

VALSPAR CORP  
Form 10-Q  
September 07, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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 29, 2011

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.)

**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. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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Non-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 1, 2011, The Valspar Corporation had 93,460,045 shares of common stock outstanding, excluding 24,982,579 shares held in treasury. We had no other classes of stock outstanding.

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THE VALSPAR CORPORATION

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for the Quarter Ended July 29, 2011

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**PART I. FINANCIAL INFORMATION**

## ITEM 1. FINANCIAL STATEMENTS

## THE VALSPAR CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (DOLLARS IN THOUSANDS)

| <b>ASSETS</b>   | July 29,<br>2011<br>(Unaudited) | October 29,<br>2010<br>(Note) | July 30,<br>2010<br>(Unaudited) |
|---|---------------------------------|-------------------------------|---------------------------------|
| <b>CURRENT ASSETS:</b>  |                                 |                               |                                 |
| Cash and cash equivalents   | \$ 152,509                      | \$ 167,621                    | \$ 232,124                      |
| Restricted cash   | 21,062                          | 12,574                        | 12,570                          |
| Accounts and notes receivable less allowance<br>(7/29/11-\$14,678; 10/29/10-\$17,459; 7/30/10-\$20,016) | 715,392                         | 628,589                       | 563,446                         |
| Inventories   | 429,733                         | 349,149                       | 270,719                         |
| Deferred income taxes   | 50,548                          | 49,069                        | 36,264                          |
| Prepaid expenses and other  | 78,302                          | 77,920                        | 82,610                          |
| <b>TOTAL CURRENT ASSETS</b>   | <b>1,447,546</b>                | <b>1,284,922</b>              | <b>1,197,733</b>                |
| <b>GOODWILL</b>   | <b>1,396,203</b>                | <b>1,355,818</b>              | <b>1,327,339</b>                |
| <b>INTANGIBLES, NET</b>   | <b>657,880</b>                  | <b>637,390</b>                | <b>622,205</b>                  |
| <b>OTHER ASSETS</b>   | <b>13,195</b>                   | <b>17,398</b>                 | <b>18,047</b>                   |
| <b>LONG-TERM DEFERRED INCOME TAXES</b>  | <b>4,988</b>                    | <b>4,778</b>                  | <b>4,520</b>                    |
| Gross property, plant and equipment   | 1,396,403                       | 1,326,070                     | 1,073,416                       |
| Less accumulated depreciation   | (821,861)                       | (758,440)                     | (631,362)                       |
| <b>NET PROPERTY, PLANT AND EQUIPMENT</b>  | <b>574,542</b>                  | <b>567,630</b>                | <b>442,054</b>                  |
| <b>TOTAL ASSETS</b>   | <b>\$ 4,094,354</b>             | <b>\$ 3,867,936</b>           | <b>\$ 3,611,898</b>             |

NOTE: The Balance Sheet at October 29, 2010 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 BALANCE SHEETS - CONTINUED  
(DOLLARS IN THOUSANDS)

| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  | July 29,<br>2011<br>(Unaudited) | October 29,<br>2010<br>(Note) | July 30,<br>2010<br>(Unaudited) |
|---|---------------------------------|-------------------------------|---------------------------------|
| <b>CURRENT LIABILITIES:</b>   |                                 |                               |                                 |
| Notes payable and commercial paper  | \$ 267,995                      | \$ 8,088                      | \$ 7,464                        |
| Current portion of long-term debt   | 208,594                         |                               |                                 |
| Trade accounts payable  | 504,401                         | 447,303                       | 398,241                         |
| Income taxes  | 43,205                          | 33,331                        | 43,130                          |
| Other accrued liabilities   | 357,153                         | 396,129                       | 337,513                         |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>1,381,348</b>                | <b>884,851</b>                | <b>786,348</b>                  |
| <b>LONG-TERM DEBT, NET OF CURRENT PORTION</b>   | <b>688,245</b>                  | <b>943,216</b>                | <b>870,726</b>                  |
| <b>DEFERRED INCOME TAXES</b>  | <b>265,300</b>                  | <b>256,525</b>                | <b>243,457</b>                  |
| <b>OTHER LONG-TERM LIABILITIES</b>  | <b>151,245</b>                  | <b>152,979</b>                | <b>162,495</b>                  |
| <b>TOTAL LIABILITIES</b>  | <b>2,486,138</b>                | <b>2,237,571</b>              | <b>2,063,026</b>                |
| <b>STOCKHOLDERS EQUITY:</b>   |                                 |                               |                                 |
| Common Stock (Par Value - \$0.50; Authorized<br>250,000,000 shares; Shares issued, including shares in<br>treasury 118,442,624) | 59,220                          | 59,220                        | 59,220                          |
| Additional paid-in capital  | 384,855                         | 383,167                       | 372,711                         |
| Retained earnings   | 1,534,277                       | 1,428,515                     | 1,392,899                       |
| Accumulated other comprehensive income (loss)   | 146,039                         | 88,087                        | 26,780                          |
| Less cost of common stock in treasury<br>(7/29/11-24,634,915 shares; 10/29/10-20,415,334 shares;<br>7/30/10-19,754,712 shares)  | (516,175)                       | (328,624)                     | (302,738)                       |
| <b>TOTAL STOCKHOLDERS EQUITY</b>  | <b>1,608,216</b>                | <b>1,630,365</b>              | <b>1,548,872</b>                |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>  | <b>\$ 4,094,354</b>             | <b>\$ 3,867,936</b>           | <b>\$ 3,611,898</b>             |

NOTE: The Balance Sheet at October 29, 2010 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 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Net sales                                   | \$ 1,070,482       | \$ 873,915       | \$ 2,905,615      | \$ 2,349,848     |
| Cost of sales                               | 746,145            | 583,111          | 2,006,855         | 1,568,700        |
| Gross profit                                | 324,337            | 290,804          | 898,760           | 781,148          |
| Research and development                    | 30,049             | 24,758           | 87,932            | 73,126           |
| Selling, general and administrative         | 183,596            | 145,921          | 537,232           | 423,705          |
| Income from operations                      | 110,692            | 120,125          | 273,596           | 284,317          |
| Interest expense                            | 15,801             | 14,322           | 46,846            | 43,433           |
| Other (income)/expense net                  | 552                | (898)            | 1,099             | (2,357)          |
| Income before income taxes                  | 94,339             | 106,701          | 225,651           | 243,241          |
| Income taxes                                | 26,952             | 31,558           | 68,529            | 72,488           |
| Net income                                  | \$ 67,387          | \$ 75,143        | \$ 157,122        | \$ 170,753       |
| Net income per common share basic           | \$ 0.72            | \$ 0.76          | \$ 1.66           | \$ 1.73          |
| Net income per common share diluted         | \$ 0.70            | \$ 0.74          | \$ 1.61           | \$ 1.69          |
| Average number of common shares outstanding |                    |                  |                   |                  |
| - basic                                     | 93,063,614         | 98,535,826       | 94,788,124        | 98,775,411       |
| - diluted                                   | 95,851,211         | 101,009,523      | 97,670,507        | 101,067,349      |
| Dividends paid per common share             | \$ 0.18            | \$ 0.16          | \$ 0.54           | \$ 0.48          |

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 29,<br>2011  | July 30,<br>2010 |
| <b>OPERATING ACTIVITIES:</b>  |                   |                  |
| Net income  | \$ 157,122        | \$ 170,753       |
| Adjustments to reconcile net income to net cash (used in)/provided by operating activities: |                   |                  |
| Depreciation  | 63,856            | 55,797           |
| Amortization  | 5,711             | 5,464            |
| Stock-based compensation  | 5,288             | 4,729            |
| (Gain)/loss on asset divestitures   | (602)             | (12,750)         |
| Changes in certain assets and liabilities, net of effects of acquired businesses:           |                   |                  |
| (Increase)/decrease in accounts and notes receivable  | (60,619)          | (56,984)         |
| (Increase)/decrease in inventories and other assets   | (48,041)          | (55,796)         |
| Increase/(decrease) in trade accounts payable and other accrued liabilities                 | (17,802)          | 50,436           |
| Increase/(decrease) in income taxes payable   | 5,773             | 30,447           |
| Increase/(decrease) in other deferred liabilities   | 3,075             | (1,480)          |
| Other   | (8,203)           | (13,747)         |
| Net Cash (Used In)/Provided By Operating Activities   | 105,558           | 176,869          |
| <b>INVESTING ACTIVITIES:</b>  |                   |                  |
| Purchases of property, plant and equipment  | (42,378)          | (35,248)         |
| Cash proceeds on disposal of assets   | 3,470             | 27,808           |
| Acquisition of businesses, net of cash acquired   | (30,579)          | (15,034)         |
| (Increase)/decrease in restricted cash  | (4,274)           | (12,570)         |
| Net Cash (Used In)/Provided By Investing Activities   | (73,761)          | (35,044)         |
| <b>FINANCING ACTIVITIES:</b>  |                   |                  |
| Net change in other borrowings  | (59,719)          | 5,348            |
| Net proceeds from issuance of commercial paper  | 255,907           |                  |
| Proceeds from sale of treasury stock  | 31,567            | 36,440           |
| Excess tax benefit from stock-based compensation  | 6,032             | 3,655            |
| Treasury stock purchases  | (218,643)         | (87,705)         |
| Dividends paid  | (51,360)          | (47,593)         |
| Purchase of equity award shares   | (11,454)          |                  |
| Net Cash (Used In)/Provided By Financing Activities   | (47,670)          | (89,855)         |
| Increase/(Decrease) in Cash and Cash Equivalents  | (15,873)          | 51,970           |
| Effect of exchange rate changes on Cash and Cash Equivalents                                | 761               | (7,565)          |
| Cash and Cash Equivalents at Beginning of Period  | 167,621           | 187,719          |
| Cash and Cash Equivalents at End of Period  | \$ 152,509        | \$ 232,124       |
| See Notes to Condensed Consolidated Financial Statements                                    |                   |                  |

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
JULY 29, 2011  
DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

#### 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 29, 2011 are not necessarily indicative of the results that may be expected for the year ending October 28, 2011.

Certain amounts in the 2010 financial statements have been reclassified to conform to the 2011 presentation. Such reclassifications had no effect on net income or stockholders' equity as previously reported.

The Condensed Consolidated Balance Sheet at October 29, 2010 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 29, 2010.

#### NOTE 2: ACCOUNTS PAYABLE

Trade accounts payable includes \$35,343 at July 29, 2011, \$33,944 at October 29, 2010 and \$25,280 at July 30, 2010 of issued checks that had not cleared our bank accounts.

#### NOTE 3: ACQUISITIONS AND DIVESTITURES

In February 2011, we acquired Isocoat Tintas e Vernizes Ltda. (Isocoat), a Brazilian powder coatings business serving customers in Brazil, Argentina and Colombia. The acquisition strengthens our general industrial product manufacturing, marketing and distribution in a growing region. Isocoat had 2010 sales of approximately \$35,000. The acquisition was recorded at fair value in the second quarter of fiscal year 2011. The purchase price allocation has been completed. Accordingly, the net assets and operating results have been included in our financial statements from the date of acquisition.

In September 2010, we acquired all the outstanding shares of Australian paint manufacturer Wattyl Limited (ASX:WYL) for approximately AUD 142,000 and assumed Wattyl's existing debt. The acquisition was paid for primarily through the use of existing cash and cash equivalents. Wattyl had fiscal year 2010 net sales of approximately AUD 386,500. Wattyl distributes leading paint brands through independent dealers, hardware chains, home centers and approximately 135 company-owned stores. The acquisition was recorded at fair value in the fourth quarter of fiscal year 2010. The purchase price allocation has been completed. Accordingly, the net assets and operating results have been included in our financial statements from the date of acquisition.

In June 2010, we sold certain non-strategic metal decorating inks assets, including inventory and intellectual property, to DIC Corporation of Japan. The sale was recorded at fair value in the third quarter of 2010 and resulted in a net gain, which was recorded as a reduction to Selling, General and Administrative expenses.

In June 2010, we purchased the shares of DIC Coatings India Limited and certain metal packaging coatings inventory and intellectual property in other countries from DIC Corporation. We obtained a manufacturing site in India. The acquisition was recorded at fair value in the third quarter of fiscal year 2010. Accordingly, the net assets and operating results have been included in our financial statements from the date of acquisition.

The net sales for both the June 2010 divestiture and acquisition are immaterial to our consolidated results.



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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.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011  
 DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

#### NOTE 4: INVENTORIES

The major classes of inventories consist of the following:

|  | July 29,<br>2011 | July 30,<br>2010 |
|--|------------------|------------------|
| Manufactured products                        | \$ 249,958       | \$ 142,756       |
| Raw materials, supplies and work-in-progress | 179,775          | 127,963          |
| Total Inventories                            | \$ 429,733       | \$ 270,719       |

#### NOTE 5: COMPREHENSIVE INCOME (LOSS)

For the three and nine-month periods ended July 29, 2011 and July 30, 2010, Comprehensive Income, a component of Stockholders' Equity, was as follows:

|  | Three Months              |                  | Nine Months Ended |                  |
|--|---------------------------|------------------|-------------------|------------------|
|  | Ended<br>July 29,<br>2011 | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Net Income                               | \$ 67,387                 | \$ 75,143        | \$ 157,122        | \$ 170,753       |
| Other Comprehensive Income, net of tax:  |                           |                  |                   |                  |
| Foreign currency translation gain (loss) | 22,337                    | (29,755)         | 63,566            | (41,141)         |
| Net gain (loss) on financial instruments | (4,617)                   | (252)            | (5,614)           | (76)             |
| Total Comprehensive Income (Loss)        | \$ 85,107                 | \$ 45,136        | \$ 215,074        | \$ 129,536       |

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

|   | October          |             |                  |
|---|------------------|-------------|------------------|
|   | July 29,<br>2011 | 29,<br>2010 | July 30,<br>2010 |
| Foreign currency translation                    | \$ 223,532       | \$ 159,966  | \$ 96,904        |
| Pension and postretirement benefits, net        | (79,100)         | (79,100)    | (77,679)         |
| Unrealized gain (loss) on financial instruments | 1,607            | 7,221       | 7,555            |
| Accumulated Other Comprehensive Income (loss)   | \$ 146,039       | \$ 88,087   | \$ 26,780        |

#### NOTE 6: GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill as of July 29, 2011 increased \$40,385 to \$1,396,203 from the end of fiscal year 2010. The increase is primarily due to foreign currency translation and the acquisition of Isocoat (see Note 3 for further details).

Total intangible asset amortization expense for the nine months ended July 29, 2011 was \$5,711, compared to \$5,464 for the same period last year. Estimated annual amortization expense for each of the next five fiscal years, based on the intangible assets as of July 29, 2011, is expected to be approximately \$8,000.

#### NOTE 7: SEGMENT INFORMATION

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. We are required 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).

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The Coatings segment aggregates our industrial and packaging product lines. Industrial products include a broad range of decorative and protective coatings for metal, wood and plastic. Packaging products include both interior and exterior coatings used in metal packaging containers, principally food containers and beverage cans. The products of this segment are sold throughout the world.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011  
 DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

The Paints segment aggregates our consumer paints and automotive refinish product lines. Consumer paints includes 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 Australia, China, New Zealand and North America. In September 2010, we acquired Watty Limited which expanded our distribution of consumer paints into Australia and New Zealand primarily through independent dealers, hardware chains, home centers and company-owned stores (see Note 3).

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 furniture protection plans and gelcoats and related products. All Other also includes our corporate administrative expenses. These administrative expenses include amortization expense, certain environmental-related expenses and other expenses not directly allocated to any other operating segment.

It is not practicable to obtain the information needed to disclose revenues attributable to each of our identified product lines within our reportable segments.

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:

|                                   | Three Months Ended  |                   | Nine Months Ended   |                     |
|-----------------------------------|---------------------|-------------------|---------------------|---------------------|
|                                   | July 29,<br>2011    | July 30,<br>2010  | July 29,<br>2011    | July 30,<br>2010    |
| <b>Net Sales:</b>                 |                     |                   |                     |                     |
| Coatings                          | \$ 560,759          | \$ 484,247        | \$ 1,526,284        | \$ 1,317,659        |
| Paints                            | 441,553             | 323,206           | 1,195,884           | 860,615             |
| All Other                         | 98,277              | 95,422            | 266,655             | 248,247             |
| Less Intersegment Sales           | (30,107)            | (28,960)          | (83,208)            | (76,673)            |
| <b>Total Net Sales</b>            | <b>\$ 1,070,482</b> | <b>\$ 873,915</b> | <b>\$ 2,905,615</b> | <b>\$ 2,349,848</b> |
| <b>EBIT</b>                       |                     |                   |                     |                     |
| Coatings                          | \$ 67,806           | \$ 80,496         | \$ 178,544          | \$ 185,868          |
| Paints                            | 42,079              | 38,577            | 100,556             | 118,570             |
| All Other                         | 255                 | 1,950             | (6,603)             | (17,764)            |
| <b>Total EBIT</b>                 | <b>\$ 110,140</b>   | <b>\$ 121,023</b> | <b>\$ 272,497</b>   | <b>\$ 286,674</b>   |
| Interest                          | \$ 15,801           | \$ 14,322         | \$ 46,846           | \$ 43,433           |
| <b>Income before Income Taxes</b> | <b>\$ 94,339</b>    | <b>\$ 106,701</b> | <b>\$ 225,651</b>   | <b>\$ 243,241</b>   |

#### NOTE 8: DERIVATIVE FINANCIAL INSTRUMENTS

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. We do not have any credit-risk-related contingent features in our derivative contracts as of July 29, 2011.

In the second quarter of 2011, our aggregate \$50,000 notional amount of interest rate swap contracts matured. These contracts were designated as cash flow hedges, to pay fixed rates of interest and receive a floating interest rate based on LIBOR. We had \$50,000 notional amount of interest rate swap contracts in place as of July 30, 2010. There was no ineffectiveness for these swaps during the year-to-date period ended July 29, 2011 and the quarter or year-to-date periods ended July 30, 2010. Prior to maturity, the interest rate swap contracts were reflected at fair value in the Condensed Consolidated Balance Sheets. Unrealized gains and losses were recorded in accumulated other comprehensive income. Amounts to be received or paid under the contracts were recognized as interest expense over the life of the contracts.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011  
 DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

At July 29, 2011, we had \$3,249 and \$6,432 notional amount of foreign currency contracts that mature during fiscal year 2011 and 2012, respectively. These foreign currency contracts have been designated as cash flow hedges 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 30, 2010, we had approximately \$2,845 notional amount of foreign currency contracts maturing during fiscal year 2010 and \$5,425 maturing during fiscal year 2011. There was no ineffectiveness for these hedges during the quarter or year-to-date periods ended July 29, 2011 or July 30, 2010.

At July 29, 2011, we had \$200,000 notional amount of treasury locks to hedge, or lock-in, interest rates on anticipated long-term debt to be issued. We designated the treasury locks as cash flow hedges with unrealized gains and losses recorded, net of tax, to accumulated other comprehensive income. The accumulated other comprehensive income amount in our Condensed Consolidated Balance Sheets represents the unrealized gains and losses, net of tax, from our current contracts and the unamortized gain, net of tax, from our settled contracts. The unamortized gain from our settled contracts is reclassified ratably to our condensed statements of income as a decrease to interest expense over the term of the related bond issuance. At July 30, 2010 we had no treasury lock contracts in place.

Our derivative assets and liabilities subject to fair value measurement disclosures are the following:

|                              | Fair Value at<br>July 29, 2011<br>Level 2 <sup>1</sup> | Fair Value at<br>July 30, 2010<br>Level 2 <sup>1</sup> |
|------------------------------|--|--|
| <b>Assets</b>                |  |  |
| Prepaid expenses and other:  |  |  |
| Foreign currency contracts   | \$   | \$ 2   |
| Total Assets                 | \$   | \$ 2   |
| <b>Liabilities</b>           |  |  |
| Accrued liabilities other:   |  |  |
| Foreign currency contracts   | \$ 275   | \$   |
| Treasury lock contracts      | 8,489  |  |
| Interest rate swap contracts |  | 707  |
| Total Liabilities            | \$ 8,764   | \$ 707   |

<sup>1</sup> See Note 1 in Notes to Consolidated Financial Statements in our Form 10-K for more information on fair value measurements.

Derivative gains (losses) recognized in AOCI <sup>2</sup> and on the Condensed Consolidated Statements of Income for the three and nine-month periods ended July 29, 2011 and July 30, 2010, respectively, are as follows:

**Three Months Ended July 29, 2011**

|   | Amount of<br>Gain (Loss)<br>recognized in<br>AOCI <sup>2</sup> | Statement of Income<br>Classification | Gain (Loss)<br>in Income <sup>2</sup> |
|---|--|---------------------------------------|---------------------------------------|
| <u>Derivatives designated as cash flow hedges</u> |  |                                       |                                       |
| Foreign currency contracts                        | \$ 359   | Other income / (expense), net         | \$ (244)                              |
| Treasury lock contracts                           | (8,091)  | Interest expense                      | 391                                   |
| Total derivatives designated as cash flow hedges  | \$ (7,732)   | Total                                 | \$ 147                                |

**Three Months Ended July 30, 2010**

|   | Amount of<br>Gain (Loss)<br>recognized in<br>AOCI <sup>2</sup> | Statement of Income<br>Classification | Gain (Loss) in<br>Income <sup>2</sup> |
|---|--|---------------------------------------|---------------------------------------|
| <u>Derivatives designated as cash flow hedges</u> |  |                                       |                                       |

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|  |    |       |                               |    |       |
|--|----|-------|-------------------------------|----|-------|
| Foreign currency contracts                       | \$ | (180) | Other income / (expense), net | \$ | 289   |
| Treasury lock contracts                          |    | (391) | Interest expense              |    | 391   |
| Interest rate swap contracts                     |    | 273   | Interest expense              |    | (329) |
| Total derivatives designated as cash flow hedges | \$ | (298) | Total                         | \$ | 351   |

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011  
 DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

| Nine Months Ended July 29, 2011                   | Amount of<br>Gain (Loss)<br>recognized in<br>AOCI <sup>2</sup> | Statement of Income Classification | Gain (Loss)<br>in Income <sup>2</sup> |
|---|--|------------------------------------|---------------------------------------|
| <u>Derivatives designated as cash flow hedges</u> |  |                                    |                                       |
| Foreign currency contracts                        | \$ 91  | Other income / (expense), net      | \$ (478)                              |
| Treasury lock contracts                           | (9,662)  | Interest expense                   | 1,173                                 |
| Interest rate swap contracts                      | 385  | Interest expense                   | (388)                                 |
| Total derivatives designated as cash flow hedges  | \$ (9,186)   | Total                              | \$ 307                                |

| Nine Months Ended July 30, 2010                   | Amount of<br>Gain (Loss)<br>recognized in<br>AOCI <sup>2</sup> | Statement of Income Classification | Gain (Loss)<br>in Income <sup>2</sup> |
|---|--|------------------------------------|---------------------------------------|
| <u>Derivatives designated as cash flow hedges</u> |  |                                    |                                       |
| Foreign currency contracts                        | \$ 172   | Other income / (expense), net      | \$ 128                                |
| Treasury lock contracts                           | (1,173)  | Interest expense                   | 1,173                                 |
| Interest rate swap contracts                      | 769  | Interest expense                   | (1,017)                               |
| Total derivatives designated as cash flow hedges  | \$ (232)   | Total                              | \$ 284                                |

<sup>2</sup> Accumulated other comprehensive income (loss) (AOCI) is included on the Condensed Consolidated Balance Sheets in the Stockholders' Equity section and is reported net of tax. The amounts disclosed in the above table are reported pretax and represent the respective period derivative activity.

**NOTE 9: DEBT AND MONEY MARKET SECURITIES**

The tables below summarize 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 either a discounted cash flow analysis based on our current borrowing costs for debt with similar maturities, or in the case of outstanding commercial paper, the carrying values approximate the fair market values as the maturities are less than three months.

|                          | July 29, 2011                     |                      |
|--------------------------|-----------------------------------|----------------------|
|                          | Balance Sheet<br>(carrying value) | Fair Market<br>Value |
| Publicly traded debt     | \$ 800,000                        | \$ 900,927           |
| Non-publicly traded debt | 364,834                           | 363,402              |
| Total Debt               | \$ 1,164,834                      | \$ 1,264,329         |

|                          | July 30, 2010                     |                      |
|--------------------------|-----------------------------------|----------------------|
|                          | Balance Sheet<br>(carrying value) | Fair Market<br>Value |
| Publicly traded debt     | \$ 800,000                        | \$ 903,227           |
| Non-publicly traded debt | 78,190                            | 76,073               |
| Total Debt               | \$ 878,190                        | \$ 979,300           |

We did not elect the option to report our debt at fair value in our Condensed Consolidated Balance Sheets.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011

DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

Our non-publicly traded debt consists of the following:

|                                | July 29,<br>2011 | July 30,<br>2010 |
|--------------------------------|------------------|------------------|
| Commercial paper               | \$ 255,907       | \$               |
| Credit facility borrowings     | 83,793           | 58,224           |
| Industrial development bonds   | 12,502           | 12,502           |
| Uncommitted borrowings         | 12,632           | 7,464            |
| Total Non-publicly Traded Debt | \$ 364,834       | \$ 78,190        |

Our credit facilities have covenants that require us to maintain certain financial ratios. We were in compliance with these covenants as of July 29, 2011. Our debt covenants do not limit, nor are they reasonably likely to limit, our ability to obtain additional debt or equity financing.

We invest in money market funds with high-credit-quality financial institutions and diversify our holdings among such financial institutions to reduce our exposure to credit losses. The fair values of our money market funds are \$17,305 and \$55,908 as of July 29, 2011 and July 30, 2010, respectively. The money market funds are included in our cash and cash equivalents and restricted cash balances with the carrying values approximating the fair market values as the maturities are less than three months. These assets have observable prices that are quoted on an active exchange, and are therefore classified as Level 1 inputs under the fair value hierarchy.

Restricted cash represents cash that is restricted from withdrawal. As of July 29, 2011 and July 30, 2010, we had restricted cash of \$21,062 and \$12,570, respectively. Such restricted cash primarily serves as collateral for our liability insurance programs.

NOTE 10: GUARANTEES AND CONTRACTUAL OBLIGATIONS

We are required to disclose information about certain guarantees and contractual obligations in our periodic financial statements.

We sell extended furniture protection plans and offer warranties for certain 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 can be estimated. 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 included in other liabilities, both short-term and long-term, during the period are as follows:

|  | Nine Months Ended |                  |
|--|-------------------|------------------|
|  | July 29,<br>2011  | July 30,<br>2010 |
| Beginning balance, October                                     | \$ 74,907         | \$ 70,503        |
| Additional net deferred revenue/accrual made during the period | 11,060            | 9,070            |
| Payments made during the period                                | (9,511)           | (6,363)          |
| Ending balance   | \$ 76,456         | \$ 73,210        |

NOTE 11: STOCK-BASED COMPENSATION



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Compensation expense associated with our stock-based compensation plans was \$1,499 (\$966 after tax) and \$5,288 (\$3,441 after tax) for the three and nine-month periods ended July 29, 2011, respectively, compared to \$1,379 (\$893 after tax) and \$4,729 (\$3,111 after tax) for the three and nine-month periods ended July 30, 2010, respectively.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011  
 DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS  
**NOTE 12: PENSIONS AND OTHER POSTRETIREMENT BENEFITS**

We sponsor a number of defined benefit pension plans for certain hourly and salaried 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.

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

|                                    | Three Months Ended |                  | Nine Months Ended |                  |
|------------------------------------|--------------------|------------------|-------------------|------------------|
|                                    | July 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Service cost                       | \$ 1,143           | \$ 785           | \$ 3,362          | \$ 2,430         |
| Interest cost                      | 3,699              | 3,177            | 11,007            | 9,660            |
| Expected return on plan assets     | (4,429)            | (4,032)          | (13,210)          | (12,194)         |
| Amortization of prior service cost | 100                | 114              | 298               | 342              |
| Recognized actuarial (gain)/loss   | 1,518              | 1,224            | 4,540             | 3,688            |
| Net periodic benefit cost          | \$ 2,031           | \$ 1,268         | \$ 5,997          | \$ 3,926         |

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

|                                    | Three Months Ended |                  | Nine Months Ended |                  |
|------------------------------------|--------------------|------------------|-------------------|------------------|
|                                    | July 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Service cost                       | \$ 47              | \$ 53            | \$ 141            | \$ 159           |
| Interest cost                      | 128                | 119              | 384               | 357              |
| Amortization of prior service cost | (32)               | (718)            | (96)              | (2,154)          |
| Recognized actuarial (gain)/loss   | 76                 | 657              | 228               | 1,971            |
| Net periodic benefit cost          | \$ 219             | \$ 111           | \$ 657            | \$ 333           |

**NOTE 13: INCOME TAXES**

At October 29, 2010, we had a \$17,817 liability recorded for gross unrecognized tax benefits (excluding interest and penalties). Of this total, \$15,646 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 29, 2010, we had accrued approximately \$5,907 of interest and penalties relating to unrecognized tax benefits.

During the first quarter of fiscal year 2011, we recorded a \$1,250 benefit to income tax expense for the retroactive extension of the U.S. federal research and development tax credit. In the same period of fiscal year 2010, we settled certain income tax audits, which reduced our liability for gross unrecognized tax benefits by \$7,244 (excluding interest and penalties). The net impact to tax expense during the first quarter of fiscal year 2010 for these audit adjustments (including interest, penalties, and other offsetting items) was a net decrease of \$4,821. There were no material adjustments to our recorded liability for unrecognized tax benefits during the second or third quarters of fiscal years 2011 or 2010.

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 2005. The Internal Revenue Service (IRS) has concluded its examination of our U.S. federal tax returns for the fiscal years ended 2004 and 2005. 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 29, 2011  
DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS  
**NOTE 14: RESTRUCTURING**

During the 2011 fiscal year, we initiated restructuring actions in our Coatings segment, primarily in our wood product line, which will further rationalize our manufacturing capacity and reduce our overall global headcount. We also initiated restructuring actions to improve the profitability of our Australian acquisition in the Paints segment, Wattyl, which include facility consolidations in manufacturing and distribution, store rationalization and other related costs. These restructuring activities for the three and nine-month periods ended July 29, 2011 resulted in pre-tax charges of \$14,333 or \$0.10 per share after tax and \$15,696 or \$0.12 per share after tax, respectively. These activities will span fiscal years 2011 and 2012, and we expect the total cost to be \$0.30 to \$0.35 per share after tax.

In fiscal year 2008, we initiated a comprehensive series of restructuring activities which are now complete. These restructuring initiatives included plant closures, reductions to Research and Development and Selling, General and Administrative expenses, manufacturing consolidation and relocation, and our exit from non-strategic product lines in certain geographies. We rationalized our manufacturing capacity and reduced our overall global headcount to lower our costs in light of the challenging global economic conditions. Pre-tax restructuring charges for these initiatives were \$1,346 or \$0.01 per share after tax for the nine-month period ended July 29, 2011.

Our total restructuring activities for the three and nine-month periods ended July 29, 2011 resulted in pre-tax charges of \$14,184 or \$0.10 per share after tax and \$17,042 or \$0.12 per share after tax, respectively. In comparison, total restructuring activities for the three and nine-month periods ended July 30, 2010 resulted in pre-tax charges of \$5,805 or \$0.04 per share after tax and \$10,067 or \$0.06 per share after tax, respectively.

The total resulting expenses included severance and employee benefits, asset impairments, professional services and site clean-up. We plan to pay the majority of the current restructuring liabilities within the next 12 months.

The following restructuring and impairment charges by segment were recorded in the 2011 and 2010 periods:

| Nine Month Period Ending July 29, 2011 | Liability                    |                  |                    | Liability        |
|--|------------------------------|------------------|--------------------|------------------|
|  | Beginning Balance 10/29/2010 | Expense          | Activity           |                  |
| <b>Coatings</b>                        |                              |                  |                    |                  |
| Severance and employee benefits        | \$ 1,139                     | \$ 5,676         | \$ (2,806)         | \$ 4,009         |
| Asset impairments                      |                              | 2,998            | (2,998)            |                  |
| Exit costs (consulting/site clean-up)  | 2,034                        | 2,030            | (1,253)            | 2,811            |
| <b>Total Coatings</b>                  | <b>3,173</b>                 | <b>10,704</b>    | <b>(7,057)</b>     | <b>6,820</b>     |
| <b>Paints</b>                          |                              |                  |                    |                  |
| Severance and employee benefits        | 19                           | 3,972            | (670)              | 3,321            |
| Asset impairments                      |                              | 1,750            | (1,750)            |                  |
| Exit costs (consulting/site clean-up)  | 2,763                        | 272              | (2,603)            | 432              |
| <b>Total Paints</b>                    | <b>2,782</b>                 | <b>5,994</b>     | <b>(5,023)</b>     | <b>3,753</b>     |
| <b>All Other</b>                       |                              |                  |                    |                  |
| Severance and employee benefits        |                              | 233              | (233)              |                  |
| Exit costs (consulting/site clean-up)  |                              | 111              | (111)              |                  |
| <b>Total All Other</b>                 |                              | <b>344</b>       | <b>(344)</b>       |                  |
| <b>Total</b>                           | <b>\$ 5,955</b>              | <b>\$ 17,042</b> | <b>\$ (12,424)</b> | <b>\$ 10,573</b> |

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JULY 29, 2011  
 DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

| Nine Month Period Ending July 30, 2010 | Liability<br>Beginning<br>Balance<br>10/30/2009 | Net <sup>1</sup><br>Expense | Activity          | Liability<br>Ending<br>Balance<br>7/30/2010 |
|--|---|-----------------------------|-------------------|---|
| <b>Coatings</b>                        |   |                             |                   |   |
| Severance and employee benefits        | \$ 1,694  | \$ 1,735                    | \$ (1,214)        | \$ 2,215                                    |
| Asset impairments                      |   | 5,710                       | (5,710)           |   |
| Exit costs (consulting/site clean-up)  | 1,012   | 897                         | (87)              | 1,822                                       |
| Contract term costs (leases)           |   | 92                          | (92)              |   |
| Total Coatings                         | 2,706   | 8,434                       | (7,103)           | 4,037                                       |
| <b>Paints</b>                          |   |                             |                   |   |
| Severance and employee benefits        | 827   | 314                         | (1,122)           | 19  |
| Asset impairments                      |   | (139)                       | 139               |   |
| Exit costs (consulting/site clean-up)  | 2,556   | 1,233                       | (900)             | 2,889                                       |
| Total Paints                           | 3,383   | 1,408                       | (1,883)           | 2,908                                       |
| <b>All Other</b>                       |   |                             |                   |   |
| Severance and employee benefits        | 55  |                             | (55)              |   |
| Asset impairments                      |   | 114                         | (114)             |   |
| Exit costs (consulting/site clean-up)  |   | 111                         | (111)             |   |
| Total All Other                        | 55  | 225                         | (280)             |   |
| <b>Total</b>                           | <b>\$ 6,144</b>                                 | <b>\$ 10,067</b>            | <b>\$ (9,266)</b> | <b>\$ 6,945</b>                             |

<sup>1</sup> The net expense column includes year-to-date changes in estimates of \$988 for the Paints segment, which reduced Cost of Sales and Selling, General and Administrative expenses by \$379 and \$609, respectively.

The liability ending balance at July 29, 2011 and at July 30, 2010 is included in other accrued liabilities on our Condensed Consolidated Balance Sheets. The restructuring reserve balances presented are considered adequate to cover committed restructuring actions. The restructuring expenses recorded are included in the Condensed Consolidated Statements of Income. For the three-month period ended July 29, 2011, \$12,224 was charged to Cost of Sales and \$1,960 was charged to Selling, General and Administrative (SG&A) expense. For the nine-month period ended July 29, 2011, \$14,149 was charged to Cost of Sales and \$2,893 was charged to SG&A expense. For the three-month period ended July 30, 2010, \$6,368 was charged to Cost of Sales and \$563 was credited to SG&A expense. For the nine-month period ended July 30, 2010, \$10,630 was charged to Cost of Sales and \$563 was credited to SG&A expense.

**NOTE 15: RECENTLY ISSUED ACCOUNTING STANDARDS**

In May 2011, the Financial Accounting Standards Board (FASB) amended the guidance on fair value measurement to expand certain disclosure requirements and converge United States General Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) measurement and reporting requirements. The change is effective for interim and annual periods beginning after December 15, 2011, which means the second quarter of our fiscal year 2012, and is to be applied prospectively. We do not expect the adoption of this accounting guidance to have a material effect on our consolidated financial statements.

In June 2011, the Financial Accounting Standards Board (FASB) updated the disclosure requirements for comprehensive income. The update requires companies to disclose total comprehensive income, the components of net income and the components of other comprehensive income, either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The change is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, which means the first quarter of our fiscal year 2013, and is to be applied retrospectively. We do not expect the adoption of these updated disclosure requirements to have an effect on our consolidated results of operations, financial condition or liquidity.

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#### ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

**Overview:** In the third quarter of 2011, we continued to experience a challenging raw material environment due to escalating costs and tight supply for certain raw materials, a trend which began in the second half of 2010. We expect the rising cost trend compared to 2010 to continue in the last quarter of 2011. Our ability to return to historical gross margins will depend on the continued implementation of selling price increases. Historically, there has been a lag between rising raw material costs and the implementation and financial impact of our pricing actions.

Net sales growth for the third quarter of 2011 was primarily driven by our acquisitions, selling price increases across all product lines and favorable foreign currency exchange. During the quarter, we experienced weakening demand in our core markets, which was partially offset by new business gains. Gross profit as a percent of net sales decreased due to the lag between higher raw material costs and the impact of our pricing actions. Operating expenses as a percent of net sales increased slightly, primarily due to a gain on sale of certain assets in 2010. Net income declined 10.3% primarily due to restructuring charges and the gain on sale of certain assets in 2010.

We continually evaluate our cost structure in the normal course of our business. During the 2011 fiscal year, we initiated restructuring actions in our Coatings segment, primarily in our wood product line, which will reduce our manufacturing capacity and overall global headcount. The end-markets served by this product line, which are heavily influenced by the U.S. housing market, have been weak for several years and we do not anticipate any significant changes to these market conditions in the near or medium term. In addition, we initiated restructuring actions related to improving the profitability of our Australian acquisition in the Paints segment, Wattyl. Specific actions include facility consolidations in manufacturing and distribution, store rationalization and other related costs. These activities will span fiscal years 2011 and 2012, and we expect total costs to be \$0.30 to \$0.35 per share after tax. Total restructuring activities during the third quarter of 2011 resulted in pre-tax charges of \$14,184 or \$0.10 per share after tax. See Note 14 in Notes to Condensed Consolidated Financial Statements for further information on restructuring.

**Earnings Per Share:** Net income per common share (diluted) was \$0.70 and \$1.61 for the three and nine-month periods ended July 29, 2011, and \$0.74 and \$1.69 for the three and nine-month periods ended July 30, 2010, respectively. The table below presents adjusted net income per common share - diluted, which excludes after-tax restructuring charges in the three and nine-month periods ended July 29, 2011 and July 30, 2010, after-tax acquisition-related charges in the nine-month period ended July 29, 2011 and a gain on sale of certain assets in the three and nine-month periods ended July 30, 2010.

|  | Three Months Ended |                  | Nine Months Ended |                  |
|--|--------------------|------------------|-------------------|------------------|
|  | July 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Net income per common share - diluted          | \$ 0.70            | \$ 0.74          | \$ 1.61           | \$ 1.69          |
| Restructuring charges                          | 0.10               | 0.04             | 0.12              | 0.06             |
| Acquisition-related charges                    |                    |                  | 0.09              |                  |
| Net gain on sale of certain assets             |                    | (0.08)           |                   | (0.08)           |
| Adjusted net income per common share - diluted | \$ 0.80            | \$ 0.70          | \$ 1.82           | \$ 1.67          |

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 impact of restructuring charges, acquisition-related charges and a net gain on sale of certain assets. The acquisition-related charges are primarily related to the step-up of inventory to fair value. This non-GAAP measure is provided to enhance investors' overall understanding of our current financial performance and prospects for the future. Specifically, we believe the non-GAAP measure provides useful information to both management and investors by excluding certain expenses, gains and losses on purchases or sales of assets and non-cash charges, which may not be indicative of our core operating results and business outlook. In addition, because we have historically reported certain non-GAAP results to investors, we believe the inclusion of this non-GAAP measure provides consistency in our presentation of financial information. See Note 14 in Notes to the Condensed Consolidated Financial Statements for further information on restructuring.

**Critical Accounting Policies:** In the third quarter of 2011, there were no material changes in our critical accounting policies.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTSOperations:

| <u>Net Sales</u>       | Three Months Ended |                  |             | Nine Months Ended |                  |             |
|------------------------|--------------------|------------------|-------------|-------------------|------------------|-------------|
|                        | July 29,<br>2011   | July 30,<br>2010 | %<br>Change | July 29,<br>2011  | July 30,<br>2010 | %<br>Change |
| Coatings               | \$ 560,759         | \$ 484,247       | 15.8%       | \$ 1,526,284      | \$ 1,317,659     | 15.8%       |
| Paints                 | 441,553            | 323,206          | 36.6%       | 1,195,884         | 860,615          | 39.0%       |
| All Other              | 68,170             | 66,462           | 2.6%        | 183,447           | 171,574          | 6.9%        |
| Consolidated Net Sales | \$ 1,070,482       | \$ 873,915       | 22.5%       | \$ 2,905,615      | \$ 2,349,848     | 23.7%       |

**Consolidated Net Sales** Adjusting for the positive impact of 11.9% from acquisitions and 3.9% from foreign currency, sales for the third quarter of 2011 increased 6.7%. Adjusting for the positive impact of 12.9% from acquisitions and 2.2% from foreign currency, year-to-date sales increased 8.6%. In both periods of 2011, weak demand was more than offset by selling price increases and new business in our Coatings segment.

**Coatings Segment Net Sales** Adjusting for the positive impact of 5.1% from foreign currency and 2.0% from acquisitions, sales for the third quarter of 2011 increased 8.7%. Adjusting for the positive impact of 3.0% from foreign currency and 1.2% from acquisitions, year-to-date sales increased 11.6%. In the third quarter of 2011, selling price increases across the entire segment and new business, particularly in our industrial product lines, more than offset weak market conditions. Year-to-date net sales increased due to selling price increases and new business in all product lines.

**Paints Segment Net Sales** Adjusting for the positive impact of 29.1% from acquisitions and 2.4% from foreign currency, sales for the third quarter of 2011 increased 5.1%. Adjusting for the positive impact of 33.4% from acquisitions and 1.1% from foreign currency, year-to-date sales increased 4.5%. The increase in sales for both 2011 periods was due to selling price increases across all product lines and volume growth in the Asia region, which more than offset the loss of business at a U.S. retail customer and soft demand in U.S. consumer paint markets.

**All Other Net Sales** The All Other category includes resins, colorants, gelcoats and furniture protection plan product lines. Adjusting for the positive impact of 2.4% from foreign currency, sales for the third quarter of 2011 increased 0.2%. Adjusting for the positive impact of 0.9% from foreign currency, year-to-date sales increased 6.0%. Higher sales in both 2011 periods were due to selling price increases, which offset weak demand.

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.

Gross Profit

|                           | Three Months Ended |                  | Nine Months Ended |                  |
|---------------------------|--------------------|------------------|-------------------|------------------|
|                           | July 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Consolidated Gross Profit | \$ 324,337         | \$ 290,804       | \$ 898,760        | \$ 781,148       |
| As a percent of Net Sales | 30.3%              | 33.3%            | 30.9%             | 33.2%            |

**Gross Profit** Third quarter gross profit as a percentage of net sales declined due to higher raw material costs and restructuring charges, partially offset by increased selling prices. Year-to-date gross profit as a percentage of net sales declined due to higher raw material costs, restructuring charges and acquisition-related charges, partially offset by increased selling prices. Restructuring charges of \$12,224 or 1.1% of net sales and \$14,149 or 0.5% of net sales were included in the third quarter and year-to-date periods of 2011, respectively. Restructuring charges of \$6,368 or 0.7% of net sales and \$10,630 or 0.5% of net sales were included in the third quarter and year-to-date periods of 2010, respectively. There were no acquisition-related charges included in gross profit in the third quarter of 2011. Acquisition-related charges of \$11,416 or 0.4% of net sales were included in the year-to-date period of 2011.

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**Operating Expenses** \*

|                                 | Three Months Ended |                  | Nine Months Ended |                  |
|---------------------------------|--------------------|------------------|-------------------|------------------|
|                                 | July 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Consolidated Operating Expenses | \$ 213,645         | \$ 170,679       | \$ 625,164        | \$ 496,831       |
| As a percent of Net Sales       | 20.0%              | 19.5%            | 21.5%             | 21.1%            |

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

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

**Consolidated Operating Expenses (dollars)** Third quarter consolidated operating expenses increased \$42,966 or 25.2% in 2011. Year-to-date consolidated operating expenses increased \$128,333 or 25.8% in 2011. The increase in both 2011 periods was driven primarily by the addition of Watty1 operating expenses in 2011 and a net gain on sale of certain assets of \$12,314 recognized in the third quarter of 2010. Restructuring charges of \$1,960 or 0.2% of net sales and \$2,893 or 0.1% of net sales were included in operating expenses in the third quarter and year-to-date periods of 2011, respectively. Restructuring charges included a credit of \$563 in the three and nine-month periods of 2010. There were no acquisition-related charges included in operating expenses in the third quarter of 2011. Acquisition-related charges of \$1,859 or 0.1% of year-to-date net sales were included in operating expenses in the year-to-date period of 2011.

**Consolidated Operating Expenses (percent of net sales)** Operating expenses as a percent of consolidated net sales increased 0.5 and 0.4 percentage points for the third quarter and year-to-date periods, respectively.

| <b>EBIT</b> *             | Three Months Ended |                  | Nine Months Ended |                  |
|---------------------------|--------------------|------------------|-------------------|------------------|
|                           | July 29,<br>2011   | July 30,<br>2010 | July 29,<br>2011  | July 30,<br>2010 |
| Coatings                  | \$ 67,806          | \$ 80,496        | \$ 178,544        | \$ 185,868       |
| As a percent of Net Sales | 12.1%              | 16.6%            | 11.7%             | 14.1%            |
| Paints                    | \$ 42,079          | \$ 38,577        | \$ 100,556        | \$ 118,570       |
| As a percent of Net Sales | 9.5%               | 11.9%            | 8.4%              | 13.8%            |
| All Other                 | \$ 255             | \$ 1,950         | \$ (6,603)        | \$ (17,764)      |
| As a percent of Net Sales | 0.4%               | 2.9%             | (3.6)%            | (10.4)%          |
| Consolidated EBIT         | \$ 110,140         | \$ 121,023       | \$ 272,497        | \$ 286,674       |
| As a percent of Net Sales | 10.3%              | 13.8%            | 9.4%              | 12.2%            |

\* We evaluate the performance of operating segments and allocate resources based on profit or loss from operations before interest expense and taxes (EBIT).

**Consolidated EBIT** EBIT for the third quarter and year-to-date periods of 2011 decreased \$10,883 or 9.0% and \$14,177 or 4.9%, respectively. Restructuring charges of \$14,184 or 1.3% of net sales and \$17,042 or 0.6% of net sales were included in the third quarter and year-to-date periods of 2011, respectively. The restructuring charges for the third quarter and year-to-date periods of 2010 were \$5,805 or 0.7% of net sales and \$10,067 or 0.4% of net sales, respectively. There were no acquisition-related charges included in EBIT in the third quarter of 2011. Acquisition-related charges of \$13,275 or 0.5% of net sales were included in the year-to-date period of 2011. EBIT included a gain on sale of certain assets of \$12,314 or 1.4% of net sales and 0.5% of net sales in the third quarter and year-to-date periods of 2010, respectively. Foreign currency exchange fluctuation had an immaterial effect on EBIT, as well as EBIT of the segments discussed below.

**Coatings Segment EBIT** EBIT as a percent of net sales for both periods decreased primarily due to higher raw material costs, restructuring charges and a net gain on sale of certain assets of \$12,314 recognized in the third quarter of 2010, partially offset by selling price increases. EBIT included restructuring charges of \$8,246 or 1.5% of net sales and \$10,704 or 0.7% of net sales in the third quarter and year-to-date periods of 2011, respectively. The restructuring charges for the third quarter and year-to-date periods of 2010 were \$5,801 or 1.2% of net sales and \$8,434 or 0.6% of net sales, respectively. EBIT included acquisition-related charges of \$1,859 or 0.1% of net sales in the year-to-date period of 2011, respectively.

**Paints Segment EBIT** EBIT as a percent of net sales for the third quarter period declined primarily due to higher raw material costs, unfavorable product mix and restructuring charges, partially offset by selling price increases. Year-to-date EBIT as a percentage of net sales declined primarily due to higher raw material costs, unfavorable product mix, acquisition-related charges and restructuring charges, partially offset by selling price increases. EBIT included restructuring charges of \$5,594 or 1.3% of net sales and \$5,994 or 0.5% of net sales in the third quarter and year-to-date periods of 2011, respectively. The restructuring charges for the third quarter of 2010 were immaterial, and the year-to-date period included charges of \$1,408 or 0.2% of net sales. EBIT included acquisition-related charges of



\$11,416 or 1.0% of net sales in the year-to-date period of 2011.

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### ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

**All Other EBIT** All Other EBIT includes corporate expenses. Third quarter EBIT as a percent of net sales declined primarily due to higher raw material costs and foreign currency transaction losses, partially offset by selling price increases and lower incentive compensation expense. Year-to-date EBIT as a percentage of net sales improved primarily due to selling price increases and lower incentive compensation. EBIT included restructuring charges of \$344 or 0.5% and 0.2% of net sales in the third quarter and year-to-date periods of 2011, respectively. EBIT included restructuring charges of \$225 or 0.1% of net sales in the 2010 year-to-date period.

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.

| <u>Interest Expense</u>       | Three Months |           | Nine Months |           |
|-------------------------------|--------------|-----------|-------------|-----------|
|                               | Ended        |           | Ended       |           |
|                               | July 29,     | July 30,  | July 29,    | July 30,  |
|                               | 2011         | 2010      | 2011        | 2010      |
| Consolidated Interest Expense | \$ 15,801    | \$ 14,322 | \$ 46,846   | \$ 43,433 |

**Interest Expense** The third quarter and year-to-date increase is primarily due to higher average debt levels as a result of acquisitions.

| <u>Effective Tax Rate</u> | Three Months |          | Nine Months |          |
|---------------------------|--------------|----------|-------------|----------|
|                           | Ended        |          | Ended       |          |
|                           | July 29,     | July 30, | July 29,    | July 30, |
|                           | 2011         | 2010     | 2011        | 2010     |
| Effective Tax Rate        | 28.6%        | 29.6%    | 30.4%       | 29.8%    |

**Effective Tax Rate** The higher year-to-date 2011 effective tax rate is due to the settlement of certain income tax audits in the 2010 period, partially offset by a benefit in 2011 from the retroactive extension of the research and development tax credit. We expect the effective tax rate for the full year to be 31% to 32%.

| <u>Net Income</u>       | Three Months Ended |           |         | Nine Months Ended |            |        |
|-------------------------|--------------------|-----------|---------|-------------------|------------|--------|
|                         | July 29,           | July 30,  | %       | July 29,          | July 30,   | %      |
|                         | 2011               | 2010      | Change  | 2011              | 2010       | Change |
| Consolidated Net Income | \$ 67,387          | \$ 75,143 | (10.3)% | \$ 157,122        | \$ 170,753 | (8.0)% |

**Financial Condition:** Net cash provided by operations was \$105,558 for the first nine months of 2011, compared to net cash provided by operations of \$176,869 in the first nine months of 2010. The cash provided by operations in the 2011 period was primarily generated by net income, partially offset by an increase in accounts and notes receivable, an increase in inventories and other assets and a decrease in trade accounts payable and other accrued liabilities. The \$60,619 increase in accounts and notes receivable was due to higher sales levels and timing of customer payments. The \$48,041 increase in inventories and other assets was primarily due to higher raw material costs and pre-buying of certain raw materials to mitigate supply disruptions, along with normal seasonality. The \$17,802 decrease in trade accounts payable and other accrued liabilities was primarily due to the timing of disbursements.

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During the 2011 period, we used \$196,188 in net proceeds from bank borrowings and cash provided by operations to fund \$218,643 in share repurchases, \$42,378 in capital expenditures, working capital needs, acquisitions and purchase of equity award shares. We used cash on hand and \$31,567 in proceeds from the sale of treasury stock to fund \$51,360 in dividend payments.

Capital expenditures for property, plant and equipment were \$42,378 in 2011, compared with \$35,248 in 2010. We anticipate capital spending in 2011 to be approximately \$75,000.

See Note 9 in Notes to the Condensed Consolidated Financial Statements for further discussion on our restricted cash primarily associated with cash collateralization of our liability insurance programs.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

The ratio of total debt-to-capital was 42.0% at July 29, 2011, compared to 36.8% at October 29, 2010 and 36.2% at July 30, 2010. Our short-term debt was \$476,589 at July 29, 2011, compared to \$8,088 and \$7,464 at October 29, 2010 and July 30, 2010, respectively. The increase was primarily attributable to commercial paper borrowings and the reclassification of long-term debt to short-term debt due to scheduled maturities. We ended our 2011 third quarter with \$475,599 of liquidity that includes \$323,090 of available committed credit facilities and \$152,509 of cash and cash equivalents. 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 have credit facilities with covenants that require us to maintain certain financial ratios. We were in compliance with these covenants as of July 29, 2011. Our debt covenants do not limit, nor are they reasonably likely to limit, our ability to obtain additional debt or equity financing.

Our cash and cash equivalent balances consist of high quality short-term money market instruments and cash held by our international subsidiaries that are used to fund day-to-day operating needs. Those 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.

Forward Looking Statements: Certain statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements.

Forward-looking statements are based on management's current expectations, estimates, assumptions and beliefs about future events, conditions and financial performance. Forward-looking statements are 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. We may identify forward-looking statements with words and phrases such as expects, projects, estimates, anticipates, believes, could, may, will, plans to, intend, should and similar expressions.

These risks, uncertainties and other factors include, but are not limited to, deterioration in general economic conditions, both domestic and international, that may adversely affect our business; fluctuations in availability and prices of raw materials, including raw material shortages and other supply chain disruptions, and the inability to pass along or delays in passing along raw material cost increases to our customers; dependence of internal sales and earnings growth on business cycles affecting our customers and growth in the domestic and international coatings industry; market share loss to, and pricing or margin pressure from, larger competitors with greater financial resources; significant indebtedness that restricts the use of cash flow from operations for acquisitions and other investments; dependence on acquisitions for growth, and risks related to future acquisitions, including adverse changes in the results of acquired businesses, the assumption of unforeseen liabilities and disruptions resulting from the integration of acquisitions; risks and uncertainties associated with operations and achievement of profitable growth in developing markets, including Asia and Central and South America; loss of business with key customers; damage to our reputation and business resulting from product claims or recalls, litigation, customer perception and other matters; our ability to respond to technology changes and to protect our technology; changes in governmental regulation, including more stringent environmental, health and safety regulations; our reliance on the efforts of vendors, government agencies, utilities and other third parties to achieve adequate compliance and avoid disruption of our business; unusual weather conditions adversely affecting sales; 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; and civil unrest and the outbreak of war and other significant national and international events.

We undertake no obligation to subsequently revise any forward-looking statement to reflect new information, events or circumstances after the date of such statement.

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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. As most of our underlying costs are denominated in the same currency as our sales, the effect has not been material. 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 is not expected to have a material effect on our results of operations or financial position.

We are also subject to interest rate risk. At July 29, 2011, approximately 31.3% 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

Our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) 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 29, 2011. 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 29, 2011 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 29, 2010.

## ITEM 1A: RISK FACTORS

There were no material changes to the risk factors disclosed in our Form 10-K for the year ended October 29, 2010.

## ITEM 2: UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Not applicable
- (b) Not applicable
- (c) We made the following repurchases of equity securities during the quarter ended July 29, 2011:

| Period                          | Total Number of Shares Purchased <sup>1</sup> | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>1</sup> | Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs <sup>1</sup> |
|---------------------------------|---|------------------------------|---|---|
| 4/30/11 5/27/11                 |   |                              |   |   |
| Repurchase program              |   | \$                           |   | 9,000,000   |
| Other transactions <sup>2</sup> |   |                              |   |   |
| 5/28/11 6/24/11                 |   |                              |   |   |
| Repurchase program              |   |                              |   | 9,000,000   |

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|                                 |     |       |           |
|---------------------------------|-----|-------|-----------|
| Other transactions <sup>2</sup> |     |       |           |
| 6/25/11 7/29/11                 |     |       |           |
| Repurchase program              |     |       | 9,000,000 |
| Other transactions <sup>2</sup> | 155 | 36.29 |           |

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<sup>1</sup> On October 13, 2010 we received board authorization to repurchase 15,000,000 shares, with no predetermined end date. As of July 29, 2011, we have repurchased 6,000,000 shares under this authorization.

<sup>2</sup> Our other transactions include our acquisition of common stock in satisfaction of tax-payment obligations upon vesting of restricted stock and our receipt of surrendered shares in connection with the exercise of stock options.

ITEM 6: EXHIBITS

Exhibits

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

**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 7, 2011

By /s/Rolf Engh  
Rolf Engh  
Secretary

Date: September 7, 2011

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