



This is Innovation



Inside front cover photo: Ron North, Steve Raskin and Mabel Ugarte (left to right) represent several Office Products North America Horizons teams. In 2005, more than 600 Horizon 1 projects were launched across the Company to develop and market new products, services or applications.

Financial Overview

(Dollars in millions, except per share amounts)

	2005	2004	2003
Net sales from continuing operations	\$5,473.5	\$5,317.0	\$4,736.8
Net income from continuing operations	\$ 291.8	\$ 281.0	\$ 245.1
Net income from continuing operations as a percent of sales	5.3	5.3	5.2
Net income from continuing operations per common share, assuming dilution	\$ 2.90	\$ 2.79	\$ 2.45
Net income	\$ 226.4	\$ 279.7	\$ 267.9
Net income, as a percent of sales	4.1	5.3	5.7
Net income per common share, assuming dilution	\$ 2.25	\$ 2.78	\$ 2.68
Dividends per common share	1.53	1.49	1.45
Capital expenditures	171.6	205.7	203.6
Return on average shareholders' equity (percent)	14.6	19.9	22.3

This is Avery Dennison

Creating innovative new products, applications and services is one way we meet our commitment to long-term, top-line growth.

Dear Fellow Shareholders:

2005 was a challenging year, due primarily to intense raw material cost inflation that drove soft demand in some of our businesses. After an admittedly rough start, we made significant progress against our strategic priorities this past year:

> We successfully implemented pricing actions across most of our businesses, which offset more than \$100 million of additional raw material and energy-related costs. > We continued to capture the rapid growth of emerging markets, and we achieved a major milestone in our RFID business by commercializing our high-speed, high-volume manufacturing process. > We increased productivity, bringing the year to a close with a much improved operating margin and with significant actions under way to drive continued margin expansion over the next few years.

Highlights of our financial results for the year

- Reported sales from continuing operations grew to \$5.5 billion in 2005 — a 3 percent increase compared with 2004.
- Diluted earnings per share were \$2.25, compared with \$2.78 per share in 2004.
- Adjusted earnings per share on a diluted basis were \$3.46, compared with \$3.06 per share in 2004, reflecting growth of 13 percent. Adjusted earnings per share exclude restructuring, asset impairment, lease cancellation and divestiture-related charges and transition costs, as well as the incremental tax expense associated

with the repatriation of earnings from certain foreign subsidiaries, expense accrual related to a patent lawsuit and gain on sale of assets.

Focus on continued margin improvement

During the fourth quarter of 2005, we took actions across most of our businesses to accelerate productivity. While these actions negatively impacted 2005 earnings, we expect these steps will yield approximately \$80 million to \$90 million in annualized cost savings over the next two years.

In 2006, we will maintain our focus on improving margins as we continue to increase prices to offset additional raw material cost increases. Margins will also improve as we focus on growing higher margin product categories, such as our Avery-brand printable media products, and as we exit product lines which have little competitive advantage. We began that process in 2005 with the planned divestiture of certain European office filing products and our raised reflective highway marker businesses.

During 2005, we also embarked on a significant program to streamline and simplify our operations. Our businesses will continue to be organized globally with operations, commercial functions and R&D remaining decentralized and focused on our customers. Support



Dean A. Scarborough
President and Chief Executive Officer



Kent Kresa
Chairman of the Board of Directors

functions, such as human resources, information technology and accounting, will be more centralized to provide services to our business units more efficiently and effectively. The result will be businesses that have fewer layers, are more responsive to customers and ultimately more cost-effective.

Sales growth a key priority

Profitable top-line growth is a top priority. Revenue growth was less than expected in 2005, due to slower market conditions in North America and some higher than expected market share loss as we raised prices. We expect sales growth to improve in 2006 as market conditions stabilize.

The emerging markets of Asia, Eastern Europe and Latin America continue to be our most important growth driver. Sales in these markets, which have grown consistently at solid double-digit rates, reached nearly \$1.2 billion in 2005, comprising more than 20 percent of our total revenue. We are accelerating our investments to capture additional growth in these markets — particularly in China and India where we will expand the manufacturing base for our pressure-sensitive materials and retail information services businesses.

Major progress in RFID

RFID technology is the hottest development in supply chain management since the invention of the now ubiquitous bar code. Capturing a major share of the emerging RFID market continues to be a key priority.

Like the bar code, the ideal method for affixing an RFID chip and antenna to virtually any item is to use a pressure-sensitive label. Spurred by supplier requirements of leading global retailers, including Wal-Mart, Target, Metro and Tesco, as well as the U.S. Department of Defense, businesses around the world are beginning to enhance the performance of their supply chains to utilize RFID technology.

2005 was a year of solid progress. We commercialized our high-speed manufacturing process, and we introduced the industry's first high-volume Gen 2 RFID inlays at a highly competitive price. In addition, we signed an intellectual property licensing agreement with Intermec Corporation that provides us with access to certain portfolios of patented RFID technology, including applications for RFID-enabled tags and printers.

“RFID technology is the hottest development in supply chain management since the invention of the now ubiquitous bar code. Capturing a major share of the emerging RFID market continues to be a key priority.”

Our competitive advantages in this market are our low-cost, high-speed, high-yield inlay manufacturing process; superior technical design to achieve excellent read rates; and our close relationship with label converters. We believe that RFID “smart labels” and related Avery Dennison Intelligent Label Technology applications will be a large growth engine for our Company in years to come.

New markets, new products, new services

Demand for pressure-sensitive label materials continues to grow as the technology begins to penetrate new markets — particularly the food and beverage segment. Sales for pressure-sensitive materials for beer label applications were approximately \$35 million globally in 2005 and are growing rapidly. New materials for electronic products and other durable goods are also growing at double-digit rates. Our graphics and reflective materials businesses are showing strong growth in emerging markets.

Our Avery-brand office products continue to rank among the industry’s most distinguished and recognizable brand names. Avery-brand products enjoy a reputation for quality, reliability and convenience. We are sharpening our focus in this business by de-

emphasizing low-margin product lines while expanding our high-margin, printable media business through targeted marketing programs to drive sales.

Our retail information services business continues to serve major apparel manufacturers and retailers, growing through geographic expansion and the development of new products — such as our new heat-transfer label that is applied directly to apparel fabric.

Values and business ethics reinforced

Avery Dennison has a seven-decade tradition of operating with a solid set of values and business ethics. To reinforce the importance of these deeply rooted principles, we have implemented a global employee education program on our values, business ethics and code of conduct. This program provides training in local languages to help ensure that our employees are informed on proper business procedures.

Transitions

As planned, Philip M. Neal retired from the positions of chief executive officer and chairman of the board of directors in 2005. We thank Phil for his many contributions during his 32-year career at Avery Dennison. He played a vital role in building Avery Dennison’s solid foundation for future growth.

“We are optimistic about 2006 and beyond. Avery Dennison has market-leading positions in pressure-sensitive materials, office products and retail information services.”

Upon Phil’s retirement from the board, Kent Kresa was elected to the position of non-executive chairman. Kent has served on our board for more than seven years, and is chairman emeritus of Northrop Grumman Corporation where he worked for 28 years in a variety of positions, including chairman and chief executive officer for 13 years.

We also welcomed Patrick Siewert, senior advisor with Coca-Cola International, as a new addition to our board in 2005. His extensive marketing and operational management experience, particularly in Asian markets, will provide valuable insight to our Company.

Confidence in our future

We are optimistic about 2006 and beyond. Avery Dennison has market-leading positions in pressure-sensitive materials, office products and retail information services. Each of these businesses has solid competitive advantages in growing markets. Emerging markets and RFID also offer excellent opportunities for future growth.

Our productivity will accelerate as we streamline and simplify our organizational structure. We have the tools — including our Horizons growth program and

Enterprise Lean Sigma continuous improvement initiative — as well as an impressive, highly dedicated workforce to achieve our aggressive goals.

We thank our talented employees around the world for their hard work in 2005. Our accomplishments last year — from our successful cost reduction efforts to the introduction of a variety of new products and services — could not have been achieved without their commitment.

We thank you, our shareholders, for your support throughout the year. We look forward to achieving significant progress in 2006.

Sincerely,



Dean A. Scarborough
President and
Chief Executive Officer



Kent Kresa
Chairman of the Board
of Directors

March 10, 2006

This is Branding

How do you communicate a product's brand image more effectively? With eye-catching labels made with clear, pressure-sensitive Fasson-brand films.



This is A Brand New Market

China's Kingway Brewery Co. Ltd. is just one of a growing number of beer producers that use Avery Dennison's clear-on-clear label material to market their premium brands in restaurants and pubs.

New Applications for Untapped Markets

Growth opportunities for pressure-sensitive materials are virtually limitless, as consumer product manufacturers continue to discover the advantages that self-adhesive labels provide. Beer and beverage companies are shifting from glue-based paper labels to pressure-sensitive labels for the enhanced shelf appeal and improved functionality they offer in environments where humidity levels and temperatures vary.

We continue to identify new applications for pressure-sensitive label materials and to work closely with consumer product manufacturers to develop materials that have the exact performance attributes they need. The result? A new image for their brand, and an entirely new market for our materials.



Christian Simcic
Group Vice President
Roll Materials Worldwide

This is Now

Avery Dennison's introduction of the first high-volume, low-cost, Gen 2 RFID inlay is making possible remarkable new efficiencies in product tracking and distribution.



This is The Future

Avery Dennison's industry-leading manufacturing capacity for RFID inlays ensures that we will meet the expected surge in demand for RFID labels.

Positioned to Meet Demand

RFID is no longer a "technology of the future" — it is here now. Retailers around the world are leading the way in adopting RFID technology into their supply chain systems and in requiring their suppliers to ship goods with RFID-enabled labels.

At Avery Dennison, we are ready. Our extensive RFID research and development has enabled us to create high-performance, cost-efficient inlays that are ideal for supply chain use. Our Intelligent Label Technology combined with our years of experience uniquely position us to build upon our close working relationships with label converters as they convert RFID inlays into finished labels.



Robert Malchione
Senior Vice President
Corporate Strategy
and Technology

This is Image

Avery-brand Clean-Edge Business Cards enable small businesses to create a customized, professional look.

EASTSIDEYOGA



This is Impact

By helping business owners succeed, we succeed. Our print-enabled office products allow business owners to create polished images that inspire customer confidence in their businesses.



Creativity Flourishes

Avery-brand products offer a variety of consumer and office solutions that enable small businesses to create virtually any promotional material that a large business can — including customized address labels, signage, business cards, banners, T-shirts, greeting cards, dividers, CD and DVD labels and even magnets.

Avery software products are designed to print with ease in virtually all desktop printer models on the market today. No wonder the Avery brand is synonymous with quality and convenience.



Tim Clyde
Group Vice President
Office Products Worldwide

This is Fashion

No more scratchy labels—thanks to Avery Dennison heat-transfer labels that apply information directly to fabric for maximum comfort.





This is A Perfect Fit

Reebok International came to us for its new line of sportswear because our proprietary heat-transfer label technology could meet its extremely stringent requirements.

Serving our Customers

Leading apparel manufacturers and retailers select Avery Dennison to supply brand identification tags, tickets and labels to bring added impact and convenience to their merchandise.

But that's not all. They also count on us to provide comprehensive data management systems and supply chain services. By positioning our ticketing sites close to our customers around the world, we ensure that the products they ship from their manufacturing facilities are accurately tagged and ready to go directly onto the retail floor for immediate merchandising.



Simon Coulson
Group Vice President
Retail Information Services
Worldwide

This is Navigation

When it comes to making road signs easy to understand anytime, anywhere, our proprietary reflective technology is as different as night and day.



This is The Right Direction

The Avery Dennison technology that makes road signs highly visible also makes them remarkably durable.

These strengths make our reflective business the partner of choice in growing markets worldwide.

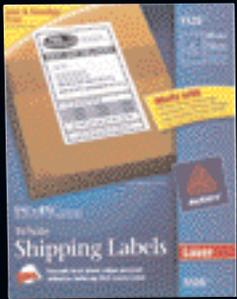
Pointing the Way

As developing countries continue to expand their highway systems, their demand for reflective signage is driving growth in our reflective materials business.

To provide the highway safety and vehicle marking markets with products that clearly meet their needs, we leverage our manufacturing expertise in glass-beaded and prismatic retroreflective films.



Sandra Beach Lin
Group Vice President
Specialty Materials and
Converting Worldwide



This is a World of Possibilities

From high-quality shipping labels to vibrant labels on consumer products... from convenient self-adhesive postage stamps to clear labels on premium beverage bottles... from garment tags that identify size by color coding to innovative office labels that are printable on desktop printers and are quick to peel... when it comes to growth opportunities for Avery Dennison, the possibilities are endless.

Our Businesses At a Glance

57%



Pressure-sensitive Materials

Pressure-sensitive Materials consists of Fasson-brand roll materials, graphics and reflective materials, performance polymers and engineered films. Roll materials are used in brand identity, barcode labeling systems, product identification and other applications by label converters and consumer products package designers and manufacturers. Graphics and reflective materials are used in wide-format digital printing, sign-making, traditional screen printing and offset printing to serve the graphic arts, vehicle marking, transportation and highway-safety industries. Performance polymers are an extensive line of water-based and solvent-based pressure-sensitive adhesives used in film and paper labels, graphic films, specialty automotive and industrial tapes, and protective films for windows and consumer goods. Locations: North America, Europe, Latin America, Asia Pacific and South Africa.

21%



Office and Consumer Products

Office and Consumer Products manufactures a wide range of products for office, home and school including Avery-brand self-adhesive labels, content and template software, binders, sheet protectors, dividers and index makers, writing instruments, cell phone labels, T-shirt transfers, security badge systems and do-it-yourself business cards. Locations: North America, Europe, Latin America and Asia Pacific.

12%



Retail Information Services

Retail Information Services designs, manufactures and sells a variety of price marking and brand identification products for retailers, apparel manufacturers, distributors and industrial customers worldwide. These include woven and printed labels, heat transfers, graphic tags, patches, integrated tags, price tickets, custom hard and soft goods packaging, RFID carton and item tags, barcode printers, software solutions, molded plastic fastening and application devices, as well as service bureau printing applications for supply chain and security management. Locations: North America, Europe, Latin America, Asia Pacific and South Africa.

10%



Other Specialty Converting Businesses

This group consists of several different businesses. The Specialty Tapes business produces technically advanced pressure-sensitive tapes that are used by industrial fabricators, original equipment manufacturers, medical device manufacturers and in disposable diaper products. The Industrial and Automotive Products business manufactures high-quality converted materials such as decorative automotive interior films and long-life paint replacement films. The Security Printing business manufactures self-adhesive postage stamps and battery labels. The RFID business produces RFID inlays for label converters who supply pressure-sensitive labels to diverse end-user markets. Locations: North America, Europe, Latin America and Asia Pacific.

Five-Year Summary

(Dollars in millions, except per share amounts)	5-Year Compound Growth Rate	2005 ⁽¹⁾		2004 ⁽²⁾		2003 ⁽³⁾		2002 ⁽⁴⁾		2001 ⁽⁵⁾	
		Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
For the Year⁽⁶⁾											
Net sales	7.6%	\$ 5,473.5	100.0	\$ 5,317.0	100.0	\$ 4,736.8	100.0	\$ 4,127.5	100.0	\$ 3,720.0	100.0
Gross profit	4.5	1,621.1	29.6	1,575.0	29.6	1,453.9	30.7	1,328.4	32.2	1,211.6	32.6
Marketing, general and administrative expense	6.4	1,132.8	20.7	1,105.8	20.8	1,026.3	21.7	894.8	21.7	811.8	21.8
Interest expense	.4	57.9	1.1	58.7	1.1	58.6	1.2	44.7	1.1	51.0	1.4
Income from continuing operations before taxes	(2.2)	366.8	6.7	375.3	7.1	338.5	7.1	361.1	8.7	349.1	9.4
Taxes on income	(11.2)	75.0	1.4	94.3	1.8	93.4	2.0	106.9	2.6	111.9	3.0
Income from continuing operations	1.3	291.8	5.3	281.0	5.3	245.1	5.2	254.2	6.2	237.0	6.4
Income (loss) from discontinued operations, net of tax	N/A	(65.4)	N/A	(1.3)	N/A	22.8	N/A	3.0	N/A	6.2	N/A
Net income	(4.4)	226.4	4.1	279.7	5.3	267.9	5.7	257.2	6.2	243.2	6.5
		5-Year Compound Growth Rate		2005	2004	2003	2002	2001			
Per Share Information											
Income per common share from continuing operations			.8%	\$ 2.91	\$ 2.81	\$ 2.47	\$ 2.58	\$ 2.42			
Income per common share from continuing operations, assuming dilution			1.1	2.90	2.79	2.45	2.56	2.40			
Net income per common share			(4.7)	2.26	2.80	2.70	2.61	2.49			
Net income per common share, assuming dilution			(4.6)	2.25	2.78	2.68	2.59	2.47			
Dividends per common share			6.6	1.53	1.49	1.45	1.35	1.23			
Average common shares outstanding			.4	100.1	99.9	99.4	98.5	97.8			
Average common shares outstanding, assuming dilution			.1	100.5	100.5	100.0	99.4	98.6			
Book value at fiscal year end			12.3	\$ 15.16	\$ 15.47	\$ 13.24	\$ 10.64	\$ 9.49			
Market price at fiscal year end			.1	55.27	59.97	54.71	59.05	56.20			
Market price range				50.30 to 62.53	54.90 to 65.78	47.75 to 63.51	52.86 to 69.49	44.39 to 60.24			
At Year End⁽⁶⁾											
Working capital ⁽⁷⁾				\$ 31.0	\$ 151.8	\$ (56.8)	\$ (92.4)	\$ 21.2			
Property, plant and equipment, net ⁽⁷⁾				1,295.7	1,374.4	1,287.1	1,178.1	1,047.6			
Total assets				4,203.9	4,399.3	4,118.1	3,656.3	2,915.0			
Long-term debt				723.0	1,007.2	887.7	837.2	626.6			
Total debt				1,087.7	1,211.7	1,180.3	1,144.2	849.3			
Shareholders' equity				1,511.9	1,548.7	1,318.7	1,056.4	929.4			
Number of employees				22,600	21,400	20,300	20,500	17,300			
Other Information⁽⁶⁾											
Depreciation expense ⁽⁷⁾				\$ 154.2	\$ 145.8	\$ 141.9	\$ 122.5	\$ 119.9			
Research and development expense ⁽⁷⁾				85.4	81.8	74.3	74.0	69.0			
Effective tax rate ⁽⁷⁾				20.4%	25.1%	27.6%	29.6%	32.1%			
Total debt as a percent of total capital				41.8	43.9	47.2	52.0	47.8			
Return on average shareholders' equity (percent)				14.6	19.9	22.3	25.7	27.4			
Return on average total capital (percent)				10.1	12.1	12.4	13.9	15.0			

(1) Results for 2005 include a net pretax charge of \$63.6 for restructuring costs, asset impairment and lease cancellation charges and legal accrual related to a patent lawsuit, partially offset by gain on sale of assets. Additionally, results for 2005 include impairment charges for goodwill and intangible assets of \$74.4 associated with the expected divestiture of a business.

(2) Results for 2004 include a pretax charge of \$35.2 for restructuring costs, asset impairment and lease cancellation charges. Results for 2004 reflect a 53-week period.

(3) Results for 2003 include a net pretax charge of \$30.5 for restructuring costs, asset impairment and lease cancellation charges and net losses associated with several product line divestitures, partially offset by a gain from the settlement of a lawsuit. Additionally, results for 2003 included a pretax gain on sale of discontinued operations of \$25.5.

(4) Results for 2002 include a pretax charge for asset impairment and lease cancellation charges of \$21.4, as well as a pretax charge of \$10.7 related to severance.

(5) Results for 2001 include a pretax gain of \$20.2 on the sale of the Company's specialty coatings business and a pretax cost reduction charge of \$19.9.

(6) Certain amounts for prior years were reclassified to conform with the current year presentation.

(7) Amounts related to continuing operations.

Management's Discussion and Analysis of Results of Operations and Financial Condition

ORGANIZATION OF INFORMATION

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

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OVERVIEW AND OUTLOOK

Overview

Sales

Our sales from continuing operations increased 3% in 2005 compared to 12% growth in 2004, reflecting the factors summarized in the following table.

Estimated change in sales due to:	2005	2004	2003
Core unit volume*	(1)%	8%	4%
Pricing & product mix	2	(1)	(2)
Foreign currency translation	2	5	7
Acquisitions	-	-	6
	3%	12%	15%

*Core unit volume is a measure of sales performance that excludes the estimated impact of acquisitions, divestitures, changes in product mix and pricing, and currency translation. We use this measure to evaluate underlying demand for our products and services, and to assess sales trends over time.

The decrease in core unit volume in 2005 reflects the following factors:

- Loss of market share in our North American roll materials business following our implementation of selling price increases to offset higher raw material costs
- The impact of an extra week in the 2004 fiscal year
- Accelerated purchases by Office and Consumer Products customers in advance of our 2005 selling price increases, which contributed to higher growth in 2004

In addition to the factors noted above for 2004, core unit volume also benefited in that year from additional sales in the Retail Information Services segment as a result of customer preparation for increased exports from China following the elimination of apparel manufacturing quotas in January 2005.

The improvement in pricing and product mix in 2005 was primarily due to the impact of selling price increases implemented to offset higher raw material costs.

Cost Reduction Actions

In 2005, we initiated company-wide cost reduction efforts which are expected to improve our global operating efficiencies. These actions include reductions in headcount, which impact most businesses and geographic regions and expected divestitures of low-margin businesses and product lines. In connection with these actions, we recorded cash and non-cash charges related to severance and other employee-related costs, as well as asset impairments. The charges are detailed in "Cost Reduction Actions" below.

As a result of our expected sale of a business in 2006 that manufactures raised reflective pavement markers and the divestiture of our package label converting business in Europe in October 2003 (discussed below in "Acquisitions and Divestitures"), the discussions which follow generally reflect summary results from our continuing operations unless otherwise noted. However, the net income and net income per share discussions include the impact of discontinued operations.

Net Income

Net income decreased \$53.3 million or 19% in 2005 compared to 2004.

Negative factors affecting the change in net income included:

- Restructuring and asset impairment charges in 2005, which exceeded charges taken in 2004
- Incremental spending on growth initiatives, including the development of our radio frequency identification ("RFID") business
- Higher pension and medical costs
- Write-off of inventories, primarily related to a product launch

Positive factors affecting the change in net income included:

- Higher sales
- Cost savings from productivity improvement initiatives, including actions taken in 2005 and the closure of two European plants during the first six months of 2004
- Benefit of a lower effective tax rate

Summary Results by Segment

(In millions)	Net Sales		Operating Income ⁽¹⁾	
	2005	2004	2005	2004
Pressure-sensitive				
Materials	\$ 3,114.5	\$ 2,984.6	\$ 259.6	\$ 221.4
Office and Consumer				
Products	1,136.1	1,172.5	168.0	186.4
Retail Information Services	674.8	636.1	42.7	47.8
Other specialty				
converting businesses	548.1	523.8	9.5	35.5
Corporate expense	-	-	(55.1)	(57.1)
Interest expense	-	-	(57.9)	(58.7)
Total from continuing operations	\$ 5,473.5	\$ 5,317.0	\$ 366.8	\$ 375.3

(1) Operating income refers to income before taxes; segment operating income refers to income before interest and taxes

Pressure-sensitive Materials (57% of net sales)

Our Pressure-sensitive Materials segment reported a 4% increase in sales in 2005 compared to 2004. Approximately 60% of the incremental sales was due to the positive impact of changes in pricing and product mix, reflecting increased selling prices implemented to offset higher raw material costs. This benefit was partially offset by a decrease in core unit volume due in part to the impact of the extra week in 2004. A decline in core unit volume in North America, which reflected market share loss (related to price increases), was partially offset by growth from international sales. Foreign currency translation also contributed to sales growth for this segment.

Operating income for this segment increased \$38 million or 17% in 2005, reflecting cost savings from productivity improvement initiatives, including the closure of two European plants during the first six months of 2004. Operating income for this segment included charges related to restructuring costs and asset impairment in both 2005 and 2004. The impact of higher raw material costs was offset by selling price increases.

Office and Consumer Products (21% of net sales)

Our Office and Consumer Products segment reported a 3% decrease in sales in 2005 compared to 2004. The decrease in sales was primarily due to the impact of accelerated purchases in 2004 by customers in advance of our 2005 selling price increases, and the impact of an extra week in 2004. The decrease in core unit volume was partially offset by a positive impact of changes in pricing and product mix and the favorable impact of foreign currency translation.

Operating income for this segment decreased \$18 million or 10%, reflecting lower sales volume and the write-off of inventories and equipment, primarily due to a product launch. Operating

income for this segment included a charge related to restructuring costs and asset impairment charges in 2005. These decreases were partially offset by cost savings from productivity improvement initiatives. The 2005 selling price increases offset the cumulative effect of raw material inflation since the beginning of 2004.

Retail Information Services (12% of net sales)

The Retail Information Services segment reported a 6% increase in sales in 2005 compared to 2004. Approximately 40% of the increase was due to core unit volume growth, reflecting continued growth of the business in Asia and Latin America. The benefit to core unit volume was partially offset by additional sales in 2004 as a result of customer preparation for increased exports from China following the elimination of apparel manufacturing quotas in January 2005. The balance of the growth reflected incremental sales from acquisitions and the favorable impact of foreign currency translation.

Operating income for this segment decreased \$5 million or 11% due to charges for restructuring and asset impairments in 2005 and higher spending associated with growth initiatives. Partially offsetting these factors was the benefit of productivity improvement actions, including the ongoing migration of production from Hong Kong to lower cost facilities in mainland China.

Other specialty converting businesses (10% of net sales)

Other specialty converting businesses reported a 5% increase in sales in 2005 compared to 2004 due to core unit volume growth, as well as the favorable impact of foreign currency translation. Operating income for these businesses decreased \$26 million or 73% reflecting costs related to the development of the RFID business and charges related to restructuring costs and asset impairments in 2005. In 2005, due to the commercialization of our RFID business, we have included RFID in this group of businesses. Financial results of this group have been restated for years presented herein to reflect this change.

Sales Growth by Region

Excluding the impact of acquisitions, divestitures, and foreign currency translation, we estimate sales growth (decline) in major regions of operation as follows:

	2005	2004	2003
U.S.	(3)%	5%	1%
Europe	3%	5%	4%
Asia	13%	26%	15%
Latin America	4%	19%	15%

In the U.S., the decrease in 2005 was partially due to market share loss and a slow market in Pressure-sensitive Materials, as well as accelerated purchases in 2004 by Office and Consumer Products customers in advance of our 2005 selling price increases.

These negative factors were partially offset by selling price increases. Weaker demand in the U.S. also reflected a practice among end users of our products to move manufacturing outside the U.S. This shift is offset by growth in emerging markets, where manufacturing has moved.

In Asia, the pace of growth in 2005 moderated throughout the region, including China. The comparison to 2004 was also affected by additional sales in the Retail Information Services segment in 2004 as a result of customer preparation for increased exports from China following the elimination of apparel manufacturing quotas in January 2005.

In Latin America, the roll materials business was affected by market share loss as a result of selling price increases, although there was a benefit from higher selling prices.

In addition to the factors above, the impact of the extra week in 2004 also affected comparisons of growth between 2005 and 2004 for all regions.

Cost Reduction Actions and Other Expense

(In millions, pretax)	2005	2004	2003
Restructuring costs	\$ 37.5	\$ 23.6	\$ 22.0
Asset impairment & lease cancellation charges	28.1	11.6	8.2
Losses from product line divestitures	–	–	4.1
Other	(2.0)	–	(3.8)
Other expense, net	\$ 63.6	\$ 35.2	\$ 30.5

During the fourth quarter of 2005, we announced cost reduction actions related to restructuring and anticipated product line divestitures (discussed in “Acquisitions and Divestitures” below). We recorded charges related to severance and related costs and non-cash charges for asset impairments, included in the table above. These actions impact most businesses and geographic regions and are expected to be completed by the end of 2006. The restructuring actions, including anticipated charges in early 2006, are expected to result in annualized pretax savings of \$80 million to \$90 million when completed. We expect to reinvest some of the savings into future growth opportunities. In addition to the fourth quarter charges, other charges were recorded earlier in 2005 including the closure of our Gainesville, Georgia label converting plant, which was completed during the third quarter of 2005.

Also included in “Other Expense” in 2005 was an accrual for legal expenses related to a patent lawsuit, offset by gains on the sale of assets.

The restructuring charges associated with severance and asset impairments recorded during 2004 were related to the completion of the integration of the 2002 acquisition of Jackstädt into our other existing businesses. We closed a manufacturing facility in France

during the first quarter of 2004 and a manufacturing facility in Italy during the second quarter of 2004.

In 2003, the restructuring charges related to the integration of Jackstädt and other productivity improvement initiatives.

See also Note 10 “Components of Other Income and Expense,” to the Consolidated Financial Statements for further detail.

Effective Rate of Taxes on Income

The effective tax rate was 20.4% for the full year 2005 compared to 25.1% for the full year 2004. Our 2005 tax rate included benefits from:

- Changes in the geographic mix of income
- Continued improvements in our global tax structure
- Several favorable global tax audit settlements

These benefits were partially offset by incremental expense associated with the repatriation of accumulated foreign earnings under the American Jobs Creation Act of 2004.

The effective tax rate for 2004 included the benefits from changes in the geographic mix of income, continued improvements in our global tax structure and several favorable global tax audit settlements.

Free Cash Flow

(In millions)	2005	2004	2003
Net cash provided by operating activities	\$ 441.6	\$ 516.9	\$ 348.3
Purchase of property, plant and equipment	(162.5)	(178.9)	(203.6)
Purchase of software and other deferred charges	(25.8)	(21.8)	(22.8)
Free cash flow	\$ 253.3	\$ 316.2	\$ 121.9

Free cash flow for 2005 decreased \$63 million, due primarily to lower net income. The changes in assets and liabilities were partially offset by lower cash spending on capital in 2005. See “Analysis of Results of Operations” and “Liquidity” below for more information. Free cash flow refers to cash flow from operating activities less spending on property, plant and equipment, and software. We use free cash flow as a measurement tool to assess the cash flow available for other corporate purposes, such as dividends, debt service and repurchase of common stock.

Acquisitions and Divestitures

In December 2005, we announced our plan to sell a business consisting of raised reflective pavement markers, with sales of approximately \$23 million in 2005. Based on the estimated value of this business, we concluded that associated goodwill and intangible assets from our acquisition of this business were impaired,

resulting in a pretax charge of approximately \$74 million. The results of this business have been accounted for as discontinued operations for the years presented herein. This business was previously included in the Pressure-sensitive Materials segment.

In December 2005, we also announced the expected divestiture of two low-margin product lines. One of these divestitures, which impacts the Office and Consumer Products segment, was completed in February 2006. This product line had estimated sales of \$60 million in 2005, and minimal impact on income. The expected divestiture of the second product line would reduce annual sales by approximately \$10 million, with minimal impact to income from operations. As part of these expected divestitures, we recorded charges of approximately \$6 million for severance and other employee-related costs, and asset impairments of approximately \$9 million, which are included in the "Other Expense" line of our Consolidated Statement of Income.

During the third quarter of 2004, we acquired Rinke Etiketten ("Rinke"), a privately held company in Germany. The incremental impact of this acquisition on our net sales was approximately \$9 million during 2004, with an additional impact of approximately \$18 million in 2005. This business is reported in our Retail Information Services segment.

In October 2003, we completed the sale of our package label converting business in Europe, which consisted of two package label converting facilities in Denmark and a package label converting facility in France, which combined, represented approximately \$30 million in sales in the first nine months of 2003. The results from this business have been accounted for as discontinued operations for 2003.

Investigations

In April 2003, we were notified by the U.S. Department of Justice's Antitrust Division ("DOJ") that it had initiated a criminal investigation into competitive practices in the label stock industry, and on August 15, 2003, the DOJ issued a subpoena to us in connection with the investigation. In May 2004, the European Commission ("EC") initiated inspections and obtained documents from our pressure-sensitive materials facilities in the Netherlands and Germany, seeking evidence of unlawful anticompetitive activities. In July 2004, we were notified by the Competition Law Division of the Department of Justice of Canada that it was seeking information in connection with a label stock investigation. In August 2005, we were notified by the Australian Competition and Consumer Commission that it was seeking information in connection with a label stock investigation. We are cooperating with these investigations. We are a named defendant in purported class actions in the U.S. seeking treble damages and other relief for alleged unlawful competitive practices, which were filed after the announcement of the DOJ investigation. We are also a named defendant in purported class actions in the U.S. seeking damages

and other relief for alleged disclosure and fiduciary duty violations pertaining to alleged unlawful competitive practices. We have discovered instances of improper conduct by certain employees in our European operations that constituted an infringement of EC competition law. Accordingly, we expect that the EC will impose a fine on us when its investigation is completed. We have discovered instances of conduct by certain employees in China that potentially violate the U.S. Foreign Corrupt Practices Act, and we have reported that conduct to authorities in the U.S. Accordingly, we expect that fines or other penalties may be incurred. We are unable to predict the effect of these matters at this time, although the effect could well be adverse and material. These matters are reported in Note 8 "Contingencies," to the Consolidated Financial Statements.

Outlook

In 2006, we anticipate unit volume growth in the range of 2% to 3%. This outlook is based on expected underlying growth of approximately 4% to 5%, partially offset by the impact of product line divestitures and withdrawal from some low-margin private label business. We expect the positive impact from price and mix to be offset by a negative effect of foreign currency translation. These expectations are subject to changes in economic and market conditions. Price increases in early 2006 are expected to offset raw material inflation incurred at the end of 2005 and early 2006.

We expect our restructuring and business realignment efforts will reduce costs by \$80 million to \$90 million when completed. We estimate that 60% to 70% of these savings will be achieved in 2006. However, we expect to reinvest some of the savings into growth opportunities across the company. In addition, we anticipate transitional costs related to our productivity improvement actions to be approximately \$15 million to \$20 million, which will be incurred in 2006. Transitional costs include accelerated depreciation on assets expected to be retired by the end of 2006, costs of moving equipment and other related costs.

To comply with the provisions of the reissued Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," we will begin recognizing expense for stock options in 2006. We expect this pretax expense to be approximately \$17 million in 2006 based on unvested stock options outstanding at year end 2005, which will have an estimated \$.12 per share impact on earnings after tax.

We expect an increase in pretax expenses related to our pension plans of approximately \$7 million, due to changes in actuarial assumptions for our U.S. and international plans.

We expect continued improvement in marketing, general and administrative expenses as a percent of sales. Additionally, in 2006, we will be classifying shipping and handling costs as an element of cost of goods sold for all businesses, to align our

businesses around a standard methodology. In 2005, several of our businesses included these costs in marketing, general and administrative expenses, totaling approximately \$145 million. Refer to the Shipping and Handling Costs section in Note 1 “Summary of Significant Accounting Policies” to the Consolidated Financial Statements for further information.

The pretax loss from our RFID business in 2006 is expected to be approximately \$2 million to \$7 million lower than in 2005 due to an increase in revenue and reduced spending.

We estimate that pretax interest expense will be between \$55 million to \$60 million for 2006, assuming expected interest rate increases will be offset by expected reductions in debt.

We anticipate an annual effective tax rate in the range of 20% to 23% for 2006, subject to changes in the geographic mix of income, with potentially wide variances from quarter to quarter.

We expect free cash flow after capital spending and purchases of software to be approximately \$300 million to \$350 million for 2006.

We expect capital expenditures for 2006 to be approximately \$175 million to \$200 million, funded through operating cash flow. Major projects in 2006 include new investments for expansion in China and India, serving both our materials and retail information services businesses, as well as spending for a new films coater in the U.S.

ANALYSIS OF RESULTS OF OPERATIONS

Income from Continuing Operations Before Taxes:

(In millions)	2005	2004	2003
Net sales	\$ 5,473.5	\$ 5,317.0	\$ 4,736.8
Cost of products sold	3,852.4	3,742.0	3,282.9
Gross profit	1,621.1	1,575.0	1,453.9
Marketing, general and administrative expense	1,132.8	1,105.8	1,026.3
Interest expense	57.9	58.7	58.6
Other expense, net	63.6	35.2	30.5
Income from continuing operations before taxes	\$ 366.8	\$ 375.3	\$ 338.5
As a Percent of Sales:	%	%	%
Gross profit (margin)	29.6	29.6	30.7
Marketing, general and administrative expense	20.7	20.8	21.7
Income from continuing operations before taxes	6.7	7.1	7.1

Sales

Sales increased 3% in 2005 compared to an increase of 12% in 2004. A decrease in core unit volume in 2005 partially reflected the loss of market share in our North American roll materials business following our implementation of selling price increases to offset higher raw material costs. The 2005 volume decline also reflected the impact of an extra week in the 2004 fiscal year and accelerated purchases by Office and Consumer Products customers in advance of our 2005 selling price increases, both of which contributed to higher growth in 2004. Combined, the accelerated purchases and extra week in 2004 represented an estimated \$60 million to \$70 million of the change in sales between the two years.

We realized selling price increases in 2005 of an estimated \$100 million related to higher raw material costs. However, we experienced some related share loss in our North American roll materials business, as previously described.

In 2004, core unit volume also benefited from higher sales in the Retail Information Services segment as a result of customer preparation for increased exports from China following the January 2005 elimination of apparel manufacturing quotas. These benefits were partially offset by the impact of share loss with one major customer in the Office and Consumer Products segment in late 2003 (estimated to be \$30 million).

Foreign currency translation had a favorable impact on the change in sales of approximately \$77 million in 2005 and approximately \$207 million in 2004.

Incremental sales from acquisitions, net of product line divestitures, contributed approximately \$19 million in 2005. In 2004, product line divestitures more than offset incremental sales from acquisitions; the net impact reduced sales by approximately \$33 million.

Gross Profit

Gross profit margin in both 2005 and 2004 benefited from our ongoing productivity improvement initiatives, including the completion of the integration of the Jackstädt business in mid-2004, and cost reduction actions in 2005. Unfavorable segment mix (faster growth in segments with lower gross profit margin as a percent of sales) and raw material inflation partially offset these benefits in both years.

In 2005, gross profit margin was also negatively impacted by:

- Write-off of inventories (approximately \$12 million), approximately half related to a product launch
- Costs related to our RFID business (approximately \$9 million)

In 2004, gross profit margin was also negatively impacted by declining selling prices during the first half of the year (estimated to be \$38 million).

Marketing, General and Administrative Expenses

Marketing, general and administrative expense as a percent of sales in 2005 and 2004 reflected the benefit of productivity improvement initiatives and cost reduction actions.

Offsetting the benefit of these productivity improvements, marketing, general and administrative expenses increased in 2005 due to:

- Higher pension and medical expenses (approximately \$14 million)
- Impact of foreign currency translation (approximately \$11 million)
- Additional spending on the development of our RFID business (approximately \$8 million), as well as other long-term growth initiatives
- Additional spending associated with acquisitions (approximately \$6 million)

In 2004, marketing, general and administrative expenses increased due to the same factors which impacted 2005, as well as higher insurance costs.

Interest Expense

Interest expense decreased slightly in 2005 and was unchanged in 2004. The decrease in 2005 was due to a reduction in total debt outstanding, partially offset by an increase in interest rates.

Other Expense (Restructuring and Cost Reduction Actions)

In 2005, other expense consisted of charges for cost reduction actions and restructuring associated with several expected product line divestitures, as well as other items:

- Severance and other employee-related costs (approximately \$38 million)
- Asset impairment and lease cancellation costs (approximately \$28 million)
- Gain on the sale of assets, partially offset by costs for a legal accrual (net gain of approximately \$2 million)

In 2004, other expense consisted of charges for productivity improvement actions, primarily related to the completion of the Jackstädt integration actions:

- Severance and employee-related costs (approximately \$24 million)
- Impairment of assets (approximately \$12 million)

In 2003, other expense consisted of charges for restructuring related to the integration of Jackstädt, productivity improvement initiatives and net losses associated with several product line divestitures, as well as other items:

- Severance and employee-related costs (approximately \$22 million)
- Impairment and planned disposition of property, plant and equipment, and lease cancellation costs (approximately \$8 million)
- Net losses associated with several product line divestitures and other associated costs (approximately \$4 million)
- Gain from settlement of a lawsuit, partially offset by net losses from disposition of fixed assets and costs associated with a plant closure (net gain of approximately \$4 million)

Refer to Note 10 "Components of Other Income and Expense," to the Consolidated Financial Statements for more information.

Net Income:

(In millions, except per share)	2005	2004	2003
Income from continuing operations before taxes	\$ 366.8	\$ 375.3	\$ 338.5
Taxes on income	75.0	94.3	93.4
Income from continuing operations	291.8	281.0	245.1
Income (loss) from discontinued operations, net of tax	(65.4)	(1.3)	22.8
Net income	\$ 226.4	\$ 279.7	\$ 267.9
Net income per common share	\$ 2.26	\$ 2.80	\$ 2.70
Net income per common share, assuming dilution	\$ 2.25	\$ 2.78	\$ 2.68

Taxes on Income

	2005	2004	2003
Effective tax rate	20.4%	25.1%	27.6%

Our 2005 tax rate included the benefit of changes in the geographic mix of income and continued improvements in our global tax structure, and a \$9 million benefit from several favorable global tax audit settlements. These benefits were partially offset by the incremental expense of \$13.5 million associated with the repatriation of accumulated foreign earnings under the American Jobs Creation Act of 2004.

Our 2004 effective tax rate included the benefit from changes in the geographic mix of income, continued improvements in our global tax structure and several favorable global tax audit settlements, which reduced tax expense by approximately \$8 million.

Income (Loss) from Discontinued Operations

Income (loss) from discontinued operations includes our raised reflective pavement markers business in 2005, 2004 and 2003, as well as our package label converting business in Europe in 2003.

Based on the estimated value of the raised reflective pavement markers business that we are expecting to sell in 2006, we concluded

that associated goodwill and intangible assets from our acquisition of this business were impaired. The resulting pretax impairment charge was approximately \$74 million in 2005.

Income from discontinued operations included net sales of approximately \$23 million in 2005 and approximately \$24 million in 2004. Net income from discontinued operations in 2003 included a gain on sale of business of \$19.7 million, net of tax of \$5.8 million. Income from all discontinued operations included net sales of approximately \$70 million in 2003.

Refer to the Discontinued Operations section of Note 1 "Summary of Significant Accounting Policies," to the Consolidated Financial Statements for more information.

Change in Net Income and Earnings Per Share:

	2005	2004	2003
Net income as a percent of sales	4.1%	5.3%	5.7%
<i>Percent change in:</i>			
Net income	(19.1)%	4.4%	4.2%
Net income per common share	(19.3)	3.7	3.4
Net income per common share, assuming dilution	(19.1)	3.7	3.5

RESULTS OF OPERATIONS BY SEGMENT

Pressure-sensitive Materials Segment

(In millions)	2005	2004	2003
Net sales including intersegment sales	\$ 3,277.2	\$ 3,153.5	\$ 2,721.9
Less intersegment sales	(162.7)	(168.9)	(175.1)
Net sales	\$ 3,114.5	\$ 2,984.6	\$ 2,546.8
Operating income ⁽¹⁾	259.6	221.4	180.2

(1) Includes cost reduction, restructuring, asset impairment & lease cancellation charges, net of gain on sale of assets

	2005	2004	2003
	\$23.0	\$34.4	\$13.6

Net Sales

Sales in our Pressure-sensitive Materials segment increased 4% in 2005 compared to 17% in 2004. A decline in core unit volume in 2005 reflected the loss of market share in North America following our implementation of selling price increases, partially offset by growth internationally. The benefit to core unit volume growth in 2004 resulting from an extra week in the fiscal year partially contributed to slower growth in 2005. Sales growth in 2005 was also affected by slow market conditions in North America.

Sales growth in 2005 reflected the positive impact of pricing and product mix, resulting from increased selling prices implemented to offset higher raw material costs.

Increased sales in our roll materials business (approximately \$112 million) reflected increased selling prices, partially offset by a decline in core unit volume. Our North American roll materials business experienced a decline in sales of approximately 3%, due to share loss related to higher selling prices. Our roll materials business in Europe experienced sales growth of approximately 7% in local currency resulting from volume growth in the region, with stronger growth in the emerging markets of Eastern Europe. Market expansion contributed to sales growth for the roll materials business in Asia, although the pace of growth moderated in this region compared to the prior year. In Latin America, loss of market share from selling price increases and loss of sales with a large customer affected growth, partially offset by selling price increases. Sales for the graphics and reflective business were comparable to 2004.

In 2004, increased sales in our roll materials business (approximately \$365 million) reflected core unit volume growth, including the extra week in the fiscal year. In North America, strong growth in new film products and selling price increases contributed to sales growth of approximately 9%. In Europe, strong growth in the emerging markets of Eastern Europe and the benefit of selling price increases contributed to sales growth of approximately 9% in local currency. Strong market growth and share gain contributed to sales growth in local currency in Asia and Latin America.

Sales growth in 2004 in our graphics and reflective business (approximately \$63 million) reflected market growth, new applications and customers, and geographic expansion.

Included in these increases was the favorable impact of foreign currency translation of approximately \$58 million in 2005 and approximately \$146 million in 2004.

Operating Income

Increased operating income in both years reflected higher sales and cost savings from productivity improvement initiatives, including two plant closures related to the Jackstädt integration in the first half of 2004. Also reflected in operating income were charges related to restructuring, asset impairments and lease cancellations in 2005 and 2004.

In 2004, this segment experienced rising raw material costs throughout the year. While selling price increases partially offset these increased costs, the net impact reduced operating income for the year. In contrast, in 2005 the impact of higher raw material costs was offset through selling price increases.

Office and Consumer Products Segment

(In millions)	2005	2004	2003
Net sales including			
intersegment sales	\$ 1,138.1	\$ 1,174.7	\$ 1,170.4
Less intersegment sales	(2.0)	(2.2)	(2.3)
Net sales	\$ 1,136.1	\$ 1,172.5	\$ 1,168.1
Operating income ⁽¹⁾	168.0	186.4	188.5

(1) Includes cost reduction, restructuring, asset impairment & lease cancellation charges	\$21.8	\$5	\$12.5
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Net Sales

Sales in our Office and Consumer Products segment decreased 3% in 2005, while sales increased by less than 1% in 2004. In 2004, higher than usual volume in the fourth quarter was due in part to customers' accelerated purchases in advance of selling price increases effective January 1, 2005, as well as the benefit from an extra week in the 2004 fiscal year. The shift in volume to late 2004 contributed to a decline in core unit volume in 2005, as customers depleted related inventories.

In 2005, the positive impact of selling price increases partially offset the decrease in core unit volume. Selling prices were increased to offset higher raw material costs.

In 2004, increased volume resulting from accelerated purchases and the extra week was offset by share loss with one major customer in late 2003 (estimated \$30 million impact in 2004), loss of sales from a discontinued product line (approximately \$14 million), reduced prices, and the continued erosion in market share of our Avery-brand products, in favor of private label brands.

Foreign currency translation had a favorable impact on the change in sales of approximately \$8 million in 2005 and approximately \$35 million in 2004.

Operating Income

Operating income reflected charges related to restructuring, asset impairment and net losses associated with product line divestitures in 2005 and 2003. While 2004 operating income was negatively affected by lower selling prices and rising raw material costs, the 2005 selling price increases offset the cumulative effect of raw material inflation over the two-year period. The changes in operating income reflected the benefit from continued cost reduction efforts, as well as the write-off of inventories (approximately \$9 million) and equipment, primarily related to a product launch.

Retail Information Services Segment

(In millions)	2005	2004	2003
Net sales including			
intersegment sales	\$ 682.6	\$ 644.9	\$ 560.2
Less intersegment sales	(7.8)	(8.8)	(7.5)
Net sales	\$ 674.8	\$ 636.1	\$ 552.7
Operating income ⁽¹⁾	42.7	47.8	24.2

(1) Includes cost reduction, restructuring, asset impairment & lease cancellation charges	\$7.5	\$3	\$7.0
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Net Sales

Sales in our Retail Information Services segment increased 6% in 2005 compared to 15% in 2004. The increase in both years was a result of core unit volume growth and incremental sales from acquisitions. Volume growth reflected continued growth of the business in Asia and Latin America and new product introductions. Sales in 2004 also reflected relatively weak results in 2003 (related to slow industry conditions), the impact of the extra week in the 2004 fiscal year and higher sales as a result of customer preparation for increased exports from China following the January 2005 elimination of apparel manufacturing quotas.

The impact of acquisitions, net of product line divestitures, was approximately \$21 million in 2005. In 2004, incremental sales from acquisitions were offset by the loss of sales from product line divestitures.

Foreign currency translation contributed to the increase in sales by approximately \$7 million in 2005 and approximately \$12 million in 2004.

Operating Income

Operating income reflected charges related to restructuring, asset impairment and lease cancellation in 2005 and 2003. In 2005, operating income benefited from productivity improvement actions, including the ongoing migration of production from Hong Kong to lower cost facilities in mainland China, partially offset by higher costs associated with growth initiatives. The increase in 2004 also reflected sales growth and the successful integration of the 2002 acquisitions.

Other specialty converting businesses

(In millions)	2005	2004	2003
Net sales including			
intersegment sales	\$ 562.7	\$ 540.6	\$ 483.7
Less intersegment sales	(14.6)	(16.8)	(14.5)
Net sales	\$ 548.1	\$ 523.8	\$ 469.2
Operating income ⁽¹⁾	9.5	35.5	43.7

(1) Includes cost reduction, restructuring, asset impairment & lease cancellation charges	\$6.2	-	\$2.5
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Net Sales

Sales in our other specialty converting businesses increased 5% in 2005 compared to 12% in 2004. The benefit to core unit volume growth in 2004 resulting from an extra week in the fiscal year partially contributed to slower growth in 2005. Growth in 2004 was partially offset by the loss of sales from divested product lines (approximately \$15 million).

Foreign currency translation had a favorable impact on the change in sales of approximately \$4 million in 2005 and approximately \$14 million in 2004.

Operating Income

The decreases in operating income in both 2005 and 2004 primarily reflect incremental costs related to the development of the RFID business. Operating income also reflects charges related to restructuring and asset impairment in 2005 and 2003.

FINANCIAL CONDITION

Liquidity

Cash Flow Provided by Operating Activities:

(In millions)	2005	2004	2003
Net income	\$ 226.4	\$ 279.7	\$ 267.9
Depreciation and amortization	201.5	188.2	181.5
Income taxes (deferred and accrued)	(44.5)	31.2	(18.4)
Asset impairment and net (gain) loss on sale of assets	108.1	12.4	(12.0)
Trade accounts receivable	(43.9)	(1.4)	(44.2)
Inventories	(11.7)	(1.2)	(37.9)
Accounts payable and accrued liabilities	30.4	26.9	51.7
Long-term retirement benefits and other liabilities	(12.9)	(27.6)	(33.9)
Other, net	(11.8)	8.7	(6.4)
Net cash provided by operating activities	\$ 441.6	\$ 516.9	\$ 348.3

For cash flow purposes, changes in assets and liabilities exclude the impact of foreign currency translation and the impact of acquisitions and divestitures and certain non-cash transactions (discussed in the "Analysis of Selected Balance Sheet Accounts" section below).

2005

Cash flow provided by operating activities for 2005 was negatively impacted by changes in working capital, as shown below:

Uses of cash

- Accounts receivable reflected higher sales and the timing of collections, partially offset by a decrease in the average days sales outstanding
- Income taxes reflected the timing of payments made, as well as the current year tax accrual

- Long-term retirement benefits and other liabilities reflected contributions of approximately \$46 million to our pension and postretirement health benefit plans during 2005, partially offset by benefit payments

- Inventory reflected higher raw material purchases to support growth and business expansion

Sources of cash

- Accounts payable and accrued liabilities reflected the timing of payments and accruals, as well as the accrual for restructuring charges in 2005

2004

Cash flow provided by operating activities was negatively impacted by changes in working capital, as shown below:

Uses of cash

- Long-term retirement benefits and other liabilities reflected contributions of approximately \$36 million to our pension and postretirement health benefit plans during 2004

Sources of cash

- Income taxes reflected the timing of refunds received, as well as the current year tax accrual

- Accounts payable and accrued liabilities reflected the timing of payments and increased activity to support higher sales in the Pressure-sensitive Materials and Retail Information Services segments

Cash Flow Used in Investing Activities:

(In millions)	2005	2004	2003
Purchase of property, plant and equipment	\$ (162.5)	\$ (178.9)	\$ (203.6)
Purchase of software and other deferred charges	(25.8)	(21.8)	(22.8)
Proceeds from sale of businesses	-	-	58.8
Other, net	20.7	(16.2)	(.2)
Net cash used in investing activities	\$ (167.6)	\$ (216.9)	\$ (167.8)

Capital Spending

Our major capital projects in 2005 included investments for growth in Asia and Latin America, equipment and other investments for our RFID business, and productivity and growth projects in our North American roll materials operations, including development work related to the addition of capacity to meet growing demand for beverage labels.

Proceeds from Sale of Businesses

Proceeds from sale of business were related to the sale of our package label converting business in Europe during 2003.

Cash Flow Used in Financing Activities:

(In millions)	2005	2004	2003
Net change of borrowings and payments of debt	\$ (80.5)	\$ (119.1)	\$ (41.0)
Dividends paid	(168.7)	(164.6)	(160.2)
Purchase of treasury stock	(40.9)	(.7)	(.3)
Proceeds from exercise of stock options	11.1	19.1	5.5
Other	18.5	18.2	18.1
Net cash used in financing activities	\$ (260.5)	\$ (247.1)	\$ (177.9)

Borrowings and Repayment of Debt

At year end 2005, our borrowings outstanding under foreign short-term lines of credit were \$108.3 million with a weighted-average interest rate of 6.6% compared to \$70.8 million at year end 2004.

The \$60 million one-year callable commercial notes issued in January 2004 were paid at maturity in 2005. In June 2005, we issued \$75 million of one-year callable commercial notes at a variable rate of 3.5%, and then called and paid the notes in November 2005.

We had medium-term notes of \$160 million and \$233 million outstanding at year end 2005 and 2004, respectively. Decreases are a result of payments on maturity. Medium-term notes have maturities from 2007 through 2025 and accrue interest at fixed rates ranging from 5.9% to 7.5%.

In August 2004, we issued \$150 million in floating rate senior notes due in 2007 under our 2001 shelf registration statement filed with the Securities and Exchange Commission ("SEC"). These notes are callable at par.

In February 2004, we paid the obligation related to the 1999 transaction with Steinbeis Holding GmbH ("Steinbeis") for approximately \$106 million. This obligation was a result of the combination of our office products business in Europe with Zweckform Büro-Produkte GmbH.

Shareholders' Equity

Our shareholders' equity was \$1.51 billion at year end 2005, compared to \$1.55 billion at year end 2004. Our annual dividend per share increased to \$1.53 in 2005 from \$1.49 in 2004.

In the fourth quarter of 2005, we repurchased 698,505 shares for \$41 million under an agreement related to the L&E Packaging ("L&E") acquisition and recorded such amount to treasury stock. (See the Other section of "Contractual Obligations, Commitments and Off-Balance Sheet Arrangements" below for further details.) As of year end 2005, a cumulative 37.9 million shares of our common stock had been repurchased since 1991, and 2.5 million shares remain available for repurchase under the Board of Directors' authorization.

Analysis of Selected Balance Sheet Accounts

Long-lived Assets

Goodwill decreased \$38 million during 2005 due to foreign currency translation (approximately \$36 million), purchase price allocation adjustments associated with the acquisition of Rinke

and the settlement of claims associated with the acquisition of RVL Packaging, Inc., partially offset by goodwill related to an acquisition in 2005 (approximately \$1 million).

Net other intangibles resulting from business acquisitions decreased \$17 million during 2005 due to amortization expense recorded during 2005 (approximately \$12 million) and the impact of foreign currency translation (approximately \$8 million), partially offset by purchase price allocation adjustments associated with the acquisition of Rinke (approximately \$3 million).

Other assets decreased approximately \$78 million during 2005 due primarily to the impairment of goodwill and other intangibles in a business held for sale. Refer to the "Discontinued Operations" section of Note 1 to the Consolidated Financial Statements.

Other Shareholders' Equity Accounts

Our employee stock benefit trusts decreased \$67 million, due to a decrease in the market value of shares held in the trust of \$48 million during 2005, as well as issuance of shares under our stock and incentive plans for 2005 of approximately \$19 million.

Effect of Foreign Currency

International operations generate approximately 55% of our net sales. Our future results are subject to changes in political and economic conditions and the impact of fluctuations in foreign currency exchange and interest rates. To reduce our income statement exposure to transactions in foreign currencies, we enter into foreign exchange forward, option and swap contracts, where available and appropriate.

Impact of Foreign Currency Translation:

(In millions)	2005	2004	2003
Change in net sales	\$ 77	\$ 207	\$ 235
Change in net income	2	8	14

While there was a benefit from foreign currency translation in 2005, this decreased significantly in 2005 compared to prior years, due to strengthening of the U.S. dollar. The benefit in 2005 reflected the strength of the Euro, Brazilian real, Canadian dollar and Korean won, against the U.S. dollar. The impact of foreign currency fluctuations on net income is smaller than the impact on net sales, because our products are generally sourced in the currencies in which they are sold. As a result, the impact of foreign exchange rates on sales is matched with a partially offsetting impact on reported expenses, thereby reducing the impact of foreign currency fluctuations on net income.

Translation gains and losses for operations in hyperinflationary economies were included in our net income. Operations are treated as being in a hyperinflationary economy for accounting purposes, based on the cumulative inflation rate over the past three years. Operations in hyperinflationary economies consist of our operations in Turkey and the Dominican Republic. These operations were not significant to our consolidated financial position or results of operations.

Analysis of Selected Financial Ratios

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

Working Capital Ratio

Working capital (current assets minus current liabilities), as a percent of net sales, decreased in 2005 primarily due to an increase in short-term debt. Working capital from continuing operations, as a percent of net sales, is shown below. We use this non-GAAP measure as a tool to assess our working capital requirements, because it excludes the impact of fluctuations due to our financing activities. The timing of financing activities is not necessarily related to our current operations and would tend to distort the working capital ratio from period to period. Our objective is to minimize our investment in working capital from operations by reducing this ratio, to maximize cash flow and return on investment.

Working capital from continuing operations:

(In millions)	2005	2004
(A) Working capital (current assets minus current liabilities)	\$ 31.0	\$ 151.8
Reconciling item:		
Short-term and current portion of long-term debt	364.7	204.5
(B) Working capital from continuing operations	\$ 395.7	\$ 356.3
(C) Net sales	\$ 5,473.5	\$ 5,317.0
Working capital, as a percent of net sales (A) ÷ (C)	.6%	2.9%
Working capital from continuing operations as a percent of net sales (B) ÷ (C)	7.2%	6.7%

In 2005, the increase in working capital from continuing operations, as a percent of sales, was primarily due to changes in accounts payable, income taxes payable, cash and cash equivalents and refundable income taxes, partially offset by the change in other accrued liabilities and trade accounts receivable. These changes included the impact of currency.

Accounts Receivable Ratio

The average number of days sales outstanding was 58 days in 2005 compared to 60 days in 2004, calculated using a four-quarter average accounts receivable balance. This decrease reflects improved collections efforts across the businesses.

Inventory Ratio

Average inventory turnover was 8.5 in both 2005 and 2004, calculated using a four-quarter average inventory balance. For purposes of comparability, the ratio was calculated using a 52-week year for 2004.

Debt Ratios

	Requirement	Year End	
		2005	2004
Total debt to total capital		41.8%	43.9%
<i>Debt covenant ratios:</i>			
Total debt to earnings before other expense, interest, taxes, depreciation and amortization	Not to exceed		
	3.5:1.0	1.6:1.0	1.8:1.0
Earnings before other expense, interest and taxes to interest	At least		
	3.5:1.0	8.4:1.0	8.0:1.0

The decrease in total debt to total capital was due to a decrease in total debt outstanding.

Our various loan agreements in effect at year end require that we maintain specified ratios of consolidated debt and consolidated interest expense in relation to certain measures of income. We were in compliance with these covenants as shown in the table above.

The fair value of our debt is estimated based on the discounted amount of the related cash flows using the current rates offered to us for debt of the same remaining maturities. At year end 2005 and 2004, the fair value of our total debt, including short-term borrowings, was \$1.1 billion and \$1.32 billion, respectively.

Shareholders' Equity Ratios

	2005	2004	2003
Return on average shareholders' equity	14.6%	19.9%	22.3%
Return on average total capital	10.1	12.1	12.4

Decreases in these returns in 2005 compared to 2004 were primarily due to lower net income. These ratios are computed using actual net income and a five-quarter average denominator for equity and total debt accounts.

Capital Resources

Capital resources include cash flows from operations and debt financing. We maintain adequate financing arrangements at competitive rates. These financing arrangements consist of our commercial paper programs in the U.S. and Europe, committed and uncommitted bank lines of credit in the countries where we operate, callable commercial notes and long-term debt, including medium-term notes.

Capital from Debt

Our total debt decreased approximately \$124 million in 2005 to \$1.09 billion compared to \$1.21 billion at year end 2004, reflecting payments of debt and the effect of foreign currency translation.

In July 2004, we entered into a revolving credit agreement with ten domestic and foreign banks for a total commitment of \$525 million, expiring July 16, 2009. We use the financing available under this agreement as a commercial paper back-up facility and to finance other corporate requirements. There was no debt outstanding under this agreement as of year end 2005.

In addition, we have a 364-day revolving credit facility with a foreign bank to provide up to Euro 30 million (\$35.6 million) in borrowings through July 19, 2006. We may extend the revolving period and due date with the approval of the bank, on an annual basis. Our intention is to renegotiate an extension of this facility in 2006. Financing under this agreement is used to finance cash requirements of our European operations. As of year end 2005, \$15.4 million was outstanding under this agreement.

We had standby letters of credit outstanding of \$81.2 million and \$81 million at the end of 2005 and 2004, respectively.

Our uncommitted lines of credit were approximately \$409 million at year end 2005. Our uncommitted lines of credit do not have a commitment expiration date, and may be cancelled by the banks or us at any time.

Contractual Obligations, Commitments and Off-balance Sheet Arrangements

Contractual Obligations at Year End 2005:

(In millions)	Payments Due by Period					
	Total	2006	2007	2008	2009	2010 Thereafter
Short-term lines of credit	\$ 363.6	\$ 363.6	–	–	–	–
Long-term debt and capital leases	724.1	1.1	\$ 211.9	\$ 51.5	\$ 1.5	\$ 456.9
Interest on long-term debt ⁽¹⁾	438.6	38.6	35.4	27.3	24.6	288.1
Operating leases	205.1	49.3	39.2	28.5	20.3	16.6
Pension and postretirement benefit contributions	13.3	13.3	–	–	–	–
Total contractual obligations	\$ 1,744.7	\$ 465.9	\$ 286.5	\$ 107.3	\$ 46.4	\$ 796.2

(1) Interest on floating rate debt was estimated using the index rate in effect as of December 31, 2005.

We enter into operating leases primarily for office and warehouse space and equipment for electronic data processing and transportation. The terms of our leases do not impose significant restrictions or unusual obligations, except for the facility in Mentor, Ohio as noted below. The table above includes minimum annual rental commitments on operating leases having initial or remaining noncancellable lease terms of one year or more.

We did not include purchase obligations or open purchase orders at year end 2005 in the table of contractual obligations above, because it is impracticable for us to either obtain such information or provide a reasonable estimate due to the decentralized nature of our purchasing systems.

In January 2006, we contributed \$25 million to our domestic pension plan, which is more than the amount required by U.S. governmental agencies for 2006.

In the fourth quarter of 2004, we filed a shelf registration statement with the SEC to permit the issuance of up to \$500 million in debt and equity securities. Proceeds from the shelf offering may be used for general corporate purposes, including repaying, redeeming or repurchasing existing debt, and for working capital, capital expenditures and acquisitions. As of December 31, 2005, no securities had been issued under the 2004 registration statement.

Credit ratings are a significant factor in our ability to raise short-term and long-term financing. When determining a credit rating, the rating agencies place significant weight on our competitive position, business outlook, consistency of cash flows, debt level and liquidity, geographic dispersion and management team.

The credit ratings assigned to us also impact the interest rates on our commercial paper and other borrowings.

Our credit ratings as of year end 2005:

	Short-term	Long-term	Outlook
Standard & Poor's Rating Service	A-2	A-	Negative
Moody's Investors Service	P2	A3	Stable

Industry Investigations

In April 2003, we were notified by the DOJ that it had initiated a criminal investigation into competitive practices in the label stock industry, and on August 15, 2003, the DOJ issued a subpoena to us in connection with the investigation. In May 2004, the EC initiated inspections and obtained documents from our pressure-sensitive materials facilities in the Netherlands and Germany, seeking evidence of unlawful anticompetitive activities. In July 2004, we were notified by the Competition Law Division of the Department of Justice of Canada that it was seeking information in connection with a label stock investigation. In August 2005, we were notified by the Australian Competition and Consumer Commission that it was seeking information in connection with a label stock investigation. We are cooperating with these investigations. We are a named defendant in purported class actions in the U.S. seeking treble damages and other relief for alleged unlawful competitive

practices, which were filed after the announcement of the DOJ investigation. We are also a named defendant in purported class actions in the U.S. seeking damages and other relief for alleged disclosure and fiduciary duty violations pertaining to alleged unlawful competitive practices. We have discovered instances of improper conduct by certain employees in our European operations that constituted an infringement of EC competition law. We accordingly expect that the EC will impose a fine on us when its investigation is completed. We are unable to predict the effect of these matters at this time, although the effect could well be adverse and material. These matters are reported in Note 8 "Contingencies," to the Consolidated Financial Statements.

Environmental

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

We have accrued liabilities for such sites, including sites in which governmental agencies have designated us as a PRP, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites and any sites which could be identified in the future for cleanup could be higher than the liability currently accrued. Amounts currently accrued are not significant to our consolidated financial position, and based upon current information, we believe that it is unlikely that the final resolution of these matters will significantly impact our consolidated financial position, results of operations or cash flows.

Other

We have contacted relevant authorities in the U.S. and reported the results of an internal investigation of potential violations of the U.S. Foreign Corrupt Practices Act. The transactions at issue were carried out by a small number of employees of our reflective business in China, and involved, among other things, impermissible payments or attempted impermissible payments. The payments or attempted payments and the contracts associated with them appear to have been relatively minor in amount and of limited duration. Corrective and disciplinary actions have been taken. Sales of our reflective business in China in 2005 were approximately \$7 million. Based on findings to date, no changes to our previously filed financial statements are warranted as a result of these matters. However, we expect that fines or other penalties may be incurred. While we are unable to predict the financial or operating

impact of any such fines or penalties, we believe that our behavior in detecting, investigating, responding to and voluntarily disclosing these matters to authorities should be viewed favorably.

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

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

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

We participate in receivable financing programs, both domestically and internationally, with several financial institutions whereby we may request advances from these financial institutions. At December 31, 2005, we guaranteed approximately \$19 million of these advances.

We guaranteed up to approximately \$21 million of certain of our foreign subsidiaries' obligations to their suppliers as of December 31, 2005.

In connection with the L&E acquisition in 2002, we issued 743,108 shares at \$63.08 per share. We also entered into an agreement with L&E whereby in the event the value of our common shares fell below the price of the shares that were issued to L&E (adjusted for dividends received), during the period from January 1, 2005 through December 31, 2007, L&E had the option to exercise a true-up right. Upon exercise of this true-up right, we had the option to (1) pay the difference in value to L&E, in the form of (a) cash or (b) common shares, or (2) repurchase the shares at the issued share price, adjusted for dividends paid. The true-up obligation was reduced by any shares sold by L&E to third parties. During 2005, L&E sold 44,603 shares to third parties. On October 20, 2005, L&E notified us that it was exercising its true-up right under the agreement for the remaining 698,505 shares. We repurchased the remaining shares under the agreement for \$41 million in the fourth quarter of 2005.

RELATED PARTY TRANSACTIONS

From time to time, we enter into transactions in the normal course of business with related parties. We believe that such transactions are at arm's-length and for terms that would have been obtained from unaffiliated third parties. One of our directors, Peter W. Mullin is the chairman, chief executive officer and a director of MC Insurance Services, Inc. ("MC"), Mullin Insurance Services, Inc. ("MINC"), and PWM Insurance Services, Inc. ("PWM"), executive compensation and benefit consultants and insurance agents. Mr. Mullin is also the majority stockholder of MC, MINC and PWM (collectively referred to as the "Mullin Companies"). We paid premiums to insurance carriers for life insurance placed by the Mullin Companies in connection with several of our employee benefit plans. The Mullin Companies have advised us that they earned commissions from such insurance carriers for the placement and renewal of this insurance. The majority of these commissions were allocated to and used by MC Insurance Agency Services, LLC (an affiliate of MC) to administer benefit plans and provide benefit statements to participants under several of our employee benefit plans. The Mullin Companies own a minority interest in M Financial Holdings, Inc. ("MFH"). Substantially all of the life insurance policies, which we placed through the Mullin Companies in 2005 and prior years, are issued by insurance carriers that participate in reinsurance agreements entered into between these insurance carriers and M Life Insurance Company ("M Life"), a wholly-owned subsidiary of MFH. Reinsurance returns earned by M Life are determined annually by the insurance carriers and can be negative or positive, depending upon the results of M Life's aggregate reinsurance pool, which consists of the insured lives reinsured by M Life. The Mullin Companies have advised us that they participated in net reinsurance gains of M Life. None of these transactions were significant to our financial position or results of operations.

Summary of Related Party Activity:

(In millions)	2005	2004	2003
Mullin Companies commissions on our insurance premiums	\$.9	\$ 1.1	\$ 1.1
Mr. Mullin's direct & indirect interest in these commissions	.7	.8	.7
Mullin Companies reinsurance gains (without risk of forfeiture) ascribed by M Life to our life insurance policies	.2	.2	—
Mr. Mullin's direct & indirect interest in reinsurance gains (without risk of forfeiture)	.1	.2	—
Mullin Companies reinsurance gains (subject to risk of forfeiture) ascribed by M Life to our life insurance policies	1.5	—	—
Mr. Mullin's direct & indirect interest in reinsurance gains (subject to risk of forfeiture)	1.1	—	—

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions for the reporting period and as of the financial statement date. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenue and expense. Actual results could differ from those estimates.

Critical accounting policies are those that are important to the portrayal of our financial condition and results, and which require us to make difficult, subjective and/or complex judgments. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. We believe that critical accounting policies include accounting for revenue recognition, sales returns and allowances, accounts receivable allowances, inventory reserves, long-lived asset impairments, pensions and postretirement benefits, income taxes, restructuring and severance costs and litigation.

Revenue Recognition

Sales are recognized when persuasive evidence of an arrangement exists, product delivery has occurred, pricing is fixed or determinable, and collection is reasonably assured. Sales, provisions for estimated sales returns, and the cost of products sold are recorded at the time title transfers to customers. Actual product returns are charged against estimated sales return allowances.

Sales rebates and discounts are common practice in the industries in which we operate. Volume, promotional, price, cash and other discounts and customer incentives are accounted for as a reduction to gross sales. Rebates and discounts are recorded based upon estimates at the time products are sold. These estimates are based upon historical experience for similar programs and products. We review such rebates and discounts on an ongoing basis and accruals for rebates and discounts are adjusted, if necessary, as additional information becomes available.

Sales Returns and Allowances

Sales returns and allowances represent credits we grant to our customers (both affiliated and non-affiliated) for the return of unsatisfactory product or a negotiated allowance in lieu of return. We accrue for returns and allowances based upon the gross price of the products sold and historical experience for such products. We record these allowances based on the following factors: (i) customer specific allowances; and (ii) an estimated amount, based on our historical experience, for issues not yet identified.

Accounts Receivable Allowances

We are required to make judgments as to the collectibility of accounts receivable based on established aging policy, historical experience and future expectations. The allowances for doubtful

accounts represent allowances for customer trade accounts receivable that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables to their net realizable value. We record these allowances based on estimates related to the following factors: (i) customer specific allowances; (ii) amounts based upon an aging schedule; and (iii) an estimated amount, based on our historical experience, for issues not yet identified. No single customer represented 10% or more of our net sales or trade receivables at year end 2005 and 2004. However, our ten largest customers at year end 2005 represented approximately 20% of trade accounts receivable and consisted of six customers of our Office and Consumer Products segment, three customers of our Pressure-sensitive Materials segment and one customer of both these segments. The financial position and operations of these customers are monitored on an ongoing basis.

Inventory Reserves

Inventories are stated at the lower of cost or market value and are categorized as raw materials, work-in-progress or finished goods. Inventory reserves are recorded for damaged, obsolete, excess and slow-moving inventory. We use estimates to record these reserves. Slow-moving inventory is reviewed by category and may be partially or fully reserved for depending on the type of product and the length of time the product has been included in inventory.

Long-lived Asset Impairments

We record impairment charges when the carrying amounts of long-lived assets are determined not to be recoverable. Impairment is measured by assessing the usefulness of an asset or by comparing the carrying value of an asset to its fair value. Fair value is typically determined using quoted market prices, if available, or an estimate of undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. The amount of impairment loss is calculated as the excess of the carrying value over the fair value. Changes in market conditions and management strategy have historically caused us to reassess the carrying amount of our long-lived assets.

Pensions and Postretirement Benefits

Assumptions used in determining projected benefit obligations and the fair value of plan assets for our pension plan and other postretirement benefits plans are evaluated by management in consultation with outside actuaries who are relied upon as experts. In the event we determine that changes are warranted in the assumptions used, such as the discount rate, expected long term rate of return, or health care costs, future pension and post-retirement benefit expenses could increase or decrease. Due to changing market conditions or changes in the participant population, the actuarial assumptions we use may differ from actual results, which could have a significant impact on our pension and postretirement liability and related cost.

Discount Rate

We, in consultation with our actuaries, annually review and determine the discount rates to be used in connection with our postretirement obligations. The assumed discount rate for each pension plan reflects market rates for high quality corporate bonds currently available. In the U.S., our discount rate was determined by evaluating several yield curves consisting of large populations of high quality corporate bonds. The projected pension benefit payment streams were then matched with the bond portfolios to determine a rate that reflected the liability duration unique to our plans.

Long-term Return on Assets

We determine the long-term rate of return assumption for plan assets by reviewing the historical and expected returns of both the equity and fixed income markets, taking into consideration that assets with higher volatility typically generate a greater return over the long run. Additionally, current market conditions, such as interest rates, are evaluated and peer data is reviewed to check for reasonability and appropriateness.

Healthcare Cost Trend Rate

Our practice is to fund the cost of the postretirement benefits on a cash basis. For measurement purposes, an 8% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2006. This rate is expected to decrease to approximately 5% by 2009.

Income Taxes

Deferred tax liabilities or assets reflect temporary differences between the amounts of assets and liabilities for financial and tax reporting purposes. Such amounts are adjusted, as appropriate, to reflect changes in tax rates expected to be in effect when the temporary differences reverse. A valuation allowance is recorded to reduce our deferred tax assets to the amount that is more likely than not to be realized.

When establishing a valuation allowance, we consider future sources of income such as forecasted earnings, the mix of earnings in the jurisdictions in which we operate, and prudent and feasible tax planning. In the event we determine that we would not be able to realize our deferred tax assets in the future, the valuation adjustment to the deferred tax assets is charged to earnings in the period in which we make such a determination. Likewise, if later it is determined that it is more likely than not that the deferred tax assets would be realized, we would reverse the previously provided valuation allowance.

We calculate current and deferred tax provisions based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the following year. Adjustments based on filed returns are recorded when identified in the subsequent year.

The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities. Our estimate of the potential outcome of any uncertain tax issue is subject to management's assessment of relevant risks, facts, and circumstances existing at that time. We believe that we have adequately provided for reasonably foreseeable outcomes related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, which may impact our effective tax rate on a quarterly basis.

Restructuring and Severance Costs

We account for restructuring costs including severance and other costs associated with exit or disposal activities following the guidance provided in SFAS No. 112, "Accounting for Postemployment Benefits," and SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." In the U.S., we have a severance pay plan ("Pay Plan"), which provides eligible employees with severance payments in the event of an involuntary termination due to qualifying cost reduction actions. We calculate severance pay using the severance benefits formula under the Pay Plan. Accordingly, we record provisions for such amounts and other related exit costs when they are probable and estimable as set forth under SFAS No. 112. In the absence of a Pay Plan, liability for severance and other employee-related costs are recognized when the liability is incurred and follow the guidance of SFAS No. 146.

Litigation

We are currently involved in various lawsuits, claims and inquiries, most of which are routine to the nature of the business, and in accordance with SFAS No. 5, "Accounting for Contingencies," we accrue estimates of the probable and estimable losses for the resolution of these claims. The ultimate resolution of these claims could affect our future results of operations for any particular quarterly or annual period should our exposure be materially different from our earlier estimates or should liabilities be incurred that were not previously accrued.

RECENT ACCOUNTING REQUIREMENTS

During 2005, we adopted several accounting and financial disclosure requirements by the Financial Accounting Standards Board ("FASB"), Emerging Issues Task Force ("EITF") and Financial Interpretations by the FASB, none of which has had a significant impact on our financial results of operations and financial position. (Refer to Note 1 "Summary of Significant Accounting Policies," to the Consolidated Financial Statements for more information).

In January 2006, we adopted the recognition provisions of SFAS 123(R), "Share-Based Payment," following the guidance under modified prospective application and expect that the associated expense will be approximately \$17 million in 2006 based on unvested stock options outstanding at year end 2005. Such expense will have an estimated \$.12 per share impact on earnings after tax.

RISK FACTORS (SAFE HARBOR STATEMENT)

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

Certain of such risks and uncertainties are discussed in more detail in Part 1, Item 1A, "Risk Factors," to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and include, but are not limited to, risks and uncertainties relating to investment in development activities and new production facilities, timely development and successful market acceptance of new products, fluctuations in cost and availability of raw materials, ability of the Company to achieve and sustain targeted cost reductions, impact of competitive products and pricing, business mix shift, credit risks, ability to obtain adequate financing arrangements, fluctuations in pension, insurance and employee benefit costs, successful integration of acquisitions, successful implementation of new manufacturing technologies and installation of manufacturing equipment, customer and supplier concentrations, financial condition and inventory strategies of customers, changes in customer order patterns, loss of significant contract(s) or customer(s), legal proceedings, including the DOJ criminal investigation, as well as the European Commission ("EC"), Canadian Department of Justice, and Australian Competition and Consumer Commission investigations, into industry competitive practices and any related proceedings or lawsuits pertaining to these investigations or to the subject matter thereof (including purported class actions seeking treble damages for alleged unlawful competitive practices, and purported class actions related to alleged disclosure and fiduciary duty violations pertaining to alleged unlawful competitive practices, which were filed after the announcement of the DOJ investigation, as well as a likely fine by the EC in respect of certain employee misconduct in Europe), impact of potential violations of the U.S. Foreign Corrupt Practices Act based on issues in China, changes in governmental regulations, fluctuations in interest rates, fluctuations in foreign currency exchange rates and other risks associated with foreign operations, changes in economic or political conditions, acts of war, terrorism,

natural disasters, impact of epidemiological events on the economy, the Company's customers and suppliers, and other factors.

The Company believes that the most significant risk factors that could affect its ability to achieve its stated financial expectations in the near-term include:

- (1) potential adverse developments in legal proceedings and/or investigations regarding competitive activities, including possible fines, penalties, judgments or settlements;
- (2) the impact of economic conditions on underlying demand for the Company's products;
- (3) the impact of competitors' actions, including expansion in key markets, product offerings and pricing;
- (4) the degree to which higher raw material costs can be passed on to customers through selling price increases (and previously implemented selling price increases can be sustained), without a significant loss of volume; and
- (5) the ability of the Company to achieve and sustain targeted cost reductions.

Any forward-looking statements should also be considered in light of the factors detailed in Part 1, Item 1A, "Risk Factors," in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

The Company's forward-looking statements represent judgment only on the dates such statements were made. By making any forward-looking statements, the Company assumes no duty to update them to reflect new, changed or unanticipated events or circumstances, other than as may be required by law.

MARKET-SENSITIVE INSTRUMENTS AND RISK MANAGEMENT

Risk Management

We are exposed to the impact of changes in interest rates and foreign currency exchange rates.

Our policy is not to purchase or hold foreign currency, interest rate or commodity contracts for trading purposes.

Our objective in managing the exposure to foreign currency changes is to reduce the risk to our earnings and cash flow associated with foreign exchange rate changes. As a result, we enter into foreign exchange forward, option and swap contracts to reduce risks associated with the value of our existing foreign currency assets, liabilities, firm commitments and anticipated foreign revenues and costs, when available and appropriate. The gains and losses on these contracts are intended to offset changes in the related exposures. We do not hedge our foreign currency exposure in a manner that would entirely eliminate the effects of changes in foreign exchange rates on our consolidated net income.

Our objective in managing our exposure to interest rate changes is to reduce the impact of interest rate changes on earnings and cash flows. To achieve our objectives, we may periodically use interest rate contracts to manage net exposure to interest rate changes related to our borrowings. In connection with the issuance of the \$250 million 10-year senior notes in 2003, we settled a forward starting interest rate swap at a loss of approximately \$32.5 million. The loss is currently being amortized to interest expense over 10 years, which corresponds to the term of the related debt.

Additionally, we enter into certain natural gas futures contracts to reduce the risks associated with anticipated domestic natural gas used in manufacturing and operations. These amounts are not material to our financial statements.

In the normal course of operations, we also face other risks that are either nonfinancial or nonquantifiable. Such risks principally include changes in economic or political conditions, other risks associated with foreign operations, commodity price risk and litigation risk, which are not represented in the analyses that follow.

Foreign Exchange Value-At-Risk

We use a Value-At-Risk ("VAR") model to determine the estimated maximum potential one-day loss in earnings associated with both our foreign exchange positions and contracts. This approach assumes that market rates or prices for foreign exchange positions and contracts are normally distributed. The VAR model estimates were made assuming normal market conditions. Firm commitments, accounts receivable and accounts payable denominated in foreign currencies, which certain of these instruments are intended to hedge, were included in the model. Forecasted transactions, which certain of these instruments are intended to hedge, were excluded from the model. The VAR was estimated using a variance-covariance methodology based on historical volatility for each currency. The volatility and correlation used in the calculation were based on two-year historical data obtained from one of our domestic banks. A 95% confidence level was used for a one-day time horizon.

The VAR model is a risk analysis tool and does not purport to represent actual losses in fair value that could be incurred by us, nor does it consider the potential effect of favorable changes in market factors.

The estimated maximum potential one-day loss in earnings for our foreign exchange positions and contracts was approximately \$4.5 million at year end 2005.

Interest Rate Sensitivity

An assumed 28 basis point move in interest rates (10% of our weighted-average interest rate on floating rate debt) affecting our variable-rate borrowings would have had an immaterial effect on our 2005 earnings.

Consolidated Balance Sheet

(Dollars in millions)	2005	2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 98.5	\$ 84.8
Trade accounts receivable, less allowances of \$61.6 and \$61.5 at year end 2005 and 2004, respectively	863.2	883.9
Inventories, net	439.7	431.9
Deferred taxes	34.5	31.7
Other current assets	122.4	110.1
Total current assets	1,558.3	1,542.4
Property, plant and equipment, net	1,295.7	1,374.4
Goodwill	673.1	710.6
Other intangibles resulting from business acquisitions, net	98.7	115.8
Other assets	578.1	656.1
	\$ 4,203.9	\$ 4,399.3
Liabilities and Shareholders' Equity		
Current liabilities:		
Short-term and current portion of long-term debt	\$ 364.7	\$ 204.5
Accounts payable	577.9	616.7
Accrued payroll and employee benefits	161.7	165.2
Accrued trade rebates	145.9	158.6
Other accrued liabilities	215.9	163.2
Income taxes payable	59.5	79.1
Total current liabilities	1,525.6	1,387.3
Long-term debt	723.0	1,007.2
Long-term retirement benefits and other liabilities	356.8	373.0
Non-current deferred taxes	86.6	83.1
Commitments and contingencies (see Notes 7 and 8)		
Shareholders' equity:		
Common stock, \$1 par value, authorized – 400,000,000 shares at year end 2005 and 2004; issued – 124,126,624 shares at year end 2005 and 2004; outstanding – 99,727,160 shares and 100,113,127 shares at year end 2005 and 2004, respectively	124.1	124.1
Capital in excess of par value	729.5	766.1
Retained earnings	1,945.3	1,887.6
Cost of unallocated ESOP shares	(7.7)	(9.7)
Employee stock benefit trusts, 10,006,610 shares and 10,343,648 shares at year end 2005 and 2004, respectively	(552.0)	(619.1)
Treasury stock at cost, 14,362,854 shares and 13,669,849 shares at year end 2005 and 2004, respectively	(638.2)	(597.6)
Accumulated other comprehensive loss	(89.1)	(2.7)
Total shareholders' equity	1,511.9	1,548.7
	\$ 4,203.9	\$ 4,399.3

See Notes to Consolidated Financial Statements

Consolidated Statement of Income

(In millions, except per share amounts)	2005	2004 ⁽¹⁾	2003
Net sales	\$ 5,473.5	\$ 5,317.0	\$ 4,736.8
Cost of products sold	3,852.4	3,742.0	3,282.9
Gross profit	1,621.1	1,575.0	1,453.9
Marketing, general and administrative expense	1,132.8	1,105.8	1,026.3
Interest expense	57.9	58.7	58.6
Other expense, net	63.6	35.2	30.5
Income from continuing operations before taxes	366.8	375.3	338.5
Taxes on income	75.0	94.3	93.4
Income from continuing operations	291.8	281.0	245.1
Income (loss) from discontinued operations, net of tax (including gain on disposal of \$19.7, net of tax of \$5.8 in 2003)	(65.4)	(1.3)	22.8
Net income	\$ 226.4	\$ 279.7	\$ 267.9
Per share amounts:			
Net income (loss) per common share:			
Continuing operations	\$ 2.91	\$ 2.81	\$ 2.47
Discontinued operations	(.65)	(.01)	.23
Net income per common share	\$ 2.26	\$ 2.80	\$ 2.70
Net income (loss) per common share, assuming dilution:			
Continuing operations	\$ 2.90	\$ 2.79	\$ 2.45
Discontinued operations	(.65)	(.01)	.23
Net income per common share, assuming dilution	\$ 2.25	\$ 2.78	\$ 2.68
Dividends	\$ 1.53	\$ 1.49	\$ 1.45
Average shares outstanding:			
Common shares	100.1	99.9	99.4
Common shares, assuming dilution	100.5	100.5	100.0
Common shares outstanding at year end	99.7	100.1	99.6

(1) Results for fiscal year 2004 reflect a 53-week period.

See Notes to Consolidated Financial Statements

Consolidated Statement of Shareholders' Equity

(Dollars in millions, except per share amounts)	Common stock, \$1 par value	Capital in excess of par value	Retained earnings	Cost of unallocated ESOP shares	Employee stock benefit trusts	Treasury stock	Accumulated other comprehensive income (loss)	Total
Fiscal year ended 2002	\$ 124.1	\$ 740.2	\$ 1,664.8	\$ (12.2)	\$ (658.7)	\$ (596.9)	\$ (204.9)	\$ 1,056.4
Comprehensive income:								
Net income			267.9					267.9
Other comprehensive income:								
Foreign currency translation adjustment							150.7	150.7
Minimum pension liability adjustment, net of tax of \$12.6							(27.8)	(27.8)
Effective portion of gains or losses on cash flow hedges, net of tax of \$(1.9)							4.4	4.4
Other comprehensive income							127.3	127.3
Total comprehensive income								395.2
Repurchase of 875 shares for treasury, net of shares issued						(.1)		(.1)
Stock issued under option plans, including \$19.5 of tax and dividends paid on stock held in stock trusts		11.9			13.5			25.4
Dividends: \$1.45 per share			(160.2)					(160.2)
ESOP transactions, net				.6	1.4			2.0
Employee stock benefit trusts market value adjustment		(48.4)			48.4			—
Fiscal year ended 2003	124.1	703.7	1,772.5	(11.6)	(595.4)	(597.0)	(77.6)	1,318.7
Comprehensive income:								
Net income			279.7					279.7
Other comprehensive income:								
Foreign currency translation adjustment							87.9	87.9
Minimum pension liability adjustment, net of tax of \$14.6							(14.9)	(14.9)
Effective portion of gains or losses on cash flow hedges, net of tax of \$2.5							1.9	1.9
Other comprehensive income							74.9	74.9
Total comprehensive income								354.6
Repurchase of 9,641 shares for treasury, net of shares issued						(.6)		(.6)
Stock issued under option plans, including \$19.2 of tax and dividends paid on stock held in stock trusts		4.4			34.3			38.7
Dividends: \$1.49 per share			(164.6)					(164.6)
ESOP transactions, net				1.9				1.9
Employee stock benefit trusts market value adjustment		58.0			(58.0)			—
Fiscal year ended 2004	124.1	766.1	1,887.6	(9.7)	(619.1)	(597.6)	(2.7)	1,548.7
Comprehensive income:								
Net income			226.4					226.4
Other comprehensive income:								
Foreign currency translation adjustment							(90.6)	(90.6)
Minimum pension liability adjustment, net of tax of \$2.2							(.9)	(.9)
Effective portion of gains or losses on cash flow hedges, net of tax of \$(3.1)							5.1	5.1
Other comprehensive income							(86.4)	(86.4)
Total comprehensive income								140.0
Repurchase of 693,005 shares for treasury, net of shares issued						(40.6)		(40.6)
Stock issued under option plans, including \$18.8 of tax and dividends paid on stock held in stock trusts		11.3			19.2			30.5
Dividends: \$1.53 per share			(168.7)					(168.7)
ESOP transactions, net				2.0				2.0
Employee stock benefit trusts market value adjustment		(47.9)			47.9			—
Fiscal year ended 2005	\$ 124.1	\$ 729.5	\$ 1,945.3	\$ (7.7)	\$ (552.0)	\$ (638.2)	\$ (89.1)	\$ 1,511.9

See Notes to Consolidated Financial Statements

Consolidated Statement of Cash Flows

(In millions)	2005	2004 ⁽¹⁾	2003 ⁽²⁾
Operating Activities			
Net income	\$ 226.4	\$ 279.7	\$ 267.9
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	155.7	147.2	146.1
Amortization	45.8	41.0	35.4
Deferred taxes	(12.6)	93.1	(3.8)
Asset impairment and net (gain) loss on sale of assets of \$7, \$2.5 and \$(19.6) in 2005, 2004 and 2003, respectively	108.1	12.4	(12.0)
Other non-cash items, net	(7.5)	(.5)	(2.4)
Changes in assets and liabilities, net of the effect of business acquisitions and divestitures:			
Trade accounts receivable	(43.9)	(1.4)	(44.2)
Inventories	(11.7)	(1.2)	(37.9)
Other current assets	(4.3)	9.2	(4.0)
Accounts payable and accrued liabilities	30.4	26.9	51.7
Taxes on income	(31.9)	(61.9)	(14.6)
Long-term retirement benefits and other liabilities	(12.9)	(27.6)	(33.9)
Net cash provided by operating activities	441.6	516.9	348.3
Investing Activities			
Purchase of property, plant and equipment	(162.5)	(178.9)	(203.6)
Purchase of software and other deferred charges	(25.8)	(21.8)	(22.8)
Payments for acquisitions	(2.8)	(15.0)	(6.9)
Proceeds from sale of assets	21.8	8.2	15.4
Proceeds from sale of business	-	-	58.8
Other	1.7	(9.4)	(8.7)
Net cash used in investing activities	(167.6)	(216.9)	(167.8)
Financing Activities			
Net increase (decrease) in borrowings (maturities of 90 days or less)	58.2	(39.9)	114.4
Additional borrowings (maturities longer than 90 days)	76.2	302.8	567.9
Payments of debt (maturities longer than 90 days)	(214.9)	(382.0)	(723.3)
Dividends paid	(168.7)	(164.6)	(160.2)
Purchase of treasury stock	(40.9)	(.7)	(.3)
Proceeds from exercise of stock options, net	11.1	19.1	5.5
Other	18.5	18.2	18.1
Net cash used in financing activities	(260.5)	(247.1)	(177.9)
Effect of foreign currency translation on cash balances	.2	2.4	4.1
Increase in cash and cash equivalents	13.7	55.3	6.7
Cash and cash equivalents, beginning of year	84.8	29.5	22.8
Cash and cash equivalents, end of year	\$ 98.5	\$ 84.8	\$ 29.5

(1) Results for fiscal year 2004 reflect a 53-week period.

(2) Revised presentation, see the "Financial Presentation" section of Note 1.

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Avery Dennison Corporation (the "Company") is a worldwide manufacturer of pressure-sensitive materials, office products and a variety of tickets, tags and other converted products. The Company's end markets include consumer products and other retail items (including apparel), logistics and shipping, industrial and durable goods, office products, transportation, and medical/health care.

Segment Reporting

During the fourth quarter of 2004, the Company reorganized its reporting segments to provide enhanced transparency of its operational results. The Company's segments are:

- Pressure-sensitive Materials – manufactures and sells pressure-sensitive roll label materials, films for graphic and reflective applications, performance polymers (largely adhesives used to manufacture pressure-sensitive materials), and extruded films
- Office and Consumer Products – manufactures and sells a variety of office and consumer products, including labels, binders, dividers, sheet protectors, and writing instruments
- Retail Information Services – designs, manufactures and sells a wide variety of price marking and brand identification products, including tickets, tags and labels, and related supplies and equipment

In addition to the reportable segments, the Company has other specialty converting businesses comprised of several businesses that produce specialty tapes and highly engineered labels, including radio-frequency identification labels ("RFID") and other converted products.

The Pressure-sensitive Materials segment contributes approximately 57% of the Company's total sales, while the Office and Consumer Products segment and the Retail Information Services segment contribute approximately 21% and 12%, respectively, of the Company's total sales. Approximately 80% of sales are generated in the United States and Europe. See also Note 12 "Segment Information," for further details.

Principles of Consolidation

The consolidated financial statements include the accounts of majority-owned subsidiaries. Intercompany accounts, transactions and profits are eliminated. Investments in certain affiliates (20% to 50% ownership) are accounted for by the equity method of accounting. Investments representing less than 20% ownership are accounted for by the cost method of accounting.

Financial Presentation

The Company has revised its 2003 statement of cash flows to combine cash flows from discontinued operations with those from continuing operations within each major category of the statement. The amounts of the operating, investing and financing portions of cash flows attributable to our discontinued operations were previously reported on a net basis; net cash flows from discontinued operations were zero in the years presented herein.

Certain prior year amounts have been reclassified to conform with the 2005 financial statement presentation.

Discontinued Operations

In December 2005, the Company announced its plan to sell a business consisting of raised reflective pavement markers. Based on the estimated value for this business, management concluded that associated goodwill and intangible assets from the acquisition of this business were impaired, resulting in a pretax charge of \$74.4 million in December 2005. The results of this business have been accounted for as discontinued operations for the years presented herein. This business was previously included in the Pressure-sensitive Materials segment.

In October 2003, the Company completed the sale of its package label converting business in Europe, which consisted of two package label converting facilities in Denmark, as well as a package label converting facility in France, to CCL Industries, Inc. Accordingly, the results for this business were accounted for as discontinued operations in the consolidated financial statements for 2003. The cash proceeds from the sale were \$58.8 million, from which the Company recognized a gain of \$19.7 million in the fourth quarter of 2003, net of taxes of \$5.8 million. Goodwill of \$11.7 million was included in the calculation of the gain on sale.

Summarized, combined statement of income for discontinued operations:

(In millions)	2005	2004	2003
Net sales	\$ 22.8	\$ 23.9	\$ 69.9
Income (loss) before taxes	\$ (76.9)	\$ (1.9)	\$ 4.3
Taxes on income	(11.5)	(.6)	1.2
Income (loss) from operations, net of tax	(65.4)	(1.3)	3.1
Gain on sale of discontinued operations	–	–	25.5
Tax on gain from sale	–	–	5.8
Income (loss) from discontinued operations, net of tax	\$ (65.4)	\$ (1.3)	\$ 22.8

Summarized, combined balance sheet for discontinued operations:

(In millions)	2005	2004
Current assets	\$ 3.9	\$ 5.5
Property, plant and equipment, net	5.1	6.6
Goodwill	–	46.4
Other intangibles resulting from business acquisitions	–	30.0
Other assets	2.9	.5
Noncurrent assets held for sale (included in “Other assets” on the Consolidated Balance Sheet)	8.0	83.5
Current liabilities	2.2	2.2
Noncurrent liabilities	.5	7.9

Amortization expense on other intangible assets resulting from business acquisitions for discontinued operations was \$2 million in 2005, 2004 and 2003.

Fiscal Year

The Company’s 2005 fiscal year reflected a 52-week period ending December 31, 2005. The 2004 fiscal year reflected a 53-week period ending January 1, 2005. Fiscal year 2003 reflected a 52-week period ending December 27, 2003. Normally, each fiscal year consists of 52 weeks, but every fifth or sixth fiscal year consists of 53 weeks.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions for the reporting period and as of the financial statement date. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenue and expense. Actual results could differ from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, deposits in banks, and short-term investments with maturities of three months or less when purchased. The carrying amounts of these assets approximate fair value due to the short maturity of the instruments. Cash paid for interest and taxes was as follows:

(In millions)	2005	2004	2003
Interest, net of capitalized amounts	\$ 55.9	\$ 59.5	\$ 47.3
Income taxes, net of refunds	113.1	68.9	124.0

In both 2005 and 2004, non-cash activities included accruals for capital expenditures of approximately \$27 million due to the timing of payments. Also in 2005, fixed assets acquired through capital lease totaled approximately \$9 million.

Accounts Receivable

The Company records trade accounts receivable at the invoiced amount. The allowance for doubtful accounts represents allowances for trade accounts receivable that are estimated to be

partially or entirely uncollectible. The customer complaint reserve represents estimated sales returns and allowances. These allowances are used to reduce gross trade receivables to their net realizable values. In 2005 and 2004, the Company recorded expenses of \$28.2 million and \$29.3 million, respectively, related to the allowances for trade accounts receivable. The Company records these allowances based on estimates related to the following factors:

- Customer specific allowances
- Amounts based upon an aging schedule
- An estimated amount, based on the Company’s historical experience

No single customer represented 10% or more of the Company’s net sales or trade receivables at year end 2005 and 2004. However, the ten largest customers at year end 2005 represented approximately 20% of trade accounts receivable and consisted of six customers of the Company’s Office and Consumer Products segment, three customers of the Pressure-sensitive Materials segment and one customer of both these segments. The Company does not require its customers to provide collateral, but the financial position and operations of these customers are monitored on an ongoing basis.

Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using methods that approximate both the first-in, first-out (“FIFO”) and last-in, first-out (“LIFO”) methods. Inventories valued using the LIFO method comprised 31% and 32% of inventories before LIFO adjustment at year end 2005 and 2004, respectively. Inventories at year end were as follows:

(In millions)	2005	2004
Raw materials	\$ 132.8	\$ 139.5
Work-in-progress	101.6	94.6
Finished goods	220.9	212.7
Inventories at lower of FIFO cost or market (approximates replacement cost)	455.3	446.8
Less LIFO adjustment	(15.6)	(14.9)
	\$ 439.7	\$ 431.9

Property, Plant and Equipment

Major classes of property, plant and equipment are stated at cost and were as follows:

(In millions)	2005	2004
Land	\$ 56.0	\$ 61.7
Buildings and improvements	623.2	631.5
Machinery and equipment	1,885.4	1,866.7
Construction-in-progress	113.5	138.7
	2,678.1	2,698.6
Accumulated depreciation	(1,382.4)	(1,324.2)
	\$ 1,295.7	\$ 1,374.4

Depreciation is generally computed using the straight-line method over the estimated useful lives of the assets ranging from five to fifty years for buildings and improvements and two to fifteen years for machinery and equipment. Leasehold improvements are depreciated over the shorter of the useful life of the asset or the term of the associated leases. Maintenance and repair costs are expensed as incurred; renewals and betterments are capitalized. Upon the sale or retirement of assets, the accounts are relieved of the cost and the related accumulated depreciation, with any resulting gain or loss included in net income.

Software

The Company capitalizes software costs in accordance with American Institute of Certified Public Accountants' Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," and are included in "Other assets" in the Consolidated Balance Sheet. Capitalized software is amortized on a straight-line basis over the estimated useful life of the software, ranging from two to ten years. Capitalized software costs were as follows:

(In millions)	2005	2004
Cost	\$ 236.7	\$ 219.4
Accumulated amortization	(126.4)	(103.3)
	\$ 110.3	\$ 116.1

Impairment of Long-lived Assets

Impairment charges are recorded when the carrying amounts of long-lived assets are determined not to be recoverable. Impairment is measured by assessing the usefulness of an asset or by comparing the carrying value of an asset to its fair value. Fair value is typically determined using quoted market prices, if available, or an estimate of future cash flows expected to result from the use of the asset and its eventual disposition. Historically, changes in market conditions and management strategy have caused the Company to reassess the carrying amount of its long-lived assets. Refer to the Discontinued Operations section of this note, as well as Note 10 "Components of Other Income and Expense," for details of impairment charges recorded in 2005, 2004 and 2003.

Goodwill and Other Intangibles Resulting from Business Acquisitions

The Company accounts for business combinations in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations." Business combinations are accounted for by the purchase method, and the excess of the acquisition cost over the fair value of net tangible assets and identified intangible assets acquired is considered goodwill. As a result, the Company discloses goodwill separately from other intangible assets and, as of the beginning of fiscal 2002, has recorded no amortization of goodwill. Other acquisition intangibles are identified using the criteria included in this Statement, including trademarks and trade names, patented and other acquired technology, customer relationships and other intangibles.

The Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," at the beginning of fiscal 2002. The Company's reporting units for the purposes of performing the impairment tests for goodwill and other intangible assets consist of office and consumer products; retail information services; roll materials; graphics and reflectives; and industrial and automotive products. For the purposes of performing the required impairment tests, a present value (discounted cash flow) method was used to determine the fair value of the reporting units with goodwill. The Company performed its annual impairment test in the fourth quarter of 2005, with an assessment that no impairment had occurred. Other intangible assets deemed to have an indefinite life are tested for impairment by comparing the fair value of the asset to its carrying amount. The Company does not have other intangible assets with an indefinite life.

The Company's reporting units are composed of either a discrete business or an aggregation of businesses with similar economic characteristics. Certain factors, including the decision to divest any individual business within a reporting unit may result in the need to perform an impairment test in between annual impairment tests. In the event that an individual business within a reporting group is divested, goodwill is allocated to that business based on its relative fair value to its reporting unit, which could result in a gain or loss. If a divested business below a reporting unit has not been integrated with other businesses within a reporting unit, the net book value of the goodwill associated with the business to be divested would be included in the carrying amount of the business when determining the gain or loss on disposal.

See also Note 3 "Goodwill and Other Intangibles Resulting from Business Acquisitions."

Foreign Currency Translation

Asset and liability accounts of international operations are translated into U.S. dollars at current rates. Revenues and expenses are translated at the weighted-average currency rate for the fiscal year. Translation gains and losses of subsidiaries operating in hyperinflationary economies are included in net income in the period incurred. Operations in hyperinflationary economies consist of the Company's operations in Turkey and the Dominican Republic. Gains and losses resulting from foreign currency transactions are included in income in the period incurred. Transaction and translation losses of hyperinflationary operations decreased net income by \$2.2 million in 2005, \$5.3 million in 2004 and \$.9 million in 2003. Gains and losses resulting from hedging the value of investments in certain international operations and from translation of balance sheet accounts are recorded directly as a component of other comprehensive income.

Financial Instruments

For purposes of this section of Note 1 and Note 5, "Financial Instruments," the terms "cash flow hedge," "derivative instrument," "fair value," "fair value hedge," "financial instrument," "firm commitment," "ineffective," and "highly effective" are used as

these terms are defined in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended.

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

On the date the Company enters into a derivative contract, it determines whether the derivative will be designated as a hedge. Those derivatives not designated as hedges are recorded on the balance sheet at fair value, with changes in the fair value recognized currently in earnings. Those derivatives designated as hedges are classified as either (1) a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment (a "fair value" hedge); or (2) a hedge of a forecasted transaction or the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a "cash flow" hedge). The Company generally does not purchase or hold any foreign currency, interest rate or commodity contracts for trading purposes.

The Company assesses, both at the inception of the hedge and on an ongoing basis, whether hedges are highly effective. If it is determined that a hedge is not highly effective, the Company prospectively discontinues hedge accounting. For cash flow hedges, the effective portion of the related gains and losses is recorded as a component of other comprehensive income, and the ineffective portion is reported currently in earnings. Amounts in accumulated other comprehensive income (loss) are reclassified into earnings in the same period during which the hedged forecasted transaction is consummated. In the event the anticipated transaction is no longer likely to occur, the Company recognizes the change in fair value of the instrument in earnings currently. Changes in fair value hedges are recognized currently in earnings. Changes in the fair value of underlying hedged items (such as recognized assets or liabilities) are also recognized currently in earnings and offset the changes in the fair value of the derivative.

For classification in the Statement of Cash Flows, hedge transactions are classified in the same category as the item hedged, primarily in operating activities.

Revenue Recognition

Sales are recognized when persuasive evidence of an arrangement exists, product delivery has occurred, pricing is fixed or determinable, and collection is reasonably assured. Sales, provisions for estimated sales returns, and the cost of products sold are recorded at the time title transfers to customers. Actual product

returns are charged against estimated sales return allowances. Volume, promotional, price, cash and other discounts and customer incentives are accounted for as a reduction to gross sales.

Shipping and Handling Costs

Shipping and handling costs consist primarily of transportation charges incurred to move finished goods to customers. These costs are included in "Cost of products sold" for the Pressure-sensitive Materials segment and specialty tapes business (included with other specialty converting businesses). These costs are included in "Marketing, general and administrative expense" for the Office and Consumer Products segment, Retail Information Services segment and industrial and automotive products business (included with other specialty converting businesses). Shipping costs included in "Marketing, general and administrative expense" were \$52.9 million in 2005, \$52.4 million in 2004 and \$50.4 million in 2003. Handling costs included in "Marketing, general and administrative expense" were \$71.6 million in 2005, \$73.2 million in 2004 and \$68.5 million in 2003.

Advertising Costs

Advertising costs included in "Marketing, general and administrative expense" were \$14.1 million in 2005, \$11.1 million in 2004 and \$8.2 million in 2003. The Company's policy is to expense advertising costs as incurred.

Research and Development

Research and development costs are related to research, design and testing of new products and applications and are expensed as incurred. Research and development expense was \$85.4 million in 2005, \$81.8 million in 2004 and \$74.3 million in 2003.

Pensions and Postretirement Benefits

Assumptions used in determining projected benefit obligations and the fair value of plan assets for the Company's pension plan and other postretirement benefits plans are evaluated by management in consultation with outside actuaries who are relied upon as experts. In the event that the Company determines that changes are warranted in the assumptions used, such as the discount rate, expected long term rate of return, or health care costs, future pension and postretirement benefit expenses could increase or decrease. Due to changing market conditions or changes in the participant population, the actuarial assumptions that the Company uses may differ from actual results, which could have a significant impact on the Company's pension and postretirement liability and related cost. Refer to Note 6 "Pensions and Other Postretirement Benefits," for further detail on such assumptions.

Product Warranty

The Company provides for an estimate of costs that may be incurred under its basic limited warranty at the time product revenue is recognized. These costs primarily include materials and labor associated with the service or sale of the product. Factors that affect the Company's warranty liability include the number of units installed or sold, historical and anticipated rate of warranty claims on those units, cost per claim to satisfy the Company's

warranty obligation and availability of insurance coverage. As these factors are impacted by actual experience and future expectations, the Company assesses the adequacy of its recorded warranty liability and adjusts the amounts as necessary.

Product warranty liabilities were as follows:

(In millions)	2005	2004	2003
Balance at beginning of year	\$ 1.9	\$ 2.2	\$ 1.3
Accruals for warranties issued	1.9	1.9	2.8
Payments	(1.3)	(2.2)	(1.9)
Balance at end of year	\$ 2.5	\$ 1.9	\$ 2.2

Stock-Based Compensation

The Company's policy is to price stock option grants at fair market value on the date of grant. Under the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," the Company uses the intrinsic value method of accounting for stock-based compensation in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Under the intrinsic value method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock.

In accordance with the disclosure provisions of SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosures," the following table reflects pro forma net income and earnings per share had the Company elected to adopt the fair value approach of SFAS No. 123:

(In millions, except per share amounts)	2005	2004	2003
Net income, as reported	\$ 226.4	\$ 279.7	\$ 267.9
Compensation expense, net of tax	(15.7)	(18.7)	(19.4)
Pro forma net income	\$ 210.7	\$ 261.0	\$ 248.5
Earnings per share, as reported	\$ 2.26	\$ 2.80	\$ 2.70
Earnings per share, assuming dilution, as reported	2.25	2.78	2.68
Pro forma earnings per share	\$ 2.10	\$ 2.61	\$ 2.50
Pro forma earnings per share, assuming dilution	2.09	2.60	2.49

Environmental Expenditures

Environmental expenditures are generally expensed. However, environmental expenditures for newly acquired assets and those which extend or improve the economic useful life of existing assets are capitalized and amortized over the remaining asset life. The Company reviews, on a quarterly basis, its estimates of costs of compliance with environmental laws related to remediation and cleanup of various sites, including sites in which governmental agencies have designated the Company as a potentially responsible party. When it is probable that obligations have been incurred and where a minimum cost or a reasonable estimate of the cost of compliance or remediation can be determined, the applicable amount is accrued. For other potential liabilities, the timing of

accruals coincides with the related ongoing site assessments. Potential insurance reimbursements are not offset against potential liabilities, and such liabilities are not discounted.

Restructuring and Severance Costs

The Company accounts for restructuring costs including severance and other costs associated with exit or disposal activities following the guidance provided in SFAS No. 112, "Accounting for Postemployment Benefits," and SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." In the U.S., the Company has a severance pay plan ("Pay Plan"), which provides eligible employees with severance payments in the event of an involuntary termination due to qualifying cost reduction actions. Severance pay is calculated by using a severance benefits formula under the Pay Plan. Accordingly, the provisions for such amounts and other related exit costs are recorded when they are probable and estimable as set forth under SFAS No. 112. In the absence of a Pay Plan, liability for severance and other employee-related costs are recognized when the liability is incurred and follow the guidance of SFAS No. 146. See also Note 10 "Components of Other Income and Expense."

Investment Tax Credits

Investment tax credits are accounted for in the period earned in accordance with the flow-through method.

Taxes on Income

Deferred tax liabilities or assets reflect temporary differences between the amount of assets and liabilities for financial and tax reporting purposes. Such amounts are adjusted, as appropriate, to reflect changes in tax rates expected to be in effect when the temporary differences reverse. A valuation allowance is recorded to reduce the Company's deferred tax assets to the amount that is more likely than not to be realized.

When establishing a valuation allowance, the Company considers future sources of income such as forecasted earnings, the mix of earnings in the jurisdictions in which the Company operates, and prudent and feasible tax planning. In the event the Company determines that it would not be able to realize the deferred tax assets in the future, the valuation adjustment to the deferred tax assets is charged to earnings in the period in which the Company makes such a determination. Likewise, if later it is determined that it is more likely than not that the deferred tax assets would be realized, the Company would reverse the previously provided valuation allowance.

The Company calculates its current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns generally filed during the following year. Adjustments based on filed returns are recorded when identified in the subsequent year.

The amount of income taxes the Company pays is subject to ongoing audits by federal, state and foreign tax authorities. The Company's estimate of the potential outcome of any uncertain tax

issue is subject to management's assessment of relevant risks, facts, and circumstances existing at that time. The Company believes that it has adequately provided for reasonably foreseeable outcomes related to these matters. However, the Company's future results may include favorable or unfavorable adjustments to its estimated tax liabilities in the period the assessments are made or resolved, which may impact the Company's effective tax rate on a quarterly basis.

See also Note 11 "Taxes Based on Income."

Net Income Per Share

Net income per common share amounts were computed as follows:

(In millions, except per share amounts)	2005	2004	2003
(A) Income from continuing operations	\$ 291.8	\$ 281.0	\$ 245.1
(B) Income (loss) from discontinued operations	(65.4)	(1.3)	22.8
(C) Net income available to common shareholders	\$ 226.4	\$ 279.7	\$ 267.9
(D) Weighted-average number of common shares outstanding	100.1	99.9	99.4
Dilutive shares (Additional common shares issuable under employee stock options using the treasury stock method, contingently issuable shares under an acquisition agreement in 2004 and 2003 and nonvested shares under employee agreements)	.4	.6	.6
(E) Weighted-average number of common shares outstanding, assuming dilution	100.5	100.5	100.0
Income from continuing operations per common share (A) ÷ (D)	\$ 2.91	\$ 2.81	\$ 2.47
Income (loss) from discontinued operations per common share (B) ÷ (D)	(.65)	(.01)	.23
Net income per common share (C) ÷ (D)	\$ 2.26	\$ 2.80	\$ 2.70
Income from continuing operations per common share, assuming dilution (A) ÷ (E)	\$ 2.90	\$ 2.79	\$ 2.45
Income (loss) from discontinued operations per common share, assuming dilution (B) ÷ (E)	(.65)	(.01)	.23
Net income per common share, assuming dilution (C) ÷ (E)	\$ 2.25	\$ 2.78	\$ 2.68

Certain employee stock options were not included in the computation of net income per common share, assuming dilution, because these options would not have had a dilutive effect. The number of stock options excluded from the computation were 4.6 million in 2005, 1.4 million in 2004 and 3.8 million in 2003.

Comprehensive Income

Comprehensive income includes net income, foreign currency translation adjustments, adjustments to the minimum pension liability, net of tax, and the gains or losses on the effective portion of cash flow and firm commitment hedges, net of tax, that are currently presented as a component of shareholders' equity. The Company's total comprehensive income was \$140 million and \$354.6 million for 2005 and 2004, respectively.

The components of accumulated other comprehensive loss at year end were as follows:

(In millions)	2005	2004
Foreign currency translation adjustment	\$ 36.6	\$ 127.2
Minimum pension liability	(111.8)	(110.9)
Net loss on derivative instruments designated as cash flow and firm commitment hedges	(13.9)	(19.0)
Total accumulated other comprehensive loss	\$ (89.1)	\$ (2.7)

Cash flow and firm commitment hedging instrument activity in other comprehensive income (loss), net of tax, was as follows:

(In millions)	2005	2004
Beginning accumulated derivative loss	\$ (19.0)	\$ (20.9)
Net loss reclassified to earnings	2.6	6.1
Net change in the revaluation of hedging transactions	2.5	(4.2)
Ending accumulated derivative loss	\$ (13.9)	\$ (19.0)

In connection with the issuance of the \$250 million 10-year senior notes in January 2003 (see Note 4 "Debt," for further detail), the Company settled a forward starting interest rate swap at a loss of approximately \$32.5 million. This unrecognized loss is being amortized to interest expense over 10 years, which corresponds to the term of the related debt. The related interest expense recognized during 2005 and 2004 was approximately \$2.7 million and \$2.5 million, respectively.

Recent Accounting Requirements

SFAS 123(R) Related

In November 2005, the Financial Accounting Standards Board ("FASB") issued Staff Position ("FSP") No. FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." This guidance allows an alternative transition method of tax treatment for initial adoption of SFAS 123(R). Election of this treatment may be made within one year of the later of its initial adoption of SFAS 123(R) or the effective date of this FSP.

In October 2005, the FASB issued FSP No. FAS 123(R)-2, "Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)," to address recent inquiries from constituents to provide guidance on the application of grant date as defined in SFAS 123 (revised 2004), "Share-Based Payment." Under this guidance, grant date occurs when a mutual understanding of the key terms and conditions of an award is

presumed to exist at the date the award is approved if (1) the award is a unilateral grant; and (2) the key terms and conditions of the award are expected to be communicated to the recipient within a relatively short time period from the date of approval. The guidance in this FSP shall be applied upon initial adoption of SFAS 123(R).

In August 2005, the FASB issued FSP No. FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)." This FSP modifies the requirements of SFAS No. 123 (revised 2004), "Share-Based Payment," to include freestanding financial instruments originally subject to Statement 123(R) even if the holder is no longer an employee. The guidance in this FSP shall be applied upon initial adoption of Statement 123(R).

In April 2005, the Securities and Exchange Commission delayed the effective date of the reissued SFAS No. 123(R), "Share-Based Payment," to the beginning of the first annual reporting period beginning after June 15, 2005. This Statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation," and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services and requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. The Company adopted the recognition provisions of this Statement in January 2006 and followed the guidance under modified prospective application. Based on current estimates, the pretax expense for stock options for 2006 is expected to be approximately \$17 million, based on unvested stock options outstanding at year end 2005.

Other Requirements

In October 2005, the FASB issued FSP No. FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period." This FSP clarifies that rental costs of operating leases that are incurred during a construction period should be recognized as rental expense. The guidance in this FSP shall be applied to the first reporting period beginning after December 15, 2005. The adoption of this guidance is not expected to have a significant impact on the Company's financial results of operations and financial position.

In September 2005, the consensus of the Emerging Issues Task Force ("EITF") Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty," was published. An entity may sell inventory to another entity in the same line of business from which it also purchases inventory. This Issue states that inventory purchases and sales transactions with the same counterparty that are entered into in contemplation of one another should be combined for purposes of applying APB Opinion No. 29. In addition, a nonmonetary exchange whereby an entity transfers finished goods inventory in exchange for the receipt of raw materials or work-in-process inventory within the same line of business is not an exchange transaction to facilitate sales to customers as described

in APB Opinion No. 29, and, therefore, should be recognized by the entity at fair value. Other nonmonetary exchanges of inventory within the same line of business should be recognized at the carrying amount of the inventory transferred. This Issue is effective for new arrangements entered into, or modifications or renewals of existing arrangements, beginning in the first interim or annual reporting period beginning after March 15, 2006. The adoption of this guidance is not expected to have a significant impact on the Company's financial results of operations and financial position.

In June 2005, the consensus of EITF Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination," was published and was effective for the reporting period after ratification. This Issue addresses the amortization period for leasehold improvements acquired in a business combination or placed in service after lease inception. The adoption of this Issue has not had a significant impact on the Company's financial results of operations and financial position.

In June 2005, the consensus of EITF Issue No. 05-5, "Accounting for Early Retirement or Postemployment Programs with Specific Features (Such as Terms Specified in Altersteilzeit Early Retirement Arrangements)," was published. This Issue addresses how an employer should account for the bonus feature and additional contributions into the German government pension scheme (collectively, the additional compensation) under a Type II Altersteilzeit ("ATZ") arrangement, and the government subsidy under Type I and Type II ATZ arrangements. The consensus in this Issue should be applied to fiscal years beginning after December 15, 2005. The adoption of this Issue is not expected to have a significant impact on the Company's financial results of operations and financial position.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3." This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement will be effective for fiscal years beginning after December 15, 2005. The adoption of this Statement could have a significant impact on the Company's financial results of operations and financial position, should there be a change in accounting principle once this Statement is implemented.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143." This Interpretation clarifies that the term "conditional asset retirement obligation" as used in SFAS No. 143, "Accounting for Asset Retirement Obligations," refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for

the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The adoption of this Interpretation did not have a significant impact on the Company's financial results of operations and financial position.

In December 2004, the FASB issued FSP No. FAS 109-1, "Application of FASB Statement No. 109, 'Accounting for Income Taxes,' to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." This Staff Position provides guidance on the application of SFAS No. 109, "Accounting for Income Taxes," to the provision of the American Jobs Creation Act of 2004 (the "Jobs Act") that provides a tax deduction on qualified production activities. The FASB staff believes that the deduction should be accounted for as a special deduction in accordance with SFAS No. 109. This Staff Position was effective immediately. The Company has adopted the provisions of this guidance in 2005 and the benefit from a tax deduction for qualified production activities was approximately \$2 million for 2005.

In December 2004, the FASB issued FSP No. FAS 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004." The Jobs Act provides for a special one-time dividends-received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision). This Staff Position provides accounting and disclosure guidance for the repatriation provision and was effective immediately. During the third quarter of 2005, the Company's Chief Executive Officer and Board of Directors approved a domestic reinvestment plan as required by the Jobs Act to repatriate \$344 million of foreign earnings. The tax impact of the repatriation was a one-time expense of \$13.5 million recognized in the third quarter of 2005. The repatriation of earnings took place in the fourth quarter of 2005.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs—an amendment of ARB No. 43, Chapter 4," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This Statement clarifies that abnormal amounts of such costs should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overhead to the costs of conversion should be based on the normal capacity of the production facilities and that unallocated overhead should be expensed as incurred. This Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company adopted this Statement in July 2005, as early application is allowed under the Statement. The adoption of this Statement has not had a significant impact on the Company's financial results of operations and financial position.

Related Party Transactions

From time to time, the Company enters into transactions in the normal course of business with related parties. Management believes that such transactions are at arm's-length and for terms that would have been obtained from unaffiliated third parties. One of the Company's directors, Peter W. Mullin, is the chairman, chief executive officer and a director of MC Insurance Services, Inc. ("MC"), Mullin Insurance Services, Inc. ("MINC"), and PWM Insurance Services, Inc. ("PWM"), executive compensation and benefit consultants and insurance agents. Mr. Mullin is also the majority stockholder of MC, MINC and PWM (collectively referred to as the "Mullin Companies"). The Company paid premiums to insurance carriers for life insurance placed by the Mullin Companies in connection with several of the Company's employee benefit plans. The Mullin Companies have advised the Company that MC, MINC and PWM earned commissions from such insurance carriers for the placement and renewal of this insurance, for which Mr. Mullin had direct and indirect interests related to these commissions. The majority of these commissions were allocated to and used by MC Insurance Agency Services, LLC (an affiliate of MC) to administer benefit plans and provide benefit statements to participants under several of the Company's employee benefit plans. The Mullin Companies own a minority interest in M Financial Holdings, Inc. ("MFH"). Substantially all of the life insurance policies, which the Company placed through the Mullin Companies, are issued by insurance carriers that participate in reinsurance agreements entered into between these insurance carriers and M Life Insurance Company ("M Life"), a wholly-owned subsidiary of MFH. Reinsurance returns earned by M Life are determined annually by the insurance carriers and can be negative or positive, depending upon the results of M Life's aggregate reinsurance pool, which consists of the insured lives reinsured by M Life. The Mullin Companies have advised the Company that they participated in net reinsurance gains of M Life. None of these transactions were significant to the financial position or results of operations of the Company.

Summary of Related Party Activity:

(In millions)	2005	2004	2003
Mullin Companies commissions on the Company's insurance premiums	\$.9	\$ 1.1	\$ 1.1
Mr. Mullin's direct & indirect interest in these commissions	.7	.8	.7
Mullin Companies reinsurance gains (without risk of forfeiture) ascribed by M Life to the Company's life insurance policies	.2	.2	—
Mr. Mullin's direct & indirect interest in reinsurance gains (without risk of forfeiture)	.1	.2	—
Mullin Companies reinsurance gains (subject to risk of forfeiture) ascribed by M Life to the Company's life insurance policies	1.5	—	—
Mr. Mullin's direct & indirect interest in reinsurance gains (subject to risk of forfeiture)	1.1	—	—

NOTE 2. ACQUISITIONS

The aggregate cost of acquired companies was approximately \$3 million in 2005 and \$15 million in 2004. Goodwill resulting from these business acquisitions was approximately \$1 million in 2005 and \$13 million in 2004. Intangibles resulting from these business acquisitions were approximately \$2 million in 2004. These amounts of goodwill and intangibles do not include acquisition adjustments in the subsequent years following acquisition. Acquisitions during 2005 and 2004 not described below were not significant to the consolidated financial position of the Company. Pro forma results for acquisitions in 2005 and 2004 are not presented, as the acquired businesses did not have a significant impact on the Company's results of operations for those years.

In 2004, the Company completed the acquisition of several small private companies, including Rinke Etiketten ("Rinke"), based in Germany, at a total cost of approximately \$15 million. Goodwill recognized for these transactions amounted to \$13.2 million and identified amortizable intangible assets amounted to \$1.8 million. This goodwill is not expected to be deductible for U.S. tax purposes. The final allocation of identifiable intangible assets and fixed assets for Rinke was assessed by a third-party valuation

expert and completed during 2005. The results of operations for these companies have been included in the Company's Retail Information Services segment as of the acquisition dates.

In connection with the L&E Packaging ("L&E") acquisition in 2002, the Company issued 743,108 shares at \$63.08 per share. The Company also entered into an agreement with L&E whereby in the event the value of the Company's common shares fell below the price of the shares that were issued to L&E (adjusted for dividends received), during the period from January 1, 2005 through December 31, 2007, L&E had the option to exercise a true-up right. Upon exercise of this true-up right, the Company had the option to (1) pay the difference in value to L&E, in the form of (a) cash or (b) common shares, or (2) repurchase the shares at the issued share price, adjusted for dividends paid. The true-up obligation was reduced by any shares sold by L&E to third parties. During 2005, L&E sold 44,603 shares to third parties. On October 20, 2005, L&E notified the Company that L&E was exercising its true-up right under the agreement for the remaining 698,505 shares. The Company repurchased the remaining shares under the agreement for approximately \$41 million in the fourth quarter of 2005 and recorded such amount to treasury stock.

NOTE 3. GOODWILL AND OTHER INTANGIBLES RESULTING FROM BUSINESS ACQUISITIONS

Changes in the net carrying amount of goodwill from continuing operations for 2005 and 2004, by reportable segment, are as follows:

(In millions)	Pressure-sensitive Materials	Office and Consumer Products	Retail Information Services	Other specialty converting businesses	Total
Balance as of December 27, 2003	\$ 314.5	\$ 160.5	\$ 194.9	\$.3	\$ 670.2
Goodwill acquired during the period	—	—	13.2	—	13.2
Acquisition adjustments ⁽¹⁾	—	—	(5.3)	—	(5.3)
Translation adjustments	20.1	9.9	2.5	—	32.5
Balance as of January 1, 2005	334.6	170.4	205.3	.3	710.6
Goodwill acquired during the period	—	—	1.1	—	1.1
Acquisition adjustments ⁽²⁾	—	—	(2.7)	—	(2.7)
Translation adjustments	(21.0)	(12.5)	(2.4)	—	(35.9)
Balance as of December 31, 2005	\$ 313.6	\$ 157.9	\$ 201.3	\$.3	\$ 673.1

(1) Acquisition adjustments in 2004 consisted of changes in goodwill for tax assessments associated with RVL Packaging, Inc. ("RVL").

(2) Acquisition adjustments in 2005 consisted of purchase price allocation of the Rinke acquisition and resolution of claims associated with RVL.

The following table sets forth the Company's other intangible assets resulting from business acquisitions at December 31, 2005 and January 1, 2005, which continue to be amortized:

(In millions)	2005			2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable other intangible assets:						
Customer relationships	\$ 85.7	\$ 19.0	\$ 66.7	\$ 92.7	\$ 16.6	\$ 76.1
Trade names and trademarks	40.1	25.6	14.5	43.0	23.1	19.9
Patented and other acquired technology	26.4	9.6	16.8	26.4	7.8	18.6
Other intangibles	4.4	3.7	.7	4.6	3.4	1.2
Total	\$ 156.6	\$ 57.9	\$ 98.7	\$ 166.7	\$ 50.9	\$ 115.8

Amortization expense on other intangible assets resulting from business acquisitions was \$12 million for 2005, \$11.8 million for 2004, and \$11.3 million for 2003. The weighted-average amortization periods for intangible assets resulting from business acquisitions are twenty-two years for customer relationships, twelve years for trade names and trademarks, eighteen years for patented and other acquired technology, seven years for other intangibles and eighteen years in total. Based on current information, estimated amortization expense for acquired intangible assets for each of the next five fiscal years is expected to be approximately \$11 million, \$7 million, \$6 million, \$6 million and \$6 million, respectively.

NOTE 4. DEBT

Long-term debt and its respective weighted-average interest rates at December 31, 2005 consisted of the following:

(In millions)	2005	2004
Medium-term notes		
Series 1993 at 6.7% – due 2005	\$ –	\$ 23.0
Series 1995 at 7.5% – due 2005 through 2025	50.0	100.0
Series 1997 at 6.6% – due 2007	60.0	60.0
Series 1998 at 5.9% – due 2008	50.0	50.0
Senior notes due 2013 at 4.9%	250.0	250.0
Senior notes due 2033 at 6.0%	150.0	150.0
Senior notes due 2007 at a floating rate of 4.5%	150.0	150.0
Other long-term borrowings	14.1	7.0
Variable rate commercial paper borrowings classified as long-term	–	290.9
Less amount classified as current	(1.1)	(73.7)
	<u>\$ 723.0</u>	<u>\$ 1,007.2</u>

The Company's medium-term notes have maturities from 2007 through 2025 and accrue interest at fixed rates.

Maturities of long-term debt during the years 2006 through 2010 are \$1.1 million (classified as current), \$211.9 million, \$51.5 million, \$1.5 million and \$1.2 million, respectively, with \$456.9 million maturing thereafter.

In August 2004, the Company refinanced some of its commercial paper borrowings by issuing \$150 million in floating interest rate senior notes due 2007, under the Company's shelf registration statement filed with the Securities and Exchange Commission ("SEC") in the third quarter of 2001, permitting the Company to issue up to \$600 million in debt and equity securities. These notes are callable at par by the Company. In January 2003, the Company refinanced some of its variable rate commercial paper borrowings through the offering of \$250 million of 4.9% senior notes due 2013 and \$150 million of 6% senior notes due 2033. The aggregate \$400 million refinancing was issued under the 2001 shelf registration.

In the fourth quarter of 2004, the Company filed a shelf registration statement with the SEC to permit the issuance of up to \$500 million in debt and equity securities. Proceeds from the shelf offering may be used for general corporate purposes, including repaying, redeeming or repurchasing existing debt, and for working capital, capital expenditures and acquisitions. This registration statement replaced the 2001 shelf registration discussed above,

which had a remaining \$50 million of issuance capacity. As of December 31, 2005, no securities have been issued under the 2004 registration statement.

Variable rate commercial paper borrowings were \$255.3 million at December 31, 2005 (weighted-average interest rate of 2.3%) and \$290.9 million at January 1, 2005. The change in outstanding commercial paper was due to the impact of currency, as these are Euro-denominated borrowings. These borrowings were classified as short-term at year end 2005, but were classified as long-term in 2004, since the Company intended to refinance this debt and had the ability to under its \$525 million revolving credit agreement, discussed below.

The \$60 million one-year callable commercial notes issued in January 2004 were paid at maturity in 2005. In June 2005, the Company issued \$75 million of one-year callable commercial notes at a variable rate of 3.5%, and then called and paid the notes in November 2005.

At December 31, 2005, the Company had \$108.3 million of borrowings outstanding under foreign short-term lines of credit with a weighted-average interest rate of 6.6%.

In July 2004, the Company entered into a revolving credit agreement with 10 domestic and foreign banks for a total commitment of \$525 million, expiring July 16, 2009. This revolving credit agreement replaced the Company's previous agreements for a \$250 million credit facility that would have expired July 1, 2006 and a \$200 million 364-day credit facility that would have expired December 3, 2004, both of which were terminated in connection with the new revolving credit agreement. Financing available under the new agreement is used as a commercial paper back-up facility and is also available to finance other corporate requirements. The terms of the new agreement are generally similar to the previous agreements. There was no debt outstanding under this agreement as of year end 2005.

In addition, the Company has a 364-day revolving credit facility with a foreign bank to provide up to Euro 30 million (\$35.6 million) in borrowings through July 19, 2006. The Company may annually extend the revolving period and due date with the approval of the bank. It is the intention of management to renegotiate an extension of this facility in 2006. Financing under this agreement is used to finance cash requirements of the Company's European operations. As of December 31, 2005, \$15.4 million was outstanding under this agreement.

Uncommitted lines of credit were \$408.9 million at year end 2005. The Company's uncommitted lines of credit do not have a commitment expiration date, and may be cancelled at any time by the Company or the banks.

At December 31, 2005, the Company had available short-term financing arrangements totaling \$336.2 million.

Commitment fees relating to the financing arrangements are not significant.

The Company's total interest costs in 2005, 2004 and 2003 were \$62.8 million, \$61.8 million and \$64.6 million, respectively, of which

\$4.9 million, \$3.1 million and \$6 million, respectively, were capitalized as part of the cost of assets.

The terms of various loan agreements in effect at year end require that the Company maintain specified ratios on debt and interest expense in relation to certain measures of income. Under the loan agreements, the ratio of debt to earnings before other expense (see Note 10 "Components of Other Income and Expense"), interest, taxes, depreciation and amortization may not exceed 3.5 to 1.0. The Company's ratio at year end 2005 was 1.6 to 1.0. Earnings before other expense, interest and taxes, as a ratio to interest, may not be less than 3.5 to 1.0. The Company's ratio at year end 2005 was 8.4 to 1.0.

The fair value of the Company's debt is estimated based on the discounted amount of future cash flows using the current rates offered to the Company for debt of the same remaining maturities. At year end 2005 and 2004, the fair value of the Company's total debt, including short-term borrowings, was \$1.1 billion and \$1.32 billion, respectively.

The Company had standby letters of credit outstanding of \$81.2 million and \$81 million at the end of 2005 and 2004, respectively. The aggregate contract amount of outstanding standby letters of credit approximated fair value.

NOTE 5. FINANCIAL INSTRUMENTS

During 2005, the amount recognized in earnings related to cash flow hedges that were ineffective was not significant. The aggregate reclassification from other comprehensive income to earnings for settlement or ineffectiveness was a net loss of \$2.6 million and \$6.1 million during 2005 and 2004, respectively. A net loss of approximately \$3 million is expected to be reclassified from other comprehensive income to earnings within the next 12 months.

In connection with the issuance of the \$250 million 10-year senior notes in January 2003, the Company settled a forward starting interest rate swap at a loss of \$32.5 million. This loss is being amortized to interest expense over a 10-year period, which corresponds to the term of the related debt.

The carrying value of the foreign exchange forward and natural gas futures contracts approximated the fair value, which, based on quoted market prices of comparable instruments, was a net asset of \$2.6 million at December 2005 and a net liability of \$7.7 million at December 2004.

The carrying value of the foreign exchange option contracts, based on quoted market prices of comparable instruments, was a net asset of \$.1 million at the end of 2005. The carrying value of the foreign exchange option contracts approximated the fair market value.

The counterparties to foreign exchange and natural gas forward, option and swap contracts consist primarily of a large number of major international financial institutions. The Company centrally monitors its positions and the financial strength of its counter-

parties. Therefore, although the Company may be exposed to losses in the event of nonperformance by these counterparties, it does not anticipate such losses.

NOTE 6. PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Defined Benefit Plans

The Company sponsors a number of defined benefit plans (the "Plan") covering substantially all U.S. employees, employees in certain other countries and non-employee directors. It is the Company's policy to make contributions to the Plan sufficient to meet the minimum funding requirements of applicable laws and regulations, plus additional amounts, if any, as the Company's actuarial consultants determine and advise to be appropriate. Plan assets are generally invested in diversified portfolios that consist primarily of equity and fixed income securities. Benefits payable to employees are based primarily on years of service and employees' pay during their employment with the Company. Certain benefits provided by one of the Company's U.S. defined benefit plans may be paid, in part, from an employee stock ownership plan. While the Company has not expressed any intent to terminate the Plan, the Company may do so at any time.

The Company uses a November 30 measurement date for the majority of its U.S. plans and a fiscal year end measurement date for its international plans.

Postretirement Health Benefits

The Company provides postretirement health benefits to certain U.S. retired employees up to the age of 65 under a cost-sharing arrangement, and provides supplemental Medicare benefits to certain U.S. retirees over the age of 65. The Company's policy is to fund the cost of the postretirement benefits on a cash basis. The Company uses a fiscal year end measurement date for its postretirement health benefit plan. While the Company has not expressed any intent to terminate postretirement health benefits, the Company may do so at any time.

Plan Assets

Assets of the Company's U.S. plans are invested in a diversified portfolio that consists primarily of equity and fixed income securities. Furthermore, equity investments are diversified across U.S. and non-U.S. stocks, including growth, value and small and large capitalization stocks. The Company's target plan asset investment allocation in the U.S. is 75% in equity securities and 25% in fixed income securities, subject to periodic fluctuations in the respective asset classes above. The Plan assets include investments in the Company's stock, which totaled approximately 630,000 shares as of December 31, 2005. This amount, however, does not include any shares that may be held in index funds.

Assets of the Company's international plans are invested in accordance with local accepted practice, with asset allocations and investments varying by country and plan. Investments utilized by the various plans include equity securities, fixed income securities, real estate and insurance contracts.

The weighted-average asset allocations for the Company's pension plans at year end 2005 and 2004, by asset category are as follows:

	2005		2004	
	U.S.	Int'l	U.S.	Int'l
Equity securities	84%	61%	79%	60%
Fixed income securities	16	36	21	37
Real estate and insurance contracts	–	3	–	3
Total	100%	100%	100%	100%

Plan Assumptions

Discount Rate

The Company, in consultation with its actuaries, annually reviews and determines the discount rates to be used in connection with its postretirement obligations. The assumed discount rate for each pension plan reflects market rates for high quality corporate bonds currently available. In the U.S., the Company's discount rate was determined by evaluating several yield curves consisting of large populations of high quality corporate bonds. The projected pension benefit payment streams were then matched with the bond portfolios to determine a rate that reflected the liability duration unique to the Company's plans.

Long-term Return on Assets

The Company determines the long-term rate of return assumption for plan assets by reviewing the historical and expected returns

Plan Reconciliations

The following provides a reconciliation of benefit obligations, plan assets and funded status of the plans:

(In millions)	Pension Benefits				U.S. Postretirement Health Benefits	
	2005		2004		2005	2004
	U.S.	Int'l	U.S.	Int'l		
Change in projected benefit obligation:						
Projected benefit obligation at beginning of year	\$ 468.7	\$ 407.9	\$ 412.8	\$ 335.4	\$ 41.6	\$ 43.1
Service cost	19.3	11.5	16.8	10.4	1.7	1.4
Interest cost	27.6	18.7	25.5	18.2	2.5	2.2
Participant contribution	–	3.4	–	3.5	–	–
Amendments	2.8	–	13.1	6.3	(14.0)	–
Actuarial loss (gain)	20.2	34.1	20.3	.8	6.1	(1.6)
Plan transfer ⁽¹⁾	1.1	–	3.7	–	–	–
Benefits paid	(26.0)	(11.4)	(23.5)	(10.3)	(3.8)	(3.5)
Special termination benefits	–	–	–	1.4	–	–
Net transfer in ⁽²⁾	–	–	–	7.0	–	–
Pension curtailment	–	(.2)	–	(.6)	–	–
Foreign currency translation	–	(48.3)	–	35.8	–	–
Projected benefit obligation at end of year	\$ 513.7	\$ 415.7	\$ 468.7	\$ 407.9	\$ 34.1	\$ 41.6
Accumulated benefit obligation at end of year	\$ 504.2	\$ 399.4	\$ 463.1	\$ 390.2		

(1) Plan transfer represents transfer from the Company's savings plan.

(2) Net transfer in represents valuation of an additional pension plan.

of both the equity and fixed income markets, taking into consideration that assets with higher volatility typically generate a greater return over the long run. Additionally, current market conditions, such as interest rates, are evaluated and peer data is reviewed to check for reasonability and appropriateness.

Healthcare Cost Trend Rate

For measurement purposes, an 8% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2006. This rate is expected to decrease to approximately 5% by 2009.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

(In millions)	One-percentage-point increase	One-percentage-point decrease
Effect on total of service and interest cost components	\$.1	\$ (.1)
Effect on postretirement benefit obligation	1.0	(1.2)

(In millions)	Pension Benefits				U.S. Postretirement Health Benefits	
	2005		2004		2005	2004
	U.S.	Int'l	U.S.	Int'l		
Change in plan assets:						
Fair value of plan assets at beginning of year	\$ 476.4	\$ 319.3	\$ 417.4	\$ 264.5	-	-
Actual return on plan assets	42.8	42.2	52.2	20.4	-	-
Plan transfer ⁽¹⁾	1.1	-	3.7	-	-	-
Employer contribution	26.4	15.6	26.6	9.8	\$ 3.8	\$ 3.5
Participant contribution	-	3.4	-	3.5	-	-
Benefits paid	(26.0)	(11.4)	(23.5)	(10.3)	(3.8)	(3.5)
Net transfer in ⁽²⁾	-	-	-	3.2	-	-
Foreign currency translation	-	(38.3)	-	28.2	-	-
Fair value of plan assets at end of year	\$ 520.7	\$ 330.8	\$ 476.4	\$ 319.3	\$ -	\$ -
Funded status of the plans:						
Plan assets in excess of (less than) benefit obligation	\$ 7.1	\$ (85.0)	\$ 7.7	\$ (88.6)	\$ (34.1)	\$ (41.6)
Unrecognized net actuarial loss	124.4	127.6	108.1	132.8	23.7	19.1
Unrecognized prior service cost	10.5	6.1	9.7	7.6	(26.0)	(12.9)
Unrecognized net asset	-	(4.2)	(.2)	(6.1)	-	-
Net amount recognized	\$ 142.0	\$ 44.5	\$ 125.3	\$ 45.7	\$ (36.4)	\$ (35.4)
Amounts recognized in the Consolidated Balance Sheet consist of:						
Prepaid benefit cost	\$ 120.7	\$ 48.7	\$ 121.4	\$ 52.7	-	-
Accrued benefit liability	(70.6)	(91.4)	(84.6)	(94.1)	\$ (36.4)	\$ (35.4)
Intangible asset	7.8	.8	6.8	1.4	-	-
Other comprehensive income	84.1	86.4	81.7	85.7	-	-
Net amount recognized	\$ 142.0	\$ 44.5	\$ 125.3	\$ 45.7	\$ (36.4)	\$ (35.4)

(1) Plan transfer represents transfer from the Company's savings plan.

(2) Net transfer in represents valuation of an additional pension plan.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets for U.S. plans were \$330.8 million, \$324.7 million and \$254.4 million, respectively, at year end 2005 and \$311 million, \$308.3 million and \$223.8 million, respectively, at year end 2004.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets for international plans were \$215.5 million, \$207.2 million and \$121.4 million, respectively, at year end 2005 and \$202.4 million, \$196.4 million and \$106.7 million, respectively, at year end 2004.

	Pension Benefits						U.S. Postretirement Health Benefits		
	2005		2004		2003		2005	2004	2003
	U.S.	Int'l	U.S.	Int'l	U.S.	Int'l			
Weighted-average assumptions used for determining year end obligations:									
Discount rate	5.75%	4.49%	6.00%	4.91%	6.25%	5.31%	5.50%	5.75%	6.25%
Rate of increase in future compensation levels	3.60	2.79	3.61	2.68	3.62	2.54	-	-	-

The following table sets forth the components of net periodic benefit cost (income):

(In millions)	Pension Benefits						U.S. Postretirement Health Benefits		
	2005		2004		2003		2005	2004	2003
	U.S.	Int'l	U.S.	Int'l	U.S.	Int'l			
Components of net periodic benefit cost (income):									
Service cost	\$ 19.3	\$ 11.5	\$ 16.8	\$ 10.4	\$ 12.3	\$ 8.5	\$ 1.7	\$ 1.4	\$ 1.4
Interest cost	27.6	18.7	25.5	18.2	25.0	15.2	2.5	2.1	2.9
Expected return on plan assets	(44.0)	(20.9)	(42.4)	(21.2)	(40.3)	(19.1)	-	-	-
Recognized net actuarial loss (gain)	5.2	3.7	3.5	2.5	(.3)	1.3	1.6	.7	.6
Amortization of prior service cost	1.9	.6	.1	.2	.1	.4	(.9)	(.9)	(.3)
Amortization of transition obligation or asset	(.3)	(1.3)	(.5)	(1.3)	(.5)	(1.1)	-	-	-
Curtailement	-	(.1)	-	.8	-	-	-	-	-
Net periodic benefit cost (income)	\$ 9.7	\$ 12.2	\$ 3.0	\$ 9.6	\$ (3.7)	\$ 5.2	\$ 4.9	\$ 3.3	\$ 4.6

(In millions)	Pension Benefits						U.S. Postretirement Health Benefits		
	2005		2004		2003		2005	2004	2003
	U.S.	Int'l	U.S.	Int'l	U.S.	Int'l			
Weighted-average assumptions used for determining net periodic cost:									
Discount rate	6.00%	4.91%	6.25%	5.31%	7.00%	5.47%	5.75%	6.25%	7.00%
Expected long-term rate of return on plan assets	8.75	6.32	9.00	6.48	9.00	6.83	-	-	-
Rate of increase in future compensation levels	3.61	2.68	3.62	2.54	3.61	2.63	-	-	-

As a result of changes in assumptions during 2005 and 2004, the accumulated benefit obligation in certain plans exceeded the fair value of the underlying pension plan assets and accrued pension liabilities. The Company's Consolidated Balance Sheet reflects an additional minimum pension liability of \$3.5 million and \$12.2 million in 2005 and 2004, respectively, for U.S. pension plans and an additional minimum pension liability of \$.1 million and \$20.2 million in 2005 and 2004, respectively, for international pension plans. These transactions generated a change in intangible pension assets of \$1.1 million and \$2.4 million, respectively, in 2005 and 2004 for U.S. pension plans and \$(.7) million and \$.5 million in 2005 and 2004, respectively, for international pension plans with a charge to equity for the remainder.

Plan Contributions

The Company expects to contribute a minimum of \$27.6 million and \$7 million to its U.S. pension plans and international pension plans, respectively, and approximately \$3.3 million to its post-retirement benefit plan in 2006. In January 2006, the Company contributed \$25 million to its domestic pension plan, which is more than the amount required by U.S. governmental agencies for 2006.

Future Benefit Payments

Benefit payments, which reflect expected future services, are as follows:

(In millions)	Pension Benefits		U.S. Postretirement Health Benefits
	U.S.	Int'l	
2006	\$ 30.0	\$ 11.8	\$ 3.3
2007	30.7	11.4	3.2
2008	31.4	12.8	2.9
2009	32.1	14.1	2.7
2010	32.7	15.3	2.7
2011-2014	168.2	86.7	11.7

Defined Contribution Plans

The Company sponsors various defined contribution plans worldwide, with the largest plan being the Avery Dennison Corporation Employee Savings Plan ("Savings Plan" - a 401(k) savings plan covering its U.S. employees). The Company matches participant contributions to the Savings Plan based on a formula within the plan. The Savings Plan has a leveraged employee stock ownership plan ("ESOP") feature, which allows the plan to borrow

funds to purchase shares of the Company's common stock at market prices. Savings Plan expense consists primarily of stock contributions from the ESOP to participant accounts.

ESOP expense is accounted for under the cost of shares allocated method. Net ESOP expense for 2005, 2004 and 2003 was \$1.2 million, \$.7 million and \$.7 million, respectively. Company contributions to pay interest or principal on ESOP borrowings were \$1.7 million, \$1.1 million and \$1.1 million in 2005, 2004 and 2003, respectively.

Interest costs incurred by the ESOP for 2005, 2004 and 2003 were \$.6 million, \$.3 million and \$.3 million, respectively. Dividends on unallocated ESOP shares used for debt service were \$1.1 million, \$1.3 million and \$1.5 million for 2005, 2004 and 2003, respectively.

The cost of shares allocated to the ESOP for 2005, 2004 and 2003 was \$2.3 million, \$2.1 million and \$2.2 million, respectively. Of the total shares held by the ESOP, 2.5 million shares were allocated and .6 million shares were unallocated at year end 2005, and 3.2 million shares were allocated and .8 million shares were unallocated at year end 2004.

Other Retirement Plans

The Company has deferred compensation plans which permit eligible employees and directors to defer a portion of their compensation. The deferred compensation, together with certain Company contributions, earns specified and variable rates of return. As of year end 2005 and 2004, the Company had accrued \$157.3 million and \$145.4 million, respectively, for its obligations under these plans. These obligations are funded by corporate-owned life insurance contracts and standby letters of credit. As of year end 2005 and 2004, these obligations were secured by standby letters of credit of \$64.5 million and \$63 million, respectively. The Company's expense, which includes Company contributions and interest expense, was \$6.9 million, \$13.8 million and \$11 million for 2005, 2004 and 2003, respectively. A portion of the interest on certain Company contributions may be forfeited by participants if employment is terminated before age 55 other than by reason of death, disability or retirement.

To assist in the funding of these plans, the Company purchases corporate-owned life insurance contracts. Proceeds from the insurance policies are payable to the Company upon the death of the participant. The cash surrender value of these policies, net of outstanding loans, included in "Other assets" in the Consolidated Balance Sheet, was \$160.6 million and \$140.8 million at year end 2005 and 2004, respectively.

NOTE 7. COMMITMENTS

Minimum annual rental commitments on operating leases having initial or remaining noncancellable lease terms of one year or more are as follows:

Year	(In millions)
2006	\$ 48.4
2007	38.7
2008	28.3
2009	20.3
2010	16.6
Thereafter	51.2
Total minimum lease payments	\$ 203.5

Operating leases relate primarily to office and warehouse space, equipment for electronic data processing and transportation. The terms of these leases do not impose significant restrictions or unusual obligations, except as included in Note 8, "Contingencies." There are no significant capital leases.

Rent expense for 2005, 2004 and 2003 was \$75 million, \$66 million and \$64 million, respectively.

NOTE 8. CONTINGENCIES

Industry Investigations

On April 14, 2003, the Company announced that it had been advised that the U.S. Department of Justice was challenging the proposed merger of UPM-Kymmene ("UPM") and the Morgan Adhesives ("MACTac") division of Bemis Co., Inc. ("Bemis") on the basis of its belief that in certain aspects of the label stock industry "the competitors have sought to coordinate rather than compete." The Company also announced that it had been notified that the U.S. Department of Justice had initiated a criminal investigation into competitive practices in the label stock industry.

On April 15, 2003, the U.S. Department of Justice filed a complaint in the U.S. District Court for the Northern District of Illinois seeking to enjoin the proposed merger ("DOJ Merger Complaint"). The DOJ Merger Complaint, which set forth the U.S. Department of Justice's theory of its case, included references not only to the parties to the merger, but also to an unnamed "Leading Producer" of North American label stock, which is the Company. The DOJ Merger Complaint asserted that "UPM and the Leading Producer have already attempted to limit competition between themselves, as reflected in written and oral communications to each other through high level executives regarding explicit anticompetitive understandings, although the extent to which these efforts have succeeded is not entirely clear to the United States at the present time."

In connection with the U.S. Department of Justice's investigation into the proposed merger, the Company produced documents and provided testimony by Messrs. Neal, Scarborough and Simcic (then CEO, President and Group Vice President—Roll Materials Worldwide, respectively). On July 25, 2003, the United States District Court for the Northern District of Illinois entered an order enjoining the proposed merger. UPM and Bemis thereafter agreed to terminate the merger agreement. The court's decision incorporated a stipulation by the U.S. Department of Justice that the paper label industry is competitive.

On April 24, 2003, Sentry Business Products, Inc. filed a purported class action in the United States District Court for the Northern District of Illinois against the Company, UPM, Bemis and certain of their subsidiaries seeking treble damages and other relief for alleged unlawful competitive practices, essentially repeating the underlying allegations of the DOJ Merger Complaint. Ten similar complaints were filed in various federal district courts. In November 2003, the cases were transferred to the United States District Court for the Middle District of Pennsylvania and consolidated for pretrial purposes. Plaintiffs filed a consolidated complaint on February 16, 2004, which the Company answered on March 31, 2004. On April 14, 2004, the court separated the proceedings as to class certification and merits discovery, and limited the initial phase of discovery to the issue of the appropriateness of class certification. On January 4, 2006, plaintiffs filed an amended complaint. The Company intends to defend these matters vigorously.

On May 6, 2003, Sekuk Global Enterprises filed a purported stockholder class action in the United States District Court for the Central District of California against the Company and Messrs. Neal, O'Bryant and Skovran (then CEO, CFO and Controller, respectively) seeking damages and other relief for alleged disclosure violations pertaining to alleged unlawful competitive practices. Subsequently, another similar action was filed in the same court. On September 24, 2003, the court appointed a lead plaintiff, approved lead and liaison counsel and ordered the two actions consolidated as the "In Re Avery Dennison Corporation Securities Litigation." Pursuant to court order and the parties' stipulation, plaintiff filed a consolidated complaint in mid-February 2004. The court approved a briefing schedule for defendants' motion to dismiss the consolidated complaint, with a contemplated hearing date in June 2004. In January 2004, the parties stipulated to stay the consolidated action, including the proposed briefing schedule, pending the outcome of the government investigation of alleged anticompetitive conduct by the Company. The court has approved the parties' stipulation to stay the consolidated actions. There has been no discovery and no trial date has been set. The Company intends to defend these matters vigorously.

On May 21, 2003, The Harman Press filed in the Superior Court for the County of Los Angeles, California, a purported class action on behalf of indirect purchasers of label stock against the Company, UPM and UPM's subsidiary Raflatac ("Raflatac"), seeking treble damages and other relief for alleged unlawful competitive practices, essentially repeating the underlying allegations of the DOJ Merger Complaint. Three similar complaints were filed in various California courts. In November 2003, on petition from the parties, the California Judicial Council ordered the cases be coordinated for pretrial purposes. The cases were assigned to a coordination trial judge in the Superior Court for San Francisco County on March 30, 2004. A further similar complaint was filed in the Superior Court for Maricopa County, Arizona on November 6, 2003. Plaintiffs voluntarily dismissed the Arizona complaint without prejudice on October 4, 2004. On January 21, 2005, American International Distribution Corporation filed a purported class action on behalf of indirect purchasers in the Superior Court for Chittenden County, Vermont. Similar actions were filed by Webtego on February 16, 2005, in the Court of Common Pleas for Cuyahoga County, Ohio; by D.R. Ward Construction Co. on February 17, 2005, in the Superior Court for Maricopa County, Arizona; by Richard Wrobel, on February 16, 2005, in the District Court of Johnson County, Kansas; and by Chad and Terry Muzzey, on February 16, 2005 in the District Court of Scotts Bluff County, Nebraska. On February 17, 2005, Judy Benson filed a purported multi-state class action on behalf of indirect purchasers in the Circuit Court for Cocke County, Tennessee. On October 7, 2005, Webtego voluntarily dismissed its complaint. The Company intends to defend the remaining matters vigorously.

On August 15, 2003, the U.S. Department of Justice issued a subpoena to the Company in connection with its criminal investigation into competitive practices in the label stock industry. The Company is cooperating with the investigation.

On June 8, 2004, Pamco Tape & Label filed in the Superior Court for the County of San Francisco, California, a purported class action on behalf of direct purchasers in California of self-adhesive label stock, against the Company, Bemis, UPM and Raflatac, seeking actual damages and other relief for alleged unlawful competitive practices, essentially repeating the underlying allegations of the DOJ Merger Complaint. Pamco voluntarily dismissed its complaint without prejudice on May 18, 2005.

On May 25, 2004, officials from the European Commission ("EC"), assisted by officials from national competition authorities, launched unannounced inspections of and obtained documents from the Company's pressure-sensitive materials facilities in the Netherlands and Germany. The investigation apparently seeks evidence of unlawful anticompetitive activities affecting the European

paper and forestry products sector, including the label stock market. The Company is cooperating with the investigation.

Based on published press reports, certain other European producers of paper and forestry products received similar visits from European authorities. One such producer, UPM, stated that it had decided to disclose to competition authorities “any conduct that has not comported with applicable competition laws,” and that it had received conditional immunity in the European Union (“EU”) and Canada with respect to certain conduct it has previously disclosed to them, contingent on full cooperation. In February 2006, UPM announced that the U.S. Department of Justice had agreed not to prosecute UPM in connection with the label stock investigation, and, further, that UPM had received conditional immunity in jurisdictions in addition to the EU and Canada.

In the course of its internal examination of matters pertinent to the EC’s investigation of anticompetitive activities affecting the European paper and forestry products sector, the Company discovered instances of improper conduct by certain employees in its European operations. This conduct violated the Company’s policies and in some cases constituted an infringement of EC competition law. As a result, the Company expects that the EC will fine the Company when its investigation is completed. The EC has wide discretion in fixing the amount of a fine, up to a maximum fine of 10% of a company’s annual revenue. Because the Company is unable to estimate either the timing or the amount or range of any fine, the Company has made no provision for a fine in its financial statements. However, the Company believes that the fine could well be material in amount. There can be no assurance that additional adverse consequences to the Company will not result from the conduct discovered by the Company or other matters under EC or other laws. The Company is cooperating with authorities, continuing its internal examination, and taking remedial actions.

On July 9, 2004, the Competition Law Division of the Department of Justice of Canada notified the Company that it was seeking information from the Company in connection with a label stock investigation. The Company is cooperating with the investigation.

On May 18, 2005, Ronald E. Dancer filed a purported class action in the United States District Court for the Central District of California against the Company, Mr. Neal, Karyn Rodriguez (VP and Treasurer) and James Bochinski (then VP, Compensation and Benefits), for alleged breaches of fiduciary duty under the Employee Retirement Income Security Act to the Company’s Employee Savings Plan and Plan participants. The plaintiff alleges, among other things, that permitting investment in and retention of Company Common Stock under the Plan was imprudent because of alleged anticompetitive activities by the Company, and that failure to disclose such activities to the Plan and participants was

unlawful. Plaintiff seeks an order compelling defendants to compensate the Plan for any losses and other relief. The parties stipulated to transfer the case to the judge in the consolidated case, “In Re Avery Dennison Corporation Securities Litigation” referenced above, and the court has approved the parties’ stipulation to stay the matter pending the outcome of the government investigation of alleged anticompetitive conduct by the Company. The Company intends to defend this matter vigorously.

On August 18, 2005, the Australian Competition and Consumer Commission notified two of the Company’s subsidiaries, Avery Dennison Material Pty Limited and Avery Dennison Australia Pty Ltd, that it was seeking information in connection with a label stock investigation. The Company is cooperating with the investigation.

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

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

Environmental

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

The Company has accrued liabilities for such sites, including sites in which governmental agencies have designated the Company as a PRP, where it is probable that a loss will be incurred and the cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites and any sites which could be identified in the future for cleanup could be higher than the liability currently accrued. Amounts currently accrued are not significant to the consolidated financial position of the Company and, based upon current information, management believes it is unlikely that the final resolution of these matters will significantly impact the Company’s consolidated financial position, results of operations or cash flows.

Other

The Company has contacted relevant authorities in the U.S. and reported on the results of an internal investigation of potential violations of the U.S. Foreign Corrupt Practices Act. The transactions

at issue were carried out by a small number of employees of the Company's reflective business in China, and involved, among other things, impermissible payments or attempted impermissible payments. The payments or attempted payments and the contracts associated with them appear to have been relatively minor in amount and of limited duration. Corrective and disciplinary actions have been taken. Sales of the Company's reflective business in China in 2005 were approximately \$7 million. Based on findings to date, no changes to the Company's previously filed financial statements are warranted as a result of these matters. However, the Company expects that fines or other penalties could be incurred. While the Company is unable to predict the financial or operating impact of any such fines or penalties, it believes that its behavior in detecting, investigating, responding to and voluntarily disclosing these matters to authorities should be viewed favorably.

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

The Company participates in receivable financing programs, both domestically and internationally, with several financial institutions whereby advances may be requested from these financial institutions. Such advances are guaranteed by the Company. At December 31, 2005, the Company had guaranteed approximately \$19 million.

The Company guaranteed up to approximately \$21 million of certain foreign subsidiaries' obligations to their suppliers as of December 31, 2005.

On September 9, 2005, the Company completed the lease financing for a commercial facility to be located in Mentor, Ohio. This facility will be the new headquarters for the Company's roll materials worldwide division, and will consist generally of land, buildings, equipment and office furnishings and equipment (the "Facility"). The Company will lease the Facility under an operating lease arrangement, which contains a residual value guarantee of \$33.4 million. The Company does not expect the residual value of the Facility to be less than the amount guaranteed.

NOTE 9. SHAREHOLDERS' EQUITY

Common Stock and Common Stock Repurchase Program

The Company's Certificate of Incorporation authorizes five million shares of \$1 par value preferred stock (none outstanding), with respect to which the Board of Directors may fix the series and terms of issuance, and 400 million shares of \$1 par value voting common stock.

In December 1997, the Company redeemed the outstanding preferred stock purchase rights and issued new preferred stock purchase rights, declaring a dividend of one such right on each outstanding share of common stock, and since such time, the Company has issued such rights with each share of common stock that has been subsequently issued. When exercisable, each new right will entitle its holder to buy one one-hundredth of a share of Series A Junior Participating Preferred Stock at a price of \$150 per one one-hundredth of a share until October 31, 2007. The rights will become exercisable if a person acquires 20% or more of the Company's common stock or makes an offer, the consummation of which will result in the person's owning 20% or more of the Company's common stock. In the event the Company is acquired in a merger, each right entitles the holder to purchase common stock of the acquiring company having a market value of twice the exercise price of the right. Likewise, if a person or group acquires 20% or more of the Company's common stock, each right entitles the holder to purchase the Company's common stock with a market value equal to twice the exercise price of the right. The rights may be redeemed by the Company at a price of one cent per right at any time prior to a person's or group's acquiring 20% of the Company's common stock. The 20% threshold may be reduced by the Company to as low as 10% at any time prior to a person's acquiring a percent of Company stock equal to the lowered threshold.

The Board of Directors has authorized the repurchase of an aggregate 40.4 million shares of the Company's outstanding common stock. The acquired shares may be reissued under the Company's stock option and incentive plans or used for other corporate purposes. At year end 2005, approximately 2.5 million shares remain available for repurchase pursuant to this authorization.

Stock Option and Incentive Plans

The Board of Directors previously authorized the issuance of up to 18 million shares to be used for the issuance of stock options and the funding of other Company obligations arising from various employee benefit plans. The remaining shares available are held in the Company's Employee Stock Benefit Trust ("ESBT"). The ESBT common stock is carried at market value with changes in share price from prior reporting periods reflected as an adjustment to capital in excess of par value.

The Company maintains various stock option and incentive plans which are fixed employee stock-based compensation plans. Under the plans, incentive stock options and stock options granted to directors may be granted at not less than 100% of the fair market value of the Company's common stock on the date of the grant, whereas nonqualified options granted to employees may be issued at prices no less than par value. The Company's policy is to price stock option grants at fair market value on the date of the grant. Options generally vest ratably over a two-year period for directors, or over a four-year period for employees. Options for certain officers may cliff-vest over a 3- to 9.75-year period based on the Company's performance. Unexercised options expire ten years from the date of grant.

The following table sets forth stock option information relative to these plans (options in thousands):

	2005		2004		2003	
	Weighted-average exercise price	Number of options	Weighted-average exercise price	Number of options	Weighted-average exercise price	Number of options
Outstanding at beginning of year	\$ 55.18	9,503.7	\$ 52.66	7,951.9	\$ 51.10	6,942.4
Granted	59.23	1,856.8	59.22	2,381.7	55.66	1,490.8
Exercised	36.95	(304.0)	36.02	(586.5)	26.09	(267.1)
Forfeited or expired	58.79	(203.3)	58.38	(243.4)	56.41	(214.2)
Outstanding at year end	56.32	10,853.2	55.18	9,503.7	52.66	7,951.9
Options exercisable at year end	\$ 53.46	5,246.2	\$ 50.14	3,684.6	\$ 46.64	3,428.1

The following table summarizes information on fixed stock options outstanding at December 31, 2005 (options in thousands):

	Options outstanding			Options exercisable	
	Number outstanding	Weighted-average remaining contractual life (in years)	Weighted-average exercise price	Number exercisable	Weighted-average exercise price
Range of exercise prices					
\$ 34.94 to 49.97	1,270.7	2.3	\$ 42.52	1,243.1	\$ 42.44
50.03 to 59.76	8,272.3	7.7	57.40	3,492.3	55.99
60.29 to 67.31	1,310.2	6.9	62.87	510.8	62.95
\$ 34.94 to 67.31	10,853.2	6.9	\$ 56.32	5,246.2	\$ 53.46

The weighted-average fair value per share of options granted during 2005, 2004 and 2003 was \$12.64, \$11.18 and \$11.71, respectively. Option grant date fair values were determined using the Black-Scholes option pricing model. The underlying assumptions used were as follows:

	2005	2004	2003
Risk-free interest rate	4.11%	3.86%	3.86%
Expected stock price volatility	20.55	19.81	21.41
Expected dividend yield	2.67	3.01	2.59
Expected option term	7 years	7 years	7 years

Restricted Stock Units and Restricted Stock Grants

In December 2005, the Board of Directors approved the award of restricted stock units ("RSUs"), which were issued under the Company's stock option and incentive plan. In 2005, RSUs were granted to certain employees, which consisted of two groups of employees. These RSUs include dividend equivalents in the form of additional RSUs, which are equivalent to the amount of the dividend paid or property distributed on a single share of common stock multiplied by the number of RSUs in the employee's account. Vesting for the two groups of RSUs is as follows:

- A vesting period of 3 years provided that a certain performance objective is met at the end of the third year after year of the award. If the performance objective is not achieved at the end of the third year, the same unvested RSUs will be subject to meeting the performance objective at the end of the fourth year, and if not achieved at the end of the fourth year, then the fifth year following the year of grant

- A vesting period of 3 years, provided that employment is continuous for 3 years

For both groups, if the above vesting conditions are not met, the RSUs will be forfeited. As of December 31, 2005, there were no forfeited RSUs.

The following table summarizes information about awarded RSUs at December 31, 2005:

	2005
Restricted stock units awarded (in thousands)	93.5
Stock price per share at award date	\$ 59.47
Pretax compensation expense related to RSUs (in millions)	\$.1

During 2005, the Company also awarded 30,000 restricted shares, which vest equally in 2009 and 2012. Pretax compensation expense of \$.2 million was recorded for this award in 2005.

NOTE 10. COMPONENTS OF OTHER INCOME AND EXPENSE

Severance charges recorded under the restructuring actions below are included in "Other accrued liabilities" in the Consolidated Balance Sheet.

Fourth Quarter 2005

In the fourth quarter of 2005, the Company recorded a pretax charge of \$55.5 million associated with restructuring actions (\$41.1 million), as well as expected product line divestitures (\$14.4 million). The charge included severance and related costs of

\$32.9 million related to the elimination of approximately 850 positions worldwide. Severance and related costs represent cash paid or to be paid to employees terminated under these actions. Final payments to the terminated employees will be made during 2006 and 2007. At December 31, 2005, approximately 395 employees impacted by these actions remain with the Company, and are expected to leave by 2007. Also included in the charge was \$22.6 million related to asset impairment, lease cancellation costs and other associated costs. Asset impairments were based on the market value of the assets. The table below details the activity related to this program:

(In millions)	Pressure-sensitive Materials Segment	Office and Consumer Products Segment	Retail Information Services Segment	Other specialty converting businesses	Corporate	Total
Severance and other employee costs						
Beginning balance	\$ 15.1	\$ 6.8	\$ 5.6	\$ 2.5	\$ 2.9	\$ 32.9
Payments	(2.5)	(1.4)	(.4)	(1.0)	—	(5.3)
Balance at December 31, 2005	\$ 12.6	\$ 5.4	\$ 5.2	\$ 1.5	\$ 2.9	\$ 27.6
Asset Impairments						
Buildings	\$ 2.4	\$ —	\$ —	\$ —	\$.8	\$ 3.2
Machinery and equipment	.1	10.7	.7	2.9	1.3	15.7
Capitalized software	—	—	—	—	2.5	2.5
Other						
Lease cancellations	—	—	.8	—	—	.8
Other costs	—	—	.4	—	—	.4
	\$ 2.5	\$ 10.7	\$ 1.9	\$ 2.9	\$ 4.6	\$ 22.6

Second Quarter 2005

In the second quarter of 2005, the Company recorded a pretax charge of \$2.1 million relating to asset impairments (\$1.4 million) and restructuring costs (\$.7 million). The asset impairment charges represented impairment of a building for \$.7 million in other specialty converting businesses and write-off of machinery and equipment for \$.7 million in the Pressure-sensitive Materials segment. Asset impairments were based on market value for similar assets.

First Quarter 2005

In the first quarter of 2005, the Company recorded a pretax charge of \$6.7 million relating to restructuring costs and asset impairment charges, partially offset by a gain on sale of assets of \$3.4 million. The charge included severance and related costs of \$4 million related to the elimination of approximately 170 positions in the Office and Consumer Products segment as a result of the Company's closure of the Gainesville, Georgia label converting plant. Severance and related costs represent cash paid or to be paid to employees terminated under these actions. The remaining employees (approximately 5 employees) impacted by these actions are expected to leave the Company by mid-2006 and final payments to the terminated employees will be made during 2006. Also included in the charge was \$2.7 million related to impairment

of buildings and land in the Pressure-sensitive Materials segment. Asset impairments were based on the market value of the assets.

Second Quarter 2004

In the second quarter of 2004, the Company recorded a pretax charge of \$13.8 million relating to restructuring costs, asset impairments and planned disposition of property, plant and equipment, and lease cancellation costs primarily associated with the completion of the Company's integration of the Jackstädt GmbH ("Jackstädt") acquisition in the Company's Pressure-sensitive Materials segment, as well as cost reduction actions in the Office and Consumer Products and Retail Information Services segments. The charge included severance and related costs of \$7.7 million related to approximately 195 positions worldwide. Severance and related costs represent cash paid or to be paid to employees terminated under these actions. At December 31, 2005, all employees impacted by these actions had left the Company. Final payments to the terminated employees will be made during 2006. Also included in the charge was \$6.1 million related to asset impairments and planned disposition of property, plant and equipment, lease cancellation costs and other associated costs in the Pressure-sensitive Materials segment. Asset impairments were based on the market values for similar assets.

First Quarter 2004

In the first quarter of 2004, the Company recorded a pretax charge of \$21.4 million relating to restructuring costs and asset impairment charges as part of the Company's integration of the Jackstädt acquisition in the Company's Pressure-sensitive Materials segment. The charge included severance and related costs of \$15.9 million, which represent cash paid or to be paid to employees terminated under these actions, involving the elimination of approximately 210 positions. All employees impacted by these actions had left the Company in 2004 and final payments will be made in 2006. Also included in the charge was \$2.9 million related to impairment of software and \$2.6 million related to impairment and planned disposition of machinery and equipment. Asset impairments were based on the market value for similar assets.

Fourth Quarter 2003

In the fourth quarter of 2003, the Company recorded a pretax charge of \$34.3 million relating to Jackstädt integration actions and productivity improvement initiatives, as well as net losses associated with several product line divestitures. The charge included severance and related costs of \$22 million related to the elimination of approximately 530 positions worldwide. Severance and related costs represent cash paid or to be paid to employees terminated under these actions. Also included in the charge was \$8.2 million related to asset impairments and planned disposition of property, plant and equipment, lease cancellation costs and other associated costs. Asset impairments were based on the market values for similar assets. The Company completed the payments for the lease cancellation costs in 2004.

NOTE 11. TAXES BASED ON INCOME

Taxes based on income were as follows:

(In millions)	2005	2004	2003
Current:			
U.S. federal tax	\$ 33.5	\$ 35.7	\$ 48.4
State taxes	3.0	6.0	8.3
International taxes	29.7	65.0	55.6
	66.2	106.7	112.3
Deferred:			
U.S. federal tax	(11.8)	8.7	5.0
State taxes	(5.2)	2.7	-
International taxes	14.3	(24.4)	(16.9)
	(2.7)	(13.0)	(11.9)
Taxes on income	\$ 63.5	\$ 93.7	\$ 100.4

The principal items accounting for the difference in taxes as computed at the U.S. statutory rate and as recorded were as follows:

(In millions)	2005	2004	2003
Computed tax at 35% of income			
from continuing operations			
before taxes	\$ 128.3	\$ 131.4	\$ 118.5
Increase (decrease) in taxes			
resulting from:			
State taxes, net of federal			
tax benefit	(3.0)	6.9	5.4
Foreign earnings taxed at			
different rates	(31.4)	(41.7)	(31.8)
Valuation allowance	(15.6)	15.3	9.8
Jobs Act repatriation of earnings	13.5	-	-
Tax credits	(6.4)	(6.6)	(4.5)
Tax audit settlements	(9.0)	(7.9)	-
Other items, net	(1.4)	(3.1)	(4.0)
Taxes on income from			
continuing operations	75.0	94.3	93.4
Taxes on income from and gain			
on sale of discontinued operations	(11.5)	(.6)	7.0
Taxes on income	\$ 63.5	\$ 93.7	\$ 100.4

Consolidated income before taxes for U.S. and international operations was as follows:

(In millions)	2005	2004	2003
U.S.	\$ 99.5	\$ 168.3	\$ 155.6
International	267.3	207.0	182.9
Income from continuing			
operations before taxes	366.8	375.3	338.5
Income (loss) from discontinued			
operations before taxes	(76.9)	(1.9)	29.8
Income before taxes	\$ 289.9	\$ 373.4	\$ 368.3

U.S. income taxes have not been provided on undistributed earnings of international subsidiaries of approximately \$924 million and \$1.03 billion at year ended 2005 and 2004, respectively, because such earnings are considered to be reinvested indefinitely outside the U.S., except for the one-time repatriation of earnings in 2005, provided for by the Jobs Act.

The Jobs Act, enacted on October 22, 2004, provided for a temporary 85% dividends-received deduction on certain foreign earnings repatriated before December 31, 2005. The deduction resulted in an approximate 5.25% federal tax rate on the repatriated earnings. During the third quarter of 2005, the Company's Chief Executive Officer and Board of Directors approved a domestic reinvestment plan as required by the Jobs Act to repatriate \$344 million of foreign earnings in fiscal 2005. The repatriation of earnings took place in the fourth quarter of 2005.

Included in the effective tax rate for 2005 is a one-time incremental expense of \$13.5 million associated with the repatriation of accumulated foreign earnings under the Jobs Act and a \$9 million benefit from several favorable global tax audit settlements.

The amount of income taxes the Company pays is subject to ongoing audits by taxing jurisdictions around the world. The Company's estimate of the potential outcome of any uncertain tax issue is subject to management's assessment of relevant risks, facts, and circumstances existing at that time. The Company believes that it has adequately provided for reasonably foreseeable outcomes related to these matters. However, the Company's future results may include favorable or unfavorable adjustments to its estimated tax liabilities in the period the assessments are made or resolved, which may impact the Company's effective tax rate.

Operating loss carryforwards of foreign subsidiaries for 2005 and 2004 are \$143.7 million and \$252.5 million, respectively. Credit carryforwards for 2005 and 2004 related to foreign investment tax credits totaled \$3.1 million and \$3.5 million, respectively. California research credits for 2005 and 2004 totaled \$3.9 million and \$3.3 million, respectively. Net operating losses, if unused, of \$6.8 million will expire by 2010, and \$22.1 million will expire after 2010. Net operating losses of \$114.8 million can be carried forward indefinitely. The foreign investment tax credit carryforwards begin to expire in 2013. The California research credit can be carried forward indefinitely. The Company has established a valuation allowance for the net operating loss and credit carryforwards not expected to be utilized. The valuation allowance for 2005 and 2004 is \$26.5 million and \$49.9 million, respectively. The decrease in 2005 is directly attributable to the decrease in net operating loss carryforwards of foreign subsidiaries.

Total tax benefits resulting from the exercise of employee stock option programs recorded in stockholders' equity for 2005 and 2004 was approximately \$7 million for both years.

Deferred income taxes reflect the temporary differences between the amounts at which assets and liabilities are recorded for financial reporting purposes and the amounts utilized for tax purposes. The primary components of the temporary differences that gave rise to the Company's deferred tax assets and liabilities were as follows:

(In millions)	2005	2004
Accrued expenses not currently deductible	\$ 34.1	\$ 30.2
Net operating losses and foreign tax credit carryforwards	40.3	73.4
Postretirement and postemployment benefits	50.3	50.9
Pension costs	9.3	3.8
Inventory reserves	12.4	11.3
Other	6.1	4.3
Valuation allowance	(26.5)	(49.9)
Total deferred tax assets	126.0	124.0
Depreciation and amortization	(141.2)	(142.4)
Total deferred tax liabilities	(141.2)	(142.4)
Total net deferred tax liabilities from continuing operations	\$ (15.2)	\$ (18.4)
Net deferred tax assets (liabilities) from discontinued operations	2.6	(7.7)
Total net deferred tax liabilities	\$ (12.6)	\$ (26.1)

The Company is subject to ongoing tax examinations by federal, state and foreign tax authorities.

NOTE 12. SEGMENT INFORMATION

The accounting policies of the segments are described in Note 1 "Summary of Significant Accounting Policies." Intersegment sales are recorded at or near market prices and are eliminated in determining consolidated sales. The Company evaluates performance based on income from operations before interest expense and taxes. General corporate expenses are also excluded from the computation of income from operations for the segments.

The Company does not disclose total assets by operating segment since the Company does not produce and review such information internally. The Company does not disclose revenues from external customers for each product because it is impracticable to do so. As the Company's reporting structure is not organized by country, results by individual country are not provided because it is impracticable to do so.

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

(In millions)	2005 ⁽¹⁾	2004 ⁽²⁾	2003 ⁽³⁾
Net sales to unaffiliated customers:			
Pressure-sensitive Materials	\$ 3,114.5	\$ 2,984.6	\$ 2,546.8
Office and Consumer Products	1,136.1	1,172.5	1,168.1
Retail Information Services	674.8	636.1	552.7
Other specialty converting businesses	548.1	523.8	469.2
Net sales to unaffiliated customers	\$ 5,473.5	\$ 5,317.0	\$ 4,736.8
Intersegment sales:			
Pressure-sensitive Materials	\$ 162.7	\$ 168.9	\$ 175.1
Office and Consumer Products	2.0	2.2	2.3
Retail Information Services	7.8	8.8	7.5
Other specialty converting businesses	14.6	16.8	14.5
Eliminations	(187.1)	(196.7)	(199.4)
Intersegment sales	\$ -	\$ -	\$ -
Income from operations before taxes:			
Pressure-sensitive Materials	\$ 259.6	\$ 221.4	\$ 180.2
Office and Consumer Products	168.0	186.4	188.5
Retail Information Services	42.7	47.8	24.2
Other specialty converting businesses	9.5	35.5	43.7
Corporate expense	(55.1)	(57.1)	(39.6)
Interest expense	(57.9)	(58.7)	(58.5)
Income before taxes	\$ 366.8	\$ 375.3	\$ 338.5
Capital expenditures:			
Pressure-sensitive Materials	\$ 73.9	\$ 115.3	\$ 131.8
Office and Consumer Products	24.8	19.6	17.0
Retail Information Services	32.4	38.3	26.7
Other specialty converting businesses	37.8	29.3	18.9
Corporate	2.5	1.6	4.5
Discontinued operations	.2	1.6	4.7
Capital expenditures⁽⁴⁾	\$ 171.6	\$ 205.7	\$ 203.6
Depreciation expense:			
Pressure-sensitive Materials	\$ 86.2	\$ 80.7	\$ 77.4
Office and Consumer Products	24.7	25.3	25.7
Retail Information Services	17.3	15.3	13.7
Other specialty converting businesses	20.0	17.9	18.2
Corporate	6.0	6.6	6.9
Discontinued operations	1.5	1.4	4.2
Depreciation expense	\$ 155.7	\$ 147.2	\$ 146.1

- (1) Results for 2005 include a pretax charge of \$63.6 for restructuring costs, asset impairment, lease cancellation charges, transition costs and legal accrual related to a patent lawsuit, partially offset by gain on sale of assets, of which the Pressure-sensitive Materials segment recorded \$23, the Office and Consumer Products segment recorded \$21.8, the Retail Information Services segment recorded \$7.5, the other specialty converting businesses recorded \$6.2 and Corporate recorded \$5.1. See Note 10 "Components of Other Income and Expense," for further information.
- (2) Results for 2004 include a pretax charge of \$35.2 for restructuring costs, asset impairment and lease cancellation charges, of which the Pressure-sensitive Materials segment recorded \$34.4, the Office and Consumer Products segment recorded \$.5 and the Retail Information Services segment recorded \$.3. See Note 10 "Components of Other Income and Expense," for further information.
- (3) Results for 2003 include a net pretax charge of \$30.5 for asset impairments, restructuring costs, lease cancellation costs and net losses associated with several product line divestitures, partially offset by gain from settlement of a lawsuit during the second quarter of 2003, of which the Pressure-sensitive Materials segment recorded \$13.6, the Office and Consumer Products segment recorded \$12.5, the Retail Information Services segment recorded \$7, the other specialty converting businesses recorded \$2.5 and Corporate recorded \$(5.1). See Note 10 "Components of Other Income and Expense," for further information.
- (4) The amount of capital spending in the Consolidated Statement of Cash Flows for 2005 was approximately \$9 lower due to the capitalization of leased assets. Capital expenditures accrued but not paid were approximately \$27 in both 2005 and 2004. Therefore the amount of capital expenditures in the Consolidated Statement of Cash Flows in 2004 was approximately \$27 lower due to the timing of payments.

Financial information relating to the Company's continuing operations by geographic area is set forth below:

(In millions)	2005	2004	2003
Net sales:			
U.S.	\$ 2,521.6	\$ 2,597.6	\$ 2,474.0
International	3,161.7	2,934.1	2,477.0
Intergeographic	(209.8)	(214.7)	(214.2)
Net sales	\$ 5,473.5	\$ 5,317.0	\$ 4,736.8
Property, plant and equipment, net:			
U.S.	\$ 580.6	\$ 599.6	\$ 607.4
International	715.1	774.8	675.5
Property, plant and equipment, net	\$ 1,295.7	\$ 1,374.4	\$ 1,282.9

Revenues are attributed to geographic areas based on the location to which the product is shipped. The Company's international operations, conducted primarily in Europe, are on the FIFO basis of inventory cost accounting. U.S. operations use both FIFO and LIFO. Export sales from the United States to unaffiliated customers are not a material factor in the Company's business.

NOTE 13. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(In millions, except per share data)	First Quarter ⁽¹⁾	Second Quarter ⁽²⁾	Third Quarter ⁽³⁾	Fourth Quarter ⁽⁴⁾
2005				
Net sales from continuing operations	\$ 1,342.8	\$ 1,411.7	\$ 1,355.0	\$ 1,364.0
Gross profit from continuing operations	387.9	424.5	394.1	414.6
Net income	57.7	89.4	86.2	(6.9)
Net income per common share	.58	.89	.86	(.07)
Net income per common share, assuming dilution	.57	.89	.86	(.07)
2004				
Net sales from continuing operations	\$ 1,242.7	\$ 1,317.2	\$ 1,329.3	\$ 1,427.8
Gross profit from continuing operations	366.1	389.0	387.8	432.1
Net income	52.6	68.5	75.0	83.6
Net income per common share	.53	.69	.75	.84
Net income per common share, assuming dilution	.52	.68	.75	.83

- (1) Results in the first quarter 2005 include a \$6.7 pretax charge for restructuring costs and asset impairment charges, partially offset by a gain on sale of assets of \$3.4. Results in the first quarter 2004 include a \$21.4 pretax charge for restructuring costs and asset impairment charges.
- (2) Results in the second quarter 2005 include a \$2.1 pretax charge for restructuring costs and asset impairment charges. Results in the second quarter 2004 include a \$13.8 pretax charge for restructuring costs, asset impairment and lease cancellation charges.
- (3) Results in the third quarter 2005 include a \$1.3 pretax charge for asset impairment charges.
- (4) Results in the fourth quarter 2005 include a \$55.5 pretax charge for restructuring costs, asset impairment and lease cancellation charges, and legal accrual related to a patent lawsuit of \$3.8, partially offset by a gain on sale of assets of \$2.4.

NOTE 14. SUBSEQUENT EVENT

On February 25, 2006, the Company completed the sale of one of its product lines, impacting the Office and Consumer Products segment, the sale of which was announced in December 2005. This product line had estimated sales of \$60 million in 2005, and minimal impact on income.

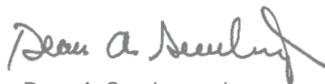
Statement of Management Responsibility for Financial Statements

The consolidated financial statements and accompanying information were prepared by and are the responsibility of management. The statements were prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts that are based on management's best estimates and judgments.

Oversight of management's financial reporting and internal accounting control responsibilities is exercised by the Board of Directors, through an Audit Committee, which consists solely of outside directors (see page 66). The Committee meets periodically with financial management, internal auditors and the independent registered public accounting firm to obtain reasonable assurance that each is meeting its responsibilities and to discuss matters concerning auditing, internal accounting control and financial reporting. The independent registered public accounting firm and the Company's internal audit department have free access to meet with the Audit Committee without management's presence.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of management, including the chief executive officer and chief financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the Company's evaluation under the framework in *Internal Control – Integrated Framework*, management has concluded that internal control over financial reporting was effective as of December 31, 2005. Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.



Dean A. Scarborough
President and
Chief Executive Officer



Daniel R. O'Bryant
Executive Vice President, Finance
and Chief Financial Officer

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Avery Dennison Corporation:

We have completed integrated audits of Avery Dennison Corporation's December 31, 2005 and January 1, 2005 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005 and an audit of its December 27, 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, shareholders' equity, and cash flows present fairly, in all material respects, the financial position of Avery Dennison Corporation and its subsidiaries at December 31, 2005 and January 1, 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying "Management's Report on Internal Control Over Financial Reporting," that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



PricewaterhouseCoopers LLP
Los Angeles, California
March 13, 2006

Directors and Officers

BOARD OF DIRECTORS

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Avery Dennison Corporation
and Chairman Emeritus,
Northrop Grumman Corporation,
an aeronautical and defense
systems manufacturer
Board member since 1999

Dean A. Scarborough ⁶

President and
Chief Executive Officer,
Avery Dennison Corporation
Board member since 2000

Richard M. Ferry ^{1, 3, 5, 6}

Founder Chairman,
Korn/Ferry International,
an international executive
search firm
Board member since 1985

Peter W. Mullin ^{3, 6}

Chairman,
Mullin Consulting, Inc.,
an executive compensation,
benefit planning and corporate
insurance consulting firm
Board member since 1988

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Chairman of the Board and
Chief Executive Officer,
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a global health care company
Board member since 1999

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Chief Executive Officer and
Chief Operating Officer,
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a restaurant chain
Board member since 2003

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an audit, tax, consulting and
financial advisory services firm
Board member since 2004

Rolf Börjesson ^{3, 4, 5, 6}

Chairman,
Rexam PLC,
a consumer packaging and
beverage can manufacturer
Board member since 2005

Patrick T. Siewert ^{3, 4, 6}

Senior Advisor,
Coca-Cola Company,
a worldwide
beverage company
Board member since 2005

Directors Emeriti (nonvoting)

Charles D. Miller

Retired Chairman and
Chief Executive Officer,
Avery Dennison Corporation

H. Russell Smith

Retired Chairman of the
Executive Committee,
Avery Dennison Corporation

- 1 – Member of Compensation and Executive Personnel Committee
- 2 – Member of Audit Committee
- 3 – Member of Finance Committee
- 4 – Member of Ethics and Conflict of Interest Committee
- 5 – Member of Nominating and Governance Committee
- 6 – Member of Strategic Planning Committee
- 7 – Non-Executive Chairman

CORPORATE OFFICERS

Dean A. Scarborough

President and
Chief Executive Officer

Robert G. van Schoonenberg

Executive Vice President,
General Counsel and Secretary

Daniel R. O'Bryant

Executive Vice President,
Finance and
Chief Financial Officer

Christian A. Simcic

Group Vice President,
Roll Materials Worldwide

Timothy S. Clyde

Group Vice President,
Office Products Worldwide

Simon D. Coulson

Group Vice President,
Retail Information Services
Worldwide

Sandra Beach Lin

Group Vice President,
Specialty Materials and
Converting Worldwide

Robert M. Malchione

Senior Vice President,
Corporate Strategy and
Technology

J. Terry Schuler

Senior Vice President,
Human Resources

Diane B. Dixon

Senior Vice President,
Worldwide Communications
and Advertising

Michael A. Skovran

Vice President and Controller

Stephen A. Mynott

Vice President,
Global Operations

Karyn E. Rodriguez

Vice President and
Treasurer

Kenneth A. Wolinsky

Vice President and
Chief Information Officer

Ahmed Rubaie

Vice President,
Internal Audit and Tax

David N. Edwards

Vice President and Chief
Technology Officer

DIVISION OFFICERS

Timothy G. Bond

Vice President
General Manager,
Office Products North America

Sara F. Cheung

Vice President
General Manager,
Commercial Functions,
Information and Brand
Management Services
Retail Information Services
Asia

Ali H. Clemens

Vice President
General Manager,
InfoChain Express
Retail Information Services

John L. Collins

Vice President,
Sales
Fasson Roll North America

Andy Cooper

Vice President
General Manager,
Office Products Asia Pacific

Johan Delvaux

Vice President
General Manager,
Specialty Tapes Europe

Angelo Depietri

Vice President
General Manager,
Materials and Office Products
South America

William M. Goldsmith

Vice President
General Manager,
Industrial and Automotive
Products
North America

Georges Gravanis

Vice President
General Manager,
Roll Materials Europe
Southern Region

Terrence L. Hemmelgarn

Vice President
General Manager,
Retail Information Services
Asia and Global Operations

David E. Herring

Vice President
General Manager,
Fastener Worldwide
Retail Information Services

Linda M. Jacober

Vice President
General Manager,
Information and Brand
Management Services
Americas and Global
Commercial Enterprises
Retail Information Services

Michael S. Johansen

Vice President
General Manager,
Specialty Tapes U.S.

Josef Kagon

Vice President,
Graphics and Reflective
Worldwide

Kamran Kian

Vice President,
Global Operations
Roll Materials Worldwide

Hans Guenther Klenk

Vice President
General Manager,
Office Products Europe

Constant Yip Wai Lam

Vice President
Managing Director,
Information and Brand
Management Services
Retail Information Services
Asia Operations

Stephen R. Landon

Vice President
General Manager,
Performance Films Division

Dagang Li

Vice President
General Manager,
Roll Materials Greater China

Kim P. Macaulay

Vice President, Marketing,
Information and Brand
Management Services
Worldwide
Retail Information Services

David R. Martin

Vice President
General Manager,
Materials Australia and
New Zealand

Mathew S. Mellis

Vice President,
Radio Frequency Identification
and Specialty Converting

Ferdinand Pranckh

Vice President
General Manager,
Reflective Products Division

John C. Quinn

Vice President
General Manager,
Roll Materials Asia Pacific

Martin Rapp

Vice President
General Manager,
Roll Materials Europe
Central Region

Michael W. Roughton

Vice President
General Manager,
Graphics North America

Helen M. Saunders

Vice President
General Manager,
Graphics Division Europe

Jef Smets

Vice President,
Specialty Tapes Worldwide

Donald W. Stoebe

Vice President
General Manager,
Roll Materials Europe

John M. Wurzburger

Vice President
General Manager,
Fasson Roll North America

T.G. Yeo

Vice President
General Manager,
Graphics Asia Pacific

Kevin E. Young

Vice President
General Manager,
Apparel Labeling
Retail Information Services

Corporate Information

Counsel

Latham & Watkins LLP
Los Angeles, California

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP
Los Angeles, California

Transfer Agent – Registrar

Computershare Trust Co., N.A.
P. O. Box 43023
Providence, RI 02940-3023
(877) 498-8861
(800) 952-9245 (hearing impaired number)
www.computershare.com (Web site)

Annual Meeting

The Annual Meeting of Shareholders will be held at 1:30 p.m. on April 27, 2006, in the Conference Center of Avery Dennison's Charles D. Miller Corporate Center, 150 North Orange Grove Boulevard, Pasadena, California.

The DirectSERVICE™ Investment Program

Shareholders of record may reinvest their cash dividends in additional shares of Avery Dennison common stock at market price. Investors may also invest optional cash payments of up to \$12,500 per month in Avery Dennison common stock at market price. Avery Dennison investors not yet participating in the program, as well as brokers and custodians who hold Avery Dennison common stock for clients, may obtain a copy of the program by writing to The DirectSERVICE™ Investment Program, c/o Computershare (include a reference to Avery Dennison in the correspondence), P.O. Box 43081, Providence, RI 02940-3081, or calling (877) 498-8861, or logging onto their Web site at <http://www.computershare.com>.

Direct Deposit of Dividends

Avery Dennison shareholders may deposit quarterly dividend checks directly into their checking or savings accounts. For more information, call Avery Dennison's transfer agent and registrar, Computershare Trust Co., Inc., at (800) 870-2340.

Other Information

The Company is including, as Exhibits 31.1 and 31.2 to its Annual Report on Form 10-K for fiscal year 2005 filing with the Securities and Exchange Commission ("SEC"), certificates of the Chief Executive Officer and Chief Financial Officer of the Company pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, and the Company submitted to the New York Stock Exchange ("NYSE"), the Company's annual written affirmation on April 29, 2005, along with the Chief Executive Officer's certificate that he is

not aware of any violation by the Company of NYSE's Corporate Governance listing standards.

A copy of the Company's Annual Report on Form 10-K, as filed with the SEC, will be furnished to shareholders and interested investors free of charge upon written request to the Secretary of the Corporation. Copies may also be obtained from the Company's web site, www.averydennison.com, in the "Investors" section.

Corporate Headquarters

Avery Dennison Corporation
Miller Corporate Center
150 North Orange Grove Boulevard
Pasadena, California 91103
Phone: (626) 304-2000
Fax: (626) 792-7312

Mailing Address:
P.O. Box 7090
Pasadena, California 91109-7090

Stock and Dividend Data

Common shares of Avery Dennison are listed on the NYSE.

Ticker symbol: AVY

	2005		2004	
	High	Low	High	Low
Market Price				
First Quarter	\$ 62.53	\$ 56.10	\$ 64.50	\$ 55.49
Second Quarter	61.48	51.35	64.94	58.63
Third Quarter	56.92	51.98	64.40	58.56
Fourth Quarter	59.44	50.30	65.78	54.90

Prices shown represent closing prices on the NYSE

	2005	2004
	Dividends Per Common Share	
First Quarter	\$.38	\$.37
Second Quarter	.38	.37
Third Quarter	.38	.37
Fourth Quarter	.39	.38
Total	\$ 1.53	\$ 1.49

Number of shareholders of record as of year end	10,216	10,750
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More Information

Our capabilities worldwide
www.averydennison.com

Investor information
www.investors.averydennison.com
Send inquiries via e-mail to investorcom@averydennison.com

Avery-brand office and consumer products
www.avery.com
Call our Consumer Service Center at (800) 462-8379

Fasson-brand products
www.fasson.com

Career opportunities
Search for job openings and apply online at
www.averydennison.apply2jobs.com

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Thanks to an Office Products North America Horizon 1 team, we succeeded in bringing the new Motorola Phone Tattoos created by Avery (cover photo) to market in record time.



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