

VALSPAR CORP  
Form 10-Q  
May 31, 2017

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 April 28, 2017

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

1101 South 3rd Street,  
Minneapolis, Minnesota 55415  
(Address of principal executive offices) (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.  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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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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 May 26, 2017, The Valspar Corporation had 79,644,992 shares of common stock outstanding, excluding 38,797,632 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 April 28, 2017

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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	April 28, 2017 (Unaudited)	October 28, 2016 (Note)	April 29, 2016 (Unaudited)
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	\$340,878	\$174,720	\$100,278
Restricted cash	9	857	734
Accounts and notes receivable net of allowances (4/28/17 – \$7,346; 10/28/16 – \$7,502; 4/29/16 – \$10,039)	826,826	815,432	827,903
Inventories	542,082	473,294	536,483
Deferred income taxes	32,715	32,033	33,385
Prepaid expenses and other	104,824	98,288	119,828
<b>TOTAL CURRENT ASSETS</b>	<b>1,847,334</b>	<b>1,594,624</b>	<b>1,618,611</b>
<b>GOODWILL</b>	<b>1,270,334</b>	<b>1,284,706</b>	<b>1,296,669</b>
<b>INTANGIBLES, NET</b>	<b>609,977</b>	<b>625,399</b>	<b>639,408</b>
<b>OTHER ASSETS</b>	<b>105,607</b>	<b>106,178</b>	<b>117,064</b>
<b>LONG-TERM DEFERRED INCOME TAXES</b>	<b>21,637</b>	<b>21,174</b>	<b>10,229</b>
Property, plant and equipment, gross	1,778,024	1,682,456	1,642,467
Less accumulated depreciation	(1,109,726 )	(1,014,013 )	(992,860 )
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	<b>668,298</b>	<b>668,443</b>	<b>649,607</b>
<b>TOTAL ASSETS</b>	<b>\$4,523,187</b>	<b>\$4,300,524</b>	<b>\$4,331,588</b>

Note: The Balance Sheet at October 28, 2016 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, EXCEPT PER SHARE AMOUNTS)

LIABILITIES AND STOCKHOLDERS' EQUITY	April 28, 2017 (Unaudited)	October 28, 2016 (Note)	April 29, 2016 (Unaudited)
<b>CURRENT LIABILITIES:</b>			
Short-term debt	\$284,279	\$71,339	\$333,100
Current portion of long-term debt	150,106	150,107	101
Trade accounts payable	605,640	553,152	533,741
Income taxes payable	13,971	28,216	21,503
Other accrued liabilities	403,227	463,006	393,282
<b>TOTAL CURRENT LIABILITIES</b>	<b>1,457,223</b>	<b>1,265,820</b>	<b>1,281,727</b>
<b>LONG-TERM DEBT, NET</b>	<b>1,543,704</b>	<b>1,542,926</b>	<b>1,692,159</b>
<b>LONG-TERM DEFERRED INCOME TAXES</b>	<b>186,146</b>	<b>191,821</b>	<b>238,173</b>
<b>OTHER LONG-TERM LIABILITIES</b>	<b>166,590</b>	<b>186,534</b>	<b>151,316</b>
<b>TOTAL LIABILITIES</b>	<b>3,353,663</b>	<b>3,187,101</b>	<b>3,363,375</b>
<b>STOCKHOLDERS' EQUITY:</b>			
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	510,983	495,920	483,383
Retained earnings	2,518,831	2,458,101	2,289,952
Accumulated other comprehensive income (loss)	(245,634 )	(217,183 )	(174,671 )
Less cost of common stock in treasury (4/28/17 – 38,812,528 shares; 10/28/16 – 39,019,811 shares; 4/29/16 – 39,184,461 shares)	(1,673,876 )	(1,682,635 )	(1,689,671 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>1,169,524</b>	<b>1,113,423</b>	<b>968,213</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$4,523,187</b>	<b>\$4,300,524</b>	<b>\$4,331,588</b>

Note: The Balance Sheet at October 28, 2016 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		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Net sales	\$1,095,833	\$1,056,797	\$2,003,485	\$1,942,553
Cost of sales	719,926	655,356	1,317,059	1,222,485
Gross profit	375,907	401,441	686,426	720,068
Research and development	35,487	35,591	68,708	68,119
Selling, general and administrative	212,382	234,925	415,089	427,316
Operating expenses	247,869	270,516	483,797	495,435
Income from operations	128,038	130,925	202,629	224,633
Interest expense	22,844	22,789	45,388	45,204
Other (income) expense - net	(2,146	) 751	(2,822	) 1,366
Income before income taxes	107,340	107,385	160,063	178,063
Income taxes	31,793	27,358	43,769	45,605
Net income	\$75,547	\$80,027	\$116,294	\$132,458
Net income per common share - basic	\$0.95	\$1.01	\$1.47	\$1.68
Net income per common share - diluted	\$0.93	\$0.99	\$1.43	\$1.64
Average number of common shares outstanding				
- basic	79,347,312	78,955,687	79,308,624	78,858,226
- diluted	81,504,531	80,878,849	81,424,897	80,739,760
Dividends paid per common share	\$0.37	\$0.33	\$0.74	\$0.66

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		Six Months Ended	
	Ended			
	April 28,	April 29,	April 28,	April 29,
	2017	2016	2017	2016
Net income	\$75,547	\$80,027	\$116,294	\$132,458
Other comprehensive income (loss)	38,711	43,567	(28,451 )	20,827
Comprehensive income (loss)	\$114,258	\$123,594	\$87,843	\$153,285

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)

	Six Months Ended			
	April 28,		April 29,	
	2017		2016	
<b>OPERATING ACTIVITIES:</b>				
Net income	\$	116,294	\$	132,458
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation		42,247		41,872
Amortization		5,772		5,811
Stock-based compensation		17,647		16,925
Changes in certain assets and liabilities:				
(Increase)/decrease in accounts and notes receivable	(26,834	)	41,365	)
(Increase)/decrease in inventories and other assets	(89,486	)	(95,488	)
Increase/(decrease) in trade accounts payable and other accrued liabilities	12,383	)	(76,484	)
Increase/(decrease) in income taxes, net	(13,284	)	(23,187	)
Increase/(decrease) in other non-current liabilities	(8,661	)	(4,531	)
Other	(1,346	)	(1,766	)
Net cash provided by (used in) operating activities	54,732		36,975	
<b>INVESTING ACTIVITIES:</b>				
Purchases of property, plant and equipment	(52,992	)	(60,554	)
Acquisition of businesses, net of cash acquired	—		(24,444	)
Purchase of noncontrolling interest	(5,820	)	—	)
Cash proceeds on disposal of assets	981		8,435	
Decrease in restricted cash	848		573	
Net cash used in investing activities	(56,983	)	(75,990	)
<b>FINANCING ACTIVITIES:</b>				



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Payments of debt	(75	)	(1,996	)
Net change in other borrowings	766		7,808	
Net proceeds (repayments) of commercial paper	212,154		(8,132	)
Proceeds from stock options exercised	7,268		12,902	
Treasury stock purchases	—		(18,134	)
Excess tax benefit from stock-based compensation	5,520		10,119	
Dividends paid	(59,541	)	(52,155	)
Net cash provided by (used in) financing activities	166,092		(49,588	)
Increase/(decrease) in cash and cash equivalents	163,841		(88,603	)
Effect of exchange rate changes on cash and cash equivalents	2,317		2,920	
Cash and cash equivalents at beginning of period	174,720		185,961	
Cash and cash equivalents at end of period	\$	340,878	\$	100,278

See Notes to Condensed Consolidated Financial Statements

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
APRIL 28, 2017  
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of The Valspar Corporation (Valspar, the Company, we, us or our) 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 three and six months ended April 28, 2017 are not necessarily indicative of the results that may be expected for the year ending October 27, 2017. The Condensed Consolidated Balance Sheet at October 28, 2016 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.

The Company made certain reclassifications to prior period amounts to conform to the current year presentation. These reclassifications did not have a material effect on the Condensed Consolidated Statements of Operations, Balance Sheets or Cash Flows.

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 28, 2016.

Proposed Merger with The Sherwin-Williams Company

On March 19, 2016, Valspar entered into an Agreement and Plan of Merger (the Merger Agreement) with The Sherwin-Williams Company (Sherwin-Williams) and Viking Merger Sub, Inc., a wholly-owned subsidiary of Sherwin-Williams (Merger Sub).

The Merger Agreement provides that, among other things and subject to the terms and conditions of the Merger Agreement, (1) Merger Sub will be merged with and into Valspar (the Merger), with Valspar surviving the Merger as a wholly-owned subsidiary of Sherwin-Williams, and (2) at the effective time of the Merger, each outstanding share of common stock of Valspar, par value \$0.50 per share (Valspar common stock) (other than Valspar common stock held in treasury by Valspar, owned by a subsidiary of Valspar or owned by Sherwin-Williams or any of its wholly-owned subsidiaries, or shares with respect to which appraisal rights have been validly exercised and not lost in accordance with Delaware law) will be converted into the right to receive the Merger Consideration.

The Merger Consideration means \$113.00 per share in cash, except that if Sherwin-Williams is required, in order to obtain the necessary antitrust approvals, to commit to any divestiture, license, hold separate, sale or other disposition of or with respect to assets, businesses or product lines of Valspar, Sherwin-Williams or their subsidiaries representing, in the aggregate, in excess of \$650 million of Net Sales (as defined in the Merger Agreement), then the Merger Consideration will be \$105.00 per share in cash.

The Merger Agreement contains certain termination rights, and we may be required to pay Sherwin-Williams a termination fee of \$300 million.

For further information on the Merger Agreement, refer to the Merger Agreement, a copy of which was filed as Exhibit 2.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 21, 2016, and which is incorporated by reference herein.

On June 29, 2016, Valspar stockholders voted to adopt the Merger Agreement at a special meeting of stockholders held for that purpose. Completion of the Merger remains subject to certain closing conditions, including the expiration or termination of the applicable waiting period under the U.S. Hart-Scott-Rodino Antitrust Improvements Act and the receipt of regulatory approvals in certain other jurisdictions.

We recognized Merger-related costs for employee-related expenses and professional services of \$8,152 and \$16,835 for the three and six months ended April 28, 2017, respectively, in Selling, general and administrative in the Condensed Consolidated Statements of Operations. Merger-related costs of \$18,240 were recognized for the three and six months ended April 29, 2016.

On March 20, 2017, in accordance with the Merger Agreement, Valspar and Sherwin-Williams extended the outside date of the Merger Agreement from March 21, 2017 to June 21, 2017.

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

On April 11, 2017, in connection with the reviews of the Federal Trade Commission (FTC) and Canadian Competition Bureau (CCB) of the proposed Merger, Valspar entered into an asset purchase agreement pursuant to which it agreed to sell to Axalta Coating Systems Ltd. the assets and liabilities related to its North American Industrial Wood Products business for a purchase price of approximately \$420 million in cash, subject to certain adjustments. Such sale is conditioned on, among other things, completion of the Merger with Sherwin-Williams.

On May 26, 2017, Valspar and Sherwin-Williams announced the receipt of regulatory approval from the FTC and CCB with respect to the Merger. The FTC and CCB were the only remaining regulatory approvals required before completing the Merger. Sherwin-Williams and Valspar expect to complete the Merger on June 1, 2017.

**NOTE 2 – ACQUISITIONS AND DIVESTITURES**

On February 4, 2016, we purchased ISVA Vernici (ISVA), a European coil coatings manufacturer headquartered in Turin, Italy, for total consideration of approximately \$23,000. The ISVA acquisition extends our manufacturing footprint in Europe and brings customers an expanded product offering and increased customer service capabilities. The acquisition was recorded at fair value in our Coatings segment and an allocation of the purchase price has been completed. The assets, liabilities and operating results have been included in our financial statements from the date of acquisition. Pro forma results of operations for ISVA are not presented as they are immaterial to the reported results.

**NOTE 3 – INVENTORIES**

Our major classes of inventories consist of the following:

	April 28, 2017	October 28, 2016	April 29, 2016
Manufactured products	\$331,411	\$279,461	\$338,791
Raw materials, supplies and work-in-progress	210,671	193,833	197,692
Total Inventories	\$542,082	\$473,294	\$536,483

Our international inventories are recorded using the first-in, first-out method. Domestic inventories, except for our Quest Specialty Chemicals (Quest) subsidiaries, 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.

**NOTE 4 – GOODWILL AND OTHER INTANGIBLE ASSETS**

The carrying amount of goodwill as of April 28, 2017 is \$1,270,334, a decrease of \$14,372 from the end of fiscal year 2016. The decrease is due to foreign currency translation.

Intangibles, net, as of April 28, 2017 are \$609,977, a decrease of \$15,422 from the end of fiscal year 2016. The decrease is due to foreign currency translation and amortization.

Total intangible asset amortization expense for the six months ended April 28, 2017 was \$5,772 compared to \$5,811 for the same period last year. Estimated annual amortization expense for fiscal 2017 and for each of the five succeeding fiscal years based on the intangible assets as of April 28, 2017 is expected to be approximately \$12,000.

**NOTE 5 – GUARANTEES**

Furniture Protection Plans: 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. The range of contractual lives for our extended furniture protection plans is three years to lifetime warranty (estimated as 20 years). We have not sold lifetime warranty plans since 2005. Our furniture protection plans outstanding as of April 28, 2017 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

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
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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.

Warranties: We offer warranties for certain products. 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.

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

	Six Months Ended	
	April 28, 2017	April 29, 2016
Beginning balance	\$90,038	\$82,871
Additional net deferred revenue/accrual made during the period	4,620	14,851
Payments made during the period	(3,920 )	(6,067 )
Ending balance	\$90,738	\$91,655

**NOTE 6 – FAIR VALUE MEASUREMENT**

We measure certain assets and liabilities at fair value or 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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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 APRIL 28, 2017  
 (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

## 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 April 28, 2017	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets				
Cash equivalents	\$184,349	\$184,349	\$ —	\$ —
Restricted cash <sup>1</sup>	9	9	—	—
Deferred compensation plan assets <sup>3</sup>	21,345	21,345	—	—
Total Assets	\$205,703	\$205,703	\$ —	\$ —

## Liabilities

Foreign currency contracts <sup>2</sup>	\$39	\$—	\$ 39	\$ —
Total Liabilities	\$39	\$—	\$ 39	\$ —

	Fair Value at October 28, 2016	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets				
Cash equivalents	\$39,842	\$39,842	\$—	\$ —
Restricted cash <sup>1</sup>	857	857	—	—
Foreign currency contracts <sup>2</sup>	267	—	267	—
Deferred compensation plan assets <sup>3</sup>	12,864	12,864	—	—
Total Assets	\$53,830	\$53,563	\$267	\$ —

	Fair Value at April 29, 2016	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets				
Cash equivalents	\$8,472	\$8,472	\$—	\$ —
Restricted cash <sup>1</sup>	734	734	—	—
Foreign currency contracts <sup>2</sup>	608	—	608	—
Deferred compensation plan assets <sup>3</sup>	11,792	11,792	—	—
Total Assets	\$21,606	\$20,998	\$ 608	\$ —

<sup>1</sup> Restricted cash represents cash that is restricted from withdrawal for contractual or legal reasons.

<sup>2</sup> 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.

<sup>3</sup> The Deferred Compensation Plan Assets consist of the investment funds maintained for the future payments under the Company'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 Company. In the Condensed Consolidated Balance Sheets, rabbi trust assets are included in Other assets.

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THE VALSPAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
 APRIL 28, 2017  
 (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

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 April 28, 2017	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Debt <sup>1</sup>				
Publicly traded debt	\$1,737,267	\$1,737,267	\$—	\$ —
Non-publicly traded debt	291,257	—	291,257	—
Total Debt	\$2,028,524	\$1,737,267	\$291,257	\$ —

	Fair Value at October 28, 2016	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Debt <sup>1</sup>				
Publicly traded debt	\$1,777,957	\$1,777,957	\$—	\$ —
Non-publicly traded debt	78,398	—	78,398	—
Total Debt	\$1,856,355	\$1,777,957	\$78,398	\$ —

	Fair Value at April 29, 2016	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Debt <sup>1</sup>				
Publicly traded debt	\$1,769,178	\$1,769,178	\$—	\$ —
Non-publicly traded debt	340,243	—	340,243	—
Total Debt	\$2,109,421	\$1,769,178	\$340,243	\$ —

<sup>1</sup> Debt, excluding debt issuance costs, is recorded at carrying value of \$1,991,257, \$1,778,398 and \$2,040,243 on the Condensed Consolidated Balance Sheets as of April 28, 2017, October 28, 2016 and April 29, 2016, respectively. The fair value of our publicly traded debt is based on quoted prices (unadjusted) in active markets. The fair value of our non-publicly traded debt was estimated using a discounted cash flow analysis based on our current borrowing costs for debt with similar maturities. In addition, the carrying values of our commercial paper included in non-publicly traded debt approximate the financial instrument's fair value as the maturities are less than three months. See Note 7 for additional information on debt.

#### Nonrecurring Fair Value Measurements

We measure certain assets at fair value on a nonrecurring basis. These assets primarily include assets acquired and liabilities assumed as part of an acquisition, as well as property, plant and equipment when the planned use of the asset changes. See Note 2 for additional information on our acquisitions and Note 14 for additional information on restructuring.

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## NOTE 7 – DEBT

Debt consists of the following:

	April 28, 2017	October 28, 2016	April 29, 2016
Short-term debt	\$284,279	\$71,339	\$333,100
Current portion of long-term debt	150,106	150,107	101
Long-term debt:			
Publicly traded bonds	1,550,000	1,550,000	\$1,700,000
Other long-term debt	6,872	6,952	7,042
Less: Debt issuance costs	(13,168 )	(14,026 )	(14,883 )
Long-term debt, net of current portion and debt issuance costs	1,543,704	1,542,926	1,692,159
Total debt, net of debt issuance costs	\$1,978,089	\$1,764,372	\$2,025,360

During the three months ended July 29, 2016, \$150,000 of Senior Notes that mature on May 1, 2017 were reclassified as Current portion of long-term debt. Subsequent to the end of our second quarter of fiscal year 2017, we retired the \$150,000 of Senior Notes in accordance with their scheduled maturity on May 1, 2017.

We maintain a \$750,000 unsecured committed revolving credit facility with a syndicate of banks with a maturity date of December 14, 2018. Under certain circumstances we have the option to increase this credit facility to \$1,000,000. This facility has covenants that require us to maintain certain financial ratios. We were in compliance with these covenants as of April 28, 2017. Our debt covenants do not limit, nor are they reasonably likely to limit, our ability to obtain additional debt or equity financing.

We maintain uncommitted bank lines of credit to meet short-term funding needs in certain of our international locations. These arrangements are reviewed periodically for renewal and modification.

## NOTE 8 – STOCK-BASED COMPENSATION

Compensation expense associated with our stock-based compensation plans was \$7,073 and \$17,647 for the three and six months ended April 28, 2017, respectively, compared to \$12,490 and \$16,925 for the three and six months ended April 29, 2016, respectively.

## NOTE 9 – PENSIONS AND OTHER POST-RETIREMENT BENEFITS

We sponsor a number of defined benefit pension plans for certain hourly and salaried employees. The benefits for most of these plans are generally based on stated amounts for each year of service.

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

	Three Months Ended April 28, 2017		Six Months Ended April 29, 2016	
Service cost	\$738	\$ 679	\$1,478	\$ 1,363
Interest cost	2,904	3,281	5,809	6,590
Expected return on plan assets	(4,915)	(4,834 )	(9,831 )	(9,712 )
Amortization of prior service cost	109	112	219	224
Recognized actuarial loss	1,786	1,638	3,574	3,280
Net periodic benefit cost	622	876	1,249	1,745

The net periodic benefit cost of our post-retirement medical benefits is as follows:

	Three Months Ended April 28, 2017		Six Months Ended April 29, 2016	
Service cost	\$35	\$ 72	\$69	\$ 144
Interest cost	75	90	151	179
Expected return on plan assets	N/A	N/A	N/A	N/A
Amortization of prior service credit	(14 )	(32 )	(28 )	(64 )
Recognized actuarial loss	80	96	161	193
Net periodic benefit cost	\$176	\$ 226	\$353	\$ 452

## NOTE 10 – INCOME TAXES

Our effective income tax rates for the three and six months ended April 28, 2017 and April 29, 2016 are as follows:

	Three Months Ended April 28, 2017		Six Months Ended April 29, 2016	
Effective tax rate	29.6%	25.5 %	27.3%	25.6 %

The second quarter 2017 effective tax rate increased compared to the second quarter of 2016 primarily due to the recognition of U.S. foreign tax credits in the prior year. The second quarter year-to-date effective tax rate increased compared to the same period of 2016 primarily due to the recognition of U.S. foreign tax credits in the prior year, partially offset by the cumulative effect of tax laws that were enacted during the first quarter of 2017 in the U.S., Germany and France.

At October 28, 2016, we had a \$19,067 liability recorded for gross unrecognized tax benefits (excluding interest and penalties) in Other long-term liabilities. Of this total, \$16,674 represents the amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. We recognize interest and penalties related to unrecognized tax benefits in income tax expense. As of October 28, 2016, we had accrued approximately \$4,179 of interest and penalties relating to unrecognized tax benefits. There were no material adjustments to our recorded liability for unrecognized tax benefits or interest and penalties during the first or second quarters of fiscal years 2017 or 2016.



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## NOTE 11 – NET INCOME PER COMMON SHARE

The following table presents the net income per common share calculations for the three and six months ended April 28, 2017 and April 29, 2016:

	Three Months Ended		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Basic				
Net income	\$75,547	\$ 80,027	\$ 116,294	\$ 132,458
Weighted-average common shares outstanding - basic	79,347,317	78,955,687	79,308,624	78,858,226
Net income per common share - basic	\$0.95	\$ 1.01	\$ 1.47	\$ 1.68
Diluted				
Net income	\$75,547	\$ 80,027	\$ 116,294	\$ 132,458
Weighted-average common shares outstanding - basic	79,347,317	78,955,687	79,308,624	78,858,226
Diluted effect of stock options and unvested restricted stock	2,157,219	1,923,162	2,116,273	1,881,534
Weighted-average common shares outstanding - diluted	81,504,536	80,878,849	81,424,897	80,739,760
Net income per common share - diluted	\$0.93	\$ 0.99	\$ 1.43	\$ 1.64

Basic earnings per share are based on the weighted-average number of common shares outstanding during each period. In computing diluted earnings per share, the number of common shares outstanding is increased by common stock options and unvested restricted stock with exercise prices lower than the average market prices of common shares during each period and reduced by the number of shares assumed to have been purchased with proceeds from the exercised options. There were no potential common shares related to our outstanding stock options and unvested restricted stock that were required to be excluded from the computation of diluted earnings per share for the three and six months ended April 28, 2017. Potential common shares of 0 and 47,420 related to our outstanding stock options and unvested restricted stock were excluded from the computation of diluted earnings per share for the three and six months ended April 29, 2016, respectively, as inclusion of these shares would have been antidilutive.

## NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss), net of tax, consisted of the following for the three and six months ended April 28, 2017 and April 29, 2016:

Three Months Ended April 28, 2017	Foreign Currency Translation <sup>1</sup>	Benefit Obligations <sup>2</sup>	Financial Instruments <sup>3</sup>	Accumulated Other Comprehensive Income (Loss)
Balance, January 27, 2017	\$(188,890 )	\$( 88,864 )	\$( 6,591 )	\$( 284,345 )
Other comprehensive income (loss) before reclassifications	36,798	—	(383 )	36,415
Amounts reclassified from accumulated other comprehensive income (loss) to earnings	—	1,961	335	2,296
Balance, April 28, 2017	\$(152,092 )	\$( 86,903 )	\$( 6,639 )	\$( 245,634 )

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	Foreign Currency Translation <sup>1</sup>	Benefit Obligations <sup>2</sup>	Financial Instruments <sup>3</sup>	Accumulated Other Comprehensive Income (Loss)
<b>Three Months Ended April 29, 2016</b>				
Balance, January 29, 2016	\$ (132,416 )	\$ (78,733 )	\$ (7,089 )	\$ (218,238 )
Other comprehensive income (loss) before reclassifications	41,361	—	205	41,566
Amounts reclassified from accumulated other comprehensive income (loss) to earnings	—	1,817	184	2,001
Balance, April 29, 2016	\$ (91,055 )	\$ (76,916 )	\$ (6,700 )	\$ (174,671 )
<b>Six Months Ended April 28, 2017</b>				
Balance, October 28, 2016	\$ (119,656 )	\$ (90,829 )	\$ (6,698 )	\$ (217,183 )
Other comprehensive income (loss) before reclassifications	(32,436 )	—	(432 )	(32,868 )
Amounts reclassified from accumulated other comprehensive income (loss) to earnings	—	3,926	491	4,417
Balance, April 28, 2017	\$ (152,092 )	\$ (86,903 )	\$ (6,639 )	\$ (245,634 )
<b>Six Months Ended April 29, 2016</b>				
Balance, October 30, 2015	\$ (107,489 )	\$ (80,541 )	\$ (7,468 )	\$ (195,498 )
Other comprehensive income (loss) before reclassifications	16,434	—	401	16,835
Amounts reclassified from accumulated other comprehensive income (loss) to earnings	—	3,625	367	3,992
Balance, April 29, 2016	\$ (91,055 )	\$ (76,916 )	\$ (6,700 )	\$ (174,671 )

<sup>1</sup> We deem our foreign investments to be permanent in nature and therefore do not provide for taxes on foreign currency translation adjustments.

<sup>2</sup> Taxes on benefit obligations are recorded in the fourth quarter of each fiscal year.

<sup>3</sup> Amounts reclassified from accumulated other comprehensive income (loss) for financial instruments were net of tax expense of \$114 and \$229 for the three and six months ended April 28, 2017, respectively, and \$115 and \$230 for the three and six months ended April 29, 2016, respectively.

Amounts related to pension and post-retirement medical adjustments are reclassified from accumulated other comprehensive income (loss) to pension cost, which is allocated to cost of sales and operating expenses based on salaries and wages.

## NOTE 13 – SEGMENT INFORMATION

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. We are required 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 earnings before interest and taxes (EBIT).

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

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The Paints segment aggregates our consumer paint and automotive refinish product lines. Consumer paint products include interior and exterior decorative paints, stains, primers, varnishes, high performance floor paints and specialty decorative products, such as enamels, aerosols and faux finishes primarily distributed for the do-it-yourself and professional markets in Australia, China, Europe and North America. Automotive refinish products include refinish paints and aerosol spray paints sold through automotive refinish distributors, body shops and automotive supply distributors and retailers in many countries around the world.

Our remaining activities are included in Other and Administrative. These activities include specialty polymers and colorants that are used internally and sold to other coatings manufacturers, as well as related products, furniture protection plans and furniture care and repair products. Also included within Other and Administrative are our corporate administrative expenses. The administrative expenses include expenses not directly allocated to any other reportable 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 segment data for the three and six months ended April 28, 2017 and April 29, 2016 are as follows:

	Three Months Ended		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Net sales				
Coatings	\$616,175	\$587,436	\$1,181,387	\$1,130,999
Paints	417,967	407,060	709,242	698,157
Other and Administrative	118,607	116,025	211,672	206,550
Less Inter-segment Sales	(56,916 )	(53,724 )	(98,816 )	(93,153 )
Total Net sales	\$1,095,833	\$1,056,797	\$2,003,485	\$1,942,553
 EBIT				
Coatings	\$87,378	\$112,372	\$174,106	\$208,919
Paints	52,314	42,742	56,201	46,561
Other and Administrative	(9,508 )	(24,940 )	(24,856 )	(32,213 )
Total EBIT	130,184	130,174	205,451	223,267
Interest expense	22,844	22,789	45,388	45,204
Income before income taxes	\$107,340	\$107,385	\$160,063	\$178,063

It is not practicable to obtain the information needed to disclose revenues attributable to each of our identified product lines within our reportable segments.

## NOTE 14 – RESTRUCTURING

Restructuring charges in the six months ended April 28, 2017 primarily relate to a continuation of fiscal year 2016 initiatives to improve the global cost structure in our Paints segment. These initiatives included consolidating three sites in our automotive refinish product lines as a result of the Quest acquisition and initiatives to improve our global cost structure by consolidating our operations in the Paints segment. These restructuring activities resulted in pre-tax charges of \$947 and \$2,841 in the three and six months ended April 28, 2017, respectively. Included in restructuring charges are non-cash asset-related charges of \$143 and \$1,112 in the three and six months ended April 28, 2017, respectively. Asset-related charges include asset impairment charges as well as accelerated depreciation for assets



with useful lives that have been shortened, accounted for in accordance with Accounting Standards Codification (ASC) Topic 360, Property, Plant and Equipment.

Restructuring charges in the first half of fiscal year 2016 primarily relate to initiatives in the Paints segment to improve our global cost structure through activities to consolidate our manufacturing operations and non-manufacturing headcount reductions. This resulted primarily from moving certain manufacturing to a third party in our consumer paints product line (continuation of initiative

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started in 2015), consolidating three sites in our automotive refinish product lines as a result of the Quest acquisition and reducing headcount in our Australia region. These restructuring activities resulted in pre-tax charges of \$9,898 and \$10,767 in the three and six months ended April 29, 2016, respectively, including non-cash asset-related charges of \$3,710 and \$4,281, respectively.

We currently expect to incur additional expenses of approximately \$300 in fiscal year 2017 for these restructuring plans, primarily related to site clean-up costs.

The following restructuring charges by segment were recorded in the 2017 and 2016 periods:

	Liability Balance October 28, 2016	Expense	Payments and Other Activity	Liability Balance April 28, 2017
Six Months Ended April 28, 2017				
Coatings				
Severance and employee benefits	\$ 1,456	\$(232 )	\$(410 )	\$ 814
Exit costs (consulting/site clean-up)	425	297	(294 )	428
Total Coatings	1,881	65	(704 )	1,242
Paints				
Severance and employee benefits	3,721	256	(2,367 )	1,610
Asset-related charges	—	1,112	(736 )	376
Exit costs (consulting/site clean-up)	856	1,412	(1,938 )	330
Total Paints	4,577	2,780	(5,041 )	2,316
Other and Administrative				
Severance and employee benefits	1,269	(4 )	(240 )	1,025
Total Other and Administrative	1,269	(4 )	(240 )	1,025
Total	\$ 7,727	\$2,841	\$(5,985 )	\$ 4,583
Six Months Ended April 29, 2016	Liability Balance October 30, 2015	Expense	Payments and Other Activity	Liability Balance April 29, 2016
Coatings				
Severance and employee benefits	\$6,679	\$175	\$(3,399 )	\$ 3,455
Asset-related charges	—	(60 )	60	—
Exit costs (consulting/site clean-up)	—	251	(251 )	—
Total Coatings	6,679	366	(3,590 )	3,455
Paints				
Severance and employee benefits	6,004	5,753	(3,540 )	8,217
Asset-related charges	—	4,341	(4,341 )	—
Exit costs (consulting/site clean-up)	1,069	348	(1,417 )	—
Total Paints	7,073	10,442	(9,298 )	8,217
Other and Administrative				
Severance and employee benefits	38	(41 )	3	—
Total Other and Administrative	38	(41 )	3	—
Total	\$13,790	\$10,767	\$(12,885 )	\$ 11,672

The ending liability balance at April 28, 2017 and April 29, 2016 is included in other accrued liabilities and other long-term liabilities on our Condensed Consolidated Balance Sheets. The restructuring reserve balances presented are considered adequate to cover committed restructuring actions.

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Restructuring charges were recorded in the Condensed Consolidated Statements of Operations for the three and six months ended April 28, 2017 and April 29, 2016 approximately as follows:

	Three Months		Six Months	
	Ended	Ended	Ended	Ended
	April 28,	April 29,	April 28,	April 29,
	2017	2016	2017	2016
Cost of sales	\$471	\$ 4,926	\$1,663	\$ 5,361
Selling, general and administrative	476	4,972	1,178	5,406
Total restructuring charges	\$947	\$ 9,898	\$ 2,841	\$ 10,767

## NOTE 15 – RECENTLY ISSUED ACCOUNTING STANDARDS

## Recently Adopted Standards

In the first quarter of fiscal 2017, we retrospectively adopted Accounting Standards Update (ASU) 2015-03, Simplifying the Presentation of Debt Issuance Costs. This guidance requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying amount of the associated debt liability, consistent with the presentation of a debt discount. Accordingly, we reclassified \$1,661 and \$12,365 of unamortized debt issuance costs previously reported within Prepaid expenses and other and Other assets as a deduction to the carrying amount of our long-term debt in the October 28, 2016 consolidated balance sheet and reclassified \$1,715 and \$13,168 of unamortized debt issuance costs previously reported within Prepaid expenses and other and Other assets as a deduction to the carrying amount of our long-term debt in the April 29, 2016 consolidated balance sheet.

In the first quarter of fiscal 2017, we adopted ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. This guidance clarifies that an entity may defer and present debt issuance costs related to a line-of-credit arrangement as an asset and subsequently amortize those costs ratably over the term of the arrangement, regardless of whether there are any outstanding borrowings on it.

Accordingly, the deferred financing fees related to our revolving credit facility will remain reported as an asset.

In the first quarter of fiscal 2017, we prospectively adopted ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. This guidance clarifies that if a cloud computing arrangement includes a software license, the customer should account for the software license consistent with the acquisition of other software licenses. If the arrangement does not include a software license, the customer should account for the arrangement as a service contract. Adoption of this guidance had no impact on our consolidated financial statements.

## Standards Not Yet Adopted

In March 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07, Compensation - Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The amendments in this update require that an employer report the service cost component of net pension benefit cost in the same line item or items as other compensation costs arising from services rendered by the pertinent employees. The guidance is effective for fiscal years beginning after December 15, 2017, which means the first quarter of our fiscal year 2019. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. Adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment, to eliminate Step 2 from the goodwill impairment test in order to simplify the subsequent measurement of goodwill. The guidance is effective for fiscal years beginning after December 15, 2019, which means the first quarter of our fiscal year 2021.

Early application is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Adoption of this guidance is not expected to have a material impact on our consolidated financial statements. In January 2017, the FASB issued ASU 2017-01, Business Combinations: Clarifying the Definition of a Business, with the objective of adding guidance to assist entities in evaluating whether transactions should be accounted for as acquisitions (disposals) of assets or of businesses. The guidance is effective for fiscal years beginning after December 15, 2017, which means the first quarter of

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our fiscal year 2019. Early adoption is permitted for interim and annual periods in which the financial statements have not been issued or made. We are currently reviewing the revised guidance and assessing the potential impact on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows: Amendment to Restricted Cash, on the classification and presentation of changes in restricted cash on the statement of cash flows. Amounts generally described as restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2017, which means the first quarter of our fiscal year 2019. Early adoption is permitted. Adoption of this guidance will not have a material impact on our consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Income Taxes: Intra-Entity Asset Transfers (Other Than Inventory), which will require immediate recognition of current and deferred income tax consequences for intercompany asset transfers (other than inventory) at the time of the asset transfer. Under the existing standard, current and deferred income tax consequences are recognized when the assets are sold to an outside party. This new guidance is intended to align with International Accounting Standards 12, Income Taxes. The guidance is effective for fiscal years beginning on or after December 15, 2017, which means the first quarter of our fiscal year 2019. Early adoption is permitted. Adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments, in the statement of cash flows and is intended to simplify guidance that is currently absent for debt prepayments and extinguishment costs, contingent consideration payments made after business combinations, and separately identifiable cash flows, among other clarifications. The guidance is effective for fiscal years beginning after December 15, 2017, which means the first quarter of our fiscal year 2019. Early adoption is permitted. We are currently reviewing the revised guidance and assessing the potential impact on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Stock Compensation: Improvements to Employee Share-Based Payment Accounting. The new guidance is intended to provide simplification of share-based payment transaction accounting, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as presentation in the statement of cash flows. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, which means the first quarter of our fiscal year 2018. Early adoption is permitted. We are currently reviewing the revised guidance and assessing the impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The new guidance requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under existing GAAP. The guidance is effective for fiscal years beginning after December 15, 2018, which means the first quarter of our fiscal year 2020, and modified retrospective adoption is required. Early adoption is permitted. We are currently reviewing the revised guidance and assessing the impact on our consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. The guidance requires that deferred tax assets and deferred tax liabilities be presented as non-current in the consolidated balance sheets. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, which means the first quarter of our fiscal year 2018. Early adoption is permitted. Adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory, by requiring certain inventory to be measured at the lower of cost or net realizable value. The guidance is effective for fiscal years, and

interim periods within those years, beginning after December 15, 2016, which means the first quarter of our fiscal year 2018. Early adoption is permitted. Adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which revised guidance on revenue recognition. The standard provides a single revenue recognition model which is intended to improve comparability over a range of industries, companies and geographical boundaries and to enhance disclosures. The guidance, following a one-year deferral issued by the FASB in August 2015, is effective for fiscal years and interim periods within those years beginning after December 15, 2017, which means the first quarter of our fiscal year 2019. Early adoption is permitted. Either full retrospective or modified

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retrospective adoption is permitted. We are evaluating the transition alternatives, but have not finalized our decision regarding the method of implementation. We have reviewed our sales contracts and practices as compared to the new guidance and are working through implementation steps and continue to assess our procedural and related system requirements related to the provisions of this standard. We are currently evaluating the impact that this guidance will have on our consolidated financial statements. In addition to the expanded disclosures regarding revenue, this guidance may impact timing of revenue recognition in some arrangements with variable consideration or contracts for the sale of goods or services.

We have determined that all other recently issued accounting standards will not have a material impact on our consolidated financial statements or do not apply to our operations.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide a reader of the financial statements of The Valspar Corporation (Valspar, the Company, we, us or our) with a narrative from the perspective of management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Unless otherwise noted, transactions, trends and other factors significantly impacting our financial condition, results of operations and liquidity are discussed in order of magnitude. In addition, unless expressly stated otherwise, the comparisons presented in this MD&A refer to the same period in the prior year. Our MD&A is presented in six sections:

Overview

Results of Operations

Financial Condition

Critical Accounting Estimates

Off-Balance Sheet Arrangements

Forward-Looking Statements

Our MD&A should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended October 28, 2016, as well as our reports on Forms 10-Q and 8-K and other publicly available information. All amounts herein are unaudited.

OVERVIEW

Valspar is a global leader in the paints and coatings industry. We develop, manufacture and distribute a broad range of coatings, paints and related products and we operate our business in two reportable segments: Coatings and Paints. Our Coatings segment aggregates our industrial and packaging product lines. Our Paints segment aggregates our consumer paints and automotive refinish product lines. See Note 13 in Notes to Condensed Consolidated Financial Statements for further information on our reportable segments.

We operate in over 25 countries, and approximately 45% of our total net sales in the first six months of fiscal year 2017 were generated outside of the U.S. In the discussions of our operating results, we sometimes refer to the impact of changes in foreign currency exchange rates or the impact of foreign currency exchange rate fluctuations, which are references to the differences between the foreign currency exchange rates we use to translate international operating results from local currencies into U.S. dollars for reporting purposes. The impact of foreign currency exchange rate fluctuations is calculated as the difference between current period activity translated using the current period's currency exchange rates and the comparable prior-year period's currency exchange rates. We use this method to calculate the impact of changes in foreign currency exchange rates for all countries where the functional currency is not the U.S. dollar.

Our fundamental business objective is to create long-term value for our stockholders. We intend to accomplish this by:

- Focusing on Customer Success by delivering coatings products and solutions that add value for our customers;
- Building Strong Brands and Distribution Partners by investing in brands that are well recognized in the markets in which we operate and building differentiated distribution networks in key markets;
- Developing Differentiated Technologies by investing in technologies that enhance our competitive position and add value for our customers;
- Driving Industry-Leading Innovation by developing unique products and services that differentiate us in the marketplace with our customers; and
- Attracting and Developing the Best People by creating a world class team with deep expertise and stockholder value orientation.

In addition to creating value for our stockholders, we are committed to:

- Adhering to our values, engaging in ethical business conduct and doing business with integrity;
- Improving the safety and reducing the environmental footprint of our business and the products we manufacture while also delivering solutions that enable our customers to meet their safety and environmental objectives; and



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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Demonstrating our corporate citizenship by supporting the communities in which we work and live through volunteer efforts and philanthropy.

Proposed Merger with The Sherwin-Williams Company

On March 19, 2016, Valspar entered into an Agreement and Plan of Merger (the Merger Agreement) with The Sherwin-Williams Company (Sherwin-Williams) and Viking Merger Sub, Inc., a wholly-owned subsidiary of Sherwin-Williams (Merger Sub).

The Merger Agreement provides that, among other things and subject to the terms and conditions of the Merger Agreement, (1) Merger Sub will be merged with and into Valspar (the Merger), with Valspar surviving the Merger as a wholly-owned subsidiary of Sherwin-Williams, and (2) at the effective time of the Merger, each outstanding share of common stock of Valspar, par value \$0.50 per share (Valspar common stock) (other than Valspar common stock held in treasury by Valspar, owned by a subsidiary of Valspar or owned by Sherwin-Williams or any of its wholly-owned subsidiaries, or shares with respect to which appraisal rights have been validly exercised and not lost in accordance with Delaware law) will be converted into the right to receive the Merger Consideration.

The Merger Consideration means \$113.00 per share in cash, except that if Sherwin-Williams is required, in order to obtain the necessary antitrust approvals, to commit to any divestiture, license, hold separate, sale or other disposition of or with respect to assets, businesses or product lines of Valspar, Sherwin-Williams or their subsidiaries representing, in the aggregate, in excess of \$650 million of Net Sales (as defined in the Merger Agreement), then the Merger Consideration will be \$105.00 per share in cash.

The Merger Agreement contains certain termination rights, and we may be required to pay Sherwin-Williams a termination fee of \$300 million.

For further information on the Merger Agreement, refer to the Merger Agreement, a copy of which was filed as Exhibit 2.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 21, 2016, and which is incorporated by reference herein.

On June 29, 2016, Valspar stockholders voted to adopt the Merger Agreement at a special meeting of stockholders held for that purpose. Completion of the Merger remains subject to certain closing conditions, including the expiration or termination of the applicable waiting period under the U.S. Hart-Scott-Rodino Antitrust Improvements Act and the receipt of regulatory approvals in certain other jurisdictions.

On March 20, 2017, in accordance with the Merger Agreement, Valspar and Sherwin-Williams extended the outside date of the Merger Agreement from March 21, 2017 to June 21, 2017.

On April 11, 2017, in connection with the reviews of the Federal Trade Commission (FTC) and Canadian Competition Bureau (CCB) of the proposed Merger, Valspar entered into an asset purchase agreement pursuant to which it agreed to sell to Axalta Coating Systems Ltd. the assets and liabilities related to its North American Industrial Wood Products business for a purchase price of approximately \$420 million in cash, subject to certain adjustments. Such sale is conditioned on, among other things, completion of the Merger with Sherwin-Williams.

On May 26, 2017, Valspar and Sherwin-Williams announced the receipt of regulatory approval from the FTC and CCB with respect to the Merger. The FTC and CCB were the only remaining regulatory approvals required before completing the Merger. Sherwin-Williams and Valspar expect to complete the Merger on June 1, 2017.

The following discussion of results of operations and financial condition should be read in the context of this overview.

**RESULTS OF OPERATIONS**

Overview

Net sales increased 3.7% for the second quarter of 2017 compared to the same period in 2016, due to higher sales in our coil, consumer paints, general industrial and wood product lines. These increases were partially offset by the impact of foreign currency exchange rates and lower sales in our packaging and automotive refinish product lines. Gross profit as a percent of net sales declined to 34.3% from 38.0% driven by unfavorable cost/price comparison and a change in mix, partially offset by productivity savings. Operating expenses as a percent of net sales declined to

22.6% from 25.6%. Net income as a percent of net sales decreased to 6.9% from 7.6%.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Foreign currency translation had a \$11,100 negative impact on our net sales during the quarter. The impact on earnings was partially mitigated by our management of operating activities at the local level, with underlying costs generally denominated in the same currency as sales. This foreign currency exchange impact reflects the strengthening of the U.S. dollar against many international currencies in the second quarter versus the prior year. If the exchange rates worsen, the translation impact on condensed consolidated net sales could be material in the balance of the year.

**Restructuring**

Restructuring charges in the six months ended April 28, 2017 primarily relate to a continuation of fiscal year 2016 initiatives to improve the global cost structure in our Paints segment. These initiatives included consolidating three sites in our automotive refinish product lines as a result of the Quest acquisition and initiatives to improve our global cost structure by consolidating our operations in the Paints segment. These restructuring activities resulted in pre-tax charges of \$947 or \$0.01 per diluted share after taxes and pre-tax charges of \$2,841 or \$0.02 per diluted share after taxes in the three and six months ended April 28, 2017, respectively. Included in restructuring charges for the three and six months ended April 28, 2017 are non-cash asset-related charges of \$143 and \$1,112, respectively.

Asset-related charges include asset impairment charges as well as accelerated depreciation for assets with useful lives that have been shortened, accounted for in accordance with ASC 360. We currently expect to incur additional expenses of approximately \$300 in fiscal year 2017 for these restructuring plans, primarily related to site clean-up costs. We currently estimate that these actions will reduce annual costs by approximately \$5,000, which is primarily due to lower employee-related costs and lower depreciation expense. We expect a portion of these savings, net of execution costs, will be achieved over the next year and the full annual benefit of these actions is expected in fiscal year 2018.

Restructuring charges in the first half of fiscal year 2016 primarily relate to initiatives in the Paints segment to improve our global cost structure through activities to consolidate our manufacturing operations and non-manufacturing headcount reductions. This resulted primarily from moving certain manufacturing to a third party in our consumer paints product line (continuation of initiative started in 2015), consolidating three sites in our automotive refinish product lines as a result of the Quest acquisition and reducing headcount in our Australia region. These restructuring activities resulted in pre-tax charges of \$9,898 or \$0.08 per diluted share after taxes and pre-tax charges of \$10,767 or \$0.08 per diluted share after taxes in the three and six months ended April 29, 2016, respectively, including non-cash asset-related charges of \$3,710 and \$4,281, respectively.

See Note 14 in Notes to Condensed Consolidated Financial Statements for further information on restructuring.

**Financial Results**

The following tables present selected financial data for the three and six months ended April 28, 2017 and April 29, 2016.

Net Sales	Three Months Ended			Six Months Ended		
	April 28, 2017	April 29, 2016	% Change	April 28, 2017	April 29, 2016	% Change
Coatings	\$616,175	\$587,436	4.9 %	\$1,181,387	\$1,130,999	4.5 %
Paints	417,967	407,060	2.7 %	709,242	698,157	1.6 %
Other and Administrative	61,691	62,301	(1.0)%	112,856	113,397	(0.5)%
Consolidated Net Sales	\$1,095,833	\$1,056,797	3.7 %	\$2,003,485	\$1,942,553	3.1 %

**Consolidated Net Sales** – Consolidated net sales for the second quarter of 2017 increased 3.7% compared to the second quarter of 2016, including a negative impact of 1.0% from foreign currency exchange. Excluding foreign currency exchange, the increase was driven by higher sales in our coil, consumer paints, general industrial and wood product lines, partially offset by lower sales in our packaging and automotive refinish product lines. Year-to-date, consolidated net sales increased 3.1%, including a negative impact of 1.4% from foreign currency exchange. Excluding foreign currency exchange, the increase was driven by higher sales in our coil, wood, consumer paints and

general industrial product lines, partially offset by lower sales in our automotive refinish and packaging product lines.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Coatings Segment Net Sales – Our Coatings segment net sales for the second quarter of 2017 increased 4.9% compared to the second quarter of 2016, including a negative impact of 1.3% from foreign currency exchange. Excluding foreign currency exchange, the increase was driven by higher sales in our coil, general industrial and wood product lines, partially offset by lower sales in our packaging product line. Year-to-date, our Coatings segment net sales increased 4.5%, including a negative impact of 1.8% from foreign currency exchange. Excluding foreign currency exchange, the increase was driven primarily by higher sales in our coil, wood and general industrial product lines, partially offset by lower sales in our packaging product line.

Paints Segment Net Sales – Our Paints segment net sales for the second quarter of 2017 increased 2.7% compared to the second quarter of 2016, including a negative impact of 0.6% from foreign currency exchange. Excluding foreign currency exchange, the increase was driven primarily by our consumer paints product line in China, partially offset by lower sales in our consumer paints product line in Australia and global automotive refinish product line. Year-to-date, our Paints segment net sales increased 1.6%, including a negative impact of 0.9% from foreign currency exchange. Excluding foreign currency exchange, the increase was driven by our consumer paints product lines in North America and China, partially offset by lower sales in our global automotive refinish and Australia consumer paints product lines.

Other and Administrative Net Sales – The Other and Administrative category includes net sales for the following product lines: resins, furniture protection plans and colorants. Other and Administrative net sales for the second quarter of 2017 decreased 1.0% compared to the second quarter of 2016, including a negative impact of 0.9% from foreign currency exchange. Year-to-date Other and Administrative net sales decreased 0.5%, including a negative impact of 1.1% from foreign currency exchange.

Due to the seasonal nature of portions of our business, sales for the three and six months ended April 28, 2017 are not necessarily indicative of sales for subsequent quarters or for the full year.

Gross Profit	Three Months Ended		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Consolidated Gross Profit	\$375,907	\$401,441	\$686,426	\$720,068
As a percent of Net Sales	34.3	% 38.0	% 34.3	% 37.1

Gross Profit – The gross profit rate for the second quarter and year-to-date periods of 2017 decreased compared to the second quarter and year-to-date periods of 2016, respectively. The decrease in both periods was driven by unfavorable cost/price comparison and change in mix, partially offset by productivity savings. Productivity includes procurement and manufacturing efficiencies, product reformulations and benefits from previously completed restructuring actions. Cost/price comparison reflects the impact of market changes in raw material costs and changes in product pricing and promotions. Restructuring charges of \$471 or 0.0% of net sales and \$1,663 or 0.1% of net sales were included in the second quarter and year-to-date of 2017, respectively. Restructuring charges of \$4,926 or 0.5% of net sales and \$5,361 or 0.3% of net sales were included in the second quarter and year-to-date of 2016, respectively.

Operating Expenses <sup>1</sup>	Three Months Ended		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Consolidated Operating Expenses	\$247,869	\$270,516	\$483,797	\$495,435
As a percent of Net Sales	22.6	% 25.6	% 24.1	% 25.5

<sup>1</sup> Includes research and development and selling, general and administrative costs. For breakout, see Condensed Consolidated Statements of Operations.

Consolidated Operating Expenses – Consolidated operating expenses for the second quarter of 2017 decreased \$22,647 or 8.4% compared to the second quarter of 2016, including a favorable impact of 0.6% from foreign currency

exchange.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Excluding foreign currency exchange, the decrease was primarily due to lower costs related to the proposed merger with The Sherwin-Williams Company, lower restructuring costs and lower employee-related costs. Year-to-date consolidated operating expenses decreased \$11,638 or 2.3%, including a favorable impact of 0.9% from foreign currency exchange. Excluding foreign currency exchange, the decrease was primarily due to lower restructuring costs. Charges related to the proposed merger of \$8,152 and \$16,835 were included in the second quarter and year-to-date of 2017, respectively. Charges related to the proposed merger of \$18,240 were included in both the second quarter and year-to-date of 2016. Restructuring charges of \$476 or 0.0% of net sales and \$1,178 or 0.1% of net sales were included in operating expenses in the second quarter and year-to-date of 2017. Restructuring charges of \$4,972 or 0.5% of net sales and \$5,406 or 0.3% of net sales were included in the second quarter and year-to-date of 2016.

EBIT <sup>1</sup>	Three Months Ended		Six Months Ended		
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016	
Coatings	\$87,378	\$112,372	\$174,106	\$208,919	
As a percent of Net Sales	14.2	% 19.1	% 14.7	% 18.5	%
Paints	\$52,314	\$42,742	\$56,201	\$46,561	
As a percent of Net Sales	12.5	% 10.5	% 7.9	% 6.7	%
Other and Administrative	\$(9,508)	\$(24,940)	\$(24,856)	\$(32,213)	
As a percent of Net Sales	(15.4)	)% (40.0)	)% (22.0)	)% (28.4)	)%
Consolidated EBIT	\$130,184	\$130,174	\$205,451	\$223,267	
As a percent of Net Sales	11.9	% 12.3	% 10.3	% 11.5	%

<sup>1</sup> EBIT is defined as earnings before interest and taxes.

Consolidated EBIT – EBIT for the second quarter of 2017 increased slightly versus the prior year. Year-to-date EBIT decreased \$17,816 or 8.0% from the prior year. Second quarter and year-to-date 2017 EBIT included \$8,152 and \$16,835 in costs related to the proposed merger, respectively, recorded in Other and Administrative. Second quarter and year-to-date 2016 EBIT both include \$18,240 in proposed merger-related charges. Restructuring charges of \$947 or 0.1% of net sales and \$2,841 or 0.1% of net sales were included in the second quarter and year-to-date of 2017, respectively. Restructuring charges of \$9,898 or 0.9% of net sales and \$10,767 or 0.6% of net sales were included in the second quarter and year-to-date of 2016. Foreign currency exchange had a negative impact on consolidated EBIT of approximately \$3,800 and \$5,200 in the second quarter and year-to-date, respectively.

Coatings Segment EBIT – EBIT as a percent of net sales declined 4.9 percentage points for the second quarter compared to the prior year period. Year-to-date EBIT as a percentage of net sales decreased 3.8 percentage points compared to the prior year period. The decline in both periods was primarily due to unfavorable cost/price comparison and higher employee-related costs, partially offset by productivity savings. Restructuring charges of \$53 and \$65 were included in the second quarter and year-to-date of 2017, respectively. Restructuring charges of \$175 and \$366 were included in the second quarter and year-to-date of 2016.

Paints Segment EBIT – EBIT as a percent of net sales for the second quarter increased 2.0 percentage points compared to the prior year period as lower restructuring costs and productivity savings were partially offset by unfavorable cost/price comparison. Year-to-date EBIT as a percent of net sales increased 1.2 percentage points compared to the prior year period. The increase was primarily due to productivity savings, lower restructuring charges and lower employee related costs, partially offset by unfavorable cost/price comparison. Restructuring charges of \$894 and \$2,780 were included in the second quarter and year-to-date of 2017, respectively. Restructuring charges of \$9,764 and \$10,442 were included in the second quarter and year-to-date of 2016.

• Other and Administrative EBIT – Other and Administrative EBIT includes corporate expenses. EBIT as a percent of net sales for the second quarter was 24.6 percentage points favorable compared to the prior year period. The increase was primarily due to lower costs related to the proposed merger and lower employee

related costs, partially offset by unfavorable

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

cost/price comparison. Year-to-date EBIT as a percent of net sales was 6.4 percentage points favorable compared to the prior year period. The increase was primarily due to lower employee related costs, partially offset by unfavorable cost/price comparison.

Due to the seasonal nature of portions of our business, EBIT for the three and six months ended April 28, 2017 is not necessarily indicative of EBIT for subsequent quarters or for the full year.

Interest Expense	Three Months Ended		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Consolidated Interest Expense	\$22,844	\$22,789	\$45,388	\$45,204

Interest Expense – Interest expense increased modestly compared to the second quarter and year-to-date periods of 2016 as lower debt levels were offset by higher average interest rates.

Effective Tax Rate	Three Months Ended		Six Months Ended	
	April 28, 2017	April 29, 2016	April 28, 2017	April 29, 2016
Effective Tax Rate	29.6%	25.5%	27.3%	25.6%

Effective Tax Rate – The second quarter 2017 effective tax rate increased compared to the second quarter of 2016 primarily due to the recognition of U.S. foreign tax credits in the prior year. The second quarter year-to-date effective tax rate increased compared to the same period of 2016 primarily due to the recognition of U.S. foreign tax credits in the prior year, partially offset by the cumulative effect of tax laws that were enacted during the first quarter of 2017 in the U.S., Germany and France.

Net Income	Three Months Ended			Six Months Ended		
	April 28, 2017	April 29, 2016	% Change	April 28, 2017	April 29, 2016	% Change
Consolidated Net Income	\$75,547	\$80,027	(5.6)%	\$116,294	\$132,458	(12.2)%

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

FINANCIAL CONDITION

Cash Flow

Cash flow from operations improved by \$17,757 in the six months ended April 28, 2017 compared to the six months ended April 29, 2016, to a cash source of \$54,732 from a cash source of \$36,975. This was driven by an overall improvement in net working capital needs, primarily due to favorable management of accounts payable and timing of tax payments.

Cash flow from investing activities increased by \$19,007 in the six months ended April 28, 2017 compared to the six months ended April 29, 2016, to a use of cash of \$56,983 from a use of cash of \$75,990. This was primarily driven by reduced property, plant and equipment expenditures in 2017 and acquisitions expenditures in 2016.

During the six months ended April 28, 2017, we used cash flow from operations, our borrowing capacity (see Debt and Capital Resources) and cash on hand to fund \$52,992 in capital expenditures. We used cash on hand to fund \$59,541 in dividend payments.

Debt and Capital Resources

Our debt classified as current was \$434,385 at April 28, 2017 compared to \$221,446 and \$333,201 at October 28, 2016 and April 29, 2016, respectively. This includes \$150,106 of long-term debt classified as short-term debt at April 28, 2017 and October 28, 2016. Total debt was \$1,978,089 at April 28, 2017 compared to \$1,764,372 and \$2,025,360 at October 28, 2016 and April 29, 2016, respectively. The reduction in total debt from April 29, 2016 was driven by positive cash flow. The ratio of total debt to capital was 62.8% at April 28, 2017 compared to 61.3% at October 28, 2016 and 67.7% at April 29, 2016. Subsequent to quarter end, we retired \$150,000 of Senior Notes, in accordance with their scheduled maturity on May 1, 2017.

We maintain a \$750,000 unsecured committed revolving credit facility with a syndicate of banks with a maturity date of December 14, 2018. Under certain circumstances we have the option to increase this credit facility to \$1,000,000. This facility has covenants that require us to maintain certain financial ratios. We were in compliance with these covenants as of April 28, 2017. Our debt covenants do not limit, nor are they reasonably likely to limit, our ability to obtain additional debt or equity financing.

We maintain uncommitted bank lines of credit to meet short-term funding needs in certain of our international locations. These arrangements are reviewed periodically for renewal and modification.

As of April 28, 2017, we had \$340,878 in cash and cash equivalents and \$475,458 in unused committed bank credit facilities, which, excluding amounts used to retire the \$150,000 Senior Note subsequent to quarter end, provided total committed liquidity of \$666,336, compared to \$862,331 and \$530,542 of committed liquidity as of October 28, 2016 and April 29, 2016, respectively.

Our cash and cash equivalent balances consist of high quality, short-term money market instruments and cash held by our international subsidiaries. Cash and cash equivalents held by our international subsidiaries are used to fund their day-to-day operating needs and have also been used to finance acquisitions outside the U.S. Our investment policy on excess cash is to preserve principal. As of April 28, 2017, \$124,480 of the \$340,878 of cash (on the Condensed Consolidated Balance Sheets) was held by our international subsidiaries. If these funds were repatriated to the U.S. we would be required to accrue and pay income taxes. No provision has been made for U.S. federal income taxes on certain undistributed earnings of foreign subsidiaries that we intend to permanently invest or that may be remitted substantially tax-free.

We believe cash flow from operations, existing lines of credit, access to credit facilities and access to debt and capital markets will be sufficient to meet our domestic and international liquidity needs. In the current market conditions, we have demonstrated continued access to capital markets. We have committed liquidity and cash reserves in excess of our anticipated funding requirements.

We use derivative instruments with a number of counterparties principally to manage interest rate and foreign currency exchange risks. We evaluate the financial stability of each counterparty and spread the risk among several financial institutions to limit our exposure. We will continue to monitor counterparty risk on an ongoing basis. We do

not have any credit-risk related contingent features in our derivative contracts as of April 28, 2017.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Share Repurchases

Weighted-average common shares outstanding – diluted for the second quarter of fiscal year 2017 were 81,504,531, up 625,682 from the same period in the prior year. On November 21, 2014, our Board of Directors approved a share repurchase program, with no expiration date, authorizing us to purchase up to \$1,500,000 of outstanding shares of common stock. During the second quarter we did not repurchase any shares. As of April 28, 2017, \$1,175,630 remained available for purchase under our repurchase authorization.

CRITICAL ACCOUNTING ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of any contingent assets and liabilities at the date of the financial statements. We regularly review our estimates and assumptions, which are based on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

A comprehensive discussion of our critical accounting estimates is included in the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended October 28, 2016. There were no material changes to our critical accounting estimates in the second quarter of fiscal year 2017.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

FORWARD-LOOKING STATEMENTS

Certain statements contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements.

Forward-looking statements are based on management's current expectations, estimates, assumptions and beliefs about future events, conditions and financial performance. Forward-looking statements are subject to risks, uncertainties and other factors, many of which are outside our control and could cause actual results to differ materially from such statements. Any statement that is not historical in nature is a forward-looking statement. We may identify forward-looking statements with words and phrases such as "expect," "project," "forecast," "outlook," "estimate," "anticipate," "believe," "could," "may," "will," "plan to," "intend," "should" and similar words or expressions.

These risks, uncertainties and other factors include, but are not limited to, deterioration in general economic conditions, both domestic and international, that may adversely affect our business; fluctuations in availability and prices of raw materials, including raw material shortages and other supply chain disruptions, and the inability to pass along or delays in passing along raw material cost increases to our customers; dependence of internal sales and earnings growth on business cycles affecting our customers and growth in the domestic and international coatings industry; market share loss to, and pricing or margin pressure from, larger competitors with greater financial resources; significant indebtedness that restricts the use of cash flow from operations for acquisitions and other investments; our access to capital is subject to global economic and capital market conditions; dependence on acquisitions for growth, and risks related to future acquisitions, including adverse changes in the results of acquired businesses, the assumption of unforeseen liabilities and disruptions resulting from the integration of acquisitions; risks and uncertainties associated with operating in foreign markets, including achievement of profitable growth in developing markets; impact of fluctuations in foreign currency exchange rates on our financial results; loss of business

with key customers; our ability to innovate in order to meet customers' product demands, which may change based on customers' preferences and competitive factors; damage

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

to our reputation and business resulting from product claims or recalls, litigation, customer perception and other matters; our ability to respond to technology changes and to protect our technology; possible interruption, failure or compromise of the information systems we use to operate our business; our reliance on the efforts of vendors, government agencies, utilities and other third parties to achieve adequate compliance and avoid disruption of our business; changes in governmental regulation, including more stringent environmental, health and safety regulations; changes in accounting policies and standards and taxation requirements such as new tax laws or revised tax law interpretations; the nature, cost and outcome of pending and future litigation and other legal proceedings; unusual weather conditions adversely affecting sales; civil unrest and the outbreak of war and other significant national and international events; risks relating to our Merger with Sherwin-Williams including, the possibility that the closing conditions to the contemplated transaction may not be satisfied or waived, including that a governmental entity may prohibit, delay or refuse to grant a necessary regulatory approval; delay in closing the transaction or the possibility of non-consummation of the transaction; the potential for regulatory authorities to require divestitures in connection with the proposed transaction and the possibility that Valspar stockholders consequently receive \$105 per share instead of \$113 per share; the occurrence of any event that could give rise to termination of the Merger Agreement; the risk that stockholder litigation in connection with the contemplated transaction may affect the timing or occurrence of the contemplated transaction or result in significant costs of defense, indemnification and liability; risks inherent in the achievement of cost synergies and the timing thereof; risks related to the disruption of the transaction to Valspar and its management; the effect of announcement of the transaction on Valspar's ability to retain and hire key personnel and maintain relationships with customers, suppliers and other third parties; and other factors set forth in the risk factors section of our Annual Report on Form 10-K for the fiscal year ended October 28, 2016, as well as Valspar's Quarterly Reports on Form 10-Q and other documents filed by Valspar with the Securities and Exchange Commission. We caution investors not to place undue reliance on any such forward-looking statements, which speak only as of the date on which such statements were made. We undertake no obligation to subsequently revise any forward-looking statement to reflect new information, events or circumstances after the date of such statement, except as required by law.

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

Our foreign sales and results of operations are subject to the impact of foreign currency fluctuations. As most of our underlying costs are denominated in the same currency as our sales, the effect has not been material. We have not used derivative financial instruments to hedge our exposure to translation gains and losses. A 10% adverse change in foreign currency rates is not expected to have a material effect on our results of operations or financial position. A change of greater than 10% in the exchange rates for individual currencies in geographies where we have a significant presence could have a material impact on our net income or financial position. At April 28, 2017, the regions where we have the largest exposure to our net sales, net income and financial position were China (CNY), Europe (EUR), Mexico (MXN), Australia (AUD), the UK (GBP), Brazil (BRL), and Canada (CAD).

We are also subject to interest rate risk. At April 28, 2017, approximately 14.4% of our total debt consisted of floating rate debt. From time to time, we may enter into interest rate derivatives to hedge a portion of either our variable or fixed rate debt. Assuming the current level of borrowings, a 10% increase in interest rates from those in effect at the end of the second quarter would not have a material impact on our results of operations or financial position.

## ITEM 4. CONTROLS AND PROCEDURES

Disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and



Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of April 28, 2017. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

There were no changes in our internal control over financial reporting during the quarter ended April 28, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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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 our Form 10-K for the year ended October 28, 2016.

ITEM 1A. RISK FACTORS

There were no material changes to the risk factors disclosed in “Part I, Item 1A. Risk Factors” of our Form 10-K for the year ended October 28, 2016.

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

(a) Not applicable

(b) Not applicable

(c) During the quarter ended April 28, 2017, we acquired 1,298 shares of our common stock at an average price per share of \$111.19 in satisfaction of tax payment obligations upon vesting of restricted stock. On November 21, 2014, our Board of Directors approved a share repurchase program, with no expiration date, which authorized us to purchase up to \$1.5 billion of outstanding shares of our common stock. As of April 28, 2017, there were 3,920,105 shares purchased under this program.

ITEM 6. EXHIBITS

Exhibit Number	Description
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31.1 *	Section 302 Certification of the Chief Executive Officer
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31.2 *	Section 302 Certification of the Chief Financial Officer
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32.1 *	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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101.INS *	XBRL Instance Document
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101.SCH *	XBRL Schema Document
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101.CAL *	XBRL Calculation Linkbase Document
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101.DEF *	XBRL Definition Linkbase Document
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101.LAB *	XBRL Label Linkbase Document
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101.PRE *	XBRL Presentation Linkbase Document
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\* Filed electronically herewith



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: May 31, 2017 By/s/ Rolf Engh  
Rolf Engh  
Executive Vice President,  
General Counsel and  
Secretary

Date: May 31, 2017 By/s/ James L. Muehlbauer  
James L. Muehlbauer  
Executive Vice President,  
Chief Financial and  
Administrative Officer