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PAXAR CORP
Form 10-Q
November 08, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2006

or

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: 1-9493

Paxar Corporation

(Exact name of registrant as specified in its charter)

New York

13-5670050

(State or other jurisdiction of incorporation or organization)

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

105 Corporate Park Drive
White Plains, New York

10604

(Address of principal executive offices)

(Zip Code)

914-697-6800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports require 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$0.10 par value: 41,267,834 shares outstanding as of November 7, 2006

PART I FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

The consolidated financial statements included herein have been prepared by Paxar Corporation (the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. While certain information disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, the Company believes that the disclosures made herein are adequate to make the information presented not misleading. It is recommended that these financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2005.

PAXAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (in millions, except per share amounts) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Sales.....	\$ 217.1	\$ 200.6	\$ 650.0	\$ 602.3
Cost of sales.....	139.4	127.1	408.5	374.3

Gross profit.....	77.7	73.5	241.5	228.0
Selling, general and administrative expenses.....	65.7	58.3	197.2	179.8
Gain on lawsuit settlement.....	39.4	-	39.4	-
Integration/restructuring and other costs..	1.8	1.9	6.3	4.4

Operating income.....	49.6	13.3	77.4	43.8
Other income (loss), net	(4.3)	0.3	(3.6)	1.0
Interest expense, net.....	1.1	2.2	3.5	7.3

Income before taxes.....	44.2	11.4	70.3	37.5
Taxes on income.....	16.7	7.3	23.0	13.7

Net income.....	\$ 27.5	\$ 4.1	\$ 47.3	\$ 23.8
	=====			
Basic earnings per share.....	\$ 0.67	\$ 0.10	\$ 1.15	\$ 0.59
	=====			
Diluted earnings per share.....	\$ 0.66	\$ 0.10	\$ 1.13	\$ 0.58
	=====			
Weighted average shares outstanding:				
Basic.....	41.1	40.7	41.0	40.3
Diluted.....	41.7	41.5	41.7	41.3

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The accompanying notes are an integral part of the financial statements.

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PAXAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (in millions, except share and per share amounts)

	September 30, 2006 ----	December 31, 2005 ----
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 43.2	48.2
Accounts receivable, net of allowances of \$12.4 and \$10.7 at September 30, 2006 and December 31, 2005, respectively.....	141.9	128.9
Inventories.....	121.5	99.2
Deferred income taxes.....	13.6	19.3
Other current assets.....	20.6	18.2
	-----	-----
Total current assets.....	340.8	313.8
Property, plant and equipment, net.....	172.5	166.1
Goodwill and other intangible, net.....	231.6	224.3
Other assets.....	18.5	23.4
	-----	-----
Total assets.....	\$ 763.4 =====	\$ 727.6 =====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Due to banks.....	\$ 0.6	\$ 3.0
Accounts payable and accrued liabilities.....	130.2	118.8
Accrued taxes on income.....	29.3	17.8
	-----	-----
Total current liabilities.....	160.1	139.6
Long-term debt.....	45.2	97.7
Deferred income taxes.....	13.9	15.9
Other liabilities.....	21.2	19.5
Commitments and contingent liabilities		
Shareholders' equity:		
Preferred stock, \$0.01 par value, 5,000,000 shares authorized and none issued.....	-	-
Common stock, \$0.10 par value, 200,000,000 shares authorized, 41,177,068 and 40,630,951 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively.....	4.1	4.1
Paid-in capital.....	41.0	26.2
Retained earnings.....	463.2	415.9
Accumulated other comprehensive income.....	14.7	8.7
	-----	-----
Total shareholders' equity.....	523.0	454.9

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	-----	-----
Total liabilities and shareholders' equity.....	\$ 763.4	\$ 727.6
	=====	=====

The accompanying notes are an integral part of the financial statements.

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PAXAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(unaudited)

	Nine Months Ended September 30,	
	2006	2005
	-----	-----
OPERATING ACTIVITIES		
Net income.....	\$ 47.3	\$ 23.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	25.5	24.2
Stock-based compensation.....	4.6	0.4
Deferred income taxes.....	3.5	(2.6)
Impairment of investment.....	5.0	-
Gain on sale of property and equipment, net.....	0.4	-
Write-off of property and equipment.....	0.7	1.8
Changes in assets and liabilities, net of businesses acquired:		
Accounts receivable.....	(11.7)	7.2
Inventories.....	(22.1)	(1.9)
Other current assets.....	(2.1)	1.0
Accounts payable and accrued liabilities.....	8.9	(2.7)
Accrued taxes on income.....	14.2	7.0
Other, net.....	2.4	(2.4)
	-----	-----
Net cash provided by operating activities.....	76.6	55.8
	-----	-----
INVESTING ACTIVITIES		
Purchases of property and equipment.....	(32.3)	(24.0)
Acquisitions, net of cash acquired.....	(3.3)	(13.4)
Proceeds from sale of property and equipment.....	0.7	0.1
Other.....	-	0.3
	-----	-----
Net cash used in investing activities.....	(34.9)	(37.0)
	-----	-----
FINANCING ACTIVITIES		
Net decrease in short-term debt.....	(2.5)	(0.1)
Repayments of long-term debt.....	(52.6)	-
Proceeds from common stock issued under employee stock option and stock purchase plans.....	7.6	14.0
	-----	-----
Net cash (used in) provided by financing activities..	(47.5)	13.9
	-----	-----
Effect of exchange rate changes on cash flow.....	0.8	(5.8)
	-----	-----

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Increase (decrease) in cash and cash equivalents.....	(5.0)	26.9
Cash and cash equivalents at beginning of year.....	48.2	92.0
	-----	-----
Cash and cash equivalents at end of period.....	\$ 43.2	\$ 118.9
	=====	=====

The accompanying notes are an integral part of the financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in millions, except headcount and per share data)

NOTE 1: GENERAL

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and the instructions for Form 10-Q. In the opinion of management, all adjustments (which consist only of normal recurring adjustments) necessary to present fairly the results of operations and financial condition for the interim periods presented have been made.

Certain reclassifications have been made to the prior periods' consolidated financial statements and related note disclosures to conform to the presentation used in the current period.

NOTE 2: STOCK-BASED COMPENSATION

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), "Share-Based Payment". This standard amends SFAS No. 123, "Accounting for Stock-Based Compensation", and concludes that services received from employees in exchange for stock-based compensation result in a cost to the employer that must be recognized in the financial statements. The cost of such awards is measured at fair value at the date of grant. The Company adopted SFAS No. 123(R) effective January 1, 2006, and is applying the modified prospective method, whereby compensation cost will be recognized for the unvested portion of awards granted prior to January 1, 2006, as well as for awards granted after adoption. Such costs are recognized in the Company's financial statements over the remaining vesting periods. Under this method, prior periods are not revised for comparative purposes. As a result of the adoption of this standard, the Company recorded a pre-tax charge of \$3.1 in the first nine months of 2006, or approximately \$.06 per share, and expects to record an estimated incremental pre-tax charge of approximately \$0.8 in the fourth quarter of 2006. The related income tax benefit recognized in the statement of income was approximately \$0.7 for the nine months ended September 30, 2006.

As of September 30, 2006, the Company had two stock option plans, a long-term incentive plan and an employee stock purchase plan, all of which are described in the Company's 2005 annual report on Form 10-K/A.

Stock Option Activity

The following is a summary of the stock option activity for the nine months ended September 30, 2006:

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	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggreg Intrinsic
	-----	-----	-----	-----
Outstanding at January 1, 2006.....	3.7	\$14.43		
Granted.....	0.3	\$20.23		
Exercised.....	(0.5)	\$13.57		

Outstanding at September 30, 2006	3.5	\$14.66	5.9	\$18
	=====	=====	===	===
Exercisable at September 30, 2006	2.5	\$14.22	5.1	\$14
	=====	=====	===	===

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The fair value of each stock option grant in 2006 was estimated on the date of grant using the Black-Scholes option-pricing model. The primary assumptions which the Company considered when determining the fair value of each option award included 1) the expected term of awards granted, 2) the expected volatility of the Company's stock price, 3) the risk-free interest rate applied and 4) an estimate for expected forfeitures. The expected term of awards granted is based upon the historical exercise patterns of the participants in the Company's plans, and expected volatility is based on the historical volatility of the Company's stock, commensurate with the expected term of the respective awards. The risk-free rate for the expected term of the awards is based on the U.S. Treasury yield curve in effect at the time of grant. The table below illustrates the aforementioned weighted average assumptions for 2006.

	2006

Risk-free interest rate	4.6%
Expected years until exercise	4.9
Expected stock volatility	37.1%
Dividend yield	0%
Weighted average fair value per share	\$7.96

The Company estimated forfeitures in the range of 7-9% based on historical experience, and will adjust estimated forfeitures over the requisite service period to the extent actual forfeitures differ, or are expected to differ, from such estimates.

The aggregate intrinsic value of options exercised during the nine months ended September 30, 2006 was \$3.3. Cash received from share-based payment arrangements for the nine months ended September 30, 2006 and 2005, was \$6.3 and \$13.6, respectively.

As of September 30, 2006, there was approximately \$4.5 of unrecognized compensation cost related to non-vested stock options. Approximately \$0.8 is expected to be recognized over the remainder of 2006, \$1.8 is expected to be recognized in 2007, \$1.2 in 2008, and \$0.7 in 2009.

Pro Forma Information Under SFAS 123 for Periods Prior to 2006

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Prior to January 1, 2006, employee stock options were accounted for under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25. Compensation expense was generally not recorded in the financial statements. For the three and nine months ended September 30, 2005, had the Company accounted for all employee stock-based compensation based on the estimated grant date fair values, as defined by SFAS 123, the Company's net income and earnings per share would have been adjusted to the following pro forma amounts:

	Three Months September 30,

Net income, as reported.....	\$ 4.1
Add: Stock-based employee compensation expense included in the determination of net income as reported, net of related tax effects....	0.2
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards granted, net of related tax effects.....	(0.7)

Pro forma net income.....	\$ 3.6

Earnings per share:	
Basic - as reported.....	\$ 0.10
Basic - pro forma.....	\$ 0.09
Diluted - as reported.....	\$ 0.10
Diluted - pro forma.....	\$ 0.09

During 2006 and 2005, the Company granted certain key executives performance-based awards, which enable them to receive payment in shares of the Company's common stock, based on certain performance criteria, as defined in the plans. The Company is required to evaluate the probability of the achievement of the performance criteria over the service period. In connection with these awards, the Company recognized compensation expense of \$0.4 and \$1.1, for the three and nine months ended September 30, 2006, and \$0.1 for the three and nine months ended September 30, 2005. As of September 30, 2006, there was approximately \$3.6 of recognized compensation cost related to performance-based awards. Approximately \$0.4 is expected to be recognized over the remainder of 2006, \$1.7 is expected to be recognized in 2007, \$1.4 in 2008, and \$0.1 in 2009. Compensation expense for performance based awards is determined based on estimates of future performance of the Company. As such, to the extent actual results differ from estimated results, unrecognized performance based compensation cost will be adjusted accordingly.

During 2005, the Company awarded its President and Chief Executive Officer 75,000 restricted shares of the Company's common stock. The restrictions on 25,000 shares lapse after three years, and the restrictions on the remaining 50,000 shares lapse after four years. The market value of the restricted shares was approximately \$1.3 at the date of the grant and is being charged to expense over the vesting period. In connection with this award, the Company recognized compensation expense of \$0.2 during the first nine months of 2006. In addition, compensation expense related to certain other restricted shares awarded approximated \$0.2 during the nine months ended September 30, 2006. The total unamortized future compensation expense related to restricted shares was approximately \$1.1 as of September 30, 2006. Approximately \$0.2 is expected to be recognized over the remainder of 2006, \$0.5 is expected to be recognized in 2007, \$0.3 in 2008, and \$0.1 in 2009.

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NOTE 3: RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2006, the Company adopted SFAS No. 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4." SFAS No. 151 amends the guidance in Accounting Research Bulletin ("ARB") No. 43, Chapter 4, "Inventory Pricing" and requires that the items such as idle facility expense, freight, handling costs and wasted material (spoilage) be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" under Paragraph 5 of ARB No. 43, Chapter 4. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS No. 151 are effective for inventory costs incurred during fiscal years beginning January 1, 2006. The Company's adoption of SFAS No. 151 did not have a material impact on the Company's results of operations or financial condition.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No.109" (FIN 48), which prescribes accounting for and disclosure of uncertainty in tax positions. This interpretation defines the criteria that must be met for the benefits of a tax position to be recognized in the financial statements and the measurement of tax benefits recognized. The provisions of FIN 48 are effective as of the beginning of the Company's 2007 fiscal year, with the cumulative effect of the change in accounting principle recognized as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. The standard applies whenever other standards require, or permit, assets or liabilities to be measured at fair value. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the requirements of SFAS 157 and have not yet determined the impact on the consolidated financial statements.

In September 2006, the FASB issued SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statement No. 87, 88, 106 and 132(R)." SFAS No. 158 requires recognition of the funded status of a benefit plan in the statement of financial position. SFAS No. 158 also requires the recognition in other comprehensive income of certain gains and losses that arise during the period but are deferred under pension accounting rules, as well as modifies the timing of reporting, and adds certain disclosures. SFAS No. 158 provides recognition and disclosure elements to be effective as of the end of the fiscal year after December 15, 2006 and measurement elements to be effective for fiscal years ending after December 15, 2008. The Company believes that the adoption of SFAS No. 158 will not have a material impact on the Company's results of operations or financial condition.

NOTE 4: FINANCIAL INSTRUMENTS AND DERIVATIVES

The Company applies the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of SFAS No. 133," SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." These statements outline the accounting treatment for all derivative activities and require that an entity recognize all derivative instruments as either assets or liabilities on its balance sheet at their fair value. Gains and losses

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resulting from changes in the fair value of derivatives are recognized each period in current or comprehensive earnings, depending on whether a derivative is designated as part of an effective hedge transaction and the resulting type of hedge transaction. Gains and losses on derivative instruments reported in comprehensive earnings will be reclassified to earnings in the period in which earnings are affected by the hedged item.

The Company manages a foreign currency hedging program to hedge against fluctuations in foreign-currency-denominated trade liabilities by periodically entering into forward foreign exchange contracts. The aggregate notional value of forward foreign exchange contracts the Company entered into amounted to \$32.1 and \$25.1 for the three months ended September 30, 2006 and 2005, respectively, and \$86.1 and \$67.0 for the nine months ended September 30, 2006 and 2005, respectively.

The Company formally designates and documents the hedging relationship and risk management objective for undertaking each hedge. The documentation describes the hedging instrument, the item being hedged, the nature of the risk being hedged and the Company's assessment of the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value.

The fair value of outstanding forward foreign exchange contracts at September 30, 2006 and December 31, 2005 for delivery of various currencies at various future dates and the changes in fair value recorded in income during the three and nine months ended September 30, 2006 were not material. The notional value of outstanding forward foreign exchange contracts at September 30, 2006 and December 31, 2005, was \$13.0 and \$7.5, respectively.

All financial instruments of the Company, with the exception of hedge instruments, are carried at cost, which approximates fair value.

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NOTE 5: INVENTORIES, NET

Inventories are stated at the lower of cost or market value. The value of inventories determined using the last-in, first-out method was \$10.8 and \$9.1 as of September 30, 2006 and December 31, 2005, respectively. The value of all other inventories determined using the first-in, first-out method was \$110.7 and \$90.1 as of September 30, 2006 and December 31, 2005, respectively.

The components of net inventories are as follows:

	September 30, 2006	December 31, 2005
	-----	-----
Raw materials.....	\$ 64.8	\$ 49.2
Work-in-process.....	9.6	9.3
Finished goods.....	65.7	57.8
	-----	-----
	140.1	116.3
Allowance for obsolescence.....	(18.6)	(17.1)
	-----	-----
	\$ 121.5	\$ 99.2
	=====	=====

NOTE 6: GOODWILL AND OTHER INTANGIBLE, NET

The Company applies the provisions of SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for using the

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purchase method of accounting and that certain intangible assets acquired in a business combination be recognized as assets apart from goodwill. Under SFAS No. 142, goodwill is not amortized. Instead, the Company is required to test goodwill for impairment at least annually using a fair value approach, at the reporting unit level. In addition, the Company evaluates goodwill for impairment if an event occurs or circumstances change, which could result in the carrying value of a reporting unit exceeding its fair value. Factors the Company considers important which could indicate impairment include the following: (1) significant under-performance relative to historical or projected future operating results; (2) significant changes in the manner of the Company's use of the acquired assets or the strategy for the Company's overall business; (3) significant negative industry or economic trends; (4) significant decline in the Company's stock price for a sustained period; and (5) the Company's market capitalization relative to net book value.

In accordance with SFAS No. 142, the Company completed its annual goodwill impairment assessment during the fourth quarter of 2005, and based on a comparison of the implied fair values of its reporting units with their respective carrying amounts, including goodwill, the Company determined that no impairment of goodwill existed at October 31, 2005, and there have been no indicators of impairment since that date. A subsequent determination that this goodwill is impaired, however, could have a significant adverse impact on the Company's results of operations or financial condition.

The changes in the carrying amounts of goodwill for the nine months ended September 30, 2006 are as follows:

	Americas -----	EMEA ----	Asia Pacific -----	Total -----
Balance, January 1, 2006.....	\$123.0	\$73.8	\$27.1	\$223.9
Acquisitions.....	-	4.9	-	4.9
Translation adjustments.....	-	2.9	(0.2)	2.7
	-----	-----	-----	-----
Balance, September 30, 2006....	\$123.0	\$81.6	\$26.9	\$231.5
	=====	=====	=====	=====

On March 16, 2006, the Company acquired the business and assets of Adhipress S.A. ("Adhipress"), a supplier of price tickets and merchandising tags for \$3.3. Additional cash purchase consideration of up to \$0.9 will be due if Adhipress achieves certain financial performance targets over a two-year period commencing April 1, 2006. In connection with this acquisition, the Company recognized goodwill of \$4.9, based on its preliminary allocation of the purchase price to the acquired assets and liabilities. The consolidated statements of earnings reflect the results of operations for Adhipress since the effective date of purchase. The pro forma impact of this acquisition was not significant.

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The Company's other intangible is as follows:

	September 30, 2006 ----	December 31, 2005 ----
Noncompete agreement.....	\$ 1.7	\$ 1.7
Accumulated amortization.....	(1.6)	(1.3)
	-----	-----
	\$ 0.1	\$ 0.4
	=====	=====

NOTE 7: INVESTMENTS

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Investments where the Company does not have significant influence and where the market value is not readily determinable are accounted for under the cost method; where market value is readily determinable, they are accounted for in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Impairment losses on the Company's investments are charged to income for other-than-temporary declines in fair value. During the three and nine months ended September 30, 2006, the Company recognized a \$5.0 impairment charge related to an other-than-temporary decline in fair value of its common stock investment in International Imaging Materials, Inc. ("IIMAK"). The impairment charge was recorded in other income (loss), net, on the accompanying consolidated statements of income. Investments, which are included in other assets in the accompanying consolidated balance sheets, approximated \$14.2 and \$18.3, as of September 30, 2006 and December 31, 2005, respectively, all of which represent the Company's remaining investment in IIMAK.

NOTE 8: ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

A summary of accounts payable and accrued liabilities is as follows:

	September 30, 2006 ----	December 31, 2005 ----
Accounts payable.....	\$ 56.8	\$ 50.3
Accrued payroll costs.....	21.7	19.6
Accrued restructuring costs.....	6.1	7.4
Trade programs.....	7.3	4.7
Advance service contracts.....	5.3	4.4
Accrued commissions.....	2.7	2.5
Accrued professional fees.....	3.3	3.1
Accrued interest.....	0.2	0.2
Other accrued liabilities.....	26.8	26.6
	-----	-----
	\$ 130.2	\$ 118.8
	=====	=====

NOTE 9: LONG -TERM DEBT

A summary of long-term debt is as follows:

	September 30, 2006 ----	December 31, 2005 ----
Revolving Credit Facility	\$ 32.1	\$ 84.1
Economic Development Revenue Bonds due 2011 and 2019.....	13.0	13.0
Other.....	0.1	0.6
	-----	-----
	\$ 45.2	\$ 97.7
	=====	=====

NOTE 10: SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes is as follows:

	Nine Months Ended September 30, -----	
	2006 -----	2005 -----
Interest.....	\$ 4.0	\$ 10.6
	=====	=====

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Income taxes.....	\$ 6.6	\$ 6.0
	=====	=====

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NOTE 11: COMPREHENSIVE INCOME

Comprehensive income for the periods presented below includes foreign currency translation items. There was no tax expense or tax benefit associated with the foreign currency translation items since the Company considers undistributed earnings of foreign subsidiaries to be permanently invested.

	Three Months Ended September 30,		Nine Sep
	2006	2005	2006
Net income.....	\$ 27.5	\$ 4.1	\$ 47.
Foreign currency translation adjustments.....	(0.3)	(0.5)	6.
Unrealized loss on derivatives.....	-	(0.1)	-
Comprehensive income.....	\$ 27.2	\$ 3.5	\$ 53.

NOTE 12: EARNINGS PER SHARE

The reconciliation of basic and diluted weighted average common shares outstanding is as follows:

	Three Months Ended September 30,		Nine Sep
	2006	2005	2006
Weighted average common shares (basic).....	41.1	40.7	41.
Options and restricted stock awards.....	0.6	0.8	0.
Adjusted weighted average common shares (diluted).....	41.7	41.5	41.

NOTE 13: SEGMENT INFORMATION

The Company develops, manufactures and markets apparel identification products and bar code and pricing solutions products to customers primarily in the retail and apparel manufacturing industries. In addition, the sales of the Company's products often result in ongoing sales of supplies, replacement parts and services. The Company's products are sold worldwide through a direct sales force, non-exclusive manufacturers' representatives, international and export distributors, and commission agents.

The Company has organized its operations into three geographic segments consisting of the following:

- (1) The Company's operations principally in the U.S., Canada, and 8 countries in Latin America ("Americas");

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- (2) Operations in 16 countries in Europe, the Middle East and Africa ("EMEA"); and
 (3) Operations in 11 countries in the Asia Pacific region ("Asia Pacific").

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Each of the three geographic segments develops, manufactures and markets the Company's products and services. The results from the three geographic segments are regularly reviewed by the Company's Chief Executive Officer to make decisions about resources to be allocated to each segment and assess its performance. Information regarding the operations of the Company in different geographic segments is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Sales to unaffiliated customers:				
Americas.....	\$ 84.0	\$ 84.0	\$ 250.2	\$ 251.1
EMEA.....	49.5	47.8	159.5	156.7
Asia Pacific.....	83.6	68.8	240.3	194.5
Total.....	\$ 217.1	\$ 200.6	\$ 650.0	\$ 602.3
Intersegment sales:				
Americas.....	\$ 16.7	\$ 16.2	\$ 56.3	\$ 51.5
EMEA.....	14.0	11.9	44.4	33.6
Asia Pacific.....	9.7	7.0	29.0	20.8
Eliminations.....	(40.4)	(35.1)	(129.7)	(105.9)
Total.....	\$ -	\$ -	\$ -	\$ -
Operating Income (a):				
Americas (b).....	\$ 8.4	\$ 7.6	\$ 31.4	\$ 24.1
EMEA (b).....	(2.9)	(1.5)	0.2	3.2
Asia Pacific.....	11.2	11.2	35.3	31.6
Corporate expenses (b)	16.7	17.3	66.9	58.9
Gain on lawsuit settlement.....	(6.5)	(3.9)	(28.7)	(14.9)
Amortization of other intangible..	39.4	-	39.4	-
Operating income.....	(0.0)	(0.1)	(0.2)	(0.2)
Other income (loss), net.....	49.6	13.3	77.4	43.8
Interest expense, net.....	(4.3)	0.3	(3.6)	1.0
Income before taxes.....	1.1	2.2	3.5	7.3
Income before taxes.....	\$ 44.2	\$ 11.4	\$ 70.3	\$ 37.5

- (a) Certain reclassifications have been made to prior periods' operating income to conform to the presentation used in the current period.
- (b) For the three and nine months ended September 30, 2006, the Americas included integration/restructuring and other costs of \$0.2 and \$0.4, respectively. For the three and nine months ended September 30, 2005, the Americas included integration/restructuring and other costs of \$0.2 and \$1.5, respectively. For the three and nine months ended September 30, 2006, Corporate expenses included integration/restructuring and other costs of \$0.1 and \$2.8, respectively, and EMEA included integration/restructuring

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and other costs of \$1.4 and \$3.0, respectively. For the three and nine months ended September 30, 2006, APAC included integration/restructuring and other costs of \$0.1. For the three and nine months ended September 30, 2005, EMEA included integration/restructuring and other costs of \$1.7 and \$2.9, respectively.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Depreciation and amortization:				
Americas.....	\$ 3.0	\$ 3.1	\$ 8.9	\$ 9.3
EMEA.....	2.4	2.3	6.8	6.8
Asia Pacific.....	2.8	2.5	8.7	7.0
	8.2	7.9	24.4	23.1
Corporate.....	0.4	0.4	1.1	1.1
Total.....	\$ 8.6	\$ 8.3	\$ 25.5	\$ 24.2
Capital expenditures:				
Americas.....	\$ 3.1	\$ 1.4	\$ 7.0	\$ 5.0
EMEA.....	1.6	2.7	8.0	6.2
Asia Pacific.....	6.1	4.7	17.1	12.3
	10.8	8.8	32.1	23.5
Corporate.....	0.2	0.4	0.2	0.5
Total.....	\$ 11.0	\$ 9.2	\$ 32.3	\$ 24.0

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	September 30, 2006	December 31, 2005
Long-lived assets:		
Americas.....	\$ 176.5	\$ 180.9
EMEA.....	134.4	123.9
Asia Pacific.....	87.5	80.3
	398.4	385.1
Corporate.....	5.7	5.3
Total.....	\$ 404.1	\$ 390.4
Total assets:		
Americas.....	\$ 279.4	\$ 272.5
EMEA.....	191.0	223.5
Asia Pacific.....	248.1	172.0
	718.5	668.0
Corporate.....	44.9	59.6
Total.....	\$ 763.4	\$ 727.6

The following table presents sales by product:

Three Months Ended	Nine Months Ended
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	September 30,		September 30,	
	2006	2005	2006	2005
Apparel Identification Products..	\$ 152.6	\$ 137.7	\$ 459.1	\$ 420.1
Bar Code and Pricing Solutions...	64.5	62.9	190.9	182.2
Total.....	\$ 217.1	\$ 200.6	\$ 650.0	\$ 602.3
	=====	=====	=====	=====

The Company generated sales in the United States of \$62.0, or 28.6% of total sales, and \$186.2, or 28.6% of total sales, for the three and nine months ended September 30, 2006, respectively, and \$61.6, or 30.7% of total sales, and \$185.0, or 30.7% of total sales, for the three and nine months ended September 30, 2005, respectively. In addition, the Company's long-lived assets in the United States as of September 30, 2006 and December 31, 2005, amounted to \$148.5 and \$157.3, respectively.

No one customer accounted for more than 10% of the Company's revenues or accounts receivable for the three and nine months ended September 30, 2006 or 2005.

NOTE 14: INTEGRATION/RESTRUCTURING AND OTHER COSTS

In October 2005, the Company announced that it would undertake realignment initiatives to restructure production capacity utilization, particularly in response to the continued migration of apparel production outside of the United States (the "2005 Restructuring Program"). The current plan is substantially focused on transferring existing apparel identification manufacturing capacity from the Company's U.S. operations primarily to facilities in Mexico, Central America and Asia Pacific. To a lesser extent, the Company is repositioning a portion of its EMEA manufacturing activities to lower cost facilities in Eastern Europe. In addition, the plan includes the realignment of the Company's design and customer service organization in response to the aforementioned production migration activities. The 2005 Restructuring Program is expected to be substantially completed during 2007. The 2005 Restructuring Program contemplates significant headcount reductions in the Company's U.S. locations and, to a lesser extent, headcount reductions in Western Europe. The Company expects to incur total pre-tax, non-recurring charges, upon completion, in the range of \$25 to \$33, including approximately \$5 to \$8 of non-cash charges. During the three and nine months ended September 30, 2006, the Company recognized charges of \$1.8 and \$6.3, respectively, in connection with the 2005 Restructuring Program. These charges were related to program management services, severance and retention programs, and other facility closure costs. In the aggregate, since October 2005 and including the aforementioned \$6.3 recognized during the nine months ended September 30, 2006, the Company has recognized charges of approximately \$15.1 in connection with the 2005 Restructuring Program, of which, approximately \$12.0 represents cash costs.

In April 2005, the Company announced initiatives to improve margins and lower costs in its EMEA region, primarily relating to workforce reductions and transportation costs. The initiative was undertaken in light of volume declines in Europe, primarily due to the migration of apparel manufacturing and softening

of the European economies, notably in the retail and apparel sectors. During the three and nine months ended September 30, 2005, the Company recognized pre-tax charges of \$1.7 and \$2.9, respectively, in connection with these initiatives, which were complete at the end of 2005.

In January 2005, the Company announced the consolidation of one of its U.S.

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woven label manufacturing facilities as part of its continuing effort to improve operating efficiency and costs. During the three and nine months ended September 30, 2005, the Company recognized pre-tax charges of \$0.2 and \$1.5, respectively, in connection with these initiatives, which were complete at the end of 2005.

All integration/restructuring and other costs are identified on a separate line on the Company's income statement as a component of operating income.

The following table presents the changes in accruals pertaining to the Company's restructuring and related initiatives for the nine months ended September 30, 2006:

	Balance, January 1, 2006	Expenses	Payments	Balance, September 30, 2006
Severance.....	\$ 5.0	\$ 1.0	\$ (1.4)	\$ 4.6
Other costs.....	2.4	5.0	(5.9)	1.5
	\$ 7.4	\$ 6.0	\$ (7.3)	\$ 6.1
	\$ 7.4	\$ 6.0	\$ (7.3)	\$ 6.1

In addition, during the first nine months of 2006, the Company recognized asset impairment charges of \$0.3 million related to the 2005 Restructuring Program.

NOTE 15: GAIN ON SETTLEMENT OF PATENT LITIGATION

On September 14, 2006, the Company settled a patent infringement lawsuit against Zebra Technologies Corporation ("Zebra") in the U.S. District Court for the Southern District of Ohio. The Company's suit alleged violation of eight of its patents involving more than 50 Zebra products. The settlement, net of legal and other costs, resulted in a gain of approximately \$39.4 (with an after-tax impact of \$24.3 on net income, or \$.58 per diluted share) for the three and nine months ended September 30, 2006, and is included as a separate component of operating income in the accompanying consolidated statements of income. In connection with the settlement, approximately \$1.7 of previously expensed and paid legal fees were reimbursed to the Company by counsel and classified as a reduction in selling, general and administrative expenses for the three and nine months ended September 30, 2006.

NOTE 16: CONTINGENCIES

The Company has been named a potentially responsible party relating to contamination that occurred at certain super-fund sites. Management, including internal counsel, currently believes that the ultimate resolution of such matters taken as a whole, and after considering such factors as 1) available levels of insurance coverage, 2) the Company's proportionate share, in certain cases, as a named potential responsible party, and 3) the dormant nature of certain matters, will not have a materially adverse effect upon its results of operations or financial condition. It is possible that new information or future developments could require the Company to reassess its potential exposure related to these environmental matters.

NOTE 17: INCOME TAXES

The effective tax rate for the three and nine months ended September 30, 2006 was 37.8% and 32.7%, respectively, compared with the effective tax rate for the three and nine months ended September 30, 2005 of 64.0% and 36.5%, respectively. For the three and nine months ended September 30, 2006, the effective rate was adversely impacted by the gain from the patent lawsuit settlement with Zebra, for which taxes were provided at a blended (state and federal) tax rate of 39.5%, the \$5.0 impairment charge recorded during the three

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months ended September 30, 2006 (see Note 7) for which no tax benefit was recognized, and the adoption of SFAS No. 123R which adversely impacted the rate by approximately 1.0%. SFAS No. 123R requires the expensing of stock compensation awards, however for certain awards, including qualified incentive stock options, no tax benefit is recognized. The adverse impacts described above were partially offset by favorable adjustments of approximately \$0.9 attributable to income tax reserves no longer required, as well as a reduction in the valuation allowance related to certain tax carryforwards of approximately \$1.0.

The effective tax rate for the three and nine months ended September 30, 2005 was adversely impacted by the \$4.4 charge recorded in September 2005 in conjunction with the Company's decision to repatriate foreign earnings pursuant to the American Jobs Creation Act of 2004 Act.

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In the event that actual results differ from these estimates or these estimates change in future periods, the Company may need to adjust the rate, which could materially impact its results of operations.

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

Forward-Looking Statements

This report contains forward-looking statements as defined in Section 27A of the Securities Act of 1933, as amended, and Section 2E of the Securities Exchange Act of 1934, as amended. These statements may be identified by their use of words, such as "anticipate," "estimates," "should," "expect," "guidance," "project," "intend," "plan," "believe" and other words and terms of similar meaning, in connection with any discussion of our future business, results of operations, liquidity and operating or financial performance or results. Such forward-looking statements involve significant material known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. These and other important risk factors are included under Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K/A. In light of the uncertainty inherent in such forward-looking statements, the readers of this report should not consider the inclusion of such forward-looking statements to be a representation that such forward-looking events or outcomes will occur. Because the information herein is based solely on data currently available, it is subject to change and should not be viewed as providing any assurance regarding the Company's future performance. Actual results and performance may differ from our current projections, estimates and expectations, and the differences may be material, individually or in the aggregate, to its business, financial condition, results of operations, liquidity or prospects. Additionally, the Company is not obligated to make public indications of changes in its forward-looking statements unless required under applicable disclosure rules and regulations.

All amounts in the following discussion are stated in millions.

RESULT OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006, COMPARED WITH THE COMPARABLE PERIODS OF 2005

Overview

Paxar Corporation seeks to deliver growth through a concentrated emphasis on executing its strategy as a global operating company, maintaining a continued focus on providing customers with innovative products and solutions, outstanding service, consistent quality, on-time delivery and competitively priced products.

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Acquisitions will continue to be a fundamental element of executing these growth initiatives. Together with continuing investments in new product development, state-of-the-art manufacturing equipment, and innovative sales and marketing initiatives, management believes the Company is well positioned to compete successfully as a provider of identification solutions to the retail and apparel industry, worldwide. The investments needed to fund this growth are generated, in part, through corporate-wide initiatives to lower costs and increase effective asset utilization.

In order to better serve a customer base consisting predominantly of retailers, branded apparel companies and contract manufacturers, the Company has organized its operations into three geographic segments consisting of the following:

- (1) The Company's operations principally in the U.S., Canada and 8 countries in Latin America ("Americas");
- (2) Operations in 16 countries in Europe, the Middle East and Africa ("EMEA"); and
- (3) Operations in 11 countries in the Asia Pacific region ("Asia Pacific").

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The Company's results of operations for the three and nine months ended September 30, 2006 and 2005, in dollars and as a percent of sales, are presented below:

	Three Months Ended				Nine M	
	Sept 30, 2006		Sept 30, 2005		Sept 30, 2006	
Sales.....	\$ 217.1	100.0%	\$ 200.6	100.0%	\$ 650.0	100.0%
Cost of sales.....	139.4	64.2	127.1	63.4	408.5	62.8
Gross profit.....	77.7	35.8	73.5	36.6	241.5	37.2
Selling, general and administrative expenses.....	65.7	30.3	58.3	29.1	197.2	30.3
Gain on lawsuit settlement.....	39.4	18.1	-	-	39.4	6.1
Integration/restructuring and other costs.....	1.8	0.8	1.9	0.9	6.3	1.0
Operating income.....	49.6	22.8	13.3	6.6	77.4	12.0
Other income, net.....	(4.3)	2.0	0.3	0.1	(3.6)	0.6
Interest expense, net.....	1.1	0.4	2.2	1.1	3.5	0.5
Income before taxes.....	44.2	20.4	11.4	5.7	70.3	10.8
Taxes on income.....	16.7	7.7	7.3	3.7	23.0	3.5
Net income.....	\$ 27.5	12.7%	\$ 4.1	2.0	\$ 47.3	7.3%

The Company's sales increased \$16.5, or 8.2% for the three months ended September 30, 2006, and increased \$47.7, or 7.9%, for the nine months ended September 30, 2006, compared with the comparable periods of 2005. The sales increase for the three months ended September 30, 2006 was due to an increase in organic sales of \$14.4, and sales related to acquisitions of \$1.4, as well as a favorable impact of changes in foreign exchange rates of \$0.7. The sales increase for the nine months ended September 30, 2006 was due to an increase in

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organic sales of \$39.0, and sales related to acquisitions of \$11.9, partially offset by the unfavorable impact of changes in foreign exchange rates of \$3.2.

During the three and nine months ended September 30, 2006, the Company settled a patent infringement lawsuit, which resulted in a gain, net of legal and other costs, of \$39.4. Furthermore, a \$5.0 impairment charge was recorded during the three and nine months ended September 30, 2006 in connection with an "other-than-temporary" decline in the fair value of one of the Company's long-term investments (see note 7 "Investments" to Notes to Financial Statements).

In the first nine months of 2006, the Company realized \$3.8 in interest savings primarily resulting from refinancing initiatives completed in the fourth quarter of 2005, which included the repayment of \$150 of 6.74% Senior Notes, the establishment of a new \$150 multi-currency revolving credit facility and the repatriation of \$122 of foreign earnings. In addition, the Company adopted the provisions of SFAS No. 123(R), "Share-Based Payment", which resulted in a charge of \$3.1 of stock-based compensation in the first nine months of 2006.

In order to adapt to the changing global apparel industry, the Company announced in October 2005 that it would undertake realignment initiatives to restructure production capacity utilization, particularly in response to the continued migration of apparel production outside of the United States (the "2005 Restructuring Program"). The current plan is substantially focused on transferring and streamlining the existing apparel identification manufacturing capacity from the Company's U.S. locations primarily to Mexico, Central America and Asia Pacific. To a lesser extent, the Company is also streamlining operations and repositioning a portion of its legacy Western Europe manufacturing capacity to lower-cost facilities. In addition, the plan includes the realignment of the Company's sales and related support functions in response to the aforementioned production migration activities.

The 2005 Restructuring Program is expected to be substantially completed during 2007. The 2005 Restructuring Program contemplates significant headcount reductions in the Company's U.S. locations and, to a lesser extent, headcount reductions in Western Europe. In addition, in connection with the closure or streamlining of certain facilities, the Company will incur charges related to write-downs of property, plant and equipment, and other costs related to exiting facilities, including lease terminations. For further information, refer to "Integration/Restructuring and Other Costs", below.

Given the continued competitive marketplace and the changing global apparel environment, the Company anticipates that the near-term operating environment will remain challenging. However, the savings and benefits from the 2005 Restructuring Program along with the Company's other ongoing cost-savings and

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growth initiatives are anticipated to generate increased levels of profitability. Specific to the 2005 Restructuring Program, the Company currently expects to realize approximately \$15.0 in cost savings during 2007 and achieve an annualized savings rate of \$20.0 to \$25.0 by the end of 2007. These savings relate principally to salaries and related expenses, and will be reflected largely as a reduction in cost of goods sold and, to a lesser extent, as a reduction in selling, general and administrative expenses; the Company does not currently expect to redirect a significant amount of these savings to spending in other areas or other income statement line items.

Sales

The following table presents sales by geographic operating segment:

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	Three Months Ended				Nine Months	
	September 30, 2006		September 30, 2005		September 30, 2006	
Americas.....	\$ 84.0	38.7%	\$ 84.0	41.9%	\$ 250.2	38.5%
EMEA.....	49.5	22.8	47.8	23.8	159.5	24.5
Asia Pacific.....	83.6	38.5	68.8	34.3	240.3	37.0
Total.....	\$ 217.1	100.0%	\$ 200.6	100.0%	\$ 650.0	100.0%

The Americas segment sales were unchanged for the three months ended September 30, 2006, compared with the comparable period of 2005, and decreased \$0.9, or 0.4%, for the nine months ended September 30, 2006, compared with the nine months ended September 30, 2005. For the three months ended September 30, 2006, organic sales decreased \$0.2 which was offset by a favorable exchange rate variance of \$0.2. The decrease for the nine months ended September 30, 2006 was due to a decrease in organic sales of \$2.7, offset by the impact of acquisition activity of \$1.1 and the favorable impact of changes in foreign exchange rates of \$0.7. The ongoing migration of U.S. apparel manufacturing to the Asia Pacific region where U.S. retailers and apparel manufacturers have realized labor savings and operating performance efficiencies continues to impact apparel sales volumes across the Americas segment, albeit at a slower pace when compared to the same prior year periods. Offsetting the impact of the migration of apparel product sales, the Company's bar code products generated modest organic growth, during the three months ended September 30, 2006.

EMEA segment sales increased \$1.7, or 3.6%, and \$2.8, or 1.8%, for the three and nine months ended September 30, 2006, respectively, compared with the comparable periods of 2005. These increases were principally affected by three factors: 1) growth in organic sales of \$0.2 and \$3.8, respectively; 2) the impact of acquisition activity of \$0.8 and \$2.4, respectively, and 3) a favorable impact of changes in foreign exchange rates of \$0.7 for the three months ended September 30, 2006 and an unfavorable impact of changes in foreign exchange rates of \$3.4 for the nine months ended September 30, 2006. The growth in organic sales was due primarily to higher RFID and heat transfer product sales volume, as well as general growth across the developing business units in Eastern Europe. These increases were partially offset by the continuing migration of apparel product sales from the Company's legacy Western European operations to the Asia Pacific region.

Asia Pacific segment sales increased \$14.8, or 21.5%, and \$45.8, or 23.5%, for the three and nine months ended September 30, 2006, respectively, compared with the comparable periods of 2005. The increases were attributable to organic sales growth of \$14.4 and \$37.9, respectively, and to a lesser extent, the impact of acquisition activity of \$0.6 and \$8.4, respectively. Partially offsetting these increases were unfavorable exchange rate variances of \$0.2 and \$0.5, for the three and nine months ended September 30, 2006, respectively. The Company's operations in this region have benefited from higher customer penetration and the benefit of migration of apparel manufacturing from the U.S., U.K. and Western Europe to minimize labor costs and maximize operating performance efficiencies.

Gross Profit

Gross profit was \$77.7, or 35.8% of sales, and \$241.5, or 37.2% of sales,

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respectively, for the three and nine months ended September 30, 2006, compared with \$73.5, or 36.6% of sales, and \$228.0, or 37.9% of sales, respectively, for the three and nine months ended September 30, 2005. The lower gross margins were primarily the result of (a) higher facilities and capacity expansion infrastructure costs in emerging markets, (b) incremental manufacturing costs and production inefficiencies related to the initial ramp-up of production at specific emerging market locations as the Company completes the build-out of capacity required to execute the 2005 Restructuring Program, (c) higher material and freight costs related to specific customer service initiatives, (d) inventory charges recorded in the Company's Americas and Asia Pacific segments, (e) unfavorable product mix, including increased sales of RFID products that, as

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anticipated, are generating lower margins during the initial phases of program expansion, and (f) specific pricing actions designed to increase our sales to certain major customers. Management's ongoing strategy includes implementing process improvements to reduce costs in all of the Company's manufacturing facilities, re-deploying assets to manage production capacity, and expanding production in new and emerging markets in order to minimize labor costs. During 2005, the Company announced that it would undertake restructuring activities related to realigning production capacity utilization, primarily related to its domestic locations (refer to discussion below, "Integration/Restructuring and Other Costs").

Selling, General and Administrative ("SG&A") Expenses

SG&A expenses were \$65.7 and \$197.2 for the three and nine months ended September 30, 2006, respectively, compared with \$58.3 and \$179.8 for the three and nine months ended September 30, 2005, respectively. As a percent of sales, SG&A expenses were 30.3% for both the three and nine months ended September 30, 2006, compared with 29.1% and 29.9% for the three and nine months ended September 30, 2005. These increases in the ratio of SG&A to sales were due primarily to continued infrastructure expansion in existing markets in Asia Pacific and Latin America to support our global realignment initiatives, as well as infrastructure costs associated with geographic expansion into new markets such as Thailand and Pakistan. In addition, contributing to the unfavorable variance were higher compensation and employee benefit costs, which included the impact of the adoption of FAS 123(R), and foreign exchange losses. Partially offsetting the above increases was \$1.7 million in cost reimbursements the Company's for previously expensed and paid legal fees associated with the settlement of the patent lawsuit with Zebra Technologies. In response to the continuing migration of sales and production from the U.S., U.K and EMEA to the Latin America and Asia Pacific regions, management is continuing to evaluate cost reduction opportunities and take appropriate steps to reduce duplicative costs in our legacy U.S., U.K and Western European businesses while properly leveraging our SG&A structure in emerging market locations.

Gain on Lawsuit Settlement

On September 14, 2006, the Company settled a patent infringement lawsuit against Zebra Technologies Corporation ("Zebra") in the U.S. District Court for the Southern District of Ohio. The Company's suit alleged violation of eight of its patents involving more than 50 Zebra products. The settlement resulted in a gain of approximately \$39.4 (with a \$24.3 impact on net income, or \$.58 per diluted share) for three and nine months ended September 30, 2006.

Integration/Restructuring and Other Costs

In October 2005, the Company announced that it would undertake realignment initiatives to restructure production capacity utilization, particularly in response to the continued migration of apparel production outside of the United

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States (the "2005 Restructuring Program"). The current plan is substantially focused on transferring existing U.S. apparel identification manufacturing capacity to facilities in Mexico, Central America and Asia Pacific. To a lesser extent, the Company is repositioning a portion of its EMEA manufacturing activities to lower cost facilities in Eastern Europe. In addition, the 2005 Restructuring Program includes the realignment of the Company's design and customer service organization in response to the aforementioned production migration activities. The 2005 Restructuring Program is expected to be substantially completed during 2007. The 2005 Restructuring Program contemplates significant headcount reductions in the Company's U.S. locations and, to a lesser extent, headcount reductions in Western Europe. The Company expects to incur total pre-tax, non-recurring charges, upon completion, in the range of \$25 to \$33, including approximately \$5 to \$8 of non-cash charges. During the three and nine months ended September 30, 2006, the Company recognized charges of \$1.8 and \$6.3 in connection with the 2005 Restructuring Program. These charges were related to program management services, severance and retention programs, and other facility closure costs. In the aggregate, since October 2005 and including the aforementioned \$6.3 recognized during the nine months ended September 30, 2006, the Company has recognized charges of approximately \$15.1 in connection with the 2005 Restructuring Program, of which, approximately \$12.0 represents cash costs.

In April 2005, the Company announced initiatives to improve margins and lower costs in its EMEA region, primarily relating to workforce reductions and transportation costs. The initiative was undertaken in light of volume declines in Europe, primarily due to the migration of apparel manufacturing and softening of the European economies, notably in the retail and apparel sectors. During the three and nine months ended September 30, 2005, the Company recognized pre-tax charges of \$1.7 and \$2.9, respectively, in connection with these initiatives, which were complete at the end of 2005.

In January 2005, the Company announced the consolidation of one of its U.S. woven label manufacturing facilities as part of its continuing effort to improve operating efficiency and costs. During the three and nine months ended September

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30, 2005, the Company recognized pre-tax charges of \$0.2 and \$1.5, respectively, in connection with these initiatives, which were complete at the end of 2005.

Operating Income

Operating income was \$49.6, or 22.8% of sales, and \$77.4, or 12.0% of sales, for the three and nine months ended September 30, 2006, respectively, compared with \$13.3, or 6.6% of sales, and \$43.8, or 7.3% of sales, for the three and nine months ended September 30, 2005, respectively. On a reportable segment basis, exclusive of corporate expenses, amortization of other intangible and the gain on lawsuit settlement, operating income, as a percent of sales, was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Americas.....	10.0%	9.0%	12.5%	9.6%
EMEA.....	(5.9)%	(3.1)%	0.1%	2.0%
Asia Pacific.....	13.4%	16.3%	14.6%	16.2%

Americas' operating income, as a percent of sales, increased to 10.0% and 12.5%, respectively, for the three and nine months ended September 30, 2006,

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compared with 9.0% and 9.6% for the three and nine months ended September 30, 2005. These increases primarily resulted from reductions and productivity gains in the Americas' domestic fixed cost base, largely as a result of the 2005 Restructuring Program, as well as the consolidation of its woven label manufacturing facilities announced in January 2005 (see Integration/Restructuring and Other Costs, above). The Americas segment included integration/restructuring and other costs, as a percent of sales, of 0.2% for the three and nine months ended September 30, 2006, and 0.2% and 0.6%, respectively, for the three and nine months ended September 30, 2005.

EMEA's operating loss, as a percent of sales, increased to (5.9)%, for the three months ended September 30, 2006, compared with (3.1)% for the three months ended September 30, 2005. EMEA's operating income, as a percent of sales, decreased to 0.1% for the nine months ended September 30, 2006, from 2.0% for the 2005 period. These declines primarily resulted from (a) unfavorable product mix, including increased sales of RFID products, which, as anticipated, are generating relatively low margins during the initial phases of program expansion, (b) production inefficiencies in the region (c) foreign exchange losses, (d) certain raw material costs increases, as well as (e) incremental costs associated with expansion in Eastern Europe to support migration of apparel sales from the U.K. and Western Europe. In addition, the EMEA segment included integration/restructuring and other costs, as a percentage of sales, of 2.8% and 1.9%, respectively, for the three and nine months ended September 30, 2006, compared to 3.6% and 1.9%, respectively, for the three and nine months ended September 30, 2005.

Asia Pacific's operating income, as a percent of sales, decreased to 13.4% and 14.6%, respectively, for the three and nine months ended September 30, 2006, compared with 16.3% and 16.2% for the three and nine months ended September 30, 2005, respectively. These declines were primarily attributable to competitive pressures and higher fixed costs associated with capacity expansion in certain locations for which such costs have not been fully absorbed, higher material, freight, and temporary labor costs to address specific customer service issues, as well as specific pricing actions designed to increase customer penetration and share.

Other Income (Expense), net

Other income (expense), net, was (\$4.3) and (\$3.6) for the three and nine months ended September 30, 2006, respectively, compared to \$0.3 and \$1.0 for the three and nine months ended September 30, 2005. These declines were primarily attributable to a \$5.0 impairment charge recognized during the three and nine months ended September 30, 2006 in connection with an other-than-temporary decline in fair value of the Company's investment in International Imaging Materials, Inc. ("IIMAK") (see Note 7 to Notes to Financial Statements).

Interest Expense, Net

Interest expense, net of interest income on invested cash, was \$1.1 and \$3.5 for the three and nine months ended September 30, 2006, respectively, compared with \$2.2 and \$7.3 for the three and nine months ended September 30, 2005. The declines were primarily attributable to the refinancing initiatives completed during the fourth quarter of 2005. The net impact of the refinancing initiatives and the use of cash generated from operations to reduce global borrowings, reduced the Company's debt position from \$167.2 as of September 30, 2005 to

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\$45.8 as of September 30, 2006. In addition, the Company's weighted average interest rate was reduced from 6.39% and 6.38% for the three and nine months ended September 30, 2005, respectively, to 5.13% and 5.04%, respectively, for the three and nine months ended September 30, 2006.

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Taxes on Income

The effective tax rate is based on management's estimates of the geographic mix of projected annual pre-tax income and, to a lesser extent, state and local taxes. In addition, the effective tax rate is adjusted for discrete events which may arise from time to time. The effective tax rate for the three and nine months ended September 30, 2006 was 37.8% and 32.7%, respectively, compared with the effective tax rate for each of the three and nine months ended September 30, 2005 of 64.0% and 36.5%, respectively. For the three and nine months ended September 30, 2006, the effective rate was adversely impacted by the gain from the patent lawsuit settlement with Zebra, for which taxes were provided at a blended (state and federal) tax rate of 39.5%, the \$5.0 impairment charge recorded during the three months ended September 30, 2006 (see Note 7) for which no tax benefit was recognized and the adoption of SFAS No. 123R which adversely impacted the rate by approximately 1.0%. SFAS No. 123R requires the expensing of stock compensation awards, however for certain awards, including qualified incentive stock options, no tax benefit is recognized. The adverse impacts described above were partially offset by favorable adjustments of approximately \$0.9 attributable to income tax reserves no longer required, as well as a reduction in the valuation allowance related to certain tax carryforwards of approximately \$1.0.

The effective tax rate for the three and nine months ended September 30, 2005 was adversely impacted by the \$4.4 charge recorded in September 2005 in conjunction with the Company's decision to repatriate foreign earnings pursuant to the American Jobs Creation Act of 2004 Act.

In the event that actual results differ from these estimates or these estimates change in future periods, the Company may need to adjust its effective tax rate, which could materially impact its results of operations.

LIQUIDITY AND CAPITAL RESOURCES

The following table presents summary cash flow information for the periods indicated:

	Nine Months Ended September 30,	
	2006	2005
Net cash provided by operating activities.....	\$ 76.6	\$ 55.8
Net cash used in investing activities.....	(34.9)	(37.0)
Net cash (used in) provided by financing activities.....	(47.5)	13.9
	-----	-----
(Decrease) increase in cash and cash equivalents (a) ..	\$ (5.8)	\$ 32.7
	=====	=====

(a) Before the effect of exchange rate changes on cash flows.

Overview

Cash provided by operating activities has been the Company's primary source of funds to finance operating needs and growth opportunities. In November 2005, the Company entered into a new five-year, \$150 multi-currency Revolving Credit Agreement (the "Credit Agreement") with a group of five domestic and three international banks. The Company may increase the existing credit facility to a maximum of \$250, subject to providing the participating banks adequate advance notice and securing their approval. Net cash provided by operating activities was \$76.6 for the nine months ended September 30, 2006, compared with \$55.8 for the nine months ended September 30, 2005. The first nine months of 2006 includes

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\$24.3 of net income attributable to the patent lawsuit settlement (Note 15). Management believes that the Company will continue to generate sufficient cash from its operating activities for the foreseeable future, supplemented by availability under the Credit Agreement, to fund its working capital needs, strengthen its balance sheet and support its growth strategy of expanding its geographic reach and product offerings.

Operating Activities

Working capital and the corresponding current ratio were \$180.7 and 2.1:1 at September 30, 2006, compared with \$174.2 and 2.2:1 at December 31, 2005. The increase in working capital resulted primarily from substantial increases in accounts receivable and inventories, which were partially offset by increases in accounts payable and accrued liabilities, as well as accrued taxes on income resulting from the aforementioned gain on lawsuit settlement. The increase in inventory was due to strong sales and order activity anticipated for the fourth quarter of 2006 and to support execution of the Company's realignment plan. The

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increase in accounts receivable was due primarily to higher levels of sales experienced during a particularly strong month of September when compared to December 2005.

In connection with the 2005 Restructuring Program, the Company expects to incur total pre-tax, non-recurring charges, upon completion, in the range of \$25.0 to \$33.0, which includes approximately \$5.0 to \$8.0 of non-cash charges. During the nine months ended September 30, 2006, the Company recognized charges of \$6.3 in connection with the 2005 Restructuring Program. In the aggregate, since October 2005, the Company has recorded charges of approximately \$15.1 in connection with the 2005 Restructuring Program, of which, approximately \$12.0 represents cash costs. The Company currently expects to realize approximately \$15.0 in cost savings during 2007 and achieve an annual savings rate of \$20.0 to \$25.0 by the end of 2007. These savings relate principally to salaries and related expenses, and will be reflected as a reduction in cost of goods sold as well as a reduction in selling, general and administrative expenses; the Company currently does not expect to redirect a significant amount of those savings to spending in other areas or other income statement line items.

Investing Activities

For the nine months ended September 30, 2006 and 2005, the Company incurred \$32.3 and \$24.0, respectively, of capital expenditures to acquire production machinery, expand capacity, install system upgrades and continue with its growth and expansion of Company operations in the emerging markets of Asia Pacific, EMEA and Latin America. Capital expenditures are typically funded by cash provided by operating activities and, where necessary, availability under the Credit Agreement. In March 2006, the Company acquired the business and assets of Adhipress S.A., a supplier of price tickets and merchandising tags to French hypermarkets, for a cash payment of \$3.3. During the first nine months of 2005, the Company acquired the business and manufacturing assets of EMCO labels for \$2.8, as well as the remaining 50% interest of a joint venture located in India for \$10.5.

Financing Activities

The components of total capital as of September 30, 2006 and December 31, 2005, respectively, are presented below:

	September 30, 2006	December 31, 2005
Due to banks.....	\$ 0.6	\$ 3.0

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Long-term debt.....	45.2	97.7
	-----	-----
Total debt.....	45.8	100.7
Shareholders' equity.....	523.0	454.9
	-----	-----
Total capital.....	\$ 568.8	\$ 555.6
	=====	=====
Total debt as a percent of total capital....	8.1%	18.1%
	=====	=====

Management believes that the borrowings available under the Company's Credit Agreement provide sufficient liquidity to supplement the Company's operating cash flow. During the three months ended September 30, 2006, the Company used the net proceeds received from the patent lawsuit settlement to reduce borrowings under the Credit Agreement. For the nine months ended September 30, 2006 and 2005, the net decreases in the Company's outstanding debt were \$55.1 and \$0.1, respectively.

The Company has various stock-based compensation plans, including two stock option plans, a long-term incentive plan, and an employee stock purchase plan. For the nine months ended September 30, 2006 and 2005, the Company received proceeds of \$7.6 and \$14.0, respectively, from sales of common stock issued under its employee stock option and stock purchase plans.

The Company has a stock repurchase plan with an authorization from its Board of Directors to use up to \$150 for the repurchase of its shares. The shares may be purchased from time to time at prevailing prices in the open-market or by block purchases. The Company did not repurchase any shares during the nine months ended September 30, 2006 and 2005. As of September 30, 2006, the Company had \$22.0 available under its \$150 stock repurchase program authorization. The Company may continue to repurchase its shares under the existing authorization, depending on market conditions and cash availability.

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The Company believes that funds from future operating cash flows and funds available under its Credit Agreement are adequate to allow it to continue to repurchase its shares under the stock repurchase plan, should management decide to do so.

Financing Arrangement - Credit Agreement

In November 2005, the Company replaced its existing three-year \$50 revolving credit facility with the new \$150 Credit Agreement with a group of five domestic and three international banks. Under the Credit Agreement, the Company pays a facility fee determined by the ratio of debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"). Borrowings under the Credit Agreement bear interest at the prime rate, negotiated rates, rates referenced to the London Interbank Offered Rate ("LIBOR") or Euro LIBOR, at the Company's option, with applicable margins varying in accordance with the Company's attainment of specified debt to EBITDA thresholds and are guaranteed by certain domestic subsidiaries of the Company. The Company may increase the credit facility to a maximum of \$250, subject to providing the participating banks adequate advance notice and securing their approval. For the three and nine months ended September 30, 2006, the interest rate on outstanding borrowings under this Agreement was based on LIBOR at a weighted average interest rate of 5.33% and 5.23%, respectively.

The Company must maintain an excess of consolidated total assets over total liabilities of not less than the sum of \$350 plus 35% of cumulative consolidated net income from October 1, 2005. The Company's maximum allowable debt to EBITDA ratio, as defined, is 3.0 to 1 and minimum allowable fixed charge coverage

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ratio, as defined, is 1.5 to 1. The Company is in compliance with all debt covenants. The Company discloses the details of the compliance calculation to its banks and certain other lending institutions in a timely manner.

Under the Credit Agreement, the Company cannot pay in excess of \$50.0 in cash dividends during any 12-month period, and cannot pay in excess of \$100.0 in cash dividends over its five-year term.

Off Balance Sheet Arrangements

The Company has no material transactions, arrangements, obligations (including contingent obligations), or other relationships with unconsolidated entities or other persons, that have or are reasonably likely to have a material current or future impact on its financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.

Market Risk

In the normal course of business, the Company is exposed to foreign currency exchange rate and interest rate risks that could impact its results of operations.

At times, the Company reduces its foreign currency risk exposures by creating offsetting positions through the use of derivative financial instruments. All of the Company's derivatives have high correlation with the underlying exposures. Accordingly, changes in fair value of derivatives are expected to be offset by changes in value of the underlying exposures. The Company does not use derivative financial instruments for trading purposes.

The Company manages a foreign currency hedging program to hedge against fluctuations in foreign-currency-denominated trade liabilities by periodically entering into forward foreign exchange contracts. The aggregate notional value of forward foreign exchange contracts the Company entered into amounted to \$32.1 and \$25.1 for the three months ended September 30, 2006 and 2005, respectively, and \$86.1 and \$67.0 for the nine months ended September 30, 2006 and 2005, respectively.

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The following table summarizes as of September 30, 2006, the Company's forward foreign exchange contracts by currency. All of the Company's forward foreign exchange contracts mature within a year. Contract amounts are representative of the expected payments to be made under these instruments:

	Contract Amounts (in thousand)			
	Receive		Pay	
Contracts to receive US\$/pay British pounds ("GBP").....	US\$	6,346	GBP	3
Contracts to receive euro ("EUR")/pay US\$.....	EUR	896	US\$	1
Contracts to receive GBP/pay US\$	GBP	2,167	US\$	4
Contracts to receive US\$/pay EUR	US\$	715	EUR	
Contract to Receive HK\$/pay EUR	HK\$	644	EUR	
Contracts to receive Swiss Francs ("CHF")/pay EUR.....	CHF	876	EUR	

A 10% change in interest rates affecting the Company's floating rate debt instruments would have an immaterial impact on the Company's pre-tax earnings

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and cash flows over the next fiscal year. Such a move in interest rates would have a minimal impact on the fair value of the Company's floating rate debt instruments.

The Company sells its products worldwide and a substantial portion of its net sales, cost of sales and operating expenses are denominated in foreign currencies. This exposes the Company to risks associated with changes in foreign currency exchange rates that can adversely impact revenues, net income and cash flow. In addition, the Company is potentially subject to concentrations of credit risk, principally in accounts receivable. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company's major customers are retailers, branded apparel companies and contract manufacturers that have historically paid their balances with the Company.

There were no significant changes in the Company's exposure to market risk for the three and nine months ended September 30, 2006 and 2005.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management has identified the following policies and estimates as critical to the Company's business operations and the understanding of the Company's results of operations. Note that the preparation of this Quarterly Report on Form 10-Q requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Company's financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates, and the differences could be material.

Revenue Recognition

The Company recognizes revenue from product sales at the time of shipment and includes freight billed to customers. In addition, in accordance with Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition, revised and updated," the Company recognizes revenues from fixed price service contracts on a pro-rata basis over the life of the contract as they are generally performed evenly over the contract period. Revenues derived from other service contracts are recognized when the services are performed.

SAB No. 104 requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed or determinable; and (4) collectibility is reasonably assured. Should changes in conditions cause management to determine that these criteria are not met for certain future transactions, revenue recognized for a reporting period could be adversely affected.

Sales Returns and Allowances

Management must make estimates of potential future product returns, billing adjustments and allowances related to current period product revenues. In establishing a provision for sales returns and allowances, management relies principally on the Company's history of product return rates as well as customer service billing adjustments and allowances, each of which is regularly analyzed.

Management also considers (1) current economic trends, (2) changes in customer demand for the Company's products and (3) acceptance of the Company's products in the marketplace when evaluating the adequacy of the Company's provision for sales returns and allowances. Historically, the Company has not experienced a significant change in its product return rates resulting from these factors. For

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the three and nine months ended September 30, 2006 and 2005, the provision for sales returns and allowances accounted for as a reduction to gross sales was not material.

Allowance for Doubtful Accounts

Management makes judgments, based on established aging policy, historical experience and future expectations, as to the collectibility of the Company's accounts receivable, and establishes an allowance for doubtful accounts. The allowance for doubtful accounts is used to reduce gross trade receivables to their estimated net realizable value. When evaluating the adequacy of the allowance for doubtful accounts, management specifically analyzes customer specific exposures, amounts based upon an aging schedule, historical bad debt experience, customer concentrations, customer creditworthiness and current trends. The Company's accounts receivable balances were \$141.9, net of allowances of \$12.4, at September 30, 2006, and \$128.9, net of allowances of \$10.7, at December 31, 2005.

Inventories

Inventories are stated at the lower of cost or market value and are categorized as raw materials, work-in-process or finished goods. The value of inventories determined using the last-in, first-out method was \$10.8 and \$9.1 as of September 30, 2006 and December 31, 2005, respectively. The value of all other inventories determined using the first-in, first-out method was \$110.7 and \$90.1 as of September 30, 2006 and December 31, 2005, respectively.

On an ongoing basis, the Company evaluates the composition of its inventories and the adequacy of its allowance for slow-turning and obsolete products. Market value of aged inventory is determined based on historical sales trends, current market conditions, changes in customer demand, acceptance of the Company's products, and current sales activities for this type of inventory.

Goodwill

The Company evaluates goodwill for impairment annually, using a fair value approach, at the reporting unit level. In addition, the Company evaluates goodwill for impairment if a significant event occurs or circumstances change, which could result in the carrying value of a reporting unit exceeding its fair value. Factors the Company considers important, which could indicate impairment, include the following: (1) significant under-performance relative to historical or projected future operating results; (2) significant changes in the manner of the Company's use of the acquired assets or the strategy for the Company's overall business; (3) significant negative industry or economic trends; (4) significant decline in the Company's stock price for a sustained period; and (5) the Company's market capitalization relative to net book value. The Company assesses the existence of impairment by comparing the implied fair values of its reporting units with their respective carrying amounts, including goodwill. During the fourth quarter of 2005, the Company completed its annual goodwill impairment assessment, and based on the results, the Company determined that no impairment of goodwill existed at October 31, 2005, and there have been no indicators of impairment since that date. A subsequent determination that this goodwill is impaired, however, could have a significant adverse impact on the Company's results of operations or financial condition.

Impairment of Long-Lived Assets

The Company periodically reviews its long-lived assets for impairment by comparing the carrying values of the assets with their estimated future undiscounted cash flows. If it is determined that an impairment loss has occurred, the loss is recognized during that period. The impairment loss is calculated as the difference between asset carrying values and fair value as

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determined by prices of similar items and other valuation techniques (discounted cash flow analysis), giving consideration to recent operating performance and pricing trends. Asset impairment analysis related to certain fixed assets in connection with the Company's restructuring initiatives requires management's best estimate of net realizable value, which includes an assessment of asset life and pricing trends impacting those assets and, where appropriate, quoted market prices. Management's analysis is, in part, sensitive to its estimates of salvage value for certain assets as well as the continuing relevance of quoted market prices of assets and other factors of fair value. Changes in management's estimates could impact the amount of the Company's impairment charges, as well as depreciation expense recorded on certain assets. There were no significant impairment charges related to long-lived assets for the three and nine months ended September 30, 2006 and 2005.

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Investments

The Company regularly evaluates the carrying value of its investments. When assessing investment securities for other-than-temporary declines in value, the Company considers such factors as, among other things, the financial condition of the investee, competitive factors, the outlook for the overall industry in which the investee operates and new products that the investee may have forthcoming that will improve its operating results. When the carrying value of an investment exceeds the fair value and the decline in fair value is deemed to be other-than-temporary, the Company reduces the carrying value of the investment to fair value. During the three and nine months ended September 30, 2006, the Company recorded \$5.0 of an other-than-temporary reduction in fair value of the Company's investment in International Imaging Materials, Inc. ("IIMAK"). Should the fair value of the Company's investment continue to decline in future periods, the Company may be required to record additional charges if the decline is determined to be other-than-temporary.

Accounting for Income Taxes

As part of the process of preparing the consolidated financial statements, management is required to estimate the income taxes in each jurisdiction in which the Company operates. This process involves estimating the actual current tax liabilities, together with assessing temporary differences resulting from the differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. Management must then assess the likelihood that the deferred tax assets will be recovered, and to the extent that management believes that recovery is not more than likely, the Company must establish a valuation allowance. If a valuation allowance is established or increased during any period, the Company must include this amount as an expense within the tax provision in the consolidated statement of income. Significant management judgment is required in determining the Company's provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recognized against net deferred assets. The valuation allowance is based on management's estimates of the taxable income in the jurisdictions in which the Company operates and the period over which the deferred tax assets will be recoverable.

Deferred taxes are not provided on the portion of undistributed earnings of non-U.S. subsidiaries, which is considered to be permanently reinvested. In the event that management changes its determination that undistributed earnings of its non-U.S. subsidiaries are permanently reinvested, circumstances change in future periods, or there is a change in accounting principles generally accepted in the United States, the Company may need to establish an additional income tax provision for the U.S. and other taxes arising from repatriation, which could materially impact its results of operations.

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Foreign Currency Translation

As of September 30, 2006 and December 31, 2005, accumulated other comprehensive income primarily consisted of cumulative foreign currency translation adjustments. The net assets of the Company's foreign operations are translated into U.S dollars using the exchange rates at each balance sheet date. Results of operations are translated using the average exchange rate prevailing throughout the period. The U.S. dollar results that arise from such translations are included in cumulative currency translation adjustments in accumulated other comprehensive income. At September 30, 2006 and December 31, 2005, the cumulative foreign translation adjustment was \$16.0 and \$10.0, respectively. No incremental U.S income taxes are provided for these translation adjustments since the Company considers undistributed earnings of foreign subsidiaries to be permanently invested. Gains and losses resulting from foreign currency transactions are included in net income. Foreign currency transactions resulted in a gain of \$0.1 and a loss of \$1.6, respectively, for the three and nine months ended September 30, 2006. Foreign currency transactions resulted in a gain of \$0.1 and a loss of \$0.3, respectively, for the three and nine months ended September 30, 2005.

Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" (SFAS 123R), which replaces SFAS 123, "Accounting for Stock-Based Compensation", by eliminating the choice to account for employee stock options under Accounting Principle Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). SFAS 123R requires that new, modified and unvested share-based awards to employees, such as stock options and restricted stock, be recognized in the financial statements based on the estimated fair value of such awards at date of grant and recognized as compensation expense over the vesting period. The fair value of each option award is estimated using the Black-Scholes option pricing model taking into account certain key assumptions. The primary assumptions which the Company considered when

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determining the fair value of each option award included 1) the expected term of awards granted, 2) the expected volatility of the Company's stock price, 3) the risk-free interest rate applied and 4) an estimate for expected forfeitures. The expected term of awards granted is based upon the historical exercise patterns of the participants in the Company's plans, and expected volatility is based on the historical volatility of the Company's stock, commensurate with the expected term of the respective awards. The risk-free rate for the expected term of the awards is based on the U.S. Treasury yield curve in effect at the time of grant. In addition, the Company estimates forfeitures when recognizing compensation expense and will adjust estimated forfeitures over the requisite service period to the extent actual forfeitures differ, or are expected to differ, from such estimates.

Item 3. Quantitative and Qualitative Disclosure About Market Risk.

The information required by this Item is set forth under the heading "Market Risk" in Management's Discussion and Analysis of Financial Condition and Results of Operations, above, which information is hereby incorporated by reference.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures. The Company, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, conducted an assessment of the effectiveness of the design and operation of its disclosure controls and

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procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report (the "Evaluation Date"). The Company's Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that its disclosure controls and procedures were effective such that the information relating to the Company required to be disclosed in its SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting identified in connection with the assessment that occurred during the third quarter of 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 6. Exhibits.

- Exhibit 10.1 Settlement Agreement
- Exhibit 31.1 Certification of the Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- Exhibit 31.2 Certification of the Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a).
- Exhibit 32.1 Certification of the Chief Executive Officer required by Rule 13a-14(b) or 18 U.S.C. 1350.
- Exhibit 32.2 Certification of the Chief Financial Officer required by Rule 13a-14(b) or 18 U.S.C. 1350.

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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.

Paxar Corporation

(Registrant)

By: /s/ Anthony S. Colatrella

Anthony S. Colatrella
Vice President
and Chief Financial Officer

November 9, 2006

Date