

AVERY DENNISON CORPORATION

Form 10-Q

August 09, 2007

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**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 June 30, 2007.**

**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: 1-7685**

**AVERY DENNISON CORPORATION**

**(Exact name of registrant as specified in its charter)**

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-1492269**

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

**150 North Orange Grove Boulevard  
Pasadena, California**

(Address of principal executive offices)

**91103**

(Zip Code)

Registrant's telephone number, including area code: (626) 304-2000

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Number of shares of \$1 par value common stock outstanding as of July 27, 2007: 106,480,795

**AVERY DENNISON CORPORATION  
FISCAL SECOND QUARTER 2007 FORM 10-Q QUARTERLY REPORT  
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**PART 1. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONDENSED CONSOLIDATED BALANCE SHEET***(Unaudited)*

(Dollars in millions)	<b>June 30, 2007</b>	<b>December 30, 2006</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 76.6	\$ 58.5
Trade accounts receivable, less allowances of \$66.4 and \$58.9 for 2007 and 2006, respectively	1,151.1	910.2
Inventories, net	640.6	471.8
Deferred taxes and other current assets	269.8	214.9
<b>Total current assets</b>	<b>2,138.1</b>	<b>1,655.4</b>
Property, plant and equipment	3,082.3	2,775.6
Accumulated depreciation	(1,504.0)	(1,466.2)
<b>Property, plant and equipment, net</b>	<b>1,578.3</b>	<b>1,309.4</b>
Goodwill	1,567.6	715.9
Other intangibles resulting from business acquisitions, net	352.0	95.5
Other assets	527.6	517.4
	<b>\$ 6,163.6</b>	<b>\$ 4,293.6</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Short-term and current portion of long-term debt	\$ 1,894.3	\$ 466.4
Accounts payable	708.2	630.1
Other current liabilities	615.6	602.3
<b>Total current liabilities</b>	<b>3,218.1</b>	<b>1,698.8</b>
Long-term debt	506.7	501.6
Non-current deferred and payable income taxes and other long-term liabilities	615.5	412.7
Commitments and contingencies (see Note 16)		
Shareholders' equity:		
Common stock, \$1 par value, authorized 400,000,000 shares at June 30, 2007 and December 30, 2006; issued 124,126,624 shares at June 30, 2007 and December 30, 2006; outstanding 98,184,414 shares and 98,313,102 shares at June 30, 2007 and December 30, 2006, respectively	124.1	124.1
Capital in excess of par value	900.9	881.5
Retained earnings	2,222.5	2,139.9
Cost of unallocated ESOP shares	(5.7)	(5.7)

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Employee stock benefit trusts, 8,266,381 shares and 8,896,474 shares at June 30, 2007 and December 30, 2006, respectively	(547.5)	(602.5)
Treasury stock at cost, 17,645,829 shares and 16,887,048 shares at June 30, 2007 and December 30, 2006, respectively	(858.2)	(806.7)
Accumulated other comprehensive loss	(12.8)	(50.1)
Total shareholders' equity	1,823.3	1,680.5
	\$ 6,163.6	\$ 4,293.6

See Notes to Unaudited Condensed Consolidated Financial Statements

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**CONSOLIDATED STATEMENT OF INCOME**  
*(Unaudited)*

(In millions, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Net sales	\$ 1,523.5	\$ 1,409.7	\$ 2,913.4	\$ 2,746.9
Cost of products sold	1,113.7	1,016.7	2,139.2	1,998.7
Gross profit	409.8	393.0	774.2	748.2
Marketing, general and administrative expense	270.8	251.3	519.1	496.1
Interest expense	20.1	13.6	35.2	28.1
Other expense, net	7.5	4.0	9.6	11.6
Income from continuing operations before taxes	111.4	124.1	210.3	212.4
Taxes on income	25.6	27.7	45.3	47.1
Income from continuing operations	85.8	96.4	165.0	165.3
Income from discontinued operations, net of tax (including gain on disposal of \$1.3 and tax benefit of \$15.4 in 2006)		15.6		15.4
Net income	\$ 85.8	\$ 112.0	\$ 165.0	\$ 180.7
Per share amounts:				
Net income per common share:				
Continuing operations	\$ .88	\$ .96	\$ 1.68	\$ 1.66
Discontinued operations		.16		.15
Net income per common share	\$ .88	\$ 1.12	\$ 1.68	\$ 1.81
Net income per common share, assuming dilution:				
Continuing operations	\$ .87	\$ .96	\$ 1.67	\$ 1.65
Discontinued operations		.16		.15
Net income per common share, assuming dilution	\$ .87	\$ 1.12	\$ 1.67	\$ 1.80
Dividends	\$ .40	\$ .39	\$ .80	\$ .78
Average shares outstanding:				
Common shares	98.0	100.0	98.0	99.9
Common shares, assuming dilution	98.7	100.4	98.8	100.3
Common shares outstanding at period end	98.2	100.1	98.2	100.1



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**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
*(Unaudited)*

(In millions)	<b>Six Months Ended</b>	
	<b>June 30, 2007</b>	<b>July 1, 2006</b>
<b>Operating Activities</b>		
Net income	\$ 165.0	\$ 180.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	79.7	77.9
Amortization	21.1	21.3
Deferred taxes	3.4	3.7
Asset impairment and net loss (gain) on sale and disposal of assets	13.1	(6.1)
Stock-based compensation	10.3	12.1
Other non-cash items, net	(9.9)	(5.4)
Changes in assets and liabilities, net of the effect of business acquisitions and divestitures	(151.8)	(151.2)
Net cash provided by operating activities	130.9	133.0
<b>Investing Activities</b>		
Purchase of property, plant and equipment	(94.7)	(80.5)
Purchase of software and other deferred charges	(29.0)	(15.7)
Payments for acquisitions	(1,284.1)	
Proceeds from sale of assets	1.7	.9
Proceeds from sale of businesses and investments		29.3
Other	.7	(.8)
Net cash used in investing activities	(1,405.4)	(66.8)
<b>Financing Activities</b>		
Net increase (decrease) in borrowings (maturities of 90 days or less)	1,423.9	(55.7)
Payments of debt (maturities longer than 90 days)	(11.7)	(1.4)
Dividends paid	(85.4)	(85.7)
Purchase of treasury stock	(63.2)	
Proceeds from exercise of stock options, net	30.5	18.6
Other	(2.1)	8.0
Net cash provided by (used in) financing activities	1,292.0	(116.2)
Effect of foreign currency translation on cash balances	.6	.6
Increase (decrease) in cash and cash equivalents	18.1	(49.4)
Cash and cash equivalents, beginning of period	58.5	98.5



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Cash and cash equivalents, end of period	\$ 76.6	\$ 49.1
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See Notes to Unaudited Condensed Consolidated Financial Statements

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1. General**

The accompanying unaudited condensed consolidated financial statements include normal recurring adjustments necessary for a fair presentation of Avery Dennison Corporation's (the Company) interim results. In management's opinion, the unaudited condensed consolidated financial statements and notes in this Form 10-Q are presented as permitted by Regulation S-X. The unaudited condensed consolidated financial statements do not contain certain information included in the Company's 2006 annual financial statements and notes. This Form 10-Q should be read in conjunction with the Company's consolidated financial statements and notes included in the Company's 2006 Annual Report on Form 10-K.

The second quarters of 2007 and 2006 consisted of thirteen-week periods ending June 30, 2007 and July 1, 2006, respectively. The interim results of operations are not necessarily indicative of future financial results.

**Note 2. Acquisitions**

On June 15, 2007, the Company completed the acquisition of Paxar Corporation (Paxar), a global leader in retail tag, ticketing, and branding systems. In accordance with the terms of the acquisition agreement, each outstanding share of Paxar common stock, par value \$0.10 (other than shares owned by the Company and its subsidiaries) was converted into the right to receive \$30.50 in cash. At June 15, 2007, outstanding options to purchase Paxar Common Stock, shares of Paxar restricted stock and Paxar performance share awards were converted into weight-adjusted options to purchase the Company's common stock, shares of the Company's restricted stock and, at the Company's election, shares of the Company's restricted stock or the Company's restricted stock units, respectively. The occurrence of certain circumstances resulted in the accelerated vesting of certain of these equity awards.

The Paxar operations are included in the Company's Retail Information Services segment. The combination of the Paxar business into the Retail Information Services segment increases the Company's presence in the expanding and fragmented retail information and brand identification market, combines complementary strengths and broadens the range of the Company's product and service capabilities, improves the Company's ability to meet customer demands for product innovation and improved quality of service, and facilitates expansion into new product and geographic segments. The integration of the acquisition into the Company's operations is also expected to result in significant cost synergies.

The total purchase price for this transaction was approximately \$1.33 billion for the outstanding shares of Paxar, including transaction costs of approximately \$14 million. Funds used to complete the acquisition were derived from commercial paper borrowings, supported by a bridge revolving credit facility (see Note 7, Debt). The Company assumed liabilities of approximately \$370 million, including accounts payable and other current and long-term liabilities. The Company included the operating results of Paxar in its unaudited Consolidated Statement of Income for the period from June 15, 2007 to June 30, 2007.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, the preliminary balance sheet allocation of the purchase price as of June 30, 2007 has been made and recorded in the unaudited Condensed Consolidated Financial Statements. The preliminary allocation of the purchase price was primarily based on preliminary third-party valuations of the acquired assets; however, ongoing assessments are expected to impact the allocation of the purchase price.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition.

(In millions)	<b>June 15, 2007</b>
Current assets (including cash and cash equivalents of approximately \$47 million)	\$ 368.0
Property, plant, and equipment	253.3
Other assets	2.6
Intangible assets	260.7
Goodwill	840.3

Total assets acquired	\$ 1,724.9
Current liabilities	192.4
Other long-term liabilities	177.9
Other equity	23.2
Total liabilities and other equity	\$ 393.5
Net assets acquired	\$ 1,331.4

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The excess of the cost-basis over the fair value of the net tangible assets acquired is currently estimated to be approximately \$1.1 billion, including goodwill of approximately \$840 million and identified intangible assets of approximately \$261 million, which includes amortizable and non-amortizable intangible assets. Identifiable intangible assets consist of customer relationships, trade name and trademarks, patents and other acquired technology and other intangibles. The goodwill from this acquisition is not expected to be deductible for U.S. tax purposes. Refer also to Note 6, Goodwill and Other Intangibles Resulting from Business Acquisitions. There were no in-progress research and development assets acquired as a result of the acquisition.

Included in the assumed current liabilities were accrued restructuring costs related to Paxar's pre-acquisition restructuring program. At June 30, 2007, \$7 million remained accrued in connection with this program.

As a result of the Paxar acquisition, the Company identified certain costs totaling approximately \$4 million related to exit activities and integration actions. Approximately \$2 million of these costs were related to severance costs for involuntary terminations of approximately 25 employees of Paxar, to be paid through 2008. Also included are lease costs (approximately \$1 million), which are expected to be completed through 2010, and other related costs. At June 30, 2007, all of the \$4 million remained accrued. Of the total positions impacted under these actions, approximately 20 employees remain with the Company as of June 30, 2007. Additional liabilities for exit activities and integration costs are being determined and are expected to be recorded in connection with future purchase price allocations.

In connection with this acquisition, certain change-in-control provisions provided that approximately \$27 million was to be paid to certain key executives of Paxar. This amount includes severance, bonuses, accelerated vesting of stock options, performance share awards, restricted stock, and other items. At June 30, 2007, all of the \$27 million remained accrued in Other current liabilities.

Included in the assumed long-term liabilities was a postretirement benefit obligation totaling approximately \$11 million for certain retired executives of Paxar. The Company expects to incur an additional \$.4 million of net periodic cost for the remainder of 2007.

Other equity includes the total amount related to converted Paxar stock options and performance share awards of approximately \$22 million. This total is net of amounts related to converted unvested stock options and performance share awards (approximately \$5 million), which will be recognized in the Company's operating results over the remaining vesting periods for these equity awards. Refer to Note 10, Stock-based Compensation, for further details. Refer to Note 13, Taxes Based on Income, for information on the tax-related impact of the acquisition.

The following table represents the unaudited pro forma results of operations for the Company as though the acquisition of Paxar had occurred at the beginning of 2006. The pro forma results include estimated interest expense associated with commercial paper borrowings to fund the acquisition; amortization of intangible assets that would have been acquired; adjustment to income tax provision using the worldwide combined effective tax rates of both the Company and Paxar; elimination of intercompany sales and profit in inventory; fair value adjustments to inventory; and additional depreciation resulting from fair value amounts allocated to real and personal property over the estimated useful lives. The pro forma results of operations have been prepared based on the preliminary allocation of the purchase price and are expected to be adjusted as a result of the finalization of the purchase price allocation. This pro forma information is for comparison purposes only, and is not necessarily indicative of the results that would have occurred had the acquisition been completed at the beginning of 2006, nor is it necessarily indicative of future results.

(In millions, except per share amounts)	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2007<sup>(1)</sup></b>	<b>July 1, 2006<sup>(2)</sup></b>	<b>June 30, 2007<sup>(3)</sup></b>	<b>July 1, 2006<sup>(4)</sup></b>
Net sales	\$ 1,726.8	\$ 1,639.5	\$ 3,327.9	\$ 3,173.0
Net income from continuing operations	77.0	90.7	139.8	143.5

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Net income per common share from continuing operations	.79	.91	1.43	1.44
Net income per common share from continuing operations, assuming dilution	.78	.90	1.41	1.43

(1) The pro forma results of operations for the second quarter of 2007 include the Company's restructuring costs and other charges discussed in Note 17, Segment Information.

(2) The pro forma results of operations for the second quarter of 2006 include the impact of Paxar's restructuring costs and other charges of \$1.6, as well as the Company's restructuring costs and other charges discussed in Note 17, Segment Information.

(3) The pro forma results of operations for the first six months of 2007 include the impact of Paxar's

restructuring costs and other charges of \$1.8 and merger-related costs of \$1.5, as well as the Company's restructuring costs and other charges discussed in Note 17, Segment Information.

- (4) The pro forma results of operations for the first six months of 2006 include the impact of Paxar's restructuring costs and other charges of \$4.6, as well as the Company's restructuring costs and other charges discussed in Note 17, Segment Information.

**Note 3. Discontinued Operations**

In 2006, the Company completed the sale of its raised reflective pavement markers business, which was announced in December 2005.

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The results for this business were accounted for as discontinued operations in the consolidated financial statements for the years presented herein. The divestiture resulted in a tax benefit (\$15.4 million) due to capital losses arising from the sale of the business and a gain on sale (\$1.3 million) reported in the second quarter of 2006. This business was previously included in the Pressure-sensitive Materials segment.

Summarized, combined statement of income for discontinued operations:

(In millions)	<b>Three Months Ended July 1, 2006</b>	<b>Six Months Ended July 1, 2006</b>
Net sales	\$ 3.3	\$ 7.0
Loss before taxes	(.7)	(1.0)
Taxes on income	.4	.3
Loss from operations, net of tax	(1.1)	(1.3)
Gain on sale of discontinued operations	1.3	1.3
Tax benefit from sale	(15.4)	(15.4)
Income from discontinued operations, net of tax	\$ 15.6	\$ 15.4

**Note 4. Accounts Receivable**

The Company recorded expenses related to the allowances for trade accounts receivable of \$4.2 million and \$17.4 million for the six months ended June 30, 2007 and July 1, 2006, respectively. The Company records these allowances based on estimates related to the following factors:

Customer specific allowances

Amounts based upon an aging schedule

An estimated amount, based on the Company's historical experience

**Note 5. Inventories**

Inventories consisted of:

(In millions)	<b>June 30, 2007</b>	<b>December 30, 2006</b>
Raw materials	\$ 234.8	\$ 157.6
Work-in-progress	143.8	118.4
Finished goods	287.6	220.9
Inventories at lower of FIFO cost or market (approximates replacement cost)	666.2	496.9
Less LIFO adjustment	(25.6)	(25.1)
Inventory, net (on blended FIFO and LIFO basis)	\$ 640.6	\$ 471.8

**Note 6. Goodwill and Other Intangibles Resulting from Business Acquisitions**

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Changes in the net carrying amount of goodwill from continuing operations for the periods shown, by reportable segment, are as follows:

(In millions)	<b>Pressure- sensitive Materials</b>	<b>Retail Information Services</b>	<b>Office and Consumer Products</b>	<b>Other specialty converting businesses</b>	<b>Total</b>
Balance as of December 31, 2005	\$ 313.6	\$ 201.3	\$ 157.9	\$ .3	\$ 673.1
Transfer of business <sup>(1)</sup>		(3.1)		3.1	
Goodwill acquired during the period				10.4	10.4
Acquisition adjustments <sup>(2)</sup>		.3			.3
Translation adjustments	18.8	2.0	11.2	.1	32.1
Balance as of December 30, 2006	332.4	200.5	169.1	13.9	715.9
Goodwill acquired during the period		840.3			840.3
Acquisition adjustments <sup>(3)</sup>		(.5)			(.5)
Translation adjustments	8.4	.6	2.9		11.9
Balance as of June 30, 2007	\$ 340.8	\$ 1,040.9	\$ 172.0	\$ 13.9	\$ 1,567.6



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- (1) Transfer of business refers to the transfer of the business media division from Retail Information Services to other specialty converting businesses to align with a change in the Company's internal reporting structure.
- (2) Acquisition adjustments in 2006 consisted of the purchase price allocation of a small acquisition in 2005.
- (3) Acquisition adjustments in 2007 consisted of a tax adjustment associated with RVL Packaging, Inc.

Goodwill and other intangible assets and related useful lives include the preliminary allocation of the purchase price of Paxar, based on preliminary third-party valuations of the acquired assets; as such, the balances may change as a result of the finalization of the purchase price allocation. Refer to Note 2, Acquisitions, for further information. In connection with the Paxar acquisition, the Company acquired approximately \$30 million of intangible assets, consisting of trade names and trademarks, which are not subject to amortization because they have an indefinite useful life. These intangible assets were not included in the table below.

The following table sets forth the Company's preliminary estimates of other intangible assets resulting from business acquisitions at June 30, 2007 and December 30, 2006, which continue to be amortized:

<b>June 30, 2007</b>			<b>December 30, 2006</b>		
<b>Gross</b>		<b>Net</b>	<b>Gross</b>		<b>Net</b>
<b>Carrying</b>	<b>Accumulated</b>	<b>Carrying</b>	<b>Carrying</b>	<b>Accumulated</b>	<b>Carrying</b>

(In millions)	Amount	Amortization	Amount	Amount	Amortization	Amount
Amortizable other intangible assets:						
Customer relationships	\$ 271.3	\$ 28.4	\$ 242.9	\$ 93.0	\$ 25.1	\$ 67.9
Trade names and trademarks	70.5	36.2	34.3	43.2	33.6	9.6
Patented and other acquired technology	52.4	11.8	40.6	28.3	11.0	17.3
Other intangibles	8.4	4.2	4.2	4.8	4.1	.7
Total	\$ 402.6	\$ 80.6	\$ 322.0	\$ 169.3	\$ 73.8	\$ 95.5

Amortization expense on other intangible assets resulting from business acquisitions was \$3 million and \$5.5 million for the three and six months ended June 30, 2007, respectively, and \$2.8 million and \$5.4 million for the three and six months ended July 1, 2006, respectively. Based on current information, including the preliminary assessment for Paxar, estimated amortization expense for other intangible assets resulting from business acquisitions for this fiscal year and each of the next four fiscal years is expected to be approximately \$21 million, \$30 million, \$29 million, \$29 million and \$29 million, respectively.

The weighted-average amortization periods from the date of acquisition for amortizable intangible assets resulting from business acquisitions are fifteen years for customer relationships, thirteen years for trade names and trademarks, thirteen years for patented and other acquired technology, ten years for other intangibles and fourteen years in total. As of June 30, 2007, the weighted-average remaining useful life of acquired amortizable intangible assets are twelve years for customer relationships, nine years for trade names and trademarks, nine years for patented and other acquired technology, eight years for other intangibles and eleven years in total.

#### **Note 7. Debt**

On June 13, 2007, the Company entered into a bridge revolving credit facility ( Credit Facility ) with five domestic and foreign banks for a total commitment of \$1.35 billion, expiring June 11, 2008, for terms which are generally similar to existing credit facilities. Financing available under this agreement is permitted to be used for working capital, commercial paper back-up and other general corporate purposes, including acquisitions.

The Company used the Credit Facility to support commercial paper borrowings totaling approximately \$1.3 billion to fund the Paxar acquisition, discussed in detail in Note 2, Acquisitions. Such commercial paper borrowings are included in Short-term and current portion of long-term debt in the unaudited Condensed Consolidated Balance Sheet. The Credit Facility is subject to customary financial covenants, including a leverage ratio and an interest coverage ratio, for which the Company is in compliance.

In connection with the Paxar acquisition, the Company has assumed additional stand-by letters of credit of \$7.3 million outstanding at June 30, 2007.

#### **Note 8. Pension and Other Postretirement Benefits**

The following table sets forth the components of net periodic benefit cost for the periods shown:

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(In millions)	<b>Pension Benefits</b>							
	<b>Three Months Ended</b>				<b>Six Months Ended</b>			
	<b>June 30, 2007</b>		<b>July 1, 2006</b>		<b>June 30, 2007</b>		<b>July 1, 2006</b>	
	<b>U.S.</b>	<b>Int 1</b>	<b>U.S.</b>	<b>Int 1</b>	<b>U.S.</b>	<b>Int 1</b>	<b>U.S.</b>	<b>Int 1</b>
Components of net periodic benefit cost:								
Service cost	\$ 3.9	\$ 3.3	\$ 4.7	\$ 3.2	\$ 9.3	\$ 6.6	\$ 9.6	\$ 6.4
Interest cost	8.7	6.0	7.7	4.7	16.7	11.8	14.9	9.3
Expected return on plan assets	(12.3)	(6.0)	(11.7)	(4.8)	(24.5)	(11.9)	(23.4)	(9.5)
Recognized net actuarial loss	2.8	1.9	2.1	1.5	4.7	3.9	4.0	3.1
Amortization of prior service cost	.5	.1	.4	.2	1.0	.3	.9	.3
Amortization of transition obligation or asset		(.2)		(.3)		(.5)		(.6)
Recognized gain on curtailment and settlement of an obligation <sup>(1)</sup>				(1				