AVERY DENNISON CORPORATION
Form 10-Q
August 12, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**
**FORM 10-Q**

**(Mark One)**

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended July 4, 2009.**

**OR**

o **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** | **95-1492269** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **150 North Orange Grove Boulevard Pasadena, California** | **91103** |
| (Address of principal executive offices) | (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 þ No o

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 o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o | Smaller Reporting Company o |
|---|---|---|---|
| | | (Do not check if a smaller reporting company) | |

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

Number of shares of $1 par value common stock outstanding as of August 1, 2009: 112,744,662

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**AVERY DENNISON CORPORATION**
**FISCAL SECOND QUARTER 2009 FORM 10-Q QUARTERLY REPORT**

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Avery Dennison Corporation

**PART 1. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**CONDENSED CONSOLIDATED BALANCE SHEET**

**(*Unaudited*)**

| (Dollars in millions) | July 4, 2009 | December 27, 2008 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 91.9 | $ 105.5 |
| Trade accounts receivable, less allowances of $55.9 and $57.3 for 2009 and 2008, respectively | 975.6 | 988.9 |
| Inventories, net | 518.4 | 583.6 |
| Current deferred and refundable income taxes | 103.5 | 115.6 |
| Other current assets | 104.7 | 136.8 |
| Total current assets | 1,794.1 | 1,930.4 |
| Property, plant and equipment | 3,170.1 | 3,173.1 |
| Accumulated depreciation | (1,766.1) | (1,680.1) |
| Property, plant and equipment, net | 1,404.0 | 1,493.0 |
| Goodwill | 940.0 | 1,716.7 |
| Other intangibles resulting from business acquisitions, net | 277.1 | 303.6 |
| Non-current deferred and refundable income taxes | 204.6 | 168.9 |
| Other assets | 423.4 | 423.1 |
| | $ 5,043.2 | $ 6,035.7 |
| **Liabilities and Shareholders Equity** | | |
| Current liabilities: | | |
| Short-term and current portion of long-term debt | $ 791.6 | $ 665.0 |
| Accounts payable | 608.0 | 672.9 |
| Current deferred and payable income taxes | 34.9 | 59.6 |
| Other current liabilities | 581.6 | 660.5 |
| Total current liabilities | 2,016.1 | 2,058.0 |
| Long-term debt | 1,134.9 | 1,544.8 |
| Long-term retirement benefits and other liabilities | 551.0 | 566.5 |
| Non-current deferred and payable income taxes | 139.9 | 116.4 |
| Commitments and contingencies (see Note 15) | | |
| Shareholders equity: | | |
| Common stock, $1 par value, authorized - 400,000,000 shares at July 4, 2009 and December 27, 2008; issued - 124,126,624 shares at July 4, 2009 and December 27, 2008; outstanding - 105,094,566 shares and 98,366,621 shares at July 4, 2009 and December 27, 2008, respectively | 124.1 | 124.1 |
| Capital in excess of par value | 623.1 | 642.9 |

| | | |
|---|---|---|
| Retained earnings | 1,432.7 | 2,381.3 |
| Cost of unallocated ESOP shares | | (1.2) |
| Employee stock benefit trusts, 7,635,096 shares and 7,888,953 shares at July 4, 2009 and December 27, 2008, respectively | (188.3) | (246.9) |
| Treasury stock at cost, 11,381,962 shares and 17,841,050 shares at July 4, 2009 and December 27, 2008, respectively | (570.8) | (867.7) |
| Accumulated other comprehensive loss | (219.5) | (282.5) |
| Total shareholders equity | 1,201.3 | 1,750.0 |
| | $ 5,043.2 | $ 6,035.7 |

See Notes to Unaudited Condensed Consolidated Financial Statements

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Avery Dennison Corporation

**CONSOLIDATED STATEMENT OF OPERATIONS**
**(*Unaudited*)**

| (In millions, except per share amounts) | Three Months Ended July 4, 2009 | Three Months Ended June 28, 2008 | Six Months Ended July 4, 2009 | Six Months Ended June 28, 2008 |
|---|---|---|---|---|
| Net sales | $ 1,455.4 | $ 1,828.9 | $ 2,881.6 | $ 3,474.1 |
| Cost of products sold | 1,065.1 | 1,338.6 | 2,146.2 | 2,559.8 |
| Gross profit | 390.3 | 490.3 | 735.4 | 914.3 |
| Marketing, general and administrative expense | 300.1 | 341.0 | 604.3 | 669.0 |
| Goodwill and indefinite-lived intangible asset impairment charges | | | 832.0 | |
| Interest expense | 20.4 | 29.3 | 47.9 | 58.8 |
| Other expense, net | 29.6 | 5.8 | 126.9 | 11.4 |
| Income (loss) before taxes | 40.2 | 114.2 | (875.7) | 175.1 |
| Provision for (benefit from) income taxes | .4 | 21.8 | (16.6) | 14.3 |
| Net income (loss) | $ 39.8 | $ 92.4 | $ (859.1) | $ 160.8 |
| Per share amounts: | | | | |
| Net income (loss) per common share | $ .38 | $ .94 | $ (8.41) | $ 1.63 |
| Net income (loss) per common share, assuming dilution | $ .38 | $ .93 | $ (8.41) | $ 1.62 |
| Dividends | $ .41 | $ .41 | $ .82 | $ .82 |
| Average shares outstanding: | | | | |
| Common shares | 105.0 | 98.5 | 102.2 | 98.5 |
| Common shares, assuming dilution | 105.7 | 98.9 | 102.2 | 98.9 |
| Common shares outstanding at period end | 105.1 | 98.5 | 105.1 | 98.5 |

See Notes to Unaudited Condensed Consolidated Financial Statements

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Avery Dennison Corporation

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

| (In millions) | Six Months Ended July 4, 2009 | Six Months Ended June 28, 2008 |
|---|---|---|
| **Operating Activities** | | |
| Net (loss) income | $ (859.1) | $ 160.8 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 94.0 | 101.6 |
| Amortization | 38.6 | 37.0 |
| Provision for doubtful accounts | 9.5 | 8.2 |
| Goodwill and indefinite-lived intangible asset impairment charges | 832.0 | |
| Asset impairment and net loss on sale and disposal of assets | 28.0 | 14.4 |
| Loss from debt extinguishment | 21.2 | |
| Stock-based compensation | 13.2 | 16.9 |
| Other non-cash expense and loss | 12.1 | |
| Other non-cash income and gain | (7.2) | (17.2) |
| Changes in assets and liabilities and other adjustments, net of the effect of business acquisitions | (49.5) | (133.0) |
| Net cash provided by operating activities | 132.8 | 188.7 |
| **Investing Activities** | | |
| Purchase of property, plant and equipment | (30.5) | (69.1) |
| Purchase of software and other deferred charges | (14.9) | (33.0) |
| Payments for acquisitions | | (125.0) |
| Proceeds from sale of investments, net | .1 | 13.0 |
| Other | (4.2) | 5.1 |
| Net cash used in investing activities | (49.5) | (209.0) |
| **Financing Activities** | | |
| Net increase (decrease) in borrowings (maturities of 90 days or less) | 65.4 | (285.1) |
| Additional borrowings (maturities longer than 90 days) | | 400.1 |
| Payments of debt (maturities longer than 90 days) | (73.4) | (.3) |
| Dividends paid | (89.6) | (87.6) |
| Proceeds from exercise of stock options, net | .2 | 1.9 |
| Other | | 5.4 |
| Net cash (used in) provided by financing activities | (97.4) | 34.4 |
| Effect of foreign currency translation on cash balances | .5 | 1.5 |

| | | |
|---|---|---|
| (Decrease) increase in cash and cash equivalents | (13.6) | 15.6 |
| Cash and cash equivalents, beginning of year | 105.5 | 71.5 |
| Cash and cash equivalents, end of period | $ 91.9 | $ 87.1 |

See Notes to Unaudited Condensed Consolidated Financial Statements

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. General**

In the opinion of management, the accompanying unaudited condensed consolidated financial statements include normal recurring adjustments necessary for a fair statement of Avery Dennison Corporation s (the Company s ) interim results. The unaudited condensed consolidated financial statements and notes in this Form 10-Q are presented as permitted by Article 10 of Regulation S-X. The unaudited condensed consolidated financial statements do not contain certain information included in the Company s 2008 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 2008 Annual Report on Form 10-K.

The Company s 2009 fiscal year includes a 53-week period, with the extra week reflected in the first quarter. Normally, each fiscal year consists of 52 weeks, but every fifth or sixth year consists of 53 weeks. The second quarters of 2009 and 2008 consisted of thirteen-week periods ending July 4, 2009 and June 28, 2008, respectively. The interim results of operations are not necessarily indicative of future financial results.

The Company has evaluated subsequent events through the time of filing this Form 10-Q with the Securities and Exchange Commission ( SEC ) on August 12, 2009.

**Financial Presentation**

Certain prior year amounts have been reclassified to conform with the current year presentation.

**Note 2. Acquisitions**

On April 1, 2008, the Company acquired DM Label Group ( DM Label ). DM Label operations are included in the Company s Retail Information Services segment.

**Note 3. Inventories**

Inventories consisted of:

| (In millions) | July 4, 2009 | December 27, 2008 |
|---|---|---|
| Raw materials | $ 221.0 | $ 256.2 |
| Work-in-progress | 124.3 | 143.4 |
| Finished goods | 241.3 | 248.6 |
| Inventories at lower of FIFO cost or market (approximates replacement cost) | 586.6 | 648.2 |
| Inventory reserves | (68.2) | (64.6) |
| Inventories, net | $ 518.4 | $ 583.6 |

**Note 4. Goodwill and Other Intangibles Resulting from Business Acquisitions**

In the first quarter of 2009, the Company recorded non-cash impairment charges of $832 million for the retail information services reporting unit, of which $820 million is related to goodwill and $12 million is related to indefinite-lived intangible assets. The Company completed its impairment test of goodwill and indefinite-lived intangible assets ( goodwill impairment ) in the second quarter of 2009, with no additional impairment charge incurred. The Company performs its goodwill impairment test in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142 Goodwill and Other Intangible Assets. In performing the required goodwill impairment test, the Company primarily applies a present value (discounted cash flow) method to determine the fair value of the reporting units with goodwill. The Company s reporting units, which are composed of either a discrete business or an aggregation of businesses with similar economic characteristics, consist of roll materials; retail information services; office and consumer products; graphics and reflective products; industrial products; and business media.

The Company performs its annual goodwill impairment test during the fourth quarter. However, certain factors may result in the need to perform a goodwill impairment test prior to the fourth quarter, including significant underperformance of the Company s business relative to expected operating results, significant adverse economic and industry trends, significant decline in the Company s market

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capitalization for an extended period of time relative to net book value, or a decision to divest an individual business within a reporting unit. Based upon the Company s assessment of these factors in connection with the preparation of the Company s first quarter financial statements, the Company determined that there was a need to initiate an interim goodwill impairment test. The factors considered included both a sustained decline in the Company s stock price and a decline in the Company s 2009 revenue projections for the retail information services reporting unit, following lower than expected revenues in March 2009, which continued in April 2009. The peak season for the retail information services reporting unit has traditionally been March through the end of the second quarter.

The Company s interim impairment analysis indicated that the fair value of each of the Company s reporting units exceeded its carrying value, except for the Company s retail information services reporting unit, which had a fair value less than its carrying value. In evaluating the fair value of the retail information services reporting unit, the Company assumed further declines in revenue for 2009 from 2008, reflecting continued and further weakness in the retail apparel market. The Company then assumed that revenues by 2012 would increase to levels comparable with 2007 (including estimated sales for Paxar and DM Label, adjusted for foreign currency translation). The Company also assumed a discount rate of 14.5% reflecting the increased uncertainty of global economic conditions in the first three months of 2009.

The primary factors contributing to the $832 million of non-cash impairment charges relative to the Company s goodwill impairment test in the fourth quarter of 2008 were the assumed increase in the discount rate, the reduced assumptions for revenue growth through 2013, and the associated cash flow impact from these reduced projections. The change in these factors reflected worsening economic projections and market conditions.

**Goodwill**

As part of the interim goodwill impairment test completed in the second quarter of 2009, which is discussed above, the Company recorded a non-cash impairment charge of $820 million for the retail information services reporting unit in the first quarter of 2009, with no additional impairment charge in the second quarter of 2009. The total amount of goodwill assigned to the retail information services reporting unit prior to impairment charges was approximately $1.2 billion.

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

| (In millions) | Pressure-sensitive Materials | Retail Information Services | Office and Consumer Products | Other specialty converting businesses | Total |
|---|---|---|---|---|---|
| Balance as of December 29, 2007 | $ 354.0 | $ 1,137.7 | $ 177.6 | $ 14.0 | $ 1,683.3 |
| Goodwill acquired during the period[1] | | 45.1 | | | 45.1 |
| Acquisition adjustments[2] | .3 | 10.3 | | | 10.6 |
| Transfers[3] | | 10.4 | | (10.4) | |
| Translation adjustments | (19.9) | 8.1 | (10.4) | (.1) | (22.3) |
| Balance as of December 27, 2008 | $ 334.4 | $ 1,211.6 | $ 167.2 | $ 3.5 | $ 1,716.7 |
| Acquisition adjustments[4] | | 30.9 | | | 30.9 |
| Goodwill impairment charges | | (820.0) | | | (820.0) |
| Translation adjustments | 7.3 | 1.4 | 3.7 | | 12.4 |
| Balance as of July 4, 2009 | $ 341.7 | $ 423.9 | $ 170.9 | $ 3.5 | $ 940.0 |

**Goodwill Summary:**

| | | | | | |
|---|---|---|---|---|---|
| Goodwill | $ 341.7 | $ 1,243.9 | $ 170.9 | $ 3.5 | $ 1,760.0 |
| Accumulated impairment losses | | (820.0) | | | (820.0) |
| Balance as of July 4, 2009 | $ 341.7 | $ 423.9 | $ 170.9 | $ 3.5 | $ 940.0 |

(1) Goodwill acquired during the period related to the DM Label acquisition in April 2008.

(2) Acquisition adjustments in 2008 consisted of opening balance sheet adjustments associated with the acquisition of Paxar Corporation ( Paxar ) in June 2007.

(3) Related to the transfer of a business from other specialty converting businesses to Retail Information Services to align with a change in the Company s internal reporting structure.

(4) Acquisition adjustments in 2009 consisted of opening balance sheet adjustments associated with the DM Label acquisition in

April 2008 of $31.1, and other acquisition adjustments of $(.2).

As of July 4, 2009, goodwill and other intangible assets and their related useful lives include the allocations of the purchase price of the DM Label acquisition based on valuations of the acquired assets.

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**Indefinite-Lived Intangible Assets**

In connection with the acquisition of Paxar, the Company acquired approximately $30 million of intangible assets, consisting of certain trade names and trademarks, which are not subject to amortization because they have an indefinite useful life. As part of the interim goodwill impairment test completed in the second quarter of 2009, which is discussed above, the Company recorded an additional non-cash impairment charge of $12 million related to these indefinite-lived intangible assets in the first quarter of 2009, with no additional impairment charge in the second quarter of 2009. The carrying value of these indefinite-lived intangible assets was $17.8 million and $29.5 million at July 4, 2009 and December 27, 2008, respectively, which include $.2 million and $.5 million of negative currency impact, respectively.

**Finite-Lived Intangible Assets**

The following table sets forth the Company s finite-lived intangible assets resulting from business acquisitions at July 4, 2009 and December 27, 2008, which continue to be amortized:

| | July 4, 2009 | | | December 27, 2008 | | |
|---|---|---|---|---|---|---|
| (In millions) | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Customer relationships | $ 297.8 | $ 81.8 | $ 216.0 | $ 295.9 | $ 67.4 | $ 228.5 |
| Patents and other acquired technology | 53.6 | 21.2 | 32.4 | 53.6 | 18.8 | 34.8 |
| Trade names and trademarks [1] | 46.1 | 38.7 | 7.4 | 45.1 | 38.1 | 7.0 |
| Other intangibles | 8.8 | 5.3 | 3.5 | 8.8 | 5.0 | 3.8 |
| Total | $ 406.3 | $ 147.0 | $ 259.3 | $ 403.4 | $ 129.3 | $ 274.1 |

(1) Includes a reclassification from Other assets of approximately $1.

Amortization expense on finite-lived intangible assets resulting from business acquisitions was $8.4 million and $17 million for the three and six months ended July 4, 2009, respectively, and $7.9 million and $15.8 million for the three and six months ended June 28, 2008, respectively. As of July 4, 2009, the estimated amortization expense for finite-lived intangible assets resulting from completed business acquisitions for this fiscal year and each of the next four fiscal years is expected to be approximately $30 million per year.

The weighted-average amortization periods from the date of acquisition for finite-lived intangible assets resulting from business acquisitions are thirteen years for customer relationships, eleven years for trade names and trademarks, thirteen years for patents and other acquired technology, eight years for other intangibles and thirteen years in total. As of July 4, 2009, the weighted-average remaining useful life of acquired finite-lived intangible assets are nine years for customer relationships, five years for trade names and trademarks, seven years for patents and other acquired technology, four years for other intangibles and eight years in total.

**Note 5. Debt**

On January 23, 2009, the Company entered into an amendment to a credit agreement for a $1 billion revolving credit facility (the Revolver ) with certain domestic and foreign banks, maturing August 10, 2012. The amendment increases the Company s flexibility for a specified period of time under the financial covenants to which the Revolver is subject and excludes certain restructuring charges from the calculation of the financial ratios under those covenants. The

amendment increases the annual interest rate of the Revolver to the annual rate of, at the Company s option, either (i) between LIBOR plus 1.8% and LIBOR plus 3.5%, depending on the Company s debt ratings by either Standard & Poor s Rating Service ( S&P ) or Moody s Investor Service ( Moody s ), or (ii) the higher of (A) the federal funds rate plu 0.50% or (B) the prime rate, plus between 0.8% and 2.5%, depending on the Company s debt ratings by either S&P or Moody s. The amendment also provides for an increase in the facility fee payable under the Revolver to the annual rate of between 0.2% and 0.5%, depending on the Company s debt ratings by either S&P or Moody s.

On January 23, 2009, a wholly-owned subsidiary of the Company entered into an amendment to a credit agreement for a $400 million term loan credit facility ( Credit Facility ) with certain domestic and foreign banks, maturing February 8, 2011. The subsidiary s payment and performance under the agreement are guaranteed by the Company. The amendment increases the Company s flexibility for a specified period of time under the financial covenants to which the Credit Facility is subject and excludes certain restructuring charges from the calculation of the financial ratios under those covenants. The amendment also increases the annual interest rate of the Credit Facility to the annual rate of, at the subsidiary s option, either (i) between LIBOR plus 2.0% and LIBOR plus 4.0%, depending on the Company s debt ratings by either S&P or Moody s, or (ii) the higher of (A) the federal funds rate plus 0.50% or (B) the prime rate, plus between 1.0% and 3.0%, depending on the Company s debt ratings by either S&P or Moody s. The amendment requires the partial repayment of the loans under the Credit Facility in $15 million quarterly installments beginning April 2009 through December

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2010, and $280 million payable upon maturity.

The financial covenant ratios permitted under the above-mentioned amendments are as follows:

| | First Quarter 2009 | Second Quarter 2009 | Third Quarter 2009 | Fourth Quarter 2009 | First Quarter 2010 | Second Quarter 2010 | Third Quarter 2010 | Fourth Quarter 2010 and thereafter |
|---|---|---|---|---|---|---|---|---|
| Interest Coverage Ratio (Minimum) | 2.50 | 2.25 | 2.10 | 2.25 | 2.60 | 3.00 | 3.25 | 3.50 |
| Leverage Ratio (Maximum) | 4.00 | 4.25 | 4.25 | 4.00 | 3.75 | 3.50 | 3.50 | 3.50 |

As of July 4, 2009, the Company was in compliance with its financial covenants. The non-cash goodwill and indefinite-lived intangible asset impairment charges recognized in the first quarter of 2009 have no adverse impact on the Company s financial covenants. Refer to Note 4, Goodwill and Other Intangibles Resulting from Business Acquisitions, for information regarding the impairments.

On March 10, 2009, the Company completed an exchange of approximately 6.6 million units (or 75.15%) of its HiMEDS units, stated amount $50.00 per unit (the HiMEDS units ), in the form of Corporate HiMEDS units (the Corporate HiMEDS units ), comprised of (i) a purchase contract obligating the holder to purchase from the Company its common stock shares, par value $1.00 per share (the common stock ), and (ii) a 1/20 or 5.0% undivided beneficial interest in a $1,000 aggregate principal amount 5.350% senior note due November 15, 2020 (the HiMEDS senior notes ), for 0.9756 shares of common stock and $6.50 in cash (which includes the accrued and unpaid contract adjustment payments with respect to the purchase contracts and the accrued and unpaid interest with respect to the HiMEDS senior notes) for each Corporate HiMEDS unit. The Company issued approximately 6.5 million shares of its common stock and paid approximately $43 million in cash for the exchanged HiMEDS units with a carrying value of approximately $331 million. As a result of this exchange, the Company recorded a debt extinguishment loss of approximately $21 million (included in Other expense, net in the unaudited Consolidated Statement of Operations), which included a write-off of $9.6 million related to unamortized debt issuance costs.

As of July 4, 2009, approximately two million HiMEDS units with a carrying value of approximately $109 million remained outstanding. The purchase contracts related to these units obligate the holders to purchase from the Company a certain number of shares in 2010 (depending on the stock price at the time).

The fair value of the Company s debt is estimated based on the discounted amount of future cash flows using the current rates offered to the Company for debt of similar remaining maturities. As of July 4, 2009, the carrying value and fair value of the Company s total debt, including short-term borrowings, was $1.93 billion and $1.85 billion, respectively.

**Note 6. Pension and Other Postretirement Benefits**

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

| | Pension Benefits | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Three Months Ended | | | | Six Months Ended | | | |
| | July 4, 2009 | | June 28, 2008 | | July 4, 2009 | | June 28, 2008 | |
| (In millions) | U.S. | Int l | U.S. | Int l | U.S. | Int l | U.S. | Int l |
| Components of net periodic benefit cost: | | | | | | | | |
| Service cost | $ 4.6 | $ 2.9 | $ 5.1 | $ 3.6 | $ 10.0 | $ 5.7 | $ 9.8 | $ 7.1 |
| Interest cost | 9.3 | 6.2 | 8.7 | 7.4 | 19.1 | 12.4 | 18.0 | 14.4 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Expected return on plan assets | (12.1) | (6.5) | (12.7) | (7.6) | (24.3) | (12.9) | (25.5) | (14.9) |
| Recognized net actuarial loss | 1.8 | .5 | 1.6 | .9 | 5.1 | 1.0 | 3.0 | 1.8 |
| Amortization of prior service cost | .2 | .1 | .3 | .2 | .4 | .2 | .6 | .3 |
| Amortization of transition asset | | (.2) | | (.2) | | (.3) | | (.3) |
| Net periodic benefit cost | $ 3.8 | $ 3.0 | $ 3.0 | $ 4.3 | $ 10.3 | $ 6.1 | $ 5.9 | $ 8.4 |

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| (In millions) | U.S. Postretirement Health Benefits Three Months Ended July 4, 2009 | Three Months Ended June 28, 2008 | Six Months Ended July 4, 2009 | Six Months Ended June 28, 2008 |
|---|---|---|---|---|
| Components of net periodic benefit cost: | | | | |
| Service cost | $ .3 | $ .2 | $ .5 | $ .5 |
| Interest cost | .5 | .5 | 1.0 | .9 |
| Recognized net actuarial loss | .4 | .4 | .8 | .8 |
| Amortization of prior service cost | (.5) | (.5) | (1.0) | (1.0) |
| Net periodic benefit cost | $ .7 | $ .6 | $ 1.3 | $ 1.2 |

The Company contributed $3.8 million and $1.8 million to its U.S. pension plans during the six months ended July 4, 2009 and June 28, 2008, respectively. The Company expects to contribute an additional $4.2 million to its U.S. pension plans for the remainder of 2009. Additionally, the Company contributed $1.3 million and $1.7 million to its U.S. postretirement health benefit plan during the six months ended July 4, 2009 and June 28, 2008, respectively. For the remainder of 2009, the Company expects to contribute an additional $1.5 million to its U.S. postretirement health benefit plan.

The Company contributed approximately $20 million and approximately $9 million to its international pension plans during the six months ended July 4, 2009 and June 28, 2008, respectively. Contributions made during the six months ended July 4, 2009 included $11 million of contributions to the Dutch pension plan made in the form of borrowings payable by the Company (included in Long-term debt in the unaudited Condensed Consolidated Balance Sheet) to the pension plan over the next three years. For the remainder of 2009, the Company expects to contribute an additional $9 million to its international pension plans.

During the six months ended July 4, 2009, the Company recognized approximately $4 million related to its match to participant contributions in the Company s defined contribution plan. This expense was recorded in marketing, general and administrative expense and was funded through the issuance of shares from the Company s Employee Stock Benefit Trust.

**Note 7. Research and Development**

Research and development expense for the three and six months ended July 4, 2009 was $21.6 million and $44.8 million, respectively. For the three and six months ended June 28, 2008, research and development expense was $23.9 million and $48.4 million, respectively.

**Note 8. Stock-Based Compensation**

Net income included stock-based compensation expense related to stock options, performance units ( PUs ), restricted stock units ( RSUs ) and restricted stock of $6.8 million and $13.2 million for the three and six months ended July 4, 2009, respectively, and $8.9 million and $16.9 million for the three and six months ended June 28, 2008, respectively. Total stock-based compensation expense was included in Marketing, general and administrative expense and was recorded in corporate expense and the Company s operating segments, as appropriate.

During the second quarter of 2008, following the Company s shareholders approval of the amended and restated stock option and incentive plan on April 24, 2008, the Company began granting PUs to certain eligible employees of the Company. These PUs are payable in shares of the Company s common stock at the end of a three-year cliff vesting period provided that certain performance objective metrics are achieved at the end of the period. The compensation expense related to PUs is included in the stock-based compensation expense noted above.

In February 2009, the Company granted its annual stock-based awards to employees and directors. The provision of SFAS No. 123(R), Share-Based Payment, requires that such awards granted to retirement-eligible employees be

treated as though they were immediately vested; as a result, the compensation expense related to these awards (approximately $.9 million) was recognized during the six months ended July 4, 2009 and is included in the stock-based compensation expense noted above.

As of July 4, 2009, the Company had approximately $53 million of unrecognized compensation expense related to unvested stock options, PUs, RSUs and restricted stock under the Company s plans. The total unrecognized compensation expense is expected to be recognized over the remaining weighted-average requisite service period of approximately two years for PUs, and approximately three years for stock options, RSUs and restricted stock.

**Note 9. Cost Reduction Actions**

Severance charges recorded under the Company s restructuring actions are included in Other current liabilities in the unaudited Condensed Consolidated Balance Sheet. Severance and other employee costs represent cash paid or to be paid to employees terminated under these actions. Charges below are included in Other expense, net in the unaudited Consolidated Statement of Operations.

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Severance, asset impairment, and lease cancellation charges recorded for the three and six months ended July 4, 2009 and June 28, 2008 are summarized by reportable segment in Note 16, Segment Information.

Beginning in 2009, the Company modified its approach to allocating Corporate costs (including costs associated with restructuring actions) to its operating segments to better reflect the costs required to support operations within segment results. Prior year amounts have been restated to conform with the new methodology.

**2009**

In 2009, the Company continued the implementation of the cost reduction action initiated in the fourth quarter of 2008, and recorded charges of $68.7 million consisting of $42.9 million of severance and other employee costs resulting in the elimination of approximately 1,930 positions impacting all segments, as well as $25.2 million of asset impairment charges, and $.6 million of lease cancellation charges. As of July 4, 2009, approximately 205 employees related to these charges remain with the Company, and are expected to leave in 2009. The table below details the accruals and payments recorded in 2009:

| (In millions) | Pressure-sensitive Materials | Retail Information Services | Office and Consumer Products | Other specialty converting businesses | Total |
|---|---|---|---|---|---|
| **Total severance and other employee costs accrued during the period ended:** | | | | | |
| April 4, 2009 | $ 7.6 | $ 5.8 | $ .9 | $ 2.8 | $ 17.1 |
| July 4, 2009 | 13.4 | 4.6 | .3 | 7.5 | 25.8 |
| 2009 Settlements | (5.8) | (8.5) | (.5) | (3.3) | (18.1) |
| Balance at July 4, 2009 | $ 15.2 | $ 1.9 | $ .7 | $ 7.0 | $ 24.8 |
| **Asset Impairment** | | | | | |
| Machinery and equipment | $ 1.5 | $ 2.9 | $ .2 | $ 11.2 | $ 15.8 |
| Buildings | .4 | .7 | 3.9 | .9 | 5.9 |
| Patents | 1.9 | .2 | .4 | 1.0 | 3.5 |
| **Other** | | | | | |
| Lease cancellations | .1 | .5 | | | .6 |
| | $ 3.9 | $ 4.3 | $ 4.5 | $ 13.1 | $ 25.8 |

**2008**

In 2008, the Company implemented cost reduction actions, including the cost reduction action initiated in the fourth quarter, resulting in a headcount reduction of approximately 1,475 positions, impairment of certain assets and software, and lease cancellations. Charges related to these actions totaled $40.7 million, including severance and related costs of $29.8 million, impairment of fixed assets and buildings of $7.7 million, lease cancellation charges of $2.3 million and software impairment of $.9 million. At July 4, 2009, approximately 90 employees related to these charges remain with the Company, and are expected to leave in 2009. The table below details the accruals and payments recorded in 2008:

| | | | | Other | |
|---|---|---|---|---|---|

| (In millions) | Pressure-sensitive Materials | Retail Information Services | Office and Consumer Products | specialty converting businesses | Total |
|---|---|---|---|---|---|
| **Total severance and other employee costs accrued during the period ended:** | | | | | |
| March 29, 2008 | $ 1.5 | $ 1.4 | $ .2 | $ .2 | $ 3.3 |
| June 28, 2008 | .2 | 2.8 | 4.2 | | 7.2 |
| September 27, 2008 | 2.5 | 1.4 | 3.2 | 1.6 | 8.7 |
| December 27, 2008 | 2.5 | 3.8 | 3.1 | 1.2 | 10.6 |
| Total expense accrued during 2008 | 6.7 | 9.4 | 10.7 | 3.0 | 29.8 |
| 2008 Settlements | (1.5) | (4.7) | (5.2) | (1.1) | (12.5) |
| 2009 Settlements | (2.7) | (4.1) | (4.0) | (1.8) | (12.6) |
| Balance at July 4, 2009 | $ 2.5 | $ .6 | $ 1.5 | $ .1 | $ 4.7 |

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| (In millions) | Pressure-sensitive Materials | Retail Information Services | Office and Consumer Products | Other specialty converting businesses | Total |
|---|---|---|---|---|---|
| **Asset Impairment** | | | | | |
| Machinery and equipment | $ 4.9 | $ 1.3 | $ 1.2 | $ .2 | $ 7.6 |
| Buildings | | .1 | | | .1 |
| **Other** | | | | | |
| Lease cancellations | .9 | 1.4 | | | 2.3 |
| Software impairment | | | .9 | | .9 |
| | $ 5.8 | $ 2.8 | $ 2.1 | $ .2 | $ 10.9 |

**Note 10. Financial Instruments and Foreign Currency**

The Company enters into certain foreign exchange hedge contracts to reduce its exposure to risk from exchange rate fluctuations associated with receivables, payables, loans and firm commitments denominated in certain foreign currencies that arise primarily as a result of its operations outside the U.S. The Company enters into certain interest rate contracts to help manage its exposure to interest rate fluctuations. The Company also enters into certain natural gas and other commodity futures contracts to hedge price fluctuations for a portion of its anticipated domestic purchases. The maximum length of time in which the Company hedges its exposure to the variability in future cash flows for forecasted transactions is generally 12 to 24 months.

As of July 4, 2009, the U.S. dollar equivalent notional values of the Company s outstanding commodity contracts and foreign currency contracts were approximately $19 million and $1.1 billion, respectively.

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with SFAS No. 133, the Company designates commodity forward contracts on forecasted purchases of commodities and foreign currency contracts on forecasted transactions as cash flow hedges and foreign currency contracts on existing balance sheet items as fair value hedges.

The following table provides the balances and locations of derivatives as of July 4, 2009:

| | Asset | | Liability | |
|---|---|---|---|---|
| (In millions) | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| **Derivatives designated as hedging instruments under SFAS No. 133:** | | | | |
| Foreign exchange contracts | Other current assets | $ 6.4 | Other current liabilities | $ 5.6 |
| Commodity contracts | Other current assets | | Other current liabilities | 5.9 |
| | | $ 6.4 | | $ 11.5 |

**Fair Value Hedges**

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings, resulting in no net material impact to income.

The following table provides the components of the gain (loss) recognized in income related to fair value hedging contracts. The corresponding gains or losses on the underlying hedged items approximated the net gain on these fair value hedging contracts.

| (In millions) | Location of Gain (Loss) in Income | Three Months Ended July 4, 2009 | Six Months Ended July 4, 2009 |
|---|---|---|---|
| Foreign exchange contracts | Cost of products sold | $ (.6) | $ (1.7) |
| Foreign exchange contracts | Marketing, general and administrative expense | .7 | 24.9 |
| | | $ .1 | $ 23.2 |

**Cash Flow Hedges**

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive (loss) income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge

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components excluded from the assessment of effectiveness are recognized in current earnings.

The following table provides the components of the gain (loss) recognized in accumulated other comprehensive loss on derivatives (effective portion) related to cash flow hedging contracts:

| (In millions) | Three Months Ended July 4, 2009 | Six Months Ended July 4, 2009 |
|---|---|---|
| Foreign exchange contracts | $ (3.6) | $ (3.7) |
| Commodity contracts | .4 | (2.9) |
| | $ (3.2) | $ (6.6) |

The following table provides the components of the gain (loss) reclassified from accumulated other comprehensive loss (effective portion) related to cash flow hedging contracts:

| (In millions) | Location of Gain (Loss) in Income | Three Months Ended July 4, 2009 | Six Months Ended July 4, 2009 |
|---|---|---|---|
| Interest rate contracts | Interest expense | $ (.9) | $ (4.8) |
| Foreign exchange contracts | Cost of products sold | (1.9) | .3 |
| Commodity contracts | Cost of products sold | (1.0) | (3.1) |
| | | $ (3.8) | $ (7.6) |

The aggregate reclassification from other comprehensive income to earnings for settlement or ineffectiveness of hedge activity was a net gain of $2 million and $.6 million during the three and six months ended June 28, 2008, respectively. As of July 4, 2009, a net loss of approximately $10 million is expected to be reclassified from other comprehensive income to earnings within the next 12 months.

Included in the reclassification amount discussed above is the amortization of certain hedge costs of approximately $7 million incurred in connection with the long-term debt issued in 2007 related to the Paxar acquisition. Such costs are being amortized over the life of the related forecasted hedge transactions.

The amount of gain or loss recognized in income related to the ineffective portion of, and the amounts excluded from, effectiveness testing for cash flow hedges and derivatives not designated as hedging instruments under SFAS No. 133 were not significant.

**Foreign Currency**

Transactions in foreign currencies (including receivables, payables and loans denominated in currencies other than the functional currency) decreased net income by $2.2 million and $1.8 million for the three and six months ended July 4, 2009, respectively. Transactions in foreign currencies increased net income by $3.6 million and $11.6 million for the three and six months ended June 28, 2008, respectively, which included a foreign currency net gain related to certain intercompany transactions of approximately $2 million and $6 million during the three and six months ended June 28, 2008, respectively. These results exclude the effects of translation of foreign currencies on the Company s financial statements.

In the first six months of 2009 and 2008, no translation gains or losses for hyperinflationary economies were recognized in net income since the Company had no operations in hyperinflationary economies.

**Note 11. Taxes Based on Income**

The effective tax rate for the three and six months ended July 4, 2009 was approximately 1% and approximately 2%, respectively, compared to approximately 19% and approximately 8% for the three and six months ended June 28, 2008, respectively. The effective tax rate for the first six months of 2009 includes a benefit of $18.4 million from discrete events, primarily the tax effect of impairments of goodwill and indefinite-lived intangible assets, partially offset by certain valuation allowance and other items. The Company s effective tax rate is lower than the U.S. federal statutory rate of 35% due to the Company s operations outside the U.S. where the statutory tax rates are generally lower. Additional taxes are not provided for most foreign earnings because the Company currently plans to indefinitely reinvest these amounts.

The amount of income taxes the Company pays is subject to ongoing audits by taxing jurisdictions around the world. The Company s

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estimate of the potential outcome of any uncertain tax issue is subject to management s assessment of relevant risks, facts, and circumstances existing at that time. The Company believes that it has adequately provided for reasonably foreseeable outcomes related to these matters. However, the Company s future results may include favorable or unfavorable adjustments to its estimated tax liabilities in the period the assessments are made or resolved, which may impact the Company s effective tax rate. With some exceptions, the Company and its subsidiaries are no longer subject to income tax examinations by tax authorities for years prior to 2004.

It is reasonably possible that during the next 12 months, the Company may realize a decrease in its gross uncertain tax positions by approximately $46 million, primarily as the result of cash payments and closing tax years. The Company anticipates that it is reasonably possible that cash payments of up to $18 million relating to gross uncertain tax positions could be paid within the next 12 months.

**Note 12. Net Income (Loss) Per Share**

Net income (loss) per common share amounts were computed as follows:

| (In millions, except per share amounts) | Three Months Ended July 4, 2009 | Three Months Ended June 28, 2008 | Six Months Ended July 4, 2009 | Six Months Ended June 28, 2008 |
|---|---|---|---|---|
| (A) Net income (loss) available to common shareholders | $ 39.8 | $ 92.4 | $ (859.1) | $ 160.8 |
| (B) Weighted-average number of common shares outstanding | 105.0 | 98.5 | 102.2 | 98.5 |
| Dilutive shares (additional common shares issuable under employee stock options, PUs, RSUs and restricted stock) | .7 | .4 | | .4 |
| (C) Weighted-average number of common shares outstanding, assuming dilution | 105.7 | 98.9 | 102.2 | 98.9 |
| Net income (loss) per common share (A) ÷ (B) | $ .38 | $ .94 | $ (8.41) | $ 1.63 |
| Net income (loss) per common share, assuming dilution (A) ÷ (C) | $ .38 | $ .93 | $ (8.41) | $ 1.62 |

In the six months ended July 4, 2009, the effect of dilutive securities (for example, employee stock options, PUs, RSUs and shares of restricted stock) was not dilutive because the Company generated a net operating loss.

Certain employee stock options, PUs, RSUs and shares of restricted stock were not included in the computation of net income per common share, assuming dilution, because they would not have had a dilutive effect. Employee stock options, PUs, RSUs and shares of restricted stock excluded from the computation totaled 11 million shares and 12.1 million shares for the three and six months ended July 4, 2009, respectively, and 10.5 million shares and 9.9 million shares for the three and six months ended June 28, 2008, respectively.

As further discussed in Note 17, Recent Accounting Pronouncements, effective at the beginning of 2009, the Company adopted provisions of FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which did not have a material impact on net income (loss) per share.

**Note 13. Comprehensive (Loss) Income**

Comprehensive income (loss) includes net income (loss), foreign currency translation adjustment, net actuarial loss, prior service cost and net transition assets, net of tax, and the gains or losses on the effective portion of cash flow and firm commitment hedges, net of tax, that are currently presented as a component of shareholders equity. The Company s total comprehensive income (loss) was $102.9 million and $(839.1) million for the three and six months

ended July 4, 2009, respectively, and $118.8 million and $271.3 million for the three and six months ended June 28, 2008, respectively.

The components of accumulated other comprehensive loss (net of tax, with the exception of the foreign currency translation adjustment) were as follows:

| (In millions) | July 4, 2009 | December 27, 2008 |
|---|---|---|
| Foreign currency translation adjustment | $ 123.8 | $ 65.8 |
| Net actuarial loss, prior service cost and net transition assets, less amortization | (328.5) | (332.5) |
| Net loss on derivative instruments designated as cash flow and firm commitment hedges | (14.8) | (15.8) |
| Accumulated other comprehensive loss | $ (219.5) | $ (282.5) |

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Cash flow and firm commitment hedging instrument activities in other comprehensive loss, net of tax, were as follows:

| (In millions) | July 4, 2009 | December 27, 2008 |
|---|---|---|
| Beginning accumulated derivative loss | $ (15.8) | $ (16.8) |
| Net loss (gain) reclassified to earnings | 7.6 | (2.9) |
| Net change in the revaluation of hedging transactions | (6.6) | 3.9 |
| Ending accumulated derivative loss | $ (14.8) | $ (15.8) |

**Note 14. Fair Value Measurement**

The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of July 4, 2009:

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| (In millions) | Total | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Other Unobservable Inputs (Level 3) |
| **Assets:** | | | | |
| Available for sale securities | $ 11.7 | $ 11.7 | $ | $ |
| Derivative assets | 6.4 | | 6.4 | |
| **Liabilities:** | | | | |
| Derivative liabilities | $ 11.5 | $ 5.9 | $ 5.6 | $ |

Available for sale securities are measured at fair value using quoted prices and classified within Level 1 of the valuation hierarchy. Derivatives that are exchange-traded are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy. Derivatives measured based on inputs that are readily available in public markets are classified within Level 2 of the valuation hierarchy.

The following table summarizes the fair value measurements of assets measured on a non-recurring basis during the six months ended July 4, 2009:

| | | Fair Value Measurements Using | | | |
|---|---|---|---|---|---|
| (In millions) | Total | Quoted Prices in Active Markets | Significant Other Observable Inputs (Level 2) | Significant Other Unobservable Inputs (Level 3) | Total |

| | | (Level 1) | | | Gains (Losses) |
|---|---|---|---|---|---|
| Goodwill | $ 415.0 | $ | $ | $ 415.0 | $ (820.0) |
| Indefinite-lived intangible asset | 18.0 | | | 18.0 | (12.0) |
| Long-lived assets held and used | 5.5 | | 2.6 | 2.9 | (15.0) |

In accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, long-lived assets held and used with carrying amounts totaling $20.5 million were written down to their fair values totaling $5.5 million, resulting in impairment charges of $2.6 million and $15 million for the three and six months ended July 4, 2009, respectively. These charges are included in Other expense, net in the unaudited Consolidated Statement of Operations.

In accordance with SFAS No. 142, goodwill with a carrying amount of $1.2 billion was written down to its estimated implied fair value of $415 million, resulting in a non-cash impairment charge of $820 million. Additionally, certain indefinite-lived assets with a carrying value of approximately $30 million were written down to their estimated implied fair value of $18 million, resulting in a non-cash impairment of $12 million. These charges are included in Goodwill and indefinite-lived intangible asset impairment charges in the unaudited Consolidated Statement of Operations for the three and six months ended July 4, 2009, respectively. Refer to Note 4, Goodwill and Other Intangibles Resulting from Business Acquisitions, for further information.

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**Note 15. Commitments and Contingencies**

**Legal Proceedings**

On April 24, 2003, Sentry Business Products, Inc. filed a purported class action on behalf of direct purchasers of label stock in the United States District Court for the Northern District of Illinois against the Company, UPM-Kymmene Corporation ( UPM ), Bemis Company Inc. ( Bemis ), and certain of their subsidiaries seeking treble damages and other relief for alleged unlawful competitive practices, with allegations including that the defendants attempted to limit competition among themselves through anticompetitive understandings. Ten similar complaints were filed in various federal district courts. In November 2003, the cases were transferred to the United States District Court for the Middle District of Pennsylvania and consolidated for pretrial purposes. Plaintiffs filed a consolidated complaint on February 16, 2004, which the Company answered on March 31, 2004. On April 14, 2004, the court separated the proceedings as to class certification and merits discovery, and limited the initial phase of discovery to the issue of the appropriateness of class certification. On January 4, 2006, plaintiffs filed an amended complaint. On January 20, 2006, the Company filed an answer to the amended complaint. On August 14, 2006, the plaintiffs moved to certify a proposed class. The court substantively granted class certification on November 19, 2007. On July 22, 2008, the court held a hearing to set a schedule for merits discovery. On May 12, 2009, the Company entered into a settlement agreement with plaintiffs. Without admitting liability, the Company has agreed to pay plaintiffs $36.5 million, plus up to $.5 million related to notice and administration expenses, in two equal installments of $18.5 million, which were paid on May 27, 2009 and July 15, 2009. On June 10, 2009, the district court entered an order preliminarily approving the settlement, and a final approval hearing is scheduled for September 17, 2009. If court approval is obtained, the matter will be dismissed with prejudice. The Company recorded an accrual of $37 million for this settlement in the first quarter of 2009.

On May 21, 2003, The Harman Press filed in the Superior Court for the County of Los Angeles, California, a purported class action on behalf of indirect purchasers of label stock against the Company, UPM and UPM s subsidiary Raflatac ( Raflatac ), seeking treble damages and other relief for alleged unlawful competitive practices, with allegations including that the defendants attempted to limit competition among themselves through anticompetitive understandings. Three similar complaints were filed in various California courts. In November 2003, on petition from the parties, the California Judicial Council ordered the cases be coordinated for pretrial purposes. The cases were assigned to a coordination trial judge in the Superior Court for the City and County of San Francisco on March 30, 2004. On September 30, 2004, the Harman Press amended its complaint to add Bemis subsidiary Morgan Adhesives Company ( MACtac ) as a defendant. On January 21, 2005, American International Distribution Corporation filed a purported class action on behalf of indirect purchasers in the Superior Court for Chittenden County, Vermont. Similar actions were filed by Richard Wrobel, on February 16, 2005, in the District Court of Johnson County, Kansas; and by Chad and Terry Muzzey, on February 16, 2005 in the District Court of Scotts Bluff County, Nebraska. On February 17, 2005, Judy Benson filed a purported multi-state class action on behalf of indirect purchasers in the Circuit Court for Cocke County, Tennessee. The Nebraska, Kansas and Vermont cases are currently stayed. Defendants motion to dismiss the Tennessee case, filed on March 30, 2006, is pending. The Company intends to defend these matters vigorously.

The Board of Directors created an ad hoc committee comprised of independent directors to oversee the foregoing matters.

The Company is unable to predict the effect of these matters at this time, although the effect could be adverse and material.

The Company and its subsidiaries are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of the business. Based upon current information, management believes that the resolution of these other matters will not materially affect the Company s financial position.

**Environmental**

As of July 4, 2009, the Company has been designated by the U.S. Environmental Protection Agency ( EPA ) and/or other responsible state agencies as a potentially responsible party ( PRP ) at fourteen waste disposal or waste recycling sites, which are the subject of separate investigations or proceedings concerning alleged soil and/or groundwater

contamination and for which no settlement of the Company s liability has been agreed. The Company is participating with other PRPs at such sites, and anticipates that its share of cleanup costs will be determined pursuant to remedial agreements entered into in the normal course of negotiations with the EPA or other governmental authorities.

The Company has accrued liabilities for these and certain other sites, including sites in which governmental agencies have designated the Company as a PRP, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites and any sites that could be identified in the future for cleanup could be higher than the liability currently accrued.

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The activity for the first six months of 2009 and full-year 2008 related to environmental liabilities, which include costs associated with compliance and remediation, were as follows:

| (In millions) | July 4, 2009 | December 27, 2008 |
|---|---|---|
| Balance at beginning of year | $ 58.5 | $ 37.8 |
| Purchase price adjustments related to acquisitions | 2.1 | 24.6 |
| Accruals | .7 | .9 |
| Payments | (2.1) | (4.8) |
| Balance at end of period | $ 59.2 | $ 58.5 |

As of July 4, 2009, approximately $12 million of the total balance is classified as short-term.

These estimates could change depending on various factors, such as modification of currently planned remedial actions, changes in remediation technologies, changes in site conditions, a change in the estimated time to complete remediation, changes in laws and regulations affecting remediation requirements and other factors.

**Product Warranty**

The Company provides for an estimate of costs that may be incurred under its basic limited warranty at the time product revenue is recognized. These costs primarily include materials and labor associated with the service or sale of the product. Factors that affect the Company s warranty liability include the number of units installed or sold, historical and anticipated rate of warranty claims on those units, cost per claim to satisfy the Company s warranty obligation and availability of insurance coverage. Because these factors are impacted by actual experience and future expectations, the Company assesses the adequacy of its recorded warranty liability and adjusts the amounts as necessary. As of July 4, 2009, the Company s product warranty liabilities were approximately $2 million.

**Other**

In 2005, the Company contacted relevant authorities in the U.S. and reported on the results of an internal investigation of potential violations of the U.S. Foreign Corrupt Practices Act. The transactions at issue were carried out by a small number of employees of the Company s reflective business in China, and involved, among other things, impermissible payments or attempted impermissible payments. The payments or attempted payments and the contracts associated with them appear to have been minor in amount and of limited duration. Sales of the Company s reflective business in China in 2005 were approximately $7 million. In addition, on or about October 10, 2008, the Company notified relevant authorities that it had discovered questionable payments to certain foreign customs and other regulatory officials by some employees of its recently acquired companies. These payments were not made for the purpose of obtaining business from any governmental entity. Corrective and disciplinary actions have been taken with respect to both internal investigations and the Company has taken remedial measures to comply with the provisions of the U.S. Foreign Corrupt Practices Act. On July 28, 2009, the Company entered into a settlement agreement with the SEC regarding the foregoing actions. Without admitting or denying liability, the Company agreed to disgorge approximately $.3 million and pay a $.2 million civil penalty. On August 10, 2009, the Company was advised by the U. S. Department of Justice that it has declined to take action against the Company in connection with the China reflective matters, which were voluntarily disclosed by the Company.

The Company and its subsidiaries are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of the Company s business. Based upon current information, management believes that the resolution of these other matters will not materially affect the Company s financial position.

On September 9, 2005, the Company completed the lease financing for a commercial facility (the Facility ) located in Mentor, Ohio, used primarily for the new headquarters and research center for the Company s roll materials division. The Facility consists generally of land, buildings, equipment and office furnishings. The Company leased the Facility under an operating lease arrangement, which contains a residual value guarantee of $33.4 million. The Company does

not expect the residual value of the Facility to be less than the amount guaranteed.

The Company participates in international receivable financing programs with several financial institutions whereby advances may be requested from these financial institutions. Such advances are guaranteed by the Company. At July 4, 2009, the Company had guaranteed approximately $13 million.

As of July 4, 2009, the Company guaranteed up to approximately $22 million of certain foreign subsidiaries obligations to their suppliers, as well as approximately $505 million of certain subsidiaries lines of credit with various financial institutions.

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As of July 4, 2009, approximately two million HiMEDS units with a carrying value of approximately $109 million remained outstanding. The purchase contracts related to these units obligate the holders to purchase from the Company a certain number of shares in 2010 (depending on the stock price at the time). Refer to Note 5, Debt, for more information.

**Note 16. Segment Information**

As discussed in Note 2, Acquisitions, the Company completed the acquisition of DM Label during the second quarter of 2008. The operating results for DM Label are included in the Retail Information Services segment.

Beginning in 2009, the Company modified its approach to allocating Corporate costs to its operating segments to better reflect the costs required to support operations within segment results. Prior year amounts have been restated to conform with the new methodology.

Financial information by reportable segment and other businesses is set forth below:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In millions) | July 4, 2009 | June 28, 2008 | July 4, 2009 | June 28, 2008 |
| **Net sales to unaffiliated customers:** | | | | |
| Pressure-sensitive Materials | $ 793.6 | $ 979.9 | $ 1,602.4 | $ 1,899.5 |
| Retail Information Services | 331.5 | 438.2 | 647.5 | 810.2 |
| Office and Consumer Products | 216.9 | 255.4 | 401.3 | 449.8 |
| Other specialty converting businesses | 113.4 | 155.4 | 230.4 | 314.6 |
| Net sales to unaffiliated customers | $ 1,455.4 | $ 1,828.9 | $ 2,881.6 | $ 3,474.1 |
| **Intersegment sales:** | | | | |
| Pressure-sensitive Materials | $ 36.0 | $ 45.8 | $ 73.4 | $ 86.6 |
| Retail Information Services | .2 | .1 | .5 | 1.3 |
| Office and Consumer Products | .1 | .3 | .4 | .6 |
| Other specialty converting businesses | 3.7 | 8.0 | 7.0 | 14.8 |
| Eliminations | (40.0) | (54.2) | (81.3) | (103.3) |
| Intersegment sales | $ | $ | $ | $ |
| **Income (loss) before taxes:** | | | | |
| Pressure-sensitive Materials | $ 50.6 | $ 82.4 | $ 50.4 | $ 154.2 |
| Retail Information Services | (5.9) | 20.3 | (859.3) | 16.6 |
| Office and Consumer Products | 34.5 | 40.7 | 57.9 | 62.6 |
| Other specialty converting businesses | (10.4) | 5.8 | (37.9) | 15.3 |
| Corporate expense | (8.2) | (5.7) | (38.9) | (14.8) |
| Interest expense | (20.4) | (29.3) | (47.9) | (58.8) |
| Income (loss) before taxes | $ 40.2[1] | $ 114.2[2] | $ (875.7)[3] | $ 175.1[4] |

(1) Operating income for the second quarter of 2009 included Other

expense, net totaling $29.6, consisting of restructuring costs of $25.8, asset impairment charges of $3.3, and lease cancellation charges of $.5. Of the total $29.6, the Pressure-sensitive Materials segment recorded $13.8, the Retail Information Services segment recorded $5.1, the Office and Consumer Products segment recorded $3, and the other specialty converting businesses recorded $7.7.

(2) Operating income for the second quarter of 2008 included Other expense, net totaling $5.8, consisting of restructuring costs of $7.2, asset impairment charges of $1.7, and lease cancellation charges of $1.4, partially offset by a gain on sale of investments of $(4.5). Of the total $5.8, the Pressure-sensitive Materials segment recorded $.5, the Retail Information Services segment

recorded $5.6, the Office and Consumer Products segment recorded $4.2, and Corporate recorded $(4.5).

Additionally, operating income for the Retail Information Services segment for the second quarter of 2008 included $5.7 of transition costs associated with the Company s acquisitions.

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(3) Operating loss for the first six months of 2009 included Other expense, net totaling $126.9, consisting of restructuring costs of $42.9, asset impairment charges of $25.2, lease cancellation charges of $.6, legal settlement costs of $37, and a loss of $21.2 from debt extinguishment. Of the total $126.9, the Pressure-sensitive Materials segment recorded $61.9, the Retail Information Services segment recorded $14.7, the Office and Consumer Products segment recorded $5.7, the other specialty converting businesses recorded $23.4, and Corporate recorded $21.2.

Additionally, operating loss for the Retail Information Services segment for the first six months of 2009 included $832 of goodwill and

indefinite-lived intangible asset impairment charges.

(4) Operating income for the first six months of 2008 included Other expense, net totaling $11.4, consisting of restructuring costs of $10.5, asset impairment charges of $4, and lease cancellation charges of $1.4, partially offset by a gain on sale of investments of $(4.5). Of the total $11.4, the Pressure-sensitive Materials segment recorded $4.3, the Retail Information Services segment recorded $7.1, the Office and Consumer Products segment recorded $4.3, the other specialty converting businesses recorded $.2, and Corporate recorded $(4.5).

Additionally, operating income for the Retail Information Services segment for the first six months of 2008 included $12.7 of transition costs associated with the Company s

acquisitions.

**Note 17. Recent Accounting Requirements**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. SFAS No. 168 establishes the FASB Accounting Standards Codification (the Codification ) as the single source of authoritative non-governmental U.S. GAAP. The Codification is effective for interim and annual periods ending after September 15, 2009. The adoption of this standard will not have a material impact on the Company s financial condition, results of operations, cash flows, or disclosures.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). Among other items, SFAS No. 167 responds to concerns about the application of certain key provisions of FIN 46(R), including those regarding the transparency of the involvement with variable interest entities. SFAS No. 167 is effective for calendar year companies beginning on January 1, 2010. The adoption of this standard will not have a material impact on the Company s financial condition, results of operations, cash flows, or disclosures.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. SFAS No. 165 defines what qualifies as a subsequent event those events or transactions that occur following the balance sheet date, but before the financial statements are issued, or are available to be issued and requires companies to disclose the date through which it has evaluated subsequent events and the basis for determining that date. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. The Company adopted the provisions of SFAS No. 165 in the second quarter of 2009. Refer to Note 1, General, for further information.

In April 2009, the FASB issued FASB Staff Position FAS 107-1 and APB28-1, Interim Disclosures about Fair Value of Financial Instruments, which require disclosure about fair value of financial instruments, whether recognized or not recognized in the statement of financial position, in interim financial information. This issue also requires fair value information to be presented together with the related carrying amount and disclosure regarding the methods and significant assumptions used to estimate fair value. This issue is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company has included the disclosures required under this issue in Note 5, Debt.

The FASB issued in December 2007, and amended in April 2009, SFAS No. 141(R), Business Combinations. This Statement replaces SFAS No. 141, Business Combinations, and defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. This Statement s scope is broader than that of SFAS No. 141, which applied only to business combinations in which control was obtained by transferring consideration. In general, SFAS No. 141(R) requires the acquiring entity in a business combination to recognize the fair value of all the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date as the fair value measurement point; and modifies the disclosure requirements. This Statement applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS No. 141(R) did not have a material impact on the Company s financial results of operations and financial condition.

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In December 2008, the FASB issued FSP 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets, which provides additional guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. This interpretation is effective for financial statements issued for fiscal years ending after December 15, 2009. The adoption of this interpretation will increase the disclosures in the financial statements related to the assets of the Company s pension and postretirement benefits plans. The Company is currently evaluating the disclosure implications of this Statement.

In August 2008, the FASB issued FSP Emerging Issues Task Force ( EITF ) 08-07, Accounting for Defensive Intangible Assets. This issue clarifies that a defensive intangible asset should be accounted for as a separate unit of accounting. This applies to all intangible assets acquired, including intangible assets acquired in a business combination, in situations in which the acquirer does not intend to actively use the asset but intends to hold (lock up) the asset to prevent its competitors from obtaining access to the asset (defensive assets). FSP-EITF 08-07 is effective for intangible assets acquired on or after the beginning of the first annual reporting period beginning on December 15, 2008. The adoption of FSP-EITF 08-07 did not have an impact on the Company s financial results of operations and financial condition because there have been no acquisitions since the effective date of this issue.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. Under this issue, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP-EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years and requires retrospective application. The adoption of FSP-EITF 03-6-1 did not have a material impact on the Company s financial results of operations and financial condition.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles for nongovernmental entities (the Hierarchy ). The Hierarchy within SFAS No. 162 is consistent with that previously defined in the AICPA Statement on Auditing Standards ( SAS ) No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The adoption of SFAS No. 162 did not have a material effect on the Company s financial statements because the Company has utilized the guidance within SAS No. 69.

In April 2008, the FASB directed the FASB Staff to issue FSP No. 142-3, Determination of the Useful Life of Intangible Assets. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used for purposes of determining the useful life of a recognized intangible asset under SFAS No. 142. FSP FAS No. 142-3 is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other U.S. generally accepted accounting principles. FSP No. 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier application is not permitted. The adoption of FSP No.142-3 did not have a material impact on the Company s financial results of operations and financial condition.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. This Statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity s derivative instruments and hedging activities and their effects on the entity s financial position, financial performance, and cash flows. SFAS No. 161 applies to all derivative instruments within the scope of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as well as related hedged items, bifurcated derivatives, and non-derivative instruments that are designated and qualify as hedging instruments. Entities with instruments subject to SFAS No. 161 must provide more robust qualitative disclosures and expanded quantitative disclosures. SFAS No. 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The Company has included the disclosures required under SFAS No. 161 in Note 10, Financial Instruments and Foreign Currency.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of Accounting Review Board ( ARB ) No. 51. This Statement is effective for fiscal years and interim

periods, beginning on or after December 15, 2008, with earlier adoption prohibited. This Statement requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the income statement. It also amends certain of ARB No. 51 s consolidation procedures for consistency with the requirements of SFAS No. 141(R). This Statement also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interest. The adoption of SFAS No. 160 did not have a material impact on the Company s financial results of operations and financial condition.
In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which is effective for fiscal years and interim periods

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after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. This statement applies to all financial assets and liabilities and to all non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The statement indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. SFAS No. 157 defines fair value based upon an exit price model. In connection with the issuance of SFAS No. 157, the FASB issued FSP Nos. 157-1 and 157-2. FSP No. 157-1 amends SFAS No. 157 to exclude SFAS No. 13, Accounting for Leases, and its related interpretive accounting pronouncements that address leasing transactions. As allowed for under FSP No. 157-2, the Company applied the provisions of SFAS No. 157 to assets and liabilities measured on a non-recurring basis as of the beginning of the 2009 fiscal year. The adoption of SFAS No. 157 did not have a significant impact on the Company s financial results of operations or financial position.

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Avery Dennison Corporation

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

**ORGANIZATION OF INFORMATION**

Management s Discussion and Analysis provides a narrative concerning our financial performance and condition that should be read in conjunction with the accompanying financial statements. It includes the following sections:


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| Forward-looking Statements | 22 |
| Overview and Outlook | 22 |
| Analysis of Results of Operations for the Second Quarter | 25 |
| Results of Operations by Segment for the Second Quarter | 27 |
| Analysis of Results of Operations for the Six Months Year-to-Date | 29 |
| Results of Operations by Segment for the Six Months Year-to-Date | 30 |
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**DEFINITION OF TERMS**

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, or GAAP. Our discussion of financial results includes several non-GAAP measures to provide additional information concerning Avery Dennison Corporation s (the Company s ) performance. These non-GAAP financial measures are not in accordance with, nor are they a substitute for, GAAP financial measures. These non-GAAP financial measures are intended to supplement the presentation of our financial results that are prepared in accordance with GAAP. Refer to Uses and Limitations of Non-GAAP Measures.

We use the following terms:

*Organic sales growth (decline)* refers to the change in sales excluding the estimated impact of currency translation, acquisitions and divestitures, and the extra week in fiscal year 2009;

*Segment operating income (loss)* refers to income (loss) before interest and taxes;

*Free cash flow* refers to cash flow from operations and net proceeds from sale of investments, less payments for capital expenditures, software and other deferred charges;

*Operational working capital* refers to trade accounts receivable and inventories, net of accounts payable.

**FORWARD-LOOKING STATEMENTS**

Certain statements contained in Management s Discussion and Analysis are forward-looking statements and are subject to certain risks and uncertainties. Refer to our Safe Harbor Statement contained elsewhere in this report.

**OVERVIEW AND OUTLOOK**

**Overview**

*Sales*

Our sales decreased 20% and 17% in the first three and six months of 2009, respectively, compared to the same period last year.

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| Estimated change in sales due to: | July 4, 2009 | June 28, 2008 | July 4, 2009 | June 28, 2008 |
| Organic sales decline | (14)% | (1)% | (14)% | (1)% |

| | | | | |
|---|---|---|---|---|
| Extra week in fiscal year 2009 [1] | | | 4 | |
| Foreign currency translation | (7) | 7 | (7) | 7 |
| Acquisitions, net of divestitures | | 14 | | 14 |
| Reported sales (decline) growth [2] | (20)% | 20% | (17)% | 19% |

[1] Our 2009 fiscal year includes a 53-week period, with the extra week reflected in the first quarter. Normally, each fiscal year consists of 52 weeks, but every fifth or sixth year consists of 53 weeks.

[2] Totals may not sum due to rounding.

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*Net Income*

In the first six months of 2009, we had a net loss of approximately $860 million compared to a net income of approximately $161 million in the same period in 2008.

Negative factors affecting net income included:

Impairment of goodwill and indefinite-lived intangible assets

Lower net sales

Higher restructuring and asset impairment charges related to cost reduction actions

Legal settlement costs

Loss on debt extinguishment

Higher raw material and employee-related costs

Unfavorable impact of foreign currency translation

Positive factors affecting net income included:

Cost savings from productivity improvement initiatives, including savings from restructuring actions

Pricing

Lower tax rate, resulting in a tax benefit for the first six months of 2009

Lower transition costs related to acquisition integrations

**Impairment of Goodwill and Indefinite-Lived Intangible Assets**

In the first quarter of 2009, we recorded non-cash impairment charges of $832 million for the retail information services reporting unit, of which $820 million is related to goodwill and $12 million is related to indefinite-lived intangible assets. We completed our impairment test of goodwill and indefinite-lived intangible assets ( goodwill impairment ) in the second quarter of 2009, with no additional impairment charge incurred.

We perform our goodwill impairment test in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142 Goodwill and Other Intangible Assets. In performing the required goodwill impairment test, we primarily apply a present value (discounted cash flow) method to determine the fair value of the reporting units with goodwill. Our reporting units, which are composed of either a discrete business or an aggregation of businesses with similar economic characteristics, consist of roll materials; retail information services; office and consumer products; graphics and reflective products; industrial products; and business media.

We perform our annual goodwill impairment test during the fourth quarter. However, certain factors may result in the need to perform a goodwill impairment test prior to the fourth quarter, including significant underperformance of our business relative to expected operating results, significant adverse economic and industry trends, significant decline in our market capitalization for an extended period of time relative to net book value, or a decision to divest an individual business within a reporting unit. Based upon our assessment of these factors in connection with the preparation of our first quarter financial statements, we determined that there was a need to initiate an interim goodwill impairment test. The factors considered included both a sustained decline in our stock price and a decline in our 2009 revenue projections for the retail information services reporting unit, following lower than expected revenues in March 2009, which continued in April 2009. The peak season for the retail information services reporting unit has traditionally been March through the end of the second quarter.

Our interim impairment analysis indicated that the fair value of each of our reporting units exceeded its carrying value, except for our retail information services reporting unit, which had a fair value less than its carrying value.

Refer to Note 4, Goodwill and Other Intangibles Resulting from Business Acquisitions, to the unaudited Condensed Consolidated Financial Statements for further information.

*Goodwill*

As part of the interim goodwill impairment test completed in the second quarter of 2009, which is discussed above, we recorded a non-cash impairment charge of $820 million for the retail information services reporting unit in the first quarter of 2009, with no additional impairment charge in the second quarter of 2009.

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*Indefinite-Lived Intangible Assets*

In connection with the acquisition of Paxar, we acquired approximately $30 million of intangible assets, consisting of certain trade names and trademarks, which are not subject to amortization because they have an indefinite useful life. As part of the interim goodwill impairment test completed in the second quarter of 2009, which is discussed above, we recorded an additional non-cash impairment charge of $12 million related to these indefinite-lived intangible assets in the first quarter of 2009, with no additional impairment charge in the second quarter of 2009.

**Acquisitions**

We completed the acquisition of DM Label Group ( DM Label ) on April 1, 2008. DM Label operations are included in our Retail Information Services segment. See also Note 2, Acquisitions, to the unaudited Condensed Consolidated Financial Statements.

**Cost Reduction Actions**

*Q4 2008 2009 Actions*

In the fourth quarter of 2008, we initiated restructuring actions that are now expected to generate over $160 million in annualized savings by the middle of 2010, of which an estimated $75 million, net of transition costs, is expected to benefit 2009. We expect to incur approximately $100 million to $110 million of cash restructuring charges associated with these actions, with the majority to be incurred in 2009. At the end of the second quarter, we achieved run-rate savings representing approximately 50% of our target.

During the fourth quarter of 2008 and the first six months of 2009, we recorded $81 million in charges related to these restructuring actions, consisting of severance and related employee costs, asset impairment charges, and lease cancellation costs. Severance and employee related costs related to approximately 2,600 positions, impacting all of our segments and geographic regions.

*Q1 2008 Q3 2008 Actions*

During the first three quarters of 2008, we implemented cost reduction actions resulting in charges of $22.8 million, including severance and employee related costs for approximately 645 positions, asset impairment charges, and lease cancellation costs.

Refer to Note 9, Cost Reduction Actions, to the unaudited Condensed Consolidated Financial Statements for further detail.

**Effective Rate of Taxes on Income**

The effective tax rate for the first six months of 2009 was approximately 2%, compared with approximately 8% for the same period in 2008. The effective tax rate for the first six months of 2009 includes a benefit of $18.4 million from discrete events, primarily the tax effect of impairments of goodwill and indefinite-lived intangible assets, partially offset by the build of certain valuation allowances and other items. Refer to Note 11, Taxes Based on Income, to the unaudited Condensed Consolidated Financial Statements for further information.

**Free Cash Flow**

Free cash flow, which is a non-GAAP measure, refers to cash flow from operating activities and net proceeds from sale of investments less spending on property, plant, equipment, software and other deferred charges. We use free cash flow as a measure of funds available for other corporate purposes, such as dividends, debt reduction, acquisitions, and repurchases of common stock. Management believes that this measure provides meaningful supplemental information to our investors to assist them in their financial analysis of the Company. This measure is not intended to represent the residual cash available for discretionary purposes. Refer to the discussion under Uses and Limitations of Non-GAAP Measures elsewhere in this report for further information regarding limitations of this measure.

| | Six Months Ended | |
|---|---|---|
| (In millions) | July 4, 2009 | June 28, 2008 |
| Net cash provided by operating activities | $ 132.8 | $ 188.7 |
| Purchase of property, plant and equipment | (30.5) | (69.1) |

| | | |
|---|---|---|
| Purchase of software and other deferred charges | (14.9) | (33.0) |
| Proceeds from sale of investments, net | .1 | 13.0 |
| Free cash flow | $ 87.5 | $ 99.6 |

Free cash flow in the first six months of 2009 declined by $12.1 million compared to the same period in 2008 due to lower income from operations, partially offset by reduced working capital and lower spending on property, plant, and equipment, software, and other deferred charges.

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See Analysis of Results of Operations and Liquidity below for more information.

**Dividend**

On July 30, 2009, we declared a third-quarter dividend of $.20 per share, a reduction from our previous dividend of $.41 per share. This precautionary action was taken in response to the possibility of continued poor market conditions beyond 2009, to focus on reducing debt and to plan for increased pension funding requirements.

**Legal Proceedings**

We are a named defendant in purported class actions in the U.S. seeking treble damages and other relief for alleged unlawful competitive practices.

The Board of Directors created an ad hoc committee comprised of certain independent directors to oversee the foregoing matters.

As previously disclosed and reported to authorities in the U.S., we have discovered instances of conduct by certain employees that potentially violate the U.S. Foreign Corrupt Practices Act. We reported that conduct to authorities in the U.S. and have entered into a settlement agreement with the SEC in this regard. Refer to Note 15, Commitments and Contingencies, to the unaudited Condensed Consolidated Financial Statements for further information.

We are unable to predict the effect of these matters at this time, although the effect could be adverse and material. These and other matters are reported in Note 15, Commitments and Contingencies, to the unaudited Condensed Consolidated Financial Statements.

**Outlook**

Certain factors that we believe may contribute to 2009 results are listed below.

If current exchange rate trends continue, they would have an unfavorable effect on earnings for 2009.

We expect incremental pension and other employee-related expenses and contributions in 2009. In addition, we currently expect increased pension contributions in the range of $200 million to $300 million from the end of the second quarter of 2009 through 2013.

We anticipate higher charges related to restructuring actions in 2009 compared to 2008.

We anticipate lower interest expense in 2009 due primarily to retirements of certain indebtedness. Our assumptions on interest expense are subject to changes in market rates through the remainder of the year.

The annual effective tax rate will be impacted by future events including changes in tax laws, geographic income mix, tax audits, closure of tax years, legal entity restructuring, and release of, or accrual for, valuation allowances on deferred tax assets. The effective tax rate can potentially have wide variances from quarter to quarter, resulting from interim reporting requirements and the recognition of discrete events.

We anticipate our capital and software expenditures to be in the range of $115 million to $130 million in 2009, including increased investment in new business opportunities to drive future growth and profitability.

We are targeting a reduction of debt of at least $350 million from the end of the second quarter of 2009 through 2010.

## ANALYSIS OF RESULTS OF OPERATIONS FOR THE SECOND QUARTER

**Income Before Taxes**

| (In millions) | **2009** | **2008** |
|---|---|---|
| Net sales | $ 1,455.4 | $ 1,828.9 |
| Cost of products sold | 1,065.1 | 1,338.6 |
| Gross profit | 390.3 | 490.3 |

| (In millions) | **2009** | **2008** |
|---|---|---|
| Marketing, general and administrative expense | 300.1 | 341.0 |
| Interest expense | 20.4 | 29.3 |
| Other expense, net | 29.6 | 5.8 |

| | | |
|---|---|---|
| Income before taxes | $ 40.2 | $ 114.2 |
| | | |
| *As a Percent of Sales:* | | |
| Gross profit (margin) | 26.8% | 26.8% |
| Marketing, general and administrative expense | 20.6 | 18.6 |
| Income before taxes | 2.8 | 6.2 |

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*Sales*

Sales decreased 20% in the second quarter of 2009 compared to the same period last year, due largely to the decline in volume, partially offset by the benefit from pricing. Foreign currency translation had an unfavorable impact on the change in sales of approximately $147 million in the second quarter of 2009.

On an organic basis, sales declined 14% in the second quarter of 2009, as continued deterioration in the global macroeconomic environment contributed to volume declines across all segments and geographic regions, except Asia.

Refer to Results of Operations by Segment for information by reportable segment.

*Gross Profit Margin*

Gross profit margin for the second quarter of 2009 remained flat compared to the same period in 2008, as reduced fixed-cost leverage was offset by benefits from pricing, productivity improvement initiatives, and restructuring.

*Marketing, General and Administrative Expenses*

The decrease in marketing, general and administrative expense in the second quarter of 2009 compared to the same period last year primarily reflected cost reductions and benefits from productivity and the impact of currency translation.

*Other Expense, net*

| (In millions) | **2009** | **2008** |
|---|---|---|
| Restructuring costs | $ 25.8 | $ 7.2 |
| Asset impairment charges and lease cancellation costs | 3.8 | 3.1 |
| Other | | (4.5) |
| Other expense, net | $ 29.6 | $ 5.8 |

In the second quarter of 2009, Other expense, net consisted of restructuring costs including severance and other employee-related costs, as well as asset impairment and lease cancellation charges. Restructuring costs in the second quarter of 2009 relate to a reduction in headcount of approximately 1,205 positions across all segments and geographic regions.

In the second quarter of 2008, Other expense, net consisted of restructuring costs including severance and other employee-related costs, asset impairment and lease cancellation charges (primarily in the Retail Information Services segment), and a gain on sale of investments. Restructuring costs in the second quarter of 2008 relate to a reduction in headcount of approximately 310 positions across all segments and geographic regions.

Refer to Note 9, Cost Reduction Actions, to the unaudited Condensed Consolidated Financial Statements for more information.

**Net Income and Earnings per Share**

| (In millions, except per share) | **2009** | **2008** |
|---|---|---|
| Income before taxes | $ 40.2 | $ 114.2 |
| Provision for income taxes | .4 | 21.8 |
| Net income | $ 39.8 | $ 92.4 |
| Net income per common share | $ .38 | $ .94 |
| Net income per common share, assuming dilution | $ .38 | $ .93 |
| Net income as a percent of sales | 2.7% | 5.1% |

| (In millions, except per share) | **2009** | **2008** |
|---|---|---|
| Percent change in: | | |
| Net income | (56.9)% | 7.2% |
| Net income per common share | (59.6) | 6.8 |
| Net income per common share, assuming dilution | (59.1) | 6.9 |

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*Provision for Income Taxes*

Our effective tax rate for the second quarter of 2009 was approximately 1%, compared with approximately 19% for the same period in 2008. The effective tax rate for the second quarter of 2009 includes a benefit of $.6 million from discrete events, primarily the impact of tax law changes and the build of certain valuation allowances, partially offset by the release of certain tax contingencies. Refer to Note 11, Taxes Based on Income, to the unaudited Condensed Consolidated Financial Statements for further information.

**RESULTS OF OPERATIONS BY SEGMENT FOR THE SECOND QUARTER**

**Pressure-sensitive Materials Segment**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net sales including intersegment sales | $ 829.6 | $ 1,025.7 |
| Less intersegment sales | (36.0) | (45.8) |
| Net sales | $ 793.6 | $ 979.9 |
| Operating income [1] | 50.6 | 82.4 |
| [1] Includes lease cancellation costs in 2009, and restructuring costs and asset impairment charges in both years | $ 13.8 | $ .5 |

*Net Sales*

Sales in our Pressure-sensitive Materials segment decreased 19% in the second quarter of 2009 compared to the same period in 2008, which included the unfavorable impact of foreign currency translation (approximately $102 million). On an organic basis, sales declined 10% in the second quarter of 2009, as the benefits from pricing were more than offset by the decline in volume.

On an organic basis, sales in our roll materials business in the second quarter of 2009 declined at a low double-digit rate in Europe, a mid single-digit rate (excluding intercompany sales) in North America, and a low single-digit rate in emerging markets (mid single-digit decline in Eastern Europe and South America, partially offset by mid single-digit increase in Asia) compared to the same period last year. These declines reflected continued weakness in end-markets. On an organic basis, sales in our graphics and reflective business declined at a double-digit rate, reflecting lower promotional spending by businesses in response to weak market conditions.

*Operating Income*

Decreased operating income in the second quarter of 2009 reflected the impact of lower volume, partially offset by the benefits from pricing and cost savings from restructuring and productivity improvement initiatives. In addition, operating income in 2009 included lease cancellation costs and higher restructuring and asset impairment charges compared to the same period in 2008.

**Retail Information Services Segment**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net sales including intersegment sales | $ 331.7 | $ 438.3 |
| Less intersegment sales | (.2) | (.1) |
| Net sales | $ 331.5 | $ 438.2 |
| Operating (loss) income [1] [2] | (5.9) | 20.3 |

| | | |
|---|---|---|
| [1] Includes asset impairment charges in 2008, and restructuring and lease cancellation costs in both years | $ 5.1 | $ 5.6 |
| [2] Includes transition costs related to acquisition integrations in 2008 | $ | $ 5.7 |

*Net Sales*

Sales in our Retail Information Services segment decreased 24% in the second quarter of 2009 compared to the same period last year,

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which included the unfavorable impact of foreign currency translation (approximately $23 million). On an organic basis, sales declined 20% in the second quarter of 2009 due primarily to lower volume from continued weakness of the retail apparel market in the U.S. and Europe.

*Operating (Loss) Income*

Operating loss in the second quarter of 2009 reflected the impact of lower volume, partially offset by the benefit of restructuring and productivity improvement initiatives. Operating (loss) income included asset impairment charges and transition costs related to acquisition integrations in 2008, and restructuring and lease cancellation costs in both years.

**Office and Consumer Products Segment**

| (In millions) | **2009** | **2008** |
|---|---|---|
| Net sales including intersegment sales | $ 217.0 | $ 255.7 |
| Less intersegment sales | (.1) | (.3) |
| Net sales | $ 216.9 | $ 255.4 |
| Operating income [1] | 34.5 | 40.7 |
| [1] Includes asset impairment charges in 2009 and restructuring costs in both years | $ 3.0 | $ 4.2 |

*Net Sales*

Sales in our Office and Consumer Products segment decreased 15% in the second quarter of 2009 compared to the same period last year, which included the unfavorable impact of foreign currency translation (approximately $13 million). On an organic basis, sales declined 11% in the second quarter of 2009 due primarily to lower volume from weak end-market demand led by slower corporate purchasing activity, partially offset by the benefit from pricing.

*Operating Income*

Decreased operating income in the second quarter of 2009 reflected the impact of lower volume, partially offset by the benefits from pricing, restructuring, and productivity improvement initiatives. Operating income included asset impairment charges in 2009 and restructuring costs in both years.

**Other specialty converting businesses**

| (In millions) | **2009** | **2008** |
|---|---|---|
| Net sales including intersegment sales | $ 117.1 | $ 163.4 |
| Less intersegment sales | (3.7) | (8.0) |
| Net sales | $ 113.4 | $ 155.4 |
| Operating (loss) income [1] | (10.4) | 5.8 |
| [1] Includes restructuring costs and asset impairment charges in 2009 | $ 7.7 | $ |

*Net Sales*

Sales in our other specialty converting businesses decreased 27% in the second quarter of 2009 compared to the same period last year, which included the unfavorable impact of foreign currency translation (approximately $9 million). On an organic basis, sales declined 22% in the second quarter of 2009, primarily reflecting lower volume in products sold

to the automotive, housing, and construction industries.

*Operating (Loss) Income*

Operating loss in the second quarter of 2009 reflected lower sales on an organic basis, partially offset by the benefits of restructuring and productivity improvement initiatives. Operating loss in 2009 included restructuring costs and asset impairment charges.

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**ANALYSIS OF RESULTS OF OPERATIONS FOR THE SIX MONTHS YEAR-TO-DATE**

**(Loss) Income Before Taxes**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net sales | $ 2,881.6 | $ 3,474.1 |
| Cost of products sold | 2,146.2 | 2,559.8 |

| (In millions) | 2009 | 2008 |
|---|---|---|
| Gross profit | 735.4 | 914.3 |
| Marketing, general and administrative expense | 604.3 | 669.0 |
| Goodwill and indefinite-lived intangible asset impairment charges | 832.0 | |
| Interest expense | 47.9 | 58.8 |
| Other expense, net | 126.9 | 11.4 |
| (Loss) income before taxes | $ (875.7) | $ 175.1 |

| | | |
|---|---|---|
| *As a Percent of Sales:* | | |
| Gross profit (margin) | 25.5% | 26.3% |
| Marketing, general and administrative expense | 21.0 | 19.3 |
| (Loss) income before taxes | (30.4) | 5.0 |

*Sales*

Sales decreased 17% in the first six months of 2009 compared to the same period last year, due largely to the decline in sales on an organic basis, partially offset by incremental sales from the DM Label acquisition (approximately $9 million) and the impact of the extra week in the first quarter of 2009. Foreign currency translation had an unfavorable impact on the change in sales of approximately $261 million in the first six months of 2009.

On an organic basis, sales declined 14% in the first six months of 2009, as continued deterioration in the global macroeconomic environment contributed to volume declines across all segments and geographic regions, except Asia. Refer to Results of Operations by Segment for information by reportable segment.

*Gross Profit Margin*

Gross profit margin for the first six months of 2009 declined compared to the same period in 2008, reflecting reduced fixed-cost leverage due to lower sales on an organic basis, and higher raw material costs, partially offset by benefits from pricing, productivity improvement initiatives, and restructuring.

*Marketing, General and Administrative Expenses*

The decrease in marketing, general and administrative expense in the first six months of 2009 compared to the same period last year primarily reflected cost reductions and the impact of currency translation, partially offset by costs associated with the extra week.

*Goodwill and Indefinite-Lived Intangible Asset Impairment Charges*

In the first quarter of 2009, we recorded non-cash estimated impairment charges of $832 million for the retail information services reporting unit. Refer to Note 4, Goodwill and Other Intangibles Resulting from Business Acquisitions, to the unaudited Condensed Consolidated Financial Statements for more information.

*Other Expense, net*

| (In millions) | 2009 | 2008 |
|---|---|---|

| | | |
|---|---|---|
| Restructuring costs | $ 42.9 | $ 10.5 |
| Asset impairment charges and lease cancellation costs | 25.8 | 5.4 |
| Other | 58.2 | (4.5) |
| Other expense, net | $ 126.9 | $ 11.4 |

In the first six months of 2009, Other expense, net consisted of restructuring costs including severance and other employee-related costs, asset impairment charges and lease cancellation costs, as well as legal settlement costs ($37 million) and a loss from debt extinguishment (approximately $21 million). Restructuring costs in the first six months of 2009 relate to a reduction in headcount of approximately 1,930 positions across all segments and geographic regions. For more information regarding the debt extinguishment, refer to Financial Condition in this report and Note 5, Debt, to the unaudited Condensed Consolidated Financial Statements. For more information regarding the legal settlement, refer to Note 15, Commitments and Contingencies, to the unaudited Condensed Consolidated Financial Statements.

In the first six months of 2008, Other expense, net consisted of restructuring costs including severance and other employee-related costs, asset impairment and lease cancellation charges (in the Pressure-sensitive Materials and Retail Information Services segments), and a gain on sale of investments. Restructuring costs in the first six months of 2008 relate to a reduction in headcount of approximately 465 positions across all segments and geographic regions.

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Refer to Note 9, Cost Reduction Actions, to the unaudited Condensed Consolidated Financial Statements for more information.

**Net (Loss) Income and Earnings per Share**

| (In millions, except per share) | 2009 | 2008 |
|---|---|---|
| (Loss) income before taxes | $ (875.7) | $ 175.1 |
| (Benefit from) provision for income taxes | (16.6) | 14.3 |
| Net (loss) income | $ (859.1) | $ 160.8 |
| Net (loss) income per common share | $ (8.41) | $ 1.63 |
| Net (loss) income per common share, assuming dilution | $ (8.41) | $ 1.62 |
| Net (loss) income as a percent of sales | (29.8)% | 4.6% |
| Percent change in: | | |
| Net (loss) income | (634.3)% | (2.7)% |
| Net (loss) income per common share | (616.0) | (3.6) |
| Net (loss) income per common share, assuming dilution | (619.1) | (3.0) |

*(Benefit from) Provision for Income Taxes*

Our effective tax rate for the first six months of 2009 was approximately 2%, compared with approximately 8% for the same period in 2008. The effective tax rate for the first six months of 2009 includes a benefit of $18.4 million from discrete events, primarily the tax effect of impairments of goodwill and indefinite-lived intangible assets, partially offset by the build of certain valuation allowances and other items. Refer to Note 11, Taxes Based on Income, to the unaudited Condensed Consolidated Financial Statements for further information.

**RESULTS OF OPERATIONS BY SEGMENT FOR THE SIX MONTHS YEAR-TO-DATE**

**Pressure-sensitive Materials Segment**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net sales including intersegment sales | $ 1,675.8 | $ 1,986.1 |
| Less intersegment sales | (73.4) | (86.6) |
| Net sales | $ 1,602.4 | $ 1,899.5 |
| Operating income [1] | 50.4 | 154.2 |
| [1] Includes legal settlement and lease cancellation costs in 2009, and restructuring costs and asset impairment charges in both years | $ 61.9 | $ 4.3 |

*Net Sales*

Sales in our Pressure-sensitive Materials segment decreased 16% in the first six months of 2009 compared to the same period in 2008, which included the unfavorable impact of foreign currency translation (approximately $180 million), partially offset by the impact of the extra week in the first quarter of 2009. On an organic basis, sales declined 7% in

the first six months of 2009, as the benefits from pricing were more than offset by the decline in volume.

On an organic basis, sales in our roll materials business in the first six months of 2009 declined at a low double-digit rate in Europe, a mid single-digit rate (excluding intercompany sales) in North America, and a mid single-digit rate in emerging markets (Asia, Eastern Europe, South America) compared to the same period last year. These declines reflected continued weakness in end-markets.

On an organic basis, sales in our graphics and reflective business declined at a double-digit rate, reflecting lower promotional spending by businesses in response to weak market conditions.

*Operating Income*

Decreased operating income in the first six months of 2009 reflected legal settlement costs, lease cancellation costs, and higher restructuring and asset impairment charges compared to the same period in 2008. In addition, lower volume and the effects of raw material inflation more than offset the benefits from pricing and cost savings from restructuring and productivity improvement initiatives.

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Avery Dennison Corporation

**Retail Information Services Segment**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net sales including intersegment sales | $ 648.0 | $ 811.5 |
| Less intersegment sales | (.5) | (1.3) |
| Net sales | $ 647.5 | $ 810.2 |
| Operating (loss) income [1] [2] | (859.3) | 16.6 |
| [1] Includes restructuring costs, asset impairment charges and lease cancellation costs in both years | $ 14.7 | $ 7.1 |
| [2] Includes goodwill and indefinite-lived intangible asset impairment charges in 2009 and transition costs related to acquisition integrations in 2008 | $ 832.0 | $ 12.7 |

*Net Sales*

Sales in our Retail Information Services segment decreased 20% in the first six months of 2009 compared to the same period last year, which included the unfavorable impact of foreign currency translation (approximately $42 million), partially offset by the impact of the extra week in the first quarter of 2009 and incremental sales from the DM Label acquisition (approximately $9 million). On an organic basis, sales declined 17% in the first six months of 2009 due primarily to lower volume from continued weakness of the retail apparel market in the U.S. and Europe.

*Operating (Loss) Income*

Operating loss in the first six months of 2009 reflected goodwill and indefinite-lived intangible asset impairment charges, lease cancellation costs, and higher restructuring and asset impairment charges, partially offset by transition costs related to acquisition integrations in 2008. In addition, incremental savings from integration actions and the benefit of restructuring and productivity improvement initiatives were more than offset by lower volume and higher employee-related and raw material cost inflation.

**Office and Consumer Products Segment**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net sales including intersegment sales | $ 401.7 | $ 450.4 |
| Less intersegment sales | (.4) | (.6) |
| Net sales | $ 401.3 | $ 449.8 |
| Operating income [1] | 57.9 | 62.6 |
| [1] Includes asset impairment charges in 2009 and restructuring costs in both years | $ 5.7 | $ 4.3 |

*Net Sales*

Sales in our Office and Consumer Products segment decreased 11% in the first six months of 2009 compared to the same period last year, which included the unfavorable impact of foreign currency translation (approximately $23 million), partially offset by the impact of the extra week in the first quarter of 2009. On an organic basis, sales declined 6% in the first six months of 2009 due primarily to lower volume from weak end-market demand led by slower corporate purchasing activity, partially offset by the benefit from pricing.

*Operating Income*

Decreased operating income in the first six months of 2009 reflected the impact of lower volume, partially offset by the benefits from pricing, restructuring, and productivity improvement initiatives. Operating income included asset impairment charges in 2009 and restructuring costs in both years.

**Other specialty converting businesses**

| (In millions) | **2009** | **2008** |
|---|---|---|
| Net sales including intersegment sales | $ 237.4 | $ 329.4 |
| Less intersegment sales | (7.0) | (14.8) |
| Net sales | $ 230.4 | $ 314.6 |
| Operating (loss) income [(1)] | (37.9) | 15.3 |
| [(1)] Includes asset impairment charges in 2009 and restructuring costs in both years | $ 23.4 | $ .2 |

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*Net Sales*

Sales in our other specialty converting businesses decreased 27% in the first six months of 2009 compared to the same period last year, which included the unfavorable impact of foreign currency translation (approximately $16 million), partially offset by the impact of the extra week in the first quarter of 2009. On an organic basis, sales declined 23% in the first six months of 2009, primarily reflecting lower volume in products sold to the automotive, housing, and construction industries.

*Operating (Loss) Income*

Operating loss in the first six months of 2009 reflected lower sales on an organic basis, partially offset by the benefit of restructuring and productivity improvement initiatives. Operating (loss) income included asset impairment charges in 2009 and restructuring costs in both years.

## FINANCIAL CONDITION

### Liquidity

**Cash Flow from Operating Activities for the First Six Months:**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net (loss) income | $ (859.1) | $ 160.8 |
| Depreciation and amortization | 132.6 | 138.6 |
| Provision for doubtful accounts | 9.5 | 8.2 |
| Goodwill and indefinite-lived intangible asset impairment charges | 832.0 | |
| Asset impairment and net loss on sale and disposal of assets | 28.0 | 14.4 |
| Loss from debt extinguishment | 21.2 | |
| Stock-based compensation | 13.2 | 16.9 |
| Other non-cash expense and loss | 12.1 | |
| Other non-cash income and gain | (7.2) | (17.2) |
| Changes in assets and liabilities and other adjustments, net of the effect of business acquisitions | (49.5) | (133.0) |
| Net cash provided by operating activities | $ 132.8 | $ 188.7 |

For cash flow purposes, changes in assets and liabilities and other adjustments, net of the effect of business acquisitions, exclude the impact of foreign currency translation (discussed below in Analysis of Selected Balance Sheet Accounts ).

In 2009, cash flow provided by operating activities decreased by $55.9 million compared to 2008 as lower income from operations was partially offset by reduced working capital.

Refer to Analysis of Selected Financial Ratios below for more information.

**Cash Flow from Investing Activities for the First Six Months:**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Purchase of property, plant and equipment | $ (30.5) | $ (69.1) |
| Purchase of software and other deferred charges | (14.9) | (33.0) |
| Payments for acquisitions | | (125.0) |
| Proceeds from sale of investments, net | .1 | 13.0 |
| Other | (4.2) | 5.1 |
| Net cash used in investing activities | $ (49.5) | $ (209.0) |

*Capital and Software Spending*

During the first six months of 2009, we invested in various small capital projects, including projects associated with the expansion in Japan. Significant capital projects during the first six months of 2008 included investments for expansion in China and India serving both our materials and retail information services businesses.

Information technology projects during the first six months of 2009 and 2008 included customer service and standardization initiatives.

*Payments for Acquisitions*

On April 1, 2008, we completed the acquisition of DM Label, which is included in our Retail Information Services segment.

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*Proceeds from Sale of Investments*

During the first six months of 2009 and 2008, net proceeds from sale of investments consist of the sale of securities held by our captive insurance company.

**Cash Flow from Financing Activities for the First Six Months:**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Net change in borrowings and payments of debt | $ (8.0) | $ 114.7 |
| Dividends paid | (89.6) | (87.6) |
| Proceeds from exercise of stock options, net | .2 | 1.9 |
| Other | | 5.4 |
| Net cash (used in) provided by financing activities | $ (97.4) | $ 34.4 |

*Borrowings and Repayment of Debt*

In March 2009, we completed an exchange of approximately 6.6 million of our Corporate HiMEDS units, or approximately 75.15% of the outstanding Corporate HiMEDS units. In aggregate, the exchange resulted in the extinguishment of approximately $331 million of senior notes that are part of the Corporate HiMEDS units, the issuance of approximately 6.5 million shares of Avery Dennison s common stock (par value $1.00 per share), and the payment of approximately $43 million in cash to participating holders who validly tendered their Corporate HiMEDS units. As a result of this exchange, we recorded a debt extinguishment loss of approximately $21 million, which included a write-off of $9.6 million related to unamortized debt issuance costs.

In February 2008, one of our subsidiaries entered into a credit agreement for a term loan credit facility with fifteen domestic and foreign banks for a total commitment of $400 million, which we guaranteed, maturing February 8, 2011. We used the term loan credit facility to reduce commercial paper borrowings previously issued to fund the Paxar acquisition. The term loan credit facility is subject to financial covenants, including a maximum leverage ratio and a minimum interest coverage ratio, which were amended in January 2009.

Refer to Note 5, Debt, to the unaudited Condensed Consolidated Financial Statements for more information.

*Shareholders Equity*

Our shareholders equity was approximately $1.2 billion at July 4, 2009 compared to approximately $2.2 billion at June 28, 2008. The decrease in our shareholders equity was primarily due to the non-cash impairment charges of $832 million in the first quarter of 2009. Refer to Note 4, Goodwill and Other Intangibles Resulting from Business Acquisitions, to the unaudited Condensed Consolidated Financial Statements for more information. Our dividend per share was $.82 in both the first six months of 2009 and 2008.

**Analysis of Selected Balance Sheet Accounts**

*Long-lived Assets*

Goodwill decreased approximately $777 million during the first six months of 2009, which reflected a non-cash impairment charge associated with our retail information services reporting unit ($820 million), partially offset by purchase price adjustments associated with the DM Label acquisition ($31 million) and the impact of foreign currency translation ($12 million).

Other intangibles resulting from business acquisitions, net decreased approximately $27 million during the first six months of 2009, which reflected a non-cash impairment charge associated with our retail information services reporting unit ($12 million), normal amortization expense ($17 million), partially offset by an asset reclassification from Other assets ($1 million) and the impact of foreign currency translation ($1 million).

Refer to Note 4, Goodwill and Other Intangibles Resulting from Business Acquisitions, to the unaudited Condensed Consolidated Financial Statements for more information.

During the first six months of 2009, other assets reflected an increase in cash surrender value of corporate-owned life insurance ($8.7 million), an increase in third-party loan receivable ($5 million), the impact of foreign currency

translation ($.8 million), as well as software and other deferred charges purchases ($14.9 million), and other additions ($1 million). These increases were partially offset by normal amortization and impairment of software and other deferred charges ($24.5 million), the write-off of unamortized debt issuance costs associated with the exchange of the HiMEDS units, net of additional financing costs related to the covenant amendments ($4.5 million) discussed above in Borrowings and Repayment of Debt, as well as an asset reclassification to Other intangibles resulting from business acquisitions, net ($1 million).

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*Other Shareholders Equity Accounts*

The value of our employee stock benefit trusts increased by $59 million during the first six months of 2009 due to higher market value of shares held in the trusts of approximately $52 million, and the issuance of shares under our employee stock option and defined contribution plans of approximately $7 million.

*Treasury Stock*

During the first six months of 2009, we issued approximately 6.5 million shares of common stock with a book value of approximately $297 million in connection with the completed exchange of the Corporate HiMEDS units, as discussed above in Borrowings and Repayment of Debt.

**Impact of Foreign Currency Translation for the First Six Months:**

| (In millions) | 2009 | 2008 |
|---|---|---|
| Change in net sales | $ (261) | $ 172 |
| Change in net income | (9) | 10 |

International operations generated approximately 65% of our net sales in the first six months of 2009. Our future results are subject to changes in political and economic conditions and the impact of fluctuations in foreign currency exchange and interest rates.

Sales from currency translation in the first six months of 2009 primarily reflected a negative impact from sales denominated in Euros, as well as sales in the currencies of Great Britain, Australia and Brazil, partially offset by a benefit from sales in the currency of China.

**Effect of Foreign Currency Transactions**

The impact on net income from transactions denominated in foreign currencies may be mitigated because the costs of our products are generally denominated in the same currencies in which they are sold. In addition, to reduce our income statement and cash flow exposure to transactions in foreign currencies, we may enter into foreign exchange forward, option and swap contracts, where available and appropriate.

**Analysis of Selected Financial Ratios**

We utilize certain financial ratios to assess our financial condition and operating performance, as discussed below.

*Operational Working Capital Ratio*

Working capital (current assets minus current liabilities), as a percent of annualized net sales, decreased in 2009 primarily due to a decrease in net trade accounts receivable and inventories, partially offset by a decrease in accounts payable.

Operational working capital, as a percent of annualized net sales, is a non-GAAP measure and is shown below. We use this non-GAAP measure as a tool to assess our working capital requirements because it excludes the impact of fluctuations attributable to our financing and other activities (that affect cash and cash equivalents, deferred taxes and other current assets and other current liabilities) that tend to be disparate in amount and timing, and therefore, may increase the volatility of the working capital ratio from period to period. Additionally, the items excluded from this measure are not necessarily indicative of the underlying trends of our operations and are not significantly influenced by the day-to-day activities that are managed at the operating level. Refer to Uses and Limitations of Non-GAAP Measures. Our objective is to minimize our investment in operational working capital, as a percentage of sales, by reducing this ratio to maximize cash flow and return on investment.

**Operational Working Capital for the First Six Months:**

| (In millions) | 2009 | 2008 |
|---|---|---|
| (A) Working capital (current assets minus current liabilities) | $ (222.0) | $ (8.3) |
| Reconciling items: | | |
| Cash and cash equivalents | (91.9) | (87.1) |

| | | |
|---|---|---|
| Current deferred and refundable income taxes and other current assets | (208.2) | (302.0) |
| Short-term and current portion of long-term debt | 791.6 | 825.8 |
| Current deferred and payable income taxes and other current liabilities | 616.5 | 685.7 |
| (B) Operational working capital | $ 886.0 | $ 1,114.1 |
| (C) Annualized net sales (year-to-date sales, multiplied by 2) | $ 5,549.7[(1)] | $ 6,948.2 |
| Working capital, as a percent of annualized net sales (A) ¸ (C) | (4.0)% | (.1)% |
| Operational working capital, as a percent of annualized net sales (B) ¸ (C) | 16.0% | 16.0% |

(1) Adjusted for the extra week in the first quarter of 2009

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As a percent of annualized sales, operational working capital in the first six months of 2009 was unchanged compared to the same period in the prior year. This measure reflects the effects of the following ratios, including the impact of foreign currency translation, and is discussed below.

*Accounts Receivable Ratio*

The average number of days sales outstanding was 61 days in the first six months of 2009 compared to 62 days in the first six months of 2008, calculated using the two-quarter average trade accounts receivable balance divided by the average daily sales for the first six months of 2009 and 2008, respectively. During the first six months of 2009, the average number of days sales outstanding was primarily impacted by the timing of sales and improvement in collections.

*Inventory Ratio*

Average inventory turnover was 7.9 in the first six months of 2009 compared to 7.7 in the first six months of 2008, calculated using the annualized cost of sales (cost of sales for the first six months multiplied by two, adjusted for the extra week in the first quarter of 2009) divided by the two-quarter average inventory balance for the first six months of 2009 and 2008, respectively. During the first six months of 2009, the average inventory turnover was primarily impacted by a decrease in inventory purchases as a result of lower sales.

*Accounts Payable Ratio*

The average number of days payable outstanding was 51 days in the first six months of 2009 compared to 55 days in the first six months of 2008, calculated using the two-quarter average accounts payable balance divided by the average daily cost of products sold for the first six months of 2009 and 2008, respectively. During the first six months of 2009, the average number of days payable outstanding was primarily impacted by lower purchases, as well as the timing of payments which was impacted by the extra week in the first quarter of 2009.

**Capital Resources**

Capital resources include cash flows from operations, cash and cash equivalents and debt financing. At July 4, 2009, we had cash and cash equivalent of $92 million held in accounts managed by third-party financial institutions. To date, we have experienced no loss or lack of access to our invested cash or cash equivalents; however, there is no assurance that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

Our $1 billion revolving credit facility, which supports our commercial paper programs in the U.S. and Europe, matures in 2012. Based upon our current outlook for our business and market conditions, we believe that this facility, in addition to the committed and uncommitted bank lines of credit maintained in the countries in which we operate, provide the liquidity to fund our current operations. During the recent turmoil in the financial markets, we did not experience interruptions in our access to funding.

Refer to Note 5, Debt, to the unaudited Condensed Consolidated Financial Statements for more information.

We are exposed to financial market risk resulting from changes in interest and foreign currency rates, and to possible liquidity and credit risks of our counterparties.

*Capital from Debt*

Our total debt decreased approximately $283 million in the first six months of 2009 to approximately $1.93 billion compared to approximately $2.21 billion at year end 2008, reflecting a decrease in long-term borrowings, partially offset by an increase in commercial paper borrowings. Refer to Borrowings and Repayment of Debt above for further information.

Credit ratings are a significant factor in our ability to raise short-term and long-term financing. The credit ratings assigned to us also impact the interest rates paid and our access to commercial paper and other borrowings. A downgrade of our short-term credit ratings below the current A-2 and P2 levels would impact our ability to access the commercial paper markets. If our access to commercial paper markets is limited, our revolving credit facility and other credit facilities are available to meet our short-term funding requirements, if necessary. When determining a credit rating, the rating agencies place significant weight on our competitive position, business outlook, consistency of cash flows, debt level and liquidity, geographic dispersion and management team.

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Avery Dennison Corporation

**Our Credit Ratings as of July 4, 2009:**

| | Short-term | Long-term | Outlook |
|---|---|---|---|
| Standard & Poor s Rating Service | A-2 | BBB | Stable |
| Moody s Investors Service | P2 | Baa2 | Negative |

**Off-Balance Sheet Arrangements, Contractual Obligations, and Other Matters**

*Legal Proceedings*

We are a named defendant in purported class actions in the U.S. seeking treble damages and other relief for alleged unlawful competitive practices.

On April 24, 2003, Sentry Business Products, Inc. filed a purported class action on behalf of direct purchasers of label stock in the United States District Court for the Northern District of Illinois against us, UPM-Kymmene Corporation ( UPM ), Bemis Company, Inc. ( Bemis ), and certain of their subsidiaries seeking treble damages and other relief for alleged unlawful competitive practices, with allegations including that the defendants attempted to limit competition among themselves through anticompetitive understandings. Ten similar complaints were filed in various federal district courts. In November 2003, the cases were transferred to the United States District Court for the Middle District of Pennsylvania and consolidated for pretrial purposes. Plaintiffs filed a consolidated complaint on February 16, 2004, which we answered on March 31, 2004. On April 14, 2004, the court separated the proceedings as to class certification and merits discovery, and limited the initial phase of discovery to the issue of the appropriateness of class certification. On January 4, 2006, plaintiffs filed an amended complaint. On January 20, 2006, we filed an answer to the amended complaint. On August 14, 2006, the plaintiffs moved to certify a proposed class. The court substantively granted class certification on November 19, 2007. On July 22, 2008, the court held a hearing to set a schedule for merits discovery. On May 12, 2009, we entered into a settlement agreement with plaintiffs. Without admitting liability, we have agreed to pay plaintiffs $36.5 million, plus up to $.5 million related to notice and administration expenses, in two equal installments of $18.5 million, which were paid on May 27, 2009 and July 15, 2009. On June 10, 2009, the district court entered an order preliminarily approving the settlement, and a final approval hearing is scheduled for September 17, 2009. If court approval is obtained, the matter will be dismissed with prejudice. We recorded an accrual of $37 million for this settlement in the first quarter of 2009.

The Board of Directors created an ad hoc committee comprised of certain independent directors to oversee the foregoing matters.

We are unable to predict the effect of these matters at this time, although the effect could be adverse and material. These and other matters are reported in Note 15, Commitments and Contingencies, to the unaudited Condensed Consolidated Financial Statements.

*Environmental*

As of July 4, 2009, we have been designated by the U.S. Environmental Protection Agency ( EPA ) and/or other responsible state agencies as a potentially responsible party ( PRP ) at fourteen waste disposal or waste recycling sites, which are the subject of separate investigations or proceedings concerning alleged soil and/or groundwater contamination and for which no settlement of our liability has been agreed upon. We are participating with other PRPs at such sites, and anticipate that our share of cleanup costs will be determined pursuant to remedial agreements to be entered into in the normal course of negotiations with the EPA or other governmental authorities.

We have accrued liabilities for these and certain other sites, including sites in which governmental agencies have designated us as a PRP, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites and any sites that could be identified in the future for cleanup could be higher than the liability currently accrued.

The activity for the first six months of 2009 and full-year 2008 related to environmental liabilities, which include costs associated with compliance and remediation, were as follows:

| (In millions) | July 4, 2009 | December 27, 2008 |
|---|---|---|
| Balance at beginning of year | $ 58.5 | $ 37.8 |
| Purchase price adjustments related to acquisitions | 2.1 | 24.6 |
| Accruals | .7 | .9 |
| Payments | (2.1) | (4.8) |
| Balance at end of period | $ 59.2 | $ 58.5 |

As of July 4, 2009, approximately $12 million of the total balance is classified as short-term.
These estimates could change depending on various factors, such as modification of currently planned remedial actions, changes in

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remediation technologies, changes in site conditions, a change in the estimated time to complete remediation, changes in laws and regulations affecting remediation requirements and other factors.

*Product Warranty*

We provide for an estimate of costs that may be incurred under our basic limited warranty at the time product revenue is recognized. These costs primarily include materials and labor associated with the service or sale of products. Factors that affect our warranty liability include the number of units installed or sold, historical and anticipated rate of warranty claims on those units, cost per claim to satisfy our warranty obligation and availability of insurance coverage. Because these factors are impacted by actual experience and future expectations, we assess the adequacy of the recorded warranty liability and adjust the amounts as necessary. As of July 4, 2009, our product warranty liabilities were approximately $2 million.

*Other*

In 2005, we contacted relevant authorities in the U.S. and reported on the results of an internal investigation of potential violations of the U.S. Foreign Corrupt Practices Act. The transactions at issue were carried out by a small number of employees of our reflective business in China, and involved, among other things, impermissible payments or attempted impermissible payments. The payments or attempted payments and the contracts associated with them appear to have been minor in amount and of limited duration. Sales of our reflective business in China in 2005 were approximately $7 million. In addition, on or about October 10, 2008, we notified relevant authorities that we had discovered questionable payments to certain foreign customs and other regulatory officials by some employees of our recently acquired companies. These payments were not made for the purpose of obtaining business from any governmental entity. Corrective and disciplinary actions have been taken with respect to both internal investigations and we have taken remedial measures to comply with the provisions of the U.S. Foreign Corrupt Practices Act. On July 28, 2009, we entered into a settlement agreement with the SEC regarding the foregoing actions. Without admitting or denying liability, we agreed to disgorge approximately $.3 million and pay a $.2 million civil penalty. On August 10, 2009, we were advised by the U. S. Department of Justice that it has declined to take action against us in connection with the China reflective matters, which were voluntarily disclosed by us.

We and our subsidiaries are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of our business. Based upon current information, we believe that the resolution of these other matters will not materially affect us.

On September 9, 2005, we completed the lease financing for a commercial facility (the Facility ) located in Mentor, Ohio, used primarily for the new headquarters and research center for our roll materials division. The Facility consists generally of land, buildings, equipment and office furnishings. We have leased the Facility under an operating lease arrangement, which contains a residual value guarantee of $33.4 million. We do not expect the residual value of the Facility to be less than the amount guaranteed.

We participate in international receivable financing programs with several financial institutions whereby advances may be requested from these financial institutions. Such advances are guaranteed by us. At July 4, 2009, we had guaranteed approximately $13 million.

As of July 4, 2009, we guaranteed up to approximately $22 million of certain of our foreign subsidiaries obligations to their suppliers, as well as approximately $505 million of certain of our subsidiaries lines of credit with various financial institutions.

As of July 4, 2009, approximately two million HiMEDS units with a carrying value of approximately $109 million remained outstanding. The purchase contracts related to these units obligate the holders to purchase from the Company a certain number of shares in 2010 (depending on the stock price at the time). Refer to Note 5, Debt, to the unaudited Condensed Consolidated Financial Statements for more information.

**USES AND LIMITATIONS OF NON-GAAP MEASURES**

We use certain non-GAAP financial measures that exclude the impact of certain events, activities or strategic decisions. The accounting effects of these events, activities or decisions, which are included in the GAAP measures, may make it difficult to assess the underlying performance of the Company in a single period. By excluding certain accounting effects, both positive and negative (e.g. gains on sales of assets, restructuring charges, asset impairments,

etc.), from certain of our GAAP measures, management believes that it is providing meaningful supplemental information to facilitate an understanding of the Company s core or underlying operating results. These non-GAAP measures are used internally to evaluate trends in our underlying business, as well as to facilitate comparison to the results of competitors for a single period.

Limitations associated with the use of our non-GAAP measures include (1) the exclusion of foreign currency translation, the impact of acquisitions and divestitures, and the impact of the extra week in fiscal year 2009 from the calculation of organic sales growth; (2) the exclusion of mandatory debt service requirements, as well as the exclusion of other uses of the cash generated by operating activities

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that do not directly or immediately support the underlying business (such as discretionary debt reductions, dividends, share repurchases, acquisitions, etc.) for calculation of free cash flow; and (3) the exclusion of cash and cash equivalents, short-term debt, deferred taxes, and other current assets and other current liabilities, as well as current assets and current liabilities of held-for-sale businesses, for the calculation of operational working capital. While some of the items the Company excludes from GAAP measures recur, these items tend to be disparate in amount and timing. Based upon feedback from investors and financial analysts, we believe that supplemental non-GAAP measures provide information that is useful to the assessment of the Company s performance and operating trends.

**RECENT ACCOUNTING REQUIREMENTS**

During the first six months of 2009, certain other accounting and financial disclosure requirements by the Financial Accounting Standards Board and the SEC were issued. Refer to Note 17, Recent Accounting Requirements, to the unaudited Condensed Consolidated Financial Statements for more information.

**SAFE HARBOR STATEMENT**

The matters discussed in this Management s Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Quarterly Report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements, which are not statements of historical fact, may contain estimates, assumptions, projections and/or expectations regarding future events, which may or may not occur. Words such as aim, anticipate, assume, believe, continue, could, estimate, expect, guidance, intend, ma plan, potential, project, seek, shall, should, target, will, would, or variations thereof and other expres to future events and trends, identify forward-looking statements. Such forward-looking statements, and financial or other business targets, are subject to certain risks and uncertainties, which could cause actual results to differ materially from expected results, performance or achievements of the Company expressed or implied by such forward-looking statements.

Certain of such risks and uncertainties are discussed in more detail in Part I, Item 1A, Risk Factors, to the Company s Annual Report on Form 10-K for the year ended December 27, 2008, and include, but are not limited to, risks and uncertainties relating to investment in development activities and new production facilities; fluctuations in cost and availability of raw materials; ability of the Company to achieve and sustain targeted cost reductions; ability of the Company to generate sustained productivity improvement; successful integration of acquisitions; successful implementation of new manufacturing technologies and installation of manufacturing equipment; the financial condition and inventory strategies of customers; customer and supplier concentrations; changes in customer order patterns; loss of significant contract(s) or customer(s); timely development and market acceptance of new products; fluctuations in demand affecting sales to customers; impact of competitive products and pricing; selling prices; business mix shift; volatility of capital and credit markets; credit risks; ability of the Company to obtain adequate financing arrangements and to maintain access to capital; fluctuations in interest rates; fluctuations in pension, insurance and employee benefit costs; impact of legal proceedings, including a previous government investigation into industry competitive practices, and any related proceedings or lawsuits pertaining thereto or to the subject matter thereof related to the concluded investigation by the U.S. Department of Justice ( DOJ ) (including purported class actions seeking treble damages for alleged unlawful competitive practices, which were filed after the announcement of the DOJ investigation), as well as the impact of potential violations of the U.S. Foreign Corrupt Practices Act; changes in tax laws and regulations; changes in governmental regulations; changes in political conditions; fluctuations in foreign currency exchange rates and other risks associated with foreign operations; worldwide and local economic conditions; impact of epidemiological events on the economy and the Company s customers and suppliers; acts of war, terrorism, natural disasters; impairment of capitalized assets, including goodwill and other intangibles; and other factors.

The Company believes that the most significant risk factors that could affect its financial performance in the near-term include (1) the impact of economic conditions on underlying demand for the Company s products and on the carrying value of its assets; (2) the impact of competitors actions, including pricing, expansion in key markets, and product offerings; (3) the degree to which higher costs can be offset with productivity measures and/or passed on to customers through selling price increases, without a significant loss of volume; (4) the impact of an increase in costs associated

with the Company s debt; and (5) the ability of the Company to achieve and sustain targeted cost reductions. The Company s forward-looking statements represent judgment only on the dates such statements were made. By making such forward-looking statements, the Company assumes no duty to update them to reflect new, changed or unanticipated events or circumstances, other than as may be required by law.

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

There are no material changes in the information provided in Part II, Item 7A of the Company s Form 10-K for the fiscal year ended December 27, 2008.

**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(f)) that are designed to ensure that information required to be disclosed in the Company s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding the required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgement in evaluating the cost-benefit relationship of possible controls and procedures.

The Company s disclosure controls system is based upon a global chain of financial and general business reporting lines that converge in the Company s headquarters in Pasadena, California. As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and the Company s Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of the end of the quarter covered by this report.

Based on the foregoing, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures are effective to provide reasonable assurance that information is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding the required disclosure.

The Company periodically assesses its overall control environment, including the control environment of acquired businesses.

There has been no change in the Company s internal control over financial reporting during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

As of July 4, 2009, the Company has been designated by the U.S. Environmental Protection Agency ( EPA ) and/or other responsible state agencies as a potentially responsible party ( PRP ) at fourteen waste disposal or waste recycling sites which are the subject of separate investigations or proceedings concerning alleged soil and/or groundwater contamination and for which no settlement of the Company s liability has been agreed. The Company is participating with other PRPs at such sites, and anticipates that its share of cleanup costs will be determined pursuant to remedial agreements entered into in the normal course of negotiations with the EPA or other governmental authorities.

The Company has accrued liabilities for these and certain other sites, including sites in which governmental agencies have designated the Company as a PRP, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites and any sites that could be identified in the future for cleanup could be higher than the liability currently accrued.

As of July 4, 2009, the Company s estimated accrued liability associated with compliance and remediation costs was approximately $59 million, including estimated liabilities related to the Company s acquisitions. As of July 4, 2009, approximately $12 million of the total balance is classified as short-term. These estimates could change depending on various factors, such as modification of currently planned remedial actions, changes in remediation technologies, changes in site conditions, a change in the estimated time to complete remediation, changes in laws and regulations affecting remediation requirements and other factors.

On April 24, 2003, Sentry Business Products, Inc. filed a purported class action on behalf of direct purchasers of label stock in the United States District Court for the Northern District of Illinois against the Company, UPM-Kymmene Corporation ( UPM ), Bemis Company, Inc. ( Bemis ), and certain of their subsidiaries seeking treble damages and other relief for alleged unlawful competitive practices, with allegations including that the defendants attempted to limit competition between themselves through anticompetitive understandings. Ten similar complaints were filed in various federal district courts. In November 2003, the cases were transferred to the United States District Court for the Middle District of Pennsylvania and consolidated for pretrial purposes. Plaintiffs filed a consolidated complaint on February 16, 2004, which the Company answered on March 31, 2004. On April 14, 2004, the court separated the proceedings as to class certification and merits discovery, and limited the initial phase of discovery to the issue of the appropriateness of class certification. On January 4, 2006, plaintiffs filed an amended complaint. On January 20, 2006, the Company filed an answer to the amended complaint. On August 14, 2006, the plaintiffs moved to certify a proposed class. The court substantively granted class certification on November 19, 2007. On July 22, 2008, the court held a hearing to set a schedule for merits discovery. On May 12, 2009, the Company entered into a settlement agreement with plaintiffs. Without admitting liability, the Company has agreed to pay plaintiffs $36.5 million, plus up to $.5 million related to notice and administration expenses, in two equal installments of $18.5 million, which were paid on May 27, 2009 and July 15, 2009. On June 10, 2009, the district court entered an order preliminarily approving the settlement, and a final approval hearing is scheduled for September 17, 2009. If court approval is obtained, the matter will be dismissed with prejudice. The Company recorded an accrual of $37 million for this settlement in the first quarter of 2009.

On May 21, 2003, The Harman Press filed in the Superior Court for the County of Los Angeles, California, a purported class action on behalf of indirect purchasers of label stock against the Company, UPM and UPM s subsidiary Raflatac ( Raflatac ), seeking treble damages and other relief for alleged unlawful competitive practices, with allegations including that the defendants attempted to limit competition between themselves through anticompetitive understandings. Three similar complaints were filed in various California courts. In November 2003, on petition from the parties, the California Judicial Council ordered the cases be coordinated for pretrial purposes. The cases were assigned to a coordination trial judge in the Superior Court for the City and County of San Francisco on March 30, 2004. On September 30, 2004, the Harman Press amended its complaint to add Bemis subsidiary Morgan Adhesives Company ( MACtac ) as a defendant. On January 21, 2005, American International Distribution Corporation filed a purported class action on behalf of indirect purchasers in the Superior Court for Chittenden County, Vermont. Similar

actions were filed by Richard Wrobel, on February 16, 2005, in the District Court of Johnson County, Kansas; and by Chad and Terry Muzzey, on February 16, 2005 in the District Court of Scotts Bluff County, Nebraska. On February 17, 2005, Judy Benson filed a purported multi-state class action on behalf of indirect purchasers in the Circuit Court for Cocke County, Tennessee. The Nebraska, Kansas and Vermont cases are currently stayed. Defendants motion to dismiss the Tennessee case, filed on March 30, 2006, is pending. The Company intends to defend these matters vigorously.

The Board of Directors created an ad hoc committee comprised of independent directors to oversee the foregoing matters.

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The Company is unable to predict the effect of these matters at this time, although the effect could be adverse and material.

In 2005, the Company contacted relevant authorities in the U.S. and reported on the results of an internal investigation of potential violations of the U.S. Foreign Corrupt Practices Act. The transactions at issue were carried out by a small number of employees of the Company s reflective business in China, and involved, among other things, impermissible payments or attempted impermissible payments. The payments or attempted payments and the contracts associated with them appear to have been minor in amount and of limited duration. Sales of the Company s reflective business in China in 2005 were approximately $7 million. In addition, on or about October 10, 2008, the Company notified relevant authorities that it had discovered questionable payments to certain foreign customs and other regulatory officials by some employees of its recently acquired companies. These payments were not made for the purpose of obtaining business from any governmental entity. Corrective and disciplinary actions have been taken with respect to both internal investigations and the Company has taken remedial measures to comply with the provisions of the U.S. Foreign Corrupt Practices Act. On July 28, 2009, the Company entered into a settlement agreement with the SEC regarding the foregoing actions. Without admitting or denying liability, the Company agreed to disgorge approximately $.3 million and pay a $.2 million civil penalty. On August 10, 2009, the Company was advised by the U. S. Department of Justice that it has declined to take action against the Company in connection with the China reflective matters, which were voluntarily disclosed by the Company.

The Company and its subsidiaries are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of the Company s business. Based upon current information, management believes that the resolution of these other matters will not materially affect the Company s financial position.

**ITEM 1A. RISK FACTORS**

Our ability to attain our goals and objectives is materially dependent on numerous factors and risks, including but not limited to matters described in Part I, Item 1A, of the Company s Form 10-K for the fiscal year ended December 27, 2008. Set forth below is an update to such risk factors.

*Proposed changes in U.S. tax legislation could materially impact our results.*

Currently, the majority of our revenues is generated from customers located outside of the U.S., and a substantial portion of our assets, including employees, are located outside of the U.S. We have not accrued income taxes and foreign withholding taxes on undistributed earnings for most non-U.S. subsidiaries, because such earnings are intended to be indefinitely reinvested in the operations of those subsidiaries. Certain recently announced proposals could substantially increase our tax expense, which would result in a negative impact on our financial position and results of operations.

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

(a) Not Applicable

(b) Not Applicable

(c) Purchases of Equity Securities by Issuer

The Board of Directors has authorized the repurchase of shares of the Company s outstanding common stock. Repurchased shares may be reissued under the Company s stock option and incentive plans or used for other corporate purposes. The Company did not repurchase any registered equity securities in the first six months of 2009. As of July 4, 2009, the maximum number of shares that may yet be purchased under the Company s plans was approximately 4 million shares.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Information called for in this Item during the period is incorporated by reference to Part II, Item 4 in the Company s Form 10-Q filed on May 14, 2009.

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**ITEM 5. OTHER INFORMATION**

On August 10, 2009, the form of employment agreement for certain executive officers of Avery Dennison Corporation (the Company ) was amended, effective January 1, 2008, with the intention to provide that the employment arrangements and the payments thereunder either comply with or are exempt from Section 409A of the Internal Revenue Code of 1986, as amended (the Code ), and the Department of Treasury regulations and other guidance issued thereunder ( Section 409A ). The amendments modify the definitions of change of control and good reason and add a new section to the employment agreements entitled Compliance with Code Section 409A. This section states the intention that the payment of any compensation or benefits that constitute nonqualified deferred compensation subject to the requirements of Section 409A is intended to comply with Section 409A and that the agreements should be so interpreted. Among other things, the section also provides that the payment of any compensation or benefits that constitute nonqualified deferred compensation subject to the requirements of Section 409A will be delayed for a six-month period following the date of termination of employment, if the terminated executive is deemed to be a specified employee (within the meaning of Section 409A) as of such date. The amendment also provides that any payment related to excise taxes imposed under Section 4999 of the Code shall be paid in compliance with Section 409A. The amendments do not materially modify or otherwise affect the economic terms of the employment agreements. The foregoing description of the amendments is qualified in its entirety by reference to the form of Amendment to Employment Agreement, which is filed as Exhibit 10.8.3.2 to this report and is incorporated herein by reference.

On August 11, 2009, the form of employment agreement between the Company and certain executive officers was further amended, effective as of January 1, 2008, for compliance with Section 409A. The amendments clarify the timing of the payment of certain bonuses, certain payments upon termination of employment and the reimbursement of attorneys fees and provide that the pro-rata bonus payment payable with respect to certain terminations of employment shall be based on the highest bonus payment in the prior three annual bonus payment periods. The amendments do not otherwise materially modify or affect the economic terms of the employment agreements. The foregoing description of the amendments is qualified in its entirety by reference to the form of Second Amendment to Employment Agreement, which is filed as Exhibit 10.8.3.3 to this report and is incorporated herein by reference.

On August 11, 2009, the retention agreement between the Company and Daniel R. O Bryant, the Company s Executive Vice President, Finance and Chief Financial Officer, was amended, effective as of January 1, 2008, with the intention to provide that the payments thereunder either comply with or are exempt from Section 409A. The amendment provides for alternate vesting event and payment event definitions for a change in control and adds a new section entitled Compliance with Code Section 409A. This section states the intention that the payment of any compensation or benefits which constitute nonqualified deferred compensation subject to the requirements of Section 409A is intended to comply with Section 409A and that the agreement should be so interpreted. Among other things, the section also provides that the payment of any compensation or benefits which constitute nonqualified deferred compensation subject to the requirements of Section 409A will be delayed for a six-month period following Mr. O Bryant s date of termination of employment if he is deemed to be a specified employee (within the meaning of Section 409A) as of such date. The amendment also provides that any payment related to excise taxes imposed under Section 4999 of the Code shall be paid in compliance with Section 409A. The amendment also clarifies the timing of certain stock option grants. The amendment does not materially modify or otherwise affect the economic terms of the retention agreement. The foregoing description of the amendment is qualified in its entirety by reference to the Amendment to Retention Agreement, dated as of August 11, 2009, between the Company and Mr. O Bryant, which is filed as Exhibit 10.8.4.1 to this report and is incorporated herein by reference.

On August 11, 2009, the Compensation and Executive Personnel Committee (the Committee ) of the Company s Board of Directors (the Board ) approved the Company s Amended and Restated Avery Dennison Corporation Supplemental Executive Retirement Plan (the SERP ), which was amended and restated, effective January 1, 2009, with the intention to provide that benefits or payments granted thereunder either comply with or are exempt from Section 409A. The definition of good reason was modified and the SERP was amended to further modify existing Section 409A provisions by clarifying the timing and form of payment thereunder upon a participant s death following another

payment event or during the specified employee six-month delay period under Section 409A and to provide that the SERP can be further amended as needed to comply with the provisions of Section 409A. The foregoing description is qualified in its entirety by reference to the SERP, which is filed as Exhibit 10.11.1 to this report and is incorporated herein by reference.

On August 11, 2009, the Committee approved the Letter of Grant under the Company s SERP between the Company and Dean A. Scarborough, the Company s President and Chief Executive Officer, which was amended and restated, effective as of January 1, 2009, to incorporate the provisions of the amended SERP and with the intent that the SERP benefit payable under the Letter of Grant would either comply with or be exempt from Section 409A. Certain actuarial calculations in the Projected Account Balance exhibit were updated, and the Letter of Grant was further amended to provide for benefits upon an early retirement, beginning at age 60. The foregoing description is qualified in its entirety by reference to the Letter of Grant, which is filed as Exhibit 10.11.2.1 to this report and is incorporated herein by reference.

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On August 11, 2009, the Committee approved the Letter of Grant under the Company s SERP between the Company and Daniel R. O Bryant, the Company s Executive Vice President, Finance and Chief Financial Officer, which was amended and restated, effective as of January 1, 2009, to incorporate the provisions of the amended SERP, including the provisions relating to a participant s death during the specified employee six-month delay period under Section 409A, and with the intent that the SERP benefit payable under the Letter of Grant would either comply with or be exempt from Section 409A. Certain actuarial calculations in the Projected Account Balance exhibit were updated. The foregoing description is qualified in its entirety by reference to the Letter of Grant, which is filed as Exhibit 10.11.4.1 to this report and is incorporated herein by reference.

**ITEM 6. EXHIBITS**

| | |
|---|---|
| Exhibit 10.8.3.2: | Form of Amendment to Employment Agreement |
| Exhibit 10.8.3.3: | Form of Second Amendment to Employee Agreement |
| Exhibit 10.8.4.1: | Amendment of Retention Agreement |
| Exhibit 10.11.1: | Supplemental Executive Retirement Plan, amended and restated ( SERP ) |
| Exhibit 10.11.2.1: | Letter of Grant to D.A. Scarborough under SERP |
| Exhibit 10.11.4.1: | Letter of Grant to D.R. O Bryant under SERP |
| Exhibit 12: | Computation of Ratio of Earnings to Fixed Charges |
| Exhibit 31.1: | D. A. Scarborough Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2: | D. R. O Bryant Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.1: | D. A. Scarborough Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.2: | D. R. O Bryant Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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Avery Dennison Corporation

**SIGNATURES**

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

AVERY DENNISON CORPORATION
(Registrant)

/s/ Daniel R. O Bryant
Daniel R. O Bryant
Executive Vice President, Finance, and
Chief Financial Officer
(Principal Financial Officer)

/s/ Mitchell R. Butier
Mitchell R. Butier
Corporate Vice President, Global Finance,
and
Chief Accounting Officer
(Principal Accounting Officer)

August 12, 2009