AVERY DENNISON CORPORATION
Form 10-K
February 28, 2007

Table of Contents

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 30, 2006
Commission file number 1-7685
AVERY DENNISON CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**95-1492269**
(State of incorporation)	*(I.R.S. Employer Identification No.)*
150 North Orange Grove Boulevard	
Pasadena, California	**91103**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(626) 304-2000
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of each exchange on which registered
Common stock, $1 par value	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
Not applicable.

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

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

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 þ No o

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of voting stock held by non-affiliates as of June 30, 2006, was approximately $5,798,821,404.

Number of shares of common stock, $1 par value, outstanding as of January 26, 2007: 106,549,314.

The following documents are incorporated by reference into the Parts of this report below indicated:

Document	Incorporated by reference into:
Portions of Annual Report to Shareholders for fiscal year ended December 30, 2006 (the 2006 Annual Report)	**Parts I, II**
Portions of Definitive Proxy Statement for Annual Meeting of Stockholders to be held April 26, 2007 (the 2007 Proxy Statement)	**Parts III, IV**

AVERY DENNISON CORPORATION
FISCAL YEAR 2006 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

		Page
PART I		
Item 1.	Business	1
Item 1A.	Risk Factors	5
Item 1B.	Unresolved Staff Comments	9
Item 2.	Properties	9
Item 3.	Legal Proceedings	10
Item 4.	Submission of Matters to a Vote of Security Holders	13
	List of Executive Officers	14
PART II		
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	15
Item 6.	Selected Financial Data	16
Item 7.	Management s Discussion and Analysis of Results of Operations and Financial Condition	17
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	43
Item 8.	Financial Statements and Supplementary Data	44
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	44
Item 9A.	Controls and Procedures	44
Item 9B.	Other Information	45
PART III		
Item 10.	Directors, Executive Officers of the Registrant and Corporate Governance	46
Item 11.	Executive Compensation	46
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	46
Item 13.	Certain Relationships and Related Transactions, and Director Independence	46
Item 14.	Principal Accounting Fees and Services	46
PART IV		
Item 15.	Exhibits, Financial Statement Schedules	47
Signatures		48
EXHIBIT 10.4		
EXHIBIT 12		
EXHIBIT 13		
EXHIBIT 21		
EXHIBIT 24		
EXHIBIT 31.1		
EXHIBIT 31.2		
EXHIBIT 32.1		
EXHIBIT 32.2		

Table of Contents

PART I

Item 1. BUSINESS

Avery Dennison Corporation (Avery Dennison, the Company, Registrant, Issuer, which may be referred to as or us) was incorporated in 1977 in the state of Delaware as Avery International Corporation, the successor corporation to a California corporation of the same name, which was incorporated in 1946. In 1990, the Company merged one of its subsidiaries into Dennison Manufacturing Company (Dennison), as a result of which Dennison became a wholly-owned subsidiary of the Company, and in connection with which Company s name was changed to Avery Dennison Corporation. *Our homepage on the internet is www.averydennison.com and you can learn more about us by visiting our Web site. Our Web site address provided in this annual report on Form 10-K is not intended to function as a hyperlink and the information on our Web site is not and should not be considered part of this report and is not incorporated by reference in this document.*

Our businesses include the production of pressure-sensitive materials, office products and a variety of tickets, tags, labels and other converted products. Some pressure-sensitive materials are converted into labels and other products through embossing, printing, stamping and die-cutting, and some are sold in unconverted form as base materials, tapes and reflective sheeting. We also manufacture and sell a variety of office products and other converted products and other items not involving pressure-sensitive components, such as binders, organizing systems, markers, fasteners, business forms, as well as tickets, tags, and imprinting equipment for retail and apparel manufacturers.

A pressure-sensitive, or self-adhesive, material is one that adheres to a surface by press-on contact. It generally consists of four elements: a face material, which may be paper, metal foil, plastic film or fabric; an adhesive, which may be permanent or removable; a release coating; and a backing material to protect the adhesive against premature contact with other surfaces, and which can also serve as the carrier for supporting and dispensing individual labels. When the products are to be used, the release coating and protective backing are removed, exposing the adhesive, and the label or other face material is pressed or rolled into place.

Self-adhesive materials may initially cost more than materials using heat or moisture activated adhesives, but the use of self-adhesive materials often provides cost savings because of their easy and instant application, without the need for adhesive activation. They also provide consistent and versatile adhesion, with minimal adhesive deterioration and are available in a large selection of materials in nearly any size, shape and color.

Our reporting segments are:

- Pressure-sensitive Materials

- Office and Consumer Products

- Retail Information Services

In addition to our reporting segments, we have other specialty converting businesses comprised of several businesses that produce specialty tapes and highly engineered labels including radio frequency identification (RFID) inlays and labels, and other converted products.

Although our segment structure remained the same as reported in the prior year, in 2006, we transferred our business media division from the Retail Information Services segment into other specialty converting businesses to align with a change in our internal reporting structure. Prior year amounts included herein have been reclassified to conform to the current year presentation.

In 2006, the Pressure-sensitive Materials segment contributed approximately 58% of our total sales, while the Office and Consumer Products and the Retail Information Services segments contribute approximately 19% and 12%, respectively, of our total sales.

In 2006, international operations constituted a significant portion of our business and represented approximately 55% of our sales. We expanded our operations, focusing particularly on Asia, Latin America and Eastern Europe. As of December 30, 2006, we operated approximately 120 manufacturing and distribution facilities located in over 40 countries, and employed approximately 22,700 persons worldwide.

We are subject to certain risks referred to in Item 1A, Risk Factors and Item 3, Legal Proceedings below, including those normally attending international and domestic operations, such as changes in economic or political conditions, currency fluctuations, exchange control regulations and the effect of international relations and domestic affairs of foreign countries on the conduct of business, legal proceedings, and the availability and pricing of raw materials.

Except as set forth below, no single customer represented 10% or more of our net sales or trade receivables at year end 2006 and 2005. However, our ten largest customers at year end 2006 represented approximately 18% of trade accounts receivable and consisted of six customers of our Office and Consumer Products segment, three customers of our Pressure-sensitive Materials segment and one customer of both these segments. The financial position and operations of these customers are monitored on an ongoing basis (see Critical Accounting Policies and Estimates of Item 7, Management s Discussion and Analysis of Results of Operations and Financial Condition). United States export sales are not a significant part of our business. Backlogs are not considered material in the industries in which we compete.

Corporate Governance and Information Related to SEC Filings

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed with, or furnished to, the Securities and Exchange Commission (SEC) pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge by way of a third-party hyperlink service through our Web site, www.averydennison.com (in the Investors section), as soon as reasonably practical after electronic filing with or furnishing of such material to the SEC. We make available at the Web site our (i) Corporate Governance Guidelines, (ii) Code of Ethics and Business Conduct, which applies to our directors and employees, (iii) Code of Ethics for the Chief Executive Officer and Senior Financial Officers, (iv) the charters of the Audit, Compensation and Executive Personnel, and Nominating and Governance Committees of our Board of Directors, and (v) Audit Committee Complaint Handling Procedures. These materials are also available free of charge in print to stockholders who request them by writing to: Secretary, Avery Dennison Corporation, 150 North Orange Grove Boulevard, Pasadena, California 91103.

On December 1, 2005, Kent Kresa was elected non-executive Chairman. Mr. Kresa presides at executive sessions of the Board. During 2006, the Board held six executive sessions with non-management directors only during regularly scheduled Board meetings, as well as one additional executive session with independent directors only. Stockholders and other interested parties may write to Mr. Kresa concerning matters other than accounting and auditing matters c/o Secretary, Avery Dennison Corporation, 150 North Orange Grove Boulevard, Pasadena, California 91103. Stockholders may also write to John T. Cardis, Chairman of the Audit Committee, regarding accounting and auditing matters c/o Secretary at the same address.

Pressure-sensitive Materials Segment

The Pressure-sensitive Materials segment manufactures and sells Fasson-, JAC-, and Avery Dennison-brand pressure-sensitive materials, Avery-brand graphics and graphic films, Avery Dennison-brand reflective products, and performance polymers. The business of this segment is generally not seasonal, except for certain outdoor graphics and highway safety products and operations in Western Europe. Pressure-sensitive materials consist primarily of papers, plastic films, metal foils and fabrics, which are coated with Company-developed and purchased adhesives, and then laminated with specially coated backing papers and films. They are sold in roll or sheet form with either solid or patterned adhesive coatings, and are available in a wide range of face materials, sizes, thicknesses and adhesive properties. These materials are sold to label printers and converters for labeling, decorating, fastening, electronic data processing and special applications on a worldwide basis.

Graphic products consist of a variety of films and other products sold to the architectural, commercial sign, digital printing, and other related markets. We also sell durable cast and reflective films to the construction, automotive, and fleet transportation markets, scrim-reinforced vinyl material for banner sign

applications, and reflective films for traffic and safety applications. Our graphic and reflective businesses are organized on a worldwide basis to serve the expanding commercial graphic arts market, including wide-format digital printing applications. We also manufacture and sell proprietary films that are used for outdoor, weather-resistant applications.

Performance polymer products include a range of solvent- and emulsion-based acrylic polymer adhesives, protective coatings and other polymer additives for internal use, as well as for sale to other companies.

In this segment, our larger competitors are Raflatac, a subsidiary of UPM-Kymmene; Morgan Adhesives (MACtac), a division of the Bemis Company; and 3M Company (for graphic and reflective products). Entry of competitors into the field of pressure-sensitive adhesives and materials may be limited by capital requirements and a need for technical knowledge. We believe that our relative size and scale of operations, our ability to serve our customers with a broad line of quality products and service programs, our distribution and brand strength, and the development and commercialization of new products are among the more significant factors in developing and maintaining our competitive position.

Office and Consumer Products Segment

The Office and Consumer Products segment manufactures and sells a wide range of Avery-brand printable media and other products. The business of this segment is seasonal, with higher volume related to the back-to-school season.

This segment s products are generally sold through office products superstores, mass market distributors, wholesalers and dealers. We manufacture and sell a wide range of Avery-brand products for office, school and home uses: printable media, such as copier, ink-jet and laser printer labels, related computer software, ink-jet and laser printer card and index products; and organization, filing and presentation products, such as binders, dividers and sheet protectors. We also offer a wide range of other stationery products, including writing instruments, markers, adhesives and specialty products under brand names such as Avery, Marks-A-Lot and HI-LITER. The extent of product offerings varies by geographic market.

In this segment, our larger competitors are Acco Brands Corporation, Esselte Corporation and manufacturers of private brands. We believe that our brand strength, a large installed base of software that facilitates the use of many of our products, our ability to serve our customers with a broad line of quality products, and the development and commercialization of new products are among the more significant factors in developing and maintaining our competitive position.

Retail Information Services Segment

The Retail Information Services segment designs, manufactures and sells a wide variety of price marking and brand identification products for retailers, apparel manufacturers, distributors and industrial customers on a worldwide basis. This business is seasonal, with higher volume in advance of the back-to-school and holiday shipping periods.

Our brand identification products include woven and printed labels, graphic tags and barcode tags. Our information management products include price tickets, carton labels, RFID tags and printing applications for supply chain and security management. Our solution enabling products include barcode printers, molded plastic fastening and application devices and security management products.

In this segment, our largest competitor is Paxar Corporation. We believe that our ability to serve our customers with product innovation, a comprehensive brand identification and information management product line, our global distribution network, service, quality, and geographic reach are the key advantages in developing and maintaining our competitive position.

Other specialty converting businesses

Other specialty converting businesses include our specialty tape, industrial, performance films and automotive products, business media, RFID and security printing businesses. These businesses manufacture and sell specialty tapes, highly engineered films, RFID inlays, pressure-sensitive postage stamps and other converted products. These businesses are generally not seasonal, except for certain automotive products due to typical summer plant shutdowns by automotive manufacturers.

The specialty tape business manufactures and sells single- and double-coated tapes and adhesive transfer tapes for use in non-mechanical fastening, bonding and sealing systems in various industries, which are sold to industrial and medical original equipment manufacturers, converters, and disposable diaper producers worldwide. These products are sold in roll form and are available in a wide range of face materials, sizes, thicknesses and adhesive properties.

Our industrial and automotive products businesses primarily consist of custom pressure-sensitive and heat-seal labels for the automotive and durable goods industries. These products are sold primarily to original equipment manufacturers.

Our performance films business produces a variety of decorative and functional films, primarily for the automotive industry, that are designed for injection mold applications.

Our business media business designs and markets customized products for printing and information workflow applications.

Our RFID business manufactures RFID inlays and labels and makes use of our existing distribution by marketing to our label converting customers.

Our security printing business manufactures and sells self-adhesive battery labels to a battery manufacturer, and self-adhesive stamps to the U.S. Postal Service.

In addition, we sell specialty print-receptive films to the industrial label market, metallic dispersion products to the packaging industry, and proprietary wood grain and other patterns of film laminates for housing exteriors and interior and exterior automotive applications.

We compete with a number of diverse businesses. Our largest competitor for this group of businesses is 3M Company in the specialty tape business. Entry of competitors into these specialty converting businesses may be limited by capital and technical requirements. We believe that our ability to serve our customers with quality, cost effective products and the development and commercialization of new products are among the more significant factors in developing and maintaining our competitive position.

Research and Development

Many of our current products are the result of our research and development efforts. Our expenses for research, design and testing of new products and applications by our operating units and the Avery Research Center (the Research Center) located in Pasadena, California were $87.9 million in 2006, $85.4 million in 2005, and $81.8 million in 2004. A significant number of our research and development activities are conducted at the Research Center, which supports each of our operating segments.

Our operating units research efforts are directed primarily toward developing new products and operating techniques and improving product performance, often in close association with customers. The Research Center supports our operating units patent and product development work, and focuses on improving adhesives, materials and coating processes, as well as related product applications and ventures. These efforts often focus on projects relating to printing and coating technologies and adhesive, release and ink chemistries.

The loss of individual patents or licenses would not be material to us taken as a whole, nor to our operating segments individually. Our principal trademarks are Avery, Fasson, Avery Dennison and the Company s symbol. These trademarks are significant in the markets in which our products compete.

Three-Year Summary of Segment Information

Certain financial information on our reporting segments and other specialty converting businesses for the three years ended December 30, 2006, which appear in Note 12, Segment Information, in the Notes to

Consolidated Financial Statements beginning on page 65 of our 2006 Annual Report to Shareholders, are incorporated herein by reference.

Other Matters

We use various raw materials, primarily paper, plastic films and resins, and specialty chemicals, which we purchase from a variety of commercial and industrial sources and which are subject to price fluctuations. Although from time to time shortages could occur, these raw materials currently are generally available.

We produce a majority of our self-adhesive materials using water-based emulsion and hot-melt adhesive technologies. Emissions from these operations contain small amounts of volatile organic compounds, which can be regulated by agencies of federal, state, local and foreign governments. We continue to evaluate the use of alternative materials and technologies to minimize these emissions.

A portion of our manufacturing process for self-adhesive materials utilizes certain organic solvents which, unless controlled, would be emitted into the atmosphere. Emissions of these substances are regulated by agencies of federal, state, local and foreign governments. In connection with the maintenance and acquisition of certain manufacturing equipment, we invest in solvent capture and control units to assist in regulating these emissions.

We have developed adhesives and adhesive processing systems that minimize the use of solvents. Emulsion adhesives, hot-melt adhesives or solventless silicone systems have been installed in our facilities in Peachtree City, Georgia; Fort Wayne and Greenfield, Indiana; and Quakertown, Pennsylvania; as well as in other plants in the United States, Argentina, Australia, Belgium, Brazil, Canada, China, Colombia, France, Germany, India, Korea, Luxembourg, Malaysia, Mexico, the Netherlands, South Africa, Thailand and United Kingdom.

Based on current information, we do not believe that the costs of complying with applicable laws regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, will have a material effect upon our capital expenditures, consolidated financial position or results of operations.

For information regarding our potential responsibility for cleanup costs at certain hazardous waste sites, see Legal Proceedings (Part I, Item 3) and Management s Discussion and Analysis of Results of Operations and Financial Condition (Part II, Item 7).

Item 1A. RISK FACTORS

Our ability to attain our goals and objectives is materially dependent on numerous factors and risks, including but not limited to, the following:

The demand for our products is impacted by economic conditions of the principal countries in which we operate. A decline in the economies in these countries could have an adverse effect on our sales and profitability.

We have operations in over 40 countries and our domestic and international operations are strongly influenced by matters beyond our control, including changes in the political, social, economic, tax and regulatory environments (including tariffs) in the countries in which we operate, as well as the impact of economic conditions on underlying demand for our products. In addition, approximately 55% of our sales are in foreign currencies, which fluctuate in relation to one another and to the United States dollar. Fluctuations in currencies can cause transaction, translation and other losses to us, which can negatively impact our sales and profitability.

Table of Contents

We operate in some highly competitive markets. If we do not compete effectively, we could lose market share and experience falling prices, adversely affecting our financial results.

We are at risk that our competitors will expand in our key markets and implement new technologies making them more competitive. There is also the possibility that competitors will be able to offer additional products, services, lower prices, or other incentives that we cannot or will not offer or that will make our products less profitable. There can be no assurance that we will be able to compete successfully against current and future competitors.

We are also at risk with regards to changes in customer order patterns, such as changes in the levels of inventory maintained by customers and the timing of customer purchases, which may be affected by announced price changes, changes in the Company s incentive programs, or the customer s ability to achieve incentive goals. Changes in customers preferences for our products can also affect the demand for our products.

As a manufacturer, our sales and profitability are also dependent upon the cost and availability of raw materials and energy, which are subject to price fluctuations, and the ability to control or pass on costs of raw materials and labor.

Inflationary and other increases in the costs of raw materials, labor and energy have occurred in the past and are expected to recur, and our performance depends in part on our ability to pass on to customers changes in costs in our selling prices for products and on improvements in productivity. Also, it is important that we are able to obtain timely delivery of materials, equipment, and packaging from suppliers. A disruption to our supply chain could adversely affect our sales and profitability.

Potential adverse developments in legal proceedings and investigations regarding competitive activities and other legal, compliance and regulatory matters, including those involving product liability, product and trade compliance, Foreign Corrupt Practices Act issues and other matters, could impact us materially.

Our financial results could be materially adversely impacted by an unfavorable outcome to pending or future litigation and investigations, including, without limitation, any relating to the Canadian Department of Justice and Australian Competition and Consumer Commission investigations, into industry competitive practices and any related proceedings or lawsuits pertaining to these investigations or to the subject matter thereof (including purported class actions in the United States seeking treble damages for alleged unlawful competitive practices, and a purported class action related to alleged disclosure and fiduciary duty violations pertaining to alleged unlawful competitive practices, which were filed after the announcement of the recently closed U.S. Department of Justice investigation). See Item 3, Legal Proceedings. There can be no assurance that any investigation or litigation outcome will be favorable.

Our future results may be affected if we generate less productivity improvement than projected.

We are undergoing efforts to reduce costs in many of our operations, including closure of facilities, headcount reductions, organizational simplification, process standardization, and using a variety of tools such as Lean Sigma and Kaizen events, to accomplish this productivity, which is not assured. Lower levels of productivity could result in lower production, sales, and profitability. Cost reduction actions, in turn, could expose us to additional production risk.

Slower growth in key markets could adversely affect our profitability.

Our business could be negatively impacted by a decline in key end use markets or applications for our products. Our overall performance will be influenced by these markets.

Our customers are widely diversified, but in certain portions of our business, industry concentration has increased the importance and decreased the number of significant customers.

In particular, sales of our office and consumer products in the United States are concentrated in a few major customers, principally office product superstores, mass market distributors and wholesalers. The business risk associated with this concentration, including increased credit risks for these and other customers, and the possibility of related bad debt write-offs, could negatively affect our margins and profits.

Our ability to develop and successfully market new products and applications is important in maintaining growth.

The timely introduction of new products and improvements in current products helps determine our success. Research and development for each of our operating segments is complex and uncertain and requires innovation and anticipation of market trends. We could focus on products that ultimately are not accepted by customers.

Infringing intellectual property rights of third parties or inadequately acquiring or protecting our intellectual property and patents could harm our ability to grow.

Because our products involve complex technology and chemistry, we are sometimes involved in litigation involving patents and other intellectual property. Parties have filed, and in the future may file, claims against us alleging that we have infringed their intellectual property rights. We could be held to be liable to pay damages or obtain licenses. There can be no assurance that licenses will be available, or will be available on commercially reasonable terms, and the cost to defend these infringement claims and to develop new technology could be significant.

We also could have our intellectual property infringed. We attempt to protect and restrict access to our intellectual property and proprietary information, but it may be possible for a third party to obtain our information and develop similar technologies. In addition, many of the countries in which we operate have limited or no protection for intellectual property rights. The costs involved to protect our intellectual property rights could adversely impact our profitability.

The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities.

Our estimate of the potential outcome of uncertain tax issues is subject to our assessment of relevant risks, facts, and circumstances existing at that time. We use these assessments to determine the adequacy of our provision for income taxes. Our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, which may impact our effective tax rate and our financial results.

We have deferred tax assets that we may not be able to use under certain circumstances.

If we are unable to generate sufficient future taxable income in certain jurisdictions, or if there is a significant change in the time period within which the underlying temporary differences become taxable or deductible, we could be required to increase our valuation allowances against our deferred tax assets. This would result in an increase in our effective tax rate, and an adverse effect on our future operating results. In addition, changes in statutory tax rates may also change our deferred tax assets or liability balances, with either favorable or unfavorable impact on our effective tax rate. Our deferred tax assets may also be impacted by new legislation or regulation.

The level of returns on pension and postretirement plan assets and the actuarial assumptions used for valuation purposes could affect our earnings in future periods.

Assumptions used in determining projected benefit obligations and the fair value of plan assets for our pension plan and other postretirement benefit plans are evaluated by us in consultation with outside actuaries. Funding obligations are determined under the Employee Retirement Income Security Act and are measured each year based on the value of assets and liabilities on a specific date. In the event that we determine that changes are warranted in the assumptions used, such as the discount rate, expected long term rate of return, or health care costs, our future pension and projected postretirement benefit expenses could increase or decrease. Due to changing market conditions or changes in the participant population, the actuarial assumptions that we use may differ from actual results, which could have a significant impact on our pension and postretirement

Table of Contents

liability and related costs. Future pension funding requirements, and the timing of funding payments, could be affected by legislation enacted in the U.S. Congress.

We have acquired companies and our interest in various acquisition opportunities has increased. Acquisitions come with significant risks and uncertainties, including integration, technology and personnel.

In order to grow our product lines and expand into new markets, we have made acquisitions and may do so in the future. Many risks, uncertainties, and costs are associated with the acquisitions. The integration of systems, objectives, personnel, product lines, markets, customers, suppliers, and cost savings can be difficult to achieve and the results are uncertain. There can be no assurance that acquisitions will be successful and contribute to our profitability.

In order for us to remain competitive, it is important to recruit and retain highly-skilled employees.

There is significant competition to recruit and retain skilled employees. Due to rapid expansion in certain markets and the ongoing productivity efforts and recent employee reductions, it may be difficult for us to retain and recruit sufficient numbers of highly-skilled employees.

We need to comply with many environmental, health, and safety laws.

Due to the nature of our business, we are subject to environmental, health, and safety laws and regulations, including those related to the disposal of hazardous waste from our manufacturing processes. Compliance with existing and future environmental, health and safety laws could subject us to future costs or liabilities; impact our production capabilities; constrict our ability to sell, expand or acquire facilities; and generally impact our financial performance. We have accrued liabilities for environmental clean-up sites, including sites for which governmental agencies have designated us as a potentially responsible party, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate currently identified sites and other sites, which could be identified in the future for cleanup, could be higher than the liability currently accrued.

In order to mitigate risk, it is important that we obtain various types of insurance.

We have various types of insurance including health, life, and property. Insurance costs can be unpredictable and may adversely impact our financial results.

Significant disruption to our information technology infrastructure could adversely impact our operations, sales, customer relations, and financial results.

We rely on the efficient and uninterrupted operation of a large and complex information technology infrastructure to link our worldwide divisions. Like other information technology systems, ours is susceptible to damage or interruptions caused by natural disasters, power failures, viruses and security breaches. We upgrade and install new systems, which if installed or programmed incorrectly, could cause significant disruptions. We have implemented various measures to manage our risk related to system and network disruptions, but if a disruption occurs, we could incur losses and costs for remediation and interruption of operations.

Our share price may be volatile.

Our stock price is influenced by changes in the overall stock market and demand for equity securities in general. Other factors, including market expectations for our performance, the level of perceived growth of our industries, announcements concerning industry investigations have also impacted our share price. There can be no assurance that our stock price will not be less volatile in the future.

If our credit ratings are downgraded, we may have difficulty obtaining acceptable short- and long-term financing from capital markets.

Credit ratings are a significant factor in our ability to raise short-term and long-term financing. The credit ratings assigned to us also impact the interest rates on our commercial paper and other borrowings. Standard and Poor s (S&P) has assigned us a credit rating of A-2 for short-term and A- for long-term financing. S&P has given us a negative outlook. Moody s Investors Service (Moody s) has assigned us a credit rating of P2 for short-term and A3 for long-term financing. Moody s has given us a stable outlook. If our credit ratings were to be downgraded, our financial flexibility would decrease and the cost to borrow would increase.

Our reputation, sales, and earnings could be affected adversely if the quality of our products and services does not meet customer expectations.

There are occasions when we ship products with quality issues resulting from defective materials, manufacturing, packaging or design. Many of these issues are discovered before shipping but this causes delays in shipping, delays in the manufacturing process, and occasionally cancelled orders. When the issues are discovered after shipment, this causes additional shipping costs, possible discounts, possible refunds, and potential loss of future sales. Both pre-shipping and post-shipping quality issues can result in financial consequences along with a negative impact on our reputation.

Some of our products are sold by third parties.

Our products are not only sold by us, but by third party distributors and retailers as well. Some of our distributors also market products that compete with our products. Changes in the financial or business condition or purchasing decisions of these third parties could affect our sales and profitability.

We outsource some of our manufacturing. If there are significant changes in the quality control or financial or business condition of these outsourced manufacturers, our business could be negatively impacted.

We manufacture most of our products, but occasionally third-party manufacturers are needed for specialty jobs or capacity overflow. Outsourced manufacturers reduce our ability to control product failure, late deliveries, customer dissatisfaction and compliance with customer requirements for labor standards. Because of possible quality problems and customer dissatisfaction, outsourced manufacturers could have an adverse effect on our business and financial results.

The risks described above are not exclusive. Additional risks not presently known to us or that we currently consider to be less significant may also have an adverse effect on us. If any of the above risks actually occur, our business, results of operations, cash flows or financial condition could suffer, which might cause the value of our securities to decline.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

As of December 30, 2006, we operated over thirty principal manufacturing facilities in excess of 100,000 square feet. The following sets forth the locations of such principal facilities and the operating segments for which they are presently used:

Pressure-sensitive Materials Segment

Domestic	Peachtree City, Georgia; Fort Wayne, Greenfield and Lowell, Indiana; Fairport Harbor, Hamilton, Mentor and Painesville, Ohio; Quakertown, Pennsylvania; and Neenah, Wisconsin
Foreign	Adelaide and Melbourne, Australia; Vinhedo, Brazil; Kunshan, China; Champ-sur-Drac, France; Gotha and Schwelm, Germany; Chungju, Korea; Rodange, Luxembourg; Queretaro, Mexico; Rayong, Thailand; Hazerswoude, the Netherlands; and Cramlington, United Kingdom

Table of Contents

Office and Consumer Products Segment

Domestic	Chicopee, Massachusetts; and Meridian, Mississippi
Foreign	Oberlaindern, Germany; and Juarez and Tijuana, Mexico

Retail Information Services Segment

Domestic	Greensboro, North Carolina
Foreign	Hong Kong and Nansha, China

Other specialty converting businesses

Domestic	Schererville, Indiana; Painesville, Ohio; and Clinton, South Carolina
Foreign	Turnhout, Belgium

In addition to our principal manufacturing facilities described above, our other principal facilities include our corporate headquarters facility and research center in Pasadena, California, and offices located in Brea and Westlake Village, California; Framingham, Massachusetts; Mentor, Ohio; Hong Kong and Kunshan, China; Leiden, the Netherlands; and Zug, Switzerland.

All of our principal properties identified above are owned except certain facilities in Brea and Westlake Village, California; Hong Kong, China; Oberlaindern, Germany; Juarez, Mexico; Greensboro, North Carolina; Hamilton and Mentor, Ohio; and Zug, Switzerland, which are leased.

All buildings owned or leased are considered suitable and generally adequate for our present needs. We expand production capacity and provide facilities as needed to meet increased demand. Owned buildings and plant equipment are insured against major losses from fire and other usual business risks, subject to deductibles. We are not aware of any material defects in title to, or significant encumbrances on, our properties except for certain mortgage liens.

Item 3. LEGAL PROCEEDINGS

The Company has been designated by the U.S. Environmental Protection Agency (EPA) and/or other responsible state agencies as a potentially responsible party (PRP) at fourteen waste disposal or waste recycling sites, which are the subject of separate investigations or proceedings concerning alleged soil and/or groundwater contamination and for which no settlement of the Company s liability has been agreed. The Company is participating with other PRPs at all such sites, and anticipates that its share of cleanup costs will be determined pursuant to remedial agreements entered into in the normal course of negotiations with the EPA or other governmental authorities.

The Company has accrued liabilities for these and certain other sites, including sites in which governmental agencies have designated the Company as a PRP, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites and any sites which could be identified in the future for cleanup could be higher than the liability currently accrued.

During the third quarter of 2006, the Company recognized an additional liability of $13 million for estimated environmental remediation costs for a former operating facility, for which $2 million had been accrued in the second quarter of 2006. The amount accrued represents the lower end of the current estimated range of $15 million to $17 million for costs expected to be incurred. Management considered additional information provided by outside consultants in revising its previous estimates of expected costs. This estimate could change depending on various factors such as modification of currently planned remedial actions, changes in the site conditions, changes in the estimated time to complete remediation, changes in laws and regulations affecting remediation requirements and other factors.

Other amounts currently accrued are not significant to the consolidated financial position of the Company and, based upon current information, management believes it is unlikely that the final resolution of these matters will significantly impact the Company s consolidated financial position, results of operations or cash flows.

On October 19, 2006, the U.S. Department of Justice notified the Company that the U.S. Department of Justice had decided to close its criminal investigation (initiated in April 2003) into competitive practices in the label stock industry without further action, as described below.

On November 15, 2006, the Company announced that it had been notified by the European Commission (EC) that the EC had closed its investigation (initiated in May 2004) into the Company s competitive activities in the label stock industry with no action, as described below.

On April 14, 2003, the Company announced that it had been advised that the U.S. Department of Justice was challenging the proposed merger of UPM-Kymmene (UPM) and the Morgan Adhesives (MACtac) division of Bemis Co., Inc. (Bemis) on the basis of its belief that in certain aspects of the label stock industry the competitors have sought to coordinate rather than compete. The Company also announced that it had been notified that the U.S. Department of Justice had initiated a criminal investigation into competitive practices in the label stock industry.

On April 15, 2003, the U.S. Department of Justice filed a complaint in the U.S. District Court for the Northern District of Illinois seeking to enjoin the proposed merger (DOJ Merger Complaint). The DOJ Merger Complaint, which set forth the U.S. Department of Justice s theory of its case, included references not only to the parties to the merger, but also to an unnamed Leading Producer of North American label stock, which is the Company. The DOJ Merger Complaint asserted that UPM and the Leading Producer have already attempted to limit competition between themselves, as reflected in written and oral communications to each other through high level executives regarding explicit anticompetitive understandings, although the extent to which these efforts have succeeded is not entirely clear to the United States at the present time.

In connection with the U.S. Department of Justice s investigation into the proposed merger, the Company produced documents and provided testimony by Messrs. Neal, Scarborough and Simcic (then CEO, President and Group Vice President Roll Materials Worldwide, respectively). On July 25, 2003, the United States District Court for the Northern District of Illinois entered an order enjoining the proposed merger. UPM and Bemis thereafter agreed to terminate the merger agreement. The court s decision incorporated a stipulation by the U.S. Department of Justice that the paper label industry is competitive.

On April 24, 2003, Sentry Business Products, Inc. filed a purported class action in the United States District Court for the Northern District of Illinois against the Company, UPM, Bemis and certain of their subsidiaries seeking treble damages and other relief for alleged unlawful competitive practices, essentially repeating the underlying allegations of the DOJ Merger Complaint. Ten similar complaints were filed in various federal district courts. In November 2003, the cases were transferred to the United States District Court for the Middle District of Pennsylvania and consolidated for pretrial purposes. Plaintiffs filed a consolidated complaint on February 16, 2004, which the Company answered on March 31, 2004. On April 14, 2004, the court separated the proceedings as to class certification and merits discovery, and limited the initial phase of discovery to the issue of the appropriateness of class certification. On January 4, 2006, plaintiffs filed an amended complaint. The Company intends to defend these matters vigorously.

On May 6, 2003, Sekuk Global Enterprises filed a purported stockholder class action in the United States District Court for the Central District of California against the Company and Messrs. Neal, O Bryant and Skovran (then CEO, CFO and Controller, respectively) seeking damages and other relief for alleged disclosure violations pertaining to alleged unlawful competitive practices. Subsequently, another similar action was filed in the same court. On September 24, 2003, the court appointed a lead plaintiff, approved lead and liaison counsel and ordered the two actions consolidated as the In Re Avery Dennison Corporation Securities Litigation. Pursuant to court order and the parties stipulation, plaintiff filed a consolidated complaint in mid-February 2004. The court approved a briefing schedule for defendants motion to dismiss the consolidated complaint, with a contemplated hearing date in June 2004. In January 2004, the parties stipulated to stay the consolidated action, including the proposed briefing schedule, pending the outcome of the government investigation of alleged anticompetitive conduct by the Company. The court has approved the parties stipulation to stay the consolidated actions. On January 12, 2007, the plaintiffs filed a notice of voluntarily dismissal of the case without prejudice. On January 17, 2007, the Court entered an order dismissing the case.

On May 21, 2003, The Harman Press filed in the Superior Court for the County of Los Angeles, California, a purported class action on behalf of indirect purchasers of label stock against the Company, UPM and UPM s subsidiary Raflatac (Raflatac), seeking treble damages and other relief for alleged unlawful competitive practices, essentially repeating the underlying allegations of the DOJ Merger Complaint. Three similar complaints were filed in various California courts. In November 2003, on petition from the parties, the California Judicial Council ordered the cases be coordinated for pretrial purposes. The cases were assigned to a coordination trial judge in the Superior Court for San Francisco County on March 30, 2004. A further similar complaint was filed in the Superior Court for Maricopa County, Arizona on November 6, 2003. Plaintiffs voluntarily dismissed the Arizona complaint without prejudice on October 4, 2004. On January 21, 2005, American International Distribution Corporation filed a purported class action on behalf of indirect purchasers in the Superior Court for Chittenden County, Vermont. Similar actions were filed by Webtego on February 16, 2005, in the Court of Common Pleas for Cuyahoga County, Ohio; by D.R. Ward Construction Co. on February 17, 2005, in the Superior Court for Maricopa County, Arizona; by Richard Wrobel, on February 16, 2005, in the District Court of Johnson County, Kansas; and by Chad and Terry Muzzey, on February 16, 2005 in the District Court of Scotts Bluff County, Nebraska. On February 17, 2005, Judy Benson filed a purported multi-state class action on behalf of indirect purchasers in the Circuit Court for Cocke County, Tennessee. On October 7, 2005, Webtego voluntarily dismissed its complaint. On February 16, 2007, D.R. Ward voluntarily dismissed its complaint. The Company intends to defend the remaining matters vigorously.

On August 15, 2003, the U.S. Department of Justice issued a subpoena to the Company in connection with its criminal investigation into competitive practices in the label stock industry. The Company produced documents and provided testimony in response to the subpoena.

On May 25, 2004, officials from the EC, assisted by officials from national competition authorities, launched unannounced inspections of and obtained documents from the Company s pressure-sensitive materials facilities in the Netherlands and Germany. The investigation apparently sought evidence of unlawful anticompetitive activities affecting the European paper and forestry products sector, including the label stock market. The Company cooperated with the investigation.

Based on published press reports, certain other European producers of paper and forestry products received similar visits from European authorities. One such producer, UPM, stated that it had decided to disclose to competition authorities any conduct that has not comported with applicable competition laws, and that it had received conditional immunity in the European Union (EU) and Canada with respect to certain conduct it has previously disclosed to them, contingent on full cooperation. In February 2006, UPM announced that the U.S. Department of Justice had agreed not to prosecute UPM in connection with the label stock investigation, and, further, that UPM had received conditional immunity in jurisdictions in addition to the EU and Canada.

On July 9, 2004, the Competition Law Division of the Department of Justice of Canada notified the Company that it was seeking information from the Company in connection with a label stock investigation. The Company is cooperating with the investigation.

On May 18, 2005, Ronald E. Dancer filed a purported class action in the United States District Court for the Central District of California against the Company, Mr. Neal, Karyn Rodriguez (VP and Treasurer) and James Bochinski (then VP, Compensation and Benefits), for alleged breaches of fiduciary duty under the Employee Retirement Income Security Act to the Company s Employee Savings Plan and Plan participants. The plaintiff alleges, among other things, that permitting investment in and retention of Company Common Stock under the Plan was imprudent because of alleged anticompetitive activities by the Company, and that failure to disclose such activities to the Plan and participants was unlawful. Plaintiff seeks an order compelling defendants to compensate the Plan for any losses and other relief. The parties stipulated to transfer the case to

the judge in the consolidated case, In Re Avery Dennison Corporation Securities Litigation referenced above, and the court has approved the parties stipulation to stay the matter pending the outcome of the government investigation of alleged anticompetitive conduct by the Company. The Company intends to defend this matter vigorously.

On August 18, 2005, the Australian Competition and Consumer Commission notified two of the Company s subsidiaries, Avery Dennison Material Pty Limited and Avery Dennison Australia Pty Ltd, that it was seeking information in connection with a label stock investigation. The Company is cooperating with the investigation.

On October 19, 2006, the U.S. Department of Justice notified the Company that the U.S. Department of Justice decided to close its criminal investigation into competitive practices in the label stock industry without further action.

On November 15, 2006, the Company announced that it had been notified that the EC had closed its investigation into the Company s competitive activities in the label stock industry, with no action.

The Board of Directors has created an ad hoc committee comprised of independent directors to oversee the foregoing matters.

The Company is unable to predict the effect of these matters at this time, although the effect could be adverse and material.

In 2005, the Company contacted relevant authorities in the U.S. and reported on the results of an internal investigation of potential violations of the U.S. Foreign Corrupt Practices Act. The transactions at issue were carried out by a small number of employees of the Company s reflectives business in China, and involved, among other things, impermissible payments or attempted impermissible payments. The payments or attempted payments and the contracts associated with them appear to have been relatively minor in amount and of limited duration. Corrective and disciplinary actions have been taken. Sales of the Company s reflectives business in China in 2005 were approximately $7 million. Based on findings to date, no changes to the Company s previously filed financial statements are warranted as a result of these matters. However, the Company expects that fines or other penalties could be incurred. While the Company is unable to predict the financial or operating impact of any such fines or penalties, it believes that its behavior in detecting, investigating, responding to and voluntarily disclosing these matters to authorities should be viewed favorably.

The Company and its subsidiaries are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of the business. Based upon current information, management believes that the resolution of these other matters will not materially affect the Company s financial position.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

Table of Contents

EXECUTIVE OFFICERS OF AVERY DENNISON[1]

Name	Age	Served as Executive Officer since	Former Positions and Offices with Avery Dennison	
Dean A. Scarborough[2] President and Chief Executive Officer (also Director of Avery Dennison)	51	August 1997	2000-2005	President and Chief Operating Officer
Robert G. van Schoonenberg Executive Vice President, General Counsel and Secretary	60	December 1981	1997-2000	S.V.P., General Counsel and Secretary
Daniel R. O Bryant Executive Vice President, Finance and Chief Financial Officer	49	January 2001	2001-2005	S.V.P., Finance and Chief Financial Officer
Diane B. Dixon Senior Vice President, Worldwide Communications and Advertising	55	December 1985	1997-2000	V.P., Worldwide Communications and Advertising
Robert M. Malchione Senior Vice President, Corporate Strategy and Technology	49	August 2000	2000-2001	S.V.P., Corporate Strategy
Karyn E. Rodriguez Vice President and Treasurer	47	June 2001	1999-2001	Assistant Treasurer, Corporate Finance and Investments
Timothy S. Clyde Group Vice President, Office Products	44	February 2001	2000-2001	V.P. and General Manager, Office Products N.A.
Sandra Beach Lin[3] Group Vice President, Specialty Materials and Converting	48	April 2005	2002-2005	President, Alcoa Closure Systems International, Div. of Alcoa, Inc.
Christian A. Simcic Group Vice President,	50	May 2000	1997-2000	V.P. and Managing Director, Asia Pacific

Roll Materials

(1) All officers are elected to serve a one-year term and until their successors are elected and qualify.

(2) Mr. Scarborough was elected President and Chief Executive Officer effective May 1, 2005.

(3) Business experience during past 5 years prior to service with the Company.

PART II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a)(b) The information called for by this item appears on page 72 of our 2006 Annual Report to Shareholders and under the Equity Compensation Plan Information table in the 2007 Proxy Statement, and is incorporated herein by reference.

Stockholder Return Performance

The following graphs compare the Company s cumulative stockholder return on its common stock, including the reinvestment of dividends, with the return on the Standard & Poor s 500 Stock Index (the S&P 500 Index) and the average return, weighted by market capitalization, of the Peer Group for five-year and ten-year periods each ending December 30, 2006. The Company has also included the median return of the Peer Group in the graph as an additional comparison.

The Peer Group is comprised of Air Products & Chemicals Inc., ArvinMeritor Inc., Baker-Hughes Incorporated, Ball Corporation, Bemis Company, Inc., Black & Decker Corporation, Bowater Incorporated, Cabot Corporation, Crane Company, Crown Holdings Inc., Cummins Inc., Dana Corporation, Danaher Corporation, Dover Corporation, Eaton Corporation, Ecolab Incorporated, Ferro Corporation, FMC Corporation, Fuller (H. B.) Company, Goodrich (B F) Company, Grace (W R) & Company, Harley-Davidson Inc., Harris Corporation, Harsco Corporation, Hercules Incorporated, Illinois Tool Works Incorporated, Ingersoll-Rand Company, MASCO Corporation, MeadWestvaco Corporation, NACCO Industries, Newell Rubbermaid Incorporated, Olin Corporation, PACCAR Inc., Parker-Hannifin Corporation, Pentair Inc., Pitney Bowes Incorporated, PolyOne Corporation, Potlatch Corporation, P.P.G. Industries Incorporated, Sequa Corporation, The Sherwin-Williams Company, Smurfit-Stone Container Corporation, Snap-On Incorporated, Sonoco Products Company, Stanley Works, Tecumseh Products Company, Temple-Inland Inc., Thermo Electron Corporation, Thomas & Betts Corporation, and Timken Company.

During 2006, Engelhard Corporation was acquired by BASF Corporation, and Maytag Corporation was acquired by Whirlpool Corporation. Therefore, they are no longer public companies and they were deleted. Temple-Inland and Potlatch were added to the Peer Group, and have been included for all periods.

Total Return Analysis[(1)]

	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006
Avery Dennison	$ 100	$ 110	$ 104	$ 114	$ 108	$ 136
S&P 500 Index	$ 100	$ 78	$ 100	$ 111	$ 117	$ 135
Market Basket (Weighted Average)[(2)]	$ 100	$ 98	$ 128	$ 167	$ 171	$ 209
Market Basket (Median)	$ 100	$ 90	$ 123	$ 142	$ 145	$ 187

(1) Assumes $100 invested on December 31, 2001, and the reinvestment of dividends; chart reflects performance on a calendar year basis.

(2) Weighted average is weighted by market capitalization.

Table of Contents

Total Return Analysis[(1)]

	12/31/1996	12/31/1997	12/31/1998	12/31/1999	12/31/2000	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006
Avery Dennison	$ 100	$ 129	$ 132	$ 217	$ 167	$ 176	$ 194	$ 183	$ 200	$ 190	$ 239
S&P 500 Index	$ 100	$ 133	$ 171	$ 208	$ 189	$ 166	$ 130	$ 167	$ 185	$ 194	$ 224
Market Basket (Weighted Average)[(2)]	$ 100	$ 133	$ 143	$ 145	$ 151	$ 174	$ 168	$ 215	$ 281	$ 266	$ 336
Market Basket (Median)	$ 100	$ 131	$ 114	$ 114	$ 103	$ 117	$ 111	$ 141	$ 162	$ 186	$ 225

(1) Assumes $100 invested on December 31, 1996, and the reinvestment of dividends; chart reflects performance on a calendar year basis.

(2) Weighted average is weighted by market capitalization.

Stock price performance reflected in the above graphs is not necessarily indicative of future price performance.

The above Stockholder Return Performance graphs in this Item 5 are not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 (Exchange Act), other than as provided in Item 201 to Regulation S-K under the Exchange Act, or subject to the liabilities of Section 18 of the Exchange Act, and will not be deemed incorporated by reference into any filing under the Securities Act of 1993 or the Exchange Act, except to the extent the Company specifically incorporates it by reference into such a filing.

(c) Purchases of Equity Securities by Issuer

On October 26, 2006, the Board of Directors authorized the repurchase of an additional 5 million shares of the Company s outstanding common stock. This authorization increased the total shares authorized for repurchase to approximately 7.4 million. Repurchased shares may be reissued under the Company s stock option and incentive plans or used for other corporate purposes. Included in the total shares repurchased were 136,665 shares that were delivered (actually or constructively) to the Company by participants exercising stock options during the fourth quarter of 2006 under the Company s stock option plans in payment of the option exercise price and/or to satisfy withholding tax obligations.

The following table sets forth the monthly repurchases of our common stock:

(Shares in thousands, except per share amounts) **Fourth Quarter**	**Total shares repurchased**	**Average price per share**	**Remaining authorization to repurchase shares**
October 1, 2006 October 28, 2006	52.2	$ 34.94	7,451.9
October 29, 2006 November 25, 2006	1,370.4	63.88	6,161.5

November 26, 2006	December 30, 2006	1,245.0		67.84	4,921.0
Quarterly Total		2,667.6	$	65.16	4,921.0

Item 6. SELECTED FINANCIAL DATA

Selected financial data for each of the Company s last five fiscal years appears on page 18 of our 2006 Annual Report to Shareholders and is incorporated herein by reference.

Table of Contents

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Management s Discussion and Analysis provides a narrative concerning our financial performance and condition that should be read in conjunction with the accompanying financial statements. It includes the following sections:

Definition of Terms	17
Overview and Outlook	18
Analysis of Results of Operations	23
Results of Operations by Segment	26
Financial Condition	29
Uses and Limitations of Non-GAAP Measures	37
Related Party Transactions	37
Critical Accounting Policies and Estimates	38
Recent Accounting Requirements	42
Safe Harbor Statement	42

DEFINITION OF TERMS

Our discussion of financial results includes several non-GAAP measures to provide additional information concerning Avery Dennison Corporation s (the Company s) performance. These non-GAAP financial measures are not in accordance with, nor are they a substitute for, GAAP financial measures. These non-GAAP financial measures are intended to supplement the presentation of our financial results that are prepared in accordance with GAAP. (Refer to Uses and Limitations of Non-GAAP Measures.)

We use the following terms:

Organic sales growth refers to the change in sales excluding the estimated impact of currency translation, acquisitions and divestitures;

Core unit volume refers to a measure of sales performance that excludes the estimated impact of currency translation, acquisitions and divestitures, as well as changes in product mix and pricing;

Segment operating income refers to income before interest and taxes;

Free cash flow refers to cash flow from operations, less payments for capital expenditures, software and other deferred charges; and

Working capital from continuing operations refers to working capital excluding short-term debt, current assets and current liabilities of held-for-sale businesses.

While our segment structure remained the same as reported in the prior year, in 2006, we transferred our business media division from the Retail Information Services segment into other specialty converting businesses, to align with a change in our internal reporting structure. Prior year amounts included herein have been reclassified to conform to the current year presentation.

As a result of the sale of our raised reflective pavement marker business during 2006 (discussed below in Acquisitions and Divestitures), the discussions which follow generally reflect summary results from our continuing operations unless otherwise noted. However, the net income and net income per share discussions include the impact of discontinued operations.

Table of Contents

OVERVIEW AND OUTLOOK

Overview

Sales

Our sales from continuing operations increased 2% in 2006 compared to growth of 3% in 2005, reflecting the factors summarized in the following table.

	2006	2005	2004
Estimated change in sales due to:			
Core unit volume	2%	(1)%	8%
Pricing & product mix	1	2	(1)
Organic sales growth	3%	1%	7%
Foreign currency translation		2	5
Divestitures, net of acquisitions	(1)		
Reported sales growth	2%	3%	12%

Organic sales growth in 2006 reflected increases in most of our businesses outside of the U.S., particularly in the emerging markets of Asia, Eastern Europe and Latin America.

In the U.S., sales were approximately even with the prior year. In our North American roll materials business, reduced market share during the first quarter of 2006 (reflecting share loss related to price increases implemented in 2005 and early 2006, to offset higher raw material costs), as well as generally slow market conditions, were offset by some share gain during the second half of 2006. The benefit from growth of Avery-brand products and a strong back-to-school season in our Office and Consumer Products segment in the U.S. was offset by the loss of sales from exiting certain low-margin private label business in that segment.

Organic sales growth in 2005 reflected favorable changes in pricing and product mix, primarily due to the impact of selling price increases implemented to offset higher raw material costs. This benefit was partially offset by a decrease in core unit volume in 2005, reflecting the following factors:

- Loss of market share in our North American roll materials business following our implementation of selling price increases during 2005 to offset higher raw material costs
- The impact of an extra week in the 2004 fiscal year
- Accelerated purchases by Office and Consumer Products customers in advance of our 2005 selling price increases, which shifted sales into the fourth quarter of 2004.

Net Income

Net income increased $141 million in 2006 compared to 2005.

Positive factors affecting the change in net income included:

- Higher sales
- Reduced restructuring and asset impairment charges in 2006 compared to 2005 (which included asset impairment charges related to discontinued operations)
- Cost savings from productivity improvement initiatives across all segments and corporate, including restructuring actions taken in 2006 and late 2005
- Tax benefit and gain on divestiture of a business

Benefit of a lower effective tax rate on continuing operations

Table of Contents

Negative factors affecting the change in net income included:

- Stock-based compensation and other employee-related costs
- Transition costs associated with 2006 restructuring actions
- Increased investment in information technology and marketing
- Accrual for environmental remediation costs

Summary Results by Segment

	Net Sales		Operating Income	
	2006	**2005**	**2006**	**2005**
(In millions)				
Pressure-sensitive Materials	$ 3,236.3	$ 3,114.5	$ 301.2	$ 258.1
Office and Consumer Products	1,072.0	1,136.1	179.0	168.0
Retail Information Services	667.7	630.4	45.0	37.7
Other specialty converting businesses	599.9	592.5	17.2	14.1
Corporate expense			(61.3)	(53.2)
Interest expense			(55.5)	(57.9)
Total from continuing operations	$ 5,575.9	$ 5,473.5	$ 425.6	$ 366.8

Pressure-sensitive Materials (58% of net sales)

Our Pressure-sensitive Materials segment reported a 4% increase in sales in 2006 compared to 2005. Organic sales growth was approximately 3%, reflecting growth in our roll materials and graphics and reflective businesses in Asia, Europe and Latin America.

Operating income for this segment increased 17% in 2006, reflecting higher sales and cost savings from restructuring and productivity improvement initiatives. Operating income for this segment included restructuring costs and asset impairments in both 2006 and 2005 and transition costs in 2006.

Office and Consumer Products (19% of net sales)

Our Office and Consumer Products segment reported a 6% decrease in sales in 2006 compared to 2005. On an organic basis, sales declined approximately 1%, reflecting the loss of sales from exiting certain low-margin private label business and decreased volume in Europe. These declines were partially offset by growth in North America for Avery-brand products, a strong back-to-school season, and accelerated purchases by customers in advance of our 2007 selling price increases for certain product lines.

Operating income for this segment increased 7% in 2006, including the benefit from cost savings from productivity improvement and restructuring initiatives. Operating income for this segment included restructuring costs, asset impairments and transition costs in both 2006 and 2005.

Retail Information Services (12% of net sales)

The Retail Information Services segment reported a 6% increase in sales in 2006 compared to 2005. Organic sales growth was approximately 5%, reflecting continued growth of the business in Asia, Latin America and Europe.

Operating income for this segment increased 19% in 2006, reflecting higher sales and cost savings from restructuring and productivity improvement initiatives. Operating income for this segment included restructuring costs, asset impairments and transition costs in 2006 and 2005.

Table of Contents

Other specialty converting businesses (11% of net sales)

Other specialty converting businesses reported a 1% increase in sales in 2006 compared to 2005. Organic sales growth was approximately 2%, reflecting solid growth in our specialty tape business, partially offset by weakness in other businesses.

Operating income for these businesses increased 22% in 2006, reflecting sales growth and cost savings from restructuring and productivity improvement initiatives. Operating income for these businesses included restructuring costs and asset impairments in both 2006 and 2005.

Organic Sales Growth by Region

We estimate organic sales growth (decline) in major regions of operation as follows:

	2006	2005	2004
U.S		(3)%	5%
Europe	3%	3%	5%
Asia	13%	13%	26%
Latin America	11%	4%	19%

As discussed above, sales in the U.S. were approximately even with the prior year, due to slow market conditions in our Pressure-sensitive Materials segment, the impact of prior year share loss in our roll materials business, and loss of sales from exiting low-margin private label business in our Office and Consumer Products segment.

Organic growth in Europe reflected strong growth in the east and modest growth in the west.

Growth in our Asian and Latin American businesses was due to continued market expansion.

Cost Reduction Actions

(Dollars in millions)	Accrued Expenses	Headcount Reduction
Q4 2005 restructuring	$ 41.1	700
2006 restructuring	23.5	450
Total Q4 2005-2006 restructuring actions	$ 64.6	1,150
Q4 2006 charges related to 2007 actions	$ 5.1	140

During late 2005 and 2006, we implemented cost reduction actions related to restructuring, which have improved our global operating efficiencies and are expected to result in annualized pretax savings of $90 million to $100 million. We estimate that approximately $50 million of these savings (net of transition costs) were achieved in 2006, with the balance to benefit 2007. These restructuring actions resulted in headcount reductions of approximately 1,150 positions, which impacted all of our segments and geographic regions and were completed in 2006. We are reinvesting some of the savings in future growth opportunities.

Additional restructuring actions were identified during the fourth quarter of 2006. These actions are expected to be completed during 2007, with savings expected to benefit 2008.

In 2005, we also incurred charges related to the planned divestitures of several low-margin businesses and product lines, as discussed in Divestitures and Acquisitions.

Restructuring charges associated with severance and asset impairments recorded during 2004 were related to the completion of the integration of the 2002 acquisition of Jackstädt into our other existing businesses. We closed a manufacturing facility in France during the first quarter of 2004 and a manufacturing facility in Italy during the second quarter of 2004.

Refer to Note 10, Cost Reduction Actions, to the Consolidated Financial Statements for further detail.

Table of Contents

Effective Rate of Taxes on Income

The effective tax rate was 17.2% for the full year 2006 compared with 20.4% for the full year 2005. Our effective tax rate in both years included benefits from:

Changes in the geographic mix of income

Continued improvements in our global tax structure

Several favorable global tax audit settlements and the closure of certain tax years

Release of certain valuation allowances

In 2005, these benefits were partially offset by incremental expense associated with the repatriation of accumulated foreign earnings under the American Jobs Creation Act of 2004.

Free Cash Flow

Free cash flow, which is a non-GAAP measure, is used as a measure of funds available for other corporate purposes, such as dividends, debt reduction, acquisitions, and repurchase of common stock. Refer to Uses and Limitations of Non-GAAP Measures.

(In millions)	**2006**	**2005**	**2004**
Net cash provided by operating activities	$ 510.8	$ 441.6	$ 516.9
Purchase of property, plant and equipment	(161.9)	(162.5)	(178.9)
Purchase of software and other deferred charges	(33.4)	(25.8)	(21.8)
Free cash flow	$ 315.5	$ 253.3	$ 316.2

The increase in free cash flow in 2006 of $62 million reflects changes in assets and liabilities and higher net income compared to 2005. See Analysis of Results of Operations and Liquidity below for more information.

Divestitures and Acquisitions

In December 2005, we announced our plan to sell our raised reflective pavement marker business, which had sales of approximately $23 million in 2005. The divestiture of this business was completed during the second quarter of 2006 and resulted in a tax benefit due to capital losses arising from the sale of the business. The results of this business have been accounted for as discontinued operations for the years presented herein. This business was previously included in the Pressure-sensitive Materials segment.

In December 2005, we also announced the divestiture of two product lines. These divestitures were completed in the first quarter of 2006. The first product line, which was included in the Office and Consumer Products segment, had estimated sales of $60 million in 2005, with minimal impact to income from operations. The second product line, which was included in other specialty converting businesses, had annual sales of approximately $10 million in 2005, with minimal impact to income from operations. As part of these divestitures, in 2005, we recorded severance and other employee-related charges of approximately $6 million and asset impairments of approximately $9 million. These charges were included in the Other Expense, net line of our Consolidated Statement of Income, as noted in Cost Reduction Actions above.

During the third quarter of 2004, we acquired Rinke Etiketten, a privately held company in Germany. The incremental impact of this acquisition on our net sales was approximately $9 million during 2004, with an additional impact of approximately $18 million in 2005. This business is included in our Retail Information Services segment.

Investigations and Legal Proceedings

On October 19, 2006, we were notified by the U.S. Department of Justice s Antitrust Division (DOJ) that the DOJ had decided to close its criminal investigation (initiated in April 2003) into competitive practices in the label stock industry without further action.

On November 15, 2006, we announced that we had been notified by the European Commission (EC) that the EC had closed its investigation (initiated in May 2004) into competitive activities in the label stock industry with no action.

In July 2004, we were notified by the Competition Law Division of the Department of Justice of Canada that it was seeking information in connection with a label stock investigation. In August 2005, we were notified by the Australian Competition and Consumer Commission that it was seeking information in connection with a label stock investigation. We are cooperating with these investigations.

We are a named defendant in purported class actions in the U.S. seeking treble damages and other relief for alleged unlawful competitive practices, which were filed after the announcement of the DOJ investigation. We are also a named defendant in a purported class action in the U.S. seeking damages and other relief for alleged disclosure and fiduciary duty violations pertaining to alleged unlawful competitive practices. We have discovered instances of conduct by certain employees in China that potentially violate the U.S. Foreign Corrupt Practices Act, and we have reported that conduct to authorities in the U.S. Accordingly, we expect that fines or other penalties may be incurred.

We are unable to predict the effect of these matters at this time, although the effect could be adverse and material. These and other matters are reported in Note 8, Contingencies, to the Consolidated Financial Statements.

Outlook

In 2007, we expect low to mid single-digit revenue growth, including a modest positive effect from foreign currency translation. Our revenue expectations are subject to changes in economic and market conditions.

We anticipate continued benefit from our productivity improvement initiatives. In particular, we estimate that our restructuring and business realignment efforts will reduce costs by an additional $45 million compared to 2006. However, we plan to reinvest some of the savings from these productivity improvements in growth initiatives. This reinvestment includes incremental spending of approximately $12 million to $15 million related to investments in information technology.

We estimate that pretax interest expense will be approximately even with 2006, subject to changes in average debt outstanding.

We expect total restructuring and asset impairment charges in 2007 will be lower than the charges taken in 2006.

We anticipate an increase in our annual effective tax rate for 2007, subject to changes in tax laws and the geographic mix of income, with potentially wide variances from quarter to quarter.

Reflecting these assumptions, we expect an increase in annual earnings and free cash flow in comparison with 2006. Additionally, the effect of share repurchase will benefit earnings per share in 2007.

We expect capital expenditures in 2007 to be approximately $160 million to $165 million, or approximately $210 million to $225 million including software investments, funded through operating cash flows. Major capital projects in 2007 include expansion in China and India, serving both our materials and retail information services businesses. Major software investments relate to customer service and standardization initiatives.

Table of Contents

ANALYSIS OF RESULTS OF OPERATIONS

Income from Continuing Operations Before Taxes:

(In millions)	2006	2005	2004
Net sales	$ 5,575.9	$ 5,473.5	$ 5,317.0
Cost of products sold	4,047.5	3,997.3	3,890.4
Gross profit	1,528.4	1,476.2	1,426.6
Marketing, general and administrative expense	1,011.1	987.9	957.4
Interest expense	55.5	57.9	58.7
Other expense, net	36.2	63.6	35.2
Income from continuing operations before taxes	$ 425.6	$ 366.8	$ 375.3

As a Percent of Sales:	%	%	%
Gross profit (margin)	27.4	27.0	26.8
Marketing, general and administrative expense	18.1	18.0	18.0
Income from continuing operations before taxes	7.6	6.7	7.1

Sales

Sales increased 2% in 2006 compared to an increase of 3% in 2005. Organic sales growth was approximately 3% in 2006 compared to approximately 1% in 2005. Organic sales growth in 2006 reflected increases in most of our businesses in Asia, Europe and Latin America. Organic growth in Europe reflected strong growth in the east and modest growth in the west. Growth in our Asian and Latin American businesses was due to continued market expansion.

On an organic basis, sales in the U.S. were approximately even in 2006, compared to a decrease of approximately 3% in 2005. In our North American roll materials business, reduced market share during the first quarter of 2006 (reflecting share loss related to price increases implemented in 2005 and early 2006 to offset higher raw material costs), as well as generally slow market conditions, were offset by some share gain during the second half of 2006. The benefit from growth of Avery-brand products and a strong back-to-school season in our Office and Consumer Products segment in the U.S. was offset by the loss of sales from exiting certain low-margin private label business (approximate impact of $22 million) in that segment.

Sales growth in 2005 was negatively impacted by an extra week in the 2004 fiscal year and accelerated purchases by Office and Consumer Products customers in advance of 2005 selling price increases, both of which contributed to higher growth in 2004. Combined, the accelerated purchases and extra week in 2004 represented an estimated $60 million to $70 million of the change in sales between 2005 and 2004. The loss of market share in our North American roll materials business also affected sales growth in 2005.

Foreign currency translation had a favorable impact on the change in sales of approximately $21 million in 2006 compared to approximately $77 million in 2005.

Product line divestitures, net of incremental sales from acquisitions, reduced sales by approximately $54 million in 2006. Incremental sales from acquisitions, net of divestitures, contributed approximately $19 million in 2005.

Gross Profit

Gross profit margin in both 2006 and 2005 benefited from our ongoing productivity improvement and cost reduction actions.

Table of Contents

In 2006, these benefits were partially offset by:

- Unfavorable segment mix (faster growth in segments with lower gross profit margin as a percent of sales)
- Energy-related cost inflation (approximately $9 million)
- Change in the last-in, first-out (LIFO) inventory reserves (approximately $9 million); refer to Critical Accounting Policies and Estimates
- Transition costs associated with restructuring (approximately $9 million)

In 2005, these benefits were partially offset by:

- Unfavorable segment mix
- Raw material inflation in excess of selling price increases
- Higher costs related to our radio frequency identification (RFID) business (approximately $9 million)

In 2006, we reclassified shipping and handling costs to Cost of products sold to align our businesses around a standard accounting policy. In 2005, several of our businesses included these costs in marketing, general and administrative expenses (approximately $143 million for 2006, $145 million for 2005, and $148 million for 2004); previous results included herein have been reclassified for comparability to the current year.

Marketing, General and Administrative Expenses

Marketing, general and administrative expense as a percent of sales in 2006 and 2005 reflected the benefit of productivity improvement initiatives and cost reduction actions.

In 2006, these benefits were offset by:

- Recognition of stock option expense (approximately $21 million)
- Increased spending on information systems and marketing (approximately $19 million)
- Increase in pension, medical and other employee-related costs (approximately $12 million)

In 2005, these benefits were offset by:

- Higher pension and medical expenses (approximately $14 million)
- Impact of foreign currency translation (approximately $11 million)
- Additional spending on the development of our RFID business (approximately $8 million), as well as other long-term growth initiatives
- Additional spending associated with acquisitions (approximately $6 million)

Interest Expense

Interest expense decreased in 2006 and 2005. The decreases were due to a reduction in debt outstanding, partially offset by an increase in interest rates.

Other Expense

(In millions, pretax)	**2006**	**2005**	**2004**
Restructuring costs	$ 21.1	$ 37.5	$ 23.6
Asset impairment & lease cancellation charges	8.7	28.1	11.6
Other	6.4	(2.0)	

Other expense, net	$ 36.2	$ 63.6	35.2

Table of Contents

In 2006 and 2005, Other expense, net, consisted of charges for restructuring, including severance and other employee-related costs and asset impairment charges related to cost reduction actions and divestitures, as well as other items discussed below.

During late 2005 and 2006, we implemented cost reduction actions related to restructuring which have improved our global operating efficiencies and are expected to result in annualized pretax savings of $90 million to $100 million. We estimate that approximately $50 million of these savings (net of transition costs) have been achieved in 2006. These restructuring actions resulted in a headcount reduction of approximately 1,150 positions, which impacted all of our segments and geographic regions, and were completed in 2006. We are reinvesting some of the savings in future growth opportunities. Refer to Note 10, Cost Reduction Actions, to the Consolidated Financial Statements for more information.

The other items included in Other expense, net, in