

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)

**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**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number: 1-7685**

**AVERY DENNISON CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-1492269**

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

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

(Address of principal executive offices)

**91103**

(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

(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  No

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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**PART 1. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONDENSED CONSOLIDATED BALANCE SHEET***(Unaudited)*

(Dollars in millions)	<b>July 4, 2009</b>	<b>December 27, 2008</b>
<b>Assets</b>		
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
<b>Total current assets</b>	<b>1,794.1</b>	<b>1,930.4</b>
Property, plant and equipment	3,170.1	3,173.1
Accumulated depreciation	(1,766.1)	(1,680.1)
<b>Property, plant and equipment, net</b>	<b>1,404.0</b>	<b>1,493.0</b>
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
	<b>\$ 5,043.2</b>	<b>\$ 6,035.7</b>
<b>Liabilities and Shareholders' Equity</b>		
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
<b>Total current liabilities</b>	<b>2,016.1</b>	<b>2,058.0</b>
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

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

(In millions, except per share amounts)	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>July 4, 2009</b>	<b>June 28, 2008</b>	<b>July 4, 2009</b>	<b>June 28, 2008</b>
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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**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
*(Unaudited)*

(In millions)	<b>Six Months Ended</b>	
	<b>July 4, 2009</b>	<b>June 28, 2008</b>
<b>Operating Activities</b>		
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
<b>Investing Activities</b>		
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)
<b>Financing Activities</b>		
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

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(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)	<b>July 4, 2009</b>	<b>December 27, 2008</b>
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)	<b>Pressure- sensitive Materials</b>	<b>Retail Information Services</b>	<b>Office and Consumer Products</b>	<b>Other specialty converting businesses</b>	<b>Total</b>
Balance as of December 29, 2007	\$ 354.0	\$ 1,137.7	\$ 177.6	\$ 14.0	\$ 1,683.3
Goodwill acquired during the period <sup>(1)</sup>		45.1			45.1
Acquisition adjustments <sup>(2)</sup>	.3	10.3			10.6
Transfers <sup>(3)</sup>		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 <sup>(4)</sup>		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:**

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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:

(In millions)	July 4, 2009			December 27, 2008		
	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 <sup>(1)</sup>	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 plus 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:

(In millions)	Pension Benefits							
	Three Months Ended				Six Months Ended			
	July 4, 2009		June 28, 2008		July 4, 2009		June 28, 2008	
	U.S.	Int 1	U.S.	Int 1	U.S.	Int 1	U.S.	Int 1
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



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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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	<b>U.S. Postretirement Health Benefits</b>			
	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
(In millions)	<b>July 4, 2009</b>	<b>June 28, 2008</b>	<b>July 4, 2009</b>	<b>June 28, 2008</b>
Components of net periodic benefit cost:				
Service cost	\$ .3	\$ .2	\$ .5	\$ .5
Interest cost	.5	.5	1	