FULLER H B CO
Form 10-Q
October 06, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 2, 2006

or

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______ to ______

Commission File Number 001-09225

H.B. FULLER COMPANY

(Exact name of Registrant as specified in its charter)

Minnesota	**41-0268370**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1200 Willow Lake Boulevard, Vadnais Heights, Minnesota	**55110-5101**
(Address of principal executive offices)	**(Zip Code)**

(651) 236-5900

(Registrant s telephone number, including area code)

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 x No ¨

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

Large accelerated filer x Accelerated filer ¨ Non- accelerated filer ¨

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

The number of shares outstanding of the Registrant s Common Stock, par value $1.00 per share, was 59,632,460 as of September 29, 2006.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

H.B. FULLER COMPANY AND SUBSIDIARIES

Consolidated Statements of Income

(In thousands, except per share amounts)

(Unaudited)

	13 Weeks Ended		39 Weeks Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Net revenue	$ 388,949	$ 358,091	$ 1,125,742	$ 1,099,003
Cost of sales	(278,610)	(260,509)	(805,881)	(811,158)
Gross profit	110,339	97,582	319,861	287,845
Selling, general and administrative expenses	(75,739)	(73,460)	(230,651)	(232,290)
Gains (losses) from sales of assets	(14)	278	831	7,076
Other income (expense), net	274	(25)	280	(839)
Interest expense	(4,575)	(2,942)	(12,285)	(9,166)
Income before income taxes, minority interests, and income from equity investments	30,285	21,433	78,036	52,626
Income taxes	(7,454)	(6,855)	(21,779)	(16,999)
Minority interests in (income) loss of subsidiaries	(259)	312	(993)	786
Income from equity investments	1,626	651	3,745	1,844
Net income	$ 24,198	$ 15,541	$ 59,009	$ 38,257
Net earnings per share:				
Basic	$ 0.41	$ 0.27	$ 1.01	$ 0.67
Diluted	$ 0.40	$ 0.26	$ 0.99	$ 0.66
Weighted-average shares outstanding:				
Basic	59,157	57,635	58,643	57,335
Diluted	60,281	58,864	59,876	58,349
Dividends declared per common share	$ 0.06250	$ 0.06125	$ 0.18625	$ 0.1800

See accompanying notes to consolidated financial statements.

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H.B. FULLER COMPANY AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

(Unaudited)

	September 2, 2006	December 3, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 123,613	$ 157,631
Trade receivables	241,885	246,596
Allowance for doubtful accounts	(8,099)	(8,046)
Inventories	157,022	142,984
Other current assets	56,858	43,269
Total current assets	**571,279**	**582,434**
Property, plant and equipment, net	310,672	298,852
Restricted cash	15,000	
Other assets	126,557	128,213
Goodwill	196,764	80,815
Other intangibles, net	172,221	17,243
Total assets	**$ 1,392,493**	**$ 1,107,557**
Liabilities and Stockholders Equity		
Current liabilities:		
Notes payable	$ 10,880	$ 9,597
Current installments of long-term debt	25,000	25,240
Trade payables	164,799	135,292
Accrued payroll and employee benefits	44,617	47,496
Other accrued expenses	34,848	30,045
Income taxes payable	13,972	14,188
Total current liabilities	**294,116**	**261,858**
Long-term debt, excluding current installments	252,000	112,001
Accrued pension liabilities	101,619	96,034
Other liabilities	49,821	34,218
Minority interests in consolidated subsidiaries	17,370	16,361
Total liabilities	**714,926**	**520,472**
Commitments and contingencies		
Stockholders equity:		
Preferred stock (no shares outstanding) Shares authorized 10,045,900		
Common stock, par value $1.00 per share, Shares authorized 160,000,000, Shares issued and outstanding 59,632,315 in 2006 and 29,184,754 on a pre-split basis in 2005	59,632	29,185
Additional paid-in capital	82,476	58,450
Retained earnings	525,319	507,217
Accumulated other comprehensive income (loss)	10,140	(7,767)

Total stockholders equity	**677,567**	**587,085**
Total liabilities and stockholders equity	**$ 1,392,493**	**$ 1,107,557**

See accompanying notes to consolidated financial statements.

H.B. FULLER COMPANY AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	39 Weeks Ended	
	September 2, 2006	**August 27, 2005**
Cash flows from operating activities:		
Net income	$ 59,009	$ 38,257
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	37,319	41,347
Deferred income taxes	(4,757)	(1,809)
Gains from sales of assets	(831)	(7,076)
Share-based compensation	4,483	1,324
Excess tax benefit from share-based compensation	(5,446)	
Change in assets and liabilities, net of assets and liabilities acquired:		
Accounts receivables, net	25,836	20,842
Inventories	(962)	(8,883)
Other assets	(11,431)	(4,059)
Accounts payables	18,841	(20,657)
Accrued payroll / employee benefits	(3,825)	7,471
Other accrued expenses	2,101	(14,363)
Restructuring liability	(240)	(2,252)
Income taxes payable	5,161	7,607
Accrued pension liabilities	3,556	(457)
Other liabilities	2,375	3,246
Other	(1,513)	4,378
Net cash provided by operating activities	129,676	64,916
Cash flows from investing activities:		
Purchased property, plant and equipment	(12,838)	(17,871)
Purchased business, net of cash acquired	(309,386)	
Purchased investment		(2,297)
Proceeds from sale of business	2,515	
Proceeds from sale of investment		8,000
Proceeds from sale of property, plant and equipment	499	11,282
Proceeds from repayment of note receivable from equity method investee		9,781
Net cash provided by (used in) investing activities	(319,210)	8,895
Cash flows from financing activities:		
Proceeds from long-term debt	195,000	
Repayment of long-term debt	(55,241)	(22,740)
Net proceeds (payments) from/on notes payable	1,191	(75)
Dividends paid	(11,022)	(10,421)
Options exercised	14,970	7,440
Excess tax benefit from share-based compensation	5,446	
Repurchased common stock	(506)	(339)
Net cash provided by (used in) financing activities	149,838	(26,135)
Effect of exchange rate changes	5,678	(1,929)
Net change in cash and cash equivalents	(34,018)	45,747
Cash and cash equivalents at beginning of period	157,631	67,028

Cash and cash equivalents at end of period	$ 123,613	$ 112,775

Supplemental disclosure of cash flow information:		
Dividends paid with company stock	$ 29,886	$ 40
Cash paid for interest	$ 9,383	$ 12,677
Cash paid for income taxes	$ 11,592	$ 10,321

See accompanying notes to consolidated financial statements.

H.B. FULLER COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Amounts in thousands, except share and per share amounts)

Note 1: Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a fair presentation of results of operations, financial position, and cash flows in conformity with U.S. generally accepted accounting principles. In the opinion of management, the interim consolidated financial statements reflect all adjustments of a normal recurring nature considered necessary for a fair presentation of the results for the periods presented. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the company s Annual Report on Form 10-K for the year ended December 3, 2005 as filed with the Securities and Exchange Commission.

The company has made certain reclassifications to the fiscal 2005 consolidated financial statements, as previously reported, to conform to current classification. These reclassifications did not change net income as previously reported. Reclassifications associated with the adoptions of SFAS 123R (see Note 3), required certain share-based awards previously reported as liabilities and contra-equity accounts to be classified as additional paid in capital.

On July 13, 2006, the company s board of directors approved a two-for-one stock split of its common stock. The stock split was payable on August 4, 2006 to shareholders of record as of July 28, 2006. The split was in the form of a stock dividend, with shareholders receiving an additional share for each existing share held. All references in the Consolidated Financial Statements to the number of common shares and related per share amounts reflect the effect of the stock split.

On July 13, 2006, the Board of Directors of the company approved a new shareholder rights plan. The shareholder rights plan provides each holder of a share of common stock a right to purchase one one-hundredth of a share of preferred stock for $95, subject to adjustment. Only whole preferred stock shares can be issued. Preferred Shares purchased upon exercise of the rights will not be redeemable. Each preferred share will be entitled to a preferential quarterly dividend payment, a preferential liquidation payment, voting rights, and participation in any merger, consolidation or other transaction in which common shares are exchanged. These rights are not currently exercisable. However, upon the occurrence of certain events, such as (1) the acquisition of 15 percent or more of the company s outstanding common stock by a person or group of affiliated persons (an acquiring person) or (2) the public announcement of a tender offer, the consummation of which would result in a person or group of affiliated persons becoming an acquiring person, each right would entitle the holder to purchase $95 worth of common stock (or in some circumstances common stock of the acquiring person) at one half of its then market value. Rights held by an acquiring person are void. The company may redeem or exchange the rights in certain instances. Unless extended or redeemed, the rights expire on July 31, 2016.

Recently Issued Accounting Pronouncements:

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that a conditional asset retirement obligation, as used in SFAS No. 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of the settlement are conditional on a future event that may or may not be within the control of the entity. The Statement is effective for the company no later than December 2, 2006. The company is in the process of evaluating the impact of FIN 47 on its financial condition, results of operations and cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for income taxes by

prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is applicable beginning December 2, 2007. The cumulative effect of applying the provisions of FIN 48, if any, will be reported as an adjustment to the opening balance of retained earnings on December 2, 2007. The company is in the process of evaluating the impact of FIN 48 on its financial condition, results of operations and cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year s financial statements are materially misstated. SAB 108 requires registrants to apply the new guidance for the first time that it identifies material errors in existence at the beginning of the first fiscal year ending after November 15, 2006 by correcting those errors through a one-time cumulative effect adjustment to beginning-of-year retained earnings. The company is currently evaluating SAB 108 and has not yet determined the impact on its results of operations or financial position.

Note 2: Acquisitions and Divestitures

Autotek Sealants, Inc.: Autotek provides bonding, sealing and coating technology to the automotive industry. The company s 70 percent owned automotive joint venture acquired a 48 percent ownership in Autotek on May 2, 2001. On September 26, 2005, the joint venture purchased the remaining 52 percent of Autotek for $894. Consideration consisted of $500 paid in cash, $357 in the form of a promissory note and $37 from direct external costs. The company accounted for this transaction as a step acquisition and began to report 100 percent of Autotek s net results beginning in the fourth quarter of 2005.

The acquisition of the remaining 52 percent adjusted goodwill by $149 and eliminated the minority interest liability of $856. In the fourth quarter of 2005, the company repaid the $500 of debt, which the automotive joint venture guaranteed.

In the first quarter of 2006, the company settled the promissory note to the previous owner for an amount of $316, which included adjustments for uncollected accounts receivable and an additional tax obligation paid by the company.

The following summarized unaudited pro forma consolidated results of operations are presented as if the acquisition of the remaining 52 percent of Autotek had occurred on November 28, 2004 (beginning of fiscal 2005). The unaudited pro forma results are not necessarily indicative of future earnings or earnings that would have been reported had the acquisition been completed as presented.

	13 weeks ended August 27, 2005	39 weeks ended August 27, 2005
Net revenue	$ 358,091	$ 1,099,003
Net income	$ 15,399	$ 37,803
Net income per share:		
Basic	$ 0.27	$ 0.66
Diluted	$ 0.26	$ 0.65

Sekisui-Fuller Joint Ventures: In the second quarter of 2005, the company completed its definitive agreements to enter into business-related partnerships in Japan and China with Sekisui Chemical Co., Ltd. In Japan, Sekisui and the company merged their Japanese adhesives businesses on April 1, 2005 to create Sekisui-Fuller Company, Ltd. H.B. Fuller contributed $15,629 of current assets, $11,463 of long-term assets, $8,665 of current liabilities, $10,639 of long-term liabilities in aggregate, net assets of $7,788. The long-term assets included $2,488 of goodwill allocated from the Global Adhesives operating segment. In exchange, H.B. Fuller received a 40 percent ownership in Sekisui-Fuller Company, Ltd. with an option to purchase an additional 10 percent in 2007 for $12,000. Additionally, the joint venture agreement included provisions requiring the company to fund the operations of the joint venture in the

event such capital contributions are approved by the joint venture board of directors. The merger was accounted for as a formation of a corporate joint venture. As a result, the company s interest in the joint venture was recorded at the carry-over basis of its Japan adhesives business. Therefore, no gain or loss was recorded on the merger. H.B. Fuller will account for this investment under the equity method. Subsequent to closing, $9,781 of intercompany debt, initially assumed by the joint venture at formation, was retired through a cash payment to the company on April 14, 2005.

With respect to China, the company received $8,000 from Sekisui on May 26, 2005 in exchange for a 20 percent investment in H.B. Fuller s China entities and an option for Sekisui to increase its investment to 30 percent in 2007 for $4,000. As a result of the 20 percent investment sold, the company recorded a pre-tax gain of $4,665. Sekisui s option to purchase an additional 10 percent in 2007 was initially recorded as a liability at a fair value of $688 and was subsequently marked-to-market at September 2, 2006 to $608. The company will continue to mark-to-market this liability through earnings in subsequent periods. H.B. Fuller will continue to consolidate China with the portion owned by Sekisui represented as a minority interest liability.

Roanoke Companies Group, Inc.: On January 30, 2006, the company signed an asset purchase agreement, under which it agreed to acquire substantially all the assets of Roanoke Companies Group, Inc. and assume certain operating liabilities. On March 17, 2006, the acquisition was completed. Roanoke is a leading U.S. manufacturer of pre-mix grouts, mortars and other products designed to enhance the installation of flooring systems with 2005 revenue of approximately $80,000. They are focused particularly on the retail home improvement market segment and are included in the company s Full-Valu/Specialty operating segment.

The total purchase price for the acquisition was approximately $275,384, which includes direct external acquisition costs of $869. In addition, if certain profitability thresholds are met, certain continuing members of Roanoke s senior management may receive additional cash consideration of up to $15,000 (in total), which would be paid out over a two-year period. Based on management s review of those profitability thresholds, no amounts have been paid out or accrued as of September 2, 2006.

The company funded the transaction with $80,384 in existing cash and $195,000 in new debt. $15,000 of the purchase price was placed into escrow to cover indemnification by the seller and shareholders. This amount is recorded in long-term restricted cash and other long-term liabilities. The company utilized its revolving credit agreement to provide the initial debt financing. The credit agreement was amended to increase the commitment level to $250,000, and revise the imbedded accordion feature.

The acquired assets consist primarily of assets used by Roanoke in the operation of its business, including, without limitation, certain real property, intellectual property, equipment, accounts, contracts and intangibles. The valuation of the net assets received involved allocations of the consideration paid to $20,581 of current assets, $23,746 of property, plant and equipment, $146,900 of intangible assets, $94,894 of goodwill, $10,581 of current liabilities and $156 of long-term liabilities. All of the goodwill was assigned to the Full-Valu/Specialty operating segment and is tax deductible over 15 years. Of the $146,900 of acquired intangibles, $131,000 and $15,900 was assigned to customer relationships and trademarks / trade names that have expected lives of 20 years and 15 years, respectively.

The following summarized unaudited pro forma consolidated results of operations are presented as if the acquisition of Roanoke had occurred on November 28, 2004 (beginning of fiscal 2005). The unaudited pro forma results are not necessarily indicative of future earnings or earnings that would have been reported had the acquisition been completed as presented.

	13 weeks ended	39 weeks ended	
	August 27, 2005	September 2, 2006	August 27, 2005
Net revenue	$ 379,585	$ 1,149,674	$ 1,159,100
Net income	$ 17,008	$ 59,024	$ 41,901
Net income per share:			
Basic	$ 0.30	$ 1.01	$ 0.73
Diluted	$ 0.29	$ 0.99	$ 0.72

Henkel KGaA s insulating glass sealant business: On March 27, 2006, the company signed an asset purchase agreement with Henkel KGaA, under which the company agreed to acquire Henkel s insulating glass sealant business. On June 9, 2006, the acquisition was completed. The insulating glass sealant business manufacturers sealants for windows used in both residential and commercial construction. This business has a strong presence in Europe and an expanding presence in Asia. The acquired business is included in the company s Full-Valu/Speciality operating segment.

The total purchase price for the acquisition was approximately $33,409, which excludes direct external acquisition costs. Direct external costs are expected to be finalized in the fourth quarter of 2006. The company funded the transaction with existing cash.

The acquired assets consist of inventory, manufacturing equipment, and intangibles. The preliminary analysis of the valuation of the net assets received involved allocations of the consideration paid to $3,166 of current assets, $1,393 of equipment, $13,297 of intangible assets, $15,702 of goodwill and $149 of long-term liabilities. All of the goodwill was assigned to the Full-Valu/Specialty operating segment and is tax deductible over 5 to 15 years. Of the $13,297 of acquired intangibles, $8,358 was assigned to customer relationships with an expected life of approximately 7 years and $4,939 was assigned to intellectual property and trademarks that have expected lives of 10 years. Allocation of consideration paid is expected to be finalized during the fourth quarter of 2006.

The following summarized unaudited pro forma consolidated results of operations are presented as if the acquisition had occurred on November 28, 2004 (beginning of fiscal 2005). The unaudited pro forma results are not necessarily indicative of future earnings or earnings that would have been reported had the acquisition been completed as presented.

	13 weeks ended		39 weeks ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Net revenue	$ 389,712	$ 371,108	$ 1,145,202	$ 1,139,924
Net income	$ 24,208	$ 16,110	$ 59,250	$ 40,046
Net income per share:				
Basic	$ 0.41	$ 0.28	$ 1.01	$ 0.70
Diluted	$ 0.40	$ 0.27	$ 0.99	$ 0.69

Note 3: Accounting for Share-Based Compensation

The company has various share-based compensation programs, which provide for equity awards including stock options, restricted stock and deferred compensation. These equity awards fall under several plans and are described below.

Effective December 4, 2005, the start of the first quarter of fiscal 2006, the company began recording compensation expense associated with share-based awards and other forms of equity compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R) as interpreted by SEC Staff Accounting Bulletin No. 107. SFAS 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS 123R is similar to the approach described in SFAS No. 123*, Accounting For Stock-Based Compensation* (SFAS 123). However, SFAS 123R requires all share-based payments to employees and non-employee directors, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant.

Historically, the company accounted for share-based compensation under the recognition and measurement principles of APB 25 and related interpretations. No compensation expense related to stock option plans was reflected in the company s Consolidated Statements of Income as all options had an exercise price equal to the market value of the underlying common stock on the date of grant. SFAS 123 established accounting and disclosure requirements using a fair-value-based method of accounting for share-based employee compensation plans. As permitted by SFAS 123, the company elected to continue

to apply the intrinsic-value-based method of APB 25, described above, and adopted only the disclosure requirements of SFAS 123, as amended by SFAS No. 148, *Accounting For Stock-Based Compensation - Transition and Disclosure*.

The company adopted the modified prospective transition method provided for under SFAS 123R, and consequently has not retroactively adjusted results from prior periods. Under this transition method, compensation cost associated with share-based awards recognized in the third quarter of fiscal year 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 3, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to December 3, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Equity Compensation Plans

The company currently grants stock options, restricted stock and stock-based units under equity compensation and deferred compensation plans.

Non-qualified stock options are granted to officers and key employees at prices not less than fair market value at the date of grant. These non-qualified options are generally exercisable beginning one year from the date of grant in cumulative yearly amounts of 25 percent and generally have a contractual term of 10 years. Options exercised represent newly issued shares.

Restricted stock awards are nonvested stock awards that may include grants of restricted stock shares or restricted stock units. Restricted stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of the restrictions. Such awards vest in either three, four or ten years from the date of grant or 25 percent per year over a four year period; depending on the grant. During the vesting period, ownership of the shares cannot be transferred. Restricted stock shares granted represent newly issued shares and have the same cash dividend and voting rights as other common stock and are considered to be currently issued and outstanding. Restricted stock units have dividend equivalent rights equal to the cash dividend paid on restricted stock shares. However, restricted stock units do not have voting rights of common stock and are not considered issued and outstanding. Restricted stock units become newly issued shares when vested. The company expenses the cost of the restricted stock awards, which is the grant date fair market value, ratably over the period during which the restrictions lapse. The grant date fair value is the company s closing stock price on the date of grant.

Directors Deferred Compensation Plan: This plan allows non-employee directors to defer all or a portion of their retainer and meeting fees in a number of investment choices, including units representing shares of company common stock. The company provides a 10 percent match on deferred compensation invested in these units. These units are required to be paid out in company common stock.

1998 Directors Stock Incentive Plan: This plan offers non-employee directors incentives to put forth maximum efforts for the success of the business and to afford non-employee directors an opportunity to acquire a proprietary interest in the company. This plan permits granting of (a) restricted stock and (b) shares for amounts non-employee directors deferred under the Directors Deferred Compensation Plan.

Year 2000 Stock Incentive Plan: This plan allows for granting of awards to employees. On April 6, 2006, this plan was amended to, among other things, extend the term of the plan until January 26, 2016. The plan permits granting of (a) stock options; (b) stock appreciation rights; (c) restricted stock awards; (d) performance awards; (e) dividend equivalents; and (f) other awards based on the company s common stock.

1992 Stock Incentive Plan: This plan permitted granting of (a) stock options; (b) stock appreciation rights; (c) restricted stock awards; (d) performance awards; (e) dividend equivalents; and (f) other awards based on the company s common stock. Since inception of the Year 2000 Stock Incentive Plan, no more awards have been granted under this plan.

Key Employee Deferred Compensation Plan: This plan allows key employees to defer a portion of their eligible compensation in a number of investment choices, including units, representing shares of company

common stock. The company provides a 10 percent match on deferred compensation invested in these units. The company also provides a match for certain amounts specified in the plan related to matching contributions under the 401(k) plan.

A summary of shares reserved and available by plan for issuance follows:

	Shares Reserved	Shares Available at September 2, 2006
Directors Deferred Compensation Plan	300,000	None
1998 Directors Stock Incentive Plan	800,000	498,956
Year 2000 Stock Incentive Plan	10,400,000	5,522,434
1992 Stock Incentive Plan	3,600,000	None
Key Employee Deferred Compensation Plan	400,000	99,555

Grant-Date Fair Value

The company uses the Black-Scholes option pricing model to calculate the grant-date fair value of an award. The fair value of options granted during the 13 and 39 weeks ended September 2, 2006 and August 27, 2005 were calculated using the following assumptions:

	13 Weeks Ended[1,2]	39 Weeks Ended[2]	
	September 2, 2006	September 2, 2006	August 27, 2005
Expected life (in years)	5.1	5.7	7.5
Weighted-average expected volatility	45.51%	45.72%	37.90%
Expected volatility	45.50% - 45.62%	45.50% - 46.0%	37.62% - 37.92%
Risk-free interest rate	4.99%	4.87%	4.30%
Expected dividend yield	1.27%	1.31%	1.60%
Weighted-average fair value of grants	$ 8.38	$ 8.45	$ 5.82

[1] There were no options granted for the 13 week period ended August 27, 2005.

[2] Share data adjusted for effect of 2-for-1 stock split effective July 28, 2006.

Expected life The company uses historical employee exercise and option expiration data to estimate the expected life assumption for the Black-Scholes grant-date valuation. The company believes that this historical data is currently the best estimate of the expected term of a new option. The company uses a weighted-average expected life for all awards. As part of its SFAS 123R adoption, the company examined its historical pattern of option exercises in an effort to determine if there were any discernable activity patterns based on certain employee populations. From this analysis, the company identified two employee populations: executives and non-executives. The analysis showed that employees above a specific pay-grade held onto their stock options for a longer period of time as compared to non-executives. Prior to adoption of SFAS 123R, the company calculated the expected life based on one employee population.

Expected volatility The company uses the company stock s historical volatility for the same period of time as the expected life. The company has no reason to believe that its future volatility will differ from the past.

Risk-free interest rate The rate is based on the U.S. Treasury yield curve in effect at the time of the grant for the same period of time as the expected life.

Expected dividend yield The calculation is based on the total expected annual dividend payout divided by the average stock price.

Expense

The company uses the straight-line attribution method to recognize expense for all option awards with graded vesting and restricted stock awards with cliff vesting. The company used the graded attribution method for restricted stock awards with graded vesting issued prior to the adoption of SFAS 123R. All share-based awards issued after the adoption of SFAS 123R will be expensed under the straight-line attribution method.

Some share-based awards are eligible to vest early in the event of retirement, involuntary termination, death, disability or change in control. To be eligible for retirement early vesting, an employee must meet certain age and service requirements. Option awards are eligible for early vesting under retirement if the employee is age 55 or older and has either 5 or 10 years of service, depending upon the grant. Restricted stock awards are eligible for early vesting under retirement if the employee is age 65 or older. All awards early vest in the event of death, disability or change in control. Some restricted stock awards allow for early vesting if the employee is involuntarily terminated.

SFAS 123R requires compensation costs associated with share-based awards to be recognized over the requisite service period, which for the company is the period between the grant date and the earlier of the award s stated vesting term or the date the employee is eligible for retirement. The company immediately recognizes the entire amount of share-based compensation cost for employees that are eligible for retirement at the date of grant. For awards granted to employees approaching retirement eligibility, the company recognizes compensation cost on a straight-line basis over the period from grant date through the retirement eligibility date. Share-based compensation expense for employees who are not retirement eligible is recognized on a straight-line basis over the statutory vesting period of the award.

The amount of share-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered award. The company currently expects, based on an analysis of its historical forfeitures and known forfeitures on existing awards, that approximately 85 percent and 91 percent of its unvested outstanding options and restricted stock awards will vest, respectively. This analysis will be re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

Total share-based compensation expense of $1,588 and $4,483 has been included in the company s Consolidated Statements of Income for the 13 and 39 week periods ended September 2, 2006, respectively. Included in this amount is $772 and $2,656 of stock option expense for the 13 and 39 week periods ended September 2, 2006, respectively, that was recognized as a result of adopting SFAS 123R. No amount of share-based compensation was capitalized. The impact of adopting SFAS 123R is as follows:

	13 Weeks Ended September 2, 2006	39 Weeks Ended September 2, 2006
Selling, general and administrative expenses	$ (772)	$ (2,656)
Share-based compensation expense before income taxes	(772)	(2,656)
Tax benefit	305	1,022
Share-based compensation expense after income taxes	$ (467)	$ (1,634)
Effect on:		
Earnings per share Basic	$ (0.01)	$ (0.03)

Earnings per share Diluted	$	(0.01)	$	(0.03)

Prior to the adoption of SFAS 123R, benefits of tax deductions in excess of recognized compensation costs (excess tax benefits) were reported as operating cash flows. SFAS 123R requires that they be recorded as a financing cash inflow rather than a deduction of taxes paid. For the 13 and 39 weeks ended September 2, 2006, there was $290 and $5,446 of excess tax benefit recognized resulting from share-based compensation cost.

In November 2005, the FASB issued FASB Staff Position 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-based Payment Awards* (FSP 123R-3). FSP 123R-3 provides an elective alternative transition method of calculating the additional paid in capital pool (APIC Pool) of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123R to the method otherwise required by paragraph 81 of SFAS 123R. The company may take up to one year from the effective date of FSP 123R-3 to evaluate its available alternatives and make its one-time election. After evaluating the alternative methods, the company believes it will elect the transitional method described in FSP 123R-3 and used this to estimate its APIC Pool upon adoption of SFAS 123R. Upon adoption of SFAS 123R, the company estimated that its APIC Pool was $993. Exercises of stock options, restricted stock lapsings and deferred compensation payouts in the 39 weeks ended September 2, 2006 increased the APIC Pool to $6,142.

The following table details the effect on net income and earnings per share had share-based compensation expense been recorded for the 13 and 39 weeks ended August 27, 2005 based on the fair-value method under SFAS 123. The reported and pro forma net income and earnings per share for the 13 and 39 week periods ended September 2, 2006 are the same since share-based compensation expense was calculated under the provisions of SFAS 123R.

	13 Weeks Ended August 27, 2005	39 Weeks Ended August 27, 2005
Net income, as reported	15,541	38,257
Add back: Share-based compensation expense recorded, net of related tax effects	435	1,134
Net income excluding share-based compensation	15,976	39,391
Deduct: Total share-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1,012)	(2,858)
Pro forma net income	14,964	36,533
Basic income per share:		
As reported	$ 0.27	$ 0.67
Pro forma	$ 0.26	$ 0.64
Diluted income per share:		
As reported	$ 0.26	$ 0.66
Pro forma	$ 0.25	$ 0.63

As of September 2, 2006, there was $6,439 of unrecognized compensation costs related to unvested stock option awards, which is expected to be recognized over a weighted-average period of 2.7 years. Unrecognized compensation costs related to unvested restricted stock awards was $3,373, which is expected to be recognized over a weighted-average period of 2.0 years.

Share-based Activity

Option activity for the 39 weeks ended September 2, 2006 was as follows:

	Options	Weighted-

		Average Exercise Price
Outstanding at December 3, 2005	4,311,226	$ 13.44
Granted	46,100	19.36
Exercised	(1,189,160)	12.59
Forfeited or Cancelled	(163,656)	14.22
Outstanding at September 2, 2006	3,004,510	$ 13.82

The fair value of options granted during the 13 weeks ended September 2, 2006 was $220. No options were granted in the third quarter of 2005. Total intrinsic value of options exercised during the 13 weeks

ended September 2, 2006 and August 27, 2005 was $300 and $2,033, respectively. Intrinsic value is the difference between the company s closing stock price on the respective trading day and the exercise price, multiplied by the number of options exercised. The fair value of options granted during the 39 weeks ended September 2, 2006 and August 27, 2005 was $390 and $5,256, respectively. Total intrinsic value of options exercised during the 39 weeks ended September 2, 2006 and August 27, 2005 was $13,238 and $2,867, respectively. Proceeds received from option exercises during the 13 and 39 weeks ended September 2, 2006 were $464 and $14,970, respectively.

The following table summarizes information concerning outstanding and exercisable options as of September 2, 2006:

Range of	**Options Outstanding**[4]				**Options Exercisable**[4]			
Exercise Prices	**Options**	**Life**[1]	**Price**[2]	**Value**[3]	**Options**	**Life**[1]	**Price**[2]	**Value**[3]
$5.01-$10.00	394,798	4.1	$ 9.49	$ 3,892	394,798	4.1	$ 9.49	$ 3,892
$10.01-$15.00	1,848,786	6.9	13.75	10,344	970,688	6.1	13.46	5,713
$15.01-$20.00	760,926	9.3	16.21	2,400	5,122	5.8	15.31	21
	3,004,510	7.1	$ 13.82	$ 16,636	1,370,608	5.5	$ 12.33	$ 9,626

1 Represents the weighted-average remaining contractual life in years.
2 Represents the weighted-average exercise price.
3 Represents the aggregate intrinsic value based on the company s closing stock price on the last trading day of the quarter for in-the-money options.
4 Share data adjusted for effect of 2-for-1 stock split effective July 28, 2006.

Nonvested restricted stock awards as of September 2, 2006 and changes during the 39 weeks ended September 2, 2006 were as follows:

	Units	**Shares**	**Total**	**Weighted-Average Grant Date Fair Value**	**Weighted-Average Remaining Contractual Life (in Years)**
Nonvested at December 3, 2005	151,530	499,820	651,350	$ 14.34	2.6
Granted		12,474	12,474	21.57	3.0
Vested	(53,470)	(59,784)	(113,254)	11.79	0.5
Forfeited	(19,984)	(10,292)	(30,276)	14.21	1.6
Nonvested at September 2, 2006	78,076	442,218	520,294	$ 15.07	2.0

Total fair value of restricted stock vested during the 13 weeks ended September 2, 2006 and August 27, 2005 was $1,325 and $1,316, respectively. Total fair value of restricted stock vested during the 39 weeks ended September 2, 2006 and August 27, 2005 was $2,957 and $1,945, respectively. The total fair value of nonvested restricted stock at September 2, 2006 was $10,068.

The company repurchased 7,306 and 11,348 restricted stock shares during the 13 weeks ended September 2, 2006 and August 27, 2005, respectively, in conjunction with restricted stock share vestings. The company repurchased 20,368 and 21,394 restricted stock shares during the

39 weeks ended September 2, 2006 and August 27, 2005, respectively, in conjunction with restricted stock share vestings. The repurchases relate to statutory minimum tax withholding. The company does not expect any additional restricted stock shares to be repurchased in fiscal 2006.

Deferred compensation units are fully vested at the date of contribution. Deferred compensation units outstanding as of September 2, 2006 and changes during the 39 weeks ended September 2, 2006 were as follows:

	39 Weeks Ended September 2, 2006		
	Non-employee Directors	**Employees**	**Total**
Units outstanding December 3, 2005	184,023	180,233	364,256
Participant contributions	14,708	13,190	27,898
Company match contributions	15,174	11,804	26,978
Payouts	(26,218)	(31,097)	(57,315)
Units outstanding September 2, 2006	187,687	174,130	361,817

Note 4: Earnings Per Share:

A reconciliation of the common share components for the basic and diluted earnings per share calculations follows:

	13 Weeks Ended		39 Weeks Ended	
	September 2, 2006	**August 27, 2005**	**September 2, 2006**	**August 27, 2005**
Weighted-average common shares basic	59,157,316	57,634,586	58,642,511	57,335,248
Equivalent shares from share based compensation plans	1,123,708	1,229,834	1,233,587	1,014,040
Weighted-average common shares diluted	60,281,024	58,864,420	59,876,098	58,349,288

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the applicable period. Diluted earnings per share is based upon the weighted average number of common and common equivalent shares outstanding during the applicable period. The difference between basic and diluted earnings per share is attributable to share-based compensation awards. The company uses the treasury stock method to calculate the effect of outstanding shares, which computes total employee proceeds as the sum of (a) the amount the employee must pay upon exercise of the award, (b) the amount of unearned share-based compensation costs attributed to future services and (c) the amount of tax benefits, if any, that would be credited to additional paid-in capital assuming exercise of the award. Share-based compensation awards for which total employee proceeds exceed the average market price over the applicable period have an antidilutive effect on earnings per share, and accordingly, are excluded from the calculation of diluted earnings per share.

Share-based compensation awards for 46,275 and 28,520 shares, for the 13 week periods ended September 2, 2006 and August 27, 2005, respectively; and 80,583 and 39,462 shares for the 39 week periods ended September 2, 2006 and August 27, 2005, respectively were excluded from the diluted earnings per share calculation because they were antidilutive.

Note 5: Comprehensive Income

The components of total comprehensive income follows:

	13 Weeks Ended		39 Weeks Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Net income	$ 24,198	$ 15,541	$ 59,009	$ 38,257
Other comprehensive income				
Foreign currency translation, net	(863)	(1,839)	17,907	(12,844)
Total comprehensive income	$ 23,335	$ 13,702	$ 76,916	$