

VALSPAR CORP
Form 10-Q
June 10, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended May 1, 2009

Or

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

For the transition period from _____ to _____

Commission File Number: 1-3011

THE VALSPAR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

36-2443580

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

901 3rd Avenue South

Minneapolis, MN 55402

(Address of principal executive offices, including zip code)

Edgar Filing: VALSPAR CORP - Form 10-Q

612/851-7000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

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

As of June 4, 2009, The Valspar Corporation had 100,516,695 shares of common stock outstanding, excluding 17,925,929 shares held in treasury. We had no other classes of stock outstanding.

Edgar Filing: VALSPAR CORP - Form 10-Q

Index to Form 10-Q

for the Quarter Ended May 1, 2009

<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>	<u>Page No.</u>
<u>Item 1.</u>	<u>Financial Statements</u>	
	<u>Condensed Consolidated Balance Sheets – May 1, 2009, April 25, 2008 and October 31, 2008</u>	2 - 3
	<u>Condensed Consolidated Statements of Income – Three months and six months ended May 1, 2009 and April 25, 2008</u>	4
	<u>Condensed Consolidated Statements of Cash Flows – Six months ended May 1, 2009 and April 25, 2008</u>	5
	<u>Notes to Condensed Consolidated Financial Statements – May 1, 2009</u>	6 - 15
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	16 - 21
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	22
<u>Item 4.</u>	<u>Controls and Procedures</u>	22
<u>PART II.</u>	<u>OTHER INFORMATION</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	23
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	23
<u>Item 6.</u>	<u>Exhibits</u>	23
	<u>SIGNATURES</u>	24

Table of Contents

- 2 -

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Edgar Filing: VALSPAR CORP - Form 10-Q

THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (DOLLARS IN THOUSANDS)

<u>ASSETS</u>	May 1, 2009 (Unaudited)	April 25, 2008 (Unaudited)	October 31, 2008 (Note)
CURRENT ASSETS:			
Cash and cash equivalents	\$ 75,640	\$ 77,917	\$ 90,073
Accounts and notes receivable less allowance (5/1/09-\$21,698; 4/25/08-\$11,651; 10/31/08-\$16,389)	491,061	578,612	565,237
Inventories:			
Manufactured products	143,556	207,798	153,325
Raw materials, supplies and work-in-process	95,683	112,456	118,098
Total inventories	239,239	320,254	271,423
Deferred income taxes	32,132	28,012	31,989
Prepaid expenses and other	88,348	93,329	88,298
TOTAL CURRENT ASSETS	926,420	1,098,124	1,047,020
GOODWILL	1,312,118	1,374,422	1,352,813
INTANGIBLES, NET	626,494	605,447	619,468
OTHER ASSETS	5,337	14,369	7,123
LONG-TERM DEFERRED INCOME TAXES	2,714	2,456	3,902
PROPERTY, PLANT AND EQUIPMENT	1,023,658	1,044,806	1,036,460
Less accumulated depreciation	(564,297)	(528,089)	(546,744)
NET PROPERTY, PLANT AND EQUIPMENT	459,361	516,717	489,716
TOTAL ASSETS	\$ 3,332,444	\$ 3,611,535	\$ 3,520,042

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

See Notes to Condensed Consolidated Financial Statements

Table of Contents

Edgar Filing: VALSPAR CORP - Form 10-Q

CONDENSED CONSOLIDATED BALANCE SHEETS - CONTINUED

(DOLLARS IN THOUSANDS)

<u>LIABILITIES AND STOCKHOLDERS EQUITY</u>	May 1, 2009 (Unaudited)	April 25, 2008 (Unaudited)	October 31, 2008 (Note)
CURRENT LIABILITIES:			
Notes payable and commercial paper	\$ 285,977	\$ 304,827	\$ 159,514
Current portion of long-term debt		27	12
Trade accounts payable	252,761	385,546	400,763
Income taxes	9,927	2,951	29,156
Accrued liabilities	245,423	243,814	290,898
TOTAL CURRENT LIABILITIES	794,088	937,165	880,343
LONG-TERM DEBT, NET OF CURRENT PORTION	695,392	807,900	763,129
DEFERRED INCOME TAXES	227,297	219,724	224,764
DEFERRED LIABILITIES	161,340	178,798	165,361
TOTAL LIABILITIES	1,878,117	2,143,587	2,033,597
HUARUN REDEEMABLE STOCK	40,213	43,170	33,577
STOCKHOLDERS EQUITY:			
Common Stock (Par Value - \$0.50; Authorized 250,000,000 shares; Shares issued, including shares in treasury 118,442,624)	59,220	59,220	59,220
Additional paid-in capital	335,523	320,261	331,083
Retained earnings	1,188,631	1,128,394	1,180,011
Other	32,975	130,620	90,036
Less cost of Common Stock in treasury (5/1/09- 17,976,105 shares; 4/25/08-19,004,144 shares; 10/31/08-18,449,741 shares)	(202,235)	(213,717)	(207,482)
TOTAL STOCKHOLDERS EQUITY	1,414,114	1,424,778	1,452,868
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 3,332,444	\$ 3,611,535	\$ 3,520,042

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

See Notes to Condensed Consolidated Financial Statements

Table of Contents

Edgar Filing: VALSPAR CORP - Form 10-Q

THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

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

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	May 1, 2009	April 25, 2008	May 1, 2009	April 25, 2008
Net sales	\$ 668,384	\$ 836,379	\$ 1,307,881	\$ 1,601,503
Cost of sales	447,248	592,118	897,401	1,146,777
Gross profit	221,136	244,261	410,480	454,726
Research and development	22,543	24,608	45,612	47,350
Selling and administrative	141,499	142,549	273,531	275,291
Income from operations	57,094	77,104	91,337	132,085
Interest expense	10,581	13,914	22,507	29,597
Other (income)/expense net	86	1,309	640	3,943
Income before income taxes	46,427	61,881	68,190	98,545
Income taxes	15,297	21,034	22,892	33,683
Net income	\$ 31,130	\$ 40,847	\$ 45,298	\$ 64,862
Huarun redeemable stock accrual (1)	(3,318)	(2,915)	(6,636)	(5,829)
Net income available to common stockholders	\$ 27,812	\$ 37,932	\$ 38,662	\$ 59,033
Net income per common share basic	\$ 0.28	\$ 0.38	\$ 0.39	\$ 0.59
Net income per common share diluted	\$ 0.28	\$ 0.38	\$ 0.39	\$ 0.59
Average number of common shares outstanding				
- basic	99,996,680	99,617,232	99,889,693	99,855,456
- diluted	100,538,299	100,180,834	100,396,752	100,556,774
Dividends paid per common share	\$ 0.15	\$ 0.14	\$ 0.30	\$ 0.28

(1) Huarun redeemable stock accrual reduced basic and diluted net income per common share \$0.03 in the second quarter and \$0.06 year-to-date in 2008 and 2009 as further described in Note 3.

See Notes to Condensed Consolidated Financial Statements

[Table of Contents](#)

Edgar Filing: VALSPAR CORP - Form 10-Q

THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(DOLLARS IN THOUSANDS)

	SIX MONTHS ENDED	
	May 1, 2009	April 25, 2008
OPERATING ACTIVITIES:		
Net income	\$ 45,298	\$ 64,862
Adjustments to reconcile net income to net cash (used in)/provided by operating activities:		
Depreciation	38,688	35,458
Amortization	3,953	3,930
Stock-based compensation	2,517	3,474
(Gain)/loss on asset divestiture	87	580
Changes in certain assets and liabilities, net of effects of acquired businesses:		
(Increase)/decrease in accounts and notes receivable	48,136	(14,100)
(Increase)/decrease in inventories and other current assets	26,754	(23,431)
Increase/(decrease) in trade accounts payable and accrued liabilities	(169,533)	(44,829)
Increase/(decrease) in income taxes payable	(18,835)	3,153
Increase/(decrease) in other deferred liabilities	(1,806)	(631)
Other	(1,887)	(2,016)
Net Cash (Used In)/Provided By Operating Activities	(26,628)	26,450
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(23,316)	(17,833)
Acquired businesses, net of cash		(64,647)
Cash proceeds on disposal of assets	75	19,113
Net Cash (Used In)/Provided By Investing Activities	(23,241)	(63,367)
FINANCING ACTIVITIES:		
Net proceeds from (payments on) borrowing	62,922	80,428
Proceeds from sale of treasury stock	5,575	11,248
Payments on deferred liability excess cash Huarun	(4,818)	
Excess tax benefit from stock-based compensation	181	69
Treasury stock purchases		(39,675)
Dividends paid	(30,042)	(27,934)
Net Cash (Used In)/Provided By Financing Activities	33,818	24,136
Increase/(Decrease) in Cash and Cash Equivalents	(16,051)	(12,781)
Effect of exchange rate changes on Cash and Cash Equivalents	1,618	5,750
Cash and Cash Equivalents at Beginning of Period	90,073	84,948
Cash and Cash Equivalents at End of Period	\$ 75,640	\$ 77,917

See Notes to Condensed Consolidated Financial Statements

[Table of Contents](#)

- 6 -

THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MAY 1, 2009

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of The Valspar Corporation have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended May 1, 2009 are not necessarily indicative of the results that may be expected for the year ending October 30, 2009.

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

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

NOTE 2: ACCOUNTS PAYABLE

Trade accounts payable includes \$23.6 million at May 1, 2009, \$33.1 million at October 31, 2008 and \$30.3 million at April 25, 2008 of issued checks that had not cleared our bank accounts.

NOTE 3: ACQUISITIONS AND DIVESTITURES

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

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

Edgar Filing: VALSPAR CORP - Form 10-Q

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

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

Table of Contents

- 7 -

THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MAY 1, 2009

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

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

Certain of the shares not purchased by us at the closing are subject to various put and call rights. The put and call rights are classified outside of stockholders' equity in Huarun Redeemable Stock. During the fourth quarter of 2008, certain minority stockholders exercised their right to sell shares to us. Acquisition accounting was applied upon the exercise of the put options and our acquisition of the shares. After those purchases, we now own approximately 85.8% of the outstanding shares of Huarun Paints. The balance in Huarun Redeemable Stock was \$40.2 million at May 1, 2009, \$33.6 million at October 31, 2008 and \$43.2 million at April 25, 2008, and represents the accrual for the remaining shares that may be put to us in July 2009.

Edgar Filing: VALSPAR CORP - Form 10-Q

The Huarun Redeemable Stock will be accrued to redemption value and the amount of accretion is shown as an adjustment below net income to arrive at the net income available to common stockholders. We accrued \$3.3 million and \$6.6 million for the three and six-months periods ended May 1, 2009 and \$2.9 million and \$5.8 million for the three and six-month periods ended April 25, 2008. This accrual reduced basic and diluted income available to common stockholders by \$0.03 and \$0.06 for both the three and six-month periods ended May 1, 2009 and April 25, 2008, respectively.

Certain other Huarun shares were awarded as part of a Long Term Incentive Plan (LTIP) by Huarun prior to the acquisition closing. The pre-acquisition share awards are classified as equity awards as there is no obligation to purchase the shares, and if we were to purchase the shares, we would purchase the shares at fair market value.

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

Table of Contents

- 8 -

THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MAY 1, 2009

NOTE 4: COMPREHENSIVE INCOME (LOSS)

For the three and six-month periods ended May 1, 2009 and April 25, 2008, Comprehensive Income, a component of Stockholders' Equity, was as follows:

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	May 1, 2009	April 25, 2008	May 1, 2009	April 25, 2008
Net Income	\$31,130	\$40,847	\$45,298	\$64,862
Other Comprehensive Income, net of tax:				
Foreign currency translation gain (loss)	(21,341)	32,351	(58,230)	48,293
Net unrealized gain (loss) on financial instruments	1,104	125	1,169	456

Edgar Filing: VALSPAR CORP - Form 10-Q

Total Comprehensive Income (Loss)	\$ 10,893	\$ 73,323	\$(11,763)	\$ 113,611
-----------------------------------	-----------	-----------	-------------	------------

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

(Dollars in thousands)	May 1, 2009	April 25, 2008	October 31, 2008
Foreign currency translation	\$ 71,629	\$ 169,968	\$ 129,859
Pension and postretirement benefits, net	(42,356)	(41,937)	(42,356)
Net unrealized gain (loss) on financial instruments	3,702	2,589	2,533
Accumulated other comprehensive income (loss)	\$ 32,975	\$ 130,620	\$ 90,036

NOTE 5: GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill as of May 1, 2009 decreased from the end of fiscal 2008 by \$40.7 million to \$1,312.1 million. The decrease is primarily due to foreign currency translation and the final purchase price allocation related to the acquisition of Aries.

Total intangible asset amortization expense for the six months ended May 1, 2009 was \$4.0 million, compared to \$3.9 million for the same period last year. Estimated amortization expense for each of the five succeeding fiscal years based on the intangible assets as of May 1, 2009 is expected to be approximately \$8.1 million annually.

NOTE 6: SEGMENT INFORMATION

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

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

[Table of Contents](#)

Edgar Filing: VALSPAR CORP - Form 10-Q

THE VALSPAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MAY 1, 2009

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

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

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

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

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	May 1, 2009	April 25, 2008	May 1, 2009	April 25, 2008
Net Sales:				
Coatings	\$ 357,862	\$ 493,928	\$ 732,514	\$ 965,333
Paints	257,161	261,813	469,861	490,562
All Other	74,468	106,285	141,568	194,378
Less Intersegment Sales	(21,107)	(25,647)	(36,062)	(48,770)
Total Net Sales	\$ 668,384	\$ 836,379	\$ 1,307,881	\$ 1,601,503
EBIT				
Coatings	\$ 29,859	\$ 49,481	\$ 54,757	\$ 88,782
Paints	35,384	23,518	51,335	41,818
All Other	(8,235)	2,796	(15,395)	