

FULLER H B CO
Form 10-Q
July 06, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 2, 2007

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number 001-09225

H.B. FULLER COMPANY

(Exact name of Registrant as specified in its charter)

Minnesota
(State or other jurisdiction of
incorporation or organization)

41-0268370
(I.R.S. Employer
Identification No.)

1200 Willow Lake Boulevard, Vadnais Heights, Minnesota
(Address of principal executive offices)

55110-5101
(Zip Code)

(651) 236-5900

(Registrant's telephone number, including area code)

Edgar Filing: FULLER H B CO - Form 10-Q

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of the Registrant's Common Stock, par value \$1.00 per share, was 60,770,699 as of June 29, 2007.

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		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Net revenue	\$ 373,515	\$ 371,807	\$ 725,270	\$ 704,817
Cost of sales	(265,368)	(264,301)	(514,833)	(503,211)
Gross profit	108,147	107,506	210,437	201,606
Selling, general and administrative expenses	(70,943)	(76,299)	(144,563)	(149,546)
Gains from sales of assets	16	32	103	845
Other income (expense), net	1,282	(502)	2,657	(11)
Interest expense	(3,181)	(4,968)	(6,789)	(7,710)
Income before income taxes, minority interests, and income from equity investments	35,321	25,769	61,845	45,184
Income taxes	(10,243)	(7,615)	(17,935)	(13,419)
Minority interests in income of subsidiaries	(70)	(493)	(111)	(734)
Income from equity investments	2,259	1,004	4,288	2,119
Income from continuing operations	27,267	18,665	48,087	33,150
Income from discontinued operations		875		1,661
Net income	\$ 27,267	\$ 19,540	\$ 48,087	\$ 34,811
Basic income per common share:				
Continuing operations	\$ 0.45	\$ 0.32	\$ 0.80	\$ 0.57
Discontinued operations		\$ 0.01		\$ 0.03
Net Income	\$ 0.45	\$ 0.33	\$ 0.80	\$ 0.60
Diluted income per common share ¹ :				
Continuing operations	\$ 0.44	\$ 0.31	\$ 0.78	\$ 0.56
Discontinued operations		\$ 0.01		\$ 0.03
Net Income	\$ 0.44	\$ 0.32	\$ 0.78	\$ 0.58
Weighted-average shares outstanding:				
Basic	60,394	58,730	60,164	58,385
Diluted	61,465	60,193	61,339	59,674
Dividends declared per common share	\$ 0.06450	\$ 0.06250	\$ 0.1270	\$ 0.12375

¹ Income per share amounts may not add due to rounding.
See accompanying notes to consolidated financial statements.

H.B. FULLER COMPANY AND SUBSIDIARIES**Consolidated Balance Sheets**

(In thousands, except share and per share amounts)

(Unaudited)

	June 2, 2007	December 2, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 200,995	\$ 255,362
Trade receivables	226,213	246,448
Allowance for sales and doubtful accounts	(8,758)	(8,293)
Inventories	131,885	128,623
Other current assets	46,303	46,071
Current assets of discontinued operations	865	883
Total current assets	597,503	669,094
Property, plant and equipment, net	289,653	298,004
Restricted cash	15,000	15,000
Other assets	128,943	128,802
Goodwill	196,103	195,208
Other intangibles, net	164,557	172,363
Total assets	\$ 1,391,759	\$ 1,478,471
Liabilities and Stockholders Equity		
Current liabilities:		
Notes payable	\$ 9,666	\$ 9,746
Current installments of long-term debt	25,000	25,000
Trade payables	153,881	172,772
Accrued payroll / employee benefits	34,672	48,227
Other accrued expenses	25,911	41,687
Income taxes payable	27,842	19,671
Current liabilities of discontinued operations	675	25,339
Total current liabilities	277,647	342,442
Long-term debt, excluding current installments	137,000	224,000
Accrued pensions	75,437	74,145
Other liabilities	41,698	42,320
Minority interests in consolidated subsidiaries	17,907	17,772
Total liabilities	549,689	700,679
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 60,738,720 and 59,931,766, respectively	60,739	59,932
Additional paid-in capital	109,468	95,263

Edgar Filing: FULLER H B CO - Form 10-Q

Retained earnings	637,848	597,115
Accumulated other comprehensive income	34,015	25,482
Total stockholders' equity	842,070	777,792
Total liabilities and stockholders' equity	\$ 1,391,759	\$ 1,478,471

See accompanying notes to consolidated financial statements.

H.B. FULLER COMPANY AND SUBSIDIARIES**Consolidated Statements of Cash Flows**

(In thousands)

(Unaudited)

	26 Weeks Ended	
	June 2, 2007	June 3, 2006
Cash flows from operating activities from continuing operations:		
Net income	\$ 48,087	\$ 34,811
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations, net of tax		(1,661)
Depreciation	18,676	19,605
Amortization	7,952	2,958
Deferred income taxes	(1,205)	(1,781)
Gains from sales of assets	(103)	(845)
Share-based compensation	1,439	2,848
Excess tax benefit from share-based compensation	(2,071)	(5,156)
Change in assets and liabilities, net of effects of acquisitions and discontinued operations:		
Accounts receivables, net	22,761	23,174
Inventories	(2,517)	1,735
Other assets	(128)	(7,891)
Trade payables	(19,726)	(7,781)
Accrued payroll / employee benefits	(13,691)	(10,309)
Other accrued expenses	(15,984)	3,921
Income taxes payable	9,974	(1,334)
Accrued / prepaid pensions	880	2,528
Other liabilities	2,862	760
Other	2,484	(1,686)
Net cash provided by operating activities from continuing operations	59,690	53,896
Cash flows from investing activities from continuing operations:		
Purchased property, plant and equipment	(11,149)	(8,162)
Purchased business, net of cash acquired		(275,236)
Proceeds from sale of property, plant and equipment	797	306
Proceeds from sale of business		2,515
Net cash used in investing activities from continuing operations	(10,352)	(280,577)
Cash flows from financing activities from continuing operations:		
Proceeds from long-term debt		195,000
Repayment of long-term debt	(87,000)	(25,241)
Net proceeds from (payments on) notes payable	(140)	1,569
Dividends paid	(7,710)	(7,296)
Proceeds from stock options exercised	11,291	14,506
Excess tax benefit from share-based compensation	2,071	5,156
Repurchased common stock	(132)	(334)
Net cash provided by (used in) financing activities from continuing operations	(81,620)	183,360
Effect of exchange rate changes	2,540	5,918
Net change in cash and cash equivalents from continuing operations	(29,742)	(37,403)
Cash provided by (used in) operating activities of discontinued operations	(24,625)	1,411

Edgar Filing: FULLER H B CO - Form 10-Q

Net change in cash and cash equivalents	(54,367)	(35,992)
Cash and cash equivalents at beginning of period	255,362	157,547
Cash and cash equivalents at end of period	\$ 200,995	\$ 121,555

Supplemental disclosure of cash flow information:

Noncash financing activities		
Dividends paid with company stock	\$ 46	\$ 49
Cash paid for interest	\$ 10,999	\$ 5,636
Cash paid for income taxes	\$ 5,808	\$ 11,548

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 2, 2006 as filed with the Securities and Exchange Commission.

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.

Recently Issued Accounting Pronouncements:

In June 2006, the Financial Accounting Standards Board (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 FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, (SFAS 157). SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. The statement provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. The adoption of SFAS 157 is effective for the company beginning December 2, 2007. The company does not expect the adoption of SFAS 157 will have a material impact on its financial condition, results of operations and cash flows.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158). This statement requires an employer to: (1) recognize in its statement of financial position an asset for a plan's over-funded status or a liability for the plan's under-funded status, (2) measure the plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions) and (3) recognize as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year but are not recognized as components of net periodic benefit cost pursuant to other relevant accounting standards. SFAS 158 also requires an employer to disclose in the notes to the financial statements additional information on how delayed recognition of certain changes in the funded status of a defined benefit postretirement plan affects net periodic benefit cost for the next fiscal year. Adoption of SFAS 158 is

required for public companies by the end of the fiscal year ending after December 15, 2006, which would be the fiscal year ending December 1, 2007 for the company. Measurement of the plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year is required to be adopted for fiscal years ending after December 15, 2008, which would be the fiscal year ending November 28, 2009 for the company. Based upon the December 2, 2006 balance sheet and pension disclosures, the impact of adopting SFAS 158 is estimated to be a decrease in assets of \$5,219, an increase in liabilities of \$46,829 and an increase in the accumulated other comprehensive loss of \$52,048. The effect of adoption will differ from the estimate due to actual plan asset and liability experience in fiscal 2007.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159)*. SFAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for the company on December 2, 2007. The company is currently determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 will have on its financial condition, results of operations and cash flows.

Note 2: Acquisitions and Divestitures

Carolina Polymers polymer and adhesive technology: On September 5, 2006, the company acquired Carolina Polymers polymer and adhesive technology for the multi-wall bag industry. The company acquired inventory, accounts receivable, personal property, intellectual property and customer lists. No other assets or liabilities were purchased. The initial cash payment was \$4,950 and was funded through existing cash. The company also incurred \$49 of direct external costs. Carolina Polymers is entitled to an earn-out of up to \$1,700 based on the company's shipment volume from September 5, 2006 to September 5, 2007. Any amount paid under the earn-out would be considered additional purchase price. The acquisition was recorded in the North America operating segment. Based on preliminary valuation estimates, the company has recorded \$1,385 of current assets, \$1,782 to intangibles, \$50 to other non-current assets and \$1,782 to goodwill. The final valuation will be completed in 2007. Due to shipment volumes, no earn-out accruals have been recorded. Pro forma information related to this acquisition is not included because its impact on the company's consolidated results of operations is not considered to be material.

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 manufactures 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 acquisition was recorded in the Europe operating segment. The total purchase price for the acquisition was approximately \$34,040, which includes direct external acquisition costs of \$631. The company funded the transaction with existing cash.

The acquired assets consist of inventory, manufacturing equipment, and intangibles. The valuation of the net assets received involved allocations of the consideration paid to \$3,166 of current assets, \$1,490 of equipment, \$14,563 of intangible assets, \$14,971 of goodwill and \$150 of long-term liabilities. Of the \$14,563 of acquired intangibles, \$10,131 was assigned to customer relationships with an expected life of approximately 12 years and \$4,432 was assigned to intellectual property and trademarks that have expected lives of 8 years. The goodwill is tax deductible over 5 to 15 years.

The following summarized unaudited pro forma consolidated results of operations are presented as if the acquisition had occurred on December 4, 2005 (beginning of fiscal 2006). 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	26 Weeks Ended
	June 3, 2006	June 3, 2006
Net revenue	\$ 381,280	\$ 723,514
Income from continuing operations	\$ 18,782	\$ 33,381
Income from continuing operations per share:		
Basic	\$ 0.32	\$ 0.57
Diluted	\$ 0.31	\$ 0.56

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. Roanoke is focused particularly on the retail home improvement market segment and is included in the company's North America operating segment. The acquisition is expected to provide business synergies, including additional distribution channels and inventory sourcing options for the company's existing specialty construction business component.

The total purchase price for the acquisition was approximately \$275,258, which includes direct external acquisition costs of \$744. 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. Any additional cash consideration payable to Roanoke's senior management will be recorded as compensation expense. Based on management's review of those profitability thresholds, no amounts have been paid out or accrued as of June 2, 2007.

The company funded the transaction with \$80,258 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. The company is not aware of any significant pre-acquisition contingencies and does not believe that any pre-acquisition contingency will be material, individually or in the aggregate. 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, \$94,769 of goodwill, \$10,582 of current liabilities and \$156 of long-term liabilities. All of the goodwill was assigned to the North America 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 had occurred on December 4, 2005 (beginning of fiscal 2006). 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	26 Weeks Ended
	June 3, 2006	June 3, 2006
Net revenue	\$ 376,621	\$ 728,749
Income from continuing operations	\$ 18,790	\$ 33,165
Income from continuing operations per share:		
Basic	\$ 0.32	\$ 0.57
Diluted	\$ 0.31	\$ 0.56

Divestitures

Powder Coatings: On October 19, 2006, the company agreed to sell its powder coatings business to The Valspar Corporation. The sale was completed on December 1, 2006. The sale price was \$104,199 and was subject to a net working capital adjustment of \$485, which was settled and paid in the second quarter of 2007. This adjustment was a reduction of the selling price and the gain.

As part of this transaction, the company recorded a gain in the fourth quarter of 2006 of \$68,916 (\$50,339 net of tax), which included direct costs to sell of \$3,561, a favorable cumulative translation adjustment reversal of \$3,002, the write-off of \$5,336 of goodwill and the estimated net working capital adjustment.

In accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets, the company has reclassified the results from the powder coatings business as discontinued operations, restating previously reported results to reflect the reclassification on a comparable basis. The operational results of this business are presented in the Income from discontinued operations, net of tax line item on the Consolidated Statements of Income. Prior to the reclassification, with operations in the United States and the United Kingdom, these results would have been reported in the North America and Europe operating segments.

Revenue and income from discontinued operations for the 13 and 26 weeks ended June 3, 2006 was as follows:

	13 Weeks Ended	26 Weeks Ended
	June 3, 2006	June 3, 2006
Net revenue	\$ 16,693	\$ 31,976
Income from operations	1,416	2,567
Income tax expense	(541)	(906)
Net income from discontinued operations	\$ 875	\$ 1,661

Income from operations excludes certain information technology and shared services charges that could not be directly attributed to the powder coatings business. In accordance with Emerging Issues Task Force (EITF) 87-24, Allocation of Interest to Discontinued Operations the company has not allocated general corporate overhead charges to the powder coatings business and has elected not to allocate general corporate interest expense.

The major classes of assets and liabilities of discontinued operations as of June 2, 2007 and December 2, 2006 were as follows:

	June 2,	December 2,
	2007	2006
Other current assets	\$ 865	\$ 883
Current assets of discontinued operations	865	883
Accrued payroll / employee benefits		1,279
Other accrued expenses	134	3,999
Income taxes payable	541	20,061
Current liabilities of discontinued operations	675	25,339

Note 3: Accounting for Share-Based Compensation

Overview: 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 in detail in the company's Annual Report filed on Form 10-K as of December 2, 2006.

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 SFAS No. 123 (revised 2004), Share-Based Payment, (SFAS 123R) as interpreted by SEC Staff Accounting Bulletin No. 107. 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.

The company adopted the modified prospective transition method provided for under SFAS 123R. Under this transition method, compensation cost associated with share-based awards recognized in the first half of fiscal years 2007 and 2006 included: (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.

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

	Shares Reserved	Shares Available at June 2, 2007
Directors' Deferred Compensation Plan	300,000	None
1998 Directors' Stock Incentive Plan	800,000	485,961
Year 2000 Stock Incentive Plan	10,400,000	5,447,918
1992 Stock Incentive Plan	3,600,000	None
Key Employee Deferred Compensation Plan	400,000	83,719

Grant-Date Fair Value: The company uses the Black-Scholes option-pricing model to calculate the grant-date fair value of an award. There were no options granted for the 13 weeks ended June 2, 2007 and June 3, 2006. The fair value of options granted during the 26 weeks ended June 2, 2007 and June 3, 2006 were calculated using the following assumptions:

	26 Weeks Ended	
	June 2, 2007	June 3, 2006 ¹
Expected life (in years)	5.9	6.4
Weighted-average expected volatility	45.82%	46.00%
Expected volatility	45.53%	45.98%
Risk-free interest rate	4.64%	4.71%
Expected dividend yield	1.88%	1.35%
Weighted-average fair value of grants	\$ 11.21	\$ 8.55

¹ 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.

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.

Edgar Filing: FULLER H B CO - Form 10-Q

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 Recognition: 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 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. The company currently expects, based on an analysis of its historical forfeitures and known forfeitures on existing awards, that approximately 81 percent and 86 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 \$859 and \$1,506 was included in the company's Consolidated Statements of Income for the 13 weeks ended June 2, 2007 and June 3, 2006, respectively. Included in these amounts were \$604 and \$973 of stock option expense, respectively. Total share-based compensation expense of \$1,439 and \$2,896 was included in the company's Consolidated Statements of Income for the 26 weeks ended June 2, 2007 and June 3, 2006, respectively. Included in these amounts were \$1,299 and \$1,989 of stock option expense, respectively. In 2007, total share-based compensation expense included \$846 of favorable adjustments from unexpected executive forfeitures. Included in the favorable 2007 forfeiture adjustments was \$205 related to stock options. No share-based compensation was capitalized. All share-based compensation was recorded as selling, general and administrative expense. For the 13 weeks ended June 2, 2007 and June 3, 2006, there was \$798 and \$4,013, respectively, of excess tax benefit recognized. For the 26 weeks ended June 2, 2007 and June 3, 2006, there was \$2,071 and \$5,156, respectively, of excess tax benefit recognized. Excess tax benefits are the benefits of tax deductions in excess of recognized compensation costs.

Excess tax benefits that are eligible to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123R are recorded in the additional paid in capital pool (APIC Pool). Upon adoption of SFAS 123R, the company calculated that its APIC Pool was \$993. Exercises of stock options, restricted stock lapsings and deferred compensation payouts since adoption has increased the APIC Pool to \$9,122.

As of June 2, 2007, there was \$5,181 of unrecognized compensation costs related to unvested stock option awards, which is expected to be recognized over a weighted-average period of 2.8 years. Unrecognized compensation costs related to unvested restricted stock awards was \$2,146, which is expected to be recognized over a weighted-average period of 2.2 years.

Share-based Activity

A summary of option activity as of June 2, 2007, and changes during the 26 weeks then ended is presented below:

	Options	Weighted-Average Exercise Price
Outstanding at December 2, 2006	2,639,618	\$ 13.80
Granted	406,743	26.79
Exercised	(799,581)	14.12
Forfeited or Cancelled	(308,082)	18.09
Outstanding at June 2, 2007	1,938,698	\$ 15.71

There were no options granted for the 13 week periods ended June 2, 2007 and June 3, 2006. Total intrinsic value of options exercised during the 13 weeks ended June 2, 2007 and June 3, 2006 was \$2,331 and \$10,254, 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 26 weeks ended June 2, 2007 and June 3, 2006 was \$4,558 and \$170, respectively. Total intrinsic value of options exercised during the 26 weeks ended June 2, 2007 and June 3, 2006 was \$10,151 and \$12,939, respectively. Proceeds received from option exercises during the 13 and 26 weeks ended June 2, 2007 were \$2,139 and \$11,291, respectively.

Edgar Filing: FULLER H B CO - Form 10-Q

The following table summarizes information concerning outstanding and exercisable options as of June 2, 2007:

Range of Exercise Prices	Options Outstanding				Options Exercisable			
	Options	Life ¹	Price ²	Value ³	Options	Life ¹	Price ²	Value ³
\$5.01-\$10.00	359,796	3.3	\$ 9.51	\$ 6,387	359,796	3.3	\$ 9.51	\$ 6,387
\$10.01-\$15.00	809,761	5.9	13.68	10,999	583,677	5.4	13.45	8,062
\$15.01-\$20.00	442,783	8.5	16.30	4,853	95,918	8.3	16.12	1,069
\$20.01-\$25.00								
\$25.01-\$30.00	326,358	9.5	26.79	153				
	1,938,698	6.6	\$ 15.71	\$ 22,392	1,039,391	5.0	\$ 12.33	\$ 15,518

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.

A summary of nonvested restricted stock activity as of June 2, 2007, and changes during the 26 weeks then ended is presented below:

	Units	Shares	Total	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Life (in Years)
Nonvested at December 2, 2006	78,076	317,932	396,008	\$ 15.13	1.9
Granted	14,993	91,257	106,250	26.80	3.0
Vested	(5,072)	(13,537)	(18,609)	13.89	0.2
Forfeited	(10,930)	(113,266)	(124,196)	17.06	1.4
Nonvested at June 2, 2007	77,067	282,386	359,453	\$ 17.98	2.2

Total fair value of restricted stock vested during the 13 weeks ended June 2, 2007 and June 3, 2006 was \$322 and \$1,243, respectively. Total fair value of restricted stock vested during the 26 weeks ended June 2, 2007 and June 3, 2006 was \$527 and \$1,632, respectively. The total fair value of nonvested restricted stock at June 3, 2006 was \$9,799.

The company repurchased 3,405 and 12,188 restricted stock shares during the 13 weeks ended June 2, 2007 and June 3, 2006, respectively, in conjunction with restricted stock share vestings. The company repurchased 4,849 and 13,062 restricted stock shares during the 26 weeks ended June 2, 2007 and June 3, 2006, respectively, in conjunction with restricted stock share vestings. The repurchases relate to statutory minimum tax withholding. The company estimates that approximately 10,000 restricted stock shares will be repurchased in fiscal 2007.

Deferred compensation units are fully vested at the date of contribution. Deferred compensation units outstanding as of June 2, 2007 and changes during the 26 weeks ended June 2, 2007 were as follows:

	26 Weeks Ended June 2, 2007		
	Non-employee Directors	Employees	Total
Units outstanding December 2, 2006	190,172	175,450	365,622
Participant contributions	9,318	10,926	20,244
Company match contributions	1,190	2,071	3,261
Payouts	(9,881)	(35,866)	(45,747)
Units outstanding June 2, 2007	190,799	152,581	343,380

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		26 Weeks Ended	
	June 2,	June 3,	June 2,	June 3,
	2007	2006	2007	2006
Weighted-average common shares basic	60,394,126	58,729,752	60,163,751	58,385,109
Equivalent shares from share based compensation plans	1,070,793	1,463,154	1,174,917	1,288,526
Weighted-average common shares diluted	61,464,919	60,192,906	61,338,668	59,673,635

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.

Options to purchase 344,358 and 19,858 shares of common stock at the weighted-average exercise price of \$26.43 and \$18.74 for the 13 week periods ended June 2, 2007 and June 3, 2006, respectively, and options to purchase 356,985 and 652,900 shares at the weighted-average exercise price of \$26.40 and \$15.42 for the 26 week periods ended June 2, 2007 and June 3, 2006, respectively, were excluded from the diluted earnings per share calculations because they were antidilutive.

Note 5: Comprehensive Income

The components of total comprehensive income follow:

	13 Weeks Ended		26 Weeks Ended	
	June 2,	June 3,	June 2,	June 3,
	2007	2006	2007	2006
Net income	\$ 27,267	\$ 19,540	\$ 48,087	\$ 34,811
Other comprehensive income				
Foreign currency translation, net	12,145	13,092	8,533	18,770
Total comprehensive income	\$ 39,412	\$ 32,632	\$ 56,620	\$ 53,581

Components of accumulated other comprehensive income follows:

Accumulated Other Comprehensive Income	June 2,	
	2007	December 2, 2006
Foreign currency translation adjustment	\$ 55,238	\$ 46,705
Minimum pension liability	(21,223)	(21,223)
Total accumulated other comprehensive income	\$ 34,015	\$ 25,482

Note 6: Components of Net Periodic Benefit Cost related to Pension and Other Postretirement Benefit Plans:

	13 Weeks Ended June 2, 2007 and June 3, 2006					
	Pension Benefits				Other Postretirement Benefits	
	U.S. Plans		Non-U.S. Plans		2007	2006
Net periodic cost (benefit):	2007	2006	2007	2006	2007	2006
Service cost	\$ 1,780	\$ 1,824	\$ 669	\$ 634	\$ 397	\$ 470
Interest cost	4,366	4,079	1,717	1,473	1,010	978
Expected return on assets	(5,098)	(4,964)	(1,898)	(1,269)	(921)	(942)
Amortization:						
Prior service cost	90	126	(1)	(1)	(433)	(554)
Actuarial (gain)/ loss	614	1,329	346	482	787	849
Transition amount			5	9		
Net periodic benefit cost	\$ 1,752	\$ 2,394	\$ 838	\$ 1,328	\$ 840	\$ 801

	26 Weeks Ended June 2, 2007 and June 3, 2006					
	Pension Benefits				Other Postretirement Benefits	
	U.S. Plans		Non-U.S. Plans		2007	2006
Net periodic cost (benefit):	2007	2006	2007	2006	2007	2006
Service cost	\$ 3,560	\$ 3,648	\$ 1,330	\$ 1,255	\$ 793	\$ 940
Interest cost	8,733	8,158	3,411	2,914	2,019	1,956
Expected return on assets	(10,196)	(9,928)	(3,774)	(2,511)	(1,841)	(1,884)
Amortization:						
Prior service cost	180	252	(2)	(1)	(867)	(1,108)
Actuarial (gain)/ loss	1,228	2,658	688	953	1,575	1,698
Transition amount			10	17		
Net periodic benefit cost	\$ 3,505	\$ 4,788	\$ 1,663	\$ 2,627	\$ 1,679	\$ 1,602

Note 7: Inventories

The composition of inventories follows:

	June 2,	
	2007	December 2, 2006
Raw materials	\$ 68,622	\$ 64,925
Finished goods	81,331	81,058
LIFO reserve	(18,068)	(17,360)
	\$ 131,885	\$ 128,623

Note 8: Derivatives

Derivatives consisted primarily of forward currency contracts used to manage foreign currency denominated assets and liabilities. Because derivative instruments outstanding were not designated as hedges for accounting purposes, the gains and losses related to mark-to-market adjustments were recognized as other income or expense in the income statement during the periods in which the derivative instruments were outstanding. Management does not enter into any speculative positions with regard to derivative instruments.

Edgar Filing: FULLER H B CO - Form 10-Q

As of June 2, 2007, the company had forward foreign currency contracts maturing between June 15, 2007 and December 17, 2007. The fair value effect associated with these contracts was a net unrealized loss of \$2,134 at June 2, 2007.

Note 9: Commitments and Contingencies

Environmental: From time to time, the company is identified as a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and/or similar state laws that impose liability for costs relating to the cleanup of contamination resulting from past spills, disposal or other release of hazardous substances. The company is also subject to similar laws in some of the countries where current and former facilities are located. The company's environmental, health and safety department monitors compliance with all applicable laws on a global basis.

Currently the company is involved in various environmental investigations, clean-up activities and administrative proceedings or lawsuits. In particular, the company is currently deemed a potentially responsible party (PRP) in conjunction with numerous other parties, in a number of government enforcement actions associated with hazardous waste sites. As a PRP, the company may be required to pay a share of the costs of investigation and cleanup of these sites. In addition, the company is engaged in environmental remediation and monitoring efforts at a number of current and former company operating facilities, including an investigation of environmental contamination at its Sorocaba, Brazil facility. Soil and water samples have been collected on and around the Sorocaba facility, and recent test results indicate that certain contaminants, including carbon tetrachloride and other solvents, exist in the soil at the Sorocaba facility and in the groundwater at both the Sorocaba facility and some neighboring properties. The company is continuing to work with Brazilian regulatory authorities to determine the necessary scope of remediation at the facility and the neighboring properties. As of June 2, 2007, \$1,672 was recorded as a liability for expected investigation and remediation expenses remaining for this site. Once the full scope of any necessary remediation is determined, the company may be required to record additional liabilities related to investigation and remediation costs at the Sorocaba facility.

As of June 2, 2007, the company had recorded \$3,512 as its best probable estimate of aggregate liabilities for costs of environmental investigation and remediation, inclusive of the accrual related to the Sorocaba facility described above. These estimates are based primarily upon internal or third party environmental studies, assessments as to the company's responsibility, the extent of the contamination and the nature of required remedial actions. The company's current assessment of the probable liabilities and associated expenses related to environmental matters is based on the facts and circumstances known at this time. Recorded liabilities are adjusted as further information is obtained or circumstances change.

Because of the uncertainties described above, the company cannot accurately estimate the cost of resolving pending and future environmental matters impacting the company. While uncertainties exist with respect to the amounts and timing of the company's ultimate environmental liabilities, based on currently available information, management does not believe that these matters, individually or in aggregate, will have a material adverse effect on the company's long-term financial condition. However, adverse developments could negatively impact the company's results of operations or cash flows in one or more future quarters.

Product Liability: As a participant in the chemical and construction products industries, the company faces an inherent risk of exposure to claims in the event that the alleged failure, use or misuse of its products results in or is alleged to result in property damage and/or bodily injury. From time to time and in the ordinary course of business, the company is a party to, or a target of, lawsuits, claims, investigations and proceedings, including product liability, personal injury, contract, patent and intellectual property, health and safety and employment matters.

A subsidiary of the company is a defendant in numerous exterior insulated finish systems (EIFS) related lawsuits. As of June 2, 2007, the company's subsidiary was a defendant in approximately 20 lawsuits and claims related primarily to single-family homes. The EIFS product was used primarily in the residential construction market in the southeastern United States. Some of the lawsuits and claims involve EIFS in commercial or multi-family structures. Lawsuits and claims related to this product seek monetary relief for water intrusion-related property damages. The company has insurance coverage for certain years with respect to this product line.

During the quarter ended June 3, 2006, the company entered into agreements to settle numerous EIFS-related lawsuits and claims, including a lawsuit involving up to 186 homes. In total, the company paid \$5,000 in settlement of these lawsuits and claims, of which insurers have paid \$983 and are expected to pay an additional \$485. As of June 2, 2007, the company had recorded \$1,290 for the probable liabilities and \$902 for insurance recoveries for all remaining EIFS-related liabilities. The company continually reevaluates these amounts.

EIFS-related liabilities include amounts for pending lawsuits and claims as well as unasserted claims. The liabilities are recorded at management's best estimate of the outcome of the lawsuits and claims taking into consideration the facts and circumstances of the individual matters as well as past experience on similar matters. Amounts accrued for the unasserted claims are based primarily on historical experience. Because of the many uncertainties involved with litigation, management has concluded that it is not possible to estimate a range of loss, if any, that would exceed the accrual.

The rollforward of EIFS-related lawsuits and claims is as follows:

	26 Weeks Ended June 2, 2007	Year Ended December 2, 2006
Lawsuits and claims at beginning of period	29	75
New lawsuits and claims asserted	5	9
Lawsuits and claims settled	(6)	(55)
Lawsuits and claims dismissed/resolved	(8)	
Lawsuits and claims at end of period	20	29

A summary of the aggregate costs and settlement amounts for EIFS-related lawsuits and claims is as follows:

	26 Weeks Ended June 2, 2007	Year Ended December 2, 2006
Settlements reached	\$ 150	\$ 5,989
Defense costs incurred	\$ 277	\$ 2,507
Insurance payments received or expected to be received	\$ 1,098	\$ 3,492

Plaintiffs in EIFS cases generally seek to have their homes repaired or the EIFS replaced, but a dollar amount for the cost of repair or replacement is not ordinarily specified in the complaint. Although complaints in EIFS cases usually do not contain a specific amount of damages claimed, a complaint may assert that damages exceed a specified amount in order to meet jurisdictional requirements of the court in which the case is filed. Therefore, the company does not believe it is meaningful to disclose the dollar amount of damages asserted in EIFS complaints.

Based on currently available information, management does not believe that the ultimate outcome of any pending legal proceedings and claims related to this product line, individually or in aggregate, will have a material adverse effect on the company's long-term financial condition. However, adverse developments could negatively impact the company's results of operations or cash flows in one or more future quarters. Given the numerous uncertainties surrounding litigation and the projection of future events, such as the number of new claims to be filed each year and the average cost of disposing of each such claim, the actual costs could be higher or lower than the current estimated reserves or insurance recoveries.

The company and/or its subsidiaries have been named as defendants in lawsuits in various courts in which plaintiffs have alleged injury due to products containing asbestos manufactured more than 20 years ago. The plaintiffs generally bring these lawsuits against multiple defendants and seek damages (both actual and punitive) in very large amounts. In many of these cases, the plaintiffs are unable to demonstrate that they have suffered any compensable injuries or that the injuries suffered were the result of exposure to products manufactured by the company or its subsidiaries. The company is typically dismissed as a defendant in these cases without payment. If the plaintiff establishes that compensable injury occurred as a result of exposure to the company's products, the case is generally settled for an amount that reflects the seriousness of the injury, the number and solvency of other defendants in the case, and the jurisdiction in which the case has been brought.

As a result of bankruptcy filings by numerous defendants in asbestos-related litigation and the prospect of national and state legislative reform relating to such litigation, the rate at which plaintiffs filed asbestos-related lawsuits against various companies (including the company) increased in 2001, 2002 and the first half of 2003. After the second half of 2003, the rate of these filings declined. However, the company currently expects that asbestos-related lawsuits will continue to be filed against the company in the future.

A significant portion of the defense costs and settlements relating to asbestos-related litigation involving the company continues to be paid by third parties, including indemnification pursuant to the provisions of a 1976 agreement under which the company acquired a business from a third party. Historically, this third party routinely defended all cases tendered to it and paid settlement amounts resulting from those cases. In the 1990s, the third party sporadically reserved its rights, but continued to defend and settle all asbestos-related claims tendered to it by the company. In 2002, the third party rejected the tender of certain cases by the company and indicated it would seek contributions from the company for past defense costs, settlements and judgments. However, this third party has continued to defend and pay settlement amounts, under a reservation of rights, in most of the asbestos cases tendered to the third party by the company.

In addition to the indemnification arrangements with third parties, the company has insurance policies that generally provide coverage for asbestos liabilities (including defense costs). Historically, insurers have paid a significant portion of the defense costs and settlements in asbestos-related litigation involving the company. However, certain of the company's insurers are insolvent. During 2005, the company and a number of its insurers entered into a cost-sharing agreement that provides for the allocation of defense costs, settlements and judgments among these insurers and the company in certain asbestos-related lawsuits. Under this agreement, the company is required to fund a share of settlements and judgments allocable to years in which the responsible insurer is insolvent. The cost-sharing agreement applies only to the asbestos litigation involving the company that is not covered by the third-party indemnification arrangements.

During the year ended December 2, 2006, the company settled five asbestos-related lawsuits, totaling \$613. The company's insurers have paid or are expected to pay \$415 of these settlement amounts. During the first six months of 2007 the company settled five asbestos-related lawsuits for \$404. The company's insurers have paid or are expected to pay \$291 of that amount.

The company does not believe that it would be meaningful to disclose the aggregate number of asbestos-related lawsuits filed against the company because relatively few of these lawsuits are known to involve exposure to asbestos-containing products made by the company. Rather, the company believes it is more meaningful to disclose the number of lawsuits that are settled.

To the extent the company can reasonably estimate the amount of its probable liability for pending asbestos-related claims, the company establishes a financial provision and a corresponding receivable for insurance recoveries if certain criteria are met. As of June 2, 2007, the company had recorded \$444 for probable liabilities and \$161 for insurance recoveries related to asbestos claims. However, the company has concluded that it is not possible to estimate the cost of disposing of other asbestos-related claims (including claims that might be filed in the future) due to its inability to project future events. Future variables include the number of new claims filed, the average cost of disposing of such claims, the uncertainty of asbestos litigation, insurance coverage and indemnification agreement issues, and the continuing solvency of certain insurance companies.

Because of the uncertainties described above, the company cannot accurately estimate the cost of resolving pending and future asbestos-related claims against the company. Based on currently available information, the company does not believe that asbestos-related litigation, individually or in aggregate, will have a material adverse effect on the company's long-term financial condition. However, adverse developments in such litigation could negatively impact the company's results of operations or cash flows in one or more future quarters.

In addition to product liability claims discussed above, the company is involved in other claims or legal proceedings related to its products, which it believes are not out of the ordinary in a business of the type and size in which it is engaged.

Note 10: Operating Segments

During the second quarter of 2007, the company completed the realignment of its management structure that was announced in the first quarter of 2007. The company's operations are now managed through the four primary geographic regions: North America, Europe, Latin America and Asia Pacific. Region Vice Presidents have been appointed that report directly to the Chief Executive Officer and are accountable for the financial results of the entire region.

The company conducted an operating segment assessment in the second quarter of 2007 in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" to determine its reportable segments for disclosure purposes. The conclusion of the assessment was that the reportable segments of the company are the four geographic regions. Therefore, the financial information disclosed in this section is now tailored to the four regions. Certain reclassifications to 2006 information, as previously reported, have been made to conform to the new segment structure. Refer to Exhibit 99 of this report for historical quarterly financial results of the new operating segments.

The conclusion of the SFAS 131 assessment that the four geographic regions are the company's reportable segments was reached because it clearly reflects the company's internal management and organizational structure. The Vice Presidents of each region are held accountable for, and are compensated based upon, the performance of the entire operating segment for which they are responsible. The business components within each operating segment are managed to maximize the results of the overall operating segment rather than the results of any individual business component of the operating segment. Results of individual components of each operating segment are subject to numerous allocations of segment-wide costs that may or may not have been focused on that particular component for a particular reporting period. The costs for these allocated resources are not tracked on a "where-used" basis as financial performance is assessed at the total operating segment level.

Management evaluates the performance of each of the company's operating segments based on operating income, which is defined as gross profit less SG&A expenses and excludes gains from sales of assets. Corporate expenses are fully allocated to each operating segment. Segment data for the quarter follows:

	13 Weeks Ended					
	Trade	June 2, 2007 Inter-Segment	Operating	Trade	June 3, 2006 Inter-Segment	Operating
	Revenue	Revenue	Income	Revenue	Revenue	Income
North America	\$ 192,303	\$ 6,756	\$ 24,689	\$ 209,768	\$ 5,228	\$ 21,101
Europe	103,998	1,725	10,080	83,692	1,736	5,995
Latin America	50,017	188	1,198	52,075	823	2,301
Asia Pacific	27,197	384	1,237	26,272	2,251	1,810
Total	\$ 373,515		\$ 37,204	\$ 371,807		\$ 31,207

	26 Weeks Ended					
	Trade	June 2, 2007 Inter-Segment	Operating	Trade	June 3, 2006 Inter-Segment	Operating
	Revenue	Revenue	Income	Revenue	Revenue	Income
North America	\$ 367,938	\$ 13,325	\$ 40,763	\$ 386,922	\$ 11,817	\$ 35,560
Europe	199,413	3,684	18,054	157,721	2,936	8,994
Latin America	104,933	440	4,445	108,148	1,225	4,457
Asia Pacific	52,986	603	2,612	52,026	5,685	3,049
Total	\$ 725,270		\$ 65,874	\$ 704,817		\$ 52,060

Reconciliation of Operating Income from Continuing Operations to Income from Continuing Operations before Income Taxes, Minority Interests and Income from Equity Investments:

	13 Weeks Ended		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Operating income from continuing operations	\$ 37,204	\$ 31,207	\$ 65,874	\$ 52,060
Gains from sales of assets	16	32	103	845
Other income (expense), net	1,282	(502)	2,657	(11)
Interest expense	(3,181)	(4,968)	(6,789)	(7,710)
Income from continuing operations before income taxes, minority interests, and income from equity investments	\$ 35,321	\$ 25,769	\$ 61,845	\$ 45,184

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**Overview**

The Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the MD&A included in the company's Annual Report on Form 10-K for the year ended December 2, 2006 for important background information related to the company's business.

The company had another strong quarter from a profitability and cash flow viewpoint. Some of the highlights compared to the second quarter of 2006 were:

Income from continuing operations increased 46.1 percent

Diluted earnings per share from continuing operations increased 41.9 percent

SG&A expenses as a percent of net revenue were 19.0 percent compared to 20.5 percent last year

Net working capital as a percentage of annualized net revenue decreased to 13.1 percent from 15.5 percent one year ago.

Net cash provided by operating activities from continuing operations increased over 35 percent

Economic slowdown continued in the second quarter, especially in the North American construction and automotive markets. This contributed to reduced sales volume in the quarter as compared to last year. Management continued to focus on the shift to more profitable product lines, which helped to maintain the gross profit margin at 29.0 percent.

A key initiative that was completed in the second quarter was the organizational realignment that was announced in the first quarter of this year. The company's operations are now managed through the four primary geographic regions: North America, Europe, Latin America and Asia Pacific. Further details on the new operating segments are provided in the Operating Segment section of this MD&A and in Note 10 of the Financial Statements. Certain historical quarterly financial results of the new segments have been provided in Exhibit 99 of this report.

Results of Operations**Net Revenue:**

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2,	June 3,	vs	June 2,	June 3,	vs
	2007	2006	2006	2007	2006	2006
Net revenue	\$ 373.5	\$ 371.8	0.5%	\$ 725.3	\$ 704.8	2.9%

Management reviews variances in net revenue in terms of changes related to product pricing, sales volume, acquisitions/divestitures and changes in foreign currency exchange rates. The following table shows the net revenue variance analysis for the second quarter and first six months of 2007 as compared to 2006:

() = Decrease	2007 vs 2006	
	13 Weeks Ended	26 Weeks Ended
	June 2, 2007	June 2, 2007
Product Pricing	2.5%	3.0%
Sales Volume	(8.9)%	(9.3)%
Acquisitions/Divestitures	4.5%	6.8%
Currency	2.4%	2.4%
Total	0.5%	2.9%

Reductions in sales volume were most prevalent in North America as slowdowns in the construction and automotive markets had negative impacts on the company's net revenue for both the second quarter and first six months of 2007 as compared to last year. Average selling prices continued to increase as compared to last year due to the continuing focus on more profitable product offerings. The second quarter net revenue increase from acquisitions/divestitures resulted primarily from the third quarter 2006 insulating glass acquisition in Europe. Smaller contributions to this variance resulted from the Roanoke and Carolina Polymers acquisitions. The Roanoke business is now part of the base business in North America as it has been more than one year since the acquisition occurred. The 2.4 percent increase in net revenue due to foreign currency fluctuations for both the second quarter and first six months of 2007 was primarily due to the strengthening of the euro as compared to the U.S. dollar.

Cost of Sales:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2,	June 3,	2007 vs	June 2,	June 3,	2007 vs
	2007	2006	2006	2007	2006	2006
Cost of sales	\$ 265.4	\$ 264.3	0.4%	\$ 514.8	\$ 503.2	2.3%
Percent of net revenue	71.0%	71.1%		71.0%	71.4%	

The raw material cost environment in the second quarter was largely the same as in the first quarter of 2007. Oil and natural gas prices remained at near historically high levels resulting in continuing upward pressure on the company's raw material costs. Although the overall raw material costs were relatively flat with the first quarter, the costs remained significantly higher than last year for both the second quarter and six months year-to-date. The cost of sales dollars in both the second quarter and first six months of 2007 were driven upward by the acquisitions made in 2006. For the second quarter of 2007 acquisition-related cost of sales were approximately \$14.0 million and for the first six months were approximately \$37.0 million. Foreign currency movements increased the second quarter and first six months cost of sales as compared to last year by approximately \$7.0 million and \$14.0 million, respectively. Cost of sales decreases resulted primarily from the lower sales volume of 8.9 percent and 9.3 percent in the second quarter and first six months of 2007, respectively as compared to the same periods of 2006. The company continued to realize reductions in cost of sales in its manufacturing facilities due to the productivity improvements gained from Lean Six SigmaSM projects.

Gross Profit Margin:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Gross profit	\$ 108.1	\$ 107.5	0.6%	\$ 210.4	\$ 201.6	4.4%
Percent of net revenue	29.0%	28.9%		29.0%	28.6%	

The second quarter and first six months of 2007 gross profit margin were both slightly higher than the same periods of 2006 as the favorable shift in product mix and productivity improvements continued to offset the effects of higher raw material costs.

Selling, General and Administrative (SG&A) Expenses:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
SG&A	\$ 70.9	\$ 76.3	(7.0)%	\$ 144.6	\$ 149.5	(3.3)%
Percent of net revenue	19.0%	20.5%		19.9%	21.2%	

The 7.0 percent reduction in SG&A expenses in the second quarter of 2007 was realized primarily through lower employee-related expenses due to reduced headcount, lower legal costs related to product liability issues, productivity gains from Lean Six SigmaSM projects and strict cost controls throughout the organization. These expense reductions more than offset expense increases related to last year's acquisitions and the effects of stronger foreign currencies. For the first six months of 2007, acquisitions accounted for approximately \$10 million in increased SG&A expenses as compared to the first six months of 2006. This increase was more than offset by the reductions in employee-related expenses, lower legal costs and strict cost controls.

Gains from Sales of Assets:

(In millions)	13 Weeks Ended		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Gains from sales of assets	\$	\$	\$ 0.1	\$ 0.8

There were no significant asset sales in the first six months of 2007. The most significant transaction impacting gains from sales of assets in 2006 was the sale of a minor adhesives product line in North America and associated assets that resulted in a gain of \$0.6 million in the first quarter of 2006.

Other Income/(expense), net:

(In millions)	13 Weeks Ended		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Other income (expense), net	\$ 1.3	\$ (0.5)	\$ 2.7	\$

Interest income of \$1.5 million in the second quarter of 2007 as compared to \$0.8 million last year was the primary reason for the improvement in Other income/(expense), net. For the first six months of 2007 the interest income was \$3.1 million compared to \$1.8 million in the first half of 2006. The increase in interest income was a direct result of the higher average cash balance resulting from strong cash flow generation and the cash proceeds from the divestiture of the powder coatings business in the fourth quarter of 2006. Currency transaction and remeasurement losses were \$0.4 million in the second quarter and \$0.5 million for the first half of 2007 as compared to \$0.8 million and \$1.2 million for the same periods of 2006, respectively.

Interest Expense:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Interest expense	\$ 3.2	\$ 5.0	(36.0)%	\$ 6.8	\$ 7.7	(11.9)%

The decrease in interest expense in both the second quarter and first half of 2007 as compared to last year was attributed to the lower average debt levels in 2007. Strong cash flow generation allowed for the company to reduce total debt levels by \$146.5 million since the end of the second quarter of 2006.

Income Taxes:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Income taxes	\$ 10.2	\$ 7.6	34.5%	\$ 17.9	\$ 13.4	33.7%
Effective tax rate	29.0%	29.6%		29.0%	29.7%	

The reduction in the 2007 rate as compared to 2006 was primarily due to a favorable geographic shift of pretax earnings generation. The most significant shift was the increase in pretax earnings coming from the company's operations outside of North America.

Minority Interests in Income of Subsidiaries:

(In millions)	13 Weeks Ended		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Minority interests in income of subsidiaries	\$ (0.1)	\$ (0.5)	\$ (0.1)	\$ (0.7)

The lower minority interest expense in 2007 as compared to 2006 was due primarily to lower pretax earnings generation from the company's North American automotive venture of which it owns 70 percent.

Income from Equity Investments:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Income from equity investments	\$ 2.3	\$ 1.0	125.0%	\$ 4.3	\$ 2.1	102.3%

The improvement in the second quarter of 2007 was due to the increase in earnings from the company's 30 percent-owned international automotive joint venture and the company's 40 percent ownership of the Sekisui-Fuller joint venture in Japan. Through six months of 2007 the automotive joint venture has generated an increase of \$1.3 million while the Japan joint venture has had a positive impact of \$0.8 million.

Income from Continuing Operations:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Income from continuing operations	\$ 27.3	\$ 18.7	46.1%	\$ 48.1	\$ 33.2	45.1%
Percent of Net Revenue	7.3%	5.0%		6.6%	4.7%	

The company's product repositioning strategy and SG&A expense reductions were the primary reasons for the improved income from continuing operations in both the second quarter and first six months of 2007 as compared to last year. The diluted earnings per share from continuing

Edgar Filing: FULLER H B CO - Form 10-Q

operations of \$0.44 and \$0.78 for the 13 and 26 weeks ended June 2, 2007, respectively, compared to \$0.31 and \$0.56 for the 13 and 26 weeks ended June 3, 2006, respectively.

Income from Discontinued Operations:

(In millions)	13 Weeks Ended		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Income from discontinued operations	\$	\$ 0.9	\$	\$ 1.7

The income from discontinued operations of \$0.9 million and \$1.7 million for the 13 and 26 weeks ended June 3, 2006, respectively, represents net income generated by the powder coatings business, net of tax, which was divested on December 1, 2006.

Net Income:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Net Income	\$ 27.3	\$ 19.5	39.5%	\$ 48.1	\$ 34.8	38.1%
Percent of Net Revenue	7.3%	5.3%		6.6%	4.9%	

The diluted earnings per share were \$0.44 and \$0.32 for the 13 weeks ended June 2, 2007 and June 3, 2006, respectively, and \$0.78 and \$0.58 for the 26 weeks ended June 2, 2007 and June 3, 2006, respectively.

Operating Segment Results

During the second quarter of 2007, the company completed the realignment of its management structure that was announced in the first quarter of 2007. The company's operations are now managed through the four primary geographic regions: North America, Europe, Latin America and Asia Pacific. Region Vice Presidents have been appointed that report directly to the Chief Executive Officer (CEO) and are accountable for the financial results of their entire region. Two new executive positions were also created within the management structure: Vice President - Chief Marketing Officer and Vice President - Chief Strategy Officer. These positions also report directly to the CEO. These two positions are expected to facilitate the regional execution of corporate strategies. Reasons for realigning to the regional structure are to improve the speed of execution on strategic initiatives, to share best practices across businesses and to focus more closely on the customer.

The company conducted an operating segment assessment in the second quarter of 2007 in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" to determine its reportable segments for disclosure purposes. The conclusion of the assessment was that the reportable segments of the company are the four geographic regions. Therefore, the financial information disclosed in this section is now tailored to the four regions with relevant financial information provided for the business components of each of the operating segments. Certain reclassifications to 2006 information, as previously reported, have been made to conform to the new segment structure. Refer to Exhibit 99 of this report for historical quarterly financial results of the new segments.

The conclusion of the SFAS 131 assessment that the four geographic regions are the company's reportable segments was reached because it clearly reflects the company's internal management and organizational structure. The Vice Presidents of each region are held accountable for, and are compensated based upon, the performance of the entire segment for which they are responsible. The business components within each segment are managed to maximize the results of the overall segment rather than the results of any individual business component of the segment. Results of individual components of each operating segment are subject to numerous allocations of segment-wide costs that may or may not have been focused on that particular component for a particular reporting period. The costs for these allocated resources are not tracked on a where-used basis as financial performance is assessed at the total operating segment level.

Net Revenue by segment:

(In millions)	13 Weeks Ended				26 Weeks Ended			
	June 2, 2007		June 3, 2006		June 2, 2007		June 3, 2006	
	Net Revenue	% of Total	Net Revenue	% of Total	Net Revenue	% of Total	Net Revenue	% of Total
North America	\$ 192.3	51%	\$ 209.8	56%	\$ 367.9	51%	\$ 387.0	55%
Europe	104.0	28%	83.7	23%	199.4	27%	157.7	22%
Latin America	50.0	13%	52.1	14%	105.0	14%	108.1	15%
Asia Pacific	27.2	7%	26.2	7%	53.0	7%	52.0	7%
Total	\$ 373.5	100%	\$ 371.8	100%	\$ 725.3	100%	\$ 704.8	100%

Operating Income by segment:

(In millions)	13 Weeks Ended				26 Weeks Ended			
	June 2, 2007		June 3, 2006		June 2, 2007		June 3, 2006	
	Operating Income	% of Total	Operating Income	% of Total	Operating Income	% of Total	Operating Income	% of Total
North America	\$ 24.7	66%	\$ 21.1	68%	\$ 40.8	62%	\$ 35.6	68%
Europe	10.1	27%	6.0	19%	18.1	27%	9.0	17%
Latin America	1.2	3%	2.3	7%	4.4	7%	4.5	9%
Asia Pacific	1.2	3%	1.8	6%	2.6	4%	3.0	6%
Total	\$ 37.2	100%	\$ 31.2	100%	\$ 65.9	100%	\$ 52.1	100%

The following table provides a reconciliation of operating income from continuing operations to income from continuing operations before income taxes, minority interests and income from equity investments, as reported on the Consolidated Statements of Income.

(In millions)	13 Weeks Ended		26 Weeks Ended	
	June 2, 2007	June 3, 2006	June 2, 2007	June 3, 2006
Operating income from continuing operations	\$ 37.2	\$ 31.2	\$ 65.9	\$ 52.1
Gains from sales of assets			0.1	0.8
Other income (expense), net	1.3	(0.5)	2.6	
Interest expense	(3.2)	(5.0)	(6.8)	(7.7)
Income from continuing operations before income taxes, minority interests, and income from equity investments	\$ 35.3	\$ 25.8	\$ 61.8	\$ 45.2

North America:

The following table shows the net revenue generated from the key components of the North America segment.

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 95.7	\$ 100.2	(4.4)%	\$ 184.6	\$ 198.3	(6.9)%
Automotive	19.8	24.5	(19.2)%	38.2	47.1	(18.9)%
Packaging Solutions	14.2	13.1	8.8%	25.4	24.4	4.1%
Specialty Construction	46.5	53.9	(13.8)%	91.3	85.0	7.4%
Insulating Glass	16.1	18.1	(11.2)%	28.4	32.1	(11.4)%

Edgar Filing: FULLER H B CO - Form 10-Q

Total North America	\$ 192.3	\$ 209.8	(8.3%)	\$ 367.9	\$ 387.0	(4.9)%
---------------------	----------	----------	--------	----------	----------	--------

Edgar Filing: FULLER H B CO - Form 10-Q

The following tables provide details of North America net revenue variances by segment component. The Pricing/Sales Volume variance is viewed as organic growth.

	13 weeks ended June 2, 2007 vs 13 weeks ended June 3, 2006					Total
	Adhesives	Automotive	Packaging Solutions	Specialty Construction	Insulating Glass	
() = Decrease						
Pricing/Sales Volume	(6.6)%	(19.2)%	9.0%	(18.3)%	(11.2)%	(10.5)%
Acquisitions/Divestitures	2.3%			4.5%		2.3%
Currency	(0.1)%		(0.2)%			(0.1)%
Total	(4.4)%	(19.2)%	8.8%	(13.8)%	(11.2)%	(8.3)%

	26 weeks ended June 2, 2007 vs 26 weeks ended June 3, 2006					Total
	Adhesives	Automotive	Packaging Solutions	Specialty Construction	Insulating Glass	
() = Decrease						
Pricing/Sales Volume	(9.0)%	(18.9)%	4.2%	(16.6)%	(11.4)%	(11.2)%
Acquisitions/Divestitures	2.2%			24.0%		6.4%
Currency	(0.1)%		(0.1)%			(0.1)%
Total	(6.9)%	(18.9)%	4.1%	7.4%	(11.4)%	(4.9)%

The following table reflects the operating income by component of the North America operating segment:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 14.2	\$ 13.7	4.1%	\$ 25.9	\$ 24.2	7.1%
Automotive	(0.7)	(0.2)	NMP	(1.5)	(1.2)	(25.0)%
Packaging Solutions	4.4	4.0	10.5%	7.6	7.0	8.0%
Specialty Construction	4.6	1.2	276.7%	6.0	1.6	280.8%
Insulating Glass	2.2	2.4	(10.8)%	2.8	4.0	(30.6)%
Total North America	\$ 24.7	\$ 21.1	17.0%	\$ 40.8	\$ 35.6	14.6%

NMP = Non-meaningful percentage

Note: Individual component results are subject to numerous allocations of segment-wide costs that may or may not have been focused on that particular component for a particular reporting period. The costs of these allocated resources are not tracked on a where-used basis as financial performance is managed to maximize the total operating segment performance. Therefore the above financial information should only be used for directional indications of performance

Total North America

The North America operating segment consists of the adhesives and automotive business that were previously reported under the Global Adhesives operating segment and the packaging solutions, specialty construction and insulating glass components that were previously reported in the Full-Valu/Specialty operating segment. The slowdown in the North American construction and automotive industries had a significant negative impact on the net revenue for both the second quarter and first six months of 2007 as compared to 2006. Approximately 50 percent of the segment's net revenue is tied to these two major industries. With strict cost controls and a favorable shift in product mix, the North America operating segment was able to improve operating income 17.0 percent for the quarter and 14.6 percent for the first six months of 2007 as compared to 2006.

Adhesives: Net revenue in the Adhesives component decreased 4.4 percent in the second quarter as compared to last year. Product pricing increased net revenue 3.5 percent while sales volume declined over 10 percent. The positive price variance was due primarily to selling price

Edgar Filing: FULLER H B CO - Form 10-Q

increases implemented during the third and fourth quarters of 2006 in response to rising raw material prices. The economic slowdown, especially in the construction-related markets, had a significant impact on the reduction in the adhesives sales volume. Stable raw material prices during the first

half of 2007 combined with disciplined selling price management resulted in an increase in the gross profit margin for both the second quarter and first six months of 2007. The improved gross margin partially mitigated the negative impact from reduced sales volume. The operating income margin was 14.8 percent in the second quarter of 2007 and 13.6 percent in the second quarter of 2006. For the first six months the operating margin was 14.0 percent and 12.2 percent in 2007 and 2006, respectively.

Automotive: In automotive, net revenue decreased 19.2 percent and 18.9 percent, respectively in the second quarter and first six months of 2007 as compared to the same periods of 2006. Reduced U.S. car and truck production combined with extended production shutdowns at some automakers were the primary contributors to the reduction in net revenue. Operating income declined in the second quarter and first half of 2007 as compared to last year as cost savings realized from 2006 initiatives were not enough to offset the overall reduction in net revenue.

Packaging Solutions: The packaging solutions component realized organic growth for the second quarter and first six months of 2007 of 9.0 percent and 4.2 percent, respectively. The higher sales volume combined with stable raw material prices resulted in increased operating income of 10.5 percent and 8.0 percent, respectively for the second quarter and first six months of 2007 as compared to last year.

Specialty Construction: Sales volume declined over 22 percent in the second quarter and nearly 21 percent in the first six months of 2007 due primarily to the slowdown in the North American construction and housing industries, the discontinuation of certain product lines from the Roanoke acquisition and repositioning of product lines to focus on more value-added solutions for customers. The gross profit margin increased in 2007 as compared to last year as last year's second quarter cost of sales included \$1.4 million of inventory step-up costs from the Roanoke acquisition. SG&A expenses were also lower in the second quarter and first six months of 2007 due primarily to a reduction in legal costs related to EIFS product liability matters. In the second quarter of 2006 the company incurred \$2.6 million of expense to settle numerous EIFS cases. These settlements, combined with an overall reduction in EIFS-related matters have significantly reduced legal expenses in 2007 as compared to last year. In the first quarter of 2007 the SG&A expense included \$1.7 million of accelerated amortization expense on a particular trade name that was discontinued. The resulting operating income for specialty construction increased nearly 300 percent in both the second quarter and first six months of 2007 as compared to last year.

Insulating Glass: Sales volume decreased 17.5 percent in the second quarter of 2007 as compared to last year a direct result of the slowdown in the North American housing industry. The reduced sales volume was the overriding issue for this business component and was the primary reason for the operating income decrease of 10.8 percent for the second quarter and 30.6 percent for the first six months of 2007 as compared to last year.

Europe:

The following table shows the net revenue generated from the key components of the Europe segment.

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 91.8	\$ 83.7	9.7%	\$ 176.0	\$ 157.7	11.6%
Insulating Glass	12.2		NMP	23.4		NMP
Total Europe	\$ 104.0	\$ 83.7	24.3%	\$ 199.4	\$ 157.7	26.4%

NMP = Non-meaningful percentage

Edgar Filing: FULLER H B CO - Form 10-Q

The following table provides details of Europe net revenue variances by segment component. The Pricing/Sales Volume variance is viewed as organic growth.

	13 weeks ended June 2, 2007			26 weeks ended June 2, 2007		
	vs June 3, 2006			vs June 3, 2006		
	Adhesives	Insulating Glass	Total	Adhesives	Insulating Glass	Total
() = Decrease						
Pricing/Sales Volume	0.6%		0.6%	2.2%		2.2%
Acquisitions/Divestitures		100.0%	14.6%		100.0%	14.8%
Currency	9.1%		9.1%	9.4%		9.4%
Total	9.7%	100.0%	24.3%	11.6%	100.0%	26.4%

The following table reflects the operating income by component of the Europe operating segment:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 10.3	\$ 6.0	70.7%	\$ 17.7	\$ 9.0	96.3%
Insulating Glass	(0.2)		NMP	0.4		NMP
Total Europe	\$ 10.1	\$ 6.0	68.1%	\$ 18.1	\$ 9.0	100.7%

NMP = Non-meaningful percentage

Note: Individual component results are subject to numerous allocations of segment-wide costs that may or may not have been focused on that particular component for a particular reporting period. The costs of these allocated resources are not tracked on a where-used basis as financial performance is managed to maximize the total operating segment performance. Therefore the above financial information should only be used for directional indications of performance

Total Europe:

The Europe operating segment includes the adhesives business that was previously reported in the Global Adhesives segment as well as the insulating glass business that was acquired in the third quarter of 2006 and was previously reported in the Full-Valu/Specialty segment. For the second quarter of 2007 the segment increased net revenue by 24.3 percent over last year with acquisitions and currency effects contributing 14.6 percent and 9.1 percent, respectively. Organic growth was a positive 0.6 percent in the quarter. The net revenue results for the first six months were similar with an increase over last year of 26.4 percent with acquisitions, currency and organic growth contributing 14.8 percent, 9.4 percent and 2.2 percent, respectively. The increased operating income in 2007 over 2006 resulted from the increased revenue combined with efficiencies gained from Lean Six SigmaSM projects implemented in 2006.

Adhesives: The increase in net revenue was driven primarily by the effects of the strengthening of the euro as compared to last year. The net effect of sales volume and product pricing was slightly positive at 0.6 percent. The improvement in operating income for both the second quarter and first six months of 2007 was mainly due to reduced costs in both cost of sales and SG&A expense resulting from cost-reduction projects that were completed in 2006.

Insulating Glass: The second quarter of 2007 is the last full quarter in which the Europe insulating glass business will be considered in acquisitions in the year-over-year comparisons. The acquisition closed in the first week of the third quarter in 2006. Net revenue was lower than management's expectations in the second quarter as lower-priced competition has taken away some market share. Operating income was also below expectations, partially due to reduced sales volume and also due to inventory writeoffs, an increase in bad debt expense and other costs that are expected to be reduced beginning in the third quarter. Management's expectation is that significant synergies will result as the insulating glass component is managed under the same management team as the adhesives component.

Latin America:

The following table shows the net revenue generated from the key components of the Latin America segment.

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 26.8	\$ 28.5	(6.2)%	\$ 54.8	\$ 57.6	(5.0)%
Paints	23.2	23.5	(1.2)%	50.1	50.5	(0.7)%
Total Latin America	\$ 50.0	\$ 52.1	(4.0)%	\$ 104.9	\$ 108.1	(3.0)%

The following table provides details of Latin America net revenue variances by segment component. The Pricing/Sales Volume variance is viewed as organic growth.

	13 weeks ended June 2, 2007			26 weeks ended June 2, 2007		
	vs June 3, 2006			vs June 3, 2006		
() = Decrease	Adhesives	Paints	Total	Adhesives	Paints	Total
Pricing/Sales Volume	(6.2)%	(1.2)%	(4.0)%	(5.0)%	(0.7)%	(3.0)%
Acquisitions/Divestitures						
Currency						
Total	(6.2)%	(1.2)%	(4.0)%	(5.0)%	(0.7)%	(3.0)%

The following table reflects the operating income by component of the Latin America operating segment:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 0.9	\$ 1.9	(50.8)%	\$ 2.4	\$ 2.9	(17.5)%
Paints	0.3	0.4	(36.1)%	2.1	1.6	30.9%
Total Latin America	\$ 1.2	\$ 2.3	(47.9)%	\$ 4.4	\$ 4.5	(0.3)%

Note: Individual component results are subject to numerous allocations of segment-wide costs that may or may not have been focused on that particular component for a particular reporting period. The costs of these allocated resources are not tracked on a where-used basis as financial performance is managed to maximize the total operating segment performance. Therefore the above financial information should only be used for directional indications of performance

Total Latin America: The Latin America operating segment includes the adhesives business that was previously reported in the Global Adhesives segment and the Paints business that was reported under the Full-Valu/Specialty segment. During the second quarter of 2007 net revenue of \$50.0 million was 4.0 percent less than the second quarter of 2006. The operating income for the region was down \$1.1 million or 47.9 percent as compared to last year primarily due to a \$1.1 million charge related to a cost reduction initiative in the Paints component. The majority of the charge relates to employee separation costs in both the manufacturing and SG&A expenses. Benefits from the initiative will begin to be realized in the third quarter of 2007. Through six months of 2007, the operating income is slightly below last year with the adhesives business lower than last year and the paints component exceeding last year.

Adhesives: Sales volume decreases of nearly 12 percent were partially offset by increases in average selling prices of approximately 6 percent. The operating income decrease in the second quarter as compared to last year was due primarily to the decrease in volume as well as a \$0.2 million charge related to the environmental remediation project in Brazil. SG&A expenses were well controlled as the impact of 2006 Lean Six SigmaSM projects had positive

effects on the 2007 results. The explanation is similar for the decrease in operating income for the first six months of 2007 as compared to last year. Decreases in sales volume were partially offset by product pricing and costs were decreased as a result of the 2006 projects.

Paints: The decrease in net revenue for the quarter was primarily due to management's decision to focus on more profitable product lines. There are several low-price competitors in the Latin America market. The cost reduction initiative referred to above resulted in a charge of \$0.5 million in cost of sales and \$0.6 million in SG&A expenses during the second quarter. Excluding this one-time charge, the gross margin was above last year due to the shift to the more profitable product lines. The favorable product shift also impacted the results for the first six months of 2007 as operating income is up over 30 percent from last year even with the \$1.1 million charge discussed above.

Asia Pacific:

The following table shows the net revenue generated from the key components of the Asia Pacific segment.

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 21.2	\$ 20.4	4.0%	\$ 41.0	\$ 40.8	0.5%
Consumer	6.0	5.9	1.7%	12.0	11.3	6.7%
Total Asia Pacific	\$ 27.2	\$ 26.3	3.5%	\$ 53.0	\$ 52.0	1.8%

The following table provides details of Asia Pacific net revenue variances by segment component. The Pricing/Sales Volume variance is viewed as organic growth.

	13 weeks ended June 2, 2007			26 weeks ended June 2, 2007		
	vs June 3, 2006			vs June 3, 2006		
	Adhesives	Consumer	Total	Adhesives	Consumer	Total
() = Decrease						
Pricing/Sales Volume	(0.7)%	(5.7)%	(1.8)%	(3.9)%	1.0%	(2.8)%
Acquisitions/Divestitures						
Currency	4.7%	7.4%	5.3%	4.4%	5.7%	4.6%
Total	4.0%	1.7%	3.5%	0.5%	6.7%	1.8%

The following table reflects the operating income by component of the Asia Pacific operating segment:

(In millions)	13 Weeks Ended			26 Weeks Ended		
	June 2, 2007	June 3, 2006	2007 vs 2006	June 2, 2007	June 3, 2006	2007 vs 2006
Adhesives	\$ 1.3	\$ 1.7	(26.1)%	\$ 2.6	\$ 2.9	(12.2)%
Consumer	(0.1)	0.1	NMP		0.1	NMP
Total Asia Pacific	\$ 1.2	\$ 1.8	(31.7)%	\$ 2.6	\$ 3.0	(14.3)%

NMP = Non-meaningful percentage

Note: Individual component results are subject to numerous allocations of segment-wide costs that may or may not have been focused on that particular component for a particular reporting period. The costs of these allocated resources are not tracked on a where-used basis as financial performance is managed to maximize the total operating segment performance. Therefore the above financial information should only be used for directional indications of performance

Total Asia Pacific: The Asia Pacific operating segment includes the adhesives business that was previously reported in the Global Adhesives segment and the Consumer business that was reported under the Full-Valu/Specialty segment. Net revenue was up during the quarter from last year due to stronger foreign currencies. The Australian dollar has the largest impact from a currency standpoint. Organic sales were down 1.8 percent in the quarter and 2.8 percent for the first six months of 2007. The operating income decrease in the second quarter as compared to last year was largely due to additional expenses incurred in China related to the new management team being formed for the organizational realignment.

Adhesives: The net revenue increase in the adhesives component was due to currency effects. Organic growth was a negative 0.7 percent with sales volume down 2.1 percent and average selling prices increasing 1.4 percent. On a sequential basis, the sales volume decline was significantly less than the decline in the first quarter of 2007. The reduction in volume combined with expenses associated with the startup of the new organization structure were the primary reasons for lower operating income in the second quarter as compared to 2006. For the first six months the reason for the reduced operating income was primarily the lower sales volume.

Consumer: The Consumer component operated at approximately breakeven for the second quarter and first six months of both 2006 and 2007. The positive impact from the stronger foreign currencies was offset by the second quarter reduction in sales volume. The gross margin was lower in the second quarter of 2007 as compared to last year partially due to approximately \$0.1 million of increased reserves for obsolete inventory.

Liquidity and Capital Resources

Total cash and cash equivalents as of June 2, 2007 were \$201.0 million as compared to \$255.4 million as of December 2, 2006. Total long and short-term debt was \$171.7 million as of June 2, 2007 and \$258.8 million as of December 2, 2006. The primary reasons for the decline in cash on hand and total debt outstanding were payments of \$62.0 million in the first quarter of 2007 to pay-off the line of credit and \$25 million in the second quarter of 2007 to pay the annual installment related to the company's senior long-term debt. Management believes that cash flows from operating activities will be adequate to meet the company's ongoing liquidity and capital expenditure needs. In addition, the company has sufficient access to capital markets to meet current expectations for acquisition funding requirements.

At June 2, 2007, the company was in compliance with all covenants of its contractual obligations. There are no rating triggers that would accelerate the maturity dates of any debt. Management believes the company has the ability to meet all of its contractual obligations and commitments in fiscal 2007.

Management anticipates that cash flows from operating activities will be positive in the third quarter and there will be sufficient cash to fund all third quarter cash requirements without the utilization of the line of credit.

The company is considering its option to purchase an additional 10 percent ownership interest in the Sekisui-Fuller Japan joint venture from Sekisui Chemical Co., Ltd for \$12 million. The option has vested and is exercisable through September 30, 2007.

Selected Metrics of Liquidity

Key metrics monitored by management are net working capital as a percent of annualized net revenue, trade account receivable days sales outstanding (DSO), inventory days on hand, free cash flow and debt capitalization ratio.

	As of	As of
	June 2, 2007	June 3, 2006
Net working capital as a percentage of annualized net revenue ¹	13.1%	15.5%
Accounts receivable DSO ²	52 Days	55 Days
Inventory days on hand ³	49 Days ⁶	52 Days ⁶
Year to date free cash flow ⁴	\$ 40.8 million	\$ 38.4 million
Debt capitalization ratio ⁵	16.9%	34.1%

¹ Current quarter net working capital (trade receivables, net of allowance for doubtful accounts plus inventory minus trade payables) divided by annualized net revenue (current quarter multiplied by four).

² (Accounts receivable less the allowance for doubtful accounts at the balance sheet date) multiplied by 90 and divided by the net revenue for the quarter.

³ Average inventory over last five quarters multiplied by 360 and divided by cost of sales for prior 12 months.

⁴ Net cash provided by operations from continuing operations, less purchased property, plant and equipment and dividends paid.

⁵ Total debt divided by total debt plus total stockholders' equity.

⁶ Due to the significant impact of the 2006 acquisitions on the 2006 and 2007 metric calculations, the company adjusted the pre-acquisition balances in the calculation as if the acquisitions had occurred on the earliest date in the calculation.

The 2007 result was driven by a company-wide focus on working capital management as both accounts receivable days sales outstanding and inventory days on hand were reduced in 2007 as compared to 2006.

Summary of Cash Flows**Cash flows from Operating Activities from Continuing Operations:**

(In millions)	26 Weeks Ended	
	June 2, 2007	June 3, 2006
Net cash provided by operating activities from continuing operations	\$ 59.7	\$ 53.9

Net income plus depreciation and amortization expense totaled \$74.7 million for the first six months of 2007 as compared to \$55.7 million for the first six months of 2006. Changes in net working capital accounted for a source of cash of \$0.5 million and \$17.2 million for the first six months of 2007 and 2006, respectively. Changes in trade accounts payable accounted for a \$19.7 million use of cash in 2007 as compared to a \$7.8 million use of cash in the first six months of 2006. Cash used for payouts of accrued compensation were \$3.4 million more than in 2006 due to the increase in employee incentive payouts in the first quarter of 2007 related to the company's financial results of 2006.

Cash flows from Investing Activities from Continuing Operations:

(In millions)	26 Weeks Ended	
	June 2, 2007	June 3, 2006
Net cash used in investing activities from continuing operations	\$ (10.4)	\$ (280.6)

Purchases of property plant and equipment were \$ 11.1 million in the first six months of 2007 as compared to \$8.2 million in the first six months of 2006. The majority of the capital expenditures in the last two years relate to information technology and process improvement projects. The company does not anticipate significant repair and maintenance activities on existing property, plant and equipment as a result of current or past capital spending policies. The company also received \$2.4 million in the first quarter of 2006 from the sale of an adhesives product line in North America

Cash flows from Financing Activities from Continuing Operations:

(In millions)	26 Weeks Ended	
	June 2, 2007	June 3, 2006
Net cash provided by (used in) financing activities from continuing operations	\$ (81.6)	\$ 183.4

The cash used in financing from continuing operations in the first half 2007 was mainly due to the \$62 million pay-off of the company's line of credit and the \$25 million annual payment on the company's long-term debt. Last year's cash provided by financing from continuing operations was mainly due to the \$195 million of new debt that was secured to finance the Roanoke acquisition. Cash generated from the exercise of stock options was \$11.3 million in the first half 2007, compared to \$14.5 million in the first half 2006. Cash dividends paid on common stock were \$7.7 million and \$7.3 million in the first six months of 2007 and 2006, respectively.

Cash Flows from Discontinued Operations:

(In millions)	26 Weeks Ended	
	June 2, 2007	June 3, 2006
Cash provided by (used in) operating activities of discontinued operations	\$ (24.6)	\$ 1.4

Cash used in operating activities of discontinued operations represents the cash used in the operations of the powder coatings business. Cash used in the operating activities of discontinued operations in the first six months of 2007 is primarily comprised of income tax payments made in conjunction with the gain on disposal of discontinued operations and closing costs payments made associated with selling the business. The related costs were recorded in the fourth quarter of 2006.

Forward-Looking Statements and Risk Factors

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In this Quarterly Report on Form 10-Q, the company discusses expectations regarding future performance of the company which include anticipated financial performance, savings from restructuring and process initiatives, global economic conditions, liquidity requirements, the impact of litigation and environmental matters, the effect of new accounting pronouncements and one-time accounting charges and credits, and similar matters. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may be identified by the use of words like plan, expect, aim, believe, project, anticipate, intend, estimate, will, show (including the negative or variations thereof) and other expressions that indicate future events and trends. These plans and expectations are based upon certain underlying assumptions, including those mentioned with the specific statements. Such assumptions are in turn based upon

internal estimates and analyses of current market conditions and trends, management plans and strategies, economic conditions and other factors. These plans and expectations and the assumptions underlying them are necessarily subject to risks and uncertainties inherent in projecting future conditions and results. Actual results could differ materially from expectations expressed in the forward-looking statements if one or more of the underlying assumptions and expectations proves to be inaccurate or is unrealized. In addition to the factors described in this report, Part II, Item 1A. Risk Factors in this report and Part I, Item 1A. Risk Factors in the company's Annual Report on Form 10-K for the fiscal year ended December 2, 2006, identify some of the important factors that could cause the company's actual results to differ materially from those in any such forward-looking statements. This list of important factors does not include all such factors nor necessarily present them in order of importance. In order to comply with the terms of the safe harbor, the company has identified these important factors which could affect the company's financial performance and could cause the company's actual results for future periods to differ materially from the anticipated results or other expectations expressed in the forward-looking statements. Additionally, the variety of products sold by the company and the regions where the company does business makes it difficult to determine with certainty the increases or decreases in revenues resulting from changes in the volume of products sold, currency impact, changes in geographic and product mix and selling prices. However, management's best estimates of these changes as well as changes in other factors have been included. References to volume changes include volume, product mix and delivery charges, combined. These factors should be considered, together with any similar risk factors or other cautionary language, which may be made elsewhere in this Quarterly Report on Form 10-Q.

The company may refer to Part II, Item 1A. Risk Factors and this section of the Form 10-Q to identify risk factors related to other forward looking statements made in oral presentations, including investor conferences and/or webcasts open to the public.

This disclosure, including that under Forward-Looking Statements and Risk Factors, and other forward-looking statements and related disclosures made by the company in this report and elsewhere from time to time, represents management's best judgment as of the date the information is given. The company does not undertake responsibility for updating any of such information, whether as a result of new information, future events, or otherwise, except as required by law. Investors are advised, however, to consult any further public company disclosures (such as in filings with the Securities and Exchange Commission or in company press releases) on related subjects.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk: The company is exposed to various market risks, including changes in interest rates, foreign currency rates and prices of raw materials. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates.

Interest Rate Risk: Exposure to changes in interest rates result primarily from borrowing activities used to fund operations. Committed floating rate credit facilities are used to fund a portion of operations.

Management believes that probable near-term changes in interest rates would not materially affect financial condition, results of operations or cash flows. The annual impact on the results of operations of a one-percentage point interest rate change on the outstanding balance of its variable rate debt as of June 2, 2007 would be approximately \$ 0.8 million.

Foreign Exchange Risk: As a result of being a global enterprise, there is exposure to market risks from changes in foreign currency exchange rates, which may adversely affect operating results and financial condition. Approximately 53 percent of net revenue was generated outside of the United States in the first six months of 2007. Principal foreign currency exposures relate to the euro, British pound sterling, Japanese yen, Australian dollar, Canadian dollar, Argentine peso, Brazilian real, Colombian peso and Chinese renminbi.

Management's objective is to balance, where possible, local currency denominated assets to local currency denominated liabilities to have a natural hedge and minimize foreign exchange impacts. The company enters into cross border transactions through importing and exporting goods to and from different countries and locations. These transactions generate foreign exchange risk as they create assets, liabilities and cash flows in currencies other than the local currency. This also applies to services provided and other cross border agreements among subsidiaries.

Management takes steps to minimize risks from foreign currency exchange rate fluctuations through normal operating and financing activities and, when deemed appropriate, through the use of derivative instruments. Management does not enter into any speculative positions with regard to derivative instruments.

From a sensitivity analysis viewpoint, based on the financial results of the first six months of 2007, a hypothetical overall 10 percent change in the U.S. dollar would have resulted in a change in net income of approximately \$2.4 million.

Raw Materials: The principal raw materials used to manufacture products include resins, polymers, synthetic rubbers, vinyl acetate monomer and plasticizers. The company generally avoids sole source supplier arrangements for raw materials. While alternate supplies of most key raw materials are available, sustained strong economical growth in North America and China coupled with unplanned supplier production outages have led to strained supply-demand situations for several key derivatives (such as ethylene and propylene), some of their derivatives, several polymers and other petroleum derivatives such as waxes.

Management's objective is to purchase raw materials that meet both its quality standards and production needs at the lowest total cost. Most raw materials are purchased on the open market or under contracts that limit the frequency but not the magnitude of price increases. In some cases, however, the risk of raw material price changes is managed by strategic sourcing agreements which limit price increases to increases in supplier feedstock costs, while requiring decreases as feedstock costs decline. The leverage of having substitute raw materials approved for use wherever possible is used to minimize the impact of possible price increases.

Item 4. Controls and Procedures

(a) Controls and procedures

As of the end of the period covered by this report, the company conducted an evaluation, under the supervision and with the participation of the company's chief executive officer and interim chief financial officer, of the company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based on this evaluation, the chief executive officer and interim chief financial officer concluded that, as of June 2, 2007, the company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and to ensure that information required to be disclosed by the company in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Change in internal control over financial reporting

There were no changes in the company's internal control over financial reporting during its most recently completed fiscal quarter that have materially affected or are reasonably likely to materially affect its internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Environmental Matters. From time to time, the company is identified as a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and/or similar state laws that impose liability for costs relating to the cleanup of contamination resulting from past spills, disposal or other release of hazardous substances. The company is also subject to similar laws in some of the countries where current and former facilities are located. The company's environmental, health and safety department monitors compliance with all applicable laws on a global basis.

Currently the company is involved in various environmental investigations, clean-up activities and administrative proceedings and lawsuits. In many of these matters, the company has entered into participation agreements, consent decrees or tolling agreements. One of these environmental matters involves the investigation and remediation of environmental contamination at the company's Sorocaba, Brazil facility. Soil and water samples have been collected on and around the Sorocaba facility, and test results indicate that certain contaminants, including carbon tetrachloride and other solvents, exist in the soil at the Sorocaba facility and in the groundwater at both the Sorocaba facility and some neighboring properties. The company is continuing to work with Brazilian regulatory authorities to determine the necessary scope of remediation at the facility and the neighboring properties. As of June 2, 2007, \$1.7 million was recorded as a liability for expected investigation and remediation expenses remaining for this site. Once the full scope of any necessary remediation is determined, the company may be required to record additional liabilities related to investigation and remediation costs at the Sorocaba facility.

From time to time, management becomes aware of compliance matters relating to, or receives notices from, federal, state or local entities regarding possible or alleged violations of environmental, health or safety laws and regulations. In some instances, these matters may become the subject of administrative proceedings or lawsuits and may involve monetary sanctions of \$0.1 million or more (exclusive of interest and litigation costs).

The company's management reviews the circumstances of each individual site, considering the number of parties involved, the level of potential liability or contribution of the company relative to the other parties, the nature and magnitude of the hazardous substances involved, the method and extent of remediation, the estimated legal and consulting expense with respect to each site and the time period over which any costs would likely be incurred. To the extent the company can reasonably estimate the amount of its probable liabilities for environmental matters, the company establishes a financial provision if certain criteria are met. As of June 2, 2007, the company had reserved \$3.5 million, which represents its best estimate of probable liabilities with respect to environmental matters, inclusive of the accrual related to the Sorocaba facility as described above. However, the full extent of the company's future liability for environmental matters is difficult to predict because of uncertainty as to the cost of investigation and clean-up of the sites, the company's responsibility for such hazardous substances and the number of and financial condition of other potentially responsible parties.

Because of the uncertainties described above, the company cannot accurately estimate the cost of resolving pending and future environmental matters impacting the company. While uncertainties exist with respect to the amounts and timing of the company's ultimate environmental liabilities, based on currently available information, management does not believe that these matters, individually or in aggregate, will have a material adverse effect on the company's long-term financial condition. However, adverse developments could negatively impact the company's results of operations or cash flows in one or more future quarters.

Other Legal Proceedings. From time to time and in the ordinary course of business, the company is a party to, or a target of, lawsuits, claims, investigations and proceedings, including product liability, personal injury, contract, patent and intellectual property, health and safety and employment matters. While the company is unable to predict the outcome of these matters, it does not believe, based upon currently available information, that the ultimate resolution of any pending matter, individually or in aggregate, including the EIFS and asbestos litigation described in the following paragraphs, will have a material adverse effect on the company's long-term financial condition. However, adverse developments could negatively impact the company's results of operations or cash flows in one or more future quarters.

A subsidiary of the company is a defendant in numerous exterior insulated finish systems (EIFS) related lawsuits. As of June 2, 2007, the company's subsidiary was a defendant in approximately 20 lawsuits and claims related primarily to single-family homes. The EIFS product was used primarily in the residential construction market in the southeastern United States. Some of the lawsuits and claims involve EIFS in commercial or multi-family structures. Lawsuits and claims related to this product line seek monetary relief for water intrusion-related property damages. The company has insurance coverage for certain years with respect to this product line.

During the quarter ended June 3, 2006, the company entered into agreements to settle numerous EIFS-related lawsuits and claims, including a lawsuit involving up to 186 homes. In total, the company paid \$5.0 million in settlement of these lawsuits and claims, of which insurers have paid \$1.0 million and are expected to pay an additional \$0.5 million. As of June 2, 2007, the company had recorded \$1.3 million for the probable EIFS-related liabilities and \$0.9 million for insurance recoveries, for all remaining EIFS-related liabilities. The company continually reevaluates these amounts.

EIFS-related liabilities include amounts for pending lawsuits and claims as well as unasserted claims. The liabilities are recorded at management's best estimate of the outcome of the lawsuits and claims taking into consideration the facts and circumstances of the individual matters as well as past experience on similar matters. Amounts accrued for the unasserted claims are based primarily on historical experience. Because of the many uncertainties involved with litigation, management has concluded that it is not possible to estimate a range of loss, if any, that would exceed the accrual.

The rollforward of EIFS-related lawsuits and claims is as follows:

	26 Weeks Ended	
	June 2, 2007	Year Ended December 2, 2006
Lawsuits and claims at beginning of period	29	75
New lawsuits and claims asserted	5	9
Lawsuits and claims settled	(6)	(55)
Lawsuits and claims dismissed/resolved	(8)	
Lawsuits and claims at end of period	20	29

A summary of the aggregate costs and settlement amounts for EIFS-related lawsuits and claims is as follows:

(In thousands)	26 Weeks Ended	
	June 2, 2007	Year Ended December 2, 2006
Settlements reached	\$ 150	\$ 5,989
Defense costs incurred	\$ 277	\$ 2,507
Insurance payments received or expected to be received	\$ 1,098	\$ 3,492

Plaintiffs in EIFS cases generally seek to have their homes repaired or the EIFS replaced, but a dollar amount for the cost of repair or replacement is not ordinarily specified in the complaint. Although complaints in EIFS cases usually do not contain a specific amount of damages claimed, a complaint may assert that damages exceed a specified amount in order to meet jurisdictional requirements of the court in which the case is filed. Therefore, the company does not believe it is meaningful to disclose the dollar amount of damages asserted in EIFS complaints.

Based on currently available information, management does not believe that the ultimate outcome of any pending legal proceedings and claims related to this product line, individually or in aggregate, will have a material adverse effect on the company's long-term financial condition. However, adverse developments could negatively impact the company's results of operations or cash flows in one or more future quarters. Given the numerous uncertainties surrounding litigation and the projection of future events, such as the number of new claims to be filed each year and the average cost of disposing of each such claim, the actual costs could be higher or lower than the current estimated reserves or insurance recoveries.

The company and/or its subsidiaries have been named as defendants in lawsuits in which plaintiffs have alleged injury due to products containing asbestos manufactured more than 20 years ago. The plaintiffs generally bring these lawsuits against multiple defendants and seek damages (both actual and punitive) in very large amounts. In many cases, plaintiffs are unable to demonstrate that they have suffered any compensable injuries or that the injuries suffered were the result of exposure to products manufactured by the company or its subsidiaries. The company is typically dismissed as a defendant in these cases without payment. If the plaintiff establishes that compensable injury occurred as a result of exposure to the company's products, the case is generally settled for an amount that reflects the seriousness of the injury, the number and solvency of other defendants in the case, and the jurisdiction in which the case has been brought.

As a result of bankruptcy filings by numerous defendants in asbestos-related litigation and the prospect of national and state legislative reform relating to such litigation, the rate at which plaintiffs filed asbestos-related lawsuits against various companies (including the company) increased in 2001, 2002 and the first half of 2003. After the second half of 2003, the rate of these filings declined. However, the company expects that asbestos-related lawsuits will continue to be filed against the company in the future.

A significant portion of the defense costs and settlements relating to asbestos-related litigation involving the company continues to be paid by third parties, including indemnification pursuant to the provisions of a 1976 agreement under which the company acquired a business from a third party. Historically, this third party routinely defended all cases tendered to it and paid settlement amounts resulting from those cases. In the 1990s, the third party sporadically reserved its rights, but continued to defend and settle all asbestos-related claims tendered to it by the company. In 2002, the third party rejected the tender of certain cases by the company and indicated it would seek contributions from the company for past defense costs, settlements and judgments. However, this third party has continued to defend and pay settlement amounts, under a reservation of rights, in most of the asbestos cases tendered to the third party by the company.

In addition to the indemnification arrangements with third parties, the company has insurance policies that generally provide coverage for asbestos liabilities (including defense costs). Historically, insurers have paid a significant portion of the defense costs and settlements in asbestos-related litigation involving the company. However, certain of the company's insurers are insolvent. During 2005, the company and a number of its insurers entered into a cost-sharing agreement that provides for the allocation of defense costs, settlements and judgments among these insurers and the company in certain asbestos-related lawsuits. Under this agreement, the company is required to fund a share of settlements and judgments allocable to years in which the responsible insurer is insolvent. The cost-sharing agreement applies only to the asbestos litigation involving the company that is not covered by the third-party indemnification arrangements.

During the year ended December 2, 2006, the company settled five asbestos-related lawsuits, totaling \$0.6 million. The company's insurers have paid or are expected to pay \$0.4 million of these settlement amounts. During the first six months of 2007 the company settled five asbestos-related lawsuits for \$0.4 million. The company's insurers have paid or are expected to pay \$0.3 million of that amount.

The company does not believe that it would be meaningful to disclose the aggregate number of asbestos-related lawsuits filed against the company because relatively few of these lawsuits are known to involve exposure to asbestos-containing products made by the company. Rather, the company believes it is more meaningful to disclose the number of lawsuits that are settled.

To the extent the company can reasonably estimate the amount of its probable liabilities for pending asbestos-related claims, the company establishes a financial provision and a corresponding receivable for insurance recoveries if certain criteria are met. As of June 2, 2007, the company had \$0.4 million accrued for probable liabilities and \$0.2 million for insurance recoveries related to asbestos claims. However, the company has concluded that it is not possible to estimate the cost of disposing of other asbestos-related claims (including claims that might be filed in the future) due to its inability to project future events. Future variables include the number of new claims filed, the average cost of disposing of such claims, the uncertainty of asbestos litigation, insurance coverage and indemnification agreement issues, and the continuing solvency of certain insurance companies.

Because of the uncertainties described above, the company cannot accurately estimate the cost of resolving pending and future asbestos-related claims against the company. Based on currently available information, the company does not believe that asbestos-related litigation, individually or in aggregate, will have a material adverse effect on the company's long-term financial condition. However, adverse developments in such litigation could negatively impact the company's results of operations or cash flows in one or more future quarters.

In addition to product liability claims discussed above, the company and its subsidiaries are involved in other claims or legal proceedings related to its products, which it believes are not out of the ordinary in a business of the type and size in which it is engaged.

Item 1A. Risk Factors

This Form 10-Q contains forward-looking statements concerning our future programs, products, expenses, revenue, liquidity and cash needs as well as our plans and strategies. These forward-looking statements are based on current expectations and the company assumes no obligation to update this information. Numerous factors could cause actual results to differ significantly from the results described in these forward-looking statements, including the risk factors identified under Part I, Item 1A. Risk Factors contained in the company's Annual Report on Form 10-K for the fiscal year ended December 2, 2006. There have been no material changes in the risk factors disclosed by the company under Part I, Item 1A. Risk Factors contained in the Annual Report on Form 10-K for the fiscal year ended December 2, 2006.

Item 1B. Unresolved Staff Comments

None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds Issuer Purchases of Equity Securities

Upon vesting of restricted stock awarded by the company to employees, shares are withheld to cover the employees' withholding taxes. Information on the company's purchases of equity securities during the second quarter follows:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)
March 4, 2007 - April 7, 2007				N/A
April 8, 2007 - May 5, 2007	3,407	\$ 27.67		N/A
May 6, 2007 - June 2, 2007				N/A

Item 4. Submission of Matters to a Vote of Security Holders

(a) The Registrant's 2007 Annual Meeting of Shareholders was held on April 5, 2007. There were 60,683,368 shares of Common Stock entitled to vote at the meeting and a total of 55,848,338 shares were represented at the meeting.

(c) The following matters were submitted to a vote of security holders during the second quarter:

Proposal 1 Election of Directors for a term expiring at the 2010 Annual Meeting of Shareholders:

Director Name	Votes in Favor	Share Votes Withheld
Knut Kleedehn	48,428,213	7,420,125
John C. van Roden, Jr.	48,604,634	7,243,704
Michele Volpi	53,171,540	2,676,798

Juliana L. Chugg, J. Michael Losh, Richard L. Marcantonio, Lee R. Mitau, Alfredo L. Rovira, and William R. Van Sant continued to serve as directors following the meeting.

Proposal 2 Proposal to Ratify the Appointment of KPMG LLP as the company's independent auditors for the fiscal year ending December 1, 2007:

For	Against	Abstain
54,875,484	741,365	231,489

Item 6.
Exhibits

- 12 Computation of Ratios
- 31.1 Form of 302 Certification Michele Volpi
- 31.2 Form of 302 Certification James C. McCreary, Jr.
- 32.1 Form of 906 Certification Michele Volpi
- 32.2 Form of 906 Certification James C. McCreary, Jr.
- 99 Quarterly Revenue and Operating Income by Segment

Lean Six SigmaSM is a registered service mark of The George Group Incorporated.

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.

H.B. Fuller Company

Dated: July 6, 2007

/s/ James C. McCreary, Jr.
James C. McCreary, Jr.
Vice President, Controller and
Interim Chief Financial Officer

Exhibit Index

Exhibits

- 12 Computation of Ratios
- 31.1 Form of 302 Certification Michele Volpi
- 31.2 Form of 302 Certification James C. McCreary, Jr.
- 32.1 Form of 906 Certification Michele Volpi
- 32.2 Form of 906 Certification James C. McCreary, Jr.
- 99 Quarterly Revenue and Operating Income by Segment