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VALSPAR CORP
Form 8-K/A
February 09, 2001

FORM 8-K/A

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

CURRENT REPORT

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

Amendment No. 1 to Form 8-K Report
Dated January 4, 2001

Date of Report (Date of earliest event reported): December 20, 2000

THE VALSPAR CORPORATION

Delaware	1-3011	36-2443580
----- (State or other Jurisdiction of Incorporation)	----- (Commission File Number)	----- (IRS Employer Identification No.)
1101 Third Street South, Minneapolis, Minnesota		55415
----- (Address of Principal Executive Offices)		----- (Zip Code)

Registrant's telephone number, including area code: (612) 332-7371

Not Applicable

(former name or former address, if changed, since last report)

Item 7: Financial Statements and Exhibits

(a) Financial Statements of Business Acquired

LILLY INDUSTRIES, INC. AND SUBSIDIARIES
Report of Independent Auditors
Audited Consolidated Balance Sheets - Years ended

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Unaudited Pro Forma Combined Condensed Statement of Income which combine the audited consolidated results of Lilly Industries, Inc. for the year ended November 30, 2000 with the audited consolidated results of Valspar for the year ended October 27,2000, along with a description of the related pro forma adjustments.	23
(c) Exhibits	
1 Agreement and Plan of Merger among Lilly Industries, Inc., Acquisition Corp. (a wholly-owned subsidiary of the registrant) and the registrant made and entered into as of June 23, 2000, incorporated by reference to Appendix A to the Definitive Proxy Statement filed by Lilly Industries, Inc. on August 22, 2000.	
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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to the report on 8-K to be signed on its behalf by the undersigned hereunto duly authorized.

THE VALSPAR CORPORATION

By /s/ Rolf Engh

Printed Name: Rolf Engh
Title: Secretary

Date: February 9, 2001

Report of Independent Auditors

The Board of Directors
Lilly Industries, Inc.

We have audited the accompanying consolidated balance sheets of Lilly Industries, Inc. as of November 30, 2000 and 1999 and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended November 30, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lilly Industries, Inc. at November 30, 2000 and 1999 and the results of its operations and its cash flows for each of the three years in the period ended November 30, 2000 in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & YOUNG LLP

Indianapolis, IN
January 12, 2001

Lilly Industries, Inc. and Subsidiaries

Consolidated Balance Sheets

	NOVEMBER 30	
	2000	1999

	(IN THOUSANDS)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 6,470	\$ 5,714
Accounts receivable, less allowance		

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for doubtful accounts (2000, \$1,701; 1999, \$1,775)	90,181	91,369
Inventories	57,116	58,500
Deferred income taxes	2,730	2,848
Other	4,958	3,426
	-----	-----
Total current assets	161,455	161,857
Other assets:		
Goodwill, less amortization (2000, \$35,311; 1999, \$27,769)	206,435	210,811
Other intangibles, less amortization (2000, \$24,489; 1999, \$23,129)	18,412	23,067
Deferred income taxes	1,925	3,974
Sundry	21,189	18,781
	-----	-----
	247,961	256,633
Property and equipment:		
Land	16,628	13,872
Buildings	86,184	75,232
Equipment	113,735	110,610
Accumulated depreciation	(77,806)	(67,778)
	-----	-----
	138,741	131,936
	-----	-----
	\$ 548,157	\$ 550,426
	=====	=====

SEE ACCOMPANYING NOTES.

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	NOVEMBER 30	
	2000	1999

	(IN THOUSANDS)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 48,230	\$ 60,317
Salaries and payroll related items	14,413	20,975
Other	24,459	27,293
Income taxes payable	4,423	4,552
	-----	-----
Total current liabilities	91,525	113,137
Long-term debt	211,514	206,803
Other liabilities	39,006	38,315
Shareholders' equity:		
Capital stock, \$.55 stated value per share:		
Class A (limited voting) - 28,077 shares issued (1999, 27,969 shares issued)	15,599	15,539
Class B (voting) - 540 shares issued	300	300
Additional capital	85,329	83,833

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Retained earnings	148,402	133,807
Accumulated other comprehensive loss	(5,241)	(3,509)
Cost of capital stock in treasury	(38,277)	(37,799)
	-----	-----
	206,112	192,171
	-----	-----
	\$ 548,157	\$ 550,426
	=====	=====

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Lilly Industries, Inc. and Subsidiaries

Consolidated Statements of Income

	YEAR ENDED NOVEMBER 30		
	2000	1999	1998

	(IN THOUSANDS, EXCEPT PER SHARE DATA)		
Net sales	\$ 669,699	\$ 656,201	\$ 619,002
Costs and expenses:			
Cost of products sold	416,122	401,286	379,641
Selling, general and administrative	174,149	160,861	146,763
Research and development	20,960	21,154	20,567
	-----	-----	-----
	611,231	583,301	546,971
Operating income	58,468	72,900	72,031
Other expense:			
Sundry income (expense)	483	(633)	(666)
Seller's transaction expense	(2,353)	--	--
Interest expense, net	(16,900)	(15,791)	(16,919)
	-----	-----	-----
	(18,770)	(16,424)	(17,585)
Income before income taxes	39,698	56,476	54,446
Income taxes	17,673	23,155	22,867
	-----	-----	-----
Net income	\$ 22,025	\$ 33,321	\$ 31,579
	=====	=====	=====
Net income per share:			
Basic	\$.95	\$ 1.44	\$ 1.36
Diluted	\$.93	\$ 1.43	\$ 1.35

SEE ACCOMPANYING NOTES.

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Lilly Industries, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	YEAR ENDED NOVEMBER 30		
	2000	1999	1998
	(IN THOUSANDS)		
OPERATING ACTIVITIES			
Net income	\$ 22,025	\$ 33,321	\$ 31,111
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	12,023	10,391	9,800
Amortization of intangibles	10,854	10,544	10,544
Deferred income taxes	2,167	5,267	2,167
Gain on disposal of fixed assets	(678)	--	--
Changes in operating assets and liabilities net of effects from acquired businesses:			
Accounts receivable	1,188	(9,162)	1,188
Inventories	1,384	(7,680)	(2,296)
Accounts payable and accrued expenses	(21,612)	11,101	5,000
Sundry	(6,220)	(15,044)	(6,220)
Net cash provided by operating activities	21,131	38,738	55,000
INVESTING ACTIVITIES			
Purchases of property and equipment	(21,665)	(41,472)	(17,000)
Payment for acquired business	(1,250)	(2,721)	(11,000)
Proceeds from the sale of fixed assets	1,566	--	1,566
Sundry	2,615	2,052	3,000
Net cash used by investing activities	(18,734)	(42,141)	(24,000)
FINANCING ACTIVITIES			
Dividends paid	(7,430)	(7,428)	(7,000)
Proceeds from short-term and long-term borrowings	4,711	3,103	4,711
Principal payments on short-term and long-term borrowings	--	--	(20,000)
Sundry	1,078	116	1,078
Net cash used by financing activities	(1,641)	(4,209)	(27,000)
Increase (decrease) in cash and cash equivalents	756	(7,612)	3,000
Cash and cash equivalents at beginning of year	5,714	13,326	10,000
Cash and cash equivalents at end of year	\$ 6,470	\$ 5,714	\$ 13,000

SEE ACCOMPANYING NOTES.

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Lilly Industries, Inc. and Subsidiaries

Consolidated Statements of Shareholders' Equity (in thousands)

	CLASS A CAPITAL STOCK	CLASS B CAPITAL STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	COS CAP STO TRE
Balance at December 1, 1997	\$ 15,375	\$ 300	\$ 79,417	\$ 83,745	\$ (
Comprehensive income:					
Net income	--	--	--	31,579	
Currency translation adjustments	--	--	--	--	
Total comprehensive income	--	--	--	--	
Stock options exercised	84	--	1,820	--	
Disqualifying disposition of stock options	--	--	653	--	
Cash dividends paid	--	--	--	(7,410)	
Repurchase of capital stock	--	--	--	--	
Balance at November 30, 1998	15,459	300	81,890	107,914	(
Comprehensive income:					
Net income	--	--	--	33,321	
Currency translation adjustments	--	--	--	--	
Total comprehensive income	--	--	--	--	
Stock options exercised	80	--	1,870	--	
Disqualifying disposition of stock options	--	--	73	--	
Cash dividends paid	--	--	--	(7,428)	
Repurchase of capital stock	--	--	--	--	
Balance at November 30, 1999	15,539	300	83,833	133,807	(
Comprehensive income:					
Net income	--	--	--	22,025	
Currency translation adjustments	--	--	--	--	
Total comprehensive income	--	--	--	--	
Stock options exercised	60	--	1,422	--	
Disqualifying disposition of stock options	--	--	74	--	
Cash dividends paid	--	--	--	(7,430)	
Repurchase of capital stock	--	--	--	--	
Balance at November 30, 2000	\$ 15,599	\$ 300	\$ 85,329	\$ 148,402	\$ (

SEE ACCOMPANYING NOTES.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - NOVEMBER 30, 2000

1. SUBSEQUENT EVENT

On June 26, 2000, Lilly Industries, Inc. and its subsidiaries (the "Company") announced it had entered into a definitive merger agreement with The Valspar Corporation ("Valspar") whereby Valspar would acquire all outstanding shares of the Company's Class A and Class B capital stock for \$31.75 per share in cash and assume all outstanding debt.

On December 20, 2000, the merger was completed and the Company became a wholly-owned subsidiary of Valspar. As a result of the merger, each outstanding share of the Company's Class A and Class B capital stock was converted into the right to receive \$31.75 in cash, without interest; the Revolving Credit Facility and German Credit Facility were extinguished and all incentive stock option plans were vested and paid off. Also, as a result of the merger the executive Supplemental Executive Retirement Plan liabilities became fully vested which resulted in an increase in these liabilities in the amount of \$5,100,000 which was recorded subsequent to year end.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS

The Company is principally in the business of formulating, manufacturing, and marketing industrial coatings and specialty chemicals to original equipment manufacturers on a worldwide basis. Primary manufacturing operations are located in North America, Europe and Asia-Pacific. The Company operates within three business segments which serve three end-use markets.

CONSOLIDATION AND USE OF ESTIMATES

The consolidated financial statements include the accounts of all subsidiaries after elimination of significant intercompany accounts and transactions. Preparation of these statements in conformity accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

REVENUE RECOGNITION

Revenue from sales of products is recognized at the time products are shipped to the customer.

CASH EQUIVALENTS

Cash equivalents include time deposits and certificates of deposit with original maturities of three months or less.

INVENTORIES

Coatings inventories in the United States are stated at the lower of cost, determined by the last-in, first-out (LIFO) method, or market. All other inventories are stated at the lower of cost, determined by the first-in, first-out (FIFO) method, or market.

INTANGIBLE ASSETS

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Goodwill, which represents the excess of cost over fair value of net assets of purchased businesses, is amortized by the straight-line method over periods ranging from 20 to 40 years. Other intangible assets consist of noncompete agreements, customer lists and technology and are amortized by the straight-line method over periods ranging from 5 to 20 years.

The Company periodically evaluates the carrying value of intangible assets to determine if an impairment has occurred. This evaluation is based on various analyses including reviewing anticipated cash flows.

PROPERTY AND EQUIPMENT

Property and equipment is recorded on the basis of cost and includes expenditures for new facilities and items which substantially increase the useful life of existing buildings and equipment. Depreciation is based on estimated useful lives (ranging from 3 to 45 years) and computed primarily by the straight-line method.

3. NEW ACCOUNTING STANDARDS

Effective December 1, 1999, the Company adopted the American Institute of Certified Public Accountants' (AICPA) Statement of Position (SOP) 98-5, "Reporting for the Costs of Start-Up Activities." The SOP requires start-up costs capitalized prior to December 1, 1999 to be written off and any future start-up costs to be expensed as incurred. The unamortized balance of start-up costs was written off as of December 1, 1999. The effect of this change in accounting principle on consolidated earnings was immaterial.

4. INVENTORIES

The principal inventory classifications at November 30 are summarized as follows (in thousands):

	2000	1999
Finished products	\$ 30,765	\$ 33,628
Raw materials	31,947	30,048
	62,712	63,676
Less adjustment of certain inventories to LIFO basis	5,596	5,176
	\$ 57,116	\$ 58,500

Inventory cost is determined by the LIFO method of inventory valuation for approximately 59% and 61% of inventories at November 30, 2000 and 1999, respectively.

5. LONG-TERM DEBT

Long-term debt consists of the following as of November 30 (in thousands):

	2000	1999
7.75% Unsecured Senior Notes	\$100,000	\$100,000
Revolving Credit Facility	107,500	100,100
German Credit Facility	4,014	6,703
	\$211,514	\$206,803

5. LONG-TERM DEBT (CONTINUED)

The Company's German subsidiary ("Subsidiary") has an unsecured Deutsche Mark ("DEM") denominated revolving credit facility ("German Facility") with a bank. The maximum borrowings available under the German Facility are \$4,014,000 until November 29, 2001; thereafter, maximum borrowings decrease to \$1,784,000 until maturity of the German Facility in February, 2003. German Facility advances of greater than \$44,600 bear interest, at the Subsidiary's option, at either (i) the money market rate of the bank's German affiliate, or (ii) the Frankfurt, Germany Interbank Offered Rate for DEM deposits plus an interest rate margin of between 0.40% and 0.80%, depending on the Subsidiary's leverage at the time of each borrowing. Other advances bear interest at the prime rate of the bank's German affiliate. The principal of the German Facility is due upon maturity in February, 2003.

The Company has a \$150,000,000 revolving credit facility ("Facility") with a group of financial institutions and \$100,000,000 of senior notes ("Notes"). The Facility is unsecured and provides for borrowings under a revolving note. The 7.75% Notes were issued as a 144A private placement offering with registration rights.

Interest is payable upon maturity of each revolving advance under the Facility, but in no case less frequently than quarterly. The principal of the Facility is due in October, 2002. The Notes are unsecured. Interest is payable on June 1 and December 1 of each year the Notes are outstanding. The principal of the Notes is due December, 2007. The Facility bears interest, at the Company's option, of (i) the higher of the agent bank's prime rate (9.50% at November 30, 2000) or the Federal Funds rate plus 0.50% or, (ii) the London Interbank Offered Rate for U.S. Dollars plus 0.30% to 0.75%, depending upon the Company's credit rating. A commitment fee ranging from 0.10% to 0.25%, depending upon the Company's credit rating, is payable on the unused portion of the Facility.

Interest of \$17,336,000, \$15,818,000 and \$12,369,000 was paid in fiscal 2000, 1999 and 1998, respectively.

The Company is subject to various debt covenants under the German Facility, Facility and Notes, including affirmative and negative covenants which require the maintenance of certain ratios for maximum leverage, fixed charge coverage and interest coverage. Additionally, such covenants place certain restrictions on the Company's ability to engage in mergers and acquisitions and incur additional indebtedness.

Subsequent to November 30, 2000, the merger with The Valspar Corporation was completed. (see Note 1). In conjunction with this transaction the Company satisfied its obligations under the Facility and the German Facility. The obligations under the Notes remain outstanding.

6. INCOME TAXES

Income tax expense for the years ended November 30 is comprised of the following components (in thousands):

2000	1999	1998
------	------	------

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Current expense:			
Federal	\$ 6,854	\$ 8,942	\$ 12,757
Foreign	7,907	8,126	7,290
State	745	820	2,358
	15,506	17,888	22,405
Deferred expense (credit):			
Federal	1,741	4,334	593
Foreign	(171)	384	(139)
State	597	549	8
	2,167	5,267	462
	\$ 17,673	\$ 23,155	\$ 22,867

A reconciliation of the statutory U.S. federal rate to the effective income tax rate for the years ended November 30 is as follows:

	2000	1999	1998
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
Increase resulting from:			
Goodwill	4.7	3.5	3.6
State income taxes, net of federal income tax benefit	2.0	1.6	2.8
Foreign	0.3	1.3	1.8
Seller's transaction expense	1.7	--	--
Other items	0.8	(.4)	(1.2)
Effective income tax rate	44.5%	41.0%	42.0%

Deferred income taxes are recorded based upon differences between the financial statement and tax basis of assets and liabilities.

The deferred tax assets and liabilities recorded on the balance sheet at November 30 are as follows (in thousands):

	2000	1999
Deferred tax assets:		
Goodwill and intangibles	\$ 541	\$ 1,121
Employee benefits	5,644	5,812
Accounts receivable, inventory and other	10,707	11,051
	16,892	17,984
Deferred tax liabilities:		
Property and equipment	6,284	6,582
Pension	5,953	4,580
	12,237	11,162
Net deferred tax assets	\$ 4,655	\$ 6,822

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6. INCOME TAXES (CONTINUED)

No provision has been made for U.S. federal income taxes on certain undistributed earnings of foreign subsidiaries that the Company intends to permanently invest or that may be remitted tax-free. The total of undistributed earnings that would be subject to federal income tax if remitted under existing law is approximately \$30,300,000 at November 30, 2000. Determination of the unrecognized deferred tax liability related to these earnings is not practicable because of the complexities with its hypothetical calculation. Upon distribution of these earnings, the Company will be subject to U.S. taxes and withholding taxes payable to various foreign governments. A credit for foreign taxes already paid would be available to reduce the U.S. tax liability.

Income taxes of \$20,850,000, \$16,600,000 and \$21,800,000 were paid in 2000, 1999 and 1998, respectively.

7. CAPITAL STOCK

The Company has two classes of capital stock, Class A stock and Class B stock. Authorized shares of Class A and Class B stock are 97,000,000 and 3,000,000, respectively. The limited voting rights of Class A shareholders are equal to voting rights of Class B shareholders only with regard to voting for merger, consolidation or dissolution of the Company and voting and electing four directors of the Company if there are ten or more directors and two directors if there are nine or fewer directors. With respect to all rights other than voting, Class A shareholders are the same as Class B shareholders.

The terms of the Class B stock, which is held only by employees, provide that these shares be exchanged for Class A stock on a share-for-share basis when the shareholder ceases to be an employee or decides to dispose of the shares. Accordingly, 3,000,000 shares of authorized Class A stock are reserved for this purpose.

On January 12, 1996, the Company's board of directors ("Board") declared a dividend of one purchase right for each outstanding share of Class A and Class B stock. In addition, one right is distributed for each share issued after January 26, 1996. Upon exercise, each right entitles holders to purchase from the Company one share of stock at \$55 per share, subject to certain adjustments. The rights become exercisable when a person or group acquires beneficial ownership of 15 percent or more of Class A stock or becomes the beneficial owner of an amount of Class A stock (but not less than 10 percent) which the Board of Directors determines to be substantial and not in the Company's best long-term interests or following the announcement of a tender or exchange offer for 30% or more of the Class A stock.

In the event a person acquires 15 percent or more of Class A stock, or is determined by the Board to be a substantial owner whose ownership is not in the Company's best long-term interests or an acquiring person engages in certain self-dealing transactions, each holder will have the right to receive that number of capital shares having a market value of two times the exercise price of the right. At any time after a person becomes an acquiring person, but before such person acquires 50 percent or more of outstanding Class A stock, the Board may exchange each right for one capital share (subject to adjustment).

In the event the Company is involved in certain business combination transactions, or 50 percent or more of the Company's consolidated assets or earning power are sold, each holder will have the right to receive, upon exercise at the then-current exercise price of the right, that number of shares of capital stock of the acquiring company having a market value of two times the exercise price of the right.

7. CAPITAL STOCK (CONTINUED)

The Company may redeem the rights at a price of \$.01 per right at any time prior to the time a person or group becomes an acquiring person as defined by the rights agreement. The rights expire in January 2006.

A summary of shares issued and held in treasury follows (in thousands):

	CAPITAL STOCK ISSUED		CAPITAL STOCK HELD IN TREASURY	
	CLASS A	CLASS B	CLASS A	CLASS B
Balance at December 1, 1997	27,674	540	4,923	182
Class A exchanged for Class B	--	--	92	(92)
Class B exchanged for Class A	--	--	(9)	9
Acquisition for treasury	--	--	39	--
Stock options exercised	151	--	37	12
Balance at November 30, 1998	27,825	540	5,082	111
Class A exchanged for Class B	--	--	36	(36)
Class B exchanged for Class A	--	--	(13)	13
Acquisition for treasury	--	--	32	--
Stock options exercised	144	--	56	19
Balance at November 30, 1999	27,969	540	5,193	107
Class A exchanged for Class B	--	--	73	(73)
Class B exchanged for Class A	--	--	(75)	75
Acquisition for treasury	--	--	7	--
Stock options exercised	108	--	22	3
Balance at November 30, 2000	28,077	540	5,220	112

The Company has adopted various incentive stock option plans which entitle certain directors, officers and other key employees to buy shares of Class A stock at prices not less than fair market value on the date of grant. The options vest and become exercisable ratably over a three-year period commencing two years after the date of grant and expire five or ten years after the date of grant. Certain options are granted with stock appreciation rights (SAR) and reload options. An SAR entitles the option holder to receive a cash payment equal to the difference between the option price and the current value of Class A stock. The reload option entitles the option holder to the same number of options exercised with an option price equal to the fair market value at the date of exercise. Shares reserved under these plans were 2,667,569 and 1,785,129 at November 30, 2000 and 1999, respectively. In connection with the sale of 100% of the outstanding capital stock of the Company subsequent to year end (see Note 1), all incentive stock options were vested and paid off.

7. CAPITAL STOCK (CONTINUED)

A summary of stock option activity for the years ended November 30 follows:

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	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE

Balance at December 1, 1997	789,502	\$13.39
Grants	460,022	18.84
Exercised	(151,233)	12.60
Terminated	(37,975)	17.41

Balance at November 30, 1998	1,060,316	15.72
Grants	561,095	18.21
Exercised	(146,291)	13.57
Terminated	(80,230)	18.93

Balance at November 30, 1999	1,394,890	16.76
Grants	573,055	14.17
Exercised	(117,560)	13.69
Terminated	(29,825)	17.06

Balance at November 30, 2000	1,820,560	16.14
=====		

At November 30, 2000 the range of exercise prices and weighted-average remaining contractual life of outstanding options were \$12.25 - \$21.63 and 7.5 years, respectively. At November 30, 2000 and 1999, the number of options exercisable was 515,000 and 342,000 respectively, and the weighted-average exercise price of those options was \$14.91 and \$13.32, respectively.

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation", (SFAS 123) permits companies to continue to apply APB Opinion 25, "Accounting for Stock Issued to Employees" (APB 25) and related Interpretations in accounting for its plans. The Company has elected to follow APB 25 and related Interpretations. Under APB 25, because the exercise price of the Company's employee stock options is not less than fair market value of the share at the date of grant, no compensation expense is recognized in the financial statements.

Pro forma information regarding net income and net income per share is required by SFAS 123 and has been determined as if the Company accounted for its employee stock options using the fair value method as prescribed by this Statement.

The fair value of options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 2000, 1999 and 1998, respectively: risk-free interest rate of 5.4%, 6.2%, and 4.7%; dividend yields of 1.9% for all years; volatility factors of the expected market price of the Company's Class A stock of .59, .29 and .27; and an expected life of options of 7 years, 7 years and 5 years.

7. CAPITAL STOCK (CONTINUED)

For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period. Pro forma amounts may not be representative of the expected effects on pro forma net income or net income per share in future years. The Company's pro forma information follows (in thousands, except per share amounts):

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	2000	1999	1998
Net income:			
As reported	\$ 22,025	\$ 33,321	\$ 31,579
Pro forma	20,543	32,235	30,924
Diluted net income per share:			
As reported	\$.93	\$ 1.43	\$ 1.35
Pro forma	.87	1.38	1.32
Weighted average fair value of options granted during the year	\$ 7.76	\$ 6.37	\$ 5.76

8. NET INCOME PER SHARE

Basic and diluted net income per share are computed by dividing net income as reported by the average number of shares outstanding as follows (in thousands):

	2000	1999	1998
Basic			
Weighted-average capital shares outstanding	23,230	23,205	23,160
Diluted			
Weighted-average capital shares outstanding	23,230	23,205	23,160
Dilutive effect of stock options	389	115	240
Average capital shares outstanding assuming dilution	23,619	23,320	23,400

9. BENEFIT PLANS

The Company maintains defined benefit retirement plans that cover substantially all employees. The change in benefit obligation, change in plan assets, funded status and amounts recognized in the consolidated balance sheets at November 30 for the Company's defined benefit plans were as follows (in thousands):

	2000	1999
Change in benefit obligation:		
Benefit obligation at beginning of the year	\$ 75,983	\$ 76,458
Service cost	327	400
Interest cost	5,720	5,020
Actuarial gain	(2,631)	(1,461)
Benefits paid	(4,350)	(4,434)
Benefit obligation at end of year	\$ 75,049	\$ 75,983

9. BENEFIT PLANS (CONTINUED)

	2000	1999
--	------	------

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Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 99,218	\$ 96,571
Actual (loss) return on plan assets	(628)	7,061
Employer contribution	--	20
Benefits paid	(4,350)	(4,434)
	-----	-----
Fair value of plan assets at end of year	\$ 94,240	\$ 99,218
	=====	=====

Funded status:		
Funded status	\$ 19,191	\$ 23,235
Unrecognized net actuarial gain	(5,497)	(13,730)
Unrecognized prior service cost	3,846	4,329
Unrecognized transition asset	(529)	(731)
	-----	-----
Net amount recognized	\$ 17,011	\$ 13,103
	=====	=====

Amounts recognized in the consolidated balance sheet consisted of:		
Prepaid benefit cost	\$ 17,011	\$ 13,103
	-----	-----
Net amount recognized	\$ 17,011	\$ 13,103
	=====	=====

Components of net periodic benefit cost:		
Service cost	\$ 327	\$ 400
Interest cost	5,720	5,020
Expected return on plan assets	(9,947)	(9,684)
Amortization of prior service cost	484	484
Amortization of transition asset	(202)	(202)
Recognized net actuarial gain	(290)	(424)
	-----	-----
Net periodic benefit	\$ (3,908)	\$ (4,406)
	=====	=====

Weighted-average assumptions as of year end:		
Discount rate	7.75%	6.75%
Expected return on plan assets	10.25%	10.25%
Rate of compensation increase	4.00%	4.00%

Certain employees from the Company's German subsidiary participate in a frozen, unfunded defined benefit retirement plan. The liability related to this plan totaled \$3,700,000 and \$4,000,000 and the expense related to this plan was \$365,000 and \$440,000 at November 30, 2000 and 1999, respectively.

Accumulated benefits for supplemental executive retirement plans totaled approximately \$8,517,000 and \$9,595,000 at November 30, 2000 and 1999, respectively. (Income)/ expense related to these plans amounted to \$(431,000) and \$1,431,000 for the years ended November 30, 2000 and 1999, respectively.

The Company also has a defined contribution retirement plan to which the Company contributed and charged to expense approximately \$4,838,000, and \$4,692,000 for the years ended November 30, 2000 and 1999, respectively.

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Lilly formulates, manufactures and markets industrial coatings and specialty chemicals primarily to original equipment manufacturers on a worldwide basis. The Company operates within three business segments which serve three end-use markets: wood coatings; metal coatings; and composites and glass coatings. Products sold to these markets have similar economic characteristics, production processes, distribution methods and regulatory environments. Based on these similarities, the Company's products are aggregated into one reportable segment, Industrial Coatings and Specialty Chemicals, for purposes of this disclosure. The accounting policies of the reportable segment are the same as those described in the summary of significant accounting policies.

Net sales of Industrial Coatings and Specialty Chemicals products by end-use market are as follows (in thousands):

	2000	1999	1998
Wood Coatings	\$ 308,632	\$ 297,741	\$ 269,585
Metal Coatings	290,268	284,463	274,951
Composites and Glass Coatings	70,799	73,997	74,466
	\$ 669,699	\$ 656,201	\$ 619,002

The Company maintains operations in the United States, Australia, Canada, China, Germany, Ireland, Malaysia, Mexico, Singapore, Taiwan and the United Kingdom. A summary of geographic data for the years ended November 30 is as follows (in thousands):

	2000	1999	1998
Net sales to unaffiliated customers:			
United States	\$ 499,981	\$ 504,875	\$ 488,703
Outside U.S.	169,718	151,326	130,299
Consolidated	\$ 669,699	\$ 656,201	\$ 619,002
Operating income:			
United States	\$ 33,237	\$ 48,473	\$ 50,942
Outside U.S.	25,231	24,427	21,089
Consolidated	\$ 58,468	\$ 72,900	\$ 72,031
Total assets:			
United States	\$ 455,486	\$ 451,357	\$ 430,081
Outside U.S.	92,671	99,069	86,404
Consolidated	\$ 548,157	\$ 550,426	\$ 516,485

11. COMMITMENTS AND CONTINGENCIES

The Company's operations, like those of most companies in the coatings industry, are subject to regulations related to maintaining or improving the quality of the environment. Such regulations, along with the Company's own internal compliance efforts, have required, and will continue to require, ongoing expenditures. The Company has been notified that it is a potentially responsible party for clean-up costs with respect to several government investigations at

independently operated waste

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11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

disposal sites previously used by the Company. Management has accrued, as appropriate, for these environmental liabilities. The accruals are reviewed periodically and, as investigations and remediations proceed, adjustments are made as necessary. Management believes the liabilities associated with these sites will not have a material adverse effect, individually and in the aggregate on its operating results or financial position.

The Company is involved with various legal proceedings, including product liability of a nature considered normal to its business. Management has accrued, as appropriate, for these liabilities. The accruals are reviewed periodically and, as investigations proceed, adjustments are made as necessary. Management believes the liabilities associated with the legal proceedings will not have a material adverse effect, individually and in the aggregate, on its operating results or financial position.

12. CHANGES IN ESTIMATES

The Company recorded year end adjustments related to the Supplemental Executive Retirement Plan ("SERP") and warranty liabilities as a result of a change in estimate. The adjustments were based on actual claims experience, and management's best estimate of future liabilities based on available information. The effect of the adjustments was a reduction of the SERP liability of approximately \$1,800,000 and an increase in the warranty liabilities of \$6,100,000.

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PRO FORMA FINANCIAL INFORMATION

THE VALSPAR CORPORATION AND
LILLY INDUSTRIES, INC.

The following unaudited pro forma combined condensed balance sheet as of October 27, 2000 combines the historical consolidated audited balance sheet information of The Valspar Corporation (the "Company") and Lilly Industries, Inc. as if the acquisition was consummated on October 27, 2000. The unaudited pro forma combined condensed statement of income for the year ended October 27, 2000 combines the historical consolidated audited income statement information of the Company and Lilly Industries, Inc. as if the acquisition had been consummated on October 30, 1999, the beginning of the period presented. The transaction is being recorded under the purchase method of accounting after giving effect to the pro forma adjustments described in the accompanying notes.

The unaudited pro forma financial information has been prepared by management of the Company and adjusts the historical statements of income and balance sheets for the effect of costs, expenses, assets and liabilities which might have been incurred or assumed had the acquisition been consummated on the date indicated. The unaudited pro forma financial information is provided for information purposes only and does not purport to be indicative of the future results or

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financial position of the Company. This information should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended October 27, 2000 and, for Lilly Industries, Inc., in this Form 8-K/A.

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UNAUDITED PRO FORMA BALANCE SHEET
THE VALSPAR CORPORATION AND
LILLY INDUSTRIES, INC.
OCTOBER 27, 2000

(000's U.S.\$)

	VALSPAR -----	LILLY (6) -----	PRO FORMA AD ----- DR --
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	\$ 20,935	\$ 6,470	
Accounts receivable, less allowance	277,763	90,181	
Inventories	154,887	57,116	
Deferred Income Taxes	18,464	2,730	
Other current assets	61,815	4,958	
	-----	-----	
Total current assets	533,864	161,455	--
INVESTMENT IN LILLY			\$ 1,036,045 (1)
GOODWILL	208,748	206,435	815,812 (3)
OTHER ASSETS	83,671	41,526	2,000 (5)
PROPERTY, PLANT AND EQUIPMENT			
Less allowances for depreciation and amortization	545,475	216,547	
	246,728	77,806	
	-----	-----	
	298,747	138,741	--
Total Assets	\$ 1,125,030	\$ 548,157	\$ 1,853,857
=====			
LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES			
Accounts payable	\$ 153,996	\$ 48,230	
Short-term borrowings	40,195	--	
Accrued Liabilities	129,187	38,872	
Income taxes payable	10,910	4,423	
	-----	-----	
Total current liabilities	334,288	91,525	
LONG-TERM DEBT	300,300	211,514	
OTHER LONG-TERM LIABILITIES	52,871	39,006	
STOCKHOLDERS' EQUITY			
Common stock, at par	26,660	15,899	\$ 15,899 (3)
Additional paid-in capital	34,267	85,329	85,329 (3)

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Retained earnings	490,860	148,402	148,402 (3)
			--
Other	(306)	(5,241)	(5,241) (3)
Treasury stock, at cost	(113,910)	(38,277)	(38,277) (3)
	-----	-----	
Total Stockholders' Equity	437,571	206,112	
Total Liabilities and Stockholders' Equity	\$ 1,125,030	\$ 548,157	\$ 206,112
	=====	=====	=====

- (1) To establish investment and record debt incurred to finance the acquisition.
- (2) To eliminate goodwill previously recorded by Lilly Industries.
- (3) To eliminate investment and record initial goodwill and assets at historical values based upon purchase price less net book value of assets acquired. The goodwill is subject to possible adjustment upon completion of appraisal valuations.
- (4) All assets and liabilities are included at Lilly Industries' historical values (except as noted in (5) below.) Valspar will obtain fair market values for these assets and liabilities to be used as the basis for establishing the opening balance sheet values for the net assets. These valuations will not be available for several months.
- (5) To record purchase accounting adjustments for pension and tax liability at fair market value.
- (6) Reported financial information as of November 30, 2000.

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UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME
THE VALSPAR CORPORATION AND
LILLY INDUSTRIES, INC.
FOR THE YEAR ENDED OCTOBER 27, 2000

(000's U.S.\$)

	VALSPAR	LILLY (5) (6)	PRO FORMA ADJUST
	-----	-----	DR

NET SALES	\$ 1,483,320	\$ 669,699	
COSTS AND EXPENSES:			
Cost of sales	1,039,267	416,122	\$
Selling, general and administrative expenses	280,118	195,109	20,395 (1)
Interest expense	21,989	16,900	56,908 (2)
Seller's transaction expense	--	2,353	

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Other expense/(income), net	200	(483)	
	-----	-----	
	1,341,574	630,001	77,304
INCOME BEFORE INCOME TAXES	141,746	39,698	(77,304)
INCOME TAXES	55,280	17,673	
NET INCOME	\$ 86,466	\$ 22,025	\$ (77,304)
	=====	=====	=====
NET INCOME PER SHARE-BASIC	\$ 2.02		
	=====		
NET INCOME PER SHARE-DILUTED	\$ 2.00		
	=====		
BASIC SHARES OUTSTANDING (IN THOUSANDS)	42,706		
	=====		
DILUTED SHARES OUTSTANDING (IN THOUSANDS)	43,196		
	=====		

- (1) To record amortization of excess of purchase price over acquired net assets, based on an estimated lives of 40 years. Such amortization expense is subject to possible adjustment upon completion of the Lilly Industries appraisal valuation.
- (2) To record additional estimated interest expense, using a 7% interest rate, resulting from the use of debt to finance the acquisition.
- (3) To record tax effect, using a 45% estimated effective tax rate. This rate is higher than the historical Valspar tax rate, due to goodwill amortization not being deductible for tax purposes.
- (4) Valspar Corporation expects to achieve certain synergies in relation to the business combination. Such synergies are not included in the above pro forma adjustments.
- (5) Reported financial information as of November 30, 2000.
- (6) Refer to Lilly Industries Notes to Consolidated Financial Statements for changes in estimates within the current year financial statements.