

VALSPAR CORP  
Form 10-Q  
March 09, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

**FORM 10-Q**

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

For the Three Months  
Ended January 28, 2005

Commission File  
Number: 1-3011

**THE VALSPAR CORPORATION**

State of Incorporation:  
Delaware

IRS Employer ID No.:  
36-2443580

Principal Executive Offices:

1101 Third Street South  
Minneapolis, MN 55415

Telephone Number: 612/332-7371

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 and (2) has been subject to such filing requirements for the past 90 days.     Yes     No

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

As of March 1, 2005, The Valspar Corporation had 50,881,371 shares of common stock outstanding, excluding 9,339,941 shares held in treasury. The Company had no other classes of stock outstanding.

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THE VALSPAR CORPORATION

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for the Quarter Ended January 28, 2005

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (DOLLARS IN THOUSANDS)

January 28, 2005	January 30, 2004	October 29, 2004
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	(Unaudited)	(Unaudited)	(Note)
<b>ASSETS</b>			
CURRENT ASSETS:			
Cash and cash equivalents	\$ 46,018	\$ 38,854	\$ 54,143
Accounts receivable less allowance (1/28/05 \$14,568; 1/30/04 \$17,484; 10/29/04 \$13,278)	425,810	390,852	411,635
Inventories:			
Manufactured products	154,917	130,897	131,312
Raw materials, supplies and work- in-process	93,189	77,181	79,242
	248,106	208,078	210,554
Deferred income taxes	35,427	38,470	34,898
Prepaid expenses and other	91,622	74,216	91,085
<b>TOTAL CURRENT ASSETS</b>	<b>846,983</b>	<b>750,470</b>	<b>802,315</b>
GOODWILL	1,009,870	1,004,445	996,562
INTANGIBLES, NET	321,576	286,027	320,733
OTHER ASSETS, NET	59,709	77,710	63,082
LONG-TERM DEFERRED INCOME TAX	23,229	23,436	23,135
PROPERTY, PLANT AND EQUIPMENT	821,724	750,745	800,706
Less accumulated depreciation	(387,890)	(328,573)	(372,275)
	433,834	422,172	428,431
	\$ 2,695,201	\$ 2,564,260	\$ 2,634,258

NOTE: The Balance Sheet at October 29, 2004 has been derived from the audited consolidated financial statements at that date.

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS CONTINUED  
(DOLLARS IN THOUSANDS)

	January 28, 2005	January 30, 2004	October 29, 2004
	(Unaudited)	(Unaudited)	(Note)
<u>LIABILITIES AND STOCKHOLDERS EQUITY</u>			
CURRENT LIABILITIES:			
Notes payable to banks	\$ 232,695	\$ 76,400	\$ 168,181
Current Portion of long-term debt	88,115	240	27
Trade accounts payable	241,131	188,648	234,446
Income taxes payable	38,011	48,000	45,254
Accrued liabilities	224,039	211,162	270,303
	<hr/>	<hr/>	<hr/>
TOTAL CURRENT LIABILITIES	823,991	524,450	718,211
LONG-TERM DEBT	465,246	790,645	549,073
DEFERRED INCOME TAXES	202,490	190,329	203,608
DEFERRED LIABILITIES	166,718	161,846	163,003
STOCKHOLDERS EQUITY:			
Common Stock (Par Value \$.50; Authorized 250,000,000 shares; Shares issued, including shares in treasury 60,221,312)	30,110	30,110	30,110
Additional paid-in capital	279,222	257,128	269,599
Retained earnings	804,560	706,418	803,156
Other	27,803	2,709	(60)
	<hr/>	<hr/>	<hr/>
	1,141,695	996,365	1,102,805
Less cost of Common Stock in treasury (1/28/05 8,560,222 shares; 1/30/04 9,167,885 shares; 10/29/04 8,916,833 shares)	104,939	99,375	102,442
	<hr/>	<hr/>	<hr/>
	1,036,756	896,990	1,000,363
	<hr/>	<hr/>	<hr/>
	\$ 2,695,201	\$ 2,564,260	\$ 2,634,258
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NOTE: The Balance Sheet at October 29, 2004 has been derived from the audited consolidated financial statements at that date.

See Notes to Condensed Consolidated Financial Statements

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## THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)  
(DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	<b>THREE MONTHS ENDED</b>	
	<b>January 28, 2005</b>	<b>January 30, 2004</b>
Net sales	\$ 557,144	\$ 501,591
Cost of goods sold	404,334	345,239
Gross profit	152,810	156,352
Research and development	18,734	17,275
Selling and administrative	103,381	98,825
Income from operations	30,695	40,252
Interest expense	10,532	10,390
Other expense	1,594	207
Income before income taxes	18,569	29,655
Income taxes	6,871	11,269
Net income	\$ 11,698	\$ 18,386
Net income per common share basic	\$ 0.23	\$ 0.36
Net income per common share diluted	\$ 0.22	\$ 0.35
Average number of common shares outstanding basic	51,440,090	50,874,763

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	<b>THREE MONTHS ENDED</b>	
	diluted	
	52,632,435	52,602,010
Dividends paid per common share	\$ 0.200	\$ 0.180

See Notes to Condensed Consolidated Financial Statements.

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THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(DOLLARS IN THOUSANDS)

	<b>THREE MONTHS ENDED</b>	
	<b>January 28, 2005</b>	<b>January 30, 2004</b>
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 11,698	\$ 18,386
Adjustments to reconcile net income to net cash (used in)/provided by operating activities:		
Depreciation	14,546	13,265
Amortization	1,193	1,123
Loss on asset divestiture	385	123
Changes in certain assets and liabilities, net of effects of acquired businesses:		
(Increase)/decrease in accounts and notes receivable	(3,257)	10,064
(Increase)/decrease in inventories and other current assets	(37,409)	(1,538)
Increase/(decrease) in trade accounts payable and accrued liabilities	(46,612)	(66,363)
Increase/(decrease) in income taxes payable	(7,606)	(1,441)
Increase/(decrease) in other deferred liabilities	6,385	3,008
Other	4,182	1,614
<b>Net Cash (Used In)/Provided By Operating Activities</b>	<b>(56,495)</b>	<b>(21,759)</b>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(13,032)	(10,802)
Net assets of businesses acquired		(43,685)
<b>Net Cash Used In Investing Activities</b>	<b>(13,032)</b>	<b>(54,487)</b>

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	<u>THREE MONTHS ENDED</u>	
<b>FINANCING ACTIVITIES:</b>		
Net proceeds from borrowings	62,592	74,990
Proceeds from sale of treasury stock	13,311	7,720
Treasury stock purchases	(4,206)	
Dividends paid	(10,295)	(9,199)
	<u>61,402</u>	<u>73,511</u>
Net Cash Provided by Financing Activities	61,402	73,511
Decrease in Cash and Cash Equivalents	(8,125)	(2,735)
Cash and Cash Equivalents at Beginning of Period	<u>54,143</u>	<u>41,589</u>
Cash and Cash Equivalents at End of Period	<u>\$ 46,018</u>	<u>\$ 38,854</u>

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JANUARY 28, 2005

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of The Valspar Corporation ( the Company ) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended January 28, 2005 are not necessarily indicative of the results that may be expected for the year ending October 28, 2005.

The Condensed Consolidated Balance Sheet at October 29, 2004 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information refer to the consolidated financial statements and footnotes thereto included in The Valspar Corporation s annual report on Form 10-K for the year ended October 29, 2004.

NOTE 2: ACCOUNTS PAYABLE

Trade accounts payable includes \$35.5 million at January 28, 2005, \$40.1 million at October 29, 2004 and \$33.0 million at January 30, 2004 of issued checks that had not cleared the Company s bank accounts.

**NOTE 3: ACQUISITIONS AND DIVESTITURES**

In August 2004, the Company purchased selected assets of the forest products coatings business of Associated Chemists, Inc. Revenues of the acquired business for the calendar year 2003 were approximately \$28 million. The net assets and operating results have been included in the Company's financial statements from the date of acquisition. The pro forma results of operations for this acquisition have not been presented, as the impact on reported results is not material.

In January 2004, the Company acquired De Beer Lakfabrieken B.V., a manufacturer and distributor of automotive refinish coatings based in The Netherlands. De Beer's revenue for calendar year 2003 was approximately 39 million EUR (approximately \$50 million at time of acquisition). The net assets and operating results have been included in the Company's financial statements from the date of acquisition. The pro forma results of operations for this acquisition have not been presented, as the impact on reported results is not material.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JANUARY 28, 2005 CONTINUED

**NOTE 4: COMPREHENSIVE INCOME**

For the three months ended January 28, 2005 and January 30, 2004, Comprehensive Income, a component of Stockholders' Equity, was as follows:

(Dollars in thousands)	Three Months Ended	
	January 28, 2005	January 30, 2004
Net Income	\$ 11,698	\$ 18,386
Other Comprehensive Income, net of tax:		
Foreign currency translation gain(loss)	26,749	4,785
Deferred gain(loss) on hedging activities	1,052	3,630
Total Comprehensive Income	\$ 39,499	\$ 26,801

**NOTE 5: GOODWILL AND OTHER INTANGIBLE ASSETS**

The carrying amount of goodwill for the quarter ended January 28, 2005 increased from the end of fiscal 2004 by \$13.3 million to \$1,009.9 million. The increase is attributable to foreign currency translation.

Total intangible amortization expense for the three months ended January 28, 2005 was \$1.2 million, compared to \$1.1 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 January 28, 2005 is expected to be approximately \$4.8 million annually.

**NOTE 6: SEGMENT INFORMATION**

In accordance with Statement of Financial Accounting Standards No. 131 (SFAS 131), Disclosures about Segments of an Enterprise and Related Information, and based on the nature of the Company's products, technology, manufacturing processes, customers, and regulatory environment, the Company has determined that it operates its business in two reportable segments: Paints and Coatings.



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

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JANUARY 28, 2005 CONTINUED

The Paints segment includes the products from the Architectural, Automotive and Specialty (AAS) product line. AAS products include interior and exterior decorative paints, primers, varnishes and specialty decorative products, such as enamels, aerosols, and faux finishes for the do-it-yourself and professional markets in North America. Other Paints products include automotive refinish paints and high performance floor paints.

The Coatings segment includes the products from the 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 rigid packaging containers, principally food containers and beverage cans. The products of this segment are sold throughout the world.

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

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

(Dollars in thousands)	Three Months Ended	
	January 28, 2005	January 30, 2004
Net Sales:		
Paints	\$ 158,608	\$ 144,935
Coatings	340,182	312,465
All Other	81,868	62,192
Less Intersegment sales	(23,514)	(18,001)
	\$ 557,144	\$ 501,591
EBIT		
Paints	\$ 8,340	\$ 13,698
Coatings	25,203	36,589
All Other	(4,442)	(10,242)
	\$ 8,101	\$ 39,045

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(Dollars in thousands)	Three Months Ended	
Total EBIT	\$ 29,101	\$ 40,045
Interest	\$ 10,532	\$ 10,390
Income before Income Taxes	\$ 18,569	\$ 29,655

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JANUARY 28, 2005 CONTINUED

NOTE 7: FINANCIAL INSTRUMENTS

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

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

At January 28, 2005, the Company had \$100 million notional amount interest rate swap contracts designated as cash flow hedges to pay fixed rates of interest and receive variable rates of interest based on LIBOR. This contract began during fiscal 2004 and will mature during fiscal 2008. The Company also had a \$100 million notional amount interest rate swap contract designated as a fair value hedge to pay floating rates of interest based on LIBOR, maturing during fiscal 2008. As the critical terms of the interest rate swaps and hedged debt match, there is an assumption of no ineffectiveness for these hedges.

NOTE 8: GUARANTEES AND CONTRACTUAL OBLIGATIONS

The Company sells extended furniture protection plans and offers warranties for certain of its products. For the furniture protection plans, revenue is deferred over the contract period, generally five years, and is recognized based on the ratio of costs incurred to estimated total costs at program completion. For product warranties, the Company estimates the costs that may be incurred under these warranties based on historical claim data and records a liability in the amount of such costs at the time revenue is recognized. The Company periodically assesses the adequacy of these recorded amounts and adjusts as necessary.

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

Balance, October 29, 2004	\$ 88,376
Additional net deferred revenue/accrual made during the period	11,831
Payments made during the period	(5,538)

Balance, January 28, 2005

\$	94,669
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THE VALSPAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
JANUARY 28, 2005 CONTINUED

**NOTE 9: STOCK PLANS**

Under the Company's Stock Option Plans, options for the purchase of up to 10,250,000 shares of common stock may be granted to officers, employees, and non-employee directors. Options are issued at market value at the date of grant and are exercisable in full or in part over a prescribed period of time. The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation is reflected in income, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	<b>Three Months Ended</b>	
	<b>January 28, 2005</b>	<b>January 30, 2004</b>
Net income, as reported	\$ 11,698	\$ 18,386
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects		
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	1,385	1,555
Pro forma net income	<u>\$ 10,313</u>	<u>\$ 16,831</u>
Earnings per share:		
Basic as reported	<u>\$ 0.23</u>	<u>\$ 0.36</u>
Basic pro forma	<u>\$ 0.20</u>	<u>\$ 0.33</u>
Diluted as reported	<u>\$ 0.22</u>	<u>\$ 0.35</u>
Diluted pro forma	<u>\$ 0.20</u>	<u>\$ 0.33</u>

**NOTE 10: PENSION AND OTHER POSTRETIREMENT BENEFITS**

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

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 JANUARY 28, 2005 CONTINUED

The cost of the pension benefits is as follows:

(Dollars in thousands)	Three Months Ended	
Net periodic benefit cost	January 28, 2005	January 30, 2004
Service cost	\$ 684	\$ 509
Interest cost	2,741	2,565
Expected return on plan assets	(3,171)	(3,001)
Amortization of transition asset	(30)	(30)
Amortization of prior service cost	199	216
Recognized actuarial (gain)/loss	863	535
	\$ 1,286	\$ 794

**NOTE 11: RECLASSIFICATION**

Certain amounts in the 2004 financial statements have been reclassified to conform with the 2005 presentation.

**NOTE 12: NEW PRONOUNCEMENTS**

The Financial Accounting Standards Board (FASB) issued FASB Statement No. 123R, Shareholder Based Payment on December 16, 2004. This statement requires companies to measure and recognize compensation cost relating to share-based payment transactions in a company's financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement No. 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company is required to adopt Statement No. 123R on its first interim period that begins after June 15, 2005 or the fourth quarter of fiscal year 2005. The Company is currently evaluating the impact of the adoption of this statement on its financial position and results of operations.

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

**Overview:** In the first quarter of fiscal 2005, our sales increased compared to the prior year as a result of strength in all of our businesses and the impact of recent acquisitions. However, we experienced sharp increases in the cost of raw materials used in the manufacture of coatings due to issues of availability and unprecedented increases in the price of raw material feedstocks, continuing the trend of raw material cost increases in the second half of fiscal 2004. This factor reduced our gross margin and profitability in the first quarter from the 2004 levels. In February 2005, we announced that we will raise prices throughout the second quarter. Our near-term ability to return to historical levels of gross margins depends on our ability to implement these price increases and to pass through to our customers future increases in raw material costs.

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

Critical Accounting Policies: There were no material changes in the Company's critical accounting policies during the first quarter ended January 28, 2005.

Operations: Consolidated net sales increased 11.1% for the quarter to \$557.1 million from \$501.6 million in the prior year. Excluding the positive effect of foreign currency exchange and acquisitions, net sales increased 6.0%.

Net sales for the Paints segment increased 9.4% to \$158.6 million in the quarter compared to the prior year. The increase in sales was largely attributable to the De Beer Lakfabrieken B.V. acquisition. Before acquisitions and excluding the positive effect of foreign currency exchange, core sales growth in Paints was 1.0%. Net sales of the Coatings segment increased 8.9% to \$340.2 million in the quarter compared to the prior year. Before acquisitions and excluding the positive effect of foreign currency exchange, core sales growth in Coatings was 4.9%. Coatings core sales growth was driven primarily by higher selling prices to customers. Due to the seasonal nature of the Company's business, sales for the first quarter are not necessarily indicative of sales for the full year.

In the first quarter of 2005, consolidated gross profit decreased \$3.5 million from the prior year to \$152.8 million. As a percent of consolidated net sales, consolidated gross profit during the first quarter of 2005 decreased to 27.4% from 31.2%. The decrease in gross margin was caused by significant increases in raw material costs, partially offset by price increases.

Consolidated operating expenses (research and development, selling and administrative) increased 5.2% to \$122.1 million (21.9% of consolidated net sales) in the quarter compared to \$116.1 million (23.1% of consolidated net sales) in the first quarter of 2004. The increase in operating expenses during the first quarter was primarily due to expenses associated with the De Beer Lakfabrieken B.V and Associated Chemists, Inc. acquisitions.

Earnings before interest and taxes (EBIT) decreased \$10.9 million or 27.3% from the prior year first quarter. Foreign currency exchange fluctuation had an immaterial effect on EBIT. EBIT in the Paints segment decreased to \$8.3 million from \$13.7 million in the prior year. As a percent of net sales for the Paints segment, EBIT decreased to 5.3% from 9.5%. The decrease was largely attributable to higher raw material costs. EBIT in the Coatings segment decreased to \$25.2 million from \$36.6 million in the quarter compared to last year. As a percent of net sales for the Coatings segment, EBIT decreased to 7.4% from 11.7%. The decrease was primarily due to higher raw materials costs, partially offset by higher prices to customers. Due to the seasonal nature of the Company's business, EBIT for the first quarter is not necessarily indicative of EBIT for subsequent quarters or for the full year.

Interest expense increased to \$10.5 million in the first quarter of 2005 from \$10.4 million in the first quarter of 2004. The increase was primarily driven by the acceleration of amortization fees related to the reduction in our revolving bank line of credit from \$1 billion to \$500 million and by higher interest on non-USD borrowings due to foreign exchange fluctuations. These increases were partly offset by lower debt levels.

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

The effective tax rate decreased from 38% to 37% as a result of increased income in lower tax jurisdictions.

Net income in the first quarter of 2005 decreased 36.4% to \$11.7 million or \$.22 per diluted share.

**Financial Condition:** The net cash used by the Company's operations was \$56.5 million for the first three months of 2005, compared with net cash used by operations of \$21.8 million for the first three months of 2004. During the same period, \$75.9 million in proceeds from bank borrowings and sale of treasury stock were used to fund \$48.4 million in working capital needs, \$13.0 million in capital expenditures, \$10.3 million in dividend payments, and \$4.2 million in treasury stock purchases.

The use of cash for operations was related to a reduction in accounts payable and accrued liabilities and an increase in inventory. Accounts payable and accrued liabilities decreased \$46.6 million largely as a result of accrued liability disbursements. Inventory increased \$37.4 million due to higher raw material costs and accelerated purchases from suppliers due to availability.

Capital expenditures for property, plant and equipment were \$13.0 million in the first three months of 2005, compared with \$10.8 million in the first three months of 2004. The Company expects capital spending in 2005 to be in the range of \$60 to \$65 million.

The ratio of total debt to capital increased to 43.1% at the end of first quarter of 2005 compared to 41.8% at the close of fiscal 2004. The total debt to capital ratio as of January 30, 2004 was 49.2%. The Company believes its cash flow from operations, existing lines of credit, access to credit facilities and access to debt and capital markets will be sufficient to meet its current and projected needs for financing.

There were no material changes in the Company's fixed cash obligations during the three months ended January 28, 2005.

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

**Forward Looking Statements:** This discussion contains certain forward-looking statements. These forward-looking statements are based on management's expectations and beliefs concerning future events. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside the control of the Company that could cause actual results to differ materially from such statements. These uncertainties and other factors include dependence of internal earnings growth on economic conditions and growth in the domestic and international coatings industry; risks related to any future significant acquisitions, including risks of adverse changes in the results of acquired businesses, risks of disruptions in business resulting from the Company's relationships with customers and suppliers; unusual weather conditions that might adversely affect sales; changes in raw materials pricing and availability; changes in governmental regulation, including more stringent environmental, health, and safety regulations; the nature, cost,

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

and outcome of pending and future litigation and other legal proceedings; the outbreak of war and other significant national and international events; and other risks and uncertainties. The foregoing list is not exhaustive, and the Company disclaims any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements.

### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The Company is also subject to interest rate risk. At January 28, 2005, approximately 43% of the Company's total debt consisted of floating rate debt. From time to time, the Company may enter into interest rate swaps to hedge a portion of either its variable or fixed rate debt. Assuming the current level of borrowings, a 10% increase in interest rates from those in effect at the end of the first quarter would increase the Company's interest expense for the second quarter of 2005 by approximately \$0.2 million.

### ITEM 4: CONTROLS AND PROCEDURES

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

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

## PART II. OTHER INFORMATION

### ITEM 1: LEGAL PROCEEDINGS

During the period covered by this report, there were no legal proceedings instituted that are reportable, and there were no material developments in any of the legal proceedings that were previously reported on the Company's Form 10-K for the year ended October 29, 2004.

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### ITEM 2(e): ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
10/30/04 - 11/26/04	90,500	46.44632	90,500	1,873,300
11/27/04 - 12/24/04	0	0	0	1,873,300
12/25/04 - 01/28/05	0	0	0	1,873,300

### ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits  
10(a) Richard M. Rompala Separation Agreement and Release

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- 10(b) The Valspar Corporation Deferred Compensation Plan for Richard M. Rompala (Restated January 1, 2005)
- 10(c) The Valspar Corporation Supplemental Executive Retirement Plan for Richard M. Rompala (Restated January 1, 2005)
- 10(d) Arrangements with New President and Chief Executive Officer
- 10(e) Confidentiality and Noncompetition Agreement between registrant and William L. Mansfield
- 31.1 Section 302 Certification of the Chief Executive Officer
- 31.2 Section 302 Certification of the Chief Financial Officer
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- (b) During the three months ended January 28, 2005, a report on Form 8-K, dated November 1, 2004, was filed on November 3, 2004, under Item 1.01 Entry Into a Material Definitive Agreement; a report on Form 8-K, dated November 22, 2004, was filed on November 22, 2004, under Item 2.02 Results of Operations and Financial Condition; a report on Form 8-K, dated December 8, 2004, was filed on December 10, 2004, under Item 5.02 Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers; a report on Form 8-K dated January 14, 2005, was filed on January 14, 2005, under Item 1.01 Entry Into a Material Definitive Agreement.

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE VALSPAR CORPORATION

Date: March 9, 2005

By /s/ Rolf Engh

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Rolf Engh  
Secretary

Date: March 9, 2005

By /s/ Paul C. Reyelts

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Paul C. Reyelts  
Executive Vice President and  
Chief Financial Officer



