VALSPAR CORP
Form 10-Q
March 09, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended January 29, 2016
	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 1-3011
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.)
1101 South 3rd Street, Minneapolis, Minnesota (Address of principal executive offices)	55415 (Zip Code)

(612) 851-7000
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ 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). x Yes ¨ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

As of March 1, 2016, The Valspar Corporation had 79,085,388 shares of common stock outstanding, excluding 39,357,236 shares held in treasury. The company had no other classes of stock outstanding.

THE VALSPAR CORPORATION

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for the Quarter Ended January 29, 2016

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

ASSETS	January 29, 2016 (Unaudited)	October 30, 2015 (Note)	January 30, 2015 (Unaudited)
CURRENT ASSETS:			
Cash and cash equivalents	$151,676	$185,961	$191,766
Restricted cash	1,383	1,307	2,720
Accounts and notes receivable less allowance (1/29/16 – $9,823; 10/30/15 – $9,550; 1/30/15 – $10,671)	672,296	857,256	747,800
Inventories	515,226	451,909	511,171
Deferred income taxes	31,899	37,707	29,805
Prepaid expenses and other	129,242	97,090	109,636
TOTAL CURRENT ASSETS	1,501,722	1,631,230	1,592,898
GOODWILL	1,281,756	1,287,703	1,103,225
INTANGIBLES, NET	633,521	643,100	587,960
OTHER ASSETS	118,171	112,735	93,707
LONG-TERM DEFERRED INCOME TAXES	10,911	11,042	7,017
Property, plant and equipment, gross	1,593,379	1,582,338	1,580,038
Less accumulated depreciation	(964,219)	(949,573)	(957,984)
PROPERTY, PLANT AND EQUIPMENT, NET	629,160	632,765	622,054
TOTAL ASSETS	$4,175,241	$4,318,575	$4,006,861

Note: The Balance Sheet at October 30, 2015 has been derived from the audited condensed 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, EXCEPT PER SHARE AMOUNTS)

LIABILITIES AND STOCKHOLDERS' EQUITY	January 29, 2016 (Unaudited)	October 30, 2015 (Note)	January 30, 2015 (Unaudited)
CURRENT LIABILITIES:			
Short-term debt	$338,185	$334,022	$193,702
Current portion of long-term debt	116	131	162,502
Trade accounts payable	504,639	553,737	578,954
Income taxes payable	20,675	36,010	36,731
Other accrued liabilities	361,707	442,839	364,463
TOTAL CURRENT LIABILITIES	1,225,322	1,366,739	1,336,352
LONG-TERM DEBT, NET OF CURRENT PORTION	1,708,431	1,706,933	1,350,081
LONG-TERM DEFERRED INCOME TAXES	234,969	240,919	218,914
OTHER LIABILITIES	151,793	148,975	138,749
TOTAL LIABILITIES	3,320,515	3,463,566	3,044,096
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	477,979	474,044	457,124
Retained earnings	2,235,998	2,209,628	1,986,399
Accumulated other comprehensive income (loss)	(218,238)	(195,498)	(72,236)
Less cost of common stock in treasury (1/29/16 – 39,430,801 shares; 10/30/15 – 39,458,773 shares; 1/30/15 – 36,900,588 shares)	(1,700,233)	(1,692,385)	(1,467,742)
TOTAL STOCKHOLDERS' EQUITY	854,726	855,009	962,765
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$4,175,241	$4,318,575	$4,006,861

Note: The Balance Sheet at October 30, 2015 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 OPERATIONS (UNAUDITED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended	
	January 29, 2016	January 30, 2015
Net sales	$885,756	$1,014,669
Cost of sales	566,694	676,528
Restructuring charges - cost of sales	435	4,849
Gross profit	318,627	333,292
Research and development	32,528	32,602
Selling, general and administrative	191,957	189,641
Restructuring charges	434	1,694
Operating expenses	224,919	223,937
Gain on sale of certain assets	—	48,001
Income from operations	93,708	157,356
Interest expense	22,415	16,315
Other (income)/expense - net	615	(965)
Income before income taxes	70,678	142,006
Income taxes	18,247	38,032
Net income	$52,431	$103,974
Net income per common share - basic	$0.67	$1.27
Net income per common share - diluted	$0.65	$1.24
Average number of common shares outstanding		
- basic	78,760,765	81,724,627
- diluted	80,612,302	83,866,879
Dividends paid per common share	$0.33	$0.30

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended	
	January 29, 2016	January 30, 2015
Net income (loss)	$52,431	$103,974
Other comprehensive income (loss)	(22,740)	(52,566)
Comprehensive income (loss)	$29,691	$51,408

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)

	Three Months Ended	
	January 29, 2016	January 30, 2015
OPERATING ACTIVITIES:		
Net income (loss)	$52,431	$103,974
Adjustments to reconcile net income (loss) to net cash (used in)/provided by operating activities:		
Depreciation	20,228	21,744
Amortization	2,793	2,157
Stock-based compensation	4,435	3,266
(Gain)/loss on asset divestitures	(135)	(47,952)
Changes in certain assets and liabilities:		
(Increase)/decrease in accounts and notes receivable	176,042	56,656
(Increase)/decrease in inventories and other assets	(89,304)	(78,469)
Increase/(decrease) in trade accounts payable and other accrued liabilities	(131,574)	(89,009)
Increase/(decrease) in income taxes, net	(23,865)	5,077
Increase/(decrease) in other deferred liabilities	12,638	3,893
Other	(3,200)	(4,659)
Net Cash Provided By/(Used in) Operating Activities	20,489	(23,322)
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(24,117)	(17,839)
Acquisition of businesses, net of cash acquired	(5,698)	(1,599)
Proceeds from divestiture of businesses	—	54,552
Cash proceeds on disposal of assets	6,753	650
(Increase)/decrease in restricted cash	(76)	148
Net Cash (Used In)/Provided By Investing Activities	(23,138)	35,912
FINANCING ACTIVITIES:		
Net proceeds from issuance of debt	—	500,000
Payments of debt	(45)	(113,938)
Net change in other borrowings	5,850	3,987
Net proceeds (repayments) of commercial paper	(450)	(234,894)
Proceeds from stock options exercised	6,454	3,189
Treasury stock purchases	(18,134)	(83,582)
Excess tax benefit from stock-based compensation	4,429	7,768
Dividends paid	(26,063)	(24,574)
Net Cash (Used In)/Provided By Financing Activities	(27,959)	57,956
Increase/(Decrease) in Cash and Cash Equivalents	(30,608)	70,546
Effect of exchange rate changes on Cash and Cash Equivalents	(3,677)	(6,983)
Cash and Cash Equivalents at Beginning of Period	185,961	128,203
Cash and Cash Equivalents at End of Period	$151,676	$191,766

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JANUARY 29, 2016
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of The Valspar Corporation have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) 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 GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended January 29, 2016 are not necessarily indicative of the results that may be expected for the year ending October 28, 2016.

The Condensed Consolidated Balance Sheet at October 30, 2015 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended October 30, 2015.

NOTE 2 – ACQUISITIONS AND DIVESTITURES

On June 1, 2015, we purchased the performance coating businesses of Quest Specialty Chemicals (Quest), which include automotive refinish, aerosol and related specialty paint products, for total consideration of approximately $350,000. The acquisition strengthens our value proposition in automotive refinish and broadens distribution and range of high-performance products. The acquisition was recorded at fair value primarily in our Paints segment and an allocation of the purchase price has been completed, with the exception of certain tax items and working capital adjustments. These adjustments are not expected to have a material impact on our condensed consolidated financial statements. We expect to finalize the purchase price allocation within one year of the date of acquisition. The assets, liabilities and operating results have been included in our financial statements from the date of acquisition.

On December 17, 2014, we completed the divestiture of a non-strategic specialty product offering in our Coatings segment. The divested assets consisted primarily of goodwill, working capital and intellectual property. We recorded the sale in the first quarter of fiscal year 2015 and recorded a pre-tax gain of $48,001 to income from operations.

Pro forma results of operations for the acquisition and divestiture noted above are not presented, as they were immaterial to the reported results.

NOTE 3 – INVENTORIES

Our major classes of inventories consist of the following:

	January 29, 2016	October 30, 2015	January 30, 2015
Manufactured products	$338,490	$268,832	$329,921
Raw materials, supplies and work-in-progress	176,736	183,077	181,250
Total Inventories	$515,226	$451,909	$511,171

Our international inventories are recorded using the first-in, first-out method. Domestic inventories are recorded using the last-in, first-out (LIFO) method. An actual valuation of inventory under the LIFO method can be made only at the end of the year based on inventory levels and costs at that time. Interim LIFO calculations are based on management reviews of price changes, as well as estimates of expected year-end inventory levels and costs, and are subject to the final year-end LIFO inventory valuation.

THE VALSPAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JANUARY 29, 2016
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE 4 – GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill as of January 29, 2016 is $1,281,756, a decrease of $5,947 from the end of fiscal year 2015. The decrease is primarily due to foreign currency translation.

Intangibles, net, as of January 29, 2016 are $633,521, a decrease of $9,579 from the end of fiscal year 2015. The decrease is due to foreign currency translation and amortization.

Total intangible asset amortization expense for the three months ended January 29, 2016 was $2,793, compared to $2,157 for the same period last year. The increase in amortization expense is primarily due to the acquisition of Quest. Estimated annual amortization expense for fiscal 2016 and for each of the five succeeding fiscal years based on the intangible assets as of January 29, 2016 is expected to be approximately $12,000.

NOTE 5 – GUARANTEES AND CONTRACTUAL OBLIGATIONS

Furniture Protection Plans and Warranties: We sell extended furniture protection plans and offer warranties for certain products. In the U.S., revenue related to furniture protection plans is deferred and recognized over the contract life. Historical claims data is used to forecast claims payments over the contract period and revenue is recognized based on the forecasted claims payments. Actual claims costs are reflected in earnings in the period incurred. Anticipated losses are charged to earnings when identified. For product warranties, we estimate the costs that may be incurred under these warranties based on historical claims data and record a liability in the amount of such costs at the time revenue is recognized. Anticipated losses are charged to earnings when identified. The range of contractual lives for our extended furniture protection plans is 3 years to lifetime warranty (estimated as 20 years). We have not sold lifetime warranty plans since 2005. Our furniture protection plans outstanding as of January 29, 2016 have a weighted average contractual life of approximately 11 years; however, we expect to pay substantially all of the claims for such plans within five years.

We periodically assess the adequacy of these recorded amounts and adjust as necessary. Provisions for estimated losses on uncompleted furniture protection plan contracts are made in the period in which such losses can be estimated. The extended furniture protection plans that we enter into have fixed prices. To the extent the actual costs to complete contracts differ from the amounts estimated as of the date of the financial statements, gross margin would be affected in future periods when we revise our estimates.

Changes in the recorded amounts included in other accrued liabilities and other long-term liabilities during the period are as follows:

	Three Months Ended	
	January 29, 2016	January 30, 2015
Beginning balance	$82,871	$80,627
Additional net deferred revenue/accrual made during the period	11,003	4,101
Payments made during the period	(2,367)	(2,162)
Ending Balance	$91,507	$82,566

Contractual Purchase Commitments: We are obligated to make payments under contractual purchase commitments, including unconditional purchase obligations. The majority of our unconditional purchase obligations relate to the supply of raw materials with five-year initial terms. The contracts require the purchase of minimum quantities of raw materials, at current market prices. We have estimated our payment obligations under existing contracts using current market prices and currently expect our purchases to exceed our minimum payment obligations. Payments for contracts with remaining terms in excess of one year are summarized below:

THE VALSPAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JANUARY 29, 2016
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	January 29, 2016
Remainder of 2016	$711
2017	1,512
2018	—
2019	—
2020	—
Thereafter	—
Total	$2,223

Total payments relating to unconditional purchase obligations were approximately $4,523 in the three months ended January 29, 2016, compared to $10,968 in the three months ended January 30, 2015, respectively.

NOTE 6 – FAIR VALUE MEASUREMENT

We measure certain assets and liabilities at fair value and disclose the fair value of certain assets and liabilities recorded at cost in the Condensed Consolidated Financial Statements on both a recurring and nonrecurring basis. Fair value is defined as an exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value accounting rules establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes use of unobservable inputs. Observable inputs must be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability based upon the best information available. Assets and liabilities measured at fair value are to be categorized into one of the three hierarchy levels based on the inputs used in the valuation. We classify assets and liabilities in their entirety based on the lowest level of input significant to the fair value measurement. Transfers of instruments between levels are recorded based on end of period values. There were no transfers between levels for all periods presented. The three levels are defined as follows:

- Level 1: Observable inputs based on quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Observable inputs based on quoted prices for similar assets and liabilities in active markets, or quoted prices for identical assets and liabilities in inactive markets.
- Level 3: Unobservable inputs that reflect an entity's own assumptions about what inputs a market participant would use in pricing the asset or liability based on the best information available in the circumstances.

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JANUARY 29, 2016
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Recurring Fair Value Measurements

The following tables provide information by level for assets and liabilities that are recorded at fair value on a recurring basis:

	Fair Value at January 29, 2016	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets				
Cash equivalents	$39,103	$39,103	$—	$—
Restricted cash[1]	1,383	1,383	—	—
Foreign currency contracts[2]	403	—	403	—
Deferred compensation plan assets[3]	10,796	10,796	—	—
Total Assets	$51,685	$51,282	$403	$—

	Fair Value at October 30, 2015	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets				
Cash equivalents	$26,139	$26,139	$—	$—
Restricted cash[1]	1,307	1,307	—	—
Foreign currency contracts[2]	207	—	207	—
Deferred compensation plan assets[3]	6,579	6,579	—	—
Total Assets	$34,232	$34,025	$207	$—

	Fair Value at January 30, 2015	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets				
Cash equivalents	$66,091	$66,091	$—	$—
Restricted cash[1]	2,720	2,720	—	—
Foreign currency contracts[2]	1,026	—	1,026	—
Deferred compensation plan assets[3]	5,957	5,957	—	—
Total Assets	$75,794	$74,768	$1,026	$—

[1] Restricted cash represents cash that is restricted from withdrawal for contractual or legal reasons.

[2] In the Condensed Consolidated Balance Sheets, foreign currency contracts are included in prepaid expenses and other when in an asset position and other accrued liabilities when in a liability position. The fair market value was estimated using observable market data for similar financial instruments.

[3] The Deferred Compensation Plan Assets consist of the investment funds maintained for the future payments under the Corporation's deferred compensation plan, which is structured as a rabbi trust. Investments held in the rabbi trust are publicly traded mutual funds. Rabbi trust assets are considered irrevocable, and may only be used to pay participant benefits under the plan. The only exception is the event of bankruptcy, in which case the assets in the rabbi trust would be subject to the claims of creditors of the Corporation. In the Condensed Consolidated Balance Sheets, rabbi trust assets are included in other assets.

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The following tables provide information regarding the estimated fair value of our outstanding debt, which is recorded at carrying value in the Condensed Consolidated Balance Sheets:

	Fair Value at	Fair Value Measurements Using Inputs Considered as		
	January 29, 2016	Level 1	Level 2	Level 3
Debt[1]				
Publicly traded debt	$1,749,610	$1,749,610	$—	$—
Non-publicly traded debt	346,732	—	346,732	—
Total Debt	$2,096,342	$1,749,610	$346,732	$—

	Fair Value at	Fair Value Measurements Using Inputs Considered as		
	October 30, 2015	Level 1	Level 2	Level 3
Debt[1]				