VALSPAR CORP
Form 10-Q
June 06, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended April 27, 2007

or

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

For the transition period from _________ to ________

Commission File Number: 1-3011

THE VALSPAR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-2443580**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1101 Third Street South
Minneapolis, MN 55415
(Address of principal executive offices, including zip code)

612/332-7371
(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. x Yes o No

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

Large accelerated filer x 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 Exchange Act). o Yes x No

As of June 1, 2007, The Valspar Corporation had 100,274,669 shares of common stock outstanding, excluding 18,167,955 shares held in treasury. The Company had no other classes of stock outstanding.

THE VALSPAR CORPORATION

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for the Quarter Ended April 27, 2007

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (DOLLARS IN THOUSANDS)

	April 27, 2007 (Unaudited)	April 28, 2006 (Unaudited)	October 27, 2006 (Note)
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	$61,424	$58,359	$88,238
Accounts receivable less allowance (4/27/07 $14,184; 4/28/06 $13,224; 10/27/06 $13,145)	549,434	516,032	475,736
Inventories:			
Manufactured products	174,589	159,472	172,561
Raw materials, supplies and work-in-process	115,330	92,160	109,256
	289,919	251,632	281,817
Deferred income taxes	31,195	39,357	32,422
Prepaid expenses and other	97,932	71,009	90,104
TOTAL CURRENT ASSETS	1,029,904	936,389	968,317

GOODWILL	1,423,307	1,064,856	1,336,098
INTANGIBLES, NET	360,450	313,315	361,957
OTHER ASSETS, NET	67,679	58,124	63,470
LONG-TERM DEFERRED INCOME TAXES	2,121	4,982	2,088
PROPERTY, PLANT AND EQUIPMENT	942,590	867,648	877,391
Less accumulated depreciation	(462,104)	(450,133)	(417,786)
	480,486	417,515	459,605
	$3,363,947	$2,795,181	$3,191,535

NOTE: The Balance Sheet at October 27, 2006 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)

LIABILITIES AND STOCKHOLDERS EQUITY	**April 27, 2007 (Unaudited)**	**April 28, 2006 (Unaudited)**	**October 27, 2006 (Note)**
CURRENT LIABILITIES:			
Notes payable	$35,542	$12,728	$139,136
Current portion of long-term debt	450,027	26	350,027
Trade accounts payable	342,024	302,139	368,159
Income taxes	36,077	50,429	38,455
Accrued liabilities	239,633	253,836	301,100
TOTAL CURRENT LIABILITIES	1,103,303	619,158	1,196,877
LONG-TERM DEBT	620,862	698,148	350,267
DEFERRED INCOME TAXES	198,217	185,705	199,816
DEFERRED LIABILITIES	163,328	152,773	185,789
MANDATORILY REDEEMABLE STOCK	28,857		18,723

STOCKHOLDERS EQUITY:			
Common Stock (Par Value $.50; Authorized 250,000,000 shares; Shares issued, including shares in treasury 118,442,624)	59,220	60,220	60,220
Additional paid-in capital	297,775	307,769	326,011
Retained earnings	1,035,661	928,228	1,007,225
Other	42,687	10,240	24,084
	1,435,343	1,306,457	1,417,540
Less cost of Common Stock in treasury (4/27/07 18,324,318 shares; 4/26/06 18,477,191 shares; 10/27/06 18,538,360 shares)	185,963	167,060	177,477
	1,249,380	1,139,397	1,240,063
	$3,363,947	$2,795,181	$3,191,535

NOTE: The Balance Sheet at October 27, 2006 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		SIX MONTHS ENDED	
	April 27, 2007	**April 28, 2006**	**April 27, 2007**	**April 28, 2006**
Net sales	$808,471	$766,816	$1,502,994	$1,396,581
Cost of goods sold	561,590	534,708	1,057,029	983,997
Gross profit	246,881	232,108	445,965	412,584
Research and development	24,097	20,500	45,894	39,948
Selling and administrative	144,565	127,100	270,633	241,591
Income from operations	78,219	84,508	129,438	131,045
Interest expense	16,238	10,930	30,929	21,710
Other (income)/expense net	(382)	346	2,044	1,155

Income before income taxes	62,363	73,232	96,465	108,180
Income taxes	20,847	25,297	31,351	37,704
Net income	$41,516	$47,935	$65,114	$70,476
Mandatorily redeemable stock accrual (1)	(5,067)		(10,134)	
Net Income Available to Common Shareholders	$36,449	$47,935	$54,980	$70,476
Net income per common share basic	$0.36	$0.47	$0.54	$0.70
Net income per common share diluted	$0.35	$0.46	$0.53	$0.69
Average number of common shares outstanding				
basic	101,672,432	101,344,587	101,717,101	100,924,295
diluted	103,371,264	103,116,052	103,453,373	102,487,907
Dividends paid per common share	$0.13	$0.11	$0.26	$0.22

See Notes to Condensed Consolidated Financial Statements

(1) Mandatorily Redeemable Stock accrual reduced basic and diluted earnings per share by five cents in the second quarter of 2007 and ten cents year to date in 2007 as further described in Note 3.

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THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(DOLLARS IN THOUSANDS)

	SIX MONTHS ENDED	
	April 27, 2007	**April 28, 2006**
OPERATING ACTIVITIES:		
Net income	$ 65,114	$ 70,476
Adjustments to reconcile net income to net cash (used in)/provided by operating activities:		
Depreciation	31,783	33,793
Amortization	2,755	2,396
Stock-based compensation	4,534	4,443
(Gain)/loss on asset divestiture	92	(255)
Changes in certain assets and liabilities, net of effects of acquired businesses:		
(Increase)/decrease in accounts and notes receivable	(50,874)	(52,582)
(Increase)/decrease in inventories and other current assets	(625)	(12,930)
Increase/(decrease) in trade accounts payable and accrued liabilities	(110,114)	21,444

Increase/(decrease) in income taxes payable	(3,282)	(7,741)
Increase/(decrease) in other deferred liabilities	5,818	(9,224)
Other	11,829	339
Net Cash (Used In)/Provided By Operating Activities	(42,970)	50,159
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(32,185)	(26,041)
Acquired Businesses, net of cash	(114,375)	
Cash proceeds on disposal of assets		2,587
Net Cash Used In Investing Activities	(146,560)	(23,454)
FINANCING ACTIVITIES:		
Net proceeds from (payments on) borrowings	258,770	(24,620)
Proceeds from sale of treasury stock	15,971	23,469
Payments on Deferred Liability Excess Cash Huarun	(15,539)	
Excess tax benefit from stock-based compensation	1,100	2,257
Treasury stock purchases	(15,821)	
Retirement of common stock	(55,220)	
Dividends paid	(26,545)	(22,297)
Net Cash (Used In)/Provided By Financing Activities	162,716	(21,191)
Increase/(Decrease) in Cash and Cash Equivalents	(26,814)	5,514
Cash and Cash Equivalents at Beginning of Period	88,238	52,845
Cash and Cash Equivalents at End of Period	$ 61,424	$ 58,359

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

APRIL 27, 2007

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of The Valspar Corporation (the Company) 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 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 April 27, 2007 are not necessarily indicative of the results that may be expected for the year ending October 26, 2007.

The Condensed Consolidated Balance Sheet at October 27, 2006 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information refer to the consolidated financial statements and footnotes thereto included in The Valspar Corporation s annual report on Form 10-K for the year ended October 27, 2006.

NOTE 2: ACCOUNTS PAYABLE

Trade accounts payable includes $39.0 million at April 27, 2007, $36.7 million at October 27, 2006 and $36.3 million at April 28, 2006 of issued checks that had not cleared the Company s bank accounts.

NOTE 3: ACQUISITIONS AND DIVESTITURES

In December 2006, the Company acquired the powder coatings business of H.B. Fuller Company. H.B. Fuller s powder coatings business, which had net sales of approximately $75 million in 2005, serves customers in 26 countries from manufacturing facilities in the United States and the United Kingdom. This transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company s financial statements from the date of acquisition. The purchase price allocation is preliminary. The pro forma results of operations for this acquisition have not been presented, as the impact on reported results is not material.

In July 2006, the Company acquired approximately 80% of the share capital of Huarun Paints Holdings Company Limited (Huarun Paints), one of China s largest independent coatings companies, from Champion Regal Limited, a Hong Kong based investment company, and certain other shareholders. Huarun Paints is one of China s leading domestic suppliers of wood and furniture coatings, and a rapidly growing supplier of architectural coatings. Huarun Paints sells its products primarily through an extensive network of distributors and retail paint stores throughout China. Huarun Paints revenue for fiscal year 2005 was approximately $180 million. The cash purchase price was approximately $290.4 million. Certain of the shares not purchased by the Company at the closing are subject to various put and call rights. The combination of put and call rights makes certain of the minority shares of Huarun Paints mandatorily redeemable, and therefore subject to classification outside of shareholders equity in Mandatorily Redeemable Stock. The balance in Mandatorily Redeemable Stock was $28.9 million at April 27, 2007 and $18.7 million at October 27, 2006.

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The Mandatorily Redeemable Stock will be accrued to redemption value at each balance sheet date. The accrual, if material, as well as any dividends, will be shown as an adjustment below net income to arrive at the net income available to common shareholders. The Company accrued $5.1 million and $10.1 million, respectively, for the three and six month periods ended April 27, 2007. This accrual reduced basic and diluted income available to common shareholders by five cents and ten cents, respectively, for the three and six month periods ended April 27, 2007. The net income per share available to common shareholders was $0.35 and $0.53, respectively, for the three and six month periods ended April 27, 2007. The accruals for the redemption value will be subsequently reversed to net income available to common shareholders and acquisition accounting applied upon exercise of the put or call option and acquisition of the underlying shares.

Certain other shares were awarded as part of a Long Term Incentive Plan (LTIP) by Huarun prior to the acquisition closing. The shares covered by the LTIP award are treated as liability awards under SFAS 123R as they are subject to a formula for repurchase at various purchase prices based upon Huarun s EBIT growth rate between January 1, 2006 and July 31, 2010 or July 31, 2011. The LTIP shares will not be considered issued and outstanding until they vest.

The terms of the acquisition also require the Company to pay to Champion Regal and certain other shareholders an amount equal to the excess cash, as defined in the purchase agreement, held by Huarun as of the closing date. The liability shall be paid as soon as practical before the third anniversary of the closing date, including interest at 6%. The excess cash of $34.4 million was recorded as a deferred liability under purchase accounting. In 2007, the Company paid $10.9 million plus interest in the first quarter and $4.6 million plus interest in the second quarter to reduce this deferred liability. The net assets and operating results have been included in the Company s financial statements from the date of acquisition.

The purchase price allocation for the Huarun Paints acquisition is preliminary pending completion of an appraisal, and goodwill has been allocated to the Paints (60%) and Coatings (40%) segments. The pro forma results of operations for this acquisition have not been presented, as the impact on reported results is not material.

NOTE 4: COMPREHENSIVE INCOME

For the three and six months ended April 27, 2007 and April 28, 2006, Comprehensive Income, a component of Stockholders Equity, was as follows:

(Dollars in thousands)	**Three Months Ended**		**Six Months Ended**	
	April 27, 2007	**April 28, 2006**	**April 27, 2007**	**April 28, 2006**
Net Income	$41,516	$47,935	$65,114	$70,476
Other Comprehensive Income, net of tax:				
Foreign currency translation gain (loss)	5,088	2,833	18,194	(2,436)
Deferred gain (loss) on hedging activities	(1,328)	1,997	369	954
Minimum pension liability adjustment net of tax	30	50	40	50
Total Comprehensive Income	$45,306	$52,815	$83,717	$69,044

THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

APRIL 27, 2007 CONTINUED

NOTE 5: GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill as of April 27, 2007 increased from the end of fiscal 2006 by $87.2 million to $1,423.3 million. The increase is due to the acquisition of the powder coatings business of H.B. Fuller and foreign currency translation.

Total intangible asset amortization expense for the six months ended April 27, 2007 was $2.8 million, compared to $2.4 million for the same period last year. Estimated amortization expense for each of the five succeeding fiscal years based on the intangible assets as of April 27, 2007 is expected to be approximately $5.6 million annually.

NOTE 6: SEGMENT INFORMATION

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

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

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

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

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

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

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THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

APRIL 27, 2007 CONTINUED

(Dollars in thousands)	**Three Months Ended**		**Six Months Ended**	
	April 27, 2007	**April 28, 2006**	**April 27, 2007**	**April 28, 2006**
Net Sales:				
Paints	$ 273,788	$ 260,900	$ 493,464	$ 448,558
Coatings	453,334	421,953	865,624	802,997
All Other	107,997	114,201	191,284	202,118
Less Intersegment sales	(26,648)	(30,238)	(47,378)	(57,092)
Total Net Sales	$ 808,471	$ 766,816	$ 1,502,994	$ 1,396,581
EBIT				
Paints	$ 30,342	$ 31,480	$ 49,985	$ 38,728
Coatings	45,583	51,637	80,165	92,803
All Other	2,676	1,045	(2,756)	(1,641)
Total EBIT	$ 78,601	$ 84,162	$ 127,394	$ 129,890
Interest	$ 16,238	$ 10,930	$ 30,929	$ 21,710
Income before Income Taxes	$ 62,363	$ 73,232	$ 96,465	$ 108,180

NOTE 7: FINANCIAL INSTRUMENTS

The Company s involvement with derivative financial instruments is limited principally to managing well-defined interest rate and foreign currency exchange risks. Forward foreign currency exchange contracts are used primarily to hedge the impact of currency fluctuations on certain inter-company and third party transactions.

The Company also holds an interest rate swap and treasury locks to manage the interest rate risk associated with its current and expected borrowings. The interest rate swap and treasury lock contracts are reflected at fair value in the condensed consolidated balance sheets. Amounts to be paid or received under the contracts are accrued as interest rates change and are recognized over the life of the contracts as an adjustment to interest expense. Credit risk is only applicable to gains on derivatives.

At April 27, 2007, the Company had a $100 million notional amount interest rate swap contract designated as a fair value hedge to pay floating rates of interest based on LIBOR, maturing during fiscal 2008. As the critical terms of the interest rate swap and hedged debt match, there is an assumption of no ineffectiveness for this hedge.

During the quarter, the Company entered into an additional $150 million notional amount of treasury locks for a total of $300 million notional amount of treasury locks. The treasury locks were in place to hedge, or lock in interest rates on the anticipated long-term debt the Company was planning to issue during fiscal year 2007. The $300 million of treasury locks were terminated on April 12, 2007, as a result of the bond issuance during the quarter, yielding a pre-tax gain of $4.6 million. This gain is reflected, net of tax, in accumulated other comprehensive income in our consolidated balance sheet as of April 27, 2007 and will be reclassified ratably to our statements of income as a decrease to interest expense over the term of the related debt.

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On April 17, 2007, the Company issued $200 million of unsecured, senior notes that mature on May 1, 2012 with a coupon rate of 5.625% and $150 million of unsecured, senior notes that mature on May 1, 2017 with a coupon rate of 6.05%. These public offerings were made pursuant to a registration statement filed with the U.S. Securities and Exchange Commission. The net proceeds of $347.2 million were used to pay off the $350 million bond that matured on May 1, 2007.

NOTE 8: GUARANTEES AND CONTRACTUAL OBLIGATIONS

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

The Company sells extended furniture protection plans and offers warranties for certain of its 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, the Company estimates the costs that may be incurred under these warranties based on historical claims data and records a liability in the amount of such costs at the time revenue is recognized.

The Company periodically assesses the adequacy of these recorded amounts and adjusts as necessary. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are estimable. Extended furniture protection plans entered into by the Company 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 the Company revises its estimates. The Company s practice is to revise estimates as soon as such changes in estimates become known.

Changes in the recorded amounts during the period are as follows (dollars in thousands):

	Six Months Ended	
	April 27, 2007	**April 28, 2006**
Beginning balance, previous October	$87,287	$95,687
Change in accrual from previous fiscal year	(590)	(911)
Additional net deferred revenue/accrual made during the period	9,559	9,451
Payments made during the period	(8,685)	(9,609)
Ending balance	$87,571	$94,618

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NOTE 9: STOCK BASED COMPENSATION

The Company s stock-based employee compensation plans are comprised primarily of fixed stock options, but also include restricted stock. Under the Company s Stock Option Plans, options for the purchase of 26,000,000 shares of common stock may be granted to officers, employees and non-employee directors. Options generally have a contractual term of 10 years, vest ratably over three years or five years for employees and vest immediately upon grant for non-employee directors. Restricted shares vest after three or five years. Employees who retire from the company after age 60 and officers who retire after age 55 generally become fully vested in their stock options.

Effective October 29, 2005, the Company adopted SFAS 123R, which requires the use of the fair value method for accounting for all stock-based compensation. The statement was adopted using the modified prospective method of application, and the Company has elected to recognize the fair value of the awards ratably over the vesting period. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized for the remaining vesting periods of awards that had been included in pro-forma expense in prior periods.

Compensation expense for the first six months ended April 27, 2007 was $4.5 million ($2.9 million after tax) compared to $4.4 million ($2.8 million after tax) for same period last year.

NOTE 10: PENSION AND OTHER POSTRETIREMENT BENEFITS

The company sponsors a number of defined benefit pension plans for certain hourly, salaried and foreign employees. The benefits for these plans are generally based on stated amounts for each year of service. The Company funds the plans in amounts consistent with the limits of allowable tax deductions.

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

(Dollars in thousands)	**Three Months Ended**		**Six Months Ended**	
	April 27, 2007	**April 28 2006**	**April 27, 2007**	**April 28, 2006**
Service cost	$ 861	$ 1,065	$ 1,713	$ 2,126
Interest cost	3,136	2,908	6,260	5,813
Expected return on plan assets	(3,735)	(3,461)	(7,459)	(6,920)
Amortization of transition asset	(31)	(31)	(62)	(61)
Amortization of prior service cost	167	180	335	359
Recognized actuarial (gain)/loss	875	1,165	1,746	2,328
Net periodic benefit cost	$ 1,273	$ 1,826	$ 2,533	$ 3,645

NOTE 11: RECLASSIFICATION

Certain amounts in the 2006 financial statements have been reclassified to conform with the 2007 presentation.

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NOTE 12: RECENTLY ISSUED ACCOUNTING STANDARDS

FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) in June 2006. This interpretation clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company effective October 27, 2007 or fiscal year 2008. The Company is currently evaluating the impact of this interpretation on its financial statements.

FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157) in September 2006. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. However, for some entities, the application of this statement will change current practice. The Company is currently evaluating the impact of SFAS 157 on its financial statements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. For the Company, this statement is effective for the fiscal year beginning 2009.

FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158) in September 2006. This statement requires an employer to: (1) recognize in its statement of financial position an asset for a plan s over-funded status or a liability for the plan s under-funded status, (2) measure the plans assets and obligations that determine its funded status as of the end of the employer s fiscal year (with limited exceptions) and (3) recognize as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year but are not recognized as components of net periodic benefit cost pursuant to other relevant accounting standards. SFAS 158 also requires an employer to disclose in the notes to the financial statements additional information on how delayed recognition of certain changes in the funded status of a defined benefit postretirement plan affects net periodic benefit cost for the next fiscal year. Adoption of SFAS 158 is required for public companies by the end of the fiscal year ending after December 15, 2006, which would be the fiscal year ending October 26, 2007 for the Company. Measurement of the plans assets and obligations that determine its funded status as of the end of the employer s fiscal year is required to be adopted for fiscal years ending after December 15, 2008, which would be the fiscal year ending October 30, 2009 for the Company. The Company is currently evaluating the impact of this statement on its financial statements.

In June 2006, FASB ratified Emerging Issues Task Force (EITF) No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF 06-3). The scope of EITF 06-3 includes any tax assessed by a governmental authority that is imposed concurrent with a revenue-producing transaction between a seller and a customer. The Company shows these taxes net. That is, they are excluded from both revenue and cost of goods sold. This guidance is effective for the first interim reporting period beginning after December 15, 2006. The Company adopted this policy for the second quarter of fiscal year 2007.

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

Overview: In the second quarter of fiscal 2007, sales increased compared to the prior year as a result of the acquisition of Huarun Paints Holdings Company Limited (Huarun Paints) and H.B. Fuller s powder coatings business, offset partially by continued weak demand in our architectural product line and wood coatings product line. Gross margins improved slightly compared to the prior year while operating expenses increased as a result of the Company s substantial investment in building the Valspar brand. The increase in debt from the end of fiscal year 2006 was driven by the acquisition of H.B. Fuller s powder coatings business, share repurchases and working capital needs.

Earnings Per Share: The Company accrued $5.1 million in the second quarter of 2007 and $10.1 million year to date in 2007 for the Mandatorily Redeemable Stock related to the Huarun Paints acquisition (See Note 3 for further details). The accrual reduced basic and diluted income available to common shareholders by 5 cents per share in the second quarter of 2007 and 10 cents year to date in 2007. The net income per share available to common shareholders was $0.35 for the period ended April 27, 2007 and $0.53 year to date in 2007.

The table below includes a non-GAAP financial measure Adjusted net income per common share-diluted which excludes a non-cash accrual relating to mandatorily redeemable stock in connection with the Huarun Paints acquisition.

	Three Months Ended		**Six Months Ended**	
	April 27, 2007	**April 28, 2006**	**April 27, 2007**	**April 28, 2006**
Net income per common share diluted	$0.35	$0.46	$0.53	$0.69
Mandatorily redeemable stock accrual	0.05		0.10	
Adjusted net income per common share diluted	$0.40	$0.46	$0.63	$.069

Management discloses this measure because it believes this measure may assist investors in comparing the Company s results of operations in the respective periods without regard to the effect on results in the 2007 periods of the non-cash accrual relating to the Huarun acquisition.

When the Mandatorily Redeemable Stock is redeemed, the accruals for the redemption value will be reversed and acquisition accounting applied.

Critical Accounting Policies: There were no material changes in the Company s critical accounting policies during the second quarter ended April 27, 2007.

Operations: Consolidated net sales increased 5.4% for the quarter to $808.5 million from $766.8 million in the prior year. Sales growth was negative 2.4%, after excluding the positive effect of foreign currency of 1.4% and the positive effect of acquisitions of 6.4%. Consolidated net sales increased 7.6% in the six-month period to $1,503.0 million from $1,396.6 million. Consolidated net sales decreased 2.6%, excluding the positive effect of foreign currency of 1.4% and the positive effect of acquisitions of 8.8%.

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

Net sales for the Paints segment increased 4.9% to $273.8 million in the quarter compared to the prior year. Net sales increased 10.0% to $493.5 million year to date compared to the same period last year. The increase in sales for the three month and six month periods ended April 27, 2007 was primarily due to the Huarun Paints acquisition. Excluding the positive effect of acquisitions and foreign currency exchange, core sales growth in Paints was negative 2.7% and negative 3.8% in the second quarter and year to date, respectively. Sales in our architectural product line have been adversely affected by continued weakness in the U.S. residential construction and housing markets. Net sales of the Coatings segment increased 7.4% to $453.3 million in the quarter compared to the prior year. Net sales increased 7.8% to $865.6 million year to date compared to the same period last year. The increase in sales for the three and six month periods ended April 27, 2007 was primarily due to the acquisition of Huarun Paints and H.B. Fuller s powder coatings business. Excluding the positive effect of acquisitions and foreign currency exchange, core sales growth in Coatings was negative 1.7% and negative 2.1% in the second quarter and year to date, respectively. Coatings core sales decline was driven by soft sales in the wood coatings product line related to weakness in the housing and new construction markets. Due to the seasonal nature of portions of the Company s business, sales for the second quarter are not necessarily indicative of sales for subsequent quarters or for the full year.

In the second quarter of 2007, consolidated gross profit increased $14.8 million from the prior year to $246.9 million. As a percent of consolidated net sales, consolidated gross profit during the second quarter of 2007 increased to 30.5% from 30.3%. For the six-month period, consolidated gross profit increased $33.4 million to $446.0 million. As a percent of consolidated net sales, gross profit during the six-month period of 2007 increased to 29.7% from 29.5%. The increase in gross margins this year compared to the prior year was due to manufacturing improvements related to the Company s 2006 manufacturing rationalization cost program, offset by manufacturing inefficiencies associated with lower volumes and higher raw material costs.

Consolidated operating expenses (research and development, selling and administrative) increased 14.3% to $168.7 million (20.9% of consolidated net sales) in the quarter compared to $147.6 million (19.2% of consolidated net sales) in the second quarter of 2006. For the six-month period, consolidated operating expenses increased 12.4% to $316.5 million (21.1% of consolidated net sales) from $281.5 million (20.2% of consolidated net sales) in the prior year. The dollar increase in operating expenses during the second quarter was primarily driven by our investment in building the Valspar brand and the acquisition of Huarun Paints and H.B. Fuller s powder coating business, partially offset by lower incentive compensation.

Second quarter earnings before interest and taxes (EBIT) decreased $5.6 million or 6.6% from the prior year second quarter. First half EBIT decreased $2.5 million or 1.9% from the prior year. Foreign currency exchange fluctuation had an immaterial effect on EBIT.

EBIT in the Paints segment decreased to $30.3 million from $31.5 million in the prior year second quarter. Year to date EBIT in the Paints segment increased to $50.0 million from $38.7 million. As a percent of net sales for the Paints segment, EBIT decreased to 11.1% from 12.1% in the prior year second quarter and increased to 10.1% from 8.6% for the prior year to date. The decrease in the quarter was attributable to spending related to our brand building initiative, partially offset by improvements in our automotive refinish business. The increase in first half EBIT compared to the prior year was driven by improved product mix and improvements in our automotive refinish business, offset by brand building expenses.

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

EBIT in the Coatings segment decreased to $45.6 million from $51.6 million in the prior year second quarter. Year to date EBIT in the Coatings segment decreased to $80.2 million from $92.8 million. As a percent of net sales for the Coatings segment, EBIT decreased to 10.1% from 12.2% in the prior year second quarter and to 9.3% from 11.6% in the prior year to date. The decrease was primarily due to lower operating profit in our wood coatings product line.

EBIT in the Other segment increased to $2.7 million from $1.0 million in the prior year second quarter. Year to date EBIT in the Other segment decreased to negative $2.8 million from negative $1.6 million. As a percent of net sales for the Other segment, EBIT increased to 3.3% from 1.2% in the prior year second quarter and decreased to negative 1.9% from negative 1.1% in the prior year to date. The increase in the quarter was due to favorable operating profit in the Other segment product lines, as well as, favorable foreign exchange. The decrease year to date resulted primarily from last year s gains on the sale of assets related to the Company s manufacturing rationalization plan.

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

Interest expense increased to $16.2 million in the second quarter of 2007 from $10.9 million in the second quarter of 2006. Year to date interest expense increased to $30.9 million in 2007 from $21.7 million in the prior year. The increase in interest expense was driven by higher debt levels.

The effective tax rate decreased to 33.4% from 34.5% in the second quarter of 2006. The year to date tax rate decreased to 32.5% from 34.9% in the prior year reflecting continued improvement in the geographical mix of earnings combined with declining non-U.S. statutory income tax rates.

Net income in the second quarter of 2007 decreased 13.4% to $41.5 million or $0.35 per diluted share. For the six-month period, net income decreased 7.6% to $65.1 million or $0.53 per diluted share. As described under Earnings Per Share above, adjusted net income per common share was $0.40 for the period ended April 27, 2007, compared to $0.46 in the 2006 period, and $0.63 year to date in 2007, compared to $0.69 in the 2006 period.

Financial Condition: For the first six months of 2007, net cash used by operations was $43.0 million, compared with $50.2 million in net cash generated for the first six months of 2006. A decrease in accounts payable and accrued liabilities is the reason for the change from cash generated to cash used. The decrease in accounts payable and accrued liabilities for the first six months of 2007 is due to lower raw materials purchases, and the resulting decline in accounts payable, stemming from the Company s focus on inventory management in response to a weak housing market. Lower accruals for incentive compensation for the first six months of 2007 compared to the same period in 2006 contributed to the decrease in accrued liabilities.

During the first six months of 2007, $274.7 million in proceeds from bank borrowings and sale of treasury stock were used to fund seasonal working capital as well as $114.4 million in acquisitions, $55.2 million in retirement of common stock, $32.2 million in capital expenditures, $26.5 million in dividend payments, $15.8 million in treasury stock purchases and $15.5 million to reduce the deferred liability for the excess cash related to the Huarun Paints acquisition (see Note 3 for additional information).

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

Capital expenditures for property, plant and equipment were $32.2 million in the first six months of 2007, compared with $26.0 million in the first six months of 2006. The Company anticipates capital spending in 2007 to be approximately $80 million.

The ratio of total debt to capital increased to 47.0% at the end of second quarter of 2007 compared to 40.4% at the close of fiscal 2006. The total debt to capital ratio as of April 28, 2006 was 38.4%. The Company believes its cash flow from operations, existing lines of credit, access to credit facilities and access to debt and capital markets will be sufficient to meet its current and projected needs for financing.

On April 17, 2007, the Company issued $200 million of unsecured, senior notes that mature on May 1, 2012 with a coupon rate of 5.625% and $150 million of unsecured, senior notes that mature on May 1, 2017 with a coupon rate of 6.05%. These public offerings were made pursuant to a shelf registration statement filed with the U.S. Securities and Exchange Commission. As of April 27, 2007 the net proceeds were used to pay down short term debt. In May 2007, short term debt was increased to retire the $350 million in senior notes with a coupon rate of 6% that matured on May 1, 2007.

During 2006, the Company established a $350 million U.S. Commercial Paper program under which $23.8 million, $301.4 million and $131.5 million was outstanding as of April 27, 2007, January 26, 2007 and October 27, 2006, respectively.

There were no material changes in the Company s fixed cash obligations during the six months ended April 27, 2007.

Off-Balance Sheet Financing: The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Forward Looking Statements: This discussion contains certain forward-looking statements. These forward-looking statements are based on management s expectations and beliefs concerning future events. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside the control of the Company that could cause actual results to differ materially from such statements. These uncertainties and other factors include, but are not limited to, dependence of internal earnings growth on economic conditions and growth in the domestic and international coatings industry; risks related to any future acquisitions, including risks of adverse changes in the results of acquired businesses and the assumption of unforeseen liabilities; risks of disruptions in business resulting from the integration process and higher interest costs resulting from further borrowing for any such acquisitions; our reliance on the efforts of vendors, government agencies, utilities and other third parties to achieve adequate compliance and avoid disruption of our business; risks of disruptions in business resulting from the Company s relationships with customers and suppliers; unusual weather conditions adversely affecting sales; changes in raw materials pricing and availability; delays in passing along cost increases to customers; changes in governmental regulation, including more stringent environmental, health and safety regulations; the nature, cost and outcome of pending and future litigation and other legal proceedings; the outbreak of war and other significant national and international events; and other risks and uncertainties. The foregoing list is not exhaustive, and the Company disclaims any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements.

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ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The Company is also subject to interest rate risk. At April 27, 2007, approximately 55% of the Company s total debt consisted of floating rate debt. From time to time, the Company may enter into interest rate swaps to hedge a portion of either its 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 second quarter would increase the Company s interest expense for the third quarter of 2007 by approximately $0.8 million.

ITEM 4: CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) or 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this report. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective.

There have been no significant changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced above.

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 the Company s Form 10-K for the year ended October 27, 2006.

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

(a) Not applicable.

(b) Not applicable.

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

(c) We made the following repurchases of equity securities during the quarter ended April 27, 2007:

Period		Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
01/27/07	02/23/07				4,000,000
02/24/07	03/23/07	596,300	26.53	596,300	3,403,700
03/24/07	04/27/07	2,000,000	27.61 (1)	2,000,000	1,403,700

(1) In the quarter, the Company repurchased two million shares of Valspar common stock at an initial purchase price of approximately $55.2 million or $27.61 per share. The shares were repurchased as part of an accelerated share repurchase agreement with Goldman, Sachs & Co. Upon completion, the accelerated share repurchase is subject to a price adjustment. At that time, Valspar may receive, or be required to pay, a price adjustment based on an adjusted volume weighted average price.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Annual Meeting of Stockholders on February 28, 2007, the stockholders took the following actions:

(i) The stockholders elected three directors in Class III for three-year terms. The stockholders present in person or by proxy cast the following numbers of votes in connection with the election of directors, resulting in the election of all nominees:

	Votes For	Votes Withheld
Charles W. Gaillard	94,616,715	1,139,239
Mae C. Jemison	64,798,280	30,957,674
Gregory R. Palen	90,186,636	5,569,318

(ii) The stockholders ratified the appointment of Ernst & Young LLP as the Company s independent registered public accounting firm for fiscal 2007. 95,315,400 votes were cast for the resolution; 339,999 votes were cast against the resolution; shares representing 100,556 votes abstained; and there were no broker non-votes.

ITEM 6. EXHIBITS

Exhibits

4.1	Second Supplemental Indenture, dated as of April 17, 2007, to Indenture dated as of April 24, 2002, between the Company and The Bank of New York Trust Company, N.A. (as successor to Bank One Trust Company, N.A.), relating to the Company s 5.625% Notes due 2012 and 6.050% Notes due 2017 (incorporated by reference to Exhibit 4.2 to Form 8-K filed on April 18, 2007)
31.1	Section 302 Certification of the Chief Executive Officer
31.2	Section 302 Certification of the Chief Financial Officer
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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: June 6, 2007

By /s/ Rolf Engh
Rolf Engh
Secretary

Date: June 6, 2007

By /s/ Paul C. Reyelts
Paul C. Reyelts
Executive Vice President and
Chief Financial Officer