TO BE THE BEST

VALSPAR ANNUAL REPORT 2001

2001

THE VALSPAR CORPORATION

Although 2001 was a very challenging year for Valspar, we strengthened our position as the world leader in packaging, coil, wood and industrial coatings. In addition, we made excellent progress in architectural and powder coatings.

At Valspar, our mission is to be the recognized leader in the coatings industry:

- By meeting customer requirements,
- By empowering our employees to maximize productivity, and
- By creating exceptional value for our shareholders.

As we look forward to 2002, our goal is simply “To be the best.”

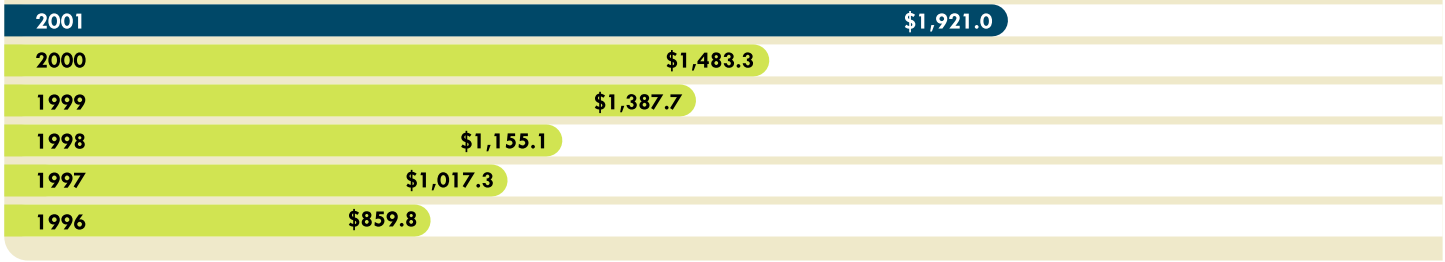
FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share amounts)

	2001	% Change from 2000	2000	% Change from 1999
Net Sales	$ 1,920,970	29.5%	$ 1,483,320	6.9%
Income before taxes	$ 91,150	-35.7%	$ 141,746	4.9%
Net Income	$ 51,500	-40.4%	$ 86,466	5.3%
Return on average shareholders' equity	13.5% *	–	20.6% *	–
Diluted earnings per share	$ 1.10	-45.0%	$ 2.00	7.0%
Diluted earnings per share adjusted	$ 1.58 *	-20.6%	$ 1.99 *	0.0%
Cash dividends per share	$ 0.54	3.8%	$ 0.52	13.0%
Total assets	$ 2,226,070	97.9%	$ 1,125,030	1.3%
Total debt	$ 1,047,817	207.7%	$ 340,495	-3.5%
Stockholders' equity	$ 654,565	49.6%	$ 437,571	11.1%
Stockholders' equity per share	$ 13.23	28.4%	$ 10.30	12.4%
Number of shares outstanding	49,481,627	16.5%	42,481,170	-1.2%

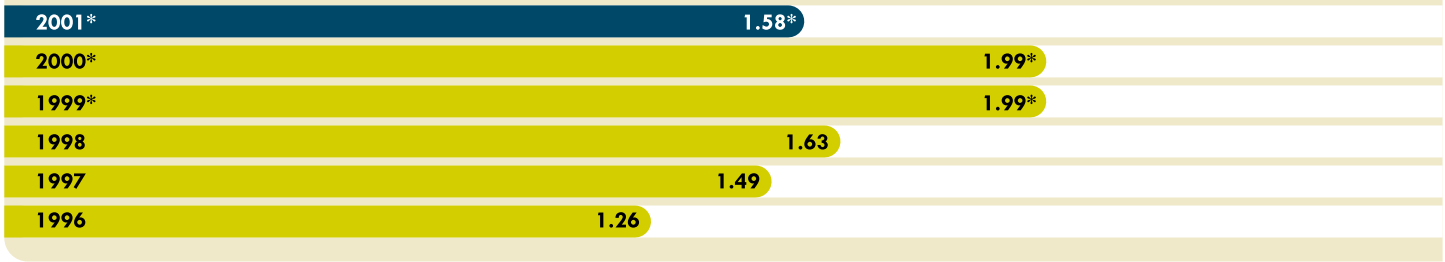
NET SALES

(Millions) 5 year average growth rate of 17.4%



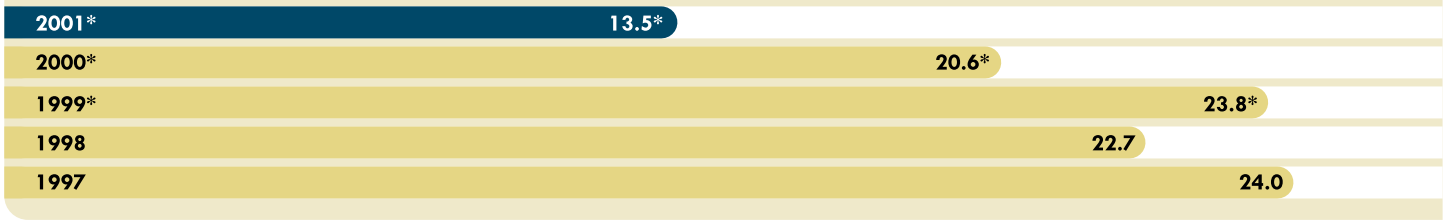
NET INCOME PER SHARE

(Dollars) 5 year average growth rate of 4.6%



RETURN ON AVERAGE EQUITY

(Percent) 5 year average return of 20.9%

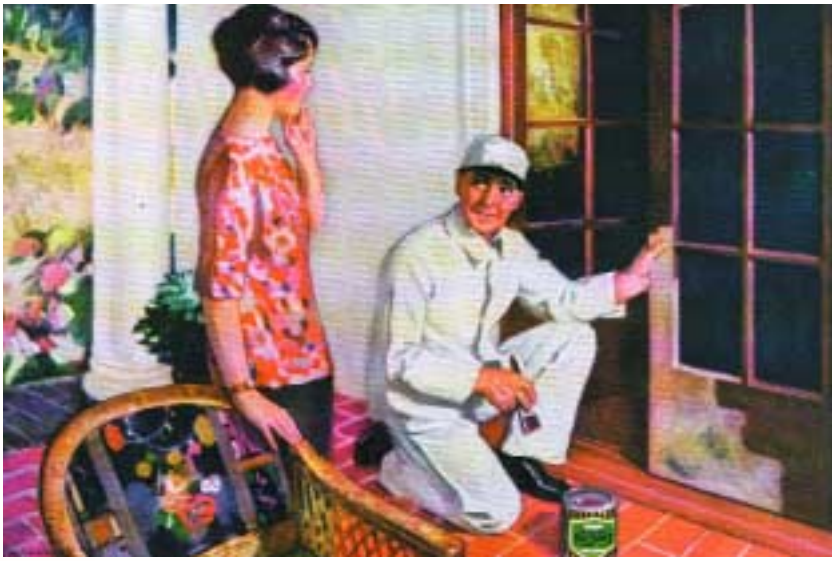


The above information and graphs have been adjusted to reflect the 2-for-1 stock split effective in March 1997. Historical data are provided in the Eleven-Year Financial Summary on pages 6 and 7.

TO OUR SHAREHOLDERS

Fiscal 2001 was a disappointing and difficult year for our company. Worldwide economic conditions were weak and worsened throughout the year; yet raw material prices remained persistently high for most of the year. As a result, for the first time in 27 years, earnings declined from the prior year. In addition, this adverse environment made our task of effectively integrating Lilly Industries into Valspar a significant challenge.

Nonetheless, we recorded many successes throughout 2001. Our Architectural Group was named Supplier of the Year at Lowe's for an unprecedented seventh time and "Valspar's American Tradition", sold exclusively at Lowe's, achieved national recognition. We strengthened our global position in Packaging Coatings with small, but strategic, acquisitions in Southeast Asia and Australia and with the purchase of our partner's interest in our Mexican joint venture. And, each of our businesses improved product quality and customer service, strengthening market position for each product line.



Our progress with the integration of Lilly is particularly noteworthy. Our original financial justification for the Lilly acquisition called for reducing costs by $70 million over three years; we achieved that $70 million savings rate in October – only ten months after closing the acquisition. Further, in September, we announced additional initiatives that will bring total integration savings to $90 – 100 million. By accelerating the integration process and improving our overall market position, we were able to achieve improved earnings in the last half of 2001 versus the prior year. This progress, as well as recent downward movements in raw material costs, positions Valspar well for future growth. Sales in 2001 reached $1.9 billion, an increase of 30 percent, primarily from adding Lilly sales. We took on $1.0 billion of debt with the Lilly acquisition, financed by a syndicate of banks, and in April we sold 6.9 million shares of common stock to new and existing shareholders to strengthen our balance sheet, using the proceeds to repay some of the acquisition debt. Excluding one-time charges, net income for the year was $73.7 million, 15% lower than the previous year. Due to the increase in shares outstanding, earnings per share decreased 21% to $1.58. With operating cash flow of $197.6 million and proceeds from the equity offering, we were able to reduce borrowings by $335 million, even after spending $36 million for fixed capital and almost $25 million for dividends.

In line with our dividend payout goals, the Board of Directors raised the annual dividend to $.56 per share, effective with the quarterly dividend payable in January 2002. This marks the 24th consecutive year of dividend increases.

Operating Results

Demand for our Architectural, Automotive and Specialty Products remained strong throughout the year, with double-digit growth in sales. We improved our position with our major customers, Lowe's and Wal★Mart, by introducing new products which helped boost same-store growth.

Packaging Coating Sales improved modestly despite lower rigid can production worldwide. In addition to new acquisitions, we upgraded a manufacturing facility in South Africa, and are preparing to strengthen our operating presence in Brazil. These actions reinforced our position as the leading packaging coatings supplier in the world.

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VALSPAR
ENAMEL
Valspar—which color do you want?
Valspar in any Color!
VALENTINE'S
VALSPAR

Industrial Coatings, which had enjoyed a decade of double-digit annual growth, succumbed to the economic malaise this year. While sales of Valspar's legacy products softened in line with the overall economy, the acquired Lilly businesses were hit harder, particularly furniture and wood coatings, which struggled through abnormally high customer bankruptcies and inventory liquidations. A bright spot, however, was our growing presence in China where we opened a new facility in Shanghai and began construction of a new wood coatings laboratory and color studio in Dongguan. Another positive was coil and extrusion coating sales, which continued to show real growth. In December 2001, we announced the purchase of selected coil and other assets of Technical Coatings, which will further bolster coil coating sales.

Sales of resins and colorants declined modestly as the addition of new customers helped offset the impact of weaker market conditions.

Safety is a core value in the Valspar culture and in 2001, outstanding progress was made towards achieving a zero-accident environment. Our overall recordable injury rate declined more than 20% with an impressive 54% reduction at the former Lilly facilities. In addition to being a market leader, we are also becoming a safety leader in the global coatings industry.

Director Changes

In December, we were pleased to welcome Dr. Mae Jemison to our Board of Directors. Dr. Jemison has an impressive record as a scientist, academician and astronaut, and will provide a fresh perspective to our Board governance.

Outlook

Since the events of September 11, 2001, it has become increasingly difficult to predict the future direction of economic conditions worldwide. However, because of cost reduction and other actions taken in 2001, even with a soft economy, we expect that 2002 will be a good year for our company. In fact, we have streamlined our operations and positioned our businesses such that if worldwide economic conditions improve early in 2002, we could have a very good year.

Once again, I want to thank all Valspar employees throughout the world for their dedication and commitment to our core values of safety, quality, environmental stewardship and profitable growth. This commitment is essential as we begin our next phase of corporate development – our quest to become the best coatings company in the world.

Richard M. Rompala
Chairman, President and Chief Executive Officer

ELEVEN-YEAR FINANCIAL SUMMARY

(Dollars in Thousands, except per share amounts)

	Fiscal Years	2001	2000	1999
Operating Results	Net Sales	$ 1,920,970	$ 1,483,320	$ 1,387,677
	Cost and Expenses			
	Cost of Sales	1,346,934	1,039,267	960,395
	Operating Expense	391,184	281,318	273,925
	Restructuring Charge	21,930	(1,200)	8,346
	Income from Operations	160,922	163,935	145,011
	Other (Income) Expense - Net	(2,787)	200	(9,164)
	Interest Expense	72,559	21,989	19,089
	Income Before Income Taxes	91,150	141,746	135,086
	Net Income	51,500	86,466	82,142
	Net Income as a Percent of Sales	2.7%	5.8%	5.9%
	Return on Average Equity	13.5% *	20.6% *	23.8% *
	Per Common Share:			
	Net Income - Basic	$ 1.12	$ 2.02	$ 1.90
	Net Income - Diluted	$ 1.10	$ 2.00	$ 1.87
	Dividends Paid	0.54	0.52	0.46
	Stockholders' Equity Per Share	13.23	10.30	9.16
Financial Position	Total Assets	$ 2,226,070	$ 1,125,030	$ 1,110,720
	Working Capital at Year-End	186,427	199,576	140,216
	Property, Plant and Equipment, Net	411,179	298,747	312,133
	Long-Term Debt, Excluding Current Portion	1,006,217	300,300	298,874
	Stockholders' Equity	654,565	437,571	393,756
Other Statistics	Property, Plant and Equipment Expenditures	$ 36,200	$ 32,425	$ 31,400
	Depreciation and Amortization Expense	73,050	45,238	39,800
	Research and Development Expense	58,105	46,353	44,091
	Total Cash Dividends	$ 24,856	$ 22,185	$ 19,785
	Average Common Shares Outstanding (000's)	46,658	43,196	43,836
	Number of Stockholders	1,702	1,728	1,818
	Number of Employees at Year-End	6,750	4,685	4,482
	Market Price Range - Common Stock: High	$ 37.80	$ 43.31	$ 39.69
	Low	24.45	19.75	28.00

* Excluding impact of restructuring and non-recurring charges in 1999, 2000 and 2001

STOCK INFORMATION

Stock traded on the New York Stock Exchange

For the Fiscal Year		2001	2000
Market Price (high/low):	First Quarter	$ 33.60-24.45	$ 43.31-29.88
	Second Quarter	33.78-26.48	38.75-31.63
	Third Quarter	36.91-30.15	40.25-30.19
	Fourth Quarter	37.80-29.90	31.38-19.75

Reference is made to the Notes in Consolidated Financial Statements for a summary of accounting policies and additional information. Per share data have been adjusted to reflect 2-for-1 stock splits effective in March 1992 and March 1997. The number of stockholders is based on recordholders at year-end.

1998	1997	1996	1995	1994	1993	1992	1991
$ 1,155,134	$ 1,017,271	$ 859,799	$ 790,175	$ 795,275	$ 700,897	$ 638,485	$ 632,562
803,240	698,474	594,935	561,170	569,063	501,135	492,092	458,953
230,152	206,834	169,873	146,344	146,683	129,997	131,232	120,643
–	–	–	–	–	–	–	–
121,742	111,963	94,991	82,661	79,529	69,765	60,161	52,966
(7,753)	(2,508)	(1,081)	(763)	631	2,036	360	1,504
10,707	5,294	3,029	4,216	2,504	1,645	2,932	5,686
118,788	109,177	93,043	79,208	76,394	66,084	56,869	45,776
72,130	65,877	55,893	47,520	45,799	40,156	34,418	27,676
6.2%	6.5%	6.5%	6.0%	5.8%	5.7%	5.0%	4.4%
22.7%	24.0%	24.0%	24.4%	24.4%	21.8%	21.7%	20.0%
$ 1.66	$ 1.51	$ 1.28	$ 1.09	$ 1.04	$ 0.92	$ 0.79	$ 0.64
$ 1.63	$ 1.49	$ 1.26	$ 1.08	$ 1.04	$ 0.91	$ 0.79	$ 0.64
0.42	0.36	0.33	0.30	0.26	0.22	0.18	0.15
7.84	6.76	5.78	4.83	3.99	4.51	3.92	3.40
$ 801,680	$ 615,470	$ 486,440	$ 398,199	$ 367,608	$ 340,479	$ 321,618	$ 319,367
158,085	97,427	96,130	90,995	87,887	85,741	57,500	58,066
233,482	185,748	153,819	130,404	107,956	103,916	101,005	98,818
164,768	35,844	31,948	21,658	35,343	7,890	10,684	30,697
340,188	295,065	253,703	212,115	176,712	198,826	169,377	147,896
$ 42,833	$ 48,131	$ 25,376	$ 38,982	$ 31,817	$ 17,213	$ 19,581	$ 8,843
30,742	25,771	22,262	20,318	19,134	20,648	19,793	18,896
39,555	39,099	32,616	27,746	27,430	24,955	24,802	23,226
$ 18,575	$ 15,741	$ 14,575	$ 13,121	$ 11,252	$ 9,471	$ 7,843	$ 6,519
44,320	44,233	44,403	44,183	44,326	44,062	43,946	43,724
1,815	1,830	1,783	1,864	1,902	1,866	1,863	1,857
3,833	3,205	2,855	2,542	2,585	2,577	2,482	2,530
$ 42.13	$ 32.94	$ 25.50	$ 20.94	$ 22.88	$ 20.75	$ 18.19	$ 11.72
25.75	24.00	19.13	15.25	16.38	15.19	11.28	7.63

DIVIDENDS

	For the Fiscal Year	2001	2000
Per Share Dividends:	First Quarter	$ 0.135	$ 0.130
	Second Quarter	0.135	0.130
	Third Quarter	0.135	0.130
	Fourth Quarter	0.135	0.130
		$ 0.54	$ 0.52

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview.

The following discussion of financial condition and operations is affected by the acquisition and divestiture activity during the reporting period:

- 2001 - Effective December 20, 2000, the Company acquired Lilly Industries, Inc., the Company's largest acquisition to date. Total consideration paid was approximately $1,036 million, including the assumption of debt of approximately $218 million. See Note 2 to the Consolidated Financial Statements for detail of the acquisition. The Company completed the sale of its existing Mirror Coatings business as a condition of Federal Trade Commission approval for the Lilly Industries acquisition. The Company acquired the Packaging Coatings business of Coates Brothers in Singapore, Malaysia, Indonesia and Thailand. The Company acquired the 49% interest in The Valspar (Mexico) Corporation, S.A. de C.V. held by its joint venture partner.
- 2000 - In October 2000, the Company combined its two joint ventures in South Africa so that the Company now has a majority position in a joint venture with Plascon (Pty) Limited for a combined packaging coatings business in South Africa.
- 1999 - The Company completed three acquisitions and two divestitures. Net consideration paid was $203.0 million.

The acquisitions were accounted for as purchases and are discussed in detail in Note 2 to the Consolidated Financial Statements.

Operations 2001 vs. 2000.

Net sales increased 29.5% to $1,920,970,000 in 2001 from $1,483,320,000 in 2000. Excluding the impact of acquisitions and divestitures during the year, sales decreased approximately 1%, primarily driven by volume decreases in the Industrial Coatings product line offset by increased volume in the Architectural, Automotive, and Specialty (AAS) Coatings product line.

The gross profit margin remained constant at 29.9% in 2001 and 2000. Included in cost of sales are charges of $17,370,000 incurred to account for the write-down of inventory resulting from new account capture and other assets related to the $39,300,000 restructuring plan announced in September 2001. Excluding the impact of the write-down, the gross profit margin increased to 30.8% in 2001 due to successful raw material price reductions with added Lilly volume.

Operating expenses (research and development, selling and administrative, excluding the impact of restructuring) increased 39.1% to $391,184,000 (20.4% of net sales) in 2001 compared to $281,318,000 (19.0% of net sales) in 2000. Excluding the impact of acquisitions and divestitures, operating expenses remained constant. During the fourth quarter of 2001, the Company recorded a $21,930,000 restructuring charge to eliminate redundant facilities and functions resulting from the Lilly acquisition in order to accelerate performance improvement. See Note 3 to the Consolidated Financial Statements for detail of the restructuring.

Other (income)/expense, increased to ($2,787,000) in 2001 from $200,000 in 2000. The 2001 income was driven by the gains on the divestiture of the Company's Mirror Coatings business and sale of certain assets, which were partially offset by losses on the disposal and abandonment of certain assets.

Interest expense increased to $72,559,000 in 2001 from $21,989,000 in 2000 due to higher debt levels resulting from the Lilly acquisition.

Net income for the full year was $51,500,000 or $1.10 per diluted share. Excluding the impact of restructuring and other non-recurring charges, net income for the full year was $73,704,000 or $1.58 per diluted share. A weak economy, rising raw material prices, and significantly higher interest and amortization expense negatively impacted the Company's financial performance in 2001. However, demand in the AAS Coatings product line remained strong and Packaging Coatings sales were stable. Additionally, the Company is aggressively implementing cost saving actions which are expected to result in $90-100 million of pre-tax savings on an annualized basis by 2003.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 (SFAS 141), "Business Combinations" and Statement of Financial Accounting Standards No. 142 (SFAS 142) "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangibles deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will early adopt these Statements effective October 27, 2001. Application of the non-amortization provisions of the Statement is expected to result in an annual increase of earnings of approximately $.35 per share. The Company will perform the first of the required tests for impairment of goodwill and indefinite lived intangible assets as of the beginning of Fiscal 2002 and will complete the initial impairment test by the end of the second quarter of 2002.

Operations 2000 vs. 1999.

Net sales increased 6.9% to $1,483,320,000 in 2000 from $1,387,677,000 in 1999. Excluding the impact of acquisitions and divestitures during the year, sales increased approximately 3%, primarily driven by volume increases in the Industrial Coatings product line.

The gross profit margin decreased to 29.9% in 2000 from 30.8% in 1999. The lower margin was attributable to higher raw material costs and a difference in product mix within the AAS Coatings product line.

Operating expenses (research and development, selling and administrative, excluding the impact of restructuring) increased 2.7% to $281,318,000 (19.0% of net sales) in 2000 compared to $273,925,000 (19.7% of net sales) in 1999. Excluding the impact of acquisitions and divestitures, operating expenses increased approximately 3%. This increase was primarily attributable to higher expenditures to support the AAS Coatings product line. The Company recorded a non-recurring restructuring charge of $8,346,000 in 1999 related to the closure of existing Valspar facilities and workforce reduction following the Dexter aquisition. During the second quarter of 2000, restructuring accruals in the amount of $1,200,000 were reversed. These reversals were primarily related to lower than estimated employee termination benefits and fewer program cancellation costs than originally estimated.

Other (income)/expense, decreased to $200,000 in 2000 from ($9,164,000) in 1999. The 1999 income was driven by the gains on the divestitures of the Company's Marine and Flexible Packaging Coatings product lines, which were partially offset by losses on the disposal and abandonment of certain assets.

Interest expense increased to $21,989,000 in 2000 from $19,089,000 in 1999 due to higher debt levels resulting primarily from the Dexter acquisition.

2000 net income of $86,466,000 or $2.00 per diluted share represented the 26th consecutive year of increased earnings for the Company. Net income increased 5.3% from 1999 primarily due to sales growth and expense controls. Income from operations increased by 13.1% and was partially offset by higher interest expense related to the Dexter acquisition.

Financial Condition.

Cash provided by operating activities was $197,609,000 in 2001 compared with $93,338,000 in 2000 and $127,249,000 in 1999. The cash provided by operating activities in 2001 and current cash balances were used largely to fund $36,200,000 in capital expenditures and $24,856,000 in dividend payments. The cash provided by borrowings and an equity offering yielding net proceeds of $184,700,000 were used to fund $830,664,000 in Lilly acquisition related commitments and in the repayment of bank borrowings.

Accounts receivable decreased $20,214,000 due to reduced sales primarily in the Industrial Coatings business. Inventories and other assets decreased $10,108,000 primarily as a result of improved inventory controls. Accounts payable and accrued liabilities decreased $26,989,000 primarily due to the timing of payable disbursements and accrued liability disbursements.

Capital expenditures for property, plant and equipment were $36,200,000 in 2001 compared with $32,425,000 in 2000 and $31,400,000 in 1999. The Company anticipates capital spending in fiscal 2002 to be approximately $40,000,000.

The Company reported $484,053,000 in net proceeds from bank borrowings during 2001. In April 2001, the Company reported net proceeds of $184,689,000 from the public offering of 6.9 million shares of common stock. The ratio of total debt to capital increased to 61.6% at the end of 2001 compared to 43.8% in 2000. Average debt outstanding during 2001 was $1,118,086,000 at a weighted average interest rate of 6.49% versus $362,855,000 at 6.06% last year, increasing the current year's interest expense to $72,559,000 from $21,989,000 in the prior year.

At October 26, 2001, the Company had unused lines of credit available from banks of $688,429,000. In November, the Company reduced its lines of credit by $350,000,000, reducing the unused lines by a similiar amount.

Common stock dividends of $24,856,000 in 2001 represented a 12% increase over 2000. The annual dividend was increased to $0.54 per share from $0.52 per share in 2000 with the payout at 29% of the prior year earnings, which is consistent with the Company's target payout rate of 25% to 35%.

The Company has continuing authorization to purchase shares of its common stock for treasury at management's discretion for general corporate purposes. There were no purchases in 2001. Purchases under this program were 661,000 and 494,000 shares in 2000 and 1999, respectively.

The Company is involved in various claims relating to environmental and waste disposal matters at a number of current and former plant sites. The Company engages or participates in remedial and other environmental compliance activities at certain of these sites. At other sites, the Company has been named as a potentially responsible party (PRP) under federal and state environmental laws for the remediation of hazardous waste. The Company's management reviews 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 wastes involved, the method and extent of remediation, the potential insurance coverage, the estimated legal and consulting expense with respect to each site, and the time period over

which any costs would likely be incurred. Based on the above analysis, management estimates the restoration or other clean-up costs and related claims for each site. The estimates are based in part on discussions with other PRPs, governmental agencies and engineering firms.

The Company accrues appropriate reserves for potential environmental liabilities, which are continuously reviewed and adjusted as additional information becomes available. While uncertainties exist with respect to the amounts and timing of the Company's ultimate environmental liabilities, management believes that such liabilities, individually and in the aggregate, will not have a material adverse effect on the Company's financial condition or results of operations.

The Company, along with other companies, is a defendant in a number of legal proceedings and claims brought by governmental bodies and private persons against companies who are alleged to have manufactured and sold paint containing lead pigment. The Company believes that the litigation is without merit and is vigorously defending these matters. It is possible that additional lawsuits or claims could be brought against the Company. At this time, management cannot estimate the scope or amount of potential costs or liabilities relating to these matters. However, based on the outcome of such matters to date, and other factors, management does not believe that the costs and liabilities of such matters will have a material adverse effect on the Company's financial condition or results of operations.

Market Risk.

The Company's foreign sales and results of operations are subject to the impact of foreign currency fluctuations. The Company has not hedged its exposure to translation gains and losses; however, it has reduced its exposure by borrowing funds in local currencies. A 10% adverse change in foreign currency rates would not have a material effect on the Company's results of operations or financial position.

The Company is also subject to interest rate risk. The Company has not hedged its exposure to interest rate fluctuations. Including the impact of debt incurred to fund the acquisition of Lilly Industries in fiscal 2001, if interest rates are 10% higher in 2002 than the average rate experienced in 2001, interest expense would increase by approximately $5 million.

Forward-looking Statements.

This discussion contains certain "forward-looking" statements. These forward-looking statements are based on management's expectations and beliefs concerning future events. Forward-looking statements are necessarily subject to risks, uncertainties and other factors, many of which are outside the control of the Company that could cause actual results to differ materially from such statements These uncertainties and other factors include risks related to the Company's acquisitions, including risks of adverse changes in the results of acqired businessses; risks of disruptions in business resulting from the integration process; and significantly higher levels of debt for the Company resulting in higher interest costs. The Company also faces general risks and uncertainties such as the Company's reliance on the efforts of vendors, government agencies, utilities, and other third parties to achieve adequate compliance and avoid disruption of its business; dependence of internal earnings growth on economic conditions and growth in the domestic and international coatings industry; changes in the Company's relationships with customers and suppliers; unusual weather conditions that might adversely affect sales; the outbreak of war and other significant national and international events; and other risks and uncertainties. The foregoing list is not exhaustive, and the Company disclaims any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements.

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, except per share amounts)

		October 26, 2001	October 27, 2000
Assets			
Current Assets	Cash and cash equivalents	$ 20,139	$ 20,935
	Accounts and notes receivable, less allowances for doubtful accounts (2001 - $10,212; 2000 - $4,925)	341,383	277,763
	Inventories	185,565	154,887
	Deferred income taxes	40,547	18,464
	Prepaid expenses and other accounts	73,860	61,815
	Total Current Assets	661,494	533,864
Goodwill, net		1,056,628	208,748
Other Assets, net		96,769	83,671
Property, Plant and Equipment	Land	35,905	21,093
	Buildings	144,158	135,205
	Machinery and equipment	520,935	389,177
		700,998	545,475
	Less accumulated depreciation	289,819	246,728
	Net Property, Plant and Equipment	411,179	298,747
	Total Assets	$2,226,070	$1,125,030
Liabilities and Stockholders' Equity			
Current Liabilities	Notes payable to banks	$ 41,114	$ 39,731
	Trade accounts payable	174,844	153,996
	Income taxes	23,328	10,910
	Accrued liabilities	235,295	129,187
	Current Portion of Long-Term Debt	486	464
	Total Current Liabilities	475,067	334,288
Long-Term Debt		1,006,217	300,300
Deferred Income Taxes		60,012	22,366
Deferred Liabilities		30,209	30,505
	Total Liabilities	1,571,505	687,459
Stockholders' Equity	Common Stock (par value $.50 per share; shares authorized 126,900,000; shares issued, including shares in treasury, 60,221,312 shares in 2001; 53,321,312 in 2000)	30,110	26,660
	Additional paid-in capital	216,756	34,267
	Retained earnings	522,805	490,860
	Other	(1,551)	(306)
		768,120	551,481
	Less cost of Common Stock in treasury (2001 – 10,739,685 shares; 2000 – 10,840,142 shares)	113,555	113,910
	Total Stockholders' Equity	654,565	437,571
	Total Liabilities and Stockholders' Equity	$2,226,070	$1,125,030

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Thousands, except per share amounts)

For the Year Ended	October 26, 2001	October 27, 2000	October 29, 1999
Net Sales	$ 1,920,970	$ 1,483,320	$1,387,677
Cost and Expenses:			
Cost of sales	1,346,934	1,039,267	960,395
Research and development	58,105	46,353	44,091
Selling and administrative	303,796	224,290	222,275
Amortization Expense	29,283	10,675	7,559
Restructuring	21,930	(1,200)	8,346
Income from Operations	160,922	163,935	145,011
Other (Income)/Expense, net	(2,787)	200	(9,164)
Interest expense	72,559	21,989	19,089
Income before Income Taxes	91,150	141,746	135,086
Income taxes	39,650	55,280	52,944
Net Income	$ 51,500	$ 86,466	$ 82,142
Net Income Per Common Share - Basic	$ 1.12	$ 2.02	$ 1.90
Net Income Per Common Share - Diluted	$ 1.10	$ 2.00	$ 1.87

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in Thousands, except per share amounts)

	Common Stock		Additional Paid-In	Retained		Treasury
	Shares	Amount	Capital	Earnings	Other	Stock
Balance October 30, 1998	53,321,312	$ 26,660	$ 24,880	$367,040	$(2,776)	$ 75,616
Common stock options exercised for 50,007 shares	–	–	715	–	–	(406)
Purchase of 494,400 shares of common stock for treasury	–	–	–	–	–	17,585
Comprehensive Income:	–	–	–	–	–	–
Net income	–	–	–	82,142	–	–
Foreign currency translation, net of tax	–	–	–	–	4,679	–
Cash dividends on common stock - $.46 per share	–	–	–	(19,785)	–	–
Other	–	–	3,301	–	94	399
Balance October 29, 1999	53,321,312	$ 26,660	$ 28,896	$429,397	$ 1,997	$ 93,194
Common stock options exercised for 84,893 shares	–	–	1,101	–	–	(840)
Purchase of 661,000 shares of common stock for treasury	–	–	–	–	–	21,124
Comprehensive income:	–	–	–	–	–	–
Net income	–	–	–	86,466	–	–
Foreign currency translation, net of tax	–	–	–	–	(1,306)	–
Cash dividends on common stock - $.52 per share	–	–	–	(22,185)	–	–
Other	–	–	4,270	(2,818)	(997)	432
Balance October 27, 2000	53,321,312	$ 26,660	$ 34,267	$490,860	$ (306)	$113,910
Common stock options exercised for 141,578 shares	–	–	918	–	–	(1,225)
Common stock issuance and sale of 6,900,000 shares, net	6,900,000	3,450	181,239	–	–	–
Comprehensive income:	–	–	–	–	–	–
Net income	–	–	–	51,500	–	–
Foreign currency translation, net of tax	–	–	–	–	(1,245)	–
Cash dividends on common stock - $.54 per share	–	–	–	(24,856)	–	–
Other	–	–	332	5,301	–	870
Balance October 26, 2001	60,221,312	$ 30,110	$216,756	$522,805	$(1,551)	$113,555

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	For the Year Ended	October 26, 2001	October 27, 2000	October 29, 1999
Operating Activities	Net income	$ 51,500	$ 86,466	$ 82,142
	Adjustments to reconcile net income to net cash provided by operating activities:			
	Restructuring and non-recurring charge	39,300	(1,200)	8,346
	Depreciation	43,767	34,563	32,241
	Amortization	29,283	10,675	7,559
	Deferred income taxes	15,055	11,526	(9,619)
	Gain on sales or abandonment of property, plant and equipment	(3,512)	–	3,358
	Gain on sales of investments	(736)	–	(13,850)
	Changes in certain assets and liabilities, net of effects of acquired businesses:			
	Decrease (increase) in accounts and notes receivable	20,214	(17,100)	(9,513)
	Decrease (increase) in inventories and other assets	10,108	(14,397)	(1,348)
	Increase (decrease) in trade accounts payable and accrued liabilities	(26,989)	(8,074)	12,687
	Increase (decrease) in income taxes payable	8,293	(10,952)	15,849
	Increase (decrease) in other deferred liabilities	6,048	(792)	717
	Other	5,278	2,623	(1,320)
	Net Cash Provided by Operating Activities	197,609	93,338	127,249
Investing Activities	Purchases of property, plant and equipment	(36,200)	(32,425)	(31,400)
	Acquired businesses, net of cash	(830,664)	(3,935)	(240,657)
	Divested businesses/assets	22,430	–	37,678
	Other investments/advances to joint ventures	–	(15,586)	(459)
	Net Cash Used in Investing Activities	(844,434)	(51,946)	(234,838)
Financing Activities	Net proceeds from borrowings	484,053	(12,278)	162,037
	Proceeds from sales of treasury stock	2,143	1,941	1,121
	Proceeds from equity offering	184,689	–	–
	Purchase of shares of Common Stock for treasury	–	(21,124)	(17,585)
	Dividends paid	(24,856)	(22,185)	(19,785)
	Net Cash provided by/(used in) financing activities	646,029	(53,646)	125,788
	(Decrease)/Increase in cash and cash equivalents	(796)	(12,254)	18,199
Cash and Cash Equivalents at Beginning of Year		20,935	33,189	14,990
Cash and Cash Equivalents at End of Year		$ 20,139	$ 20,935	$ 33,189

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Valspar Corporation • Years Ended October 2001, 2000 and 1999
(Dollars in thousands except per share amounts)

NOTE 1 - Significant Accounting Policies

Fiscal Year: The Company has a 4-4-5 accounting cycle with the fiscal year ending on the Friday on or immediately preceding October 31. All years presented include 52 weeks.

Principles of Consolidation: The consolidated financial statements include the accounts of the parent company and its subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation. Investments in which the Company has a 20 to 50 percent interest and where the Company does not have management control are accounted for using the equity method.

Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Revenue Recognition: Other than long-term warranty programs, revenue from sales is recognized upon product shipment and passage of title to the customer. Revenue from long-term warranty programs is recognized based on the ratio of costs incurred to estimated total costs at program completion, using historical claim data. Adjustments in estimated costs are reflected in earnings in the current period. Anticipated losses on programs in progress are charged to earnings when identified.

Cash Equivalents: The Company considers all highly liquid instruments purchased with an original maturity of less than three months to be cash equivalents.

Inventories: Inventories are stated at the lower of cost or market. The Company's domestic inventories are recorded on the last-in, first-out (LIFO) method. The remaining inventories are recorded using the first-in, first-out (FIFO) method.

Property, Plant and Equipment: Property, plant and equipment are recorded at cost. Provision for depreciation of property is made by charges to operations at rates calculated to amortize the cost of the property over its useful life (twenty years for buildings; three to ten years for machinery and equipment) primarily using the straight-line method. Effective October 30, 1999, the Company adopted Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use".

Intangible and Long-Lived Assets: Intangible assets, including goodwill, are carried at cost and amortized using the straight-line method over their estimated period of benefit (6 to 40 years). The Company reviews its intangible and long-lived assets for impairment in accordance with Statement of Financial Accounting Standard No. 121 (SFAS 121). Under SFAS 121, impairment losses are recorded on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

Stock Options: As permitted by Statement of Financial Accounting Standards No. 123 (SFAS 123), the Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting For Stock Issued to Employees" and its interpretations in accounting for its stock options and other stock-based employee compensation awards. Pro forma information regarding net income and earnings per share as calculated under the fair value provisions of SFAS 123 is disclosed in Note 8 to the financial statements.

Foreign Currency: Foreign currency denominated assets and liabilities are translated into U.S. dollars using the exchange rates in effect at the balance sheet date. Results of operations are translated using the average exchange rates throughout the period. The effect of exchange rate fluctuations on translation of assets and liabilities are recorded as a component of stockholders' equity. Gains and losses from foreign currency transactions are included in other (income)/expense, net.

Net Income Per Share: The following table reflects the components of common shares outstanding for each of the three years ended October 26, 2001 in accordance with Statement of Financial Accounting Standards No. 128 (SFAS 128):

	2001	2000	1999
Weighted average common shares outstanding–basic	46,062,459	42,706,168	43,298,367
Dilutive effect of stock options	595,296	489,599	537,212
Equivalent average common shares outstanding diluted	46,657,755	43,195,767	43,835,579

Under the provisions of SFAS 128, basic earnings per share are based on the weighted average number of common shares outstanding during each year. In computing diluted earnings per share, the number of common shares outstanding is increased by common stock options with

exercise prices lower than the average market prices of common shares during each year and reduced by the number of shares assumed to have been purchased with proceeds from the exercised options.

Financial Instruments: All financial instruments are held for purposes other than trading. The estimated fair values of the Company's financial instruments approximate their carrying amounts in the consolidated balance sheet at October 26, 2001.

Comprehensive Income: Comprehensive income consists of net income and foreign currency translation adjustment and is presented in the Consolidated Statements of Changes in Stockholders' Equity.

NOTE 2 – Acquisitions and Divestitures

Effective July 31, 2001, the Company acquired the Packaging Coatings business of Coates Brothers in Singapore, Malaysia, Indonesia and Thailand. Revenues for these businesses were $7 million in 2000. This acquisition significantly strengthens the Company's presence in the Southeast Asia packaging coatings market. The transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company's financial statements from the date of acquisition. The effect of this transaction on the Company's results of operations for 2001 was not material.

Effective December 20, 2000, the Company acquired all outstanding Class A and Class B stock of Lilly Industries, Inc. for $31.75 per share in cash. Total consideration paid was approximately $1,036 million, including the assumption of debt of approximately $218 million. Lilly Industries was one of the five largest industrial coatings and specialty chemicals manufacturers in North America, with reported net sales of $656.2 million for the year ended November 30, 1999, and $669.7 for the year ended November 30, 2000. Lilly Industries formulates, manufactures and markets industrial coatings and specialty chemicals to original equipment manufacturers for products such as home and office furniture, cabinets, appliances, building products, transportation, and agricultural and construction equipment. The transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company's financial statements from the date of acquisition. The excess of the purchase price over the estimated fair value of the net assets acquired has been recorded as goodwill, and prior to the adoption of Statement of Financial Accounting Standards No. 142, is being amortized over the estimated period of benefit.

The following unaudited pro forma combined summary statements of income information for the twelve month periods ended October 26, 2001 and October 27, 2000 were prepared in accordance with Accounting Principles Board Opinion No. 16 and assumes the acquisition had occurred at the beginning of the periods presented. The following pro forma data reflect adjustments for interest expense, amortization of goodwill and depreciation of fixed assets. The unaudited pro forma financial information is provided for informational purposes only and does not purport to be indicative of the future results of the Company.

Unaudited Pro Forma Consolidated Statements of Income
(Thousands of dollars, except per share data)

	Year ended October 26, 2001	Year ended October 27, 2000
Net sales	$ 2,018,468	$ 2,153,019
Net income	45,420	57,275
Net income per share-basic	.99	1.34
Net income per share-diluted	.97	1.33

During the first quarter of fiscal 2001, the Company completed the sale of its existing Mirror Coatings business as a condition of Federal Trade Commission approval for the Lilly Industries acquisition. This product line had revenues of approximately $12 million for the year ended October 27, 2000. The effect of this divestiture on the Company's results of operations for 2001 was not material.

In November 2000, the Company acquired the 49% interest in The Valspar (Mexico) Corporation, S.A. de C.V. held by its joint venture partner. The Valspar (Mexico) Corporation has operations in Mexico City and Monterrey and produces Industrial and Packaging coatings. The transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company's financial statements from the date of acquisition. The effect of this transaction on the Company's results of operations for 2001 was not material.

In December 1997, as a part of the Coates acquisition, the Company acquired a 49% interest in a joint venture with Coates for packaging coatings in South Africa. In February 1999, as a part of the Dexter acquisition, the Company acquired Dexter's majority position in a joint venture with Plascon (Pty) Limited, a South African company, for packaging coatings in South Africa. As of October 2000, the Company acquired Coates' 51% interest in the Valspar/Coates joint venture and reorganized the businesses of both South African joint ventures so that Valspar now has a majority position in a joint venture with Plascon for a combined packaging coatings business in South Africa. The transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company's financial statements from the date of acquisition. The effect of this transaction on the Company's results of operations for 2000 was not material.

Effective September 30, 1999, the Company acquired the 50% interest in Farboil Company held by its joint venture partner. Farboil Company, located in Baltimore, Maryland, produces decorative powder coatings with annual revenues in 1999 of $17 million. The transaction was accounted for as a purchase. Accordingly, the net assets and operating

results have been included in the Company's financial statements from the date of acquisition.

Effective February 26, 1999, the Company acquired Dexter Corporation's worldwide packaging coatings business and its French industrial coatings subsidiary, Dexter SAS. Dexter is a worldwide supplier of beverage can, food can and specialty coatings to the packaging market. Dexter SAS supplies a variety of coatings to the European industrial market. The transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company's financial statements from the date of acquisition. The excess of the purchase price over the estimated fair value of the net assets acquired has been recorded as good will and is being amortized over the estimated period of benefit.

Effective December 17, 1998, the Company acquired a majority interest in Dyflex B.V., a Netherlands based producer of specialty water-based polymers. The transaction was accounted for as a purchase. Accordingly, the net assets and operating results have been included in the Company's financial statements from the date of acquisition.

Effective March 26 and April 20,1999, the Company completed the sale of its Marine and Flexible Packaging Coatings product lines. These product lines had revenues of $25 million and $12 million, respectively, for the year ended October 1998.

NOTE 3 - Restructuring

In September 2001, the Company's Board of Directors approved and the Company initiated actions to eliminate redundant facilities and functions resulting from the Lilly Industries acquisition in order to accelerate performance improvement. These actions resulted in the Company recording aggregate pre-tax charges of $39,300. The charges include $21,930 classified as restructuring and $17,370 of inventory and other asset write-downs classified in cost of sales. Through October 26, 2001, the Company has paid or incurred $21,678 of the $39,300 charge. The Company anticipates that substantially all of the remaining restructuring costs will be paid by October 25, 2002.

	Total Charge	Incurred through October 26, 2001	Balance October 26, 2001
Severance costs	$ 8,384	$ 888	$ 7,496
Exit and termination costs	2,049	115	1,934
Property, plant and equipment	11,497	7,733	3,764
Inventory and other assets	17,370	12,942	4,428
	$ 39,300	$ 21,678	$ 17,622

These plans contemplated a workforce reduction of worldwide headcount by 350 or five percent. As of October 26, 2001 the Company had communicated the benefits due to employees resulting from the workforce reduction. The net cash impact of the charges over the next two years will be negligible.

During 1999, the Company initiated actions to eliminate redundant facilities and functions resulting from the acquired Dexter packaging coatings operations, resulting in a pre-tax restructuring charge of $8,346. During 2000, accruals in the amount of $1,200 were reversed related to lower than estimated costs.

NOTE 4 - Inventories

The major classes of inventories consist of the following:

	2001	2000
Manufactured products	$ 114,967	$ 108,225
Raw materials, supplies and work-in-process	70,598	46,662
	$ 185,565	$ 154,887

Inventories stated at cost determined by the last-in, first-out (LIFO) method aggregate $128,450 at October 26, 2001 and $108,031 at October 27, 2000, approximately $28,530 and $27,335 lower, respectively, than such costs determined under the first-in, first-out (FIFO) method.

NOTE 5 - Trade Accounts Payable and Accrued Liabilities

Trade accounts payable include $24,459 and $23,326 of issued checks which had not cleared the Company's bank accounts as of October 26, 2001 and October 27, 2000, respectively.

Accrued liabilities include the following:

	2001	2000
Employee compensation	$ 58,860	$ 43,879
Uninsured loss reserves	56,372	22,575
Customer volume rebates	34,006	25,541
Contribution to employees' retirement trusts	5,642	7,789
Restructuring	17,622	1,093
Deferred Revenue	17,619	–
Other	45,174	28,310
Total	$ 235,295	$ 129,187

The increase in accrued liabilities is due to the Lilly acquisition, restructuring, and deferred revenue.

NOTE 6 - Long-Term Debt and Credit Arrangements

Long-term debt consists of the following:

	2001	2000
Notes to banks		
(3.225% - 5.6233% at October 26, 2001)	$ 890,597	$ 283,741
Senior Notes		
(7.75% at October 26, 2001 payable in 2007)	100,000	
Industrial development bonds		
(2.2 - 7.6% at October 26,		
2001, payable in 2015 and 2018)	14,955	15,204
Obligations under capital lease		
(7.5% at October 26, 2001,		
payable through 2004)	1,151	1,819
	$ 1,006,703	$ 300,764
Less current maturities	(486)	(464)
	$ 1,006,217	$ 300,300

The Company has $1,150,000 of committed revolving multi-currency credit facilities with two syndicates of banks at optional interest rates of prime or IBOR-based rates. The 364-day facility in the amount of $150,000 matures November 14, 2002 and the five-year facility in the amount of $1,000,000 matures November 17, 2005. Included in the $1 billion credit facility are notes to banks totaling $890,597 at October 26, 2001 and $283,741 at October 27, 2000. The maturities of the remaining long-term debt are as follows: 2002 - $486; 2003 - $519; 2004 - $718; 2005-$150; 2006-$127 and $114,106 thereafter. The revolving credit loan agreement contains covenants that require the Company to maintain certain financial ratios. The Company is in compliance with these covenants as of October 26, 2001.

Under other short-term bank lines of credit around the world, the Company may borrow up to $118,673 on such terms as the Company and the banks may mutually agree. These arrangements are reviewed periodically for renewal and modification. Borrowings under these debt arrangements, including the revolver, had an average annual interest rate of 6.37% in 2001 and 6.06% in 2000.

The Company had unused lines of credit under short-term bank lines and the revolving credit facility of $688,429 at October 26, 2001, which was reduced by $350 million in November 2001.

Interest paid during 2001, 2000 and 1999 was $67,660, $22,369 and $19,092, respectively.

NOTE 7 - Income Taxes

Significant components of the provision for income taxes are as follows:

Year Ended	2001	2000	1999
Current			
Federal	$ 14,558	$ 32,312	$ 49,820
State	(1,443)	3,412	5,943
Foreign	7,938	8,212	5,319
Total Current	21,053	43,936	61,082
Deferred			
Federal	15,302	9,586	(4,717)
State	2,731	1,565	(860)
Foreign	564	193	(2,561)
Total Deferred	18,597	11,344	(8,138)
Total Income Taxes	$ 39,650	$ 55,280	$ 52,944

Significant components of the Company's deferred tax assets and liabilities are as follows:

	2001	2000	1999
Deferred tax assets:			
Product liability accruals	$ 9,372	$ 2,508	$ 2,749
Insurance accruals	3,392	3,418	4,459
Deferred compensation	7,414	7,125	7,797
Workers' compensation accruals	2,141	2,538	2,177
Employee compensation accruals	2,693	1,931	2,943
Other	31,769	20,974	19,142
Total deferred tax assets	56,781	38,494	39,267
Deferred tax liabilities:			
Tax in excess of book depreciation	(33,510)	(24,445)	(15,336)
Other	(42,736)	(17,951)	(16,658)
Total deferred tax liabilities	(76,246)	(42,396)	(31,994)
Net deferred tax (liabilities)/assets	$ (19,465)	$ (3,902)	$ 7,273

A reconciliation of income tax computed at the U.S. Federal statutory tax rate to the effective income tax rate is as follows:

	2001	2000	1999
Tax at U.S. statutory Rate	35.0%	35.0%	35.0%
Goodwill Amortization	5.5%	0.5%	0.4%
State income taxes, net of Federal benefit	0.8%	2.1%	2.4%
Non-U.S. Taxes	2.7%	0.7%	0.1%
Other	-0.5%	0.7%	1.3%
	43.5%	39.0%	39.2%

No provision has been made for U.S. Federal Income taxes on certain undistributed earnings of foreign subsidiaries that the Company intends to permanently invest or that may be remitted substantially tax-free. The total of undistributed earnings that would be subject to federal income tax if remitted under existing law is approximately $84,931 at October 26, 2001. Determination of the unrecognized deferred tax liability related to these earnings is not practicable because of the complexities with its hypothetical calculation. Upon distribution of these earnings, the Company will be subject to U.S. taxes and withholding taxes payable to various foreign governments. A credit for foreign taxes already paid would be available to reduce the U.S. tax liability.

Income taxes paid during 2001, 2000 and 1999 were $21,292, $51,669 and $45,749, respectively.

NOTE 8 - Stock Plans

Stock Options: Under the Company's Stock Option Plan, options for the purchase of up to 8,000,000 shares of common stock may be granted to officers, employees and non-employee directors. Options are issued at market value at the date of grant and are exercisable in full or in part over a prescribed period of time.

As permitted by SFAS 123, the Company has elected to continue following the guidance of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" for measurement and recognition of stock-based transactions with employees. Accordingly, no compensation expense has been recorded for options granted under the stock option plan as the exercise price equals or exceeds the market price of the underlying stock on the date of grant. Had compensation expense for the stock option plan been determined based on the fair value at the date of grant, consistent with the provisions of SFAS 123, the Company's net income and earnings per share would have been reported as follows:

	2001	2000	1999
Pro forma net income	$49,785	$ 79,406	$ 80,974
Pro forma earnings per share:			
Basic	1.08	1.86	1.87
Diluted	1.07	1.84	1.85

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2001	2000	1999
Expected dividend yield	1.5%	1.5%	1.5%
Expected stock price volatility	29.8%	27.9%	22.2%
Risk-free interest rate	4.2%	5.5%	6.2%
Expected life of options	6 years	6 years	6 years

The weighted average fair value for options granted during 2001, 2000 and 1999 is $11.05, $10.83, and $8.71 per share, respectively. Stock option activity for the three years ended October 26, 2001 is summarized as follows:

	Shares Reserved	Options Outstanding	Weighted Average Exercise Price
October 30, 1998 Balance	1,691,481	1,600,368	$ 22.70
Shares reserved	2,250,000	–	–
Granted	(706,500)	706,500	$ 35.02
Exercised		(50,007)	$ 22.40
Canceled	28,466	(28,466)	$ 32.24
October 29, 1999 Balance	3,263,447	2,228,395	$ 26.49
Shares reserved	–	–	–
Granted	(1,444,172)	1,444,172	$ 33.32
Exercised	–	(84,893)	$ 22.86
Canceled	68,192	(68,192)	$ 37.24
October 27, 2000 Balance	1,887,467	3,519,482	$ 29.47
Shares reserved	3,010,000	–	–
Granted	(2,428,825)	2,428,825	$ 32.16
Exercised	–	(130,364)	$ 20.94
Canceled	163,554	(163,554)	$ 35.92
October 26, 2001	2,632,196	5,654,389	$ 30.64

Options outstanding at October 26, 2001 had an average remaining contractual life of 7.86 years. Options exercisable of 2,395,331 at October 26, 2001, 1,911,232 at October 27, 2000, and 939,257 at October 29, 1999 had weighted average exercise prices of $26.32, $23.20, and $19.61, respectively. The exercise price for options outstanding as of October 26, 2001 range from $12.00 to $40.31, with 1,372,214 shares outstanding in the $12.00 - $25.00 range and 4,282,175 shares outstanding in the $25.00 - $40.31 range.

Employee Stock Ownership Plans: Under the Company's Employee Stock Ownership Plans, substantially all of the Company's domestic employees are eligible to participate and may contribute 1% to 9% of their compensation to the Plans. The Company contributes a minimum amount equal to one-half of the employee contributions up to 3% of employees' compensation, with the potential to match up to 6% based upon the financial performance of the Company. The Company's contributions were $4,328, $3,314 and $5,307, for 2001, 2000 and 1999, respectively.

Key Employee Bonus Plan: In 1993, the Company established a Key Employee Bonus Plan for certain employees. Under the Plan, participants can elect to convert all or any portion of the cash bonus awarded under certain incentive bonus plans into a grant of restricted stock receivable three years from the date of grant.

NOTE 9 - Leasing Arrangements

The Company has operating lease commitments outstanding at October 26, 2001, for plant and warehouse equipment, office and warehouse space, and automobiles. The leases have initial periods ranging from one to ten years, with minimum future rental payments as follows:

	Minimum Lease Payments
2002	$ 8,533
2003	6,595
2004	3,867
2005	1,045
2006	838
2007 and beyond	2,373
	$ 23,251

Rent expense for operating leases was $12,408 in 2001, $6,426 in 2000 and $6,338 in 1999.

NOTE 10 – Pensions and Other Postretirement Benefits

The Company sponsors a Profit Sharing Plan for substantially all of its domestic employees. Under the Plan, the Company makes a contribution based on return on assets as defined in the Plan up to a maximum of 10% of the aggregate compensation of eligible participants. Contributions to the Profit Sharing Plan totaled $9,264, $10,657, and $9,869, for 2001, 2000, and 1999, respectively.

The Company also sponsors a number of defined benefit pension plans for certain hourly and foreign employees. The benefits for these plans are generally based on stated amounts for each year of service. The Company funds the plans in amounts consistent with the limits of allowable tax deductions. The Company assumed the liabilities and assets under the Lilly pension plan for employees eligible as of the date of acquisition.

The cost of the pension benefits is as follows:

Net Periodic Cost	2001	2000	1999
Service cost	$ 1,837	$ 1,185	$ 1,158
Interest cost	7,861	2,328	2,016
Expected return on plan assets	(12,774)	(3,818)	(3,059)
Amortization of transition asset obligation	(301)	(91)	(92)
Amortization of prior service cost	817	343	367
Recognized actuarial gain	(409)	(406)	(292)
Net-periodic benefit cost	(2,969)	(459)	98
Settlement gain	–	(787)	–
Net-periodic benefit cost after settlement	$ (2,969)	$(1,246)	$ 98

The plans' funded status is shown below, along with a description of how the status changed during the past two years. The benefit obligation is the projected benefit obligation—the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date.

Change in Benefit Obligation	2001	2000
Benefit obligation at beginning of year	$ 37,582	$ 35,628
Service cost	1,837	1,185
Interest cost	7,861	2,328
Plan participants' contributions	125	134
Amendments	1,316	148
Actuarial loss	20,889	2,278
Acquisitions	79,211	–
Benefits paid	(5,813)	(1,824)
Settlements	–	(2,295)
Benefit obligation at end of year	$ 143,008	$ 37,582

Change in Plan Assets	2001	2000
Fair value of plan assets at beginning of year	$ 51,806	$ 47,460
Actual return on plan assets	(6,955)	6,759
Employer contributions	628	1,572
Plan participants' contributions	125	134
Benefit payments	(5,813)	(1,824)
Acquisitions	94,240	–
Settlements	–	(2,295)
Fair value of plan assets at end of year	$134,031	$ 51,806

Funded Status	2001	2000
Funded status at end of year	$ (8,977)	$ 14,224
Unrecognized transition asset	(1,098)	(871)
Unrecognized prior service cost	7,752	3,414
Unrecognized net loss/(gain)	24,534	(11,622)
Net amount recognized in statement of financial position	$ 22,211	$ 5,145

The actuarial assumptions were as follows:

	2001	2000
Discount rate	6.0%-7.0%	6.25%-7.25%
Expected return on plan assets	7.0%-9.0%	7.0%-9.0%
Average increase in compensation	2.75%-4.0%	3.75%-6.0%

In addition to the Company's defined benefit pension plans, the Company sponsors a health care plan that provides post-retirement medical benefits for some of its employees. The Company's policy is to fund these benefits as they are paid. The Company's accrued post-retirement benefit liability recognized in the Company's balance sheet was $5,331 and $1,607 at October 26, 2001 and October 27, 2000, respectively. Net periodic post-retirement expense was $487, $150 and $95 in 2001, 2000 and 1999, respectively.

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 7.0% and 7.5% at October 26, 2001 and October 27, 2000, respectively. The assumed health-care cost trend rate used in measuring the accumulated post-retirement benefit obligation was 6.5% in 2001, then declining by .5% per year to an ultimate rate of 5.5%. A 1% change in the cost trend rate would not have a material effect on the accumulated post-retirement benefit obligation or net periodic post-retirement expense.

NOTE 11 - Segment Information

Prior to the Lilly Industries acquisition, the Company had two reportable segments: coatings and coating intermediates. Following the acquisition, the Company included the former Lilly Industries operations in its coatings segment, and the coating intermediates segment no longer meets the quantitative criteria for separate reporting. The Company now refers to these products as Other.

The Company now operates its business in one reportable segment: Coatings. The Company manufactures and distributes a broad portfolio of coatings products. The Industrial product line includes decorative and protective coatings for wood, metal, plastic, and glass. The Architectural, Automotive, and Specialty (AAS) product line includes interior and exterior decorative paints, primers, varnishes and specialty decorative products, such as enamels, aerosols and faux finishes, as well as automotive refinish and high performance floor coatings. The Packaging product line includes coatings and inks for rigid packaging containers. The Other category includes specialty polymers and colorants, which are used internally and sold to other coatings manufacturers.

Net sales by product line are as follows:

	2001	2000	1999
Industrial	$ 739,479	$ 372,142	$ 328,669
AAS	558,262	505,087	510,960
Packaging	494,146	508,536	452,846
Other	129,083	97,555	95,202
	$ 1,920,970	$ 1,483,320	$ 1,387,677

Geographic net sales are based on the country from which the customer was billed for the products sold. The United States is the largest country for customer sales. No single country outside the United States represents more than 10% of consolidated net sales. Long-lived assets include property, plant and equipment and goodwill attributable to each country's operations. No single country outside the United States represents more than 10% of consolidated long-lived assets. Net sales and long-lived assets by geographic region are as follows:

	2001	2000	1999
Net sales-External			
United States	1,470,394	1,137,219	1,116,347
Outside United States	450,576	346,101	271,330
Total net sales-External	1,920,970	1,483,320	1,387,677

	2001	2000	1999
Long-lived assets:			
United States	1,245,059	343,813	339,760
Outside United States	222,748	163,682	191,041
Total long-lived assets	1,467,807	507,495	530,801

NOTE 12 - Quarterly Results of Operations (Unaudited)

The following is a tabulation of the unaudited quarterly results for the years ended October 26, 2001 and October 27, 2000:

	Net Sales	Gross Margin	Net Income	Net Income Per Share-Diluted
2001 Quarter Ended:				
January 26	$ 336,980	$ 93,335	$ 4,458	$ .10
April 27	513,745	162,099	19,036	.44
July 27	544,888	170,392	25,502	.51
October 26	525,357	148,210	2,504	.05
	$ 1,920,970	$ 574,036	$ 51,500	$ 1.10
2000 Quarter Ended:				
January 28	$ 323,671	$ 92,441	$ 11,455	$ .26
April 28	392,780	120,025	25,371	.59
July 28	385,070	117,292	25,466	.59
October 27	381,799	114,295	24,174	.56
	$1,483,320	$ 444,053	$ 86,466	$ 2.00

NOTE 13 - Recently Issued Accounting Standards

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards no. 144 (SFAS 144), "Accounting for the Impairment and Disposal of Long-Lived Assets," which is effective for fiscal years beginning after December 15, 2001. The adoption of this standard is not expected to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 (SFAS 141), "Business Combinations" and Statement of Financial Accounting Standards No. 142 (SFAS 142) "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangibles deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will early adopt these Statements effective October 27, 2001. Application of the non-amortization provisions of the Statement is expected to result in an annual increase of earnings of approximately $.35 per share. The Company will perform the first of the required tests for impairment of goodwill and indefinite lived intangible assets as of the beginning of Fiscal 2002 and will complete the initial impairment test by the end of the second quarter of 2002.

Effective October 28, 2000, the Company adopted Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." The Company has developed procedures and policies for the use of derivative instruments and hedging strategies. The adoption of this standard did not have a material impact on the Company's consolidated results of operations, financial position or cash flows.

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

Board of Directors and Stockholders
The Valspar Corporation

We have audited the accompanying consolidated balance sheets of The Valspar Corporation and subsidiaries as of October 26, 2001 and October 27, 2000 and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended October 26, 2001. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Valspar Corporation and subsidiaries at October 26, 2001 and October 27, 2000 and the consolidated results of their operations and their cash flows for each of the three years in the period ended October 26, 2001, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Minneapolis, Minnesota
November 16, 2001

REPORT OF MANAGEMENT

Board of Directors and Stockholders
The Valspar Corporation

The management of The Valspar Corporation is responsible for the integrity and objectivity of the financial statements and related information presented in this report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles. Where necessary, they reflect estimates based on management's judgment.

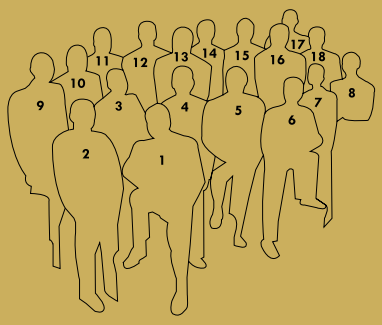
Management relies upon established accounting procedures and related systems of internal control for meeting its responsibilities to maintain reliable financial records. These systems are designed to provide reasonable assurance that assets are safeguarded and that transactions are recorded and executed in accordance with management's intentions. This system is supported by written policies and procedures, an effective internal audit function and qualified financial staff.

The Audit Committee of the Board of Directors, composed of outside directors, meets regularly with management, the Company's internal auditors and its independent auditors to discuss the adequacy and effectiveness of audit functions, control systems and the quality of financial accounting and reporting. The independent and internal auditors have access to the Audit Committee without management's presence.

Richard M. Rompala
Chairman, President and Chief Executive Officer

Paul C. Reyelts
Senior Vice President, Finance and Chief Financial Officer

VALSPAR'S CHAIRMAN'S COUNCIL



Seated in front: Ken Arthur(1)
Row 1: Tom White(2), Deborah Weiss(3), Rolf Engh(4), Steve Erdahl(5), Joel Hart(6), Lori Walker(7), Tom Wood(8)
Row 2: Gary Hendrickson(9), Gary Gardner(10), Bill Mansfield(11), John Ballbach(12), Rich Rompala(13), John Knox(14), Don Nolan(15), Larry Brandenburger(16), Steve Lindberg(17), Paul Reyelts(18)

CORPORATE DATA

DIRECTORS

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Jeffrey H. Curler
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Charles W. Gaillard
Retired President, General Mills, Inc.
Thomas R. McBurney
President,
McBurney Management Advisors
Gregory R. Palen
Chairman and Chief Executive Officer,
Spectro Alloys Corporation
Lawrence Perlman
Chairman, Arbitron, Inc.
Chairman and Chief Executive Officer,
XIOtech Corporation
Private Investor
Edward B. Pollak
Retired Senior Vice President,
Olin Corporation
Richard M. Rompala
Chairman, President and Chief Executive Officer,
The Valspar Corporation
Michael P. Sullivan, Sr.
Chairman of the Board,
International Dairy Queen, Inc.
Richard L. White, Ph.D.
Former Executive Vice President,
Bayer Corporation

OFFICERS

Richard M. Rompala
Chairman, President and Chief Executive Officer
John M. Ballbach
Senior Vice President,
EPS, Color Corporation of America and Operations
Rolf Engh
Senior Vice President, General Counsel and Secretary
Steven L. Erdahl
Senior Vice President, Industrial and Automotive Coatings
William L. Mansfield
Senior Vice President,
Architectural, Packaging and Specialty Coatings
Paul C. Reyelts
Senior Vice President, Finance and Chief Financial Officer
Kenneth H. Arthur
Group Vice President, Architectural
Joel C. Hart
Group Vice President, Automotive, International and Glass
Robert T. Smith
Group Vice President, Industrial
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Vice President, Technology, Research and Development
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Vice President, Human Resources and Public Affairs
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Vice President and President – Packaging Asia-Pacific
John R. Knox
Vice President and President – Packaging Europe,
South Africa and Middle East
Steven C. Lindberg
Vice President, Engineered Polymer Solutions and
Color Corporation of America
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Vice President and Vice President – Packaging Americas
Lori A. Walker
Vice President and Controller
Deborah D. Weiss
Vice President and Treasurer
Thomas A. White
Vice President, Manufacturing
Thomas L. Wood
Vice President and President – Valspar Sourcing

CORPORATE HEADQUARTERS

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Internet: www.valspar.com

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Overpeck Centre, Ridgefield Park, NJ 07660
Phone: 800-205-8318
Internet: www.melloninvestor.com

ANNUAL MEETING

Wednesday, February 27, 2002, 11:00 AM CST, Valspar Corporate Research and Development Center, 312 South 11th Avenue, Minneapolis, MN 55415

CORPORATE REPORTS, EARNINGS ANNOUNCEMENTS AND NEWS RELEASES

Shareholders seeking information about Valspar are invited to call or write to Corporate Secretary at Corporate Headquarters. Quarterly earnings releases, stock split history and other company announcements are published on Valspar's corporate website at www.valspar.com

STOCK TRADING

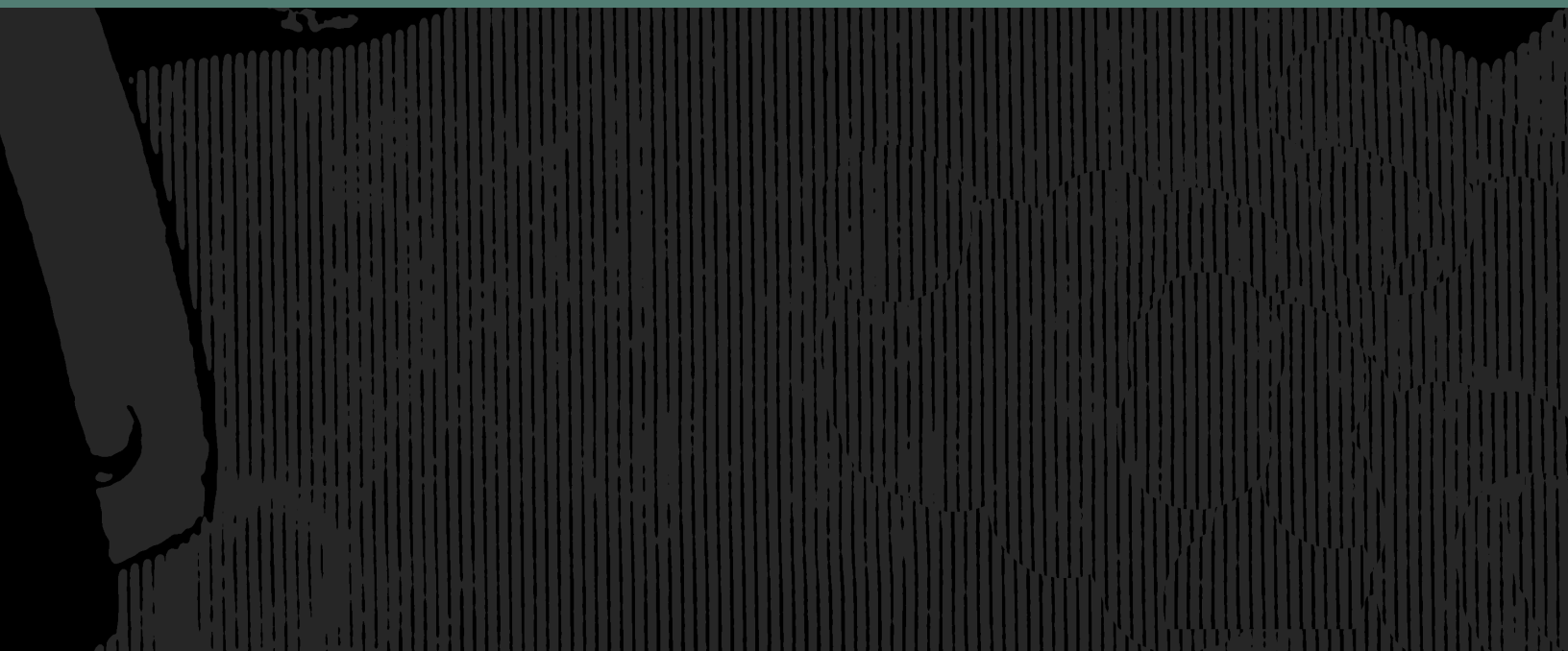
Valspar's common stock is traded on the New York Stock Exchange under the symbol VAL.

INVESTOR SERVICES PROGRAM/DIVIDEND REINVESTMENT PLAN

Investor Services Program, Mellon Investor Services LLC.
Call 800-842-7629 for information.
Internet: www.melloninvestor.com

The Valspar Corporation

1101 Third Street South

Minneapolis, MN 55415

Information on Valspar and its businesses is available on the World Wide Web at: www.valspar.com