

VALSPAR CORP  
Form 10-Q  
September 09, 2009  
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

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FORM 10-Q

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

For the quarterly period ended July 31, 2009

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-3011

**THE VALSPAR CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

36-2443580

(I.R.S. Employer  
Identification No.)

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901 3rd Avenue South

Minneapolis, MN 55402

(Address of principal executive offices, including zip code)

612/851-7000

(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  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  No

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

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

As of September 2, 2009, The Valspar Corporation had 100,829,218 shares of common stock outstanding, excluding 17,613,406 shares held in treasury. We had no other classes of stock outstanding.

THE VALSPAR CORPORATION

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for the Quarter Ended July 31, 2009

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**PART I. FINANCIAL INFORMATION**

ITEM 1. FINANCIAL STATEMENTS

## THE VALSPAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (DOLLARS IN THOUSANDS)

<u>ASSETS</u>	July 31, 2009 (Unaudited)	July 25, 2008 (Unaudited)	October 31, 2008 (Note)
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	\$ 127,305	\$ 101,114	\$ 90,073
Accounts and notes receivable less allowance (7/31/09-\$21,701; 7/25/08-\$12,760; 10/31/08-\$16,389)	548,985	651,925	565,237
Inventories:			
Manufactured products	140,883	193,965	153,325
Raw materials, supplies and work-in-process	93,208	113,676	118,098
Total inventories	234,091	307,641	271,423
Deferred income taxes	33,149	28,552	31,989
Prepaid expenses and other	88,647	92,539	88,298
<b>TOTAL CURRENT ASSETS</b>	<b>1,032,177</b>	<b>1,181,771</b>	<b>1,047,020</b>
GOODWILL	1,334,586	1,379,393	1,352,813
INTANGIBLES, NET	630,202	607,924	619,468
OTHER ASSETS	5,003	15,597	7,123
LONG-TERM DEFERRED INCOME TAXES	3,100	2,264	3,902
PROPERTY, PLANT AND EQUIPMENT	1,053,170	1,058,117	1,036,460
Less accumulated depreciation	(593,304)	) (546,777	) (546,744 )
<b>NET PROPERTY, PLANT AND EQUIPMENT</b>	<b>459,866</b>	<b>511,340</b>	<b>489,716</b>
<b>TOTAL ASSETS</b>	<b>\$ 3,464,934</b>	<b>\$ 3,698,289</b>	<b>\$ 3,520,042</b>

NOTE: The Balance Sheet at October 31, 2008 has been derived from the audited consolidated financial statements at that date.

See Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED BALANCE SHEETS - CONTINUED

(DOLLARS IN THOUSANDS)

<u>LIABILITIES AND STOCKHOLDERS EQUITY</u>	July 31, 2009 (Unaudited)	July 25, 2008 (Unaudited)	October 31, 2008 (Note)
<b>CURRENT LIABILITIES:</b>			
Notes payable and commercial paper	\$ 7,213	\$ 301,105	\$ 159,514
Current portion of long-term debt		19	12
Trade accounts payable	305,755	436,897	400,763
Income taxes	21,337	8,089	29,156
Accrued liabilities	310,723	264,228	290,898
<b>TOTAL CURRENT LIABILITIES</b>	<b>645,028</b>	<b>1,010,338</b>	<b>880,343</b>
<b>LONG-TERM DEBT, NET OF CURRENT PORTION</b>	<b>872,169</b>	<b>783,744</b>	<b>763,129</b>
<b>DEFERRED INCOME TAXES</b>	<b>233,092</b>	<b>223,752</b>	<b>224,764</b>
<b>DEFERRED LIABILITIES</b>	<b>154,294</b>	<b>160,576</b>	<b>165,361</b>
<b>TOTAL LIABILITIES</b>	<b>1,904,583</b>	<b>2,178,410</b>	<b>2,033,597</b>
<b>HUARUN REDEEMABLE STOCK</b>	<b>43,531</b>	<b>46,219</b>	<b>33,577</b>
<b>STOCKHOLDERS EQUITY:</b>			
Common Stock (Par Value - \$0.50; Authorized 250,000,000 shares; Shares issued, including shares in treasury 118,442,624)	59,220	59,220	59,220
Additional paid-in capital	338,601	322,486	331,083
Retained earnings	1,235,184	1,158,404	1,180,011
Other	82,988	145,593	90,036
Less cost of Common Stock in treasury (7/31/09- 17,703,937 shares; 7/25/08-18,855,276 shares; 10/31/08-18,449,741 shares)	(199,173 )	(212,043 )	(207,482 )
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>1,516,820</b>	<b>1,473,660</b>	<b>1,452,868</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 3,464,934</b>	<b>\$ 3,698,289</b>	<b>\$ 3,520,042</b>

NOTE: The Balance Sheet at October 31, 2008 has been derived from the audited consolidated financial statements at that date.

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Net sales	\$ 794,580	\$ 957,683	\$ 2,102,461	\$ 2,559,186
Cost of sales	504,334	682,981	1,401,735	1,829,758
Gross profit	290,246	274,702	700,726	729,428
Research and development	22,829	25,063	68,441	72,413
Selling and administrative	156,988	163,297	430,519	438,588
Income from operations	110,429	86,342	201,766	218,427
Interest expense	13,433	13,862	35,940	43,459
Other (income)/expense net	2,495	1,928	3,135	5,871
Income before income taxes	94,501	70,552	162,691	169,097
Income taxes	29,550	23,563	52,442	57,246
Net income	\$ 64,951	\$ 46,989	\$ 110,249	\$ 111,851
Huarun redeemable stock accrual (1)	(3,318)	) (3,049)	) (9,954)	) (8,877)
Net income available to common stockholders	\$ 61,633	\$ 43,940	\$ 100,295	\$ 102,974
Net income per common share basic	\$ 0.61	\$ 0.44	\$ 1.00	\$ 1.03
Net income per common share diluted	\$ 0.61	\$ 0.44	\$ 1.00	\$ 1.03
Average number of common shares outstanding				
- basic	100,274,346	99,280,953	100,017,910	99,663,955
- diluted	101,342,785	99,835,078	100,632,888	100,314,575
Dividends paid per common share	\$ 0.15	\$ 0.14	\$ 0.45	\$ 0.42

(1) Huarun redeemable stock accrual reduced basic and diluted net income per common share \$0.03 in the third quarter of 2009, \$0.10 year-to-date in 2009, \$0.03 in the third quarter of 2008 and \$0.09 year-to-date in 2008 as further described in Note 3.

See Notes to Condensed Consolidated Financial Statements

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## THE VALSPAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(DOLLARS IN THOUSANDS)

	NINE MONTHS ENDED	
	July 31, 2009	July 25, 2008
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 110,249	\$ 111,851
Adjustments to reconcile net income to net cash (used in)/provided by operating activities:		
Depreciation	57,602	53,054
Amortization	5,755	5,924
Stock-based compensation	3,789	4,911
(Gain)/loss on asset divestiture	564	814
Changes in certain assets and liabilities, net of effects of acquired businesses:		
(Increase)/decrease in accounts and notes receivable	4,473	(83,307)
(Increase)/decrease in inventories and other current assets	34,171	(7,606)
Increase/(decrease) in trade accounts payable and accrued liabilities	(63,115)	) 18,718
Increase/(decrease) in income taxes payable	(7,470)	) 8,322
Increase/(decrease) in other deferred liabilities	(6,852)	) (6,710)
Settlement of treasury lock contracts (see Note 7 for further details)	11,600	
Other	5,043	2,402
Net Cash (Used In)/Provided By Operating Activities	155,809	108,373
<b>INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(33,339)	) (26,393)
Acquired businesses, net of cash		(64,647)
Cash proceeds on disposal of assets	549	19,113
Net Cash (Used In)/Provided By Investing Activities	(32,790)	) (71,927)
<b>FINANCING ACTIVITIES:</b>		
Net proceeds from (payments on) borrowing	(48,051)	) 51,660
Proceeds from sale of treasury stock	10,429	13,708
Payments on deferred liability excess cash Huarun	(4,818)	) (11,390)
Excess tax benefit from stock-based compensation	496	113
Treasury stock purchases		(39,675)
Dividends paid	(45,122)	) (41,863)
Net Cash (Used In)/Provided By Financing Activities	(87,066)	) (27,447)

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Increase/(Decrease) in Cash and Cash Equivalents	35,953	8,999
Effect of exchange rate changes on Cash and Cash Equivalents	1,279	7,167
Cash and Cash Equivalents at Beginning of Period	90,073	84,948
Cash and Cash Equivalents at End of Period	\$ 127,305	\$ 101,114

See Notes to Condensed Consolidated Financial Statements

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## THE VALSPAR CORPORATION AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

#### NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of The Valspar Corporation have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles (GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended July 31, 2009 are not necessarily indicative of the results that may be expected for the year ending October 30, 2009. We have evaluated subsequent events through September 9, 2009, which is our Form 10-Q filing date. See Note 3 for further details regarding the acquisition of the remaining Huarun Redeemable Stock in the fourth quarter of 2009.

The Condensed Consolidated Balance Sheet at October 31, 2008 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

For further information refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended October 31, 2008.

#### NOTE 2: ACCOUNTS PAYABLE

Trade accounts payable includes \$18.2 million at July 31, 2009, \$33.1 million at October 31, 2008 and \$26.4 million at July 25, 2008, of issued checks that had not cleared our bank accounts.



NOTE 3: ACQUISITIONS AND DIVESTITURES

In October 2008, we completed the sale of a non-strategic specialty product line to W.M. Barr & Co., Inc. No manufacturing equipment or plants were included in the transaction.

In January 2008, we completed the sale of our commercial/industrial polymer floor coatings product line to Sika AG. The product line had annual sales of approximately \$17 million in fiscal year 2007. No manufacturing equipment or plants were included in the transaction.

In December 2007, we acquired control of Aries Coil Coatings S.A. de C.V. (Aries), a privately owned manufacturer of high-performance coil and packaging coatings based in Monterrey, Mexico. We acquired the remaining shares of this business in the second quarter of 2008. Aries had annual sales in calendar year 2007 of approximately \$40 million. This transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in our financial statements from the date of acquisition.

In January 2007, we acquired, from Tekno S.A., a majority of the voting shares of a coil coatings business in Brazil. Tekno's revenue for 2006 was \$10.7 million. In the fourth quarter of 2008, we acquired the remaining shares of this business and have accounted for this transaction as a purchase. The net assets and operating results have been included in our fiscal year 2008 financial statements from the date of acquisition.

Pro forma results of operations for the acquisitions and divestitures noted above have not been presented, as they were immaterial to the reported results on an individual and combined basis.

In July 2006, we acquired approximately 80% of the share capital of Huarun Paints Holdings Company Limited (Huarun Paints), one of China's largest independent coatings companies, from Champion Regal Limited, a Hong Kong based investment company, and certain other stockholders. Huarun Paints is one of China's leading domestic suppliers of wood and furniture coatings, and a supplier of architectural coatings. Huarun Paints sells its products primarily through an extensive network of distributors and retail paint stores throughout China. Huarun Paints revenue for fiscal year 2005 was approximately \$180 million. The cash purchase price was approximately \$290.4 million. The net assets and operating results have been included in our financial statements from the date of acquisition. Goodwill has been allocated to the Paints (approximately 60%) and Coatings (approximately 40%) segments.

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THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

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Certain of the shares not purchased by us at the closing are subject to various put and call rights. The put and call rights are classified outside of stockholders' equity in Huarun Redeemable Stock. During the fourth quarter of 2008, certain minority stockholders exercised their right to sell shares to us. Acquisition accounting was applied upon the exercise of the put options and our acquisition of the shares. The balance in Huarun Redeemable Stock was \$43.5 million at July 31, 2009, \$33.6 million at October 31, 2008 and \$46.2 million at July 25, 2008, and represents the accrual for the remaining shares that may be put to us as of those dates. On July 26, 2009, we notified the holders of the put options of our intent to exercise our call option to buy all of the remaining Huarun Redeemable Stock. During the fourth quarter of 2009, we acquired the remaining Huarun Redeemable Stock. Acquisition accounting will be applied to the acquisition of the shares.

The Huarun Redeemable Stock is accrued to redemption value and the amount of accretion is shown as an adjustment below net income to arrive at the net income available to common stockholders. We accrued \$3.3 million and \$10.0 million for the three and nine-month periods ended July 31, 2009 and \$3.0 million and \$8.9 million for the three and nine-month periods ended July 25, 2008. This accrual reduced basic and diluted net income per common share \$0.03 in the third quarter of 2009, \$0.10 year-to-date in 2009, \$0.03 in the third quarter of 2008 and \$0.09 year-to-date in 2008.

Certain other Huarun shares were awarded by Huarun prior to the acquisition closing. The pre-acquisition share awards are classified as equity awards as there is no obligation to purchase the shares, and if we were to purchase the shares, we would purchase the shares at fair market value.

The terms of the acquisition required us to pay to Champion Regal and certain other stockholders an amount equal to the excess cash, as defined in the purchase agreement, held by Huarun as of the closing date. The liability was to be paid as soon as practical before the third anniversary of the closing date, including interest at 6%. The excess cash of \$34.4 million was recorded as a deferred liability under purchase accounting. We made a payment of \$4.8 million plus accrued interest during the first quarter of 2009 to reduce this liability to zero. During fiscal years 2008 and 2007, we paid \$11.4 million and \$19.7 million, plus interest, respectively. The total payments, excluding interest, of \$35.9 million included \$1.5 million of unfavorable foreign currency exchange.

### NOTE 4: COMPREHENSIVE INCOME (LOSS)

For the three and nine-month periods ended July 31, 2009 and July 25, 2008, Comprehensive Income, a component of Stockholders' Equity, was as follows:

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Net Income	\$ 64,951	\$ 46,989	\$ 110,249	\$ 111,851
Other Comprehensive Income, net of tax:				
Foreign currency translation gain (loss)	46,551	14,500	(11,679)	) 62,793
Net unrealized gain (loss) on financial instruments	3,462	473	4,631	929
Total Comprehensive Income (Loss)	\$ 114,964	\$ 61,962	\$ 103,201	\$ 175,573

The period end balances of accumulated other comprehensive income (loss), net of tax, were comprised of the following:

(Dollars in thousands)

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		July 31, 2009		July 25, 2008		October 31, 2008
Foreign currency translation	\$	118,180		\$ 184,468		\$ 129,859
Pension and postretirement benefits, net		(42,356	)	(41,937	)	(42,356
Net unrealized gain (loss) on financial instruments		7,164		3,062		2,533
Accumulated other comprehensive income (loss)	\$	82,988		\$ 145,593		\$90,036

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THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

NOTE 5: GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill as of July 31, 2009 decreased from the end of fiscal year 2008 by \$18.2 million to \$1,334.6 million. The decrease is primarily due to foreign currency translation and the final purchase price allocation related to the acquisition of Aries.

Total intangible asset amortization expense for the nine months ended July 31, 2009 was \$5.8 million, compared to \$5.9 million for the same period last year. Estimated amortization expense for each of the five succeeding fiscal years based on the intangible assets as of July 31, 2009 is expected to be approximately \$7.5 million annually.

NOTE 6: SEGMENT INFORMATION

In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), and based on the nature of our products, technology, manufacturing processes, customers and regulatory environment, we aggregate our operating segments into two reportable segments: Coatings and Paints.

SFAS 131 requires an enterprise to report segment information in the same way that management internally organizes its business for assessing performance and making decisions regarding allocation of resources. We evaluate the performance of operating segments and allocate resources based on profit or loss from operations before interest expense and taxes (EBIT).

The Coatings segment aggregates our industrial and packaging product lines. Industrial products include a broad range of decorative and protective coatings for metal, wood, plastic and glass. Packaging products include both interior and exterior coatings used in metal packaging

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containers, principally food containers and beverage cans. The products of this segment are sold throughout the world.

The Paints segment aggregates our architectural and automotive refinish product lines. Architectural products include interior and exterior decorative paints, primers, varnishes, high performance floor paints and specialty decorative products, such as enamels, aerosols and faux varnishes for the do-it-yourself and professional markets in North America and China.

Our remaining activities are included in All Other. These activities include specialty polymers and colorants that are used internally and sold to other coatings manufacturers, as well as gelcoats and related products and furniture protection plans. Also included within All Other are our Corporate administrative expenses. The administrative expenses include interest and amortization expense, certain environmental-related expenses and other expenses not directly allocated to any other operating segment.

In the following table, sales between segments are recorded at selling prices that are below market prices, generally intended to recover internal costs. Segment EBIT includes income realized on inter-segment sales. Comparative third quarter and year-to-date results on this basis are as follows:

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Net Sales:				
Coatings	\$ 415,243	\$ 543,277	\$ 1,147,757	\$ 1,508,610
Paints	318,570	335,692	788,431	826,254
All Other	88,886	107,569	230,454	301,947
Less Intersegment Sales	(28,119)	) (28,855	) (64,181	) (77,625
Total Net Sales	\$ 794,580	\$ 957,683	\$ 2,102,461	\$ 2,559,186
 EBIT				
Coatings	\$ 61,556	\$ 52,061	\$ 116,313	\$ 140,843
Paints	48,801	29,432	100,136	71,250
All Other	(2,423	) 2,921	(17,818	) 463
Total EBIT	\$ 107,934	\$ 84,414	\$ 198,631	\$ 212,556
Interest	\$ 13,433	\$ 13,862	\$ 35,940	\$ 43,459
Income before Income Taxes	\$ 94,501	\$ 70,552	\$ 162,691	\$ 169,097

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THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

NOTE 7: FINANCIAL INSTRUMENTS

In March 2008, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). It requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value gains and losses on derivative instruments and their location in the financial statements and disclosures about credit-risk-related contingent features in derivative agreements. We do not have any credit-risk-related contingent features in our derivative contracts as of July 31, 2009. This statement is effective for financial statements issued for fiscal periods beginning after November 15, 2008. Accordingly, we adopted SFAS 161 in the second quarter of fiscal year 2009.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework in GAAP for measuring fair value and expands disclosures about fair value measurements. It does not increase the use of fair value measurement. SFAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities, and will be effective for nonfinancial assets and liabilities for years beginning after November 15, 2008.

During the first quarter of 2009, we adopted SFAS 157 for our financial assets and liabilities. At July 31, 2009, we did not have any financial assets subject to SFAS 157. As of July 31, 2009, our financial liabilities subject to SFAS 157 consist of interest rate swaps and foreign currency contracts with fair values totaling \$1.5 million and \$0.3 million, respectively. The interest rate swaps and foreign currency contracts have observable prices that are not quoted on active exchanges, and are therefore classified as Level 2 inputs under the hierarchy established by SFAS 157.

We use derivative financial instruments to manage well-defined interest rate and foreign currency exchange risks. We enter into derivative financial instruments with high-credit quality counterparties and diversify our positions among such counterparties to reduce our exposure to credit losses.

At July 31, 2009, we had an aggregate \$50 million of notional amount interest rate swap contracts which have been designated as cash flow hedges under SFAS 133 to pay fixed rates of interest and receive a floating interest rate based on LIBOR. All contracts mature during fiscal year 2011. The interest rate swap contracts are reflected at fair value in the condensed consolidated balance sheet. Unrealized gains and losses are recorded in accumulated other comprehensive income. Amounts to be received or paid under the contracts will be recognized as interest expense over the life of the contracts. There was no ineffectiveness for these swaps recognized in interest expense for the quarter ended July 31, 2009. We had \$100 million of notional amount interest rate swap contracts in place as of July 25, 2008. There was an immaterial amount of ineffectiveness for these swaps recognized in interest expense for the quarter ended July 25, 2008.

During the third quarter of 2009, we terminated \$50 million notional amount of interest rate swap contracts yielding a pretax loss of \$1.7 million. The contracts had been designated as cash flow hedges under SFAS 133 to pay fixed rates of interest and receive a floating interest rate based on LIBOR. The interest rate swap contracts were terminated as a result of the repayment of the hedged LIBOR based borrowings. The loss is reflected as an increase to interest expense in our statement of income for the quarter.

At July 31, 2009, we had \$5.5 million notional amount of forward foreign currency exchange contracts (foreign currency contracts) maturing during fiscal year 2009 and 2010. These foreign currency contracts have been designated as cash flow hedges under SFAS 133 with unrealized gains or losses recorded in accumulated other comprehensive income. Realized gains and losses will be recognized in Other Expense (Income) when they occur. At July 25, 2008, we had approximately \$10.1 million notional amount of foreign currency contracts. There was no ineffectiveness for these hedges during the quarter ended July 31, 2009 or for the quarter ended July 25, 2008.

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During the third quarter of 2009, we terminated \$150 million of treasury lock contracts as a result of the bond issuance during the quarter, yielding a pretax gain of \$11.6 million. This gain is reflected, net of tax, in accumulated other comprehensive income in our consolidated balance sheet as of July 31, 2009 and will be reclassified ratably to our statements of income as a decrease to interest expense over the term of the related debt. At July 25, 2008 we had no treasury locks in place.

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### THE VALSPAR CORPORATION AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

The following table shows the balance sheet classifications of our derivative instruments for the quarter ended July 31, 2009.

#### **Derivative Balance Sheet Location as of 7/31/09**

(Dollars

in thousands)	Balance Sheet Classification	Fair Value as of 7/31/09
<u>Asset derivatives</u>		
Derivatives designated as hedges:		
Treasury lock contracts	Prepaid expenses and other	\$
Total asset derivatives		\$
<u>Liability derivatives</u>		
Derivatives designated as hedges:		
Foreign currency contracts	Accrued liabilities	\$ 348
Interest rate swap contracts	Deferred liabilities	1,518
Total liability derivatives		\$ 1,866

The gain (loss) on our derivative instruments during the third quarter of fiscal year 2009 was as follows:

#### **Derivative Gains and Losses for the Third Quarter ended 7/31/09**

(Dollars in thousands)	Amount of Gain (Loss) Recognized in AOCI *	Statement of Income Classification	Gain (Loss) in Income **
<u>Derivatives designated as cash flow hedges</u>			
Foreign currency contracts	\$ (726)	Other income / (expense), net	\$ 761

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Interest rate swap contracts	(934)	Interest expense	(2,117)
Total derivatives designated as cash flow hedges	\$ (1,660)	\$	(1,356)

\* Accumulated other comprehensive income (loss) (AOCI) is included on the Consolidated Balance Sheet in the Stockholders' Equity section called Other and is reported net of tax

\*\* Amounts reported are pretax

Additionally, as of the quarter ended July 31, 2009, the AOCI balance includes a net unrealized after-tax gain of \$8.8 million that resulted from treasury locks that have been settled. The gain is recognized as a benefit to interest expense over the life of the issued debt, which resulted in a pretax benefit of \$0.3 million for the quarter ended July 31, 2009.

### NOTE 8: DEBT SECURITIES

The table below summarizes the carrying value and fair market value of our outstanding debt. The fair market value of our publicly traded debt is based on observable market prices. The fair market value of our non-publicly traded debt was estimated using a discounted cash flow analysis based on our current borrowing costs for debt with similar maturities.

(Dollars in thousands)	Balance Sheet (carrying value)	Fair Market Value
Publicly traded debt	\$ 800.0	\$ 826.6
Non-publicly traded debt	79.4	76.7
Total debt	\$ 879.4	\$ 903.3

We did not elect the option to report our debt at fair value available in SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159).

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## THE VALSPAR CORPORATION AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

During the third quarter of 2009, we issued \$300 million of unsecured, senior notes that mature on June 15, 2019 with a coupon rate of 7.25%. The public offering was made pursuant to a registration statement filed with the U.S. Securities and Exchange Commission. We used the net

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proceeds of \$296.8 million to repay our commercial paper borrowings and a portion of our borrowings under our existing bank credit facilities.

During the third quarter of 2009, we entered into a \$465 million unsecured committed revolving credit facility with a syndicate of banks expiring on June 30, 2012. The new credit facility replaces our \$150 million 364-Day Credit Agreement that was due to mature in November 2009 and our \$600 million Five-Year Credit Agreement that was due to mature in October 2010, which were both terminated on June 26, 2009. The credit facility is a backstop to our \$350 million U.S. Commercial Paper program established in 2006. The credit facility contains covenants that require us to maintain certain financial ratios. We were in compliance with these covenants as of July 31, 2009.

### NOTE 9: GUARANTEES AND CONTRACTUAL OBLIGATIONS

We account for and disclose guarantees and contractual obligations in accordance with FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). The interpretation requires disclosure in periodic financial statements of certain guarantee arrangements. The interpretation also clarifies situations where a guarantor is required to recognize the fair value of certain guarantees in the financial statements. We do not have any guarantees that require recognition at fair value under the interpretation.

We sell extended furniture protection plans and offer warranties for certain of our products. Revenue related to furniture protection plans is deferred and recognized over the contract life. Historical claims data is used to forecast claims payments over the contract period and revenue is recognized based on the forecasted claims payments. Actual claims costs are reflected in earnings in the period incurred. Anticipated losses on programs in progress are charged to earnings when identified. For product warranties, we estimate the costs that may be incurred under these warranties based on historical claims data and record a liability in the amount of such costs at the time revenue is recognized.

We periodically assess the adequacy of these recorded amounts and adjust as necessary. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are estimable. The extended furniture protection plans that we enter into have fixed prices. To the extent the actual costs to complete contracts are higher than the amounts estimated as of the date of the financial statements, gross margin would be negatively affected in future quarters when we revise our estimates. Our practice is to revise estimates as soon as such changes in estimates become known.

Changes in the recorded amounts, both short and long-term, during the period are as follows:

(Dollars in thousands)	Nine Months Ended	
	July 31, 2009	July 25, 2008
Beginning balance, October	\$ 77,993	\$ 85,142
Additional net deferred revenue/accrual made during the period	656	6,516
Payments made during the period	(4,855)	(9,561)
Ending balance	\$ 73,794	\$ 82,097

### NOTE 10: STOCK BASED COMPENSATION



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Compensation expense associated with our stock-based compensation plans was \$1.3 million (\$0.8 million after tax) and \$3.8 million (\$2.5 million after tax) for the three and nine-month periods ended July 31, 2009, compared to \$1.4 million (\$0.9 million after tax) and \$4.9 million (\$3.2 million after tax) for the three and nine-month periods ended July 25, 2008.

### NOTE 11: PENSION AND OTHER POSTRETIREMENT BENEFITS

We sponsor a number of defined benefit pension plans for certain hourly, salaried and non-U.S. employees. The benefits for most of these plans are generally based on stated amounts for each year of service. We fund the plans in amounts consistent with the limits of allowable tax deductions.

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#### THE VALSPAR CORPORATION AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

The net periodic benefit cost of the pension benefits is as follows:

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Service cost	\$ 675	\$ 955	\$ 2,034	\$ 2,844
Interest cost	3,308	3,374	9,963	10,113
Expected return on plan assets	(3,822)	) (3,923)	) (11,523)	) (11,785)
Amortization of transition asset		(8)		(25)
Amortization of prior service cost	145	184	452	551
Recognized actuarial (gain)/loss	506	759	1,530	2,281
Settlement loss			2,333	
Curtailement			161	
Net periodic benefit cost	\$ 812	\$ 1,341	\$ 4,950	\$ 3,979

The net periodic benefit cost of the post-retirement medical benefits is as follows:

(Dollars in thousands)	Three Months Ended	Nine Months Ended
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	July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Service cost	\$ 71	\$ 292	\$ 213	\$ 876
Interest cost	150	232	450	696
Amortization of prior service cost	(947	) (20	) (2,841	) (61
Recognized actuarial (gain)/loss	804	97	2,412	291
Net periodic benefit cost	\$ 78	\$ 601	\$ 234	\$ 1,802

NOTE 12: RECLASSIFICATION

Certain amounts in the 2008 financial statements have been reclassified to conform with the 2009 presentation.

NOTE 13: INCOME TAXES

At October 31, 2008, we had a \$44.8 million liability recorded under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), for gross unrecognized tax benefits (excluding interest and penalties). Of this total, \$32.0 million represents the amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate.

We recognize interest and penalties related to unrecognized tax benefits in income tax expense. As of October 31, 2008, we had accrued approximately \$12.4 million of interest and penalties relating to unrecognized tax benefits. There were no material adjustments to our recorded liability for unrecognized tax benefits during the first, second or third quarters of fiscal year 2009.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and numerous state and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003. The Internal Revenue Service (IRS) concluded its examination of our U.S. federal tax returns for the fiscal years ended 2004 and 2005 in April 2008. There were no material adjustments to our income tax expense or balance of unrecognized tax benefits as a result of the IRS examination. We are currently under audit in several state and foreign jurisdictions. We also expect various statutes of limitation to expire during the year. Due to the uncertain response of taxing authorities, a range of outcomes cannot be reasonably estimated at this time.

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THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

### NOTE 14: RESTRUCTURING

During the third quarter of 2008, we initiated a comprehensive series of actions to lower our cost structure and further increase our operational efficiency. During the first quarter of 2009, we expanded these restructuring activities. We expect the total restructuring cost to be \$0.35 to \$0.38 per share after tax. The restructuring activities in the three and nine-month periods ending July 31, 2009 resulted in pre-tax charges of \$4.7 million or \$0.03 per share after tax and \$21.7 million or \$0.14 per share after tax, respectively. The restructuring activities for the three and nine-month periods ended July 25, 2008 resulted in pre-tax charges of \$3.8 million or \$0.03 per share after tax. The restructuring charges for the full year of 2008 resulted in pre-tax charges of \$23.5 million or \$0.16 per share after tax. The remaining restructuring charges to be incurred during fiscal year 2009 are primarily in the Coatings and Paints segments. The expenses include severance and employee benefits, asset impairments, professional services and site cleanup. We plan to pay the majority of the current restructuring liabilities by the middle of fiscal year 2010.

The restructuring initiatives include plant closures, reductions to research and development and selling and administrative expenses, manufacturing consolidation and relocation, and the exit of non-strategic product lines in certain geographies. We have reduced manufacturing capacity and our overall global headcount to lower our costs in light of challenging global economic conditions.

The severance and employee benefits, exit costs and contract termination costs associated with restructuring initiatives are primarily accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146). Asset impairment charges are primarily accounted for in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). The following net restructuring and impairment charges by segment were recorded in the nine-month period ending July 31, 2009:

<b>Nine-Month Period Ending 7/31/2009</b>	Liability			Liability
(Dollars in thousands)	Beginning			Ending
	Balance			Balance
	10/31/2008	Expense	Activity	7/31/2009
<b>Coatings</b>				
Severance and employee benefits	\$ 7,842	\$ 10,404	\$ (13,761 )	\$ 4,485
Asset impairments		2,623	(2,623 )	
Exit costs (consulting/site clean-up)	423	793	(1,185 )	31
Contract term costs (leases)		471	(471 )	
<b>Total Coatings</b>	<b>8,265</b>	<b>14,291</b>	<b>(18,040 )</b>	<b>4,516</b>
<b>Paints</b>				
Severance and employee benefits		725	(483 )	242
Asset impairments		1,695	(1,695 )	
Exit costs (consulting/site clean-up)	2,252	73	(73 )	2,252
Contract term costs (leases)				
<b>Total Paints</b>	<b>2,252</b>	<b>2,493</b>	<b>(2,251 )</b>	<b>2,494</b>
<b>All Other</b>				
Severance and employee benefits	806	580	(1,202 )	184
Asset impairments		3,072	(3,072 )	
Exit costs (consulting/site clean-up)	64	1,244	(1,308 )	
Contract term costs (leases)				

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Total All Other	870		4,896	(5,582 )	184
Total	\$ 11,387		\$ 21,680	\$ (25,873 )	\$ 7,194

The ending liability balance at July 31, 2009 is included in accrued liabilities on our Consolidated Balance Sheet. The restructuring reserve balances presented are considered adequate to cover committed restructuring actions that we expect to complete in fiscal year 2009 and 2010. The restructuring expenses recorded are included in the Consolidated Statement of Income. For the three-month period ended July 31, 2009, \$4.7 million was charged to Cost of Sales. For the nine-month period ended July 31, 2009, \$17.5 million was charged to Cost of Sales and \$4.2 million was charged to Selling and Administrative expense.

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## THE VALSPAR CORPORATION AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JULY 31, 2009

#### NOTE 15: RECENTLY ISSUED ACCOUNTING STANDARDS

The FASB issued SFAS 157 in September 2006. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements. This statement does not require us to make any new fair value measurements. We adopted SFAS 157 for financial assets and liabilities in the first quarter of 2009 (see Note 7 for further details).

In February 2008, the FASB issued FSP FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS 157-2) which delays the effective date for the implementation of SFAS 157 solely for nonfinancial assets and nonfinancial liabilities, except those nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis (i.e., at least annually). The new effective date would be for fiscal years beginning after November 15, 2008 or our fiscal year 2010.

The FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158), in September 2006. We adopted the recognition and disclosure provisions of SFAS 158 in fiscal year 2007. SFAS 158 will further require us to measure the plans' assets and obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions). This will be required to be adopted for fiscal years ending after December 15, 2008, which would be our fiscal year end 2009. We do not expect the adoption of SFAS 158 to have a material effect on our consolidated financial statements.

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In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)), and SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements – an Amendment of ARB No. 51* (SFAS 160), which changed the accounting for and reporting of business combinations and non-controlling interests in consolidated financial statements. SFAS 141(R) and SFAS 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008, which is our fiscal year 2010. Earlier adoption is prohibited. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the date of adoption. SFAS 160 shall be applied prospectively as of the beginning of the fiscal year of adoption, except for the presentation and disclosure requirements, which shall be applied retrospectively for all periods presented. Generally, the effect of SFAS 141(R) will depend on future acquisitions. However, the accounting for the resolution of any tax uncertainties remaining will be subject to the provisions of SFAS 141(R). We do not expect the adoption of SFAS 141(R) and SFAS 160 to have a material impact on our consolidated financial statements.

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## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Overview:** Sales for the third quarter of 2009 continue to be negatively affected by the challenging global economic environment; however, our earnings increased in the quarter due to a combination of improved raw material cost comparisons, previous customer price increases, improved efficiency in our operations resulting from previously completed restructuring actions and effective control of expenses. Sales for the quarter decreased compared to the prior year primarily due to volume declines and unfavorable foreign currency exchange rates. Sales in our Coatings segment decreased significantly reflecting continued weakness in industrial markets. Global demand in our general industrial and wood product lines has not improved, however, sales in our domestic coil and global packaging product lines improved compared to the second quarter of 2009 as customers began to restock their inventory. Sales in our Paints segment for the third quarter of 2009 were down primarily due to weakness in our Asia architectural and global automotive refinish product lines. While the overall U.S. architectural paint market declined, sales in our domestic architectural product line improved in the quarter compared to last year. Gross profit as a percent of net sales in the third quarter of 2009 increased compared to last year as a result of better raw material cost comparisons, previous price increases, favorable product mix and productivity gains from previously completed restructuring actions, partially offset by continuing restructuring charges. Operating expense dollars decreased in the third quarter of 2009 compared to last year primarily as a result of the positive impact of foreign currency exchange, benefits from previously completed restructuring actions and effective expense controls, partially offset by higher incentive-based compensation accruals.

During the third quarter of 2008, we initiated a comprehensive series of actions to lower our cost structure and further increase our operational efficiency. During the first quarter of 2009, we expanded these restructuring activities. We presently expect the total restructuring cost to be \$0.35 to \$0.38 per share after tax. The restructuring activities for the three and nine-month periods ended July 31, 2009, resulted in pre-tax charges of \$4.7 million or \$0.03 per share after tax, and \$21.7 million or \$0.14 per share after tax, respectively. The restructuring activities for the three and nine-month periods ended July 25, 2008, resulted in pre-tax charges of \$3.8 million or \$0.03 per share after tax. The restructuring charges for the full year of 2008 resulted in pre-tax charges of \$23.5 million or \$0.16 per share after tax.

**Earnings Per Share:** Net income per share available to common stockholders was \$0.61 and \$1.00 for the three and nine-month periods ended July 31, 2009, and \$0.44 and \$1.03 for the three and nine-month periods ended July 25, 2008, respectively. We accrued \$3.3 million in the third quarter of 2009 and \$10.0 million year-to-date for the Huarun Redeemable Stock (see Note 3 for further details). This compares to an accrual of \$3.0 million for the third quarter of 2008 and \$8.9 million year-to-date in 2008. The accrual reduced basic and diluted net income per common share \$0.03 in the third quarter of 2009, \$0.10 year-to-date in 2009, \$0.03 in the third quarter of 2008 and \$0.09 year-to-date in 2008. The table below presents adjusted net income per common share – diluted, which excludes the non-cash accrual relating to Huarun Redeemable Stock. The table also presents restructuring charges included in net income in the respective periods.

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	Three Months Ended		Nine Months Ended	
	July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Net income per common share - diluted	\$0.61	\$0.44	\$1.00	\$1.03
Huarun redeemable stock accrual	0.03	0.03	0.10	0.09
Adjusted net income per common share - diluted	\$0.64	\$0.47	\$1.10	\$1.12
Restructuring Charges	\$0.03	\$0.03	\$0.14	\$0.03

Adjusted net income per common share - diluted is a non-GAAP financial measure. Management discloses this measure because we believe the measure may assist investors in comparing our results of operations in the respective periods without regard to the effect on results in the 2009 and 2008 periods of the non-cash accrual related to the Huarun Redeemable Stock. As the Huarun Redeemable Stock is redeemed, acquisition accounting is applied. We acquired the remaining Huarun Redeemable Stock in the fourth quarter of 2009; refer to Note 3 for further details.

Critical Accounting Policies: There were no material changes in our critical accounting policies during the three-month period ended July 31, 2009.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Operations:

<b>Net Sales</b> (Dollars in millions)	Three Months Ended				Nine Months Ended			
	July 31, 2009	July 25, 2008	%		July 31, 2009	July 25, 2008	%	
			Change			Change		
Coatings	\$415.2	\$543.3	(23.6)	%	\$1,147.8	\$1,508.6	(23.9)	%
Paints	318.6	335.7	(5.1)	%	788.4	826.3	(4.6)	%
All Other	60.8	78.7	(22.8)	%	166.3	224.3	(25.9)	%
Consolidated Net Sales	\$794.6	\$957.7	(17.0)	%	\$2,102.5	\$2,559.2	(17.8)	%

**Consolidated Net Sales** The sales decline for the third quarter of 2009 was 13.6% after excluding the negative effect of foreign currency of 3.4%. The sales decline year-to-date was 14.3% after excluding the negative effect of foreign currency of 3.7% and the positive effect of acquisitions of 0.2%. The decrease in core sales for the third quarter was primarily due to lower volume. The decrease in core sales for the year-to-date period was primarily due to lower volume and unfavorable product mix, partially offset by previous price increases.

**Coatings Segment Net Sales** The sales decline for the third quarter of 2009 was 18.8% after excluding the negative effect of foreign currency of 4.8%. The sales decline year-to-date was 19.1% after excluding the negative effect of foreign currency of 5.1% and the positive effect of acquisitions of 0.3%. Our coil, general industrial and wood product lines primarily drove the core sales decline for the quarter and year-to-date periods. In our general industrial and wood product lines, the global markets remain down, however, our domestic coil and global packaging product lines improved compared to the second quarter of 2009 as customers began to restock their

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inventory.

**Paints Segment Net Sales** The sales decline for the third quarter of 2009 was 3.7% after excluding the negative effect of foreign currency of 1.4%. The sales decline year-to-date was 3.5% after excluding the negative effect of foreign currency of 1.1%. Sales were down in third quarter and year-to-date periods primarily due to weak demand for our Asia architectural and global automotive refinish product lines, partially offset by increased sales in our domestic architectural product line.

**All Other Net Sales** The All Other category includes resins, colorants, gelcoats and our furniture protection plan business. The sales decline for the third quarter of 2009 was 20.2% after excluding the negative effect of foreign currency of 2.6%. The sales decline year-to-date was 22.8% after excluding the negative effect of foreign currency of 3.1%. The primary driver of the lower sales for the quarter and year-to-date periods was weak demand in the U.S. coatings market.

Due to the seasonal nature of portions of our business, sales for the third quarter are not necessarily indicative of sales for subsequent quarters or for the full year.

<b>Gross Profit</b> (Dollars in millions)	Three Months Ended				Nine Months Ended			
	July 31, 2009	July 25, 2008	%	%	July 31, 2009	July 25, 2008	%	%
Consolidated Gross Profit	\$290.2	\$274.7			\$700.7	\$729.4		
As a percent of Net Sales	36.5	28.7	%	%	33.3	28.5	%	%

**Gross Profit** The gross profit increase, as a percent of net sales, for the third quarter and year-to-date periods was driven primarily by improved raw material cost comparisons, previous price increases, favorable product mix and productivity gains from previously completed restructuring actions, partially offset by continuing restructuring charges. Gross profit for the quarter and year-to-date periods ending July 31, 2009 included restructuring charges of \$4.7 million or 0.6% of net sales and \$17.5 million or 0.8% of net sales, respectively. Restructuring charges of \$2.8 million are included in both the third quarter and year-to-date periods of 2008, or 0.2% and 0.1% of net sales, respectively.

<b>Operating Expenses</b> *	Three Months Ended				Nine Months Ended			
	July 31, 2009	July 25, 2008	%	%	July 31, 2009	July 25, 2008	%	%
Consolidated Operating Expenses	\$179.8	\$188.4			\$499.0	\$511.0		
As a percent of Net Sales	22.6	19.7	%	%	23.7	20.0	%	%

\* Includes research and development, selling and administrative costs. For breakout see Consolidated Statement of Income.

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## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Consolidated Operating Expenses (dollars)** Consolidated operating expenses decreased 4.5% to \$179.8 million in the third quarter of 2009 compared to the prior year. Consolidated operating expenses declined 2.4% to \$499.0 million year-to-date compared to the prior

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year. The decrease in both periods was driven primarily by favorable foreign currency, benefits from previously completed restructuring actions and effective expense controls, partially offset by higher incentive-based compensation accruals. The 2009 year-to-date period was also affected by restructuring charges of \$4.2 million or 0.2% of net sales. There were no restructuring charges in operating expenses in the third quarter of 2009. Restructuring charges of \$1.1 million are included in both the third quarter and year-to-date periods of 2008.

**Consolidated Operating Expenses (percent of net sales)** As a percent of consolidated net sales, operating expenses increased 290 basis points for the third quarter compared to last year. As a percent of consolidated net sales, operating expenses increased 370 basis points for the year-to-date period compared to last year. The increase in both periods is primarily due to lower sales volume and higher incentive-based compensation accruals.

<b>EBIT</b> * (Dollars in millions)	Three Months Ended				Nine Months Ended			
	July 31, 2009		July 25, 2008		July 31, 2009		July 25, 2008	
Coatings	\$61.6		\$52.1		\$116.3		\$140.8	
As a percent of Net Sales	14.8	%	9.6	%	10.1	%	9.3	%
Paints	\$48.8		\$29.4		\$100.1		\$71.3	
As a percent of Net Sales	15.3	%	8.8	%	12.7	%	8.6	%
All Other	\$(2.4)	)	\$2.9		\$(17.8)	)	\$0.5	
As a percent of Net Sales	(4.0)	)%	3.7	%	(10.7)	)%	0.2	%
Consolidated EBIT	\$107.9		\$84.4		\$198.6		\$212.6	
As a percent of Net Sales	13.6	%	8.8	%	9.4	%	8.3	%

\* Defined as profit or loss from operations before interest expense and taxes.

**Consolidated EBIT** EBIT for the third quarter of 2009 increased \$23.5 million or 27.9% compared to the prior year. EBIT year-to-date decreased \$13.9 million or 6.6% compared to the prior year. The third quarter and year-to-date periods of 2009 included restructuring charges of \$4.7 million or 0.6% of net sales and \$21.7 million or 1.0% of net sales, respectively. Restructuring charges of \$3.8 million are included in both the third quarter and year-to-date periods of 2008, or 0.4% and 0.1% of net sales, respectively. Foreign currency exchange fluctuation had an immaterial effect on EBIT.

**Coatings Segment EBIT** The EBIT increase as a percentage of net sales for the third quarter and year-to-date periods was driven primarily by improved raw material cost comparisons, previous price increases and productivity gains from previously completed restructuring actions, partially offset by continuing restructuring charges. The third quarter and year-to-date periods of 2009 included restructuring charges of \$1.5 million or 0.4% of net sales and \$14.3 million or 1.2% of net sales, respectively. Restructuring charges of \$0.9 million are included in both the third quarter and year-to-date periods of 2008, or 0.2% and 0.1% of net sales, respectively.

**Paints Segment EBIT** The EBIT increase as a percentage of net sales for third quarter and year-to-date periods was driven primarily by improved raw material cost comparisons, previous price increases and effective expense controls. The third quarter and year-to-date periods of 2009 included restructuring charges of \$1.9 million or 0.6% of net sales and \$2.5 million or 0.3% of net sales, respectively. Restructuring charges of \$2.3 million are included in both the third quarter and year-to-date periods of 2008, or 0.7% and 0.3% of net sales, respectively.

**All Other EBIT** The All Other category includes resins, colorants, gelcoats, our furniture protection plan business and corporate expenses. The decrease for the third quarter and year-to-date periods was primarily due to the decline in net sales, higher incentive compensation accruals and restructuring charges. The third quarter and year-to-date periods of 2009 included restructuring charges of \$1.2 million or 2.0% of net sales and \$4.9 million or 2.9% of net sales, respectively. Restructuring charges of \$0.6 million are included in both the third quarter and year-to-date periods of 2008, or 0.8% and 0.3% of net sales, respectively.

Due to the seasonal nature of portions of our business, EBIT for the third quarter is not necessarily indicative of EBIT for subsequent quarters or for the full year.



## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Interest Expense**

(Dollars in millions)

		Three Months Ended		Nine Months Ended	
		July 31, 2009	July 25, 2008	July 31, 2009	July 25, 2008
Consolidated Interest Expense	\$	13.4	\$ 13.9	\$ 35.9	\$ 43.5

**Interest Expense** The third quarter and year-to-date decrease is primarily due to lower average debt levels partially offset by higher average interest rates on our new bond issuance.

**Effective Tax Rate**

	Three Months Ended				Nine Months Ended			
	July 31, 2009		July 25, 2008		July 31, 2009		July 25, 2008	
Effective Tax Rate	31.3	%	33.4	%	32.2	%	33.9	%

**Effective Tax Rate** The third quarter 2009 tax rate reflects the expected quarter-to-quarter volatility due to the accounting for uncertain tax positions and a one-time adjustment related to a prior year. We expect the effective tax rate for the full year to be 33.5% to 34%.

**Net Income**

(Dollars in millions)

	Three Months Ended			Nine Months Ended		
	July 31, 2009	July 25, 2008	Change	July 31, 2009	July 25, 2008	Change
Consolidated Net Income	\$ 65.0	\$ 47.0	38.2 %	\$ 110.2	\$ 111.9	(1.4) %

**Financial Condition:** Net cash provided by operations was \$155.8 million for the first nine months of 2009, compared with net cash provided by operations of \$108.4 million for the first nine months of 2008. The cash provided by operations in 2009 was primarily generated by net income, a net decline in inventory and other current assets and the third quarter 2009 settlement of treasury locks (see Note 7 for further details), partially offset by a net reduction in accounts payable and accrued liabilities. The inventory and other current assets net decrease of \$34.2 million is primarily due to proactive inventory management in response to lower sales levels. The net decline of \$63.1 million in accounts payable and accrued liabilities is due to a reduction of purchases and timing of disbursements.

During 2009, cash provided by operations and \$10.4 million in proceeds from the sale of treasury stock were used to reduce our bank borrowings by \$48.1 million, fund \$45.1 million in dividend payments and \$33.3 million in capital expenditures, and pay \$4.8 million to settle the remaining deferred liability for excess cash related to the Huarun Paints acquisition (see Note 3 for further details).

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Capital expenditures for property, plant and equipment were \$33.3 million in the first nine months of 2009, compared with \$26.4 million in the first nine months of 2008. We anticipate capital spending in 2009 to be approximately \$60 million.

On June 19, 2009, we issued \$300 million of unsecured senior notes that mature on June 15, 2019 with a coupon rate of 7.25% pursuant to a shelf registration statement filed with the U.S. Securities and Exchange Commission. The net proceeds of this offering were used to repay commercial paper borrowings and a portion of our borrowings under our existing bank credit facilities. On June 30, 2009, we entered into a \$465 million unsecured committed revolving credit facility with a syndicate of banks expiring on June 30, 2012. The new credit facility replaces our \$150 million 364-Day Credit Agreement that was due to mature in November 2009 and our \$600 million Five-Year Credit Agreement that was due to mature in October 2010, which were both terminated on June 26, 2009. The credit facility is a backstop to our \$350 million U.S. Commercial Paper program established in 2006.

The ratio of total debt to capital was 36.7% at July 31, 2009, compared to 38.8% at October 31, 2008 and 42.4% at July 25, 2008. Short-term debt (notes payable plus current portion of long-term debt) was \$7.2 million at July 31, 2009. This debt was comprised of foreign subsidiary borrowings. We believe cash flow from operations, existing lines of credit, access to credit facilities and access to debt and capital markets will be sufficient to meet our current and projected financing needs. We ended our 2009 third quarter with \$537.9 million of liquidity that includes \$410.6 million of available committed credit facilities and \$127.3 million of cash, which is in excess of our anticipated funding requirements for fiscal year 2009.

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## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our cash balances are primarily held by our international subsidiaries and are used to fund day-to-day operating needs. Those cash balances have also been used to finance acquisitions. Our investment policy on excess cash is to preserve principal.

We use derivative instruments with a number of counterparties principally to manage well-defined interest rate and foreign currency exchange risks. We evaluate the financial stability of each counterparty and spread the risk among several financial institutions to limit our exposure. We will continue to monitor counterparty risk on an ongoing basis.

Off-Balance Sheet Financing: We do not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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**Forward Looking Statements:** This discussion contains certain forward-looking statements. These forward-looking statements are based on management's expectations and beliefs concerning future events. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside our control and could cause actual results to differ materially from such statements. Any statement that is not historical in nature is a forward-looking statement and may be identified by the use of words and phrases such as expects, anticipates, believes, will, will likely result, will continue, plans to and similar expressions. These uncertainties and other factors include, but are not limited to, changes in general economic conditions both domestic and international, including recessions and other external economic and political factors, which may adversely affect our business, the value of our investments, the financial stability of our customers and suppliers and our ability to obtain financing; dependence of internal earnings growth on economic conditions and growth in the domestic and international coatings industry; competitive factors including pricing pressure and product competition; risks related to any future acquisitions, including risks of adverse changes in the results of acquired businesses and the assumption of unforeseen liabilities; risks of disruptions in business resulting from the integration process and higher interest costs resulting from further borrowing for any such acquisitions; our reliance on the efforts of vendors, government agencies, utilities and other third parties to achieve adequate regulatory compliance and avoid disruption of our business; risks of disruptions in business resulting from strains in or the loss of relationships with our material customers and suppliers; risks and uncertainties associated with operations and achievement of growth in developing markets, including China and Central and South America; unusual weather conditions adversely affecting sales; changes in raw materials pricing and availability; delays in passing along cost increases to customers; changes in governmental regulation, including more stringent environmental, health and safety regulations; changes in accounting policies and standards and taxation requirements such as new tax laws or revised tax law interpretations; the nature, cost and outcome of pending and future litigation and other legal proceedings; civil unrest and the outbreak of war and other significant national and international events; and other risks and uncertainties. The foregoing list is not exhaustive, and we disclaim any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements.

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#### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our foreign sales and results of operations are subject to the impact of foreign currency fluctuations. We have not hedged our exposure to translation gains and losses; however, we have reduced our exposure by borrowing funds in local currencies. A 10% adverse change in foreign currency rates would not have a material effect on our results of operations or financial position.

We are also subject to interest rate risk. At July 31, 2009, approximately 3.3% of our total debt consisted of floating rate debt. From time to time, we may enter into interest rate swaps to hedge a portion of either our variable or fixed rate debt. Assuming the current level of borrowings, a 10% increase in interest rates from those in effect at the end of the third quarter would not have a material impact on our results of operations or financial position.

#### ITEM 4: CONTROLS AND PROCEDURES

Disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of July 31, 2009. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

There were no changes in our internal control over financial reporting during the quarter ended July 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1: LEGAL PROCEEDINGS

During the period covered by this report, there were no legal proceedings instituted that are reportable, and there were no material developments in any of the legal proceedings that were previously reported on our Form 10-K for the year ended October 31, 2008.

### ITEM 6: EXHIBITS

#### Exhibits

- 1.1 Underwriting Agreement, dated June 16, 2009, by and among the Company and several Underwriters represented by Banc of America Securities L.L.C., Goldman, Sachs & Co. and Wachovia Capital Markets, LLC<sup>(1)</sup>
- 3.1 The Valspar Corporation By-Laws, as amended to and including August 19, 2009
- 4.1 Third Supplemental Indenture, between the Company and U.S. Bank National Association, as trustee, dated as of June 19, 2009, to Indenture dated April 24, 2002, between the Company and The Bank of New York Trust Company, N.A.<sup>(2)</sup>
- 10.1 Three-Year Credit Agreement with Wells Fargo Bank, National Association, as administrative Agent and an issuing bank, Wachovia Bank, National Association, as an issuing bank, and certain other lenders<sup>(3)</sup>
- 31.1 Section 302 Certification of the Chief Executive Officer
- 31.2 Section 302 Certification of the Chief Financial Officer
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(1) Incorporated by reference to Exhibit 1.1 to the Corporation's Form 8-K filed on June 23, 2009.

(2) Incorporated by reference to Exhibit 4.2 to the Corporation's Form 8-K filed on June 23, 2009.

(3) Incorporated by reference to Exhibit 10.1 to the Corporation's Form 8-K filed on July 2, 2009.

**SIGNATURES**

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

THE VALSPAR CORPORATION

Date: September 9, 2009

By /s/Rolf Engh  
Rolf Engh  
Secretary

Date: September 9, 2009

By /s/Lori A. Walker  
Lori A. Walker  
Senior Vice President and  
Chief Financial Officer

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