a field extension drilling project to exploit an undeveloped acreage position in the Guijarral Hills Field located in the San Joaquin basin of central California. Solimar purchased 25% of the 100% working interest in the Solimar Energy 76-33 Well (modifying the Farmout Agreement which provided for the Company to hold 50% of the 100% working interest), and the Company agreed to participate on all go-forward costs associated with the Guijarral Hills project on a heads up 25% of 100% basis (governed by the JOA) in exchange for $311,872 of unpaid drilling costs.

The Farmout Agreement and subsequent participation in the Solimar Energy 76-33 well is reported in the balance sheet under "Unproved oil and gas properties, not subject to amortization."

NOTE 7 – NOTES PAYABLE

Related Party Transactions

Related Party Advances

The Company was advanced $2,050 from Michael Peterson, former Interim President and CEO, and $2,050 each from Pat Herbert and Don Boyd, directors of the Company, for the purpose of paying the Company's Directors' and Officers' insurance premiums in the month of September 2011. These advances are noninterest bearing, unsecured and are due on demand (reflected as Accrued expenses – related parties in the accompanying balance sheet).

Promissory Note with Clyde Berg

On May 19, 2011, the Company entered into a $100,000 promissory note with Clyde Berg, a significant shareholder. The note carries a 25% interest rate, has a one-year term and the Company's performance under the note was guaranteed by Eric McAfee, another affiliate of Berg McAfee Companies, LLC. The proceeds from this note were used to partially pay the cost of testing operations on the Solimar Energy 76-33 well. On June 26, 2012, the promissory note and accrued interest thereon was converted into 57,009 shares of Common Stock. See Note 4.

AFJ Note

On July 15, 2005, the Company entered into an agreement to develop its initial applied jetting rig with Berg McAfee Companies, LLC ("BMC"). The arrangement involved two loans for a total of $1 million to fund the completion of the initial rig and sharing in the expected rig revenues for a ten-year period. Under the terms of the loan agreement with BMC, cash revenues will be shared on the basis of allocating 90% to the Company and 10% to BMC for a ten-year period following repayment. After ten years, the Company will receive all of the revenue from the rig. BMC also has the option to fund an additional three rigs under these commercial terms.

In 2008, BMC extended the term for the $1 million Note secured on the Applied Fluid Jetting rig for three years. The revised Note was issued for $1.12 million, including accumulated interest, and carries an 8% interest rate and was convertible into common stock at $22.40 per share.

On January 5, 2011, the Company and BMC agreed to (a) enter into Amendment No. 1 to the February 27, 2008 Promissory Note, pursuant to which the Company owed BMC, $1.12 million (the "Amended Note"); and (b) to amend the terms of the Company's Series A Convertible Preferred Stock (the "Preferred Stock") to provide for a reduction in the conversion price of such Preferred Stock from $56.00 per share to $22.40 per share (the "Amendment").

The Amended Note revised and amended the terms of the original note, entered into between the Company and BMC on February 27, 2008, to extend the maturity date of such note from February 27, 2011, to February 27, 2013; to increase the amount of notice the Company is required to provide BMC in the event the Company desires to prepay the note from five (5) days to thirty (30) days; to subordinate the security for such note to the Company's obligations due to and in connection with the drilling and completion of the Guijarral Hills development project and the payoff of the Company's $300,000 promissory note due to Sun Resources Texas, Inc.; and to provide BMC the right to convert the amount outstanding under the Note into shares of the Company's common stock at a reduced rate of $8.96 per share, rather than $22.40 per share as provided for in the original note agreement.

The Company evaluated the terms of the Amended Note and determined that, due to the change in the common stock conversion rate, the original note had been extinguished and consequently, the Amended Note would be recorded at its current fair value. Based upon the new common stock conversion rate, which was equivalent to the Company's closing stock price at January 5, 2011, the Company determined that the Amended Note had a fair value of $1,120,000, based upon the value of the Company's common stock, the Amended Note could be converted into at the date of the amendment. Therefore, no gain or loss was recognized.

On June 26, 2012, the promissory note and accrued interest thereon was converted into 673,461 shares of Common Stock. See Note 4. In conjunction with the conversion, the revenue sharing agreement for the AFJ rig was eliminated.

Third Party Transactions

Promissory Note - North Sugar Valley Field

Under the terms of the sales agreement with Sun, the Company issued an interest free promissory note for $300,000 payable at a rate of $10,000 per month commencing October 31, 2010, with the final balance payable in full on or before October 8, 2011. The promissory note is secured by a lien against the North Sugar Valley Field.

As the promissory note is noninterest bearing, the Company discounted the promissory note to its estimated net present value using an 8% interest rate, which the Company believes is representative of its incremental cost of borrowing given the secured nature of the promissory note. The resulting discount of $18,902 was to be amortized using the effective interest rate method over the term of the promissory note.

In February 2011, this note was paid in full.

Lending Arrangement

On February 24, 2011 (the "Closing"), the Company entered into the Note Purchase Agreement and related agreements (as described below) with Centurion Credit Funding LLC ("the Lender") to fund its Guijarral Hills project and to repay the Sun promissory note. Pursuant to the Purchase Agreement, the Company agreed with the Lender to enter into the Promissory Notes in the aggregate principal amount of $2,522,111, with a Senior Secured Promissory Note in the amount of $2,111,111 (the "First Note") delivered to the Lender at the Closing and a second Note delivered in April 2011 in the amount of $411,000 (the "Second Note").

The Company granted the Lender a right of first refusal to provide the Company with additional funding on such terms and conditions as the Company may receive from third parties, until the later of (a) one year from the date that the Promissory Notes are repaid in full; or (b) such time as the Company ceases paying a Royalty to the Lender pursuant to the Royalty Agreement (described below).

The Company also agreed that if the test well on the project failed to achieve an initial production average of at least 350 barrels of oil equivalent per day for the 30-day period commencing on the first day on which the Test Well is at full production, the Company would issue to the Lender a common stock purchase warrant to purchase up to 107,143 shares of the Company's common stock (the "Warrant"). The Warrant will have a term of two years, and provide for cashless exercise rights in the event the shares of common stock issuable upon exercise of the Warrant are not registered with the Commission. The Warrant will also contain certain anti-dilution provisions and will have an exercise price, in the event it is granted, equal to the weighted average of the trading price of the Company's common stock over the ten day period prior to the grant date. The Warrant was granted in October 2011. In April 2012, the warrant agreement was further amended to provide that the lowest exercise price of the warrant is $1.12 per share. As a result of this warrant grant and under the terms of the finder fee agreement with Trident Partners, they have earned warrants to purchase 10,714 shares under the same terms.

The Company delivered to the Lender the First and Second Notes in the amount of $2,111,111 and $411,000 at the Closing. The Company paid an aggregate original issue discount to the Lender on the notes of 10%, or $252,211 (the "Original Issue Discount"). The notes accrue interest at the rate of ten percent (10%) per annum.

The terms of this note were amended in February 2012 and May 2012 as described above. The Company also agreed to pay the Lender an exit fee at such time as the First Note is paid in full of twelve percent (12%) of the amount of

such repayment (the “Exit Fee”).

The Company incurred $381,506 in legal and finders’ fees associated with the lending arrangement, which has been recorded as deferred financing costs to be amortized over the term of the notes. Net proceeds to the Company after the original issue discount, reimbursement of the lender’s legal fees and the Company’s own expenses were approximately $1.6 million with an effective interest rate of approximately 36%.

Stock Purchase Agreement

As additional security for the repayment of the Loans, and pursuant to a Stock Purchase Agreement, the Company sold the Lender one (1) share of its newly designated Series B Preferred Stock, in consideration for $100, which entitles the Lender to consent to and approve the Company's or any of its subsidiaries' entry into any bankruptcy proceeding, consent to the appointment of a receiver, liquidator or trustee or the assignment by the Company or any of its subsidiaries for the benefit of any creditors. The Company assigned no value to this Series B Preferred Share. The one share of the Company's Series B Preferred Stock was converted on a one-for-one basis into one (1) share of the Company's pre Reverse Split common stock in connection with the Merger. See Note 16.

Royalty Payment Letter

As additional consideration for the Lender agreeing to make the Loans, the Company agreed to a Royalty Payment Letter (the "Royalty Payment Letter") to pay the Lender 30% of all amounts earned (the "Royalty") by the Company under the initial test well.

In connection with the Merger in July 2012 the Company is planning to convert the other outstanding debt obligations that are covered by debt conversion agreements into common stock. See Note 4.

NOTE 8 – COMMITMENTS

Placement Agreement

In November 2010, the Company entered into a non-exclusive Placement Agent Agreement with Trident Partners Ltd. ("Trident" and the "Placement Agreement"). Pursuant to the Placement Agreement, certain principals of Trident were granted fully vested warrants, exercisable for one year from the date of the agreement, to purchase up to 6,696 shares of the Company's common stock at an exercise price of $1.12 per share. All of the warrants were exercised during 2011.

Additionally, the Company agreed to pay Trident a cash fee of 10% of the proceeds received from the sale of any equity or equity-linked securities to any party introduced by Trident; warrants to purchase shares of common stock equal to 10% of the total number of shares of common stock sold or granted in connection with any funding (on similar terms as the Placement Warrants); and the Company agreed to grant Trident a net revenue interest equal to 10% of any revenue interest provided to any investors in any closing (the "Placement Fees"). The requirement to pay the Placement Fees in connection with any subsequent investment by an investor continues in effect for 12 months following the expiration of the Placement Agreement on or about February 15, 2011.

On May 18, 2011, the Company amended the Placement Agent Agreement to eliminate the provision for the contingent grant of a 10% net revenue interest in oil and gas properties in exchange for the issuance of fully vested warrants to purchase 3,571 shares with a term of two years and an exercise price of $1.12 per share. The Company recorded $44,528 as share-based compensation for the issuance of the warrants.

On December 22, 2011, the Company granted additional fully vested warrants to purchase 10,714 shares of restricted common stock to Trident in connection with capital raising services rendered in February 2011 and December 2011. The warrants are exercisable for $1.12 per share of common stock and have a one (1) year term. The Company recorded $9,406 as share-based compensation for the issuance of the warrants.

In May 2012, Trident, various affiliates of Trident and the Company agreed to enter into settlement agreements to release each other from any ongoing claims and obligations. Pursuant to the settlement agreements, the $119,990 finder's fee payable to Trident was reduced to $47,960 by the payment in early May 2012 of $10,000 to Trident and

certain affiliates (provided that we reserved the right to convert such unpaid fees into shares of our common stock at the rate of $2.24 per share at any time upon notice from the Company prior to December 31, 2012). Based upon the common stock conversion rate, which was more than the Company's closing stock price in the month of May 2012, the Company determined no gain or loss was recognized. The settlement will result in a gain from a reduction in payables in the amount of $62,030 and is reflected as other income in the accompanying statement of operations.

NOTE 9 – PREFERRED STOCK – RELATED PARTIES

Series A Convertible Preferred Stock – Pre-Merger

The Series A Preferred Stock (the "Preferred Stock") accrue dividends at the rate of 8% per annum, in arrears for each month that the Preferred Stock is outstanding. The Company has the right to pay any or all of the accrued dividends at any time by providing the holders of the Preferred Stock at least five days written notice of their intent to pay such dividends. The shares of Series A Preferred Stock shall have the same voting rights as those accruing to the common stock and shall vote based upon the number of underlying shares of common stock that the holder owns at the effective date of the vote. In the event of any liquidation, dissolution or winding up of the Company, either voluntary or involuntary, the holders of the Preferred Stock shall be entitled to receive, prior and in preference to, any distribution of any of the assets of the Company to the holders of the common stock by reason of their ownership of such stock.

The Preferred Stock and any accrued and unpaid dividends, have optional conversion rights into shares of the Company's common stock at a conversion price of $0.20 per pre-Reverse Split share. The Preferred Stock automatically converts if the Company's common stock trades for a period of more than twenty (20) consecutive trading days at a price greater than $3.00 per share and if the average trading volume of the Company's common stock exceeds 50,000 shares per day.

As of June 30, 2012, the aggregate and per pre-Reverse Split share arrearages on the outstanding Preferred Stock were $1,092,822, and $0.18 per share respectively, which includes dividends in arrearage of $50,630 related to 2,000,000 preferred shares that were redeemed in October 2008.

Series A Convertible Preferred Stock – Post- Merger

In July 2012, in connection with the filing of the Amended and Restated Certificate of Formation, the outstanding Series A Preferred Stock converted into pre-Reverse Split shares of the Company's common stock on a one-for-one basis. On July 27, 2012, the Company filed an Amended and Restated Series A Convertible Preferred designation with the Secretary of State of Texas (the "new Series A Preferred Stock").

The holders of the shares of our new Series A Preferred Stock will be entitled to receive non-cumulative dividends at an annual rate of 6% of the "Original Issue Price" per share for the new Series A Preferred Stock, which is $0.75 per share (as appropriately adjusted for any recapitalizations). These dividends will only accrue and become payable if declared by our Board of Directors in its discretion. The right to receive dividends on shares of Series A Preferred Stock will not be cumulative, and no right to such dividends will accrue to holders of Series A Preferred Stock by reason of the fact that dividends on said shares are not declared or paid in any calendar year. All declared but unpaid dividends of the shares of new Series A Preferred Stock will be payable in cash upon conversion of such shares. Any dividends declared on our new Series A Preferred Stock will be prior and in preference to any declaration or payment of any dividends or other distributions on our common stock. In the event of any liquidation, dissolution or winding up of our Company, either voluntary or involuntary, the holders of our new Series A Preferred Stock will be entitled to receive distributions of any of our assets prior and in preference to the holders of our common stock in an amount per share of new Series A preferred stock equal to the sum of (i) the Original Issue Price of $0.75 per share, and (ii) all declared but unpaid dividends on such shares of new Series A Preferred Stock. Each share of new Series A Preferred Stock will be convertible at the option of the holder into that number of fully-paid, nonassessable shares of common stock determined by dividing the "Original Issue Price" for the new Series A preferred stock by the conversion price of $0.75 per share (subject to adjustment). Therefore, each share of new Series A Preferred Stock will initially be convertible into one share of our common stock. Our shares of new Series A Preferred Stock will automatically convert into shares of common stock according to the conversion rate described above upon the first to occur of (i) the consent of a majority of the outstanding shares of Series A Preferred Stock or (ii) the date on which the new Series A

Preferred Stock issued on the original issuance date to holders who are not affiliates of the Company may be re-sold by such holders without registration in reliance on Rule 144 promulgated under the Securities Act of 1933, as amended, or another similar exemption. The holders of our new Series A Preferred Stock will vote together with the holders of our common stock as a single class (on an “as converted” basis) on all matters to which our shareholders have the right to vote, except as may otherwise be required by law.

Series B Preferred Stock

As additional security for the repayment of the Promissory Notes and pursuant to a Stock Purchase Agreement in 2011, the Company sold the Lender one (1) share of its newly designated Series B Preferred Stock, in consideration for $100, which entitled the Lender to consent to and approve the Company's or any of its subsidiaries entry into any bankruptcy proceeding, consent to the appointment of a receiver, liquidator or trustee or the assignment by the Company or any of its subsidiaries for the benefit of any creditors. The shares of Series B Preferred Stock shall have the same voting rights as those accruing to the common stock and shall have the right to vote one share of Series B Preferred Stock for each share held by the holders of Series B Preferred Stock, on all matters which come before a vote of the common stock holders. The holder of the Series B Preferred Stock share shall be entitled to receive and to be paid out of the assets of the Company available for distribution to its stockholders, before any payment or distribution shall be made on the common stock of the Company or on any other class of stock ranking junior to the Series B Preferred Stock upon liquidation. In July 2012, in connection with the filing of the Amended and Restated Certificate of Formation, the outstanding Series B Preferred Stock converted into one pre-Reverse Split share of the Company's common stock.

NOTE 10 – COMMON STOCK

Stock Issuances

During the six months ended June 30, 2012, the Company issued 730,470 shares of Common Stock as follows:

- 57,009 shares were issued in connection with the conversion of the Clyde Berg notes payable and accrued interest. See Note 4.
- 673,461 shares were issued in connection with the conversion of the BMC notes payable and accrued interest. See Note 4.

NOTE 11 – STOCK OPTIONS AND WARRANTS

2003 Stock Option Plan

The 2003 Stock Option Plan was replaced by the 2009 Stock Incentive Plan. The number of securities originally grantable pursuant to the 2003 Stock Option Plan was 71,429 shares. Any options granted under the 2003 Stock Option Plan remain in effect. Effective April 1, 2009, all grants of shares have been made from the 2009 Stock Incentive Plan described below.

2009 Stock Incentive Plan

The 2009 Stock Incentive Plan (the "Incentive Plan") authorizes the issuance of various forms of stock-based awards, including incentive or non-qualified options, restricted stock awards, performance shares and other securities as described in greater detail in the Incentive Plan, to the Company's employees, officers, directors and consultants. Options to purchase a total of 44,643 shares were initially authorized to be issued under the Incentive Plan. Effective January 1, 2011, the number of shares available under the Incentive Plan increased by 17,857 shares, and effective January 1, 2012, the number of shares available under the Incentive Plan increased by an additional 17,857 shares. As of June 30, 2012, 17,857 shares have been granted under this plan.

During the six months ended June 30, 2012, no options were granted by the Company.

During the six month period ending June 30, 2012, the Company recognized stock-based compensation expense of $-0-. The remaining amount of unamortized option expense at June 30, 2012 is $-0-. The intrinsic value of

outstanding as well as exercisable options at June 30, 2012 was $-0-.

Activity in options during the six-month period ended June 30, 2012 and related balances outstanding as of that date are reflected below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Term (# years)
Outstanding at January 1, 2012	38,918	$ 41.72	
Granted	0	0	
Exercised	0	0	
Forfeited and cancelled	0	0	
Outstanding at June 30, 2012	38,918	$ 41.72	5.34
Exercisable at June 30, 2012	38,918	$ 41.72	5.34

Warrants

During the six-month period ended June 30, 2012, the Company recognized share-based compensation expense of $-0-. The remaining amount of unamortized warrant expense at June 30, 2012 was $-0-. The intrinsic value of outstanding as well as exercisable warrants at June 30, 2012 was $-0-.

Activity in warrants during the six months ended June 30, 2012 and related balances outstanding as of that date are reflected below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Term (# years)
Outstanding at January 1, 2012	206,206	$ 47.85	
Granted	0	0	
Exercised	0	0	
Expired	0	0	
Forfeited and cancelled	0	0	
Outstanding at June 30, 2012	206,206	$ 47.85	1.18
Exercisable at June 30, 2012	206,206	$ 47.85	1.18

PEDCO 2012 Equity Incentive Plan

As a result of the Merger, the Company assumed the PEDCO 2012 Equity Incentive Plan (the “PEDCO Incentive Plan”), which was adopted by PEDCO on February 9, 2012. The PEDCO Incentive Plan authorized PEDCO to issue an aggregate of 3,000,000 shares of common stock in the form of restricted shares, incentive stock options, non-qualified stock options, share appreciation rights, performance share, and performance unit under the PEDCO Incentive Plan. As of June 30, 2012, options to purchase 1,345,000 shares of PEDCO common stock and 1,655,000 shares of PEDCO restricted common stock had been granted under this plan (all of which were granted by PEDCO prior to the closing of the Merger, with such grants being assumed by the Company and remaining subject to the PEDCO Incentive Plan following the consummation of the Merger). The Company does not plan to grant any additional awards under the PEDCO Incentive Plan post-Merger.

NOTE 12 – CONTINGENCIES

Quicksilver Resources Lawsuit

In September 2008, the Company and Eagle Domestic Drilling Operations LLC, our wholly-owned subsidiary (“Eagle”), entered into a Compromise Settlement and Release Agreement with Quicksilver Resources, Inc. (“Quicksilver”) to resolve the pending litigation and the parties agreed to release all claims against one another and certain related parties. Quicksilver agreed to pay Eagle a total of $10 million which has been received to date, including $2 million ($1.44 million net of associated legal fees) which was received as final payment in September 2011.

General

Other than the aforementioned matters, the Company is not aware of any other pending or threatened legal proceedings. The foregoing is also true with respect to each officer, director and control shareholder as well as any entity owned by any officer, director and control shareholder, over the last five years.

As part of its regular operations, the Company may become party to various pending or threatened claims, lawsuits and administrative proceedings seeking damages or other remedies concerning its' commercial operations, products, employees and other matters. Although the Company can give no assurance about the outcome of these or any other pending legal and administrative proceedings and the effect such outcomes may have on the Company, except as described above, the Company believes that any ultimate liability resulting from the outcome of such proceedings, to the extent not otherwise provided for or covered by insurance, will not have a material adverse effect on the Company's financial condition or results of operations.

NOTE 13 – BUSINESS SEGMENTS

As of June 30, 2012, the Company has two reportable segments: (1) Oil and Gas Producing Properties and (2) Down-hole Solutions. A reportable segment is a business unit that has a distinct type of business based upon the type and nature of services and products offered.

The Company evaluates performance and allocates resources based on profit or loss from operations before other income or expense and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. The table below reports certain financial information by reportable segment:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Oil and Gas Properties	$108,375	$136,543	$226,589	$243,070
Down-hole Solutions	0	0	0	0
Total Revenue	$108,375	$136,543	$226,589	$243,070
Cost of Goods Sold:				
Oil and Gas Properties	$78,614	$86,454	$166,759	$176,234
Down-hole Solutions	15,332	16,710	30,664	37,544
Corporate	203,296	270,060	394,277	696,752
Total Operating expenses	$297,242	$373,224	$591,700	$910,530
Operating profit (loss):				
Oil and Gas Properties	$29,761	$50,089	$59,830	$66,836
Down-hole Solutions	(15,332)	(16,710)	(30,664)	(37,544)
Corporate	(203,296)	(270,060)	(394,277)	(696,752)
Operating Loss	$(188,867)	$(236,681)	$(365,111)	$(667,460)

NOTE 14 – DISCONTINUED OPERATIONS

On December 30, 2010, the Company entered into an Asset Purchase Agreement with GlobaLogix, Inc. ("GlobaLogix" and the "Purchase Agreement"). Pursuant to the Purchase Agreement, the Company sold all of its Satellite Communications assets, rights and interests, including all goodwill, customer and vendor contracts (collectively "Satellite Contracts"), inventory, test equipment, software and other assets associated with its Satellite Communications operations to GlobaLogix in consideration for (a) $50,000; and (b) GlobaLogix agreeing to assume any and all liabilities, obligations and rights associated with the Satellite Contracts. Additionally, GlobaLogix agreed to offer full-time employment to one of the Company's employees in connection with the Purchase Agreement. The $50,000 payment was received in January 2011.

Pursuant to the Purchase Agreement, the Company also agreed not to compete with GlobaLogix in connection with the Satellite Communications services in the United States or attempt to solicit any employees from GlobaLogix for a period of one year following the closing of the Purchase Agreement.

As a result of the consummation of the Purchase Agreement, the Company no longer has any operations or assets in connection with Satellite Communications and anticipates solely focusing its efforts, resources and operations moving forward on its Down-hole Solutions and Oil and Gas Production segments.

Net income (loss) from the discontinuance of satellite operations for the three and six months ended June 30, 2012 and 2011 is as follows:

	For the Six Months Ended June 30,	
	2012	2011
Revenues	$ -	$ -
Operating expenses:		
Bad debts expense	-	(3,686)
Total operating expenses	-	(3,686)
Net income (loss) from discontinued operations	$ -	$ (3,686)

At June 30, 2011, bad debt expense of $3,686 was recorded related to a delinquent receivable balance from the discontinued satellite business.

NOTE 15 – SUBSEQUENT EVENTS

Merger with PEDCO

Effective July 27, 2012, the Company completed the transactions contemplated by the January 13, 2012, Agreement and Plan of Reorganization (as amended from time to time, the “Merger Agreement”), by and between the Company, Blast Acquisition Corp., a wholly-owned Nevada subsidiary of the Company (“MergerCo”), and Pacific Energy Development Corp., a privately-held Nevada corporation (“PEDCO”).

Pursuant to the Merger Agreement and effective July 27, 2012, MergerCo was merged with and into PEDCO, with PEDCO continuing as the surviving entity and becoming a wholly-owned subsidiary of the Company, in a transaction structured to qualify as a tax-free reorganization (the “Merger”). In connection with the Merger, we will issue former security holders of PEDCO 17,917,261 shares of common stock, 19,716,676 shares of new Series A Preferred Stock (as defined below), warrants to purchase an aggregate of 1,120,000 shares of our common stock, warrants to purchase 692,584 shares of our new Series A Preferred Stock, and options to purchase 4,235,000 shares of our common stock.

Additionally, immediately prior to the Merger becoming effective, the shareholders of the Company approved an Amended and Restated Certificate of Formation which among other things, changed the Company’s name to PEDEVCO Corp., converted all of the Company’s outstanding shares of preferred stock into common stock on a one-for-one basis, and affected a reverse split of the Company’s issued and outstanding shares on a basis of 1:112, with any fractional shares rounded up on a per shareholder basis the “Reverse Split” and the “Amended and Restated Certificate of Formation”). As a result, the Company’s issued and outstanding common stock decreased from 153,238,555 shares to 1,411,850 shares. All shares and per share amounts used throughout this report have been retroactively revised for the impact of the Reverse Split. The Amended and Restated Certificate of Formation also increased the Company’s authorized capital stock subsequent to the Reverse Split from 180,000,000 shares of common stock to 200,000,000 shares of common stock and from 20,000,000 shares of preferred stock to 100,000,000 shares of preferred stock. Finally, on or around July 27, 2012, the Company filed an Amended and Restated Series A Convertible Preferred designation with the Secretary of State of Texas.

The acquisition is being accounted for as a "reverse acquisition," and Pacific Energy Development Corp. is deemed to be the accounting acquirer in the acquisition. The Company's assets and liabilities are recorded at their fair value. Pacific Energy Development Corp.'s assets and liabilities are carried forward at their historical costs. The financial statements of Pacific Energy Development Corp. are presented as the continuing accounting entity since it is the acquirer for the purpose of applying purchase accounting. The equity section of the balance sheet and earnings per share of Pacific Energy Development Corp. are retroactively restated to reflect the effect of the exchange ratio established in the merger agreement. Goodwill is recorded for the excess of fair value of consideration transferred and fair value of net assets. As a result of the issuance of the shares of common stock pursuant to the merger agreement, a change in control of the Company will occur as a result of the acquisition.

The Company is in the process of valuing the assets acquired and liabilities assumed. Disclosures required by ASC 805, Business Combinations, will be provided once the initial accounting for the merger is complete.

2012 Incentive Plan

On July 27, 2012, the shareholders of the Company approved the 2012 Equity Incentive Plan (the "2012 Incentive Plan"), which was previously approved by the Board of Directors on June 27, 2012, which plan authorizes the issuance of various forms of stock-based awards, including incentive or non-qualified options, restricted stock awards, performance shares and other securities as described in greater detail in the 2012 Incentive Plan, to the Company's employees, officers, directors and consultants. A total of 6,000,000 shares are eligible to be issued under the 2012 Incentive Plan.

Guijarral Hills Exploitation Project

On August 6, 2012, the Company was notified by Solimar Energy, LLC ("Solimar") of Solimar's desire to assign the Guijarral Hills Wells No. 76-33 ("Well") to Vintage Production California LLC ("Vintage"), the lessor of the Well in return for payment of the salvage value of the equipment in the Well. Pursuant to the Guijarall Hills Joint Operating Agreement among Solimar, the Company and Neon Energy Corporation, the Company had 48 hours to respond to this notification as to its intent to either take over the Well and be responsible for all plugging and abandoning and clean-up costs, or in the alternative, agree to assign its interest in the Well to Vintage, who would be responsible for Well plugging, abandoning and clean-up costs. The Company did not respond within the 48 hours and thus gave up its right to take over the Well and agreed to assign its interest in the Well to Vintage. As of August 10, 2012 Solimar had offered the well assignment to Vintage but Vintage had not yet responded as to its intentions whether to accept it or not. The Guijarral Hills Field lease will expire pursuant to its own terms on September 30, 2012.

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

The following discussion of our financial condition and results of operations should be read in conjunction with the accompanying consolidated financial statements and the related footnotes thereto.

Forward-Looking Statements

Some of the statements contained in this report discuss future expectations, contain projections of results of operations or financial condition, or state other "forward-looking" information. The words "believe," "intend," "plan," "expect," "anticipate," "estimate," "project," "goal" and similar expressions identify such a statement was made. These statements are subject to known and unknown risks, uncertainties, and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and is derived using numerous assumptions. Factors that might cause or contribute to such a discrepancy include, but are not limited to the risks discussed in this and our other SEC filings. We do not promise to or take any responsibility to update forward-looking information to reflect actual results or changes in assumptions or other factors that could affect those statements. Future events and actual results could differ materially from those expressed in, contemplated by, or underlying such forward-looking statements.

Merger

On January 13, 2012, the Company entered into an Agreement and Plan of Reorganization with Blast Acquisition Corp., a newly formed wholly-owned Nevada subsidiary of the Company (“MergerCo”), and Pacific Energy Development Corp., a privately-held Nevada corporation (“PEDCO”), pursuant to which MergerCo was to be merged with and into PEDCO, with PEDCO being the surviving entity and becoming a wholly-owned subsidiary of the Company, in a transaction structured to qualify as a tax-free reorganization (the “Merger”). The Merger closed on July 27, 2012. In connection with the Merger, we will issue former security holders of PEDCO 17,917,261 shares of common stock, 19,716,676 shares of new Series A Preferred Stock (as defined below), warrants to purchase an aggregate of 1,120,000 shares of our common stock, warrants to purchase 692,584 shares of our new Series A Preferred Stock, and options to purchase 4,235,000 shares of our common stock (all post-Reverse Split (as defined below) shares).

Additionally on or around July 27, 2012, the Company filed an Amended and Restated Certificate of Formation with the Secretary of State of Texas, which among other things, changed the Company’s name to PEDEVCO Corp., converted all of the Company’s outstanding shares of preferred stock into common stock on a one-for-one basis, and affected a reverse split of the Company’s issued and outstanding shares on a basis of 1:112 (the “Reverse Split”), with any fractional shares rounded up on a per shareholder basis. As a result, the Company’s issued and outstanding shares of common stock decreased from 153,238,555 shares to approximately 1,411,850 shares (which does not affect the issuance of shares in connection with the Merger as described above). All shares and per share amounts used throughout this report have been retroactively revised for the impact of the Reverse Split. The Amended and Restated Certificate of Formation also increased the Company’s authorized capital stock subsequent to the Reverse Split from 180,000,000 shares of common stock to 200,000,000 shares of common stock and from 20,000,000 shares of preferred stock to 100,000,000 shares of preferred stock. Finally, on July 27, 2012, the Company filed an Amended and Restated Series A Convertible Preferred designation with the Secretary of State of Texas (the “new Series A Preferred Stock”).

The holders of the shares of our new Series A Preferred Stock will be entitled to receive non-cumulative dividends at an annual rate of 6% of the "Original Issue Price" per share for the new Series A Preferred Stock, which is $0.75 per share (as appropriately adjusted for any recapitalizations). These dividends will only accrue and become payable if declared by our Board of Directors in its discretion. The right to receive dividends on shares of Series A Preferred Stock will not be cumulative, and no right to such dividends will accrue to holders of Series A Preferred Stock by reason of the fact that dividends on said shares are not declared or paid in any calendar year. All declared but unpaid dividends of the shares of new Series A Preferred Stock will be payable in cash upon conversion of such shares. Any dividends declared on our new Series A Preferred Stock will be prior and in preference to any declaration or payment of any dividends or other distributions on our common stock. In the event of any liquidation, dissolution or winding up of our Company, either voluntary or involuntary, the holders of our new Series A Preferred Stock will be entitled to receive distributions of any of our assets prior and in preference to the holders of our common stock in an amount per share of new Series A preferred stock equal to the sum of (i) the Original Issue Price of $0.75 per share, and (ii) all declared but unpaid dividends on such shares of new Series A Preferred Stock. Each share of new Series A Preferred Stock will be convertible at the option of the holder into that number of fully-paid, non-assessable shares of common stock determined by dividing the "Original Issue Price" for the new Series A preferred stock by the conversion price of $0.75 per share (subject to adjustment). Therefore, each share of new Series A Preferred Stock will initially be convertible into one share of our common stock. Our shares of new Series A Preferred Stock will automatically convert into shares of common stock according to the conversion rate described above upon the first to occur of (i) the consent of a majority of the outstanding shares of Series A Preferred Stock or (ii) the date on which the new Series A Preferred Stock issued on the original issuance date to holders who are not affiliates of the Company may be re-sold by such holders without registration in reliance on Rule 144 promulgated under the Securities Act of 1933, as amended, or another similar exemption. The holders of our new Series A Preferred Stock will vote together with the holders of our common stock as a single class (on an as converted basis) on all matters to which our shareholders have the right to vote, except as may otherwise be required by law.

The following discussion and analysis of the Company's operations and financial condition is as of June 30, 2012, prior to the July 27, 2012, closing of the Merger. As a result of the Merger, the operations and assets of PEDCO became the operations and assets of the Company (provided that the Company maintained its prior pre-Merger operations and assets). However, as the Merger closed after the date of the financial statements set forth herein, the disclosures and financial statements below relate (except as otherwise provided) to the Company's pre-Merger operations and assets. For more information regarding PEDCO, including its business, plan of operations, and risk factors regarding its operations readers are encouraged to review the Company's Definitive Schedule 14A Proxy Statement filed with the Securities and Exchange Commission on July 3, 2012 (the "Proxy Statement") and the Amendment Report on Form 8-K filed with the Securities and Exchange Commission on August 8, 2012. The Company's Form 10-Q for the Quarter Ended September 30, 2012 will include information regarding the operations of the combined company and results of operations which include PEDCO, which is subsequent to the Merger, the Company's wholly-owned subsidiary.

Our results of operations and cash flows should be read in conjunction with our unaudited financial statements and notes thereto included elsewhere in this report and the audited financial statements and the notes thereto included in our Form 10-K for the year ended December 31, 2011.

Business Overview

Unless otherwise indicated, we use "PEDEVCO," "the Company," "we," "our" and "us" in this quarterly report to refer to the businesses of PEDEVCO Corp., formerly Blast Energy Services, Inc. and its subsidiaries before giving effect to the Merger.

Prior to the closing of the Merger, the Company was seeking to become an independent oil and gas producer with additional revenue potential from its applied fluid jetting technology. We planned to grow operations initially through the acquisition of oil producing properties (as described below) and then eventually, to acquire oil and gas properties where our applied fluid jetting process could be used to increase the field production volumes and value of the properties in which we own an interest.

Subsequent to the Merger, the Company plans to continue its pre-Merger operations and to (i) engage in the business of oil and gas exploration, development and production of primarily shale oil and gas and secondarily conventional oil and gas opportunities in the United States, and (ii) subsequently utilize its strategic relationships for exploration, development and production in the Pacific Rim countries, with a particular focus in China.

Effective in connection with the closing of the Merger, a change in control of the Company occurred, and the former shareholders of PEDCO obtained voting control over the Company. The current significant shareholders of the Company are described in greater detail in the report on Form 8-K/A, filed with the Securities and Exchange Commission on August 8, 2012 (the "Form 8-K/A").

Effective on July 27, 2012, as a required term of the Merger, Roger P. (Pat) Herbert resigned as a Director of, as Chairman of the Board of Directors of, and as Interim President and Chief Executive Officer of the Company; Donald E. Boyd resigned as a member of the Board of Directors of the Company; and John A. MacDonald resigned as the Executive Vice President, Chief Financial Officer and Secretary of the Company.

Additionally effective July 27, 2012, Frank C. Ingriselli was appointed as Chairman of the Board of Directors of the Company and Michael L. Peterson and Jamie Tseng were appointed as Directors of the Company, and Mr. Ingriselli was further appointed as the President and Chief Executive Officer of the Company; Mr. Peterson was further appointed as the Chief Financial Officer and Executive Vice President of the Company; Mr. Tseng was further appointed as the Senior Vice President of the Company; and Clark R. Moore was appointed as the Executive Vice President, General Counsel and Secretary of the Company.

Biographical information for the new officers and Directors of the Company is set forth in the Form 8-K/A.

Oil and Gas Properties As of June 30, 2012

As noted above, this discussion does not include information regarding the properties of PEDCO acquired in the Merger, which are described in greater detail in the Proxy Statement.

North Sugar Valley Field

On September 23, 2010, the Company closed on a sales agreement with Sun Resources Texas, Inc. (“Sun”) a privately-held company based in Longview, Texas, to acquire Sun’s oil and gas interests in the North Sugar Valley Field located in Matagorda County, Texas for a total purchase price of $1,181,000. Under the terms of the agreement, the purchase price was paid in cash, common stock and through the issuance of a promissory note (which has since been repaid) for Sun’s approximately 65% working interest (net revenue interest of approximately 50%) in three wells. The acquired wells are currently producing a total of approximately 43 gross barrels of oil per day (or approximately 21.5 net barrels of oil) from the Gravier Sand formation, which our year end reserve report estimates contains approximately 44,640 barrels of recoverable reserves net to the interest acquired by the Company.

The effective date of the sale was October 1, 2010. Under the terms of the agreement, Sun will continue to act as Operator of the properties. Sun has retained a 1% working interest in the wells.

Guijarral Hills Exploitation Project

In February 2011, the Company entered into a farmout agreement with Solimar Energy LLC (“Solimar”), which provided the Company the right to participate in a field extension drilling project to exploit an undeveloped acreage position in the Guijarral Hills Field located in the San Joaquin basin of central California. Solimar is a wholly-owned subsidiary of Solimar Energy Limited, a publicly-traded company on the Australia Stock Exchange based in Melbourne, Australia.

Under the terms of the agreement with Solimar, the Company was to participate in the Guijarral Hills project on a promoted basis of 66-2/3 percent (%) of the costs to drill and complete the initial planned exploratory well. After the drilling of the initial well, the Company was to earn a 50% working interest, with net revenue interest of 38% in the entire project’s acreage position and will be required to contribute on an equal heads up basis (i.e., 50% of all costs) on any additional wells that may be drilled in the project.

In March 2011, the Solimar Energy 76-33 well in the Guijarral Hills Field Area located in Fresno County, California (the “Test Well”) reached its total drilling depth of 10,550 feet.

On May 19, 2011, a completion rig moved on location to commence the flow testing program on the well. The three intervals selected to be tested have all been productive in the adjacent Guijarral Hills field. While drilling, each interval had indications that hydrocarbons were present which were also indicated on wireline logs that were run after drilling was completed. While such petro-physical analysis indicates that hydrocarbon pay is present, the flow testing program is necessary to determine whether the reservoir quality will meet commercial production rates.

The testing program involved perforating the selected interval followed by periods when the well was shut-in to measure the pressure response and to evaluate fluid properties. The test sequence involved testing the deepest interval, the Lower Gatchell, first and then working up the well to the shallower Avenal and Leda objectives.

However, none of the zones tested resulted in an oil producing well. Solimar and the Company have discussed the potential of further testing on the well, including an evaluation of a large interval of Kreyhegan Shale that was

encountered while drilling.

Modification Agreement

On December 22, 2011, the Company entered into a Modification Agreement ("Modification Agreement") with Solimar. The Modification Agreement amended certain existing agreements, including the Guijarral Hills Farmout Agreement and the related Guijarral Hills Joint Operating Agreement with Solimar.

Solimar purchased 25% of the 100% working interest in the Solimar Energy 76-33 Well (modifying the Farmout Agreement which provided for the Company to hold 50% of the 100% working interest), and the Company agreed to participate on all go-forward costs associated with the Guijarral Hills project on a heads up 25% of 100% basis (governed by the JOA) in exchange for $311,872 of unpaid drilling costs.

The Farmout Agreement and subsequent participation in the Solimar Energy 76-33 well is reported in the balance sheet under “Unproved oil and gas properties, not subject to amortization.”

Recent Updates to Project

On August 6, 2012, the Company was notified by Solimar Energy, LLC (“Solimar”) of its desire to assign the Guijarral Hills Wells No. 76-33 (“Well”) to Vintage Production California LLC (“Vintage”), the lessor of the Well in return for payment of the salvage value of the equipment in the Well. Pursuant to the Guijarall Hills Joint Operating Agreement among Solimar, the Company and Neon Energy Corporation, the Company had 48 hours to respond to this notification as to its intent to either take over the Well and be responsible for all plugging and abandoning and clean-up costs, or in the alternative, agree to assign its interest in the Well to Vintage, who would be responsible for Well plugging, abandoning and clean-up costs. The Company did not respond within the 48 hours and thus gave up its right to take over the Well and agreed to assign its interest in the Well to Vintage. As of August 10, 2012 Solimar had offered the well assignment to Vintage but Vintage had not yet responded as to its intentions whether to accept it or not. The Guijarral Hills Field lease will expire pursuant to its own terms on September 30, 2012.

Applied Fluid Jetting Technology

Over the past several years, the Company has developed a down-hole stimulation service that management believes has the potential to dramatically increase production volumes and reserves from existing or newly drilled wells. The Company previously filed for a patent on behalf of the inventor to protect this proprietary AFJ process and has recently received a notice of allowance from the U.S. Patent Office. This notice means that the patent will be awarded to the inventor upon the payment of certain filing and issuance fees which the Company has paid. The Company is currently in the process of working with the inventor to assign the rights to the patent to the Company.

The theory behind AFJ is both simple and extremely bold to maximize the reservoir area contacted by the well bore, both vertically and horizontally, in order to increase production rates and improve reservoir recovery rates. Recent experience has moved the theory closer to commercial realization. The Company enters existing or new well bores to access the productive formations containing oil and natural gas. By jetting laterally into the formations, more of the reservoir is exposed to the wellbore and if successful, additional hydrocarbons are flowed to the surface. It is believed that this AFJ process can be successful in many types of sandstone and limestone/carbonate formations.

During 2009, the Company further tested the AFJ process on wells in the Austin Chalk play in Central Texas operated by Reliance Oil & Gas, Inc. (“Reliance”) with some initial production success. Later the Company attempted to apply the process to third-party wells in West Texas and in Kentucky. Unfortunately, due to mechanical failures of the surface equipment we were not able to achieve any lateral jetting in the down-hole environment. Currently the AFJ rig and other support vehicles have been moved back to a storage yard in Spring, Texas. The Company intends to restart its down-hole stimulation service line over the next few years once liquidity permits.

BMC Debt Conversion

In connection with the Merger Agreement, on January 13, 2012, the Company entered into a Debt Conversion Agreement (the “BMC Debt Conversion Agreement”) with Berg McAfee Companies, LLC (“BMC”), and Clyde Berg, (“Berg”). The Company had previously entered into: (1) a Secured Promissory Note Agreement, dated February 27, 2008, as amended on January 5, 2011 with BMC in the aggregate principal amount of $1,120,000 (the "BMC Note"); and (2) a Promissory Note, dated May 19, 2011, with Berg in the aggregate principal amount of $100,000 (the "Berg Note" and collectively with the BMC Note, the “Notes”).

The BMC Debt Conversion Agreement modified the Notes to provide that all principal and accrued interest under the Notes shall be converted into shares of the Company's Common Stock at a conversion price of $2.24 per share (the "Conversion"). On May 29, 2012, BMC and Berg entered into a "First Amendment to the Voting Agreement and Debt Conversion Agreement" (the "Amendment"). On June 26, 2012, the outstanding principal under the Notes, consisting of $1,120,000 under the BMC Note and $100,000 under the Berg Note and accrued interest of $415,953, comprised of $388,553 under the BMC Note and $27,700 under the Berg Note was converted into 730,470 shares of the Company's Common Stock.

Debt Modifications

In connection with the Merger, on January 13, 2012, the Company entered into the Amendment to Note Purchase Agreement (the "Note Purchase Amendment"), and on May 29, 2012, the Company entered into the Second Amendment to First Tranche Promissory Note and the Second Amendment to the Second Tranche Promissory Note (collectively, the "Second Amendments to the Promissory Notes"), with the Lender in connection with the Company's debt obligations under certain secured notes with the Lender. The Note Purchase Amendment and the Second Amendments to the Promissory Notes amended the Note Purchase Agreement, dated February 24, 2011 (the "Note Purchase Agreement") primarily in order (i) to grant consent to the Merger Agreement, (ii) to waive, solely with respect to the Company post-Merger, certain loan covenants and restrictions as they relate to the assets of PEDCO and the operations of the Company post-Merger, (iii) to waive the Lender's right of first refusal to provide additional funding to the Company; and (iv) to provide for the conversion of up to 50% of the loan amounts outstanding to the Lender in the original principal amount of $2,522,111, of which approximately $1,306,078 was owed as of the date of the parties entry into the Note Purchase Amendment, into shares of the Company's Common Stock at $0.75 per share at the option of Lender at any time after June 9, 2012, provided that the Company in its sole discretion may waive the 50% conversion limitation. The conversion rights described above are subject to the Lender being prohibited from converting any portion of the outstanding notes which would cause it to beneficially own more than 4.99% of the Company's then outstanding shares of common stock, subject to the Lender's right to increase such limit to up to 9.99% of the Company's outstanding shares with 61 days prior written notice to the Company.

The Promissory Notes issued in connection with the Note Purchase Amendment were amended to provide an extension of the maturity date of such Promissory Notes, which were due February 2, 2012 under the terms of the original notes, to the earlier of (i) thirty (30) days after the termination of the Merger Agreement, if the Merger Agreement is terminated before June 1, 2012, (ii) August 1, 2012, or (iii) the date all obligations and indebtedness under such Promissory Notes are accelerated in accordance with the terms and conditions of such Promissory Notes. Furthermore, commencing February 2, 2012, the interest amount on the Promissory Notes was increased from 10% to 18% per annum, and the new interest rate includes both the principal amount and the Exit Fee payable below, and as further described under the Promissory Notes. Lastly, the Exit Fee, which is 12% of the repayment amount, was increased by an aggregate of $15,000 for the Promissory Notes.

Other Debt Conversions

In connection with the Merger, the Company further approved the conversion of certain other outstanding debt obligations of the Company at $2.24 per share. As of June 30, 2012, these debt obligations include: $335,500 of accrued compensation due to the members of Board of Directors, $6,150 of short term loans from members of the Board of Directors, and $225,958 of accrued salaries and vacation pay owed to the Company's employees for a total amount of $567,608. These amounts will convert at $2.24 per share under debt conversion agreements ("Debt Conversion Agreements") into approximately 253,396 shares of the Company's Common Stock shortly after the date of this filing. Additionally, in May 2012, under the terms of a settlement amongst the principals for Trident, the placement fee amount owed by the Company was reduced to $47,960 and debt conversion agreements for this payable amount were signed as described herein. This amount will convert at $2.24 per share into approximately 21,411 shares of the Company's Common Stock shortly after the date of this filing.

Lending Arrangement

On February 24, 2011 (the "Closing"), the Company entered into the Note Purchase Agreement and related agreements (as described below) with Centurion Credit Funding LLC ("the Lender") to fund its Guijarral Hills project and to repay the Sun promissory note. Pursuant to the Purchase Agreement, the Company agreed with the Lender to enter into the Promissory Notes in the aggregate principal amount of $2,522,111, with a Senior Secured Promissory Note in the amount of $2,111,111 (the "First Note") delivered to the Lender at the Closing and a second Note delivered in April 2011 in the amount of $411,000 (the "Second Note").

The Company granted the Lender a right of first refusal to provide the Company with additional funding on such terms and conditions as the Company may receive from third parties, until the later of (a) one year from the date that the Promissory Notes are repaid in full; or (b) such time as the Company ceases paying a Royalty to the Lender pursuant to the Royalty Agreement (described below).

The Company also agreed that if the test well on the project failed to achieve an initial production average of at least 350 barrels of oil equivalent per day for the 30-day period commencing on the first day on which the Test Well is at full production, the Company would issue to the Lender a common stock purchase warrant to purchase up to 107,143 shares of the Company's common stock (the "Warrant"). The Warrant will have a term of two years, and provide for cashless exercise rights in the event the shares of common stock issuable upon exercise of the Warrant are not registered with the Commission. The Warrant will also contain certain anti-dilution provisions and will have an exercise price, in the event it is granted, equal to the weighted average of the trading price of the Company's common stock over the ten day period prior to the grant date. The Warrant was granted in October 2011. In April 2012, the warrant agreement was further amended to provide that the lowest exercise price of the warrant is $1.12 per share. As a result of this warrant grant and under the terms of the finder fee agreement with Trident Partners, they have earned warrants to purchase 10,714 shares under the same terms.

The Company delivered to the Lender the First and Second Notes in the amount of $2,111,111 and $411,000 at the Closing. The Company paid an aggregate original issue discount to the Lender on the notes of 10%, or $252,211 (the "Original Issue Discount"). The notes accrue interest at the rate of ten percent (10%) per annum.

The terms of this note were amended in February 2012 and May 2012 as described above. The Company also agreed to pay the Lender an exit fee at such time as the First Note is paid in full of twelve percent (12%) of the amount of such repayment (the "Exit Fee").

The Company incurred $381,506 in legal and finders' fees associated with the lending arrangement, which has been recorded as deferred financing costs to be amortized over the term of the notes. Net proceeds to the Company after the original issue discount, reimbursement of the lender's legal fees and the Company's own expenses were approximately $1.6 million with an effective interest rate of approximately 36%.

Stock Purchase Agreement

As additional security for the repayment of the Loans, and pursuant to a Stock Purchase Agreement, the Company sold the Lender one (1) share of its newly designated Series B Preferred Stock, in consideration for $100, which entitles the Lender to consent to and approve the Company's or any of its subsidiaries' entry into any bankruptcy proceeding, consent to the appointment of a receiver, liquidator or trustee or the assignment by the Company or any of its subsidiaries for the benefit of any creditors. The Company assigned no value to this Series B Preferred Share. The one share of the Company's Series B Preferred Stock was converted on a one-for-one basis into one (1) share of the Company's pre-Reverse Split common stock in connection with the Merger. See Note 15.

Royalty Payment Letter

As additional consideration for the Lender agreeing to make the Loans, the Company agreed to a Royalty Payment Letter (the "Royalty Payment Letter") to pay the Lender 30% of all amounts earned (the "Royalty") by the Company under the initial test well.

In connection with the Merger in July 2012 the Company is planning to convert the other outstanding debt obligations that are covered by debt conversion agreements into common stock. See Note 4.

Warrant Agreement

On February 24, 2011, the Company and the Lender entered into the Note Purchase Agreement which provided that if the Test Well failed to achieve an initial production average of at least 350 barrels of oil equivalent per day for the 30-day period commencing on the first day on which the Test Well is at full production, the Company would issue to the Lender a common stock purchase warrant to purchase up to 107,143 shares of the Company's common stock (the "Warrant"). The Warrant will have a term of two years, and provide for cashless exercise rights in the event the shares of common stock issuable upon exercise of the Warrant are not registered with the Commission. The Warrant will also contain certain anti-dilution provisions and will have an exercise price, in the event it is granted, equal to the weighted average of the trading price of the Company's common stock over the ten day period prior to the grant date. The Warrant was granted in October 2011. In April 2012, the warrant agreement was further amended to provide that the lowest exercise price of the warrant is $1.12 per share. As a result of this warrant issuance and under the terms of the finder fee agreement with Trident Partners, they have earned warrants to purchase 10,714 shares under the same terms.

Placement Agreement

In May 2012, Trident, various affiliates of Trident and the Company agreed to enter into settlement agreements to release each other from any ongoing claims and obligations. Pursuant to the settlement agreements, the $119,990 finder's fee payable to Trident was reduced to $47,960 by the payment in early May 2012 to Trident and certain affiliates (provided that we reserved the right to convert such unpaid fees into shares of our common stock at the rate of $2.24 per share at any time upon notice from the Company prior to December 31, 2012). The settlement will result in a gain from a reduction in payables in the amount of $62,030.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our most significant judgments and estimates used in preparation of our financial statements.

Revenue Recognition. All revenue is recognized when persuasive evidence of an arrangement exists, the service or sale is complete, the price is fixed or determinable and collectability is reasonably assured. Revenue is derived from the sale of crude oil and down hole services. Revenue from crude oil sales is recognized when the crude oil is delivered to the purchaser and collectability is reasonably assured. Revenue from services is recognized when the service is delivered or completed and collection is reasonably assured. The Company follows the "sales method" of accounting for oil and natural gas revenue, so it recognizes revenue on all natural gas or crude oil sold to purchasers, regardless of whether the sales are proportionate to its ownership in the property. A receivable or liability is recognized only to the extent that the Company has an imbalance on a specific property greater than its share of the expected remaining proved reserves. If collection is uncertain, revenue is recognized when cash is collected. We recognize reimbursements received from third parties for out-of-pocket expenses incurred as service revenues and account for out-of-pocket expenses as direct costs.

Oil and Gas Properties, Full Cost Method. The Company uses the full cost method of accounting for oil and gas producing activities. Costs to acquire mineral interests in oil and gas properties, to drill and equip exploratory wells used to find proved reserves, and to drill and equip development wells, including directly related overhead costs, and related asset retirement costs are capitalized.

Under this method, all costs, including internal costs directly related to acquisition, exploration and development activities are capitalized as oil and gas property costs on a field by field basis. Sales of oil and gas properties or interests therein are credited against capitalized costs in the full cost pool. Properties not subject to amortization consist of exploration and development costs which are evaluated on a property-by-property basis. Amortization of these unproved property costs begins when the properties become proved or their values become impaired. The Company will assess the probability of realization of unproved properties, if any, on at least an annual basis or when there has been an indication that impairment in value may have occurred. Impairment of unproved properties is assessed based on management's intention with regard to future exploration and development of individually significant properties and the ability of the Company to obtain funds to finance such exploration and development. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized. Costs of oil and gas properties will be amortized using the units of production method.

Ceiling Test. In applying the full cost method, the Company performs an impairment test (ceiling test) at each reporting date commencing on December 31, 2010, whereby the carrying value of property and equipment is compared to the "estimated present value" of its proved reserves, discounted at a 10% interest rate of future net revenues based on current operating conditions at the end of the period and the average, first day of the month price received for oil and gas production over the preceding 12 month period, plus the cost of properties not being amortized, plus the lower of cost or fair market value of unproved properties included in costs being amortized, less the income tax effects related to book and tax basis differences of the properties.

Following the Merger, the Company will follow the successful efforts method of accounting for oil and gas producing activities.

Accounting for Asset Retirement Obligations. If a reasonable estimate of the fair value of an obligation to perform site reclamation, dismantle facilities or plug and abandon wells can be made, the Company will record a liability (an asset retirement obligation or "ARO") on its consolidated balance sheet and capitalize the present value of the asset retirement cost in oil and gas properties in the period in which the retirement obligation is incurred. In general, the amount of an ARO and the costs capitalized will be equal to the estimated future cost to satisfy the abandonment obligation assuming the normal operation of the asset, using current prices that are escalated by an assumed inflation factor up to the estimated settlement date, which is then discounted back to the date that the abandonment obligation was incurred using an assumed cost of funds for the Company. After recording these amounts, the ARO will be accreted to its future estimated value using the same assumed cost of funds and the capitalized costs are depreciated on a unit-of-production basis within the related full cost pool. Both the accretion and the depreciation will be included in depreciation, depletion and amortization expense on our consolidated statement of income.

Stock-Based Compensation. Pursuant to the provisions of FASB ASC 718, Compensation – Stock Compensation, which establishes accounting for equity instruments exchanged for employee service, we utilize the Black-Scholes option pricing model to estimate the fair value of employee stock option awards at the date of grant, which requires the input of highly subjective assumptions, including expected volatility and expected life. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. These assumptions are subjective and generally require significant analysis and judgment to develop. When estimating fair value, some of the assumptions will be based on, or determined from, external data and other assumptions may be derived from our historical experience with stock-based payment arrangements. The appropriate weight to place on historical experience is a matter of judgment, based on relevant facts and circumstances. We estimate volatility by considering historical stock volatility. We have opted to use the simplified method for estimating expected term, which is equal to the midpoint between the vesting period and the contractual term.

Results of Operations and Financial Condition

All dollar amounts discussed in "Item 2" are rounded to the nearest $1,000, or for larger numbers, to the nearest tenth of a million dollars. Please consult the financial statements in "Item 1" for exact dollar amounts.

Comparison of the Three Months Ended June 30, 2012 with the Three Months Ended June 30, 2011

Oil and Gas Properties. Oil and gas revenues decreased by $29,000 to $108,000 for the three months ended June 30, 2012 compared to $137,000 for the three months ended June 30, 2011 primarily due to lower production volumes from the Sugar Valley field. Operating expenses associated with the oil and gas properties decreased by $7,000 to $79,000 for the three months ended June 30, 2012 compared to $86,000 for the three months ended June 30, 2011 as certain expenses are related to the lower production volumes. The gross profit from oil and gas activities for the three months ended June 30, 2012 was $30,000 compared to $50,000 for the same period in 2011.

Down-hole Solutions. There were no Down-hole Solutions' revenues for the three months ended June 30, 2012 or 2011. The loss from Down-hole Solutions decreased by $2,000 to $15,000 for the three months ended June 30, 2012 compared to a loss of $17,000 for the three months ended June 30, 2011. This reduction is related to storage fees and equipment related insurance premiums in 2011 not applicable to 2012.

Depreciation, Depletion and Amortization ("DD&A"). DD&A costs appear consistent at $37,000 for the three months ended June 30, 2012 compared to $37,000 for the three months ended June 30, 2011.

Selling, General and Administrative. Selling, general and administrative ("SG&A") expenses decreased by $67,000 to $203,000 for the three months ended June 30, 2012 compared to $270,000 for the three months ended June 30, 2011. The decrease was primarily due to stock compensation expense in 2011 not applicable to 2012 and a reduction in 2012 payroll and overhead costs partially offset by higher legal fees and external services associated with the pending merger.

	For the Three Months Ended June 30,		
(in thousands)	2012	2011	Increase (Decrease)
Payroll and related costs	$ 30	$ 120	$ (90)
Option and warrant expense	0	46	(46)
Legal fees and settlements	56	9	47
External services	91	65	26
Insurance	23	13	10
Travel & entertainment	0	5	(5)
Office rent, communications, misc.	3	12	(9)
	$ 203	$ 270	$ (67)

Other Income. Other income was $62,000 for the three months ended June 30, 2012 compared to $-0- for the three months ended June 30, 2011. The increase resulted from the net impact from the placement fee dispute settlement agreements with Trident.

Interest Expense. Interest expense was $162,000 for the three months ended June 30, 2012 compared to $254,000 for the three months ended June 30, 2011, a decrease of $92,000 from the prior period. This decrease is primarily due to a partial payment toward the principal of the lending arrangement that closed in February 2011 following the receipt of the final payment under the Quicksilver lawsuit settlement received in September 2011.

Loss From Continuing Operations. The loss from continuing operations decreased by $202,000 to $289,000 for the three months ended June 30, 2012 compared to a loss from continuing operations of $491,000 for the three months ended June 30, 2011. This decrease is primarily due to stock compensation expense associated with the granting of options in 2011 not applicable to 2012 and Quicksilver's interest expense in 2011 which was not applicable in 2012.

Loss From Discontinued Operations. Loss from discontinued operations was $-0- for the three months ended June 30, 2012 and June 30, 2011.

Net Loss. Net loss decreased by $202,000 to a net loss of $289,000 for the three months ended June 30, 2012 compared to a net loss of $491,000 for the three months ended June 30, 2011. This decrease is primarily due to stock compensation expense associated with the granting of options in 2011, which was not applicable to 2012 and Quicksilver's interest expense in 2011 which was not applicable in 2012.

Comparison of the Six Months Ended June 30, 2012 with the Six Months Ended June 30, 2011

Oil and Gas Properties. Oil and gas revenues decreased by $16,000 to $227,000 for the six months ended June 30, 2012 compared to $243,000 for the six months ended June 30, 2011 primarily due to lower production volumes from the Sugar Valley field. Operating expenses associated with the oil and gas properties decreased by $9,000 to $167,000 for the six months ended June 30, 2012 compared to $176,000 for the six months ended June 30, 2011 as certain expenses are related to the lower production volumes. The gross profit from oil and gas activities for the six months ended June 30, 2012 was $60,000 compared to $67,000 for the same period in 2011.

Down-hole Solutions. There were no Down-hole Solutions' revenues for the six months ended June 30, 2012 or 2011. The loss from Down-hole Solutions decreased by $7,000 to $31,000 for the six months ended June 30, 2012 compared to a loss of $38,000 for the six months ended June 30, 2011. This reduction is related to storage fees and equipment related insurance premiums in 2011 not applicable to 2012.

Depreciation, Depletion and Amortization ("DD&A"). DD&A costs increased $1,000 to $73,000 for the six months ended June 30, 2012 compared to $72,000 for the six months ended June 30, 2011.

Selling, General and Administrative. Selling, general and administrative ("SG&A") expenses decreased by $303,000 to $394,000 for the six months ended June 30, 2012 compared to $697,000 for the six months ended June 30, 2011. The decrease was primarily due to stock compensation expense in 2011 not applicable to 2012 and a reduction in 2012 payroll and overhead costs partially offset by higher legal fees associated with the pending merger.

	For the Six Months Ended June 30,		
(in thousands)	2012	2011	Increase (Decrease)
Payroll and related costs	$ 68	$ 222	$ (154)
Option and warrant expense	0	217	(217)
Legal fees and settlements	122	21	101
External services	165	157	8
Insurance	35	35	0
Travel & entertainment	0	12	(12)
Office rent, communications, misc.	4	33	(29)
	$ 394	$ 697	$ (303)

Other Income. Other income was $62,000 for the six months ended June 30, 2012 compared to $-0- for the six months ended June 30, 2011. The increase resulted from the net impact from the placement fee dispute settlement agreements with Trident.

Interest Expense.
Interest expense was $352,000 for the six months ended June 30, 2012 compared to $368,000 for the six months ended June 30, 2011, a decrease of $16,000 from the prior period. This decrease is primarily due to a partial payment toward the principal of the lending arrangement that closed in February 2011 following the receipt of the final payment under the Quicksilver lawsuit settlement received in September 2011, partially offset by the expensing of the portion of the debt discount and deferred financing costs associated with the principal payment during the 2011 period as well as the Exit Fee calculated on the remaining principal balance which was triggered by the agreement with the lender to extend the maturity date of the note from February 2012 to August 2012.

Loss From Continuing Operations. The loss from continuing operations decreased by $381,000 to $655,000 for the six months ended June 30, 2012 compared to a loss from continuing operations of $1,036,000 for the six months ended June 30, 2011. This decrease is primarily due to stock compensation expense associated with the granting of options in 2011 not applicable to 2012.

Loss From Discontinued Operations. Loss from discontinued operations was $-0- for the six months ended June 30, 2012 compared to a loss from discontinued operations of $3,686 for the six months ended June 30, 2011.

Net Loss. Net loss decreased by $384,000 to a net loss of $655,000 for the six months ended June 30, 2012 compared to a net loss of $1,039,000 for the six months ended June 30, 2011. This decrease is primarily due to stock compensation expense associated with the granting of options in 2011, which was not applicable to 2012.

Liquidity and Capital Resources

Prior to the completion of the merger with PEDCO, PEDCO raised approximately $11.5 million through the sale of Series A Preferred stock (the "Offering"). The Offering closed on July 27, 2012. The proceeds of this offering have been used by PEDCO to purchase producing oil and gas assets in the Eagle Ford shale prospect in southern Texas as well as prospective oil and gas leases in the Niobrara shale prospect in Colorado and for general working capital expenses. The Eagle Ford asset had two producing wells when purchased and the Company has been receiving revenues since March from those wells. A third well was drilled and completed in July 2012, oil and gas is being produced and revenues to the Company are expected in September 2012. In the Niobrara asset, the first well has been completed successfully, oil and gas is being sold and revenues are being produced. Management plans on drilling two additional wells in the Niobrara asset by year end and has the cash on hand to do so. The Company's management believes it can execute its business plan of developing their current assets as well as raising additional capital to purchase and develop additional oil and gas properties.

The Company had total current assets of $57,000 as of June 30, 2012, including cash of $2,000, compared to total current assets of $66,000 as of December 31, 2011, including a cash balance of $19,000.

The Company had total assets of $1.8 million as of June 30, 2012 and $1.9 million as of December 31, 2011. Included in total assets as of June 30, 2012 and December 31, 2011 were $1.2 million of proved oil and gas properties subject to amortization.

The Company had total liabilities of $2.6 million as of June 30, 2012, including current liabilities of $2.5 million, compared to total liabilities of $3.6 million as of December 31, 2011, including current liabilities of $2.5 million.

The Company had negative working capital of $2.5 million, total stockholders' deficit of $0.8 million and a total accumulated deficit of $78.9 million as of June 30, 2012, compared to negative working capital of $2.4 million, total stockholders' deficit of $1.7 million and a total accumulated deficit of $78.2 million as of December 31, 2011.

On January 13, 2012, the Company entered into the Merger Agreement, described above, which Merger closed on July 27, 2012. Following the consummation of the Merger, the Company acquired the assets and operations of and assumed the debts, obligations, and liabilities of PEDCO, which are described in greater detail in the Proxy Statement. As the Merger had not closed as of June 30, 2012, the date of the financial statements included herein, such financial statements do not include the assets, liabilities or operations of PEDCO, which will be included in the Company's next quarterly report.

Prior to the closing of the Merger, PEDCO advanced the Company approximately $488,330 to cover the Company's operating and merger expenses and an additional $30,000 in the form of a deposit which amounts were forgiven by PEDCO upon the closing of the Merger.

Cash Flows From Operating Activities. The Company had net cash used in operating activities of approximately $386,000 for the six months ended June 30, 2012 which was primarily due to $655,000 of loss from continuing operations offset by $191,000 of amortization of financing costs.

Cash Flows from Investing Activities. The Company had no net cash used in investing activities for the six months ended June 30, 2012.

Cash Flows from Financing Activities. The Company had net cash provided from financing activities of $369,000 for the six months ended June 30, 2012 which was due to borrowings on short-term debt.

Recent Accounting Pronouncements

For the period ended June 30, 2012, there were no other changes to our critical accounting policies as identified in our annual report on Form 10-K for the year ended December 31, 2011.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Pursuant to Item 305(e) of Regulation S-K (§ 229.305(e)), the Company is not required to provide the information required by this Item as it is a "smaller reporting company," as defined by Rule 229.10(f)(1).

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit to the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified by the Securities and Exchange Commission's rules and forms, and that information is

accumulated and communicated to our management, including our principal executive and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. Our management evaluated, with the participation of our principal executive and principal financial officer, the effectiveness of our disclosure controls and procedures as of June 30, 2012, pursuant to Rule 13a-15(b) under the Securities Exchange Act. Based upon that evaluation, our principal executive and principal financial officer concluded that, as of June 30, 2012, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We will continue to evaluate the effectiveness of internal controls and procedures on an on-going basis.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Quicksilver Resources Lawsuit

In September 2008, the Company and Eagle Domestic Drilling Operations LLC, our wholly-owned subsidiary (“Eagle”), entered into a Compromise Settlement and Release Agreement with Quicksilver Resources, Inc. (“Quicksilver”) in the Court to resolve the pending litigation and the parties agreed to release all claims against one another and certain related parties. Quicksilver agreed to pay Eagle a total of $10 million which has been received to date, including $2 million ($1.44 million net of associated legal fees) which was received in September 2011.

General

Other than the aforementioned matters, the Company is not aware of any other pending or threatened legal proceedings. The foregoing is also true with respect to each officer, director and control shareholder as well as any entity owned by any officer, director and control shareholder, over the last five years.

As part of its regular operations, the Company may become party to various pending or threatened claims, lawsuits and administrative proceedings seeking damages or other remedies concerning its’ commercial operations, products, employees and other matters. Although the Company can give no assurance about the outcome of these or any other pending legal and administrative proceedings and the effect such outcomes may have on the Company, except as described above, the Company believes that any ultimate liability resulting from the outcome of such proceedings, to the extent not otherwise provided for or covered by insurance, will not have a material adverse effect on the Company’s financial condition or results of operations.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the registrant’s Form 10-K for the fiscal year ended December 31, 2011, filed with the Commission on April 16, 2012 and its Definitive Proxy Statement on Schedule 14A, filed with the Commission on July 3, 2012, which included risk factors regarding the Company, PEDCO and the post-Merger operations of the Company. Investors are encouraged to read and review the risk factors included in the Form 10-K and Proxy Statement prior to making an investment in the Company.

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

Included below is a summary of the unregistered sales of equity securities affected by the Company prior to and including the date of the Merger:

In connection with the Merger Agreement, the Company entered into other agreements, including the Debt Conversion Agreement (the “BMC Debt Conversion Agreement”) with Berg McAfee Companies, LLC, a California limited liability company (“BMC”), and Clyde Berg, an individual (“Berg”). The Company had previously entered into: (1) a Secured Promissory Note Agreement, dated February 27, 2008, as amended on January 5, 2011, with BMC in the aggregate principal amount of $1,120,000 (the "BMC Note"); and (2) a Promissory Note, dated May 19, 2011, with Berg in the aggregate principal amount of $100,000 (the "Berg Note" and collectively with the BMC Note, the “Notes”).

On June 26, 2012, the Company provided BMC and Berg notice of its intent to exercise its rights under the BMC Debt Conversion Agreement. On June 27, 2012, all amounts of principal and accrued interest under the Notes, which totaled $1,636,253, were extinguished in connection with the issuance of shares of common stock in the Company as follows: $1,508,553 of principal and interest was converted into 673,461 shares of common stock under the BMC Note, and $127,700 of principal and interest was converted into 57,009 shares of common stock under the Berg Note, for a total of 730,470 shares of common stock. The shares were issued at a conversion price of $2.24 per share of common stock as provided for in the Debt Conversion Agreement, and represent 49% of the then total voting shares of the Company.

The Company claims an exemption from registration afforded by Section 4(2) of the Securities Act of 1933, as amended (the "Act") since the foregoing issuances did not involve a public offering, the recipients took the securities for investment and not resale, the Company took appropriate measures to restrict transfer, and the recipients were "accredited investors". No underwriters or agents were involved in the foregoing issuances and the Company paid no underwriting discounts or commissions.

As described above, all of the Company's outstanding shares of Series A Convertible Preferred Stock and Series B Preferred Stock were automatically converted into shares of common stock on a one for one hundred and twelve (1:112) basis in connection with the Amended and Restated Certificate of Formation.

We claim an exemption from registration afforded by Section 3(a)(9) of the Act for the above conversions, as the securities were exchanged by the Company with its existing security holder exclusively in transactions where no commission or other remuneration was paid or given directly or indirectly for soliciting such exchange.

In connection with the closing of the Merger, the Company has agreed to issue an aggregate of 17,917,261 shares of common stock and 19,716,676 shares of new Series A Preferred Stock to former shareholders of PEDCO.

Additionally, the Company agreed to grant warrants to purchase an aggregate of (1) 100,000 shares of common stock with an exercise price of $0.08 per share; (2) 500,000 shares of common stock with an exercise price of $1.25 per share; (3) 500,000 shares of common stock with an exercise price of $1.50 per share; (4) 20,000 shares of common stock with an exercise price of $0.75 per share, to former common stock warrant holders of PEDCO; and (5) 692,584 shares of new Series A Convertible Preferred Stock with an exercise price of $0.75 per share to former Series A Convertible Preferred Stock warrant holders of PEDCO; and options to purchase an aggregate of 470,000 shares of common stock with an exercise price of $0.08 per share; 365,000 shares of common stock with an exercise price of $0.10 per share; and 3,400,000 shares of the Company's common stock with an exercise price of $0.17 per share, to former option holders of PEDCO.

Additionally, promptly after the filing of this report, the Company intends to provide the debt holders who entered into Debt Conversion Agreements with the Company in January 2012, notice of the Company's intent to convert such individuals' and entities' debt into shares of the Company's common stock at a rate of $2.24 per share. We anticipate that approximately 253,396 shares of common stock will be issued to the various debt holders in connection with and pursuant to the Debt Conversion Agreements.

The issuances and grants described above will be exempt from registration pursuant to Section 4(2), Rule 506 of Regulation D and/or Regulation S of the Act since the foregoing issuances and grants will not involve a public offering, the recipients will take the securities for investment and not resale, the Company will take appropriate measures to restrict transfer, and the recipients will (a) be "accredited investors"; (b) have access to similar documentation and information as would be required in a Registration Statement under the Act; and/or (c) be non-U.S. persons.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description
1.1	Second Amendment to Warrant Filed December 27, 2011 with the SEC, Form 8-K
1.2	Third Amendment to Warrant dated April 10, 2012 Filed April 16, 2012 with the SEC, Form 10-K
2.1	Modification Agreement with Solimar Energy LLC Filed December 27, 2011 with the SEC, Form 8-K
2.2	Placement Agent Warrant Agreement with Trident Partners Ltd. Filed December 27, 2011 with the SEC, Form 8-K
2.3	Modification , dated December 22, 2011 Filed December 27, 2011 with the SEC, Form 8-K
2.4	Placement Agent Warrant Agreement, dated December 22, 2011 Filed December 27, 2011 with the SEC, Form 8-K
2.5	Agreement and Plan of Reorganization, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
2.6	Form of Trident Partners, Ltd., affiliate Warrants Filed May 18, 2012 with the SEC, Form 10-Q
2.7	First Amendment to the Agreement and Plan of Merger Filed May 31, 2012 with the SEC, Form 8-K
3.1	Amended and Restated Certificate of Formation (as filed with the Secretary of State of Texas) Filed August 2, 2012 with the SEC, Form 8-K
3.2	Amended and Restated Certificate of Designations of Series A Convertible Preferred Stock (as filed with the Secretary of State of Texas) Filed August 2, 2012 with the SEC, Form 8-K
3.3	Form of Articles of Merger (Nevada) Filed January 20, 2012 with the SEC, Form 8-K
3.4	Articles of Merger (as filed with the Secretary of State of Nevada) by and between Blast Acquisition Corp. and Pacific Energy Development Corp. Filed August 2, 2012 with the SEC, Form 8-K
4.1	$800,000 Secured Promissory Note dated July 15, 2005 by and among the Company and Berg McAfee Companies, LLC Filed July 26, 2005 with the SEC, Form 8-K

4.2	$200,000 Secured Subordinated Promissory Note dated July 15, 2005 by and among the Company and Berg McAfee Companies, LLC Filed July 26, 2005 with the SEC, Form 8-K
4.3	2003 Stock Option Plan Filed November 20, 2003 with the SEC, Form 10-QSB
4.4	The Company's 2009 Stock Incentive Plan Filed August 14, 2009 with the SEC, Form 10Q

4.5	2012 Equity Incentive Plan Filed August 2, 2012 with the SEC, Form 8-K
10.1	Note Purchase Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.2	Senior Secured Promissory Note (First Tranche) Filed March 2, 2011 with the SEC, Form 8-K
10.3	Senior Secured Promissory Note (Second Tranche) Filed April 4, 2011 with the SEC, Form 10-K
10.4	Guaranty Filed March 2, 2011 with the SEC, Form 8-K
10.5	Security Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.6	Stock Purchase Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.7	Royalty Payment Letter Filed March 2, 2011 with the SEC, Form 8-K
10.8	Subordination and Intercreditor Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.9	Placement Agent Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.10	Amendment to Placement Agency Agreement Filed August 22, 2011 with the SEC, Form 10-Q
10.11	Second Amendment to Placement Agency Agreement Filed August 22, 2011 with the SEC, Form 10-Q
10.12	Warrant to Purchase Shares of Common Stock Filed November 14, 2011 with the SEC, Form 10-Q
10.13	First Amendment to Warrant Filed November 14, 2011 with the SEC, Form 10-Q
10.14	Second Amendment to the Warrant Agreement, dated December 16, 2011 Filed December 27, 2011 with the SEC, Form 8-K
10.15	Form of Voting Agreement Filed January 20, 2012 with the SEC, Form 8-K
10.16	BMC Debt Conversion Agreement, dated January 13, 2012

	Filed January 20, 2012 with the SEC, Form 8-K
10.17	Form of Debt Conversion Agreement Filed on March 5, 2008 with the SEC, Form 8-K
10.18	Amendment to the Note Purchase Agreement, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K

10.19	Amendment to the First Tranche Promissory Note, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
10.20	Amendment to the Second Tranche Promissory Note, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
10.21	Amendment to the Security Agreement, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
10.22	PEDCO Guarantee Agreement Filed January 20, 2012 with the SEC, Form 8-K
10.23	First Amendment To The Voting Agreement and The Debt Conversion Agreement with BMC Filed May 31, 2012 with the SEC, Form 8-K
10.24	Second Amendment To Senior Secured Promissory Note (First Tranche) Filed May 31, 2012 with the SEC, Form 8-K
10.25	Second Amendment To Senior Secured Promissory Note (Second Tranche) Filed May 31, 2012 with the SEC, Form 8-K
10.26	Form of Lockup And Standstill Agreement Filed May 31, 2012 with the SEC, Form 8-K
10.27	BMC Debt Conversion Agreement, dated January 13, 2012 Filed June 28, 2012 with the SEC, Form 8-K
10.28	First Amendment To The Voting Agreement and The Debt Conversion Agreement with BMC Filed June 28, 2012 with the SEC, Form 8-K
14.1	Code of Business Conduct and Ethics Filed August 8, 2012 with the SEC, Form 8-K
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Audited Financial Statements of PEDCO for the period from February 5, 2011 (Inception) through December 31, 2011 Filed August 8, 2012 with the SEC, Form 8-K
99.2	Unaudited Financial Statements of PEDCO for the three months ended March 31, 2012 and 2011 Filed August 8, 2012 with the SEC, Form 8-K

99.3	Pro Forma Financial Information Filed August 8, 2012 with the SEC, Form 8-K

101.INS**	XBRL Instance Document
101.SCH **	XBRL Taxonomy Extension Schema Document
101.CAL **	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF **	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB **	XBRL Taxonomy Extension Label Linkbase Document
101.PRE **	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith

** Pursuant to Rule 405(a)(2) of Regulation S-T, the Company will furnish the XBRL Interactive Data Files with detailed footnote tagging as Exhibit 101 in an amendment to this Form 10-Q within the permitted 30-day grace period for the first quarterly period in which detailed footnote tagging is required after the filing date of this Form 10-Q.

SIGNATURES

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

	PEDEVCO Corp.	
Date: August 14, 2012	By:	/s/ Frank C. Ingriselli Frank C. Ingriselli President, CEO and Principal Executive Officer
Date: August 14, 2012	By:	/s/ Michael L. Peterson Michael L. Peterson Executive Vice President, Chief Financial Officer and Principal Accounting Officer

EXHIBIT INDEX

Exhibit Number	Description
1.1	Second Amendment to Warrant Filed December 27, 2011 with the SEC, Form 8-K
1.2	Third Amendment to Warrant dated April 10, 2012 Filed April 16, 2012 with the SEC, Form 10-K
2.1	Modification Agreement with Solimar Energy LLC Filed December 27, 2011 with the SEC, Form 8-K
2.2	Placement Agent Warrant Agreement with Trident Partners Ltd. Filed December 27, 2011 with the SEC, Form 8-K
2.3	Modification , dated December 22, 2011 Filed December 27, 2011 with the SEC, Form 8-K
2.4	Placement Agent Warrant Agreement, dated December 22, 2011 Filed December 27, 2011 with the SEC, Form 8-K
2.5	Agreement and Plan of Reorganization, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
2.6	Form of Trident Partners, Ltd., affiliate Warrants Filed May 18, 2012 with the SEC, Form 10-Q
2.7	First Amendment to the Agreement and Plan of Merger Filed May 31, 2012 with the SEC, Form 8-K
3.1	Amended and Restated Certificate of Formation (as filed with the Secretary of State of Texas) Filed August 2, 2012 with the SEC, Form 8-K
3.2	Amended and Restated Certificate of Designations of Series A Convertible Preferred Stock (as filed with the Secretary of State of Texas) Filed August 2, 2012 with the SEC, Form 8-K
3.3	Form of Articles of Merger (Nevada) Filed January 20, 2012 with the SEC, Form 8-K
3.4	Articles of Merger (as filed with the Secretary of State of Nevada) by and between Blast Acquisition Corp. and Pacific Energy Development Corp. Filed August 2, 2012 with the SEC, Form 8-K
4.1	$800,000 Secured Promissory Note dated July 15, 2005 by and among the Company and Berg McAfee Companies, LLC Filed July 26, 2005 with the SEC, Form 8-K

4.2	$200,000 Secured Subordinated Promissory Note dated July 15, 2005 by and among the Company and Berg McAfee Companies, LLC Filed July 26, 2005 with the SEC, Form 8-K
4.3	2003 Stock Option Plan Filed November 20, 2003 with the SEC, Form 10-QSB
4.4	The Company's 2009 Stock Incentive Plan Filed August 14, 2009 with the SEC, Form 10Q

4.5	2012 Equity Incentive Plan Filed August 2, 2012 with the SEC, Form 8-K
10.1	Note Purchase Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.2	Senior Secured Promissory Note (First Tranche) Filed March 2, 2011 with the SEC, Form 8-K
10.3	Senior Secured Promissory Note (Second Tranche) Filed April 4, 2011 with the SEC, Form 10-K
10.4	Guaranty Filed March 2, 2011 with the SEC, Form 8-K
10.5	Security Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.6	Stock Purchase Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.7	Royalty Payment Letter Filed March 2, 2011 with the SEC, Form 8-K
10.8	Subordination and Intercreditor Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.9	Placement Agent Agreement Filed March 2, 2011 with the SEC, Form 8-K
10.10	Amendment to Placement Agency Agreement Filed August 22, 2011 with the SEC, Form 10-Q
10.11	Second Amendment to Placement Agency Agreement Filed August 22, 2011 with the SEC, Form 10-Q
10.12	Warrant to Purchase Shares of Common Stock Filed November 14, 2011 with the SEC, Form 10-Q
10.13	First Amendment to Warrant Filed November 14, 2011 with the SEC, Form 10-Q
10.14	Second Amendment to the Warrant Agreement, dated December 16, 2011 Filed December 27, 2011 with the SEC, Form 8-K
10.15	Form of Voting Agreement Filed January 20, 2012 with the SEC, Form 8-K
10.16	BMC Debt Conversion Agreement, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K

10.17	Form of Debt Conversion Agreement Filed on March 5, 2008 with the SEC, Form 8-K
10.18	Amendment to the Note Purchase Agreement, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K

10.19	Amendment to the First Tranche Promissory Note, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
10.20	Amendment to the Second Tranche Promissory Note, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
10.21	Amendment to the Security Agreement, dated January 13, 2012 Filed January 20, 2012 with the SEC, Form 8-K
10.22	PEDCO Guarantee Agreement Filed January 20, 2012 with the SEC, Form 8-K
10.23	First Amendment To The Voting Agreement and The Debt Conversion Agreement with BMC Filed May 31, 2012 with the SEC, Form 8-K
10.24	Second Amendment To Senior Secured Promissory Note (First Tranche) Filed May 31, 2012 with the SEC, Form 8-K
10.25	Second Amendment To Senior Secured Promissory Note (Second Tranche) Filed May 31, 2012 with the SEC, Form 8-K
10.26	Form of Lockup And Standstill Agreement Filed May 31, 2012 with the SEC, Form 8-K
10.27	BMC Debt Conversion Agreement, dated January 13, 2012 Filed June 28, 2012 with the SEC, Form 8-K
10.28	First Amendment To The Voting Agreement and The Debt Conversion Agreement with BMC Filed June 28, 2012 with the SEC, Form 8-K
14.1	Code of Business Conduct and Ethics Filed August 8, 2012 with the SEC, Form 8-K
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Audited Financial Statements of PEDCO for the period from February 5, 2011 (Inception) through December 31, 2011 Filed August 8, 2012 with the SEC, Form 8-K
99.2	Unaudited Financial Statements of PEDCO for the three months ended March 31, 2012 and 2011 Filed August 8, 2012 with the SEC, Form 8-K

99.3	Pro Forma Financial Information Filed August 8, 2012 with the SEC, Form 8-K

101.INS**	XBRL Instance Document
101.SCH **	XBRL Taxonomy Extension Schema Document
101.CAL **	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF **	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB **	XBRL Taxonomy Extension Label Linkbase Document
101.PRE **	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith

** Pursuant to Rule 405(a)(2) of Regulation S-T, the Company will furnish the XBRL Interactive Data Files with detailed footnote tagging as Exhibit 101 in an amendment to this Form 10-Q within the permitted 30-day grace period for the first quarterly period in which detailed footnote tagging is required after the filing date of this Form 10-Q.

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Schedule II — Valuation and Qualifying Accounts F-56

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Revlon, Inc.:

We have audited the accompanying consolidated balance sheets of Revlon, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' deficiency and comprehensive loss, and cash flows for each of the years in the three-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed on the index on page F-1. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Revlon, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the Consolidated Financial Statements, the Company adopted Statement of Financial Accounting Standards (''SFAS'') No. 123(R), ''Share-Based Payment'', as of January 1, 2006, and SFAS No. 158, ''Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — An Amendment of FASB Statement No. 87, 88, 106 and 132(R)'', as of December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Revlon, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2007, expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

New York, New York

March 13, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Revlon, Inc.:

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting in item 9A(b), that Revlon, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Revlon, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Revlon, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Revlon, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Revlon, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' deficiency and comprehensive loss, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated March 13, 2007 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ KPMG LLP

New York, New York

March 13, 2007

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REVLON, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in millions, except per share amounts)

	December 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35.4	$ 32.5
Trade receivables, less allowances of $17.7 and $18.9 as of December 31, 2006 and 2005, respectively	207.8	282.2
Inventories	186.5	220.6
Prepaid expenses and other	58.3	56.7
Total current assets	488.0	592.0
Property, plant and equipment, net	115.3	119.7
Other assets	142.4	146.0
Goodwill, net	186.2	186.0
Total assets	$ 931.9	$ 1,043.7
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		

Short-term borrowings	$ 9.6	$ 9.0
Current portion of long-term debt	—	—
Accounts payable	95.1	133.1
Accrued expenses and other	272.5	328.4
Total current liabilities	377.2	470.5
Long-term debt	1,501.8	1,413.4
Long-term pension and other post-retirement plan liabilities	175.7	162.4
Other long-term liabilities	107.0	93.3
Stockholders' deficiency:		
Class B Common Stock, par value $0.01 per share; 200,000,000 shares authorized, 31,250,000 issued and outstanding as of December 31, 2006 and 2005, respectively	0.3	0.3
Class A Common Stock, par value $0.01 per share; 900,000,000 shares authorized and 390,001,154 and 344,472,735 shares issued as of December 31, 2006 and 2005, respectively	3.8	3.4
Additional paid-in capital	884.9	764.8
Treasury stock, at cost; 429,666 and 236,315 shares of Class A Common Stock as of December 31, 2006 and 2005, respectively	(1.4)	(0.8)
Accumulated deficit	(1,993.2)	(1,741.9)
Accumulated other comprehensive loss	(124.2)	(121.7)
Total stockholders' deficiency	(1,229.8)	(1,095.9)
Total liabilities and stockholders' deficiency	$ 931.9	$ 1,043.7

See Accompanying Notes to Consolidated Financial Statements

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REVLON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in millions, except per share amounts)

	Year Ended December 31,		
	2006	2005	2004
Net sales	$ 1,331.4	$ 1,332.3	$ 1,297.2
Cost of sales	545.5	508.1	485.3
Gross profit	785.9	824.2	811.9
Selling, general and administrative expenses	808.7	757.8	717.6
Restructuring costs and other, net	27.4	1.5	5.8
Operating (loss) income	(50.2)	64.9	88.5
Other expenses (income):			
Interest expense	148.8	130.0	130.8
Interest income	(1.1)	(5.8)	(4.8)

Amortization of debt issuance costs	7.5	6.9	8.2
Foreign currency (gains) losses, net	(1.5)	0.5	(5.2)
Loss on early extinguishment of debt	23.5	9.0	90.7
Miscellaneous, net	3.8	(0.5)	2.0
Other expenses, net	181.0	140.1	221.7
Loss before income taxes	(231.2)	(75.2)	(133.2)
Provision for income taxes	20.1	8.5	9.3
Net loss	$ (251.3)	$ (83.7)	$ (142.5)
Basic and diluted loss per common share	$ (0.62)	$ (0.22)	$ (0.47)
Weighted average number of common shares outstanding:			
Basic and diluted	404,542,722	374,060,951	303,428,981

See Accompanying Notes to Consolidated Financial Statements

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REVLON, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY AND COMPREHENSIVE LOSS

(dollars in millions)

	Preferred Stock	Common Stock	Additional Paid-In-Capital (Capital Deficiency)	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Loss	St D
Balance, January 1, 2004	$ 54.6	$0.7	$(143.2)	$ —	$(1,515.7)	$(122.0)	$
Common stock issued in exchange for debt, accrued interest and preferred stock [b]	(54.6)	3.0	879.3				
Reduction of liabilities assumed from indirect parent			16.4[a]				
Stock option compensation			1.2				
Amortization of deferred compensation for restricted stock			5.2				
Comprehensive loss:							
Net loss					(142.5)		
Adjustment for minimum pension liability						(1.6)	
Revaluation of foreign currency forward exchange contracts						(1.3)	
Currency translation adjustment						0.6	
Total comprehensive loss							
Balance, December 31, 2004	—	3.7	758.9	—	(1,658.2)	(124.3)	
Treasury stock acquired, at cost [c]				(0.8)			

Exercise of stock options for common stock			0.1				
Amortization of deferred compensation for restricted stock			5.8				
Comprehensive loss:							
Net loss					(83.7)		
Adjustment for minimum pension liability						6.7	
Revaluation of foreign currency forward exchange contracts						2.4	
Currency translation adjustment						(6.5)	
Total comprehensive loss							
Balance, December 31, 2005	—	3.7	764.8	(0.8)	(1,741.9)	(121.7)	
Net proceeds from $110 Million Rights Offering		0.4	106.8				
Treasury stock acquired, at cost [c]				(0.6)			
Stock option compensation			7.1				
Exercise of stock options for common stock			0.2				
Amortization of deferred compensation for restricted stock			6.0				
Comprehensive loss:							
Net loss					(251.3)		
Revaluation of foreign currency forward exchange contracts						(0.1)	
Currency translation adjustment						3.2	
Total comprehensive loss							
Net adjustment to initially apply SFAS No. 158, net of tax [d]						(5.6)	
Balance, December 31, 2006	$ —	$4.1	$ 884.9	$(1.4)	$(1,993.2)	$(124.2)	$

(a) During 2004, the Company resolved various state and federal tax audits and determined that certain tax liabilities assumed by Revlon Consumer Products Corporation in connection with transfer agreements related to Revlon Consumer Products Corporation's formation in 1992 were no longer probable. As a result, $16.4 was recorded directly to capital deficiency. (See Note 16, ''Related Party Transactions'').

(b) The changes in Preferred Stock, Common Stock, Additional Paid-in-Capital and a portion of Accumulated Deficit are a result of the consummation of the Revlon Exchange Transactions. (See Note 8, ''Long-Term Debt'').

(c) Amount relates to 193,351 and 236,315 shares of Revlon, Inc. Class A Common Stock received from certain executives to satisfy the minimum statutory tax withholding requirements related to the vesting of shares of restricted stock during 2006 and 2005, respectively. (See Note 13, ''Stockholders' Equity — Treasury Stock'').

(d) In December 2006, the Company adopted SFAS No. 158, ''Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans''. As a result, in December 2006, a net adjustment of $5.6 million was recorded directly to Accumulated Other Comprehensive Loss, which represents the difference between (1) the $107.0 million reversal of additional minimum pension liability recognized under the provisions of FASB Statement No. 132(R) in the 2005 financial statements and (2) the $112.6 million of actuarial gains and prior service costs related to the Company's pension and other post-retirement plans that arose during 2006 but were not recognized in net loss as components of net periodic pension cost pursuant to FASB Statement Nos. 87 and 106. (See Note 11, ''Savings Plan, Pension, and Post-retirement Benefits'').

See Accompanying Notes to Consolidated Financial Statements

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REVLON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	December 31,		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (251.3)	$ (83.7)	$ (142.5)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	122.8	102.9	106.1
Amortization of debt discount	0.6	0.2	1.8
Stock compensation amortization	13.1	5.8	6.4
Loss on early extinguishment of debt	23.5	9.0	77.3
Change in assets and liabilities:			
Decrease (increase) in trade receivables	77.9	(86.5)	(12.1)
Decrease (increase) in inventories	36.5	(69.8)	(7.8)
Decrease (increase) in prepaid expenses and other current assets	0.2	2.6	(22.3)
(Decrease) increase in accounts payable	(29.9)	22.0	(4.4)
(Decrease) increase in accrued expenses and other current liabilities	(69.0)	12.9	(60.3)
Purchase of permanent displays	(98.7)	(69.6)	(56.0)
Other, net	35.6	14.5	19.6
Net cash used in operating activities	(138.7)	(139.7)	(94.2)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(22.4)	(25.8)	(18.9)
Investment in debt defeasance trust	—	(197.9)	—
Liquidation of investment in debt defeasance trust	—	197.9	—
Payment received on note from parent	—	10.0	—
Net cash used in investing activities	(22.4)	(15.8)	(18.9)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease) increase in short-term borrowings and overdraft	(9.1)	(8.8)	6.0
Borrowings under the 2006 Revolving Credit Facility, net	57.5	—	—
Borrowings under the 2004 Term Loan Facility	100.0		
Borrowings under the 2006 Term Loan Facility	840.0	—	—
Proceeds from the issuance of long-term debt — third parties	—	386.2	1,136.2
Repayment of long-term debt, including pre-payment fee and premiums	(917.8)	(297.9)	(960.2)
Proceeds from the issuance of long-term debt — affiliates	—	—	42.4
Repayment of long-term debt — affiliates	—	—	(19.5)
Net Proceeds from the $110 Million Rights Offering	107.2	—	—
Proceeds from the exercise of stock options for common stock	0.2	0.1	—
Payment of financing costs	(14.8)	(12.0)	(30.4)
Net cash provided by financing activities	163.2	67.6	174.5
Effect of exchange rate changes on cash and cash equivalents	0.8	(0.4)	2.9

Net increase (decrease) in cash and cash equivalents	2.9	(88.3)	64.3
Cash and cash equivalents at beginning of period	32.5	120.8	56.5
Cash and cash equivalents at end of period	$ 35.4	$ 32.5	$ 120.8
Supplemental schedule of cash flow information:			
Cash paid during the period for:			
Interest	$ 155.6	$ 123.5	$ 133.9
Income taxes, net of refunds	$ 12.5	$ 17.9	$ 11.1
Supplemental schedule of non-cash investing and financing activities:			
Conversion of long-term debt and accrued interest into Class A Common Stock	$ —	$ —	$ 813.8
Exchange and conversion of Series A and Series B Preferred Stock into Class A Common Stock	$ —	$ —	$ 54.6
Treasury stock received to satisfy minimum tax withholding liabilities	$ 0.6	$ 0.8	$ —
Reduction of liabilities assumed from indirect parent	$ —	$ —	$ 16.4

See Accompanying Notes to Consolidated Financial Statements

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REVLON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts in millions, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation:

Revlon, Inc. (and together with its subsidiaries, the ''Company'') conducts its business exclusively through its direct wholly-owned operating subsidiary, Revlon Consumer Products Corporation and its subsidiaries (''Products Corporation''). The Company operates in a single segment and manufactures and sells an extensive array of cosmetics, skincare, fragrances, beauty tools, hair color, anti-perspirants/deodorants and other personal care products. The Company's principal customers include large mass volume retailers and chain drug and food stores, as well as certain department stores and other specialty stores, such as perfumeries. The Company also sells consumer products to U.S. military exchanges and commissaries and has a licensing business, pursuant to which the Company licenses certain of its key brand names to third parties for complementary beauty-related products and accessories.

Unless the context otherwise requires, all references to the Company mean Revlon, Inc. and its subsidiaries. Revlon, Inc., as a public holding company, has no business operations of its own and its only material asset has been all of the outstanding capital stock of Products Corporation. As such, its net (loss) income has historically consisted predominantly of the net (loss) income of Products Corporation, and in 2006, 2005 and 2004 included approximately $6.6 million, $7.6 million and $1.2 million, respectively, in expenses incidental to being a public holding company.

Revlon, Inc. is a direct and indirect majority-owned subsidiary of MacAndrews & Forbes Holdings Inc. (''MacAndrews & Forbes Holdings'' and, together with certain of its affiliates other than the Company, ''MacAndrews & Forbes''), a corporation wholly-owned by Ronald O. Perelman.

The accompanying Consolidated Financial Statements include the accounts of the Company after elimination of all material intercompany balances and transactions.

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the periods presented. Actual results could differ from these estimates. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Significant estimates made in the accompanying Consolidated Financial Statements include, but are not limited to, allowances for doubtful accounts, inventory valuation reserves, expected sales returns and allowances, certain assumptions related to the recoverability of intangible and long-lived assets, reserves for estimated tax liabilities, restructuring costs, certain estimates and assumptions used in the calculation of the fair value of stock options issued to employees and the derived compensation expense and certain estimates regarding the calculation of the net periodic benefit costs and the projected benefit obligation for the Company’s pension and other post-retirement plans.

Certain prior year amounts have been reclassified to conform to the current year’s presentation, including the transfer, during the second quarter of 2006, of management responsibility for the Company’s Canadian operations from the Company’s North American operations to the European region of its international operations.

Cash and Cash Equivalents:

Cash equivalents are primarily investments in high-quality, short-term money market instruments with original maturities of three months or less and are carried at cost, which approximates fair value. Cash equivalents were $5.1 million and $9.7 million as of December 31, 2006 and 2005, respectively. Accounts payable includes $9.1 million and $18.2 million of outstanding checks not yet presented for payment at December 31, 2006 and 2005, respectively.

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In accordance with borrowing arrangements with certain financial institutions, Products Corporation is permitted to borrow against its cash balances. The cash available to Products Corporation is the net of the cash position less amounts supporting these short-term borrowings. The cash balances and related borrowings are shown gross in the Company’s Consolidated Balance Sheets. As of December 31, 2006 and 2005, the Company had $2.7 million and $3.2 million, respectively, of cash supporting such short-term borrowings. (See Note 7, ‘‘Short-Term Borrowings’’).

Accounts Receivable:

Accounts receivable represent payments due to the Company for previously recognized net sales, reduced by an allowance for doubtful accounts for balances, which are estimated to be uncollectible at December 31, 2006 and 2005. The Company grants credit terms in the normal course of business to its customers. Trade credit is extended based upon periodically updated evaluations of each customer’s ability to perform its obligations. The Company does not normally require collateral or other security to support credit sales. The allowance for doubtful accounts is determined based on historical experience and ongoing evaluations of the Company’s receivables and evaluations of the risks of payment. Accounts receivable balances are recorded against the allowance for doubtful accounts when they are deemed uncollectible. Recoveries of accounts receivable previously recorded against the allowance are recorded in the Consolidated Statements of Operations when received. At December 31, 2006 and 2005, the Company’s three largest

customers accounted for an aggregate of approximately 40% and 43%, respectively, of outstanding accounts receivable.

Inventories:

Inventories are stated at the lower of cost or market value. Cost is principally determined by the first-in, first-out method. The Company records adjustments to the value of inventory based upon its forecasted plans to sell its inventories, as well as planned discontinuances. The physical condition (e.g., age and quality) of the inventories is also considered in establishing its valuation. These adjustments are estimates, which could vary significantly, either favorably or unfavorably, from the amounts that the Company may ultimately realize upon the disposition of inventories if future economic conditions, customer inventory levels, product discontinuances, return levels or competitive conditions differ from the Company’s estimates and expectations.

Property, Plant and Equipment and Other Assets:

Property, plant and equipment is recorded at cost and is depreciated on a straight-line basis over the estimated useful lives of such assets as follows: land improvements, 20 to 40 years; buildings and improvements, 5 to 45 years; machinery and equipment, 3 to 17 years; and office furniture and fixtures and capitalized software, 2 to 12 years. Leasehold improvements are amortized over their estimated useful lives or the terms of the leases, whichever is shorter. Repairs and maintenance are charged to operations as incurred, and expenditures for additions and improvements are capitalized.

Long-lived assets, including fixed assets and intangibles other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, the Company estimates the undiscounted future cash flows (excluding interest) resulting from the use of the asset and its ultimate disposition. If the sum of the undiscounted cash flows (excluding interest) is less than the carrying value, the Company recognizes an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset.

Included in other assets are net permanent wall displays amounting to approximately $103.9 million and $91.4 million as of December 31, 2006 and 2005, respectively, which are amortized over a period of 1 to 3 years in the U.S. and generally over 3 to 5 years outside of the U.S. In the event of product discontinuances, from time to time the Company may accelerate the amortization of related permanent wall displays based on the estimated remaining useful life of the asset. Amortization expense for permanent wall displays for 2006, 2005 and 2004 was $85.8 million, $70.4 million and $60.9 million, respectively. The Company has included in other assets net costs related to the issuance of Products

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Corporation’s debt instruments amounting to approximately $22.2 million and $33.9 million as of December 31, 2006 and 2005, respectively, which are amortized over the terms of the related debt instruments. In addition, the Company has included in other assets trademarks, net, of $8.2 million and $8.1 million as of December 31, 2006 and 2005, respectively, and patents, net, of $1.4 million and $2.3 million as of December 31, 2006 and 2005, respectively. Patents and trademarks are recorded at cost and amortized ratably over approximately 10 to 17 years. Amortization expense for patents and trademarks for 2006, 2005 and 2004 was $2.2 million, $2.0 million and $1.8 million, respectively.

Intangible Assets Related to Businesses Acquired:

Intangible assets related to businesses acquired principally represent goodwill, which represents the excess purchase price over the fair value of assets acquired. The Company accounts for its goodwill and intangible assets in accordance with SFAS No. 142, ‘‘Goodwill and Other Intangible Assets’’, and does not amortize its goodwill. The Company reviews its goodwill for impairment at least annually, or whenever events or changes in circumstances would indicate possible impairment. The Company performs its annual impairment test of goodwill as of September 30 and performed the annual test as of September 30, 2006 and 2005 and concluded that no impairment existed. The Company operates in one reportable segment, which is also the only reporting unit for purposes of SFAS No. 142. Since the Company currently only has one reporting unit, all of the goodwill has been assigned to the enterprise as a whole. The Company compared its estimated fair value as measured by, among other factors, its market capitalization to its net assets and since the fair value was substantially greater than the net assets, the Company concluded that as of December 31, 2006 there was no impairment of goodwill. The amount outstanding for goodwill, net, was $186.2 million and $186.0 million at December 31, 2006 and 2005, respectively. Accumulated amortization aggregated $117.3 million and $117.2 million at December 31, 2006 and 2005, respectively. Amortization of goodwill ceased on January 1, 2002 upon the Company’s adoption of SFAS No. 142.

In accordance with SFAS No. 142, the Company’s intangible assets with finite useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment whenever events or changes in circumstances would indicate possible impairment in accordance with FASB Statement No. 144, ‘‘Accounting for the Impairment or Disposal of Long-Lived Assets’’.

Revenue Recognition:

Sales are recognized when revenue is realized or realizable and has been earned. The Company’s policy is to recognize revenue when risk of loss and title to the product transfers to the customer. Net sales is comprised of gross revenues less expected returns, trade discounts and customer allowances, which include costs associated with off-invoice mark-downs and other price reductions, as well as trade promotions and coupons. These incentive costs are recognized at the later of the date on which the Company recognizes the related revenue or the date on which the Company offers the incentive. The Company allows customers to return their unsold products if and when they meet certain Company-established criteria as outlined in the Company’s trade terms. The Company regularly reviews and revises, when deemed necessary, its estimates of sales returns based primarily upon actual returns, planned product discontinuances, new product launches, estimates of customer inventory and promotional sales, which would permit customers to return items based upon the Company’s trade terms. The Company records sales returns as a reduction to sales and cost of sales, and an increase to accrued liabilities and to inventories. Returned products, which are recorded as inventories, are valued based upon the amount that the Company expects to realize upon their subsequent disposition. The physical condition and marketability of the returned products are the major factors considered by the Company in estimating realizable value. Actual returns, as well as realized values on returned products, may differ significantly, either favorably or unfavorably, from the Company’s estimates if factors such as product discontinuances, customer inventory levels or competitive conditions differ from the Company’s estimates and expectations and, in the case of actual returns, if economic conditions differ significantly from the Company’s estimates and expectations. Revenues derived from licensing arrangements, including any pre-payments, are recognized in the period in which they become due and payable but not before the initial license term commences.

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Cost of sales includes all of the costs to manufacture the Company’s products. For products manufactured in the Company’s own facilities, such costs include raw materials and supplies, direct labor and factory overhead. For products manufactured for the Company by third-party contractors, such costs represent the amounts invoiced by the contractors. Cost of sales also includes the cost of refurbishing products returned by customers that will be offered for resale and the cost of inventory write-downs associated with adjustments of held inventories to net realizable value. These costs are reflected in the statement of operations when the product is sold and net sales revenues are recognized or, in the case of inventory write-downs, when circumstances indicate that the carrying value of inventories is in excess of its recoverable value. Additionally, cost of sales reflects the costs associated with free products. These incentive costs are recognized on the later of the date that the Company recognizes the related revenue or the date on which the Company offers the incentive.

Selling, general and administrative expenses (‘‘SG&A’’) include expenses to advertise the Company’s products, such as television advertising production costs and air-time costs, print advertising costs, promotional displays and consumer promotions. SG&A also includes the amortization of permanent wall displays and intangible assets, distribution costs (such as freight and handling), non-manufacturing overhead, principally personnel and related expenses, insurance and professional fees.

Income Taxes:

Income taxes are calculated using the asset and liability method in accordance with the provisions of SFAS No. 109, ‘‘Accounting for Income Taxes’’.

Revlon, Inc. and its U.S. subsidiaries, including Products Corporation, for federal income tax purposes, were included through the period ended March 25, 2004 in the affiliated group of which MacAndrews & Forbes Holdings was the common parent (the ‘‘MacAndrews & Forbes Group’’), and Revlon, Inc.’s and its U.S. subsidiaries, including Products Corporation, federal taxable income and loss was, through the period ended March 25, 2004, included in such group’s consolidated tax return filed by MacAndrews & Forbes Holdings. As a result of the Revlon Exchange Transactions (as hereinafter defined) (see Note 8, ‘‘Long-Term Debt’’), as of the end of the day on March 25, 2004, Revlon, Inc. and its U.S. subsidiaries, including Products Corporation, were no longer included in the MacAndrews & Forbes Group for federal income tax purposes.

Research and Development:

Research and development expenditures are expensed as incurred. The amounts charged against earnings in 2006, 2005 and 2004 for research and development expenditures were $24.4 million, $26.1 million and $24.0 million, respectively.

Foreign Currency Translation:

Assets and liabilities of foreign operations are translated into U.S. dollars at the rates of exchange in effect at the balance sheet date. Income and expense items are translated at the weighted average exchange rates prevailing during each period presented. Gains and losses resulting from foreign currency transactions are included in the results of operations. Gains and losses resulting from translation of financial statements of foreign subsidiaries and branches operating in non-hyperinflationary economies are recorded as a component of accumulated other comprehensive loss until either sale or upon complete or substantially complete liquidation by the Company of its investment in a foreign entity. Foreign subsidiaries and branches operating in hyperinflationary economies translate non-monetary assets and liabilities at historical rates and include translation adjustments in the results of operations.

Sale of Subsidiary Stock:

The Company recognizes gains and losses on sales of subsidiary stock in its Consolidated Statements of Operations.

Basic and Diluted Loss per Common Share and Classes of Stock:

Shares used in basic loss per share are computed using the weighted average number of common shares outstanding each period. Shares used in diluted loss per share include the dilutive effect of

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unvested restricted shares and outstanding stock options under the Stock Plan (as hereinafter defined) using the treasury stock method. Options to purchase 24,993,016, 33,033,097 and 30,781,700 shares of Revlon, Inc. Class A common stock, par value of $0.01 per share (the ''Class A Common Stock''), with weighted average exercise prices of $4.54, $4.25 and $4.66, respectively, were outstanding at December 31, 2006, 2005 and 2004, respectively. Additionally, 8,120,643, 3,810,002 and 5,725,000 shares of unvested restricted stock were outstanding as of December 31, 2006, 2005 and 2004, respectively. Because the Company incurred losses in 2006, 2005 and 2004, these options and restricted shares are excluded from the calculation of diluted loss per common share as their effect would be antidilutive.

For each period presented, the amount of loss used in the calculation of diluted loss per common share was the same as the amount of loss used in the calculation of basic loss per common share.

Stock-Based Compensation:

Prior to January 1, 2006, the Company applied the intrinsic value method as outlined in Accounting Principles Board (''APB'') Opinion No. 25, ''Accounting for Stock Issued to Employees'' (''APB No. 25'') and related interpretations in accounting for stock options granted. Under the intrinsic value method, no compensation expense was recognized in fiscal periods ended prior to January 1, 2006 if the exercise price of the Company's employee stock options was greater than or equal to the market price of Revlon, Inc.'s Class A Common Stock on the date of the grant. Since all options granted under the Stock Plan (as hereinafter defined) had an exercise price equal to the market value of the underlying Class A Common Stock on the date of grant, no compensation expense was recognized in the accompanying consolidated statements of operations for the fiscal periods ended on or before December 31, 2005 in respect of stock options granted to employees under the Stock Plan.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (''SFAS'') No. 123(R), ''Share-Based Payment'' (''SFAS No. 123(R)''). This statement replaces SFAS No. 123, ''Accounting for Stock-Based Compensation'' (''SFAS No. 123'') and supersedes APB No. 25. SFAS No. 123(R) requires that effective for fiscal periods ending after December 31, 2005 all stock-based compensation be recognized as an expense, net of the effect of expected forfeitures, in the financial statements and that such expense be measured at the fair value of the Company's stock-based awards and generally recognized over the grantee's required service period. The Company uses the modified prospective method of application, which requires recognition of compensation expense on a prospective basis. Therefore, the Company's financial statements for fiscal periods ended on or before December 31, 2005 have not been restated to reflect compensation expense in respect of awards of stock options under the Stock Plan. Under this method, in addition to reflecting compensation expense for new share-based awards granted on or after January 1, 2006, expense is also recognized to reflect the remaining service period (generally, the vesting period of the award) of awards that had been included in the Company's pro forma disclosures in fiscal periods ended on or before December 31, 2005. For stock option awards, the Company has continued to recognize stock option compensation expense using the accelerated attribution method under FASB Financial Interpretation Number (''FIN'') 28, ''Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans''. For stock option awards granted after January

1, 2006, the Company recognizes stock option compensation expense based on the estimated grant date fair value using the Black-Scholes option valuation model using a straight-line amortization method. SFAS No. 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows. For the year ended December 31, 2006, no adjustments have been made to the cash flow statement, as any excess tax benefits that would have been realized have been fully provided for, given the Company's historical losses and deferred tax valuation allowance.

Derivative Financial Instruments:

The Company accounts for derivative financial instruments in accordance with SFAS No. 133, ''Accounting for Derivative Instruments and Hedging Activities'', as amended by SFAS No. 149, ''Amendment of Statement 133 on Derivative Instruments and Hedging Activities''. The standard requires the recognition of all derivative instruments on the balance sheet as either assets or liabilities

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measured at fair value. Changes in fair value are recognized immediately in earnings unless the derivatives qualify as hedges of future cash flows. For derivatives qualifying as hedges of future cash flows, the effective portion of changes in fair value is recorded as a component of other comprehensive income (loss) and recognized in earnings when the hedged transaction is recognized in earnings. Any ineffective portion (representing the extent that the change in fair value of the hedges does not completely offset the change in the anticipated net payments being hedged) is recognized in earnings as it occurs. If a derivative instrument designated as a hedge is terminated, the unrecognized fair value of the hedge previously recorded in accumulated other comprehensive income (loss) is recognized in earnings when the hedged transaction is recognized in earnings. If the transaction being hedged is terminated, the unrecognized fair value of the Company's related hedge instrument is recognized in earnings at that time.

The Company formally designates and documents each financial instrument as a hedge of a specific underlying exposure, as well as the risk management objectives and strategies for entering into the hedge transaction upon inception. The Company also formally assesses upon inception and quarterly thereafter whether the financial instruments used in hedging transactions are effective in offsetting changes in the fair value or cash flows of the hedged items.

The Company uses derivative financial instruments, primarily foreign currency forward exchange contracts, to reduce the effects of fluctuations in foreign currency exchange rates. These contracts, which have been designated as cash flow hedges, were entered into primarily to hedge anticipated inventory purchases and certain intercompany payments denominated in foreign currencies and have maturities of less than one year. Any unrecognized income (loss) related to these contracts is recorded in the Statement of Operations primarily in cost of goods sold when the underlying transactions hedged are realized (e.g., when inventory is sold or intercompany transactions are settled). Products Corporation enters into these contracts with counterparties that are major financial institutions, and accordingly the Company believes that the risk of counterparty nonperformance is remote. During 2006, 2005 and 2004, net derivative losses of $0.3 million, $2.2 million and $1.5 million, respectively, were reclassified to the Statement of Operations. The notional amount of the foreign currency forward exchange contracts outstanding at December 31, 2006 and 2005 was $42.5 million and $31.9 million, respectively. The fair value of the foreign currency forward exchange contracts outstanding at December 31, 2006 and 2005 was $(0.4) million and $(0.2) million, respectively, and is recorded in ''Prepaid expenses and other'' in the amount of $0.6 million $0.5 million, respectively, and in ''Accrued expenses and other'' in the amount of $1.0 million and $0.7 million, respectively, in the accompanying Consolidated Balance Sheets.

The Company had accumulated net derivative losses of $(0.4) million in other comprehensive loss as of December 31, 2006 related to cash flow hedges, all of which will be reclassified into earnings within 12 months. The amount of the hedges' ineffectiveness for the years ended December 31, 2006 and 2005 recorded in the Consolidated Statements of Operations was not significant.

Advertising and Promotion:

The costs of promotional displays are expensed in the period in which they are shipped to customers. Television, print and other advertising production costs are expensed the first time the advertising takes place. Advertising and promotion expenses were $269.0 million, $230.5 million and $225.2 million for 2006, 2005 and 2004, respectively, and were included in SG&A in the Company's Consolidated Statements of Operations. The Company also has various arrangements with customers pursuant to its trade terms to reimburse them for a portion of their advertising or promotional costs, which provide advertising and promotional benefits to the Company. Additionally, from time to time the Company may pay fees to customers in order to expand or maintain shelf space for its products. The costs that the Company incurs for ''cooperative'' advertising programs, end cap placement, shelf placement costs and slotting fees are expensed as incurred and are netted against revenues on the Company's Consolidated Statements of Operations.

Distribution Costs:

Costs, such as freight and handling costs, associated with distribution are expensed within SG&A when incurred. Distribution costs were $67.6 million, $68.3 million and $62.0 million for 2006, 2005 and 2004, respectively.

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Recent Accounting Pronouncements:

In June 2006, the FASB issued FIN 48, ''Accounting for Uncertainty in Income Taxes — an interpretation of SFAS No. 109''. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, ''Accounting for Income Taxes''. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of the adoption of FIN 48 and currently expects that the adoption of FIN 48 will result in a reduction of its total tax reserves by approximately $25 million, which will reduce accumulated deficit.

In September 2006, the FASB issued SFAS No. 157, ''Fair Value Measurements.'' This statement clarifies the definition of fair value of assets and liabilities, establishes a framework for measuring fair value of assets and liabilities, and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact that SFAS No. 157 could have on its results of operations or financial condition.

In September 2006, the FASB issued SFAS No. 158, ''Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statement Nos. 87, 88, 106, and 132(R)'' (''SFAS No. 158''). SFAS No. 158 is intended by FASB to improve financial reporting by requiring an employer to recognize the overfunded or

underfunded status of a defined benefit post-retirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 is also intended by the FASB to improve financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions.

SFAS No. 158 requires an employer that sponsors one or more single-employer defined benefit plans to:

a. Recognize the funded status of a benefit plan — measured as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation — in its statement of financial position. For a pension plan, the benefit obligation is the projected benefit obligation; for any other post-retirement benefit plan, such as a retiree health care plan, the benefit obligation is the accumulated post-retirement benefit obligation;
b. Recognize as a component of other comprehensive income (loss), net of tax, the gains or losses recognized and prior service costs or credits that arise during the year but are not recognized in net income (loss) as components of net periodic benefit cost pursuant to FASB Statement No. 87, ''Employers' Accounting for Pensions'', or No. 106, ''Employers' Accounting for Postretirement Benefits Other Than Pensions''. Amounts recognized in accumulated other comprehensive income, including the gains or losses, prior service costs or credits, and the transition assets or obligations remaining from the initial application of Statements Nos. 87 and 106, are adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of Statements Nos. 87 and 106;
c. Measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions), which for the Company applies beginning with respect to the fiscal year ended December 31, 2008; and
d. Disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations.

An employer with publicly traded equity securities is required to initially recognize the funded status of the defined benefit pension plans and other post-retirement plans and to provide the required

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disclosures as of the end of its fiscal years ending after December 15, 2006. See Note 11 to the Consolidated Financial Statements for further discussion of the impact of adopting SFAS No. 158 on the results of operations or financial condition of the Company.

In September 2006, the SEC issued Staff Accounting Bulletin (''SAB'') No. 108, ''Considering the Effects of Prior Year Misstatements when Qualifying Misstatements in Current Year Financial Statements,'' which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The SEC staff believes that registrants must quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier

application encouraged for any interim period of the first fiscal year ending after November 15, 2006, filed after the publication of SAB No. 108 (which occurred on September 13, 2006). The application of SAB No. 108 did not have any impact on the Company's consolidated results of operations and/or financial condition.

2. RESTRUCTURING COSTS AND OTHER, NET

During 2006, the Company recorded total restructuring charges of approximately $27.4 million, of which $17.5 million was associated with the restructuring announced in September 2006 (the ''September 2006 Program''), primarily for employee severance and other employee-related termination costs, and approximately $10.1 million was associated with the restructuring announced in February 2006 (the ''February 2006 Program''), primarily for employee severance and other employee-related termination costs, as to which approximately 300 employees had been terminated as of December 31, 2006 in relation to the September 2006 Program and the February 2006 Program. During 2005, the Company recorded net charges of $1.5 million for employee severance and other related personnel benefits. During 2004, the Company recorded net charges of $5.8 million primarily for employee severance and other related personnel benefits.

The September 2006 Program was designed to reduce costs and improve the Company's profit margins, largely through a broad organizational streamlining that involved consolidating responsibilities in certain related functions and reducing layers of management to increase accountability and effectiveness; streamlining support functions to reflect the new organization structure; eliminating certain senior executive positions; and consolidating various facilities.

The February 2006 Program involved the consolidation of certain functions within the Company's sales, marketing and creative groups, as well as certain headquarters functions, which changes were designed to streamline internal processes and to enable the Company to continue to be more effective and efficient in meeting the needs of its consumers and retail customers.

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Details of the activity described above during 2006, 2005 and 2004 are as follows:

	Balance Beginning of Year	Expenses, Net	Utilized, Net		Balance End of Year
			Cash	Noncash	
2006					
Employee severance and other personnel benefits:					
2003 programs	$ 1.2	$ (0.3)	$ (0.8)	$ —	$ 0.1
2004 programs	2.4	—	(2.3)	—	0.1
February 2006 Program	—	10.1	(6.7)	—	3.4
September 2006 Program	—	17.5	(3.7)	—	13.8
Other 2006 programs[(a)]	—	0.3	(0.2)	—	0.1
	3.6	27.6	(13.7)	—	17.5

Leases and equipment write-offs	0.6	(0.2)	0.2	(0.2)	0.4
	$ 4.2	$ 27.4	$ (13.5)	$ (0.2)	$ 17.9
2005					
Employee severance and other personnel benefits:					
2003 programs	$ 3.1	$ —	$ (1.7)	$ (0.2)	$ 1.2
2004 programs	5.1	1.5	(3.9)	(0.3)	2.4
	8.2	1.5	(5.6)	(0.5)	3.6
Leases and equipment write-offs	2.9	—	(2.0)	(0.3)	0.6
	$ 11.1	$ 1.5	$ (7.6)	$ (0.8)	$ 4.2
2004					
Employee severance and other personnel benefits:					
2000 program	$ 1.8	$ —	$ (1.8)	$ —	$ —
2003 program	5.0	0.1	(2.4)	0.4	3.1
2004 program	—	5.9	(0.8)	—	5.1
	6.8	6.0	(5.0)	0.4	8.2
Leases and equipment write-offs	2.2	(0.2)	0.6	0.3	2.9
	$ 9.0	$ 5.8	$ (4.4)	$ 0.7	$ 11.1

(a) Other 2006 programs refer to various immaterial international restructurings in respect of Chile, Brazil and Israel.

As of December 31, 2006, 2005 and 2004, the unpaid balance of the restructuring costs and other, net for reserves are included in ‘‘Accrued expenses and other’’ and ‘‘Other long-term liabilities’’ in the Company’s Consolidated Balance Sheets. The remaining balance at December 31, 2006 for employee severance and other personnel benefits is $17.9 million, of which $14.8 million is expected to be paid by the end of 2007 and the remaining obligations of $3.1 million are expected to be paid by the end of 2009.

3. INVENTORIES

	December 31,	
	2006	2005
Raw materials and supplies	$ 50.5	$ 60.7
Work-in-process	15.9	17.6
Finished goods	120.1	142.3
	$ 186.5	$ 220.6

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4. PREPAID EXPENSES AND OTHER

	December 31, 2006	December 31, 2005
Prepaid expenses	$ 38.6	$ 37.8
Other	19.7	18.9
	$ 58.3	$ 56.7

5. PROPERTY, PLANT AND EQUIPMENT, NET

	December 31, 2006	December 31, 2005
Land and improvements	$ 2.3	$ 2.2
Building and improvements	59.5	57.6
Machinery, equipment and capital leases	133.3	125.7
Office furniture, fixtures and capitalized software	115.9	110.3
Leasehold improvements	17.3	18.9
Construction-in-progress	15.9	14.9
	344.2	329.6
Accumulated depreciation	(228.9)	(209.9)
	$ 115.3	$ 119.7

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was $26.5 million, $22.7 million and $34.0 million, respectively.

6. ACCRUED EXPENSES AND OTHER

	December 31, 2006	December 31, 2005
Sales returns and allowances	$ 124.9	$ 141.2
Advertising and promotional costs	43.0	48.0
Compensation and related benefits	28.5	61.5
Interest	21.0	28.5
Taxes, other than federal income taxes	13.7	13.8
Restructuring costs	14.7	3.8
Other	26.7	31.6
	$ 272.5	$ 328.4

7. SHORT-TERM BORROWINGS

Products Corporation had outstanding short-term bank borrowings (excluding borrowings under the 2004 Credit Agreement and 2006 Credit Agreements, which are reflected in Note 8, ‘‘Long-Term Debt’’), aggregating $9.6 million and $9.0 million at December 31, 2006 and 2005, respectively. The weighted average interest rate on short-term borrowings outstanding at December 31, 2006 and 2005 was 11.5% and 13.7%, respectively. Under these short-term borrowing arrangements, the Company is permitted to borrow against its cash balances. The cash balances and related borrowings are shown gross in the Company’s Consolidated Balance Sheets. As of December 31, 2006 and 2005, the Company had $2.7 million and $3.2 million, respectively, of cash supporting such short-term borrowings. Interest rates on these cash balances at December 31, 2006 was 1.2% and ranged from 0.3% to 0.5% in 2005.

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8. LONG-TERM DEBT

	December 31,	
	2006	2005
2004 Term Loan Facility due 2010 (See (a) below)	$ —	$ 700.0
2006 Term Loan Facility due 2012 (See (a) below)	840.0	—
2006 Revolving Credit Facility due 2012 (See (a) below)	57.5	—
9½% Senior Notes due 2011, net of discounts (See (b) below)	386.9	386.4
8 5/8% Senior Subordinated Notes due 2008 (See (c) below)	217.4	327.0
2004 Consolidated MacAndrews & Forbes Line of Credit (See (d) below)	—	—
	1,501.8	1,413.4
Less current portion	—	—
	$ 1,501.8	$ 1,413.4

2006 Transactions

The Company completed several significant financing transactions during 2006.

Credit Agreement Refinancing — December 2006

Products Corporation completed a refinancing of its 2004 Credit Agreement (as hereinafter defined) by entering into the new 5-year $840.0 million 2006 Term Loan Facility (as hereinafter defined), and entering into the 2006 Revolving Credit Facility (as hereinafter defined), amending and restating its existing $160.0 million multi-currency revolving credit facility under the 2004 Credit Agreement and extending its maturity through the same 5-year period.

$110 Million Rights Offering — March 2006

In March 2006, Revlon, Inc. completed the $110 Million Rights Offering (as hereinafter defined), which allowed stockholders of record to purchase additional shares of Class A Common Stock. The subscription price for each share of Class A Common Stock purchased in the $110 Million Rights Offering, including shares purchased in the private placement by MacAndrews & Forbes, was $2.80 per share. Upon completing the $110 Million Rights Offering, Revlon, Inc. promptly transferred the net proceeds to Products Corporation, which it used to redeem approximately $109.7 million aggregate principal amount of its 8 5/8% Senior Subordinated Notes in satisfaction of the applicable requirements under the 2004 Credit Agreement, at an aggregate redemption price of $111.8 million, including $2.1 million of accrued and unpaid interest up to, but not including, the redemption date.

See Note 20, ‘‘Subsequent Events’’ regarding the completion of the $100 Million Rights Offering (as hereinafter defined).

2005 Transactions

The Company completed two significant financing transactions during 2005: (i) Products Corporation issued $310.0 million aggregate principal amount of its 9½% Senior Notes (as hereinafter defined), and using the proceeds of such notes, Products Corporation completed the redemption of all $116.2 million aggregate principal amount outstanding

of its 8 1/8% Senior Notes due 2006 (the ‘‘8 1/8% Senior Notes’’) and all $75.5 million aggregate principal amount outstanding of its 9% Senior Notes due 2006 (the ‘‘9% Senior Notes’’) and prepaid $100.0 million of the 2004 Term Loan Facility (as hereinafter defined) and paid related fees and expenses incurred in connection with such transactions and (ii) Products Corporation issued $80.0 million aggregate principal amount of its additional 9½% Senior Notes (as hereinafter defined), which priced at 95¼% of par, and used the proceeds to fund general corporate purposes, principally to fund certain brand initiatives, namely the complete re-stage of the Almay brand and the Vital Radiance brand before its discontinuance.

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(a) Credit Agreements:

Complete Refinancing of the 2004 Credit Agreement in December 2006

In July 2004, Products Corporation entered into a credit agreement (the ‘‘2004 Credit Agreement’’) with certain of its subsidiaries as local borrowing subsidiaries, a syndicate of lenders, Citicorp USA, Inc., as multi-currency administrative agent, term loan administrative agent and collateral agent, UBS Securities LLC as syndication agent and Citigroup Global Markets Inc., as sole lead arranger and sole bookrunner.

The 2004 Credit Agreement originally provided up to $960.0 million and consisted of a term loan facility of $800.0 million (the ‘‘2004 Term Loan Facility’’) and a $160.0 million multi-currency revolving credit facility, the availability under which varied based upon the borrowing base that was determined based upon the value of eligible accounts receivable and eligible inventory in the U.S. and the U.K. and eligible real property and equipment in the U.S. from time to time (the ‘‘2004 Multi-Currency Facility’’). In March 2005, Products Corporation pre-paid $100.0 million of the 2004 Term Loan Facility, and in July 2006, the 2004 Term Loan Facility was increased back to $800.0 million as a result of the $100.0 million Term Loan Add-on (as hereinafter defined).

On December 20, 2006, Products Corporation replaced the $800 million 2004 Term Loan Facility under its 2004 Credit Agreement with a new 5-year, $840 million term loan facility (the ‘‘2006 Term Loan Facility’’) by entering into a new term loan agreement (the ‘‘2006 Term Loan Agreement’’), dated as of December 20, 2006, among Products Corporation, as borrower, the lenders party thereto, Citicorp USA, Inc., as administrative agent and collateral agent, Citigroup Global Markets Inc., as sole lead arranger and sole bookrunner, and JPMorgan Chase Bank, N.A., as syndication agent. As part of the bank refinancing, Products Corporation also amended and restated the 2004 Multi-Currency Facility (the ‘‘2006 Revolving Credit Facility’’ and together with the 2006 Term Loan Facility the ‘‘2006 Credit Facilities’’) by entering into a new $160.0 million asset-based, multi-currency revolving credit agreement that amended and restated the 2004 Credit Agreement (the ‘‘2006 Revolving Credit Agreement’’ and together with the 2006 Term Loan Agreement, the ‘‘2006 Credit Agreements’’).

Among other things, the 2006 Credit Facilities eliminated the requirement that Products Corporation redeem by October 30, 2007 all but $25 million in aggregate principal amount of its 8 5/8% Senior Subordinated Notes due February 2008, and extended the maturity dates for Products Corporation’s bank credit facilities from July 9, 2009 to January 15, 2012 in the case of the 2006 Revolving Credit Facility and from July 9, 2010 to January 15, 2012 in the case of the 2006 Term Loan Facility.

Availability under the 2006 Revolving Credit Facility varies based on a borrowing base that is determined by the value of eligible accounts receivable and eligible inventory in the U.S. and the U.K. and eligible real property and equipment in the U.S. from time to time.

In each case subject to borrowing base availability, the 2006 Revolving Credit Facility is available to:

(i) Products Corporation in revolving credit loans denominated in U.S. dollars;
(ii) Products Corporation in swing line loans denominated in U.S. dollars up to $30 million;
(iii) Products Corporation in standby and commercial letters of credit denominated in U.S. dollars and other currencies up to $60 million; and
(iv) Products Corporation and certain of its international subsidiaries designated from time to time in revolving credit loans and bankers' acceptances denominated in U.S. dollars and other currencies.

If the value of the eligible assets is not sufficient to support a $160 million borrowing base under the 2006 Revolving Credit Facility, Products Corporation will not have full access to the 2006 Revolving Credit Facility. Products Corporation's ability to make borrowings under the 2006 Revolving Credit Facility is also conditioned upon the satisfaction of certain conditions precedent and Products Corporation's compliance with other covenants in the 2006 Revolving Credit Facility, including a fixed charge coverage ratio that applies if and when the excess borrowing base (representing the difference between (1) the

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borrowing base under the 2006 Revolving Credit Facility and (2) the amounts outstanding under the 2006 Revolving Credit Facility) is less than $20.0 million.

Borrowings under the 2006 Revolving Credit Facility (other than loans in foreign currencies) bear interest at a rate equal to, at Products Corporation's option, either (i) the Eurodollar Rate plus 2.00% per annum or (ii) the Alternate Base Rate plus 1.00% per annum (reducing the applicable margins from 2.50% and 1.50% per annum, respectively, that were applicable under the previous 2004 Credit Agreement). Loans in foreign currencies bear interest in certain limited circumstances, or if mutually acceptable to Products Corporation and the relevant foreign lenders, at the Local Rate, and otherwise at the Eurocurrency Rate, in each case plus 2.00%. At December 31, 2006, the effective weighted average interest rate for borrowings under the 2006 Revolving Credit Facility was 7.4%.

Products Corporation pays to the lenders under the 2006 Revolving Credit Facility a commitment fee of 0.30% (reduced from 0.50% applicable under the previous 2004 Credit Agreement) of the average daily unused portion of the 2006 Revolving Credit Facility, which fee is payable quarterly in arrears. Under the 2006 Revolving Credit Facility, Products Corporation pays:

(i) to foreign lenders a fronting fee of 0.25% per annum on the aggregate principal amount of specified Local Loans (which fee is retained by foreign lenders out of the portion of the Applicable Margin payable to such foreign lender);
(ii) to foreign lenders an administrative fee of 0.25% per annum on the aggregate principal amount of specified Local Loans;
(iii) to the multi-currency lenders a letter of credit commission equal to the product of (a) the Applicable Margin for revolving credit loans that are Eurodollar Rate loans (adjusted for the term that the letter of credit is outstanding) and (b) the aggregate undrawn face amount of letters of credit; and
(iv) to the issuing lender, a letter of credit fronting fee of 0.25% per annum of the aggregate undrawn face amount of letters of credit, which fee is a portion of the Applicable Margin.

The 2006 Term Loan Facility provides for up to $840 million in term loans which were drawn in full on the December 20, 2006 closing date. The proceeds of the term loans under the 2006 Term Loan Facility were used to repay in full the approximately $798 million of outstanding term loans under the 2004 Credit Agreement (plus accrued interest of approximately $15.3 million and a pre-payment fee of approximately $8.0 million) and the remainder was used to repay approximately $13.3 million of indebtedness outstanding under the 2006 Revolving Credit Facility, after paying fees and expenses related to the credit agreement refinancing.

Under the 2006 Term Loan Facility, Eurodollar Loans bear interest at the Eurodollar Rate plus 4.00% per annum and Alternate Base Rate loans bear interest at the Alternate Base Rate plus 3.00% per annum (reducing the applicable margins from 6.00% and 5.00% per annum, respectively, that were applicable under the previous 2004 Credit Agreement). At December 31, 2006, the effective weighted average interest rate for borrowings under the 2006 Term Loan Facility was 9.4%.

Prior to the termination date of the 2006 Term Loan Facility, on April 15, July 15, October 15 and January 15 of each year (commencing April 15, 2008), Products Corporation is required to repay $2.1 million of the principal amount of the term loans outstanding under the 2006 Term Loan Facility on each respective date. In addition, the term loans under the 2006 Term Loan Facility are required to be prepaid with:

(i) the net proceeds in excess of $10.0 million for each twelve-month period ending on each July 9 (or $25.0 million for the twelve-month period ending on July 9, 2007) received during such period from sales of Term Loan First Lien Collateral (as defined below) by Products Corporation or any of its subsidiary guarantors (subject to carryover of unused annual basket amounts up to a maximum of $25.0 million and subject to certain specified dispositions up to an additional $25.0 million in the aggregate);

(ii) the net proceeds from the issuance by Products Corporation or any of its subsidiaries of certain additional debt; and

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(iii) 50% of Products Corporation’s Excess Cash Flow.

Under the 2006 Term Loan Facility, certain pre-payments require the payment of fees of 3% if such pre-payment is on or prior to December 20, 2007, 2% if on or prior December 20, 2008 and 1% if on or prior to December 20, 2009, in each case of the amount prepaid.

Under certain circumstances, Products Corporation will have the right to request the 2006 Revolving Credit Facility to be increased by up to $50.0 million and the 2006 Term Loan Facility to be increased by up to $200.0 million, provided that the lenders are not committed to provide any such increase.

The 2006 Credit Facilities (as was the 2004 Credit Agreement) are supported by, among other things, guarantees from Revlon, Inc. and, subject to certain limited exceptions, the domestic subsidiaries of Products Corporation. The obligations of Products Corporation under the 2006 Credit Facilities and the obligations under the guarantees are secured by, subject to certain limited exceptions, substantially all of the assets of Products Corporation and the subsidiary guarantors, including:

(i) mortgages on owned real property, including Products Corporation’s facilities in Oxford, North Carolina and Irvington, New Jersey;

(ii)

the capital stock of Products Corporation and the subsidiary guarantors and 66% of the capital stock of Products Corporation's and the subsidiary guarantors' first-tier foreign subsidiaries;

(iii) intellectual property and other intangible property of Products Corporation and the subsidiary guarantors; and

(iv) inventory, accounts receivable, equipment, investment property and deposit accounts of Products Corporation and the subsidiary guarantors.

The liens on, among other things, inventory, accounts receivable, deposit accounts, investment property (other than the capital stock of Products Corporation and its subsidiaries), real property, equipment, fixtures and certain intangible property related thereto secure the 2006 Revolving Credit Facility on a first priority basis and the 2006 Term Loan Facility on a second priority basis. The liens on the capital stock of Products Corporation and its subsidiaries and intellectual property and certain other intangible property (the ''Term Loan First Lien Collateral'') secure the 2006 Term Loan Facility on a first priority basis and the 2006 Revolving Credit Facility on a second priority basis. Such arrangements are set forth in the Amended and Restated Intercreditor and Collateral Agency Agreement, dated as of December 20, 2006, by and among Products Corporation and the lenders (the ''2006 Intercreditor Agreement''). The 2006 Intercreditor Agreement (like the intercreditor agreement under the 2004 Credit Agreement) also provides that the liens referred to above may be shared from time to time, subject to certain limitations, with specified types of other obligations incurred or guaranteed by Products Corporation, such as foreign exchange and interest rate hedging obligations and foreign working capital lines.

Each of the 2006 Credit Facilities contains various restrictive covenants prohibiting Products Corporation and its subsidiaries from:

(i) incurring additional indebtedness or guarantees, with certain exceptions;

(ii) making dividend and other payments or loans to Revlon, Inc. or other affiliates, with certain exceptions, including among others,

(a) exceptions permitting Products Corporation to pay dividends or make other payments to Revlon, Inc. to enable it to, among other things, pay expenses incidental to being a public holding company, including, among other things, professional fees such as legal, accounting and insurance fees, regulatory fees, such as SEC filing fees, and other miscellaneous expenses related to being a public holding company,

(b) subject to certain circumstances, to finance the purchase by Revlon, Inc. of its Class A Common Stock in connection with the delivery of such Class A Common Stock to grantees under the Stock Plan and/or the payment of withholding taxes in connection with the vesting of restricted stock awards under such plan, and

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(c) subject to certain limitations, to pay dividends or make other payments to finance the purchase, redemption or other retirement for value by Revlon, Inc. of stock or other equity interests or equivalents in Revlon, Inc. held by any current or former director, employee or consultant in his or her capacity as such;

(iii) creating liens or other encumbrances on Products Corporation's or its subsidiaries' assets or revenues, granting negative pledges or selling or transferring any of Products Corporation's or its subsidiaries' assets, all subject to certain limited exceptions;

(iv) with certain exceptions, engaging in merger or acquisition transactions;

(v)

prepaying indebtedness and modifying the terms of certain indebtedness and specified material contractual obligations, subject to certain exceptions;

(vi) making investments, subject to certain exceptions; and

(vii) entering into transactions with affiliates of Products Corporation other than upon terms no less favorable to Products Corporation or its subsidiaries than it would obtain in an arms' length transaction.

In addition to the foregoing, the 2006 Term Loan Facility contains a financial covenant limiting the senior secured leverage ratio of Products Corporation (the ratio of Products Corporation's Senior Secured Debt (excluding debt outstanding under the 2006 Revolving Credit Facility) to EBITDA, as each such term is defined in the 2006 Term Loan Facility) to 5.5 to 1.0 for each period of four consecutive fiscal quarters ending during the period from December 31, 2006 to September 30, 2008, stepping down to 5.0 to 1.0 for each period of four consecutive fiscal quarters ending during the period from December 31, 2008 to the January 2012 maturity date of the 2006 Term Loan Facility.

Under certain circumstances if and when the difference between (i) the borrowing base under the 2006 Revolving Credit Facility and (ii) the amounts outstanding under the 2006 Revolving Credit Facility is less than $20.0 million for a period of 30 consecutive days or more, the 2006 Revolving Credit Facility requires Products Corporation to maintain a consolidated fixed charge coverage ratio (the ratio of EBITDA minus Capital Expenditures to Cash Interest Expense for such period, as each such term is defined in the 2006 Revolving Credit Facility) of 1.0 to 1.0.

The events of default under each 2006 Credit Facility include customary events of default for such types of agreements, including:

(i) nonpayment of any principal, interest or other fees when due, subject in the case of interest and fees to a grace period;

(ii) non-compliance with the covenants in such 2006 Credit Facility or the ancillary security documents, subject in certain instances to grace periods;

(iii) the institution of any bankruptcy, insolvency or similar proceedings by or against Products Corporation, any of Products Corporation's subsidiaries or Revlon, Inc., subject in certain instances to grace periods;

(iv) default by Revlon, Inc. or any of its subsidiaries (A) in the payment of certain indebtedness when due (whether at maturity or by acceleration) in excess of $5.0 million in aggregate principal amount or (B) in the observance or performance of any other agreement or condition relating to such debt, provided that the amount of debt involved is in excess of $5.0 million in aggregate principal amount, or the occurrence of any other event, the effect of which default referred to in this subclause (iv) is to cause or permit the holders of such debt to cause the acceleration of payment of such debt;

(v) in the case of the 2006 Term Loan Facility, a cross default under the 2006 Revolving Credit Facility, and in the case of the 2006 Revolving Credit Facility, a cross default under the 2006 Term Loan Facility;

(vi) the failure by Products Corporation, certain of Products Corporation's subsidiaries or Revlon, Inc. to pay certain material judgments;

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(vii) a change of control such that (A) Revlon, Inc. shall cease to be the beneficial and record owner of 100% of Products Corporation's capital stock, (B) Ronald O. Perelman (or his

estate, heirs, executors, administrator or other personal representative) and his or their controlled affiliates shall cease to ''control'' Products Corporation, and any other person or group or persons owns, directly or indirectly, more than 35% of the total voting power of Products Corporation, (C) any person or group of persons other than Ronald O. Perelman (or his estate, heirs, executors, administrator or other personal representative) and his or their controlled affiliates shall ''control'' Products Corporation or (D) during any period of two consecutive years, the directors serving on Products Corporation's Board of Directors at the beginning of such period (or other directors nominated by at least 66 2/3% of such continuing directors) shall cease to be a majority of the directors;

(viii) the failure by Revlon, Inc. to contribute to Products Corporation all of the net proceeds it receives from any other sale of its equity securities or Products Corporation's capital stock, subject to certain limited exceptions;

(ix) the failure of any of Products Corporation's, its subsidiaries' or Revlon, Inc.'s representations or warranties in any of the documents entered into in connection with the 2006 Credit Facility to be correct, true and not misleading in all material respects when made or confirmed;

(x) the conduct by Revlon, Inc., of any meaningful business activities other than those that are customary for a publicly traded holding company which is not itself an operating company, including the ownership of meaningful assets (other than Products Corporation's capital stock) or the incurrence of debt, in each case subject to limited exceptions;

(xi) any M&F Lenders' failure to fund any binding commitments by such M&F Lender under any agreement governing any M&F Loan; and

(xii) the failure of certain of Products Corporation's affiliates which hold Products Corporation's or its subsidiaries' indebtedness to be party to a valid and enforceable agreement prohibiting such affiliate from demanding or retaining payments in respect of such indebtedness.

If Products Corporation is in default under the senior secured leverage ratio under the 2006 Term Loan Facility or the consolidated fixed charge coverage ratio under the 2006 Revolving Credit Facility, Products Corporation may cure such default by issuing certain equity securities to, or receiving capital contributions from, Revlon, Inc. and applying the cash therefrom which is deemed to increase EBITDA for the purpose of calculating the applicable ratio. This cure right may be exercised by Products Corporation two times in any four quarter period.

Products Corporation was in compliance with all applicable covenants under the 2006 Credit Agreements as of December 31, 2006. At December 31, 2006, the 2006 Term Loan Facility was fully drawn and availability under the $160.0 million 2006 Revolving Credit Facility, based upon the calculated borrowing base less approximately $15.1 million of outstanding letters of credit and approximately $57.5 million then drawn on the 2006 Revolving Credit Facility was approximately $87.4 million. See Note 20, ''Subsequent Events'' regarding Products Corporation's repayment of all amounts outstanding under the 2006 Revolving Credit Facility in January 2007 with a portion from the proceeds from the $100 Million Rights Offering.

Other Transactions under the 2004 Credit Agreement Prior to Its Complete Refinancing in December 2006

During July and August 2004, Products Corporation used the proceeds from borrowings under the 2004 Term Loan Facility to repay in full the $290.5 million of outstanding indebtedness (including accrued interest) under Products Corporation's credit agreement dated November 30, 2001 and which was scheduled to mature on May 30, 2005 (as amended, the ''2001 Credit Agreement''), to purchase and redeem in July and August 2004 (the ''Tender Offer'') all of the $363.0 million aggregate principal amount of Products Corporation's 12% Senior Secured Notes due 2005 (the ''12% Senior Secured Notes'') for a purchase price of approximately $412.3 million (including the applicable premium and accrued interest), and to pay fees and expenses incurred in connection with entering into the 2004 Credit Agreement,

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consummating the Tender Offer for the 12% Senior Secured Notes and in consummating the Revlon Exchange Transactions, including the payment of expenses related to a refinancing that Products Corporation launched in May 2004 but did not consummate. The balance of such proceeds was available to Products Corporation for general corporate purposes.

In March 2005, the 2004 Term Loan Facility was reduced to $700.0 million following Products Corporation's March 2005 pre-payment of $100.0 million with a portion of the proceeds from its issuance of the 9½% Senior Notes and in July 2006, the Term Loan Facility was increased back to $800.0 million as a result of the $100.0 million Term Loan Add-on.

In February 2006, Products Corporation secured an amendment to the 2004 Credit Agreement (the ''first amendment''), which excluded from various financial covenants certain charges in connection with the February 2006 Program described in Note 2 above, as well as some start-up costs incurred by the Company in 2005 related to the Vital Radiance brand before its discontinuance and the complete re-stage of the Almay brand. Specifically, the first amendment provided for the add-back to the 2004 Credit Agreement's definition of ''EBITDA'' the lesser of (i) $50 million; or (ii) the cumulative one-time charges associated with (a) the February 2006 Program described in Note 2 and (b) the non-recurring costs in the third and fourth quarters of 2005 associated with the Vital Radiance brand before its discontinuance and the complete re-stage of the Almay brand. Under the 2004 Credit Agreement, ''EBITDA'' was used in the determination of Products Corporation's senior secured leverage ratio and the consolidated fixed charge coverage ratio.

In July 2006, Products Corporation secured a further amendment (the ''second amendment'') to its 2004 Credit Agreement to, among other things, add an additional $100.0 million to the 2004 Credit Agreement's 2004 Term Loan Facility (the ''Term Loan Add-on''). The second amendment also reset the 2004 Credit Agreement's senior secured leverage ratio covenant to 5.5 to 1.0 through June 30, 2007, stepping down to 5.0 to 1.0 for the remainder of the term of the 2004 Credit Agreement. The second amendment also enabled Products Corporation to add back to the 2004 Credit Agreement's definition of ''EBITDA'' up to $25 million related to restructuring charges (in addition to the restructuring charges permitted to be added back pursuant to the first amendment to the 2004 Credit Agreement) and charges for certain product returns and/or product discontinuances. The proceeds from the $100.0 million Term Loan Add-on were used to repay in July 2006 $78.6 million of outstanding indebtedness under the 2004 Multi-Currency Facility under the 2004 Credit Agreement, without any permanent reduction in the commitment under that facility, and the balance of $11.7 million, after the payment of fees and expenses incurred in connection with consummating such transaction, was used for general corporate purposes.

In September 2006, Products Corporation secured an additional amendment (the ''third amendment'') to its 2004 Credit Agreement, which enabled Products Corporation to add back to the 2004 Credit Agreement's definition of ''EBITDA'' up to $75 million of restructuring charges (in addition to the restructuring charges permitted to be added back pursuant to the first and second amendments to the 2004 Credit Agreement), asset impairment charges, inventory write offs, inventory returns costs and in each case related charges in connection with the previously-announced discontinuance of the Vital Radiance brand, the Company's CEO change in September 2006 and the September 2006 Program described in Note 2.

(b) 9½% Senior Notes due 2011:

Products Corporation issued $310.0 million aggregate principal amount of 9½% Senior Notes due 2011 (the ''Original 9½% Senior Notes'') pursuant to an indenture, dated as of March 16, 2005, by and between Products Corporation and U.S. Bank National Association, as trustee. This issuance and the related transactions extended the maturities of

Products Corporation's debt that would have otherwise been due in 2006.

The proceeds from the Original 9½% Senior Notes were used in March 2005 to prepay $100.0 million of indebtedness outstanding under the 2004 Term Loan Facility of Products Corporation's 2004 Credit Agreement, together with accrued interest and the associated $5.0 million pre-payment fee and to pay $7.0 million in certain fees and expenses associated with the issuance of the Original 9½% Senior Notes.

The remaining $197.9 million of proceeds from the Original 9½% Senior Notes was placed in a debt defeasance trust and, in April 2005, used to redeem all of the $116.2 million aggregate principal amount

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outstanding of Products Corporation's 8 1/8% Senior Notes, plus $1.9 million of accrued interest, and all of the $75.5 million aggregate principal amount outstanding of Products Corporation's 9% Senior Notes, plus $3.1 million of accrued interest and the applicable premium of $1.1 million. The aggregate redemption amounts for the 8 1/8% Senior Notes and 9% Senior Notes were $118.1 million and $79.8 million, respectively, which constituted the principal amount and interest payable on the 8 1/8% Senior Notes and the 9% Senior Notes up to, but not including, the redemption date, and, with respect to the 9% Senior Notes, the applicable premium. In connection with the redemption, the Company recognized a loss on extinguishment of debt of $1.5 million.

In June 2005, all of the Original 9½% Senior Notes were exchanged for new 9½% Senior Notes (the ''March 2005 9½% Senior Notes''), which have substantially identical terms to the Original 9½% Senior Notes, except that the March 2005 9½% Senior Notes are registered with the SEC under the Securities Act of 1933, as amended (the ''Securities Act''), and the transfer restrictions and registration rights applicable to the Original 9½% Senior Notes do not apply to the March 2005 9½% Senior Notes.

In August 2005, Products Corporation issued $80.0 million aggregate principal amount of additional 9½% Senior Notes due 2011, which priced at 95¼% of par (the ''Additional 9½% Senior Notes''), in a private placement to institutional buyers, as additional notes pursuant to the same indenture governing the Original 9½% Senior Notes. The issuance of the Additional 9½% Senior Notes constituted a further issuance of, are the same series as, and will vote on any matters submitted to note holders with, the Original 9½% Senior Notes. The Company used the proceeds of this issuance to help fund investments in certain brand initiatives and for general corporate purposes, as well as to pay fees and expenses in connection with the issuance of the Additional 9½% Senior Notes and any outstanding fees and expenses in connection with the issuance of and exchange offer for the Original 9½% Senior Notes.

In December 2005, all of the Additional 9½% Senior Notes issued by Products Corporation in August 2005 were exchanged for new 9½% Senior Notes (the ''August 2005 9½% Senior Notes''), which have substantially identical terms to the Additional 9½% Senior Notes, except that the August 2005 9½% Senior Notes are registered with the SEC under the Securities Act, and the transfer restrictions and registration rights applicable to the Additional 9½% Senior Notes do not apply to the August 2005 9½% Senior Notes (which are collectively referred to with the March 2005 9½% Senior Notes as the ''9½% Senior Notes'').

The 9½% Senior Notes are senior unsecured obligations of Products Corporation ranking equally in right of payment with any of Products Corporation's present and future senior indebtedness, including the indebtedness under the 2006 Credit Agreements and the indebtedness under the 2004 Consolidated MacAndrews & Forbes Line of Credit, and are senior to the 8 5/8% Senior Subordinated Notes and to all future subordinated indebtedness of Products Corporation.

The 9½% Senior Notes are effectively subordinated to the outstanding indebtedness and other liabilities of Products Corporation's subsidiaries. The 9½% Senior Notes bear interest at an annual rate of 9½%, which is payable on April 1 and October 1 of each year, commencing with October 1, 2005.

The 9½% Senior Notes indenture provides that Products Corporation may redeem the 9½% Senior Notes at its option, in whole or in part, at any time on or after April 1, 2008, at the redemption prices set forth in the 9½% Senior Notes indenture. In addition, at any time prior to April 1, 2008 Products Corporation is entitled to redeem up to 35% of the aggregate principal amount of the 9½% Senior Notes at a redemption price of 109.5% of the aggregate principal amount thereof, plus accrued and unpaid interest, if any, to the date of redemption, with, to the extent actually received, the net cash proceeds of one or more public equity offerings, provided that at least 65% of the aggregate principal amount of the 9½% Senior Notes issued remains outstanding immediately after giving effect to such redemption.

In addition, the 9½% Senior Notes indenture provides that Products Corporation is entitled to redeem the 9½% Senior Notes at any time or from time to time prior to April 1, 2008 at a redemption price per note equal to the sum of (1) the then outstanding principal amount thereof, plus (2) accrued and unpaid interest, if any, to the date of redemption, plus (3) the greater of (i) 1.0% of the then outstanding principal amount of such note and (ii) the excess of (A) the present value at such redemption date of (1) the redemption price of such note on April 1, 2008 (exclusive of any accrued interest) plus (2) all required

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remaining scheduled interest payments due on such note through April 1, 2008, computed using a discount rate equal to the applicable treasury rate plus 75 basis points, over (B) the then outstanding principal amount of such note.

Pursuant to the 9½% Senior Notes indenture, upon a Change of Control (as defined in the 9½% Senior Notes indenture), each holder of the 9½% Senior Notes has the right to require Products Corporation to make an offer to repurchase all or a portion of such holder's 9½% Senior Notes at a price equal to 101% of the aggregate principal amount of such holder's 9½% Senior Notes, plus accrued and unpaid interest, if any, thereon to the date of repurchase.

The 9½% Senior Notes indenture contains covenants which, subject to certain exceptions, limit the ability of Products Corporation and its subsidiaries to, among other things, incur additional indebtedness, pay dividends on or redeem or repurchase stock, engage in certain asset sales, make certain types of investments and other restricted payments, engage in transactions with affiliates, restrict dividends or payments from subsidiaries and create liens on their assets. All of these limitations and prohibitions, however, are subject to a number of important qualifications and exceptions. The 9½% Senior Notes indenture contains customary events of default (see below item (c) for certain details).

(c) The 8 5/8% Senior Subordinated Notes due 2008 (the ''8 5/8% Senior Subordinated Notes''):
The 8 5/8% Senior Subordinated Notes are unsecured obligations of Products Corporation and (i) are subordinate in right of payment to all existing and future senior debt of Products Corporation, including the 9½% Senior Notes, the indebtedness under the 2006 Credit Agreements and the indebtedness under the 2004 Consolidated MacAndrews & Forbes Line of Credit, (ii) rank equally in right of payment with all future senior subordinated debt, if any, of Products Corporation and (iii) are senior in right of payment to all future junior subordinated debt, if any, of Products Corporation. The 8 5/8% Senior Subordinated Notes are effectively subordinated to the outstanding indebtedness and other liabilities of Products Corporation's subsidiaries. Interest is payable on February 1 and August 1.

The 8 5/8% Senior Subordinated Notes are due on February 1, 2008 and may be redeemed at the option of Products Corporation in whole or from time to time in part at any time on or after February 1, 2003 at the redemption prices set forth in the 8 5/8% Senior Subordinated Notes indenture, plus accrued and unpaid interest, if any, to the date of redemption. In 2004, approximately $322.9 million in aggregate principal amount of the 8 5/8% Senior Subordinated Notes were exchanged for Class A Common Stock in the Revlon Exchange Transactions, as discussed below.

In March 2006, Revlon, Inc. completed the $110 Million Rights Offering and promptly transferred the proceeds to Products Corporation, which it used in April 2006, together with available cash, to complete the redemption of $109.7 million aggregate principal amount of its 8 5/8% Senior Subordinated Notes in satisfaction of the applicable requirements under the 2004 Credit Agreement, at an aggregate redemption price of $111.8 million, including $2.1 million of accrued and unpaid interest up to, but not including, the redemption date. Following such redemption, there remained outstanding $217.4 million in aggregate principal amount of the 8 5/8% Senior Subordinated Notes.

In December 2006, Revlon, Inc. launched the $100 Million Rights Offering and announced that it expected to use approximately $50.0 million of the proceeds from the $100 Million Rights Offering to redeem approximately $50.0 million in aggregate principal amount of Products Corporation’s outstanding 8 5/8% Senior Subordinated Notes, with the remainder of such proceeds to be used to repay indebtedness outstanding under Products Corporation’s 2006 Revolving Credit Facility, without any permanent reduction in that commitment, after paying fees and expenses incurred in connection with the $100 Million Rights Offering. (See Note 20, ‘‘Subsequent Events’’ regarding the completion of the $100 Million Rights Offering in January 2007 and the redemption of $50.0 million in aggregate principal amount of Products Corporation’s outstanding 8 5/8% Senior Subordinated Notes, leaving $167.4 million in aggregate principal amount of such notes outstanding as of February 2007).

Upon a Change of Control, as defined in the 8 5/8% Senior Subordinated Notes indenture, Products Corporation will have the option to redeem the 8 5/8% Senior Subordinated Notes in whole at a redemption price equal to the aggregate principal amount thereof, plus accrued and unpaid interest, if any, thereon to the date of redemption, plus the applicable premium, as defined in the 8 5/8% Senior Subordinated Notes

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indenture, and, subject to certain conditions, each holder of the 8 5/8% Senior Subordinated Notes will have the right to require Products Corporation to repurchase all or a portion of such holder’s 8 5/8% Senior Subordinated Notes at a price equal to 101% of the aggregate principal amount thereof, plus accrued and unpaid interest, if any, thereon to the date of repurchase.

The 8 5/8% Senior Subordinated Notes indenture contains covenants, which, subject to certain exceptions, limit, among other things: (i) the issuance of additional debt and redeemable stock by Products Corporation; (ii) the incurrence of liens; (iii) the issuance of debt and preferred stock by Products Corporation’s subsidiaries; (iv) the payment of dividends on capital stock of Products Corporation and its subsidiaries and the redemption of capital stock of Products Corporation; (v) the sale of assets and subsidiary stock; (vi) transactions with affiliates; (vii) consolidations, mergers and transfers of all or substantially all of Products Corporation’s assets; and (viii) the issuance of additional subordinated debt that is senior in right of payment to the 8 5/8% Senior Subordinated Notes.

The 8 5/8% Senior Subordinated Notes indenture also prohibits certain restrictions on distributions from subsidiaries. All of these limitations and prohibitions, however, are subject to a number of important qualifications and exceptions. (See Note 20, ‘‘Subsequent Events’’ regarding the completion of the $100 Million Rights Offering in January 2007 and

the redemption of $50.0 million in aggregate principal amount of Products Corporation's outstanding 8 5/8% Senior Subordinated Notes, leaving $167.4 million in aggregate principal amount of such notes outstanding as of February 2007).

The indenture for each of the 9½% Senior Notes and the 8 5/8% Senior Subordinated Notes contain customary events of default for debt instruments of such type and includes a cross acceleration provision which provides that it shall be an event of default under each such indenture if any debt (as defined in each such indenture) of Products Corporation or any of its significant subsidiaries (as defined in each such indenture) is not paid within any applicable grace period after final maturity or is accelerated by the holders of such debt because of a default and the total principal amount of the portion of such debt that is unpaid or accelerated exceeds $25.0 million and such default continues for 10 days after notice from the trustee under such indenture. If any such event of default occurs, the trustee under such indenture or the holders of at least 25% in aggregate principal amount of the outstanding notes under such indenture may declare all such notes to be due and payable immediately, provided that the holders of a majority in aggregate principal amount of the outstanding notes under such indenture may, by notice to the trustee, waive any such default or event of default and its consequences under such indenture. In connection with the Revlon Exchange Transactions, in February 2004, Revlon, Inc. entered into a supplemental indenture pursuant to which it agreed to guarantee Products Corporation's obligations under the 8 5/8% Senior Subordinated Notes indenture.

(d) 2004 Consolidated MacAndrews & Forbes Line of Credit:

In July 2004, Products Corporation and MacAndrews & Forbes entered into an agreement, which effective as of August 10, 2004 amended, restated and consolidated the facilities for the MacAndrews & Forbes $65 million line of credit (which was undrawn at such time) and the 2004 MacAndrews & Forbes $125 million term loan (as to which after the Revlon Exchange Transactions the total term loan availability was $87.0 million) into a single consolidated line of credit (as amended, the ''2004 Consolidated MacAndrews & Forbes Line of Credit''). The commitment under the 2004 Consolidated MacAndrews & Forbes Line of Credit reduced to $87.0 million from $152.0 million as of July 1, 2005 and as of December 31, 2006, the 2004 Consolidated MacAndrews & Forbes Line of Credit had availability of $87.0 million and remained undrawn. In February 2006, Products Corporation entered into an amendment to its 2004 Consolidated MacAndrews & Forbes Line of Credit, which was then scheduled to expire on March 31, 2006, extending the term of such agreement until consummation of Revlon, Inc.'s planned $75 million rights offering (which was subsequently increased to $100 million). Pursuant to a December 2006 amendment, upon consummation of the $100 Million Rights Offering, which was completed in January 2007, $50.0 million of the 2004 Consolidated MacAndrews & Forbes Line of Credit will remain available to Products Corporation through January 31, 2008 on substantially the same terms (which line of credit would otherwise have terminated pursuant to its terms upon the consummation of the $100 Million Rights Offering). (See Note 20, ''Subsequent Events'').

Loans are available under the 2004 Consolidated MacAndrews & Forbes Line of Credit if: (i) the 2006 Revolving Credit Facility under the 2006 Revolving Credit Agreement has been substantially drawn (after taking into account anticipated needs for Local Loans (as defined in the 2006 Revolving Credit Agreement) and letters of credit); (ii) such borrowing is necessary to cause the excess borrowing base under the 2006 Revolving Credit Facility to remain greater than $20.0 million; (iii) additional revolving loans are not available under the 2006 Revolving Credit Facility; (iv) such borrowing is reasonably necessary to prevent or to cure a default or event of default under the 2006 Credit Agreements; or (v) Products Corporation requests such loan to assist in funding investments in certain brand initiatives.

Loans under the 2004 Consolidated MacAndrews & Forbes Line of Credit bear interest (which is not payable in cash but is capitalized quarterly in arrears) at a rate per annum equal to the lesser of (a) 12.0% and (b) 0.25% less than the rate payable from time to time on Eurodollar loans under the 2006 Term Loan Facility under the 2006 Term Loan Credit Agreement, which effective interest rate was 9.4% as of December 31, 2006, provided that at any time that the Eurodollar Base Rate under the 2006 Term Loan Credit Agreement is equal to or greater than 3.0%, the applicable rate on loans under the 2004 Consolidated MacAndrews & Forbes Line of Credit will be equal to the lesser of (x) 12.0% and (y) 5.25% over the Eurodollar Base Rate then in effect. No amounts were borrowed under the 2004 Consolidated MacAndrews & Forbes Line of Credit during 2006 and as of December 31, 2006 the 2004 Consolidated MacAndrews & Forbes Line of Credit remained undrawn.

The aggregate amounts of contractual long-term debt maturities at December 31, 2006 in the years 2007 through 2011 and thereafter are as follows:

Years ended December 31,	Long-term debt maturities
2007	$ —
2008	223.7(a)
2009	8.4
2010	8.4
2011	398.4(b)
Thereafter	866.0
Total long-term debt	$ 1,504.9

(a) In connection with completing the $100 Million Rights Offering in January 2007 (See Note 20, ‘‘Subsequent Events’’), Products Corporation redeemed $50.0 million in aggregate principal amount of its 8 5/8% Senior Subordinated Notes. Accordingly, at February 22, 2007, the principal amount outstanding, which matures in 2008 is $173.7 million, including $167.4 million in aggregate principal amount of the 8 5/8% Senior Subordinated Notes maturing in February 2008.

(b) Amount refers to the principal balance due on the 9½% Senior Notes. The difference between this amount and the carrying amount is due to the issuance of the $80.0 million in aggregate principal amount of the Additional 9½% Senior Notes at a discount, priced at 95¼% of par.

Revlon Exchange Transactions

In February 2004, Revlon, Inc. entered into agreements with Fidelity Management & Research Co. (‘‘Fidelity’’) and MacAndrews & Forbes confirming that if Revlon, Inc. were to commence an offer to exchange or convert certain indebtedness of Products Corporation and Revlon, Inc. preferred stock for Class A Common Stock, Fidelity and MacAndrews & Forbes would tender, or cause to be tendered, certain indebtedness in the exchange. In February 2004, Revlon, Inc. launched debt-for-equity exchange offers to exchange any and all of Products Corporation’s outstanding 8 1/8% Senior Notes, 9% Senior Notes, and 8 5/8% Senior Subordinated Notes (collectively, the ‘‘Revlon Exchange Notes’’) for shares of Revlon, Inc.’s Class A Common Stock or, under certain conditions, cash.

Fidelity and MacAndrews & Forbes agreed to tender the Revlon Exchange Notes at a ratio of 400 shares of Class A Common Stock for each one thousand dollars aggregate principal amount of 8 1/8% Senior Notes or 9% Senior Notes and 300 shares of Class A Common Stock for each one thousand dollars aggregate principal amount of 8 5/8% Senior Subordinated Notes tendered for exchange. The agreements allowed Fidelity the right to elect to receive cash or additional shares of Class A Common Stock for

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accrued interest on the notes tendered while MacAndrews & Forbes received Class A Common Stock for the accrued interest. Other holders were offered the opportunity to exchange their Revlon Exchange Notes for (i) shares of Class A Common Stock at the same exchange ratios or, under certain conditions, (ii) cash up to a maximum of $150 million aggregate principal amount of tendered Revlon Exchange Notes, subject to proration, at $830 per one thousand dollars of aggregate principal amount for the 8 1/8% Senior Notes, $800 per one thousand dollars of aggregate principal amount for the 9% Senior Notes and $620 per one thousand dollars of aggregate principal amount for the 8 5/8% Senior Subordinated Notes. Accrued interest was paid in cash or additional shares of Class A Common Stock, at the holder's option.

An aggregate of approximately $631.2 million in outstanding notes, consisting of approximately $133.8 million in aggregate principal amount of 8 1/8% Senior Notes, approximately $174.5 million in aggregate principal amount of the 9% Senior Notes and approximately $322.9 million in aggregate principal amount of the 8 5/8% Senior Subordinated Notes were exchanged, along with the related accrued interest, for an aggregate of approximately 224.1 million shares of Class A Common Stock. These amounts included approximately $1.0 million in aggregate principal amount of 9% Senior Notes and $286.7 million in aggregate principal amount of 8 5/8% Senior Subordinated Notes tendered by MacAndrews & Forbes and related entities and approximately $85.9 million in aggregate principal amount of 9% Senior Notes, approximately $77.8 million in aggregate principal amount of 8 1/8% Senior Notes and approximately $32.1 million in aggregate principal amount of 8 5/8% Senior Subordinated Notes tendered by funds and accounts managed by Fidelity. No cash was paid for any principal amount of notes exchanged.

MacAndrews & Forbes also received Class A Common Stock for amounts outstanding as of the March 25, 2004 closing date under the MacAndrews & Forbes $100 million term loan (approximately $109.7 million, including accrued interest), the 2004 MacAndrews & Forbes $125 million term loan (approximately $38.9 million, including accrued interest) and approximately $24.1 million in subordinated promissory notes. Amounts under the MacAndrews & Forbes $100 million term loan and 2004 MacAndrews & Forbes $125 million term loan, which exchanged at 400 shares per thousand dollars, exchanged for approximately 43.9 million shares and 15.6 million shares, respectively. Amounts under the subordinated promissory notes, which exchanged at 300 shares per thousand dollars, exchanged for approximately 7.2 million shares. Portions of the 2004 MacAndrews & Forbes $125 million term loan and the MacAndrews & Forbes $65 million line of credit not exchanged remained available to Products Corporation, subject to a borrowing limitation, which was subsequently eliminated. As mentioned above, the 2004 MacAndrews & Forbes $125 million term loan and the MacAndrews & Forbes $65 million line of credit were consolidated into the 2004 Consolidated MacAndrews & Forbes Line of Credit in July 2004.

REV Holdings LLC (''REV Holdings''), a wholly-owned indirect subsidiary of MacAndrews & Forbes Holdings, owned all 546 shares of Revlon, Inc.'s outstanding Series A preferred stock with a par value of $0.01 per share and a liquidation preference of $54.6 million (''Revlon, Inc. Series A Preferred Stock'') and all 4,333 shares of Revlon, Inc.'s outstanding Series B convertible preferred stock, with a par value of $0.01 per share (''Revlon, Inc. Series B Preferred Stock''), and which were convertible into 433,333 shares of Class A Common Stock. As part of the Revlon Exchange Transactions, REV Holdings exchanged each $1,000 of liquidation preference of Revlon, Inc. Series A Preferred Stock for 160 shares of Class A Common Stock for an aggregate of approximately 8.7 million shares of Class A Common Stock and converted its shares of Revlon, Inc. Series B Preferred Stock into an aggregate of 433,333 shares of Class A Common Stock.

The consummation of the Revlon Exchange Transactions on March 25, 2004 resulted in (i) the reduction of debt, preferred stock and accrued interest of approximately $804 million (as of such date), $54.6 million and $9.9 million, respectively, resulting from the issuance of 299,969,493 shares of Class A Common Stock and (ii) resulted in a decrease to capital deficiency of $879.3 million, including $79.9 million as a result of the exchange or conversion of debt and preferred stock by MacAndrews & Forbes, calculated as the difference between the market value on March 25, 2004 of the Class A Common Stock issued and the principal amount of debt and preferred stock exchanged or converted, together with accrued interest. Additionally, the Company recognized a loss on early extinguishment of debt of $32.0 million for the write-off of unamortized debt issuance costs and debt discount, estimated fees and expenses and the difference between the market value on March 25, 2004 of the shares of Class A

Common Stock issued and the principal amount of debt exchanged by third parties (other than by MacAndrews & Forbes), together with accrued interest, of $15.5 million.

In February 2004, Revlon, Inc. and Fidelity also entered into a stockholders agreement (the ‘‘Stockholders Agreement’’) pursuant to which, among other things, (i) Revlon, Inc. agreed to continue to maintain a majority of independent directors (as defined by New York Stock Exchange listing standards) on its Board of Directors, as it currently does; (ii) Revlon, Inc. would establish and maintain a Nominating and Corporate Governance Committee of the Board of Directors, which it formed in March 2004; and (iii) Revlon, Inc. agreed to certain restrictions with respect to Revlon, Inc.'s conducting any business or entering into any transactions or series of related transactions with any of its affiliates, any holders of 10% or more of the outstanding voting stock or any affiliates of such holders (in each case, other than its subsidiaries). This Stockholders Agreement will terminate when Fidelity ceases to be the beneficial holder of at least 5% of Revlon, Inc.'s outstanding voting stock.

Also in February 2004, Revlon, Inc. and MacAndrews & Forbes also entered into an investment agreement (as amended, the ‘‘2004 Investment Agreement’’) pursuant to which MacAndrews and Forbes committed to assisting the Company with its goal of reducing Products Corporation's indebtedness by an additional $200 million in the aggregate by the end of 2004 and further by an additional $100 million in the aggregate by March 2006. Pursuant to the 2004 Investment Agreement, MacAndrews & Forbes agreed, among other things, (i) to the extent that a minimum of $150 million aggregate principal amount of notes were not tendered in the Revlon Exchange Transaction, to back-stop the exchange offers by subscribing for additional shares of Revlon, Inc.'s Class A Common Stock at a purchase price of $2.50 per share, to the extent of any shortfall, the proceeds of which would be used to reduce Products Corporation's outstanding indebtedness; (ii) to back-stop a rights offering in an amount necessary to meet the $200 million aggregate debt reduction target by December 31, 2004, not to exceed $50 million since at least $150 million of debt reduction in the aggregate was ensured as a result of the MacAndrews & Forbes back-stop obligations discussed in (i) above; and (iii) to back-stop an equity or rights offering in an amount necessary to meet the $300 million aggregate debt reduction target by March 31, 2006, not to exceed $100 million since at least $200 million of debt reduction in the aggregate is ensured as a result of the back-stop obligations discussed in (i) and (ii) above (such equity offerings together with the Revlon Exchange Transactions are the ‘‘Debt Reduction Transactions’’). In connection with the closing of the Revlon Exchange Transactions on March 25, 2004, MacAndrews & Forbes Holdings executed a joinder agreement to the Revlon, Inc. registration rights agreement pursuant to which all Class A Common Stock acquired by MacAndrews & Forbes pursuant to the 2004 Investment Agreement will be deemed to be registrable securities.

In August 2005, Revlon, Inc. announced its plan to issue $185.0 million of equity. In connection with Revlon, Inc.'s plan to issue $185.0 million of equity, in August 2005 MacAndrews & Forbes and Revlon, Inc. amended the 2004

Investment Agreement to increase MacAndrews & Forbes' commitment to purchase such equity as is necessary to ensure that Revlon, Inc. issues $185.0 million of equity. In the first quarter of 2006, Revlon, Inc. completed the $110 Million Rights Offering and transferred to proceeds to Products Corporation, which it used, together with available cash, to reduce Products Corporation's debt by approximately $110 million by redeeming approximately $109.7 million in aggregate principal amount of Products Corporation's 8 5/8% Senior Subordinated Notes. Having completed the $110 Million Rights Offering in March 2006, to facilitate Revlon, Inc.'s plans to issue the $185 million of equity, Revlon, Inc. and MacAndrews & Forbes entered into various amendments to the 2004 Investment Agreement to extend the time for the completion of $75 million of such issuance (which was subsequently increased to $100 million) from March 31, 2006 until March 31, 2007, in each case, by extending MacAndrews & Forbes' $75 million back-stop to such later date. (See Note 20, ''Subsequent Events'' regarding the completion of the $100 Million Rights Offering.)

Liquidity Considerations

The Company expects that operating revenues, cash on hand and funds available for borrowing under the 2006 Credit Agreements, the 2004 Consolidated MacAndrews & Forbes Line of Credit and other permitted lines of credit will be sufficient to enable the Company to cover its operating expenses for 2007, including cash requirements in connection with the payment of operating expenses, including

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expenses in connection with the execution of the Company's business strategy, purchases of permanent wall displays, capital expenditure requirements, payments in connection with the Company's restructuring programs (including, without limitation, the Company's February 2006 Program, its September 2006 Program and prior programs), executive severance not otherwise included in the Company's restructuring programs, debt service payments and costs and regularly scheduled pension and post-retirement benefit plan contributions. However, there can be no assurance that such funds will be sufficient to meet the Company's cash requirements on a consolidated basis. If the Company's anticipated level of revenue growth is not achieved because of, for example, decreased consumer spending in response to weak economic conditions or weakness in the mass-market cosmetics category; adverse changes in currency; decreased sales of the Company's products as a result of increased competitive activities from the Company's competitors; changes in consumer purchasing habits, including with respect to shopping channels; retailer inventory management; retailer space reconfigurations; less than anticipated results from the Company's existing or new products or from its advertising and/or marketing plans; or if the Company's expenses, including, without limitation, for advertising and promotions or for returns related to any reduction of retail space or product discontinuances, exceed the anticipated level of expenses, the Company's current sources of funds may be insufficient to meet the Company's cash requirements.

In the event of a decrease in demand for the Company's products, reduced sales, lack of increases in demand and sales, changes in consumer purchasing habits, including with respect to shopping channels, retailer inventory management, retailer space reconfigurations, product discontinuances and/or advertising and promotion expenses or returns expenses exceeding its expectations or less than anticipated results from the Company's existing or new products or from its advertising and/or marketing plans, any such development, if significant, could reduce the Company's revenues and could adversely affect Products Corporation's ability to comply with certain financial covenants under the 2006 Credit Agreements and in such event the Company could be required to take measures, including, among other things, reducing discretionary spending.

If the Company is unable to satisfy its cash requirements from the sources identified above or comply with its debt covenants or refinance Products Corporation's 8 5/8% Senior Subordinated Notes on or before their maturity in February 2008, the Company could be required to adopt one or more of the following alternatives:

- delaying the implementation of or revising certain aspects of the Company's business strategy;
- reducing or delaying purchases of wall displays or advertising or promotional expenses;
- reducing or delaying capital spending;
- delaying, reducing or revising the Company's restructuring programs;
- restructuring Products Corporation's indebtedness;
- selling assets or operations;
- seeking additional capital contributions or loans from MacAndrews & Forbes, Revlon, Inc., the Company's other affiliates and/or third parties;
- selling additional Revlon, Inc. equity securities or debt securities of Products Corporation; or
- reducing other discretionary spending.

There can be no assurance that the Company would be able to take any of the actions referred to above because of a variety of commercial or market factors or constraints in Products Corporation's debt instruments, including, for example, market conditions being unfavorable for an equity or debt issuance, additional capital contributions or loans not being available from affiliates and/or third parties, or that the transactions may not be permitted under the terms of Products Corporation's various debt instruments then in effect, because of restrictions on the incurrence of debt, incurrence of liens, asset dispositions and related party transactions. In addition, such actions, if taken, may not enable the Company to satisfy its cash requirements or enable Products Corporation to comply with its debt covenants if the actions do not generate a sufficient amount of additional capital.

Revlon, Inc., as a holding company, will be dependent on the earnings and cash flow of, and dividends and distributions from, Products Corporation to pay its expenses and to pay any cash dividend or

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distribution on Revlon, Inc.'s Class A Common Stock that may be authorized by Revlon, Inc.'s Board of Directors. The terms of the 2006 Credit Agreements, the 2004 Consolidated MacAndrews & Forbes Line of Credit and the indentures governing the 9½% Senior Notes and the 8 5/8% Senior Subordinated Notes generally restrict Products Corporation from paying dividends or making distributions, except that Products Corporation is permitted to pay dividends and make distributions to Revlon, Inc. to enable Revlon, Inc., among other things, to pay expenses incidental to being a public holding company, including, among other things, professional fees, such as legal, accounting and insurance fees, regulatory fees, such as SEC filing fees and other miscellaneous expenses related to being a public holding company and, subject to certain limitations, to pay dividends or make distributions in certain circumstances to finance the purchase by Revlon, Inc. of its Class A Common Stock in connection with the delivery of such Class A Common Stock to grantees under the Second Amended and Restated Revlon, Inc. Stock Plan (the ''Stock Plan'').

9. FINANCIAL INSTRUMENTS

The fair value of the Company's long-term debt is based on the quoted market prices for the same issues or on the current rates offered to the Company for debt of the same remaining maturities. The estimated fair value of long-term debt at December 31, 2006 and 2005, respectively, was approximately $16.0 million and $40.0 million less than the carrying values of $1,501.8 million and $1,413.4 million, respectively.

Products Corporation also maintains standby and trade letters of credit with certain banks for various corporate purposes under which Products Corporation is obligated, of which approximately $15.1 million and $16.0 million (including amounts available under credit agreements in effect at that time) were maintained at December 31, 2006 and 2005, respectively. Included in these amounts is approximately $9.8 million and $11.9 million, at December 31, 2006 and 2005, respectively, in standby letters of credit, which support Products Corporation's self-insurance programs. The estimated liability under such programs is accrued by Products Corporation.

The carrying amounts of cash and cash equivalents, marketable securities, trade receivables, notes receivable, accounts payable and short-term borrowings approximate their fair values.

10. INCOME TAXES

The Company's loss before income taxes and the applicable provision (benefit) for income taxes are as follows:

	Year Ended December 31,		
	2006	2005	2004
Loss before income taxes:			
Domestic	$ (244.4)	$ (97.2)	$ (165.8)
Foreign	13.2	22.0	32.6
	$ (231.2)	$ (75.2)	$ (133.2)
Provision (benefit) for income taxes:			
Federal	$ 0.2	$ 0.1	$ (1.7)
State and local	1.2	0.4	(0.8)
Foreign	18.7	8.0	11.8
	$ 20.1	$ 8.5	$ 9.3
Current	$ 22.5	$ 15.2	$ 12.6
Deferred	0.2	0.1	1.6
Benefits of operating loss carryforwards	(2.6)	(3.0)	(2.0)
Resolution of tax matters	—	(3.8)	(2.9)
	$ 20.1	$ 8.5	$ 9.3

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The effective tax rate on loss before income taxes is reconciled to the applicable statutory federal income tax rate as follows:

	Year Ended December 31,		
	2006	2005	2004
Statutory federal income tax rate	(35.0)%	(35.0)%	(35.0)%
State and local taxes, net of federal income tax benefit	(3.4)	(4.5)	(4.0)
Foreign and U.S. tax effects attributable to operations outside the U.S.	3.2	14.4	(4.5)
Loss on early extinguishment of debt	—	—	(14.9)

Change in valuation allowance	43.1	41.7	65.7
Sale of businesses	—	—	—
Resolution of tax audits	—	(5.2)	(2.2)
Other	0.8	(0.2)	1.8
Effective rate	8.7%	11.2%	6.9%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are presented below:

	December 31,	
	2006	2005
Deferred tax assets:		
Accounts receivable, principally due to doubtful accounts	$ 1.2	$ 1.3
Inventories	22.2	14.8
Net operating loss carryforwards — domestic	286.6	202.5
Net operating loss carryforwards — foreign	122.2	122.9
Accruals and related reserves	6.8	1.5
Employee benefits	68.1	69.6
State and local taxes	7.9	7.7
Advertising, sales discount, returns and coupon redemptions	47.9	55.3
Other	38.7	35.4
Total gross deferred tax assets	601.6	511.0
Less valuation allowance	(570.7)	(478.2)
Total deferred tax assets, net of valuation allowance	30.9	32.8
Deferred tax liabilities:		
Plant, equipment and other assets	(26.8)	(27.3)
Other	(0.3)	(1.6)
Total gross deferred tax liabilities	(27.1)	(28.9)
Net deferred tax assets	$ 3.8	$ 3.9

In assessing the recoverability of its deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income for certain international markets and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of certain deductible differences existing at December 31, 2006. The valuation allowance increased by $92.5 million during 2006 and increased by $11.5 million during 2005.

During 2006, 2005 and 2004, certain of the Company’s foreign subsidiaries used operating loss carryforwards to credit the current provision for income taxes by $2.6 million, $1.1 million and

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$2.0 million, respectively. Certain other foreign operations generated losses during 2006, 2005 and 2004 for which the potential tax benefit was reduced by a valuation allowance. At December 31, 2006, the Company had tax loss carryforwards, subject to the conditions described in the following paragraph, of approximately $1,145.8 million of which $403.2 million are foreign and $742.6 million are domestic. The losses expire in future years as follows: 2007-$118.3 million; 2008-$182.8 million; 2009-$88.0 million; 2010-$15.1 million; 2011 and beyond–$446.7 million; and unlimited–$294.9 million.

The Company could receive the benefit of such tax loss carryforwards only to the extent it has taxable income during the carryforward periods in the applicable tax jurisdictions. As a result of the closing of the Revlon Exchange Transactions, as of the end of the day on March 25, 2004, Revlon, Inc., Products Corporation and its U.S. subsidiaries were no longer included in the MacAndrews & Forbes Group for federal income tax purposes (see further discussion immediately below). The Internal Revenue Code of 1986 (as amended, the ‘‘Code’’) and the Treasury regulations issued thereunder govern both the calculation of the amount and allocation to the members of the MacAndrews & Forbes Group of any consolidated federal net operating losses (‘‘CNOLs’’) of the group that will be available to offset Revlon, Inc.'s taxable income and the taxable income of its U.S. subsidiaries, including Products Corporation, for the taxable years beginning after March 25, 2004. Only the amount of any CNOLs that the MacAndrews & Forbes Group did not absorb by December 31, 2004 will be available to be allocated to Revlon, Inc. and its U.S. subsidiaries, including Products Corporation, for their taxable years beginning on March 26, 2004. MacAndrews & Forbes Holdings has indicated that, after giving effect to the CNOLs that the MacAndrews & Forbes Group reported as having absorbed on its 2004 consolidated federal income tax return, $415.9 million in U.S. federal net operating losses, and $15.2 million of alternative minimum tax losses were available to Revlon, Inc. and its U.S. subsidiaries, including Products Corporation, after March 25, 2004; as a result of the expiration of $24.8 million in U.S. federal net operating losses at the end of 2006, $391.1 million in U.S. federal net operating losses and $15.2 million of alternative minimum tax losses are available to Revlon, Inc. and its U.S. subsidiaries, including Products Corporation, after December 31, 2006. The amounts set forth in the previous sentence are subject to change if the Internal Revenue Service (the ‘‘IRS’’) adjusts the results of the MacAndrews & Forbes Group or if the MacAndrews & Forbes Group amends its returns for the tax years ended on or before December 31, 2004. Accordingly, of the Company's $742.6 million of domestic CNOLs, $351.5 million of such CNOLs, as well as other losses that Revlon, Inc. and its U.S. subsidiaries, including Products Corporation, generate after March 25, 2004, will be available to Revlon, Inc. for its use and its U.S. subsidiaries', including Products Corporation's, use and will not be available for the use of the MacAndrews & Forbes Group.

The Company has not provided for U.S. Federal and foreign withholding taxes on $58.3 million of foreign subsidiaries' undistributed earnings as of December 31, 2006, because such earnings are intended to be indefinitely reinvested overseas. The amount of unrecognized deferred tax liabilities for temporary differences related to investments in undistributed earnings is not practicable to determine at this time.

In June 1992, Revlon Holdings, Revlon, Inc., Products Corporation and certain of its subsidiaries, and MacAndrews & Forbes Holdings entered into a tax sharing agreement (as subsequently amended and restated, the ‘‘MacAndrews & Forbes Tax Sharing Agreement’’), pursuant to which MacAndrews & Forbes Holdings agreed to indemnify Revlon, Inc. and Products Corporation against federal, state or local income tax liabilities of the MacAndrews & Forbes Group (other than in respect of Revlon, Inc. and Products Corporation) for taxable periods beginning on or after January 1, 1992 during which Revlon, Inc. and Products Corporation or a subsidiary of Products Corporation was a member of such group. Pursuant to the MacAndrews & Forbes Tax Sharing Agreement, for all such taxable periods, Products Corporation was required to pay to Revlon, Inc., which in turn was required to pay to Revlon Holdings, amounts equal to the taxes that Products Corporation would otherwise have had to pay if it were to file separate federal, state or local income tax returns (including any amounts determined to be due as a result of a redetermination arising from an audit or otherwise of the consolidated or combined tax liability relating to any such period which was attributable to Products Corporation), except that Products Corporation was not entitled to carry back any losses to taxable periods ending prior to January 1, 1992.

No payments were required by Products Corporation or Revlon, Inc. if and to the extent Products Corporation was prohibited under the terms of its bank credit agreement from making tax sharing payments to Revlon, Inc. The 2004 Credit Agreement, as well as the 2006 Credit Agreements, permit

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Products Corporation to make such tax sharing payments under the MacAndrews & Forbes Tax Sharing Agreement in respect of state, local and federal taxes with respect to taxable periods through and including March 25, 2004. As a result of tax net operating losses, there were no federal tax payments or payments in lieu of taxes pursuant to the MacAndrews & Forbes Tax Sharing Agreement in respect of 2004.

As a result of the closing of the Revlon Exchange Transactions, as of the end of March 25, 2004, Revlon, Inc., Products Corporation and their U.S. subsidiaries were no longer included in the MacAndrews & Forbes Group for federal income tax purposes. The MacAndrews & Forbes Tax Sharing Agreement will remain in effect solely for taxable periods beginning on or after January 1, 1992, through and including March 25, 2004. In these taxable periods, Revlon, Inc. and Products Corporation were included in the MacAndrews & Forbes Group, and Revlon, Inc.'s and Products Corporation's federal taxable income and loss were included in such group's consolidated tax return filed by MacAndrews & Forbes Holdings. Revlon, Inc. and Products Corporation were also included in certain state and local tax returns of MacAndrews & Forbes Holdings or its subsidiaries.

Following the closing of the Revlon Exchange Transactions, Revlon, Inc. became the parent of a new consolidated group for federal income tax purposes and Products Corporation's federal taxable income and loss will be included in such group's consolidated tax returns. Accordingly, Revlon, Inc. and Products Corporation entered into a tax sharing agreement (the ''Revlon Tax Sharing Agreement'') pursuant to which Products Corporation will be required to pay to Revlon, Inc. amounts equal to the taxes that Products Corporation would otherwise have had to pay if Products Corporation were to file separate federal, state or local income tax returns, limited to the amount, and payable only at such times, as Revlon, Inc. will be required to make payments to the applicable taxing authorities. The 2004 Credit Agreement, as well as the 2006 Credit Agreements, permit payments from Products Corporation to Revlon, Inc. to the extent required under the Revlon Tax Sharing Agreement. As a result of tax net operating losses, there were no federal tax payments or payments in lieu of taxes from Products Corporation to Revlon, Inc. pursuant to the Revlon Tax Sharing Agreement in respect of 2004. The Company expects that there will be no federal alternative minimum tax payments from Products Corporation to Revlon, Inc. pursuant to the Revlon Tax Sharing Agreement in respect of 2006.

Pursuant to the asset transfer agreement referred to in Note 16, Products Corporation assumed all tax liabilities of Revlon Holdings other than (i) certain income tax liabilities arising prior to January 1, 1992 to the extent such liabilities exceeded reserves on Revlon Holdings' books as of January 1, 1992 or were not of the nature reserved for and (ii) other tax liabilities to the extent such liabilities are related to the business and assets retained by Revlon Holdings.

During 2005, the Company resolved various tax matters and determined certain tax liabilities were no longer probable, which resulted in a tax benefit of $3.8 million, none of which was recorded to capital deficiency. In the normal course of business, the Company is subject to tax examinations in both domestic and foreign jurisdictions. The Company believes that adequate provisions have been made for adjustments that may result from such tax examinations.

11. SAVINGS PLAN, PENSION AND POST-RETIREMENT BENEFITS

Savings Plan:

The Company offers a qualified defined contribution plan for U.S.-based employees, the Revlon Employees' Savings, Investment and Profit Sharing Plan (as amended, the ''Savings Plan''), which allows eligible participants to contribute up to 25% and highly compensated employees to contribute up to 6% of qualified compensation through payroll deductions. The Company matches employee contributions at fifty cents for each dollar contributed up to the first 6% of eligible compensation. The Company may also contribute from time to time profit sharing contributions (if any) for non-bonus eligible employees. In 2006, 2005 and 2004, the Company made cash matching contributions to the Savings Plan of approximately $2.8 million, $2.9 million and $2.7 million, respectively. There were no additional contributions or profit sharing contributions made during those years.

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Pension Benefits:

The Company sponsors a number of qualified defined benefit pension plans covering a substantial portion of the Company's employees in the U.S., as well as certain other non-U.S. employees. The Company also has nonqualified pension plans which provide benefits in excess of IRS limitations in the U.S. and in certain limited cases contractual benefits for designated officers of the Company. These plans are funded from the general assets of the Company.

Other Post-retirement Benefits:

The Company previously sponsored an unfunded retiree benefit plan, which provides death benefits payable to beneficiaries of a very limited number of former employees. Participation in this plan was limited to participants enrolled as of December 31, 1993. The Company also administers an unfunded medical insurance plan on behalf of Revlon Holdings, the cost of which has been apportioned to Revlon Holdings under the transfer agreements among Revlon, Inc., Products Corporation and MacAndrews & Forbes. (See Note 16, ''Related Party Transactions — Transfer Agreements'').

On December 31, 2006, the Company adopted the recognition and dislosure provisions of SFAS No. 158, ''Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statment Nos. 87, 88, 106, and 132(R)''. SFAS No. 158 requires the Company to recognize the funded status of its defined benefit pension plans and other post-retirement plans in the December 31, 2006 Consolidated Balance Sheet, measured as the difference between plan assets at fair value and the benefit obligations. The net funded status of the underfunded pension and other post-retirement plans is recognized as a net liability on the Consolidated Balance Sheet. SFAS No. 158 also requires the Company to recognize as a component of other comprehensive loss, net of tax, the actuarial gains and losses and prior service costs or credits that arose during the year but are not recognized in net loss as components of net periodic benefit cost pursuant to FASB Statement Nos. 87 and 106. The Company recognized $112.6 million in accumulated other comprehensive income for actuarial gains and prior service costs, which amount will be adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition of amortization provisions of FASB Statement Nos. 87 and 106 In addition, the additional minimum pension liability (''AML'') recognized under the provisions of FASB Statement No. 132(R) in the 2005 financial statements of $107.0 million is required to be reversed through other comprehensive loss upon adoption of SFAS No. 158.

The following table summarizes the effect of the reversal of the additional minimum liabilities at the year ended December 31, 2005, as well as the recognition of actuarial gains and prior service costs as a component of other comprehensive loss upon adoption of SFAS No. 158:

		AML Adjustment				
	Prior to Adjustments	Prior to SFAS No. 158 Adoption	Adjustment to Reverse AML	Total AML Adjustment	SFAS No. 158 Adjustment	As Reported at December 31, 2006
Other assets [a]	$ 142.6	$ (0.1)	$ —	$ (0.1)	$ (0.1)	$ 142.4
Pension and other post-retirement benefit liabilities [b]	177.6	(19.1)	(88.0)	(107.1)	112.5	183.0
Accumulated other comprehensive (loss)	(118.6)	19.0	88.0	107.0	(112.6)	(124.2)
Total stockholders' deficiency [a]	(1,224.2)	19.0	88.0	107.0	(112.6)	(1,229.8)

(a) The incremental effect of deferred tax assets at December 31, 2006 after giving effect to the adoption of SFAS No. 158 was offset by a valuation allowance, which resulted in no net tax impact due to the adoption of SFAS No. 158.

(b) The total liability for pension benefits includes the current portion of the pension liability, $7.3 million, which is recognized in the other current liabilities on the Consolidated Balance Sheet and $175.7 million, which is recognized in the long-term pension and other post-retirement liability on the Consolidated Balance Sheet.

In accordance with SFAS No. 158, prior year amounts have not been adjusted. SFAS No. 158 also requires that beginning in 2008, the Company's assumptions used to measure the annual pension and

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other post-retirement expenses be determined as of December 31, the date of the Consolidated Balance Sheet. Currently, the Company uses September 30 as its measurement date for pension and other post-retirement plans obligations and assets.

Information regarding the Company's significant pension and other post-retirement plans at the dates indicated is as follows:

	Pension Plans		Other Post-retirement Benefit Plans	
	2006	2005	2006	2005

Change in Benefit Obligation:				
Benefit obligation — September 30 of prior year	$ (587.8)	$ (557.8)	$ (13.2)	$ (13.0)
Service cost	(10.0)	(9.6)	(0.0)	(0.1)
Interest cost	(32.1)	(31.0)	(0.8)	(0.9)
Plan amendments	—	—	—	(0.5)
Actuarial gain (loss)	11.1	(20.3)	(2.3)	—
Benefits paid	29.9	27.5	1.1	1.1
Foreign exchange (loss) gain	(6.7)	4.9	0.1	0.2
Plan participant contributions	(0.2)	(0.2)	—	—
Benefit obligation — September 30 of current year	(595.8)	(586.5)	(15.1)	(13.2)
Change in Plan Assets:				
Fair value of plan assets — September 30 of prior year	383.0	341.5	—	—
Actual return on plan assets	35.7	44.0	—	—
Employer contributions	30.6	27.5	1.1	1.1
Plan participant contributions	0.2	0.2	—	—
Benefits paid	(29.9)	(27.2)	(1.1)	(1.1)
Foreign exchange gain (loss)	4.4	(3.0)	—	—
Fair value of plan assets — September 30 of current year	424.0	383.0	—	—
Funded status of plans — September 30 of current year	(171.8)	(203.5)	(15.1)	(13.2)
Amounts contributed to plans during fourth quarter	3.7	2.3	0.2	0.2
Unrecognized net loss	n/a	130.0	n/a	1.6
Unrecognized prior service cost	n/a	(3.6)	n/a	—
Accrued net periodic benefit cost at December 31,	n/a	$ (74.8)	n/a	$ (11.4)
Pension and other post-retirement benefit plan liabilities [(a)]	$ (168.1)	N/A	$ (14.9)	N/A

(a) Under SFAS No. 158, the requirement to recognize the funded status of defined benefit post-retirement plans is not applied for fiscal years ended prior to December 31, 2006.

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In respect of pension plans and other post-retirement benefit plans, amounts recognized in the Company’s Consolidated Balance Sheets at December 31, 2006 and 2005 consist of the following:

	Pension Plans		Other Post-retirement Benefit Plans	
	December 31,			
	2006	2005	2006	2005
Prepaid expenses	$ —	$ —	$ —	$ —
Intangible assets	—	0.2	—	—
Other long-term assets	—	0.6	—	—
Accrued expenses	(6.1)	(31.6)	(1.2)	—
Pension and other post-retirement benefit liabilities	(162.0)	(151.0)	(13.7)	(11.4)

	(168.1)	(181.8)	(14.9)	(11.4)
Accumulated other comprehensive loss	109.4	107.0	3.7	—
	$ (58.7)	$ (74.8)	$ (11.2)	$ (11.4)

With respect to the above accrued net periodic benefit costs, the Company has recorded receivables from affiliates of $1.9 million and $1.9 million at December 31, 2006 and 2005, respectively, relating to pension plan liabilities retained by such affiliates and $0.9 million and $1.0 million at December 31, 2006 and 2005, respectively, for other post-retirement costs attributable to Revlon Holdings under the 1992 transfer agreements referred to in Note 16, ‘‘Related Party Transactions’’.

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for the Company’s pension plans are as follows:

	September 30,		
	2006	2005	2004
Projected benefit obligation	$ 595.8	$ 586.5	$ 557.8
Accumulated benefit obligation	574.0	567.6	541.0
Fair value of plan assets	424.0	383.0	341.5

The components of net periodic benefit cost for the pension plans and other post-retirement benefit plans are as follows:

	Pension Plans			Other Post-retirement Benefit Plans		
	Years Ended December 31,					
	2006	2005	2004	2006	2005	2004
Net periodic benefit cost:						
Service cost	$ 10.0	$ 9.6	$ 9.9	$ —	$ 0.1	$ 0.1
Interest cost	32.1	31.0	30.6	0.8	0.9	0.8
Expected return on plan assets	(31.8)	(28.3)	(24.7)	—	—	—
Amortization of prior service cost	(0.5)	(0.6)	(0.6)	—	—	—
Amortization of net transition asset	—	—	(0.1)	—	—	—
Amortization of actuarial loss (gain)	6.6	7.4	9.6	0.1	0.1	—
Settlement cost	0.1	—	—	—	—	—
Curtailment cost	(0.8)	—	—	—	—	—
	15.7	19.1	24.7	0.9	1.1	0.9
Portion allocated to Revlon Holdings	(0.1)	(0.1)	(0.1)	—	—	—
	$ 15.6	$ 19.0	$ 24.6	$ 0.9	$ 1.1	$ 0.9

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Amounts recognized in accumulated other comprehensive loss at December 31, 2006, which have not yet been recognized as a component of net periodic pension cost, are as follows:

	Pension Benefits	Post-retirement Benefits	Total
Net actuarial loss	$ 112.1	$ 3.7	$ 115.8
Prior service credit	(2.7)	—	(2.7)
	109.4	3.7	113.1
Portion allocated (to) from Revlon Holdings	(0.6)	0.1	(0.5)
	$ 108.8	$ 3.8	$ 112.6

The total actuarial losses and prior service credits included in accumulated other comprehensive income and expected to be recognized in net periodic pension cost during the fiscal year-ended December 31, 2007 is $4.4 million and $(0.5) million, respectively.

The following weighted-average assumptions were used to develop the actuarial present value of projected benefit obligation for the year listed and also the Company's estimate of the net periodic benefit cost for the following year:

	U.S. Plans			International Plans		
	2006	2005	2004	2006	2005	2004
Discount rate	5.75%	5.5%	5.75%	5.0%	5.0%	5.5%
Expected return on plan assets	8.5	8.5	8.5	6.7	6.7	7.0
Rate of future compensation increases	4.0	4.0	4.0	3.9	3.7	3.7

The 5.75% discount rate for the U.S. plans was derived by reference to appropriate benchmark yields on high quality corporate bonds, with terms which approximate the duration of the benefit payments and the relevant benchmark bond indices considering the individual plan's characteristics, such as Moody's Aa Corporate Bond Index and the Citigroup Pension Discount Curve, to select a rate at which the Company believes the U.S. pension benefits could be effectively settled. The discount rates for the Company's primary international plans were derived from similar local studies, in conjunction with local actuarial consultants and asset managers.

The Company considers a number of factors to determine its expected rate of return on plan assets assumption, including, without limitation, recent and historical performance of plan assets, asset allocation and other third-party studies and surveys. The Company considered the plan portfolios' asset allocations over a variety of time periods and compared them with third-party studies and reviewed performance of the capital markets in recent years and other factors and advice from various third parties, such as the pension plans' advisers, investment managers and actuaries. While the Company considered recent performance and the historical performance of plan assets over a ten-year period (from 1996 to 2006), the results of which exceeded the Company's expected rate of return, the Company's assumptions are based primarily on its estimates of long-term, prospective rates of return. Using the aforementioned methodologies, the Company selected the 8.5% return on assets assumption used for the U.S pension plans. Differences between actual and expected asset returns are recognized in the net periodic benefit cost over the remaining service period of the active participating employees.

The rate of future compensation increases is an assumption used by the actuarial consultants for pension accounting and is determined based on the Company's current expectation for such increases.

The following table presents domestic and foreign pension plan assets information at September 30, 2006, 2005 and

2004:

	U.S. Plans			International Plans		
	2006	2005	2004	2006	2005	2004
Fair value of plan assets	$ 380.3	$ 347.5	$ 308.9	$ 43.7	$ 35.5	$ 32.6

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The Investment Committee for the Company's pension plans (the ''Investment Committee'') has adopted (and revises from time to time) an investment policy for the U.S. pension plans intended to meet or exceed the expected rate of return on plan assets assumption. In connection with this objective, the Investment Committee retains professional investment managers that invest plan assets in the following asset classes: equity and fixed income securities, real estate, and cash and other investments, which may include hedge funds and private equity and global balanced strategies. The International plans follow a similar methodology in conjunction with local actuarial consultants and asset managers.

The U.S. pension plans currently have the following target ranges for these asset classes, which are reviewed quarterly and considered for readjustment when an asset class weighting is outside of its target range (recognizing that these are flexible target ranges that may vary from time to time) with the goal of achieving the required return at a reasonable risk level as follows:

	Target Ranges
Asset Category:	
Equity securities	31% – 41%
Fixed income securities	18% – 28%
Real estate	0% – 2%
Cash and other investments	11% – 21%
Global balanced strategies	20% – 30%

The U.S. pension plans weighted-average asset allocations at September 30, 2006 and 2005 by asset categories were as follows:

	2006	2005
Asset Category:		
Equity securities	36.3%	43.6%
Fixed income securities	20.1	17.9
Real estate	—	4.4
Cash and other investments	19.0	13.7
Global balanced strategies	24.6	20.4

	100.0%	100.0%

Within the equity securities asset class, the investment policy provides for investments in a broad range of publicly-traded securities ranging from small to large capitalization stocks and U.S. and international stocks. Within the fixed income securities asset class, the investment policy provides for investments in a broad range of publicly-traded debt securities ranging from U.S. Treasury issues, corporate debt securities, mortgages and asset-backed issues, as well as international debt securities. Within the real estate asset class, the investment policy provides for investment in a diversified commingled pool of real estate properties across the U.S. In the cash and other investments asset class, investments may be in cash and cash equivalents and other investments, which may include hedge funds and private equity not covered in the classes listed above, provided that such investments are approved by the Investment Committee prior to their selection. Within the global balanced strategies, the investment policy provides for investments in a broad range of publicly traded stocks and bonds in both U.S. and international markets as described in the asset classes listed above. In addition, the global balanced strategies can include commodities, provided that such investments are approved by the Investment Committee prior to their selection.

The Investment Committee's investment policy does not allow the use of derivatives for speculative purposes, but such policy does allow its investment managers to use derivatives to reduce risk exposures or to replicate exposures of a particular asset class.

Contributions:

The Company's policy is to fund at least the minimum contributions required to meet applicable federal employee benefit and local laws, or to directly pay benefit payments where appropriate. During

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2007, the Company expects to contribute approximately $33.4 million to its pension plans and $1.1 million to other post-retirement benefit plans.

Estimated Future Benefit Payments:

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Total Pension Benefits	Total Other Benefits
2007	$ 32.1	$ 1.1
2008	33.1	1.2
2009	34.8	1.2
2010	36.5	1.2
2011	38.0	1.2
Years 2012 to 2016	215.0	6.3

12. RIGHTS OFFERINGS

$110 Million Rights Offering

In March 2006, Revlon, Inc. completed a $110 million Rights Offering (including the related private placement to MacAndrews & Forbes, the ''$110 Million Rights Offering'') that it launched in February 2006, which allowed each stockholder of record of Revlon, Inc.'s Class A and Class B Common Stock, as of the close of business on February 13, 2006, the record date set by Revlon, Inc.'s Board of Directors, to purchase additional shares of Class A Common Stock. The subscription price for each share of Class A Common Stock purchased in the $110 Million Rights Offering, including shares purchased in the private placement by MacAndrews & Forbes, was $2.80 per share. Upon completing the $110 Million Rights Offering, Revlon, Inc. promptly transferred the proceeds to Products Corporation, which it used as described under Note 8 — ''$110 Million Rights Offering — March 2006''.

In completing the $110 Million Rights Offering, Revlon, Inc. issued an additional 39,285,714 shares of its Class A Common Stock, including 15,885,662 shares subscribed for by public shareholders (other than MacAndrews & Forbes) and 23,400,052 shares issued to MacAndrews & Forbes in a private placement directly from Revlon, Inc. The shares issued to MacAndrews & Forbes represented the number of shares of Revlon, Inc.'s Class A Common Stock that MacAndrews & Forbes would otherwise have been entitled to purchase pursuant to its basic subscription privilege in the $110 Million Rights Offering (which was approximately 60% of the shares of Revlon, Inc.'s Class A Common Stock offered in the $110 Million Rights Offering).

$100 Million Rights Offering

In December 2006, Revlon, Inc. launched a $100 million rights offering of Class A Common Stock (including the related private placement to MacAndrews & Forbes, the ''$100 Million Rights Offering''), which it completed in January 2007. See Note 20, ''Subsequent Events'' regarding the completion of the $100 Million Rights Offering in January 2007, including a description of the use of the proceeds from such offering. The $100 Million Rights Offering allowed each stockholder of record of Revlon, Inc.'s Class A and Class B Common Stock, as of the close of business on December 11, 2006, the record date set by Revlon, Inc.'s Board of Directors, to purchase additional shares of Class A Common Stock. The subscription price for each share of Class A Common Stock purchased in the $100 Million Rights Offering, including shares purchased in the private placement by MacAndrews & Forbes, was $1.05 per share.

Additionally, on December 18, 2006, Products Corporation entered into an amendment to the 2004 Consolidated MacAndrews & Forbes Line of Credit providing that, upon the consummation of the $100 Million Rights Offering, $50.0 million of the line of credit will remain available to Products Corporation through January 31, 2008 on substantially the same terms (which line of credit would otherwise have terminated pursuant to its terms upon the consummation of the $100 Million Rights Offering). (See Note 20, ''Subsequent Events'').

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13. STOCKHOLDERS' EQUITY

Information about the Company's preferred, common and treasury stock issued and/or outstanding is as follows:

	Preferred Stock	Common Stock		Treasury
	Class B	Class A	Class B	Stock

	Class A				
Balance, January 1, 2004	546	4,333	40,178,451	31,250,000	—
Stock issuances	—	—	299,536,000	—	—
Conversions	(546)	(4,333)	433,493	—	—
Restricted stock grants	—	—	4,495,000	—	—
Cancellation of restricted stock	—	—	(50,000)	—	—
Balance, December 31, 2004	—	—	344,592,944	31,250,000	—
Exercise of stock options for common stock	—	—	18,125	—	—
Restricted stock grants	—	—	50,000	—	—
Cancellation of restricted stock	—	—	(188,334)	—	—
Repurchase of restricted stock	—	—	—	—	236,315
Balance, December 31, 2005	—	—	344,472,735	31,250,000	236,315
Stock issuances	—	—	39,285,714	—	—
Exercise of stock options for common stock	—	—	60,400	—	—
Cancellation of restricted stock	—	—	(329,370)	—	—
Restricted stock grants	—	—	6,511,675	—	—
Repurchase of restricted stock	—	—	—	—	193,351
Balance, December 31, 2006	—	—	390,001,154	31,250,000	429,666

Preferred Stock

Prior to its elimination in March 2004, the Company's designated preferred stock consisted of 20 million shares of Series A Preferred Stock, and 20 million shares of Series B Preferred Stock. In March 2004, as part of the Revlon Exchange Transactions, shares of the Series A Preferred Stock were exchanged for approximately 8.7 million shares of Revlon, Inc. Class A Common Stock and shares of Series B Preferred Stock were converted into 433,333 shares of Revlon, Inc. Class A Common Stock and the Company eliminated the Series A and Series B Preferred Stock. See Note 8, ''Long-Term Debt — Revlon Exchange Transactions''.

Common Stock

As of December 31, 2006, the Company's authorized common stock consisted of 900 million shares of Class A Common Stock and 200 million shares of Class B common stock, par value $0.01 per share (''Class B Common Stock'' and together with the Class A Common Stock, the ''Common Stock''). The holders of Class A Common Stock and Class B Common Stock vote as a single class on all matters, except as otherwise required by law, with each share of Class A Common Stock entitling its holder to one vote and each share of the Class B Common Stock entitling its holder to ten votes. All of the shares of Class B Common Stock are owned by REV Holdings. The holders of the Company's two classes of Common Stock are entitled to share equally in the earnings of the Company from dividends, when and if declared by Revlon, Inc.'s Board of Directors. Each outstanding share of Class B Common Stock is convertible into one share of Class A Common Stock.

In completing the $110 Million Rights Offering, Revlon, Inc. issued an additional 39,285,714 shares of its Class A Common Stock, including 15,885,662 shares subscribed for by public shareholders (other than MacAndrews & Forbes) and 23,400,052 shares issued to MacAndrews & Forbes in a private placement directly from Revlon, Inc.

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As of December 31, 2006, MacAndrews & Forbes beneficially owned approximately 57% of Revlon, Inc.'s Class A Common Stock, 100% of Revlon, Inc.'s Class B Common Stock, together representing approximately 60% of Revlon, Inc.'s outstanding shares of Common Stock and approximately 76% of the combined voting power of the outstanding shares of Revlon Inc.'s Common Stock. As filed by Fidelity with the SEC on February 14, 2007 and reporting, as of December 31, 2006, on a Schedule 13G/A, Fidelity held approximately 63.1 million shares of Class A Common Stock, representing approximately 16.5% of Revlon, Inc.'s outstanding shares of Class A Common Stock, 15.3% of the outstanding shares of Common Stock and approximately 9.1% of the combined voting power of the Common Stock.

(See Note 20, ''Subsequent Events'' for shares issued and outstanding following the completion of the $100 Million Rights Offering and the related effect on MacAndrews & Forbes' beneficial ownership of shares of Revlon, Inc. Common Stock.)

Treasury stock

In the first, second, and third quarters of 2006, certain executives, in lieu of paying withholding taxes on the vesting of certain restricted stock awarded under the Stock Plan, authorized the withholding of an aggregate of 17,594, 156,857, and 18,900 shares, respectively, of Revlon, Inc. Class A Common Stock to satisfy the minimum statutory tax withholding requirements related to such vesting in accordance with the share withholding provisions of the Stock Plan, a stock-based compensation plan. These shares were recorded as treasury stock using the cost method, at $3.56, $3.16, and $1.28 per share, respectively, the market price on the respective vesting dates, for a total of approximately $0.1 million, $0.5 million and nil, respectively.

In the second and third quarters of 2005, certain executives, in lieu of paying withholding taxes on vesting of certain restricted stock awarded under the Stock Plan, authorized the withholding of an aggregate of 183,914 and 52,401 shares, respectively, of Revlon, Inc. Class A Common Stock to satisfy the minimum statutory tax withholding requirements related to such vesting in accordance with the share withholding provisions of the Stock Plan. These shares were recorded as treasury stock using the cost method, at $3.29 and $3.57, respectively, the market price on the respective vesting dates, for a total of approximately $0.6 million and $0.2 million, respectively.

14. STOCK COMPENSATION PLAN

Revlon, Inc. maintains the Second Amended and Restated Revlon, Inc. Stock Plan (the ''Stock Plan''), which provides for awards of stock options, stock appreciation rights, restricted or unrestricted stock and restricted stock units to eligible employees and directors of Revlon, Inc. and its affiliates, including Products Corporation.

In June 2004, the Stock Plan was amended and restated to, among other things, increase the number of shares available for grant and to reduce the maximum term of the option grants to 7 years. Pursuant to the June 2004 amendment, awards may be granted for up to an aggregate of 40,650,000 shares of Class A Common Stock.

In November 2006, the Stock Plan was amended and restated to:

(1) rename the Stock Plan as the Second Amended and Restated Revlon, Inc. Stock Plan;
(2) increase the number of shares that may be issued as restricted and unrestricted stock and restricted stock units from 5,935,000 to 15,000,000;
(3) increase from 300,000 to 4,065,000 the number of awards, other than stock option and stock appreciation right awards, that may be granted without regard to the one-year and three-year minimum vesting requirements under the Stock Plan and clarify that such number does not include awards granted without regard to such minimum vesting requirements that are cancelled without payment of cash or other consideration in connection with the termination of the grantee's employment, services or otherwise;

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(4) provide that, in connection with any future merger, consolidation, sale of all or substantially all of the Company's assets or other similar transactions, the Company's Compensation and Stock Plan Committee (the ''Compensation Committee'') may, by notice to grantees, accelerate the dates upon which all outstanding stock options and stock appreciation rights awards of such grantees shall be exercisable and the dates upon which action may be taken with respect to all other awards requiring action on the part of grantees, without requiring that such awards terminate (which right the Compensation Committee had previously with respect to restricted stock awards); and

(5) make certain technical amendments to clarify that restricted stock awards may be in either book-entry or certificated form.

The amendment and restatement of the Stock Plan, which became effective on November 12, 2006, did not increase the total number of shares as to which awards may be granted under the Stock Plan. The primary purpose of the amendments was to enable the Company to grant restricted stock awards, some of which may vest over a period of less than three years, from shares available for issuance as awards under the Stock Plan as a retention incentive for key employees who are expected to contribute to the execution of the Company's business strategy, which awards were granted to key employees in November 2006.

Non-qualified options granted under the Stock Plan are granted at prices that equal or exceed the fair market value of Class A Common Stock on the grant date and have a term of 7 years (option grants under the Stock Plan prior to June 4, 2004 have a term of 10 years). Option grants vest over service periods that range from one to five years. Certain option grants contain provisions that allow for accelerated vesting if the Class A Common Stock closing price equals or exceeds amounts ranging from $30.00 to $40.00 per share. Additionally, employee stock option grants outstanding in November 2006 vest upon a ''change in control''.

Stock options:

Total net stock option compensation expense includes amounts attributable to the granting of, and the remaining requisite service period of, stock options issued under the Stock Plan, which awards were unvested at January 1, 2006 or granted on or after such date. Net stock option compensation expense for the year ended December 31, 2006 was $7.1 million (including $1.4 million related to the departure of Mr. Jack Stahl, the Company's former President and Chief Executive Officer, in September 2006), or $0.02 for both basic and diluted earnings per share. As of December 31, 2006, the total unrecognized stock option compensation expense related to unvested stock options in the aggregate was $2.8 million (which included the write-off of unrecognized stock option compensation related to stock options forfeited as a result of terminations of employment after September 30, 2006 primarily related to restructuring events under the September 2006 Program (as described in Note 2)). The unrecognized stock option compensation expense is expected to be recognized over a weighted-average period of 1.4 years. The total fair value of stock options that vested during the year ended December 31, 2006 was $10.1 million.

At December 31, 2006, 2005 and 2004 there were 17,990,458, 15,972,389 and 10,415,745 stock options exercisable under the Stock Plan, respectively.

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A summary of the status of stock option grants under the Stock Plan as of December 31, 2006, 2005 and 2004 and changes during the years then ended is presented below:

	Shares (000's)	Weighted Average Exercise Price
Outstanding at January 1, 2004	7,707.6	$ 10.66
Granted	24,517.4	3.03
Exercised	—	—
Forfeited and expired	(1,443.3)	9.01
Outstanding at December 31, 2004	30,781.7	4.66
Granted	5,200.4	2.56
Exercised	(18.1)	3.03
Forfeited and expired	(2,930.9)	5.59
Outstanding at December 31, 2005	33,033.1	4.25
Granted	47.5	1.95
Exercised	(60.4)	2.90
Forfeited and expired	(8,027.2)	3.34
Outstanding at December 31, 2006	24,993.0	4.54

The weighted average grant date fair value of options granted during 2006, 2005 and 2004 approximated $1.11, $1.38 and $2.08, respectively, and were estimated using the Black-Scholes option valuation model with the following weighted-average assumptions:

	Year Ended December 31,		
	2006	2005	2004
Expected life of option [a]	4.75 years	4.75 years	7.00 years
Risk-free interest rate [b]	4.76%	3.95%	3.95%
Expected volatility [c]	65%	61%	69%
Expected dividend yield [d]	N/A	N/A	N/A

(a) The expected life of an option is calculated using a formula based on the vesting term and contractual life of the option.

(b) The risk-free interest rate is based upon the rate in effect at the time of the option grant on a zero coupon U.S. Treasury bill for periods approximating the expected life of the option.

(c) Expected volatility is based on the daily historical volatility of the NYSE closing price of the Company's Class A Common Stock over the expected life of the option.

(d) Assumes a dividend rate of nil on the Company's Class A Common Stock for options granted during the years ended December 31, 2006 and 2005, respectively.

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The following table summarizes information about the Stock Plan's options outstanding at December 31, 2006:

	Outstanding				Exerciseable		
Range of Exercise Prices	Number of Options (000's)	Weighted Average Years Remaining	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Options (000's)	Weighted Average Years Remaining	Weighted Average Exercise Price
$1.46 to $1.59	35.0	6.76	$ 1.55	—	—		$ —
2.31 to 3.45	20,692.1	4.52	2.95	—	14,124.5	4.46	3.00
3.76 to 5.15	1,975.9	5.51	3.95	—	1,575.9	5.61	3.99
5.66 to 8.25	821.7	4.07	6.22	—	821.7	4.07	6.22
8.82 to 10.44	300.1	3.24	8.81	—	300.1	3.24	8.81
15.00 to 18.50	366.9	2.12	15.01	—	366.9	2.12	15.01
24.13 to 34.88	497.2	0.72	32.47	—	497.2	0.72	32.47
36.38 to 50.00	304.1	1.32	49.90	—	304.1	1.32	49.90
1.46 to 50.00	24,993.0	4.42	4.54	—	17,990.4	4.32	5.18

Restricted stock awards and restricted stock units:

The Stock Plan and the Supplemental Stock Plan (as hereinafter defined) allow for awards of restricted stock and restricted stock units to employees and directors of Revlon, Inc. and its affiliates, including Products Corporation. The restricted stock awards granted under the Stock Plan vest over service periods that generally range from 19 months to five years. In 2006, 2005 and 2004, the Company granted 6,511,675, 50,000 and 4,495,000 shares, respectively, of restricted stock and restricted stock units under the Stock Plan with weighted average fair values, based on the market price of Class A Common Stock on the dates of grant, of $1.59, $3.13 and $3.03, respectively. At December 31, 2006 and 2005, there were 8,120,643 and 3,810,002 shares, respectively, of restricted stock and restricted stock units outstanding and unvested under the Stock Plan.

A summary of the status of grants of restricted stock and restricted stock units under the Stock Plan and Supplemental Stock Plan (as hereinafter defined) as of December 31, 2006, 2005, and 2004 and changes during the years then ended is presented below:

	Shares (000's)	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2004	1,970.0	$ 4.11
Granted	4,495.0	3.03
Vested	(690.0)	4.88
Forfeited	(50.0)	3.03
Outstanding at December 31, 2004	5,725.0	3.18
Granted	50.0	3.13

Vested [a]	(1,776.7)	3.17
Forfeited	(188.3)	3.17
Outstanding at December 31, 2005	3,810.0	3.19
Granted	6,511.7	1.59
Vested [b]	(1,871.7)	3.13
Forfeited	(329.4)	3.01
Outstanding at December 31, 2006	8,120.6	1.92

(a)Of the amounts vested during 2005, 236,315 shares of Revlon, Inc. Class A Common Stock were withheld by the Company to satisfy certain grantees' minimum withholding tax requirements. (See discussion under ''Treasury Stock'' in Note 13, ''Stockholders' Equity'').

(b)Of the amounts vested during 2006, 193,351 shares of Revlon, Inc. Class A Common Stock were withheld by the Company to satisfy certain grantees' minimum withholding tax requirements. (See discussion under ''Treasury Stock'' in Note 13, ''Stockholders' Equity'').

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In 2002, Revlon, Inc. adopted the Revlon, Inc. 2002 Supplemental Stock Plan (the ''Supplemental Stock Plan''), the purpose of which was to provide Mr. Stahl, the Company's former President and Chief Executive Officer, the sole eligible participant under the Supplemental Stock Plan, with inducement awards to entice him to join the Company. The Supplemental Stock Plan covers 530,000 shares of Class A Common Stock. All of the 530,000 shares were issued in the form of restricted shares of Class A Common Stock to Mr. Stahl in February 2002. The terms of the Supplemental Stock Plan and the foregoing grant of restricted shares to Mr. Stahl are substantially the same as the terms and grants under the Stock Plan. Pursuant to the terms of the Supplemental Stock Plan, such grant was made conditioned upon his execution of the Company's standard Employee Agreement as to Confidentiality and Non-Competition.

Generally, no dividends will be paid on unvested restricted stock, provided, however, that in connection with the 2002 grants to Mr. Stahl of 470,000 shares of restricted stock under the Stock Plan and 530,000 shares of restricted stock under the Supplemental Stock Plan (of which an aggregate 500,000 shares of restricted stock from both plans remained unvested at December 31, 2006), in the event any cash or in-kind distributions are made in respect of Common Stock prior to the lapse of the restrictions on such shares, such dividends will be held by the Company and paid to Mr. Stahl when and if such restrictions lapse.

Mr. Stahl ceased employment with the Company in September 2006. Mr. Stahl and the Company entered into a separation agreement in September 2006 that provided him with the separation benefits that he was entitled to receive (and no others) pursuant to the employment agreement he enterered into in 2002 when he joined the Company. In connection with entering into such separation agreement during 2006, the Company incurred charges within SG&A of $3.2 million for the accelerated amortization of his unvested options and unvested restricted stock.

The Company recognizes non-cash compensation expense related to restricted stock awards and restricted stock units under the Stock Plan and Supplemental Stock Plan using the straight-line method over the remaining service period. The Company recorded compensation expense related to restricted stock awards under the Stock Plan and Supplemental Stock Plan of $6.0 million, $5.8 million and $5.2 million during 2006, 2005 and 2004, respectively. The deferred stock-based compensation related to restricted stock awards is $9.9 million and $6.5 million at December 31, 2006 and 2005, respectively (which includes the write-off of deferred stock-based compensation related to restricted

share awards that were forfeited as a result of terminations during 2006, as well as terminations which will occur after December 31, 2006 as a result of the February 2006 organizational realignment and the September 2006 organizational streamlining). The deferred stock-based compensation related to restricted stock awards is expected to be recognized over a weighted-average period of 2.1 years. The total fair value of restricted stock and restricted stock units that vested during the year ended December 31, 2006 was $5.9 million. At December 31, 2006, there were 8,120,643 shares of unvested restricted stock and restricted stock units under the Stock Plan and the Supplemental Stock Plan.

Pro forma net loss:

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

The following table illustrates the effect on net loss and net loss per basic and diluted common share as if the Company had applied the fair value method to its stock-based compensation under the disclosure provisions of SFAS No. 123 and amended disclosure provisions of SFAS No. 148:

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	Year Ended December 31,	
	2005	2004
Net loss as reported	$ (83.7)	$ (142.5)
Add-back: Stock-based employee compensation expense included in reported net loss	5.8	5.2
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards	(22.1)	(30.3)
Pro forma net loss	$ (100.0)	$ (167.6)
Basic and diluted loss per common share:		
As reported	$ (0.22)	$ (0.47)
Pro forma	$ (0.27)	$ (0.56)

15. COMPREHENSIVE LOSS

The components of comprehensive loss during 2006, 2005 and 2004 are as follows:

	Foreign Currency	Minimum Pension	Actuarial Gain / Loss	Prior Service Cost on	Deferred Loss-	Accumulated Other

	Translation	Liability	on Post-retirement Benefits	Post-retirement Benefits	Hedging	Comprehensive Loss
Balance, January 1, 2004	$ (8.5)	$ (112.1)	$ —	$ —	$ (1.4)	$ (122.0)
Unrealized gains (losses)	0.6	(1.6)	—	—	(2.8)	(3.8)
Reclassifications into net loss	—	—	—	—	1.5	1.5
Balance December 31, 2004	(7.9)	(113.7)	—	—	(2.7)	(124.3)
Unrealized gains (losses)	(6.9)	6.7	—	—	0.2	1.5
Reclassifications into net loss	0.4	—	—	—	2.2	1.1
Balance December 31, 2005	(14.4)	(107.0)	—	—	(0.3)	(121.7)
Unrealized gains (losses)	3.2	—	—	—	(0.4)	2.8
Reclassifications under SFAS No. 158 [(a)]	—	107.0	(115.8)	2.7	—	(6.1)
Portion of SFAS No. 158 reclassification allocated to Revlon Holdings [(a)]	—	—	0.5	—	—	0.5
Reclassifications into net loss	—	—	—	—	0.3	0.3
Balance December 31, 2006	$ (11.2)	$ —	$ (115.3)	$ 2.7	$ (0.4)	$ (124.2)

(a) Due to the adoption of SFAS No. 158 in December 2006, the minimum pension liability, as set forth in the table above, is no longer recognized as a component of comprehensive loss. The $5.6 million net adjustment represents the difference between (1) $115.8 million of actuarial gains and $2.7 million of prior service costs calculated under SFAS No. 158, both of which have not yet been recognized as a component of net periodic pension cost, (2) the net $0.5 million reclassification of actuarial gains and prior service costs calculated under SFAS No. 158, which are attributable to Revlon Holdings under the 1992 transfer agreements referred to in Note 16, ''Related Party Transactions'', and (3) the $107.0 reversal of the minimum pension liability, which under SFAS No. 158 is no longer required as a component of comprehensive loss to be recognized during 2006 as a component of comprehensive loss. (See Note 11 ''Savings Plan, Pension and Other Post-retirement Benefits'').

16. RELATED PARTY TRANSACTIONS

As of December 31, 2006, MacAndrews & Forbes beneficially owned shares of Revlon, Inc.'s Common Stock having approximately 76% of the combined voting power of such outstanding shares. As a result, MacAndrews & Forbes is able to elect Revlon, Inc.'s entire Board of Directors and control the vote on all matters submitted to a vote of Revlon, Inc.'s stockholders. MacAndrews & Forbes is wholly-owned by Ronald O. Perelman, Chairman of Revlon, Inc.'s Board of Directors. (See Note 20, ''Subsequent Events'' regarding the consummation of the $100 Million Rights Offering in January 2007 and the related effect on the MacAndrews & Forbes beneficial ownership of shares of Revlon, Inc. Common Stock.)

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Transfer Agreements

In June 1992, Revlon, Inc. and Products Corporation entered into an asset transfer agreement with Revlon Holdings LLC, a Delaware limited liability company and formerly a Delaware corporation known as Revlon Holdings Inc.

(‘‘Revlon Holdings’’), and which is an affiliate and an indirect wholly-owned subsidiary of MacAndrews & Forbes and certain of Revlon Holdings’ wholly-owned subsidiaries. Revlon, Inc. and Products Corporation also entered into a real property asset transfer agreement with Revlon Holdings. Pursuant to such agreements, on June 24, 1992 Revlon Holdings transferred assets to Products Corporation and Products Corporation assumed all of the liabilities of Revlon Holdings, other than certain specifically excluded assets and liabilities (the liabilities excluded are referred to as the ‘‘Excluded Liabilities’’). Certain consumer products lines sold in demonstrator-assisted distribution channels considered not integral to Revlon, Inc.’s business and that historically had not been profitable and certain other assets and liabilities were retained by Revlon Holdings. Revlon Holdings agreed to indemnify Revlon, Inc. and Products Corporation against losses arising from the Excluded Liabilities, and Revlon, Inc. and Products Corporation agreed to indemnify Revlon Holdings against losses arising from the liabilities assumed by Products Corporation. The amounts reimbursed by Revlon Holdings to Products Corporation for the Excluded Liabilities for 2006, 2005 and 2004 were $0.3 million, $0.2 million, and $0.2 million, respectively.

Reimbursement Agreements

Revlon, Inc., Products Corporation and MacAndrews & Forbes Inc. (a wholly-owned subsidiary of MacAndrews & Forbes Holdings) have entered into reimbursement agreements (the ‘‘Reimbursement Agreements’’) pursuant to which (i) MacAndrews & Forbes Inc. is obligated to provide (directly or through affiliates) certain professional and administrative services, including employees, to Revlon, Inc. and its subsidiaries, including Products Corporation, and purchase services from third party providers, such as insurance, legal and accounting services and air transportation services, on behalf of Revlon, Inc. and its subsidiaries, including Products Corporation, to the extent requested by Products Corporation, and (ii) Products Corporation is obligated to provide certain professional and administrative services, including employees, to MacAndrews & Forbes and purchase services from third party providers, such as insurance, legal and accounting services, on behalf of MacAndrews & Forbes to the extent requested by MacAndrews & Forbes Inc., provided that in each case the performance of such services does not cause an unreasonable burden to MacAndrews & Forbes or Products Corporation, as the case may be.

Products Corporation reimburses MacAndrews & Forbes for the allocable costs of the services purchased for or provided to Products Corporation and its subsidiaries and for the reasonable out-of-pocket expenses incurred in connection with the provision of such services. MacAndrews & Forbes Inc. (or such affiliates) reimburses Products Corporation for the allocable costs of the services purchased for or provided to MacAndrews & Forbes and for the reasonable out-of-pocket expenses incurred in connection with the purchase or provision of such services. Each of Revlon, Inc. and Products Corporation, on the one hand, and MacAndrews & Forbes Inc., on the other, has agreed to indemnify the other party for losses arising out of the provision of services by it under the Reimbursement Agreements, other than losses resulting from its willful misconduct or gross negligence.

The Reimbursement Agreements may be terminated by either party on 90 days’ notice. Products Corporation does not intend to request services under the Reimbursement Agreements unless their costs would be at least as favorable to Products Corporation as could be obtained from unaffiliated third parties. Revlon, Inc. and Products Corporation participate in MacAndrews & Forbes’ directors and officers liability insurance program, which covers Revlon, Inc. and Products Corporation as well as MacAndrews & Forbes. The limits of coverage are available on an aggregate basis for losses to any or all of the participating companies and their respective directors and officers.

Revlon, Inc. and Products Corporation reimburse MacAndrews & Forbes from time to time for their allocable portion of the premiums for such coverage or they pay the insurers directly, which premiums the Company believes are more favorable than the premiums the Company would pay were it to secure stand-alone coverage. Any amounts paid by Revlon, Inc. and Products Corporation directly to MacAndrews & Forbes in respect of premiums are included in the amounts paid under the Reimbursement

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Agreements. The net amounts reimbursable from (payable to) MacAndrews & Forbes Inc. to Products Corporation for the services provided under the Reimbursement Agreements for 2006, 2005 and 2004, were $0.5 million, $(3.7) million, and $1.0 million, respectively.

Tax Sharing Agreements

As a result of the closing of the Revlon Exchange Transactions, as of the end of March 25, 2004, Revlon, Inc., Products Corporation and their U.S. subsidiaries were no longer included in the MacAndrews & Forbes Group for federal income tax purposes. See Note 10, ''Income Taxes'', for further discussion on these agreements and related transactions in 2006, 2005 and 2004.

Registration Rights Agreement

Prior to the consummation of Revlon, Inc.'s initial public equity offering in February 1996, Revlon, Inc. and Revlon Worldwide Corporation (which subsequently merged into REV Holdings), the then direct parent of Revlon, Inc., entered into a registration rights agreement (the ''Registration Rights Agreement''), and in February 2003, MacAndrews & Forbes executed a joinder agreement to the Registration Rights Agreement, pursuant to which REV Holdings, MacAndrews & Forbes and certain transferees of Revlon, Inc.'s Common Stock held by REV Holdings (the ''Holders'') had the right to require Revlon, Inc. to register under the Securities Act all or part of the Class A Common Stock owned by such Holders, including shares of Class A Common Stock purchased by MacAndrews & Forbes in connection with the $50.0 million equity rights offering consummated by Revlon, Inc. in 2003 and shares of Class A Common Stock issuable upon conversion of Revlon, Inc.'s Class B Common Stock owned by such Holders (a ''Demand Registration''). In connection with the closing of the Revlon Exchange Transactions and pursuant to the 2004 Investment Agreement, MacAndrews & Forbes executed a joinder agreement that provided that MacAndrews & Forbes would also be a Holder under the Registration Rights Agreement and that all shares acquired by MacAndrews & Forbes pursuant to the 2004 Investment Agreement are deemed to be registrable securities under the Registration Rights Agreement. This would include all of the shares of Class A Common Stock acquired by MacAndrews & Forbes in connection with the $110 Million Rights Offering and the $100 Million Rights Offering. (See Note 20, ''Subsequent Events'' regarding the consummation of the $100 Million Rights Offering in January 2007).

Revlon, Inc. may postpone giving effect to a Demand Registration for a period of up to 30 days if Revlon, Inc. believes such registration might have a material adverse effect on any plan or proposal by Revlon, Inc. with respect to any financing, acquisition, recapitalization, reorganization or other material transaction, or if Revlon, Inc. is in possession of material non-public information that, if publicly disclosed, could result in a material disruption of a major corporate development or transaction then pending or in progress or in other material adverse consequences to Revlon, Inc. In addition, the Holders have the right to participate in registrations by Revlon, Inc. of its Class A Common Stock (a ''Piggyback Registration''). The Holders will pay all out-of-pocket expenses incurred in connection with any Demand Registration. Revlon, Inc. will pay any expenses incurred in connection with a Piggyback Registration, except for underwriting discounts, commissions and expenses attributable to the shares of Class A Common Stock sold by such Holders.

2004 Consolidated MacAndrews & Forbes Line of Credit

For a description of transactions with MacAndrews & Forbes in 2006, 2005 and 2004 in connection with the 2004 loan agreements with MacAndrews & Forbes, see Note 8, ''Long-Term Debt''.

Refinancing Transactions and Rights Offerings

For a description of transactions with MacAndrews & Forbes in 2006, 2005 and 2004 in connection with the Debt Reduction Transactions, the Revlon Exchange Transactions and the 2004 Investment Agreement, including in connection with the $110 Million Rights Offering and the $100 Million Rights Offering, see Note 8, ''Long-Term Debt''.

Other

Pursuant to a lease dated April 2, 1993 (the ''Edison Lease''), Revlon Holdings leased to Products Corporation the Edison research and development facility for a term of up to 10 years with an annual rent

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of $1.4 million and certain shared operating expenses payable by Products Corporation which, together with the annual rent, were not to exceed $2.0 million per year. In August 1998, Revlon Holdings sold the Edison facility to an unrelated third party, which assumed substantially all liability for environmental claims and compliance costs relating to the Edison facility, and in connection with the sale Products Corporation terminated the Edison Lease and entered into a new lease with the new owner. Revlon Holdings agreed to indemnify Products Corporation through September 1, 2013 (the term of the new lease) to the extent that rent under the new lease exceeds rent that would have been payable under the terminated Edison Lease had it not been terminated. The net amounts reimbursed by Revlon Holdings to Products Corporation with respect to the Edison facility for 2006, 2005 and 2004 were $0.3 million, $0.3 million, and $0.3 million, respectively.

During 2005 and 2004, Products Corporation leased to MacAndrews & Forbes a small amount of space at certain facilities pursuant to occupancy agreements and leases, including space at Products Corporation's New York headquarters. The rent paid by MacAndrews & Forbes to Products Corporation for 2005 and 2004 was $0.2 million, and $0.3 million, respectively. MacAndrews & Forbes vacated the leased space in August 2005.

Certain of Products Corporation's debt obligations have been, and may in the future be, supported by, among other things, guaranties from Revlon, Inc. and, subject to certain limited exceptions, all of the domestic subsidiaries of Products Corporation, including the 2006 Credit Agreements, the 2004 Credit Agreement prior to its refinancing in December 2006, and the 12% Senior Secured Notes prior to their complete redemption in July and August 2004. The obligations under such guaranties are and were secured by, among other things, the capital stock of Products Corporation and, subject to certain limited exceptions, the capital stock of all of Products Corporation's domestic subsidiaries and 66% of the capital stock of Products Corporation's and its domestic subsidiaries' first-tier foreign subsidiaries. In connection with the Revlon Exchange Transactions, in February 2004, Revlon, Inc. entered into supplemental indentures pursuant to which it agreed to guarantee the obligations of Products Corporation under the indentures governing Products Corporation's 8 5/8% Senior Subordinated Notes and, prior to their complete redemption in April 2005, Products Corporation's 8 1/8% Senior Notes and 9% Senior Notes.

Pursuant to his employment agreement, Mr. Jack Stahl, the Company's former President and Chief Executive Officer, received two loans (prior to the passage of the Sarbanes-Oxley Act of 2002) from Products Corporation, one, in March 2002, to satisfy state, local and federal income taxes (including withholding taxes) incurred by him as a result of his having made an election under Section 83(b) of the Code in connection with the 1,000,000 shares of restricted stock that were granted to him in connection with his joining the Company, and a second in May 2002 to cover the purchase of a principal residence in the New York metropolitan area, as he was relocating from Atlanta, Georgia. As a

result of the termination of his employment in September 2006, the outstanding principal amount and all accrued interest on such loans was forgiven in accordance with the terms of his employment agreement, being approximately $2.2 million (which included accrued interest) and $1.9 million, respectively.

During 2000, prior to the passage of the Sarbanes-Oxley Act of 2002, Products Corporation made an advance of $0.8 million to Mr. Douglas Greeff, the Company’s former Executive Vice President Strategic Finance, pursuant to his employment agreement, which loan bore interest at the applicable federal rate and was payable in 5 equal annual installments on each of May 9, 2001, 2002, 2003, 2004 and May 9, 2005. Mr. Greeff has fully repaid such loan, including installments of $0.2 million, $0.2 million and $0.2 million during 2005, 2004 and 2003, respectively. Pursuant to his employment agreement, Mr. Greeff was entitled to receive bonuses from Products Corporation, payable on each May 9th commencing on May 9, 2001 and ending on May 9, 2005, in each case equal to the sum of the principal and interest on the advance repaid in respect of such year by Mr. Greeff, provided that he remained employed by Products Corporation on each such May 9th, which bonus installments were paid to Mr. Greeff. Pursuant to the terms of Mr. Greeff’s separation agreement, as a result of the fact that Mr. Greeff ceased employment in February 2005, Mr. Greeff repaid the remaining amount of the loan on or about May 9, 2005 and Products Corporation paid the final bonus installment to Mr. Greeff on or about May 12, 2005.

During 2006, 2005 and 2004 Products Corporation made payments of $0.2 million, $0.6 million and $0.4 million, respectively, to Ms. Ellen Barkin under a written agreement pursuant to which she provided

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voiceover services for certain of the Company’s advertisements, which payments were competitive with industry rates for similarly situated talent.

During 2004, Products Corporation placed advertisements in magazines and other media operated by Martha Stewart Living Omnimedia, Inc. (‘‘MSLO’’), which is controlled by Ms. Martha Stewart, a former member of Revlon, Inc.’s Board of Directors, who served as MSLO’s Founder and Chief Creative Officer. Products Corporation paid MSLO $0.9 million for such services in 2004, which fees were less than 1% of the Company’s estimate of MSLO’s consolidated gross revenues, and less than 1% of the Company’s consolidated gross revenues, for 2004. Products Corporation’s decision to place advertisements for its products in MSLO’s magazines and other media was based upon their popular appeal to women and the rates paid were competitive with industry rates for similarly situated magazines and media. Ms. Stewart ceased serving as a director in March 2004.

During 2006, 2005 and 2004, Products Corporation paid $0.9 million, $1.0 million and $1.0 million, respectively, to a nationally-recognized security services company, in which MacAndrews & Forbes has a controlling interest, for security officer services. Products Corporation’s decision to engage such firm was based upon its expertise in the field of security services, and the rates were competitive with industry rates for similarly situated security firms.

Although not required to be disclosed under SFAS No. 57, ‘‘Related Party Disclosures’’ during 2006, 2005 and 2004, Products Corporation obtained advertising, media, direct marketing and other public relations services from various subsidiaries of WPP in the ordinary course of business. Ms. Linda Gosden Robinson, a member of Revlon, Inc.’s Board of Directors, is employed by one of WPP’s subsidiaries, however, she is not an executive officer of WPP and has no direct or indirect material interest in the business that the Company conducts with WPP.

17. COMMITMENTS AND CONTINGENCIES

The Company currently leases manufacturing, executive, including research and development, and sales facilities and various types of equipment under operating and capital lease agreements. Rental expense was $19.5 million, $17.3 million and $19.4 million for the years ended December 31, 2006, 2005 and 2004, respectively. Minimum rental commitments under all noncancelable leases, including those pertaining to idled facilities, with remaining lease terms in excess of one year from December 31, 2006 aggregated $90.4 million. Such commitments for each of the five years and thereafter subsequent to December 31, 2006 are $16.9 million, $9.4 million, $8.2 million, $7.4 million, $11.8 million and $36.7 million, respectively.

As part of the September 2006 organizational streamlining, the Company has agreed to cancel its lease and modify its sublease of its New York City headquarters space, including vacating 23,000 square feet in December 2006 and approximately 77,300 square feet which the Company will vacate during the first quarter of 2007. The Company expects these space reductions will result in savings in rental and related expense, while allowing the Company to maintain its corporate offices in a smaller, more efficient space, reflecting its streamlined organization.

The Company and its subsidiaries are defendants in litigation and proceedings involving various matters. In the opinion of the Company's management, based upon advice of its counsel handling such litigation and proceedings, adverse outcomes, if any, will not result in a material effect on the Company's consolidated financial condition or results of operations.

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18. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations:

	Year Ended December 31, 2006			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	$ 325.5	$ 321.1	$ 305.9	$ 378.9
Gross profit	208.2	183.1	157.0	237.6
Net (loss) income [(a)]	(58.2)	(87.1)	(100.5)	(5.5)
Basic loss per common share:				
Net (loss) income per common share	$ (0.15)	$ (0.21)	$ (0.24)	$ (0.01)
Diluted loss per common share:				
Net (loss) income per common share	$ (0.15)	$ (0.21)	$ (0.24)	$ (0.01)

	Year Ended December 31, 2005			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	$ 300.9	$ 318.3	$ 275.3	$ 437.8
Gross profit	186.7	199.4	158.3	279.8
Net (loss) income [(b)]	(46.8)	(35.8)	(65.4)	64.3
Basic loss per common share:				

Net (loss) income per common share	$ (0.13)	$ (0.10)	$ (0.17)	$ 0.17
Diluted loss per common share:				
Net (loss) income per common share	$ (0.13)	$ (0.10)	$ (0.17)	$ 0.17

(a) During 2006, primarily in the third and fourth quarters, the Company incurred charges of (1) $9.4 million in connection with the departure of Mr. Jack Stahl, the Company's former President and Chief Executive Officer, in September 2006 (including $6.2 million for severance and related costs and $3.2 million for the accelerated amortization of Mr. Stahl's unvested options and unvested restricted stock), (2) $60.4 million in connection with the discontinuance of the Vital Radiance brand and (3) restructuring charges of approximately $17.5 million in connection with the September 2006 organizational streamlining. In addition, primarily during the first and second quarters of 2006, the Company recorded charges for brand support and display amortization of approximately $57 million, including higher advertising and consumer promotional spending, primarily to support the launch of certain brand initiatives. In addition, the Company incurred restructuring charges of approximately $10.1 million, most of which were incurred in the first quarter of 2006, in connection with the February 2006 organizational realignment.

(b) During 2005, primarily in the third and fourth quarters, the Company recorded upfront launch costs of approximately $62 million associated with the launch of its brand initiatives, including the launch of Vital Radiance and the complete re-stage of the Almay brand. In addition, primarily during the first and second quarters of 2005, the Company recorded an aggregate $9.0 million loss on early extinguishment of debt, which includes a $5.0 million pre-payment fee related to the pre-payment of $100.0 million of indebtedness outstanding under the 2004 Term Loan Facility of the 2004 Credit Agreement with a portion of the proceeds from the issuance of the Original 9½% Senior Notes, the loss on the redemption of Products Corporation's 8 1/8% Senior Notes and 9% Senior Notes of $1.5 million in the aggregate, as well as the write-off of the portion of deferred financing costs related to such prepaid amount.

19. GEOGRAPHIC, FINANCIAL AND OTHER INFORMATION

The Company manages its business on the basis of one reportable operating segment. See Note 1, ''Summary of Significant Accounting Policies'', for a brief description of the Company's business. As of December 31, 2006, the Company had operations established in 15 countries outside of the U.S. and its products are sold throughout the world. The Company's results of operations and the value of its foreign assets and liabilities may be adversely affected by, among other things, weak economic conditions, political uncertainties, military actions, terrorist activities, adverse currency fluctuations, competitive activities, retailer inventory management and changes in consumer purchasing habits, including with respect to shopping channels. Net sales by geographic area are presented by attributing revenues from external customers on the basis of where the products are sold. During 2006, 2005 and 2004, Wal-Mart and its affiliates worldwide accounted for approximately 23%, 24% and 21%, respectively, of the Company's net sales. The Company expects that Wal-Mart and a small number of other customers will, in the aggregate, continue to account for a large portion of the Company's net sales. As is customary in the

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consumer products industry, none of the Company's customers is under an obligation to continue purchasing products from the Company in the future.

In the tables below, certain prior year amounts have been reclassified to conform to the current period's presentation, including the transfer, during the second quarter of 2006, of management responsibility for the Company's Canadian operations from the Company's North America operations to the European region of its international operations.

	Year Ended December 31,					
	2006		2005		2004	
Geographic area:						
Net sales:						
United States	$ 764.9	57%	$ 788.3	59%	$ 792.7	61%
International	566.5	43%	544.0	41%	504.5	39%
	$ 1,331.4		$ 1,332.3		$ 1,297.2	

	December 31,					
	2006		2005		2004	
Long-lived assets — net:						
United States	$ 362.1	82%	$ 366.9	81%	$ 371.3	82%
International	81.8	18%	84.8	19%	83.4	18%
	$ 443.9		$ 451.7		$ 454.7	

	Year Ended December 31,					
	2006		2005		2004	
Classes of similar products:						
Net sales:						
Cosmetics, skincare and fragrances	$ 832.0	62%	$ 904.3	68%	$ 874.7	67%
Personal care	499.4	38%	428.0	32%	422.5	33%
	$ 1,331.4		$ 1,332.3		$ 1,297.2	

20. SUBSEQUENT EVENTS

In January 2007, Revlon, Inc. completed the $100 Million Rights Offering of Class A Common Stock (including the related private placement to MacAndrews & Forbes), which it launched in December 2006. The $100 Million Rights Offering allowed each stockholder of record of Revlon, Inc.'s Class A and Class B Common Stock, as of the close of business on December 11, 2006, the record date set by Revlon, Inc.'s Board of Directors, to purchase additional shares of Class A Common Stock. The subscription price for each share of Class A Common Stock purchased in the $100 Million Rights Offering, including shares purchased in the private placement by MacAndrews & Forbes, was $1.05 per share. Upon completing the $100 Million Rights Offering, Revlon, Inc. promptly transferred the proceeds to Products Corporation, which it used to reduce indebtedness as described below.

On February 22, 2007, using the proceeds of the $100 Million Rights Offering, Products Corporation completed the redemption of $50.0 million aggregate principal amount of Products Corporation's outstanding 8 5/8% Senior Subordinated Notes at an aggregate redemption price of $50.3 million, including $0.3 million of accrued and unpaid interest up to, but not including, the redemption date. Following such redemption, there remained outstanding $167.4 million in aggregate principal amount of the 8 5/8% Senior Subordinated Notes. The remainder of such proceeds was used to repay approximately $43.3 million of indebtedness outstanding under Products Corporation's 2006 Revolving Credit Facility, after paying fees and expenses of approximately $2 million incurred in connection with the $100 Million Rights Offering, with approximately $5.0 million of the remaining proceeds being available for general corporate purposes.

In completing the $100 Million Rights Offering, Revlon, Inc. issued an additional 95,238,095 shares of its Class A Common Stock, including 37,847,472 shares subscribed for by public shareholders (other

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than MacAndrews & Forbes) and 57,390,623 shares issued to MacAndrews & Forbes in a private placement directly from Revlon, Inc. The shares issued to MacAndrews & Forbes represented the number of shares of Revlon, Inc.'s Class A Common Stock that MacAndrews & Forbes would otherwise have been entitled to purchase pursuant to its basic subscription privilege in the $100 Million Rights Offering (which was approximately 60% of the shares of Revlon, Inc.'s Class A Common Stock offered in the $100 Million Rights Offering).

As a result of completing the $100 Million Rights Offering in January 2007, Revlon, Inc.'s total number of outstanding shares of Class A Common Stock increased to 476,688,940 shares at such date and the total number of shares of Common Stock outstanding, including Revlon, Inc.'s existing 31,250,000 shares of Class B Common Stock, increased to 507,938,940 shares at such date. Following the completion of these transactions in January 2007, MacAndrews & Forbes beneficially owned approximately 58% of Revlon, Inc.'s outstanding Class A Common Stock and approximately 60% of Revlon, Inc.'s total outstanding Common Stock, which shares together represented approximately 74% of the combined voting power of such shares at such date.

Effective upon consummation of the $100 Million Rights Offering, $50.0 million of the 2004 Consolidated MacAndrews & Forbes Line of Credit will remain available to Products Corporation through January 31, 2008 on substantially the same terms.

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Schedule II

REVLON, INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
Years Ended December 31, 2006, 2005 and 2004
(dollars in millions)

	Balance at Beginning Year	Charged to Cost and Expenses	Other Deductions	Balance at End of Year
Year ended December 31, 2006:				
Applied against asset accounts:				

Allowance for doubtful accounts	$ 5.1	$ (1.7)	$ (0.6)[1]	$ 4.0
Allowance for volume and early payment discounts	$ 13.8	$ 52.1	$ (52.2)[2]	$ 13.7
Year ended December 31, 2005:				
Applied against asset accounts:				
Allowance for doubtful accounts	$ 5.6	$ 0.6	$ (1.1)[1]	$ 5.1
Allowance for volume and early payment discounts	$ 13.4	$ 49.6	$ (49.2)[2]	$ 13.8
Year ended December 31, 2004:				
Applied against asset accounts:				
Allowance for doubtful accounts	$ 7.7	$ (1.6)	$ (0.5)[1]	$ 5.6
Allowance for volume and early payment discounts	$ 11.7	$ 47.4	$ (45.7)[2]	$ 13.4

Notes:

(1) Doubtful accounts written off, less recoveries, reclassifications and foreign currency translation adjustments.

(2) Discounts taken, reclassifications and foreign currency translation adjustments.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Revlon, Inc.
(Registrant)

By: /s/ David L. Kennedy
David L. Kennedy
President, Chief Executive Officer, and Director

By: /s/ Alan T. Ennis
Alan T. Ennis
Executive Vice President and Chief Financial Officer, Controller and Chief Accounting Officer

Dated: March 13, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant on March 13, 2007 and in the capacities indicated.

Signature	Title
* (Ronald O. Perelman)	Chairman of the Board and Director

* (Howard Gittis)	Director
* (Donald G. Drapkin)	Director
/s/ David L. Kennedy (David L. Kennedy)	President, Chief Executive Officer and Director
* (Alan S. Bernikow)	Director
* (Paul J. Bohan)	Director
* (Meyer Feldberg)	Director
* (Edward J. Landau)	Director
* (Debra L. Lee)	Director
* (Linda Gosden Robinson)	Director
* (Kathi P. Seifert)	Director
* (Kenneth L. Wolfe)	Director

*Robert K. Kretzman, by signing his name hereto, does hereby sign this report on behalf of the directors of the registrant above whose typed names asterisks appear, pursuant to powers of attorney duly executed by such directors and filed with the Securities and Exchange Commission.

By: /s/ Robert K. Kretzman
Robert K. Kretzman
Attorney-in-fact