

STANLEY WORKS
Form 10-Q
November 03, 2008

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(STANLEY LOGO)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

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

For the quarterly period ended September 27, 2008.

OR

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

For the transition period from [] to []

Commission File Number 1-5224

THE STANLEY WORKS

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

CONNECTICUT

06-0548860

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

(I.R.S. EMPLOYER
IDENTIFICATION NUMBER)

**1000 STANLEY DRIVE
NEW BRITAIN, CONNECTICUT**

06053

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(ZIP CODE)

(860) 225-5111

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

78,794,900 shares of the registrant's common stock were outstanding as of October 24, 2008

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THE STANLEY WORKS AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE AND NINE MONTHS ENDED SEPTEMBER 27, 2008 AND SEPTEMBER 29, 2007

(Unaudited, Millions of Dollars, Except Per Share Amounts)

| | Third Quarter | | Year to Date | |
|---|----------------------|-------------|---------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| NET SALES | \$ 1,119.7 | \$ 1,106.2 | \$ 3,347.6 | \$ 3,240.0 |
| COSTS AND EXPENSES | | | | |
| Cost of sales | 688.3 | 684.6 | 2,068.3 | 2,009.8 |
| Selling, general and administrative | 269.4 | 250.6 | 822.7 | 762.0 |
| Provision for doubtful accounts | 5.6 | 1.8 | 10.6 | 8.1 |
| Interest expense | 21.0 | 21.3 | 61.9 | 63.8 |
| Interest income | (2.7) | (1.1) | (7.4) | (3.2) |
| Other, net | 28.7 | 25.2 | 70.1 | 67.7 |
| Restructuring charges and asset impairments | 4.8 | 2.8 | 25.0 | 10.4 |
| | 1,015.1 | 985.2 | 3,051.2 | 2,918.6 |
| Earnings from continuing operations before income taxes | 104.6 | 121.0 | 296.4 | 321.4 |
| Income taxes | 26.2 | 32.5 | 76.9 | 84.8 |
| Net earnings from continuing operations | 78.4 | 88.5 | 219.5 | 236.6 |
| Earnings from discontinued operations before income taxes (including a \$128.1 gain on divestiture in the third quarter 2008 and \$129.7 year-to-date 2008) | 130.4 | 4.6 | 139.2 | 12.4 |
| Income taxes on discontinued operations | 44.3 | 1.7 | 46.6 | 4.7 |
| Net earnings from discontinued operations | 86.1 | 2.9 | 92.6 | 7.7 |
| NET EARNINGS | \$ 164.5 | \$ 91.4 | \$ 312.1 | \$ 244.3 |
| NET EARNINGS PER SHARE OF COMMON STOCK | | | | |
| Basic: | | | | |
| Continuing operations | \$ 1.00 | \$ 1.08 | \$ 2.78 | \$ 2.86 |
| Discontinued operations | 1.09 | 0.03 | 1.17 | 0.09 |
| Total basic earnings per common share | \$ 2.09 | \$ 1.11 | \$ 3.96 | \$ 2.96 |

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| | | | | |
|---|---------|---------|---------|---------|
| Diluted: | | | | |
| Continuing operations | \$ 0.98 | \$ 1.05 | \$ 2.74 | \$ 2.80 |
| Discontinued operations | 1.08 | 0.03 | 1.16 | 0.09 |
| Total diluted earnings per common share | \$ 2.06 | \$ 1.09 | \$ 3.90 | \$ 2.89 |
| DIVIDENDS PER SHARE OF COMMON STOCK | \$ 0.32 | \$ 0.31 | \$ 0.94 | \$ 0.91 |
| AVERAGE SHARES OUTSTANDING (in thousands): | | | | |
| Basic | 78,808 | 82,288 | 78,867 | 82,616 |
| Diluted | 79,846 | 83,999 | 80,025 | 84,417 |

See notes to condensed consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS
SEPTEMBER 27, 2008 AND DECEMBER 29, 2007
(Unaudited, Millions of Dollars)

| | 2008 | 2007 |
|---|-------------|-------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 299.3 | \$ 240.4 |
| Accounts and notes receivable | 884.7 | 831.1 |
| Inventories | 571.4 | 556.4 |
| Other current assets | 88.9 | 86.0 |
| Assets held for sale | 4.2 | 106.0 |
| Total current assets | 1,848.5 | 1,819.9 |
| Property, plant and equipment | 1,477.4 | 1,449.0 |
| Less: accumulated depreciation | 888.7 | 884.1 |
| | 588.7 | 564.9 |
| Goodwill | 1,664.7 | 1,512.5 |
| Trademarks | 342.5 | 332.2 |
| Customer relationships | 433.6 | 321.4 |
| Other intangible assets | 46.1 | 40.6 |
| Other assets | 197.2 | 188.4 |
| Total assets | \$ 5,121.3 | \$ 4,779.9 |
| LIABILITIES AND SHAREOWNERS EQUITY | | |
| Current liabilities | | |
| Short-term borrowings | \$ 442.9 | \$ 282.5 |
| Current maturities of long-term debt | 13.3 | 10.3 |
| Accounts payable | 523.8 | 499.6 |
| Accrued expenses | 516.4 | 467.5 |
| Liabilities held for sale | 2.4 | 18.5 |
| Total current liabilities | 1,498.8 | 1,278.4 |
| Long-term debt | 1,194.4 | 1,212.1 |
| Other liabilities | 556.6 | 560.9 |
| Commitments and contingencies (Note L) | | |
| Shareowners equity | | |
| Common stock, par value \$2.50 per share | 233.9 | 233.9 |
| Retained earnings | 2,288.9 | 2,045.5 |
| Accumulated other comprehensive income | 19.0 | 47.7 |
| ESOP | (88.8) | (93.8) |

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| | | |
|---|------------|------------|
| | 2,453.0 | 2,233.3 |
| Less: cost of common stock in treasury | 581.5 | 504.8 |
| Total shareowners' equity | 1,871.5 | 1,728.5 |
| Total liabilities and shareowners' equity | \$ 5,121.3 | \$ 4,779.9 |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE AND NINE MONTHS ENDED SEPTEMBER 27, 2008 AND SEPTEMBER 29, 2007
(Unaudited, Millions of Dollars)

| | Third Quarter | | Year to Date | |
|--|----------------------|-----------------|---------------------|-----------------|
| | 2008 | 2007 | 2008 | 2007 |
| OPERATING ACTIVITIES | | | | |
| Net earnings | \$ 164.5 | \$ 91.4 | \$ 312.1 | \$ 244.3 |
| Depreciation and amortization | 47.2 | 42.2 | 128.5 | 120.1 |
| Changes in working capital | 28.0 | (22.3) | (4.7) | (54.4) |
| Net gain on sale of businesses | (84.3) | | (85.9) | |
| Changes in other assets and liabilities | 10.5 | 19.0 | 7.1 | 16.2 |
| Cash provided by operating activities | 165.9 | 130.3 | 357.1 | 326.2 |
| INVESTING ACTIVITIES | | | | |
| Capital expenditures | (28.3) | (11.5) | (81.9) | (55.0) |
| Proceeds from sale of businesses, net of income taxes paid | 162.5 | | 165.8 | |
| Business acquisitions | (336.2) | (64.2) | (364.4) | (633.1) |
| Other investing activities | 15.8 | 6.6 | 24.5 | 9.7 |
| Cash used in investing activities | (186.2) | (69.1) | (256.0) | (678.4) |
| FINANCING ACTIVITIES | | | | |
| Payments on long-term debt | (1.0) | (0.5) | (8.7) | (76.9) |
| Proceeds from long-term borrowings | 0.2 | | 0.2 | 529.8 |
| Deferred financing costs and other | (4.0) | | (11.8) | (12.1) |
| Bond hedge premium | | | | (49.3) |
| Net short-term borrowings | (31.5) | 13.4 | 141.0 | 145.7 |
| Cash dividends on common stock | (25.2) | (25.4) | (73.8) | (74.9) |
| Proceeds from issuance of common stock and warrants | 7.4 | 4.1 | 17.4 | 89.9 |
| Purchase of common stock for treasury | | | (102.3) | (106.9) |
| Cash (used in) provided by financing activities | (54.1) | (8.4) | (38.0) | 445.3 |
| Effect of exchange rate changes on cash | (10.5) | 2.1 | (4.2) | 10.9 |
| Change in cash and cash equivalents | (84.9) | 54.9 | 58.9 | 104.0 |
| Cash and cash equivalents, beginning of period | 384.2 | 225.7 | 240.4 | 176.6 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 299.3 | \$ 280.6 | \$ 299.3 | \$ 280.6 |

See notes to condensed consolidated financial statements.

Table of Contents**THE STANLEY WORKS AND SUBSIDIARIES****BUSINESS SEGMENT INFORMATION****THREE AND NINE MONTHS ENDED SEPTEMBER 27, 2008 AND SEPTEMBER 29, 2007**

(Unaudited, Millions of Dollars)

| | Third Quarter | | Year to Date | |
|---|----------------------|-------------|---------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| NET SALES | | | | |
| Construction & DIY | \$ 426.7 | \$ 437.5 | \$ 1,284.3 | \$ 1,274.4 |
| Industrial | 298.1 | 298.1 | 969.0 | 908.4 |
| Security | 394.9 | 370.6 | 1,094.3 | 1,057.2 |
| Total | \$ 1,119.7 | \$ 1,106.2 | \$ 3,347.6 | \$ 3,240.0 |
| SEGMENT PROFIT | | | | |
| Construction & DIY | \$ 54.2 | \$ 72.2 | \$ 167.0 | \$ 194.0 |
| Industrial | 40.2 | 41.4 | 133.0 | 132.5 |
| Security | 74.0 | 68.3 | 192.9 | 181.3 |
| Segment Profit | 168.4 | 181.9 | 492.9 | 507.8 |
| Corporate Overhead | (12.0) | (12.7) | (46.9) | (47.7) |
| Total | \$ 156.4 | \$ 169.2 | \$ 446.0 | \$ 460.1 |
| Interest expense | 21.0 | 21.3 | 61.9 | 63.8 |
| Interest income | (2.7) | (1.1) | (7.4) | (3.2) |
| Other, net | 28.7 | 25.2 | 70.1 | 67.7 |
| Restructuring charges and asset impairments | 4.8 | 2.8 | 25.0 | 10.4 |
| Earnings from continuing operations before income taxes | \$ 104.6 | \$ 121.0 | \$ 296.4 | \$ 321.4 |

See notes to condensed consolidated financial statements.

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THE STANLEY WORKS AND SUBSIDIARIES
NOTES TO (UNAUDITED) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 27, 2008

A. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (hereafter referred to as generally accepted accounting principles or GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of the results of operations for the interim periods have been included and are of a normal, recurring nature. For further information, refer to the consolidated financial statements and footnotes included in The Stanley Works and Subsidiaries (collectively, the Company) Form 10-K for the year ended December 29, 2007.

Certain prior year amounts have been reclassified to conform to the current year presentation. The assets and liabilities of discontinued operations have been reclassified as held for sale in the 2007 consolidated balance sheet, and the earnings from discontinued operations have been reclassified within the consolidated statements of operations.

B. New Accounting Standards

Implemented: The Company adopted Statement of Financial Accounting Standard No. 157, Fair Value Measurements (SFAS 157), with respect to items that are regularly adjusted to fair value, as of the beginning of its fiscal year. SFAS 157 provides a common fair value hierarchy to follow in determining fair value measurements in the preparation of financial statements and expands disclosure requirements relating to how such measurements were developed. SFAS 157 indicates that an exit value (selling price) should be utilized in fair value measurements rather than an entrance value, or cost basis, and that performance risks, such as credit risk, should be included in the measurements of fair value even when the risk of non-performance is remote. SFAS 157 clarifies the principle that fair value measurements should be based on assumptions the marketplace would use when pricing an asset whenever practicable, rather than company-specific assumptions. On February 12, 2008 the FASB issued Staff Position No. 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2) which amends SFAS 157 to delay the effective date for all non-financial assets and non-financial liabilities, except for those that are recognized at fair value in the financial statements on a recurring basis. Accordingly, in fiscal 2008 the Company has followed the SFAS 157 guidance to value its financial assets and liabilities that are routinely adjusted to fair value, predominantly derivatives. The remaining assets and liabilities, to which the FSP 157-2 deferral relates, will be measured at fair value as applicable beginning in fiscal 2009. The partial adoption of SFAS 157 as described above had an immaterial impact on the Company in the current fiscal year. The Company is in the process of determining the impact, if any, that the second phase of the adoption of SFAS 157 in fiscal 2009 will have relating to its fair value measurements of non-financial assets and liabilities (such as intangible assets). Refer to Note O for further information regarding fair value measurements.

In February 2007, the FASB issued SFAS No 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This statement became effective for the Company at the beginning of the current fiscal year. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The Company did not elect to utilize voluntary fair value measurements as permitted by the standard.

Not Yet Implemented: In May 2008, the FASB issued Staff Position Accounting Principles Board (APB) 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1). FSP APB 14-1 applies to

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convertible debt instruments that have a net settlement feature permitting settlement partially or fully in cash upon conversion. The guidance requires issuers of such convertible debt securities to separately account for the liability and equity components in a manner that reflects the issuer's nonconvertible, unsecured debt borrowing rate. The FSP requires bifurcation of a component of the debt into equity, representative of the approximate fair value of the conversion feature at inception, and the amortization of the resulting debt discount to interest expense in the Consolidated Statement of Operations. The Company is in the process of assessing the impact of FSP APB 14-1, but estimates that approximately \$55 million of Long-term debt will be reclassified to equity as of the inception of the \$330 million of convertible notes issued in March 2007. The estimated \$55 million debt discount will be amortized to interest expense resulting in the recognition of approximately \$8-\$12 million of additional non-cash interest expense annually. The non-cash interest recognized will gradually increase over time using the effective interest method. FSP APB 14-1 will become effective for the Company beginning in the first quarter of 2009 and is required to be applied retrospectively with early adoption prohibited.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141(R)). SFAS 141(R) requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition), establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose the information needed to evaluate and understand the nature and effect of the business combination. This statement applies to all transactions or other events in which the acquirer obtains control of one or more businesses, including those sometimes referred to as true mergers or mergers of equals and combinations achieved without the transfer of consideration, for example, by contract alone or through the lapse of minority veto rights. For new acquisitions made following the adoption of SFAS 141(R), significant costs directly related to the acquisition including legal, audit and other fees, as well as most acquisition-related restructuring, will have to be expensed as incurred rather than recorded to goodwill as is generally permitted under Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS 141). Additionally, contingent purchase price arrangements (also known as earn-outs) will be re-measured to estimated fair value with the impact reported in earnings, whereas under present rules the contingent purchase consideration is recorded to goodwill when determined. The Company is continuing to assess the impact the adoption of SFAS 141(R) will entail. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 4, 2009.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS 160). SFAS 160 requires reporting entities to present non-controlling (minority) interests as equity (as opposed to a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and non-controlling interests. SFAS 160 will apply prospectively and is effective as of the beginning of fiscal 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented upon adoption. The Company is in the process of determining the impact, if any, that the adoption of SFAS 160 will have on its results of operations and financial position.

In June 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Emerging Issues Task Force (EITF) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. Under the FSP, unvested share-based payment awards that contain rights to receive nonforfeitable dividends (whether paid or unpaid) are participating securities, and should be included in the two-class method of computing EPS. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years, and is not expected to have a significant impact on the Company's results of operations, financial condition or liquidity.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension

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assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R), and other GAAP. This FSP applies prospectively to all intangible assets acquired after the effective date in fiscal 2009, whether acquired in a business combination or otherwise. Early adoption is prohibited. The Company is evaluating this guidance but does not expect it to have a significant impact on its financial position or results of operations.

C. Earnings Per Share

The following table reconciles the weighted average shares outstanding used to calculate basic and diluted earnings per share for the three and nine month periods ended September 27, 2008 and September 29, 2007:

| | Third Quarter | | Year to Date | |
|--|----------------------|-------------|---------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Numerator (in millions): | | | | |
| Net earnings basic and diluted | \$ 164.5 | \$ 91.4 | \$ 312.1 | \$ 244.3 |
| Denominator (in thousands): | | | | |
| Basic earnings per share weighted average shares | 78,808 | 82,288 | 78,867 | 82,616 |
| Dilutive effect of stock options and awards | 1,038 | 1,711 | 1,158 | 1,801 |
| Diluted earnings per share weighted average shares | 79,846 | 83,999 | 80,025 | 84,417 |
| Earnings per share of common stock: | | | | |
| Basic | \$ 2.09 | \$ 1.11 | \$ 3.96 | \$ 2.96 |
| Diluted | \$ 2.06 | \$ 1.09 | \$ 3.90 | \$ 2.89 |

The following weighted-average stock options and warrants to purchase the Company's common stock were outstanding during the three and nine month periods ended September 27, 2008 and September 29, 2007, but were not included in the computation of diluted shares outstanding because the effect would be anti-dilutive.

| | Third Quarter | | Year to Date | |
|---|----------------------|-------------|---------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Number of stock options (in thousands) | 1,902 | 569 | 1,640 | 745 |
| Number of stock warrants (in thousands) | 5,093 | 5,093 | 5,093 | 3,565 |

D. Comprehensive Income

Comprehensive income for the three and nine month periods ended September 27, 2008 and September 29, 2007 is as follows (in millions):

| | Third Quarter | | Year to Date | |
|--|----------------------|-------------|---------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |

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| | | | | |
|---|----------|----------|----------|----------|
| Net earnings | \$ 164.5 | \$ 91.4 | \$ 312.1 | \$ 244.3 |
| Other comprehensive gain (loss), net of tax | (72.0) | 40.9 | (28.7) | 77.8 |
| Comprehensive income | \$ 92.5 | \$ 132.3 | \$ 283.4 | \$ 322.1 |

Other comprehensive gain (loss) is primarily the impact of foreign currency translation and changes in the fair value of cash flow hedges.

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In June 2008, the Company acquired a third party's interest in a Special Purpose Entity (SPE). As a result, the entity became non-qualifying and the net assets, which consisted of accounts receivable of \$17.3 million, were consolidated in the Company's balance sheet. Net cash flows between the Company and the SPE for 2008 totaled \$43.2 million, primarily related to receivable sales, collections on receivables and servicing fees. There were no gains or losses on the sale of receivables to the SPE or on the acquisition of the third party interest.

F. Inventories

The components of inventories at September 27, 2008 and December 29, 2007 are as follows (in millions):

| | 2008 | 2007 |
|-------------------|----------|----------|
| Finished products | \$ 406.8 | \$ 397.2 |
| Work in process | 70.9 | 57.5 |
| Raw materials | 93.7 | 101.7 |
| Total inventories | \$ 571.4 | \$ 556.4 |

G. Assets Held for Sale

The assets of one small security business (Blick Alfia) are classified as held for sale at September 27, 2008, as detailed in Note P Discontinued Operations . In addition to the security business, the assets of CST/berger and one other small business (Facom Lista) in the amount of \$76.5 million were held for sale as of December 29, 2007. Further, the Company held \$24.3 million of financing lease receivables generated by the Blick business as of December 29, 2007. These receivables were sold during the first quarter of 2008.

H. Acquisitions and Goodwill

In July 2008, the Company completed the acquisitions of Sonitrol Corporation (Sonitrol) and Xmark Corporation (Xmark) for \$281.3 million in cash and \$46.6 million in cash, respectively. The Sonitrol acquisition has preliminarily resulted in \$133.1 million of goodwill, the majority of which, will not be deductible for income tax purposes. Sonitrol is a market leader in North American commercial security monitoring services, access control and fire detection systems, with annual revenues of approximately \$110 million. The acquisition will complement the product offering of the pre-existing security integration businesses including HSM acquired in early 2007. The Xmark acquisition has preliminarily resulted in \$22.7 million of goodwill, none of which is deductible for income tax purposes. Xmark, headquartered in Canada, markets and sells radio frequency identification based systems used to identify, locate and protect people and assets, with annual revenues of approximately \$30 million. The acquisition will enhance the Company's personal security business.

The Company also made five small acquisitions relating to its mechanical access systems and convergent security solutions businesses during 2008. These five acquisitions were acquired for a combined purchase price of \$34.0 million.

The total purchase price of \$361.9 for the 2008 acquisitions was accounted for as purchases in accordance with SFAS 141. The total purchase price for the acquisitions reflects transaction costs and is net of cash acquired, and was

allocated to the assets acquired and liabilities assumed based on their estimated fair values. The purchase price allocations of these acquisitions are preliminary, mainly with respect to the finalization of intangible asset valuations, related deferred taxes, and certain other items.

During 2007, the Company completed nine acquisitions for a total purchase price of \$646.7 million. The purchase price allocation for one small acquisition with a total purchase price of \$11.1 million is preliminary, mainly with respect to execution of acquisition date integration plans and other minor items. There were no significant changes to the purchase price allocation made during 2008.

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Changes in the carrying amount of goodwill by segment are as follows (in millions):

| | Construction & DIY | Industrial | Security | Total |
|------------------------------------|-----------------------------------|-------------------|-----------------|--------------|
| Balance as of December 29, 2007 | \$ 214.2 | \$ 387.3 | \$ 911.0 | \$ 1,512.5 |
| Acquisitions during the year | | | 173.0 | 173.0 |
| Foreign currency translation/other | (0.7) | (4.6) | (15.5) | (20.8) |
| Balance as of September 27, 2008 | \$ 213.5 | \$ 382.7 | \$ 1,068.5 | \$ 1,664.7 |

I. Restructuring Charges and Asset Impairments

At September 27, 2008, the Company's restructuring reserve balance was \$25.4 million. This will be substantially expended during 2008, aside from approximately \$7 million pertaining to the Facom acquisition for which the timing of payments depends upon the actions of certain European governmental agencies. A summary of the Company's restructuring reserve activity from December 29, 2007 to September 27, 2008 is as follows (in millions):

| | 12/29/07 | Net Additions | Usage | Currency | 9/27/08 |
|-------------------------|-----------------|--------------------------|--------------|-----------------|----------------|
| Acquisitions | | | | | |
| Severance | \$ 18.8 | \$ 0.8 | \$ (6.0) | | \$ 13.6 |
| Facility Closure | 1.6 | 1.4 | (0.9) | | 2.1 |
| Other | 1.0 | | (0.4) | | 0.6 |
| 2008 Actions | | 25.0 | (15.1) | (0.8) | 9.1 |
| Pre-2008 Actions | 2.3 | | (2.3) | | |
| | \$ 23.7 | \$ 27.2 | \$ (24.7) | \$ (0.8) | \$ 25.4 |

2008 Actions: During the first nine months of 2008, the Company initiated cost reduction initiatives in order to maintain its cost competitiveness. Severance and related charges of \$20.0 million were recorded during the first nine months relating to the reduction of approximately 700 employees. In addition to severance, \$5.0 million was recorded for asset impairments primarily relating to the exit of a business. Approximately \$10.9 million of the total charges pertained to the Construction and DIY segment; \$6.2 million to the Industrial segment; and \$7.9 million to the Security segment. Of these amounts, \$15.1 million has been utilized to date, with \$9.1 million of reserves remaining as of September 27, 2008.

Pre-2008 Actions: During 2007, the Company initiated \$11.8 million of cost reduction actions in various businesses. These actions were comprised of the severance of 525 employees and the exit of a leased facility. This entire amount has been utilized as of September 27, 2008.

Acquisition Related: During the third quarter of 2008, \$2.0 million of reserves were established primarily relating to the Sonitrol acquisition. Of this amount, \$0.6 million was for severance of approximately 100 employees and \$1.4 million relates to the planned closure of 9 facilities. During 2007, \$3.0 million of reserves were established for HSM in purchase accounting. Of this amount, \$1.1 million was for severance of approximately 80 employees and \$1.9 million related to the closure of 13 branch facilities. As of September 27, 2008, \$2.1 million has been utilized, leaving \$0.9 million remaining. The Company also utilized \$6.7 million of restructuring reserves during the first nine months of 2008 established for various other current year and prior year acquisitions. As of September 27, 2008, \$16.3 million in accruals for restructuring remain, primarily relating to the Facom, HSM and Sonitrol acquisitions.

Table of Contents**J. Credit Facility**

On February 27, 2008, the Company amended its credit facility to provide for an increase and extension of its committed credit facility to \$800 million from \$550 million. In May 2008, the Company's commercial paper program was also increased to \$800 million. The credit facility continues to be designated as a liquidity back-stop for the Company's commercial paper program. The amended and restated facility expires in February 2013.

K. Financial Instruments

In an effort to continue to optimize the mix of fixed versus floating rate debt in the Company's capital structure, in May 2008 the Company entered into a \$200 million interest rate swap. The swap matures November 2012, matching the maturity of the outstanding 4.9%, \$200 million Note. On the interest rate swap, the Company will pay a floating rate of interest and will receive a fixed rate of interest equal to the fixed rate payable on the Note. The swap hedges the fluctuations in the fair value resulting from changes in interest rates. At September 27, 2008, the fair value of this interest rate swap was a loss of \$1.2 million. This amount is recorded in Long-term debt in the Consolidated Balance Sheet to recognize the change in the fair value of the long-term debt and in Other liabilities to record the fair value of the swap. The swap is highly effective and, accordingly, no amount is recorded for ineffectiveness in the Consolidated Statement of Operations.

L. Commitments and Contingencies

The Company is involved in various legal proceedings relating to environmental issues, employment, product liability and workers' compensation claims and other matters. The Company periodically reviews the status of these proceedings with both inside and outside counsel, as well as an actuary for risk insurance. Management believes that the ultimate disposition of these matters will not have a material adverse effect on the Company's operations or financial condition taken as a whole.

The Company's policy is to accrue environmental investigatory and remediation costs for identified sites when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. As of September 27, 2008 and December 29, 2007, the Company had reserves of \$29.3 million and \$30.1 million, respectively, primarily for remediation activities associated with company-owned properties as well as for Superfund sites. The range of environmental remediation costs that is reasonably possible is \$19.5 million to \$52.5 million which is subject to change in the near term.

As of September 27, 2008 the Company has commitments to purchase Générale de Protection (GdP) and Scan Modul for approximately \$166 million and \$20 million in cash, respectively. Both acquisitions closed on October 1 as disclosed in Note Q. Subsequent Events.

M. Guarantees

The Company's financial guarantees at September 27, 2008 were as follows (in millions):

| | Term | Maximum Potential Payment | Liability Carrying Amount |
|--|---------------|----------------------------------|----------------------------------|
| Guarantees on the residual values of leased properties | Up to 6 years | \$ 80.5 | \$ 19.2 |

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| | | | |
|---|------------------|----------|---------|
| Standby letters of credit | Generally 1 year | 35.1 | |
| Commercial customer financing arrangements | Up to 5 years | 17.7 | 15.3 |
| Guarantee on the external Employee Stock Ownership Plan (ESOP) borrowings | Through 2009 | 2.0 | 2.0 |
| | | \$ 135.3 | \$ 36.5 |

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The Company has guaranteed a portion of the residual value arising from its synthetic lease and U.S. master personal property lease programs. The lease guarantees aggregate \$80.5 million while the fair value of the underlying assets is estimated at \$96.9 million. The related assets would be available to satisfy the guarantee obligations and therefore it is unlikely the Company will incur any future loss associated with these lease guarantees. The Company has recorded \$19.2 million in debt pertaining to one of these synthetic leases. The Company has issued \$35.1 million in standby letters of credit that guarantee future payments which may be required under certain insurance programs. The Company provides various limited and full recourse guarantees to financial institutions that provide financing to U.S. and Canadian Mac Tool distributors for their initial purchase of the inventory and truck necessary to function as a distributor. In addition, the Company provides a full recourse guarantee to a financial institution that extends credit to certain end retail customers of its U.S. Mac Tool distributors. The gross amount guaranteed in these arrangements is \$17.7 million and the \$15.3 million carrying value of the guarantees issued is recorded in debt and other liabilities as appropriate in the consolidated balance sheet.

The Company provides product and service warranties which vary across its businesses. The types of warranties offered generally range from one year to limited lifetime, while certain products carry no warranty or customer service considerations. Further, the Company at times incurs discretionary costs to service its products in connection with product performance issues. Historical warranty and service claim experience forms the basis for warranty obligations recognized. Adjustments are recorded to the warranty liability as new information becomes available.

The changes in the carrying amount of product and service warranties for the nine months ended September 27, 2008 are as follows (in millions):

| | |
|----------------------------------|---------|
| Balance December 29, 2007 | \$ 63.7 |
| Warranties and guarantees issued | 16.7 |
| Warranty payments | (17.2) |
| Currency and other | 1.7 |
| Balance September 27, 2008 | \$ 64.9 |

N. Net Periodic Benefit Cost Defined Benefit Plans

Following are the components of net periodic benefit cost for the three and nine month periods ended September 27, 2008 and September 29, 2007 (in millions):

| | Third Quarter | | | | | |
|---|-------------------------|-------------|-----------------------|-------------|-----------------------|-------------|
| | Pension Benefits | | | | Other Benefits | |
| | U.S. Plans | | Non-U.S. Plans | | U.S. Plans | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | \$ 0.7 | \$ 0.6 | \$ 0.9 | \$ 0.9 | \$ 0.2 | \$ 0.4 |
| Interest cost | 2.4 | 2.2 | 3.2 | 3.5 | 0.2 | 0.2 |
| Expected return on plan assets | (2.6) | (2.5) | (3.8) | (4.6) | | |
| Amortization of transition liability | | | | 0.1 | | |
| Amortization of prior service cost/(credit) | 0.3 | (0.8) | | | (0.1) | |
| Amortization of net (gain) loss | 0.1 | 0.1 | 0.6 | 1.3 | (0.1) | (0.2) |
| Curtailement (gain) loss | | 1.1 | (0.2) | 0.3 | | |

| | | | | | | |
|---------------------------|--------|--------|--------|--------|--------|--------|
| Net periodic benefit cost | \$ 0.9 | \$ 0.7 | \$ 0.7 | \$ 1.5 | \$ 0.2 | \$ 0.4 |
|---------------------------|--------|--------|--------|--------|--------|--------|

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| | Year to Date | | | | | |
|---|-------------------------|-------------|-----------------------|-------------|-----------------------|-------------|
| | Pension Benefits | | | | Other Benefits | |
| | U.S. Plans | | Non-U.S. Plans | | U.S. Plans | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | \$ 2.0 | \$ 2.0 | \$ 3.4 | \$ 3.3 | \$ 0.8 | \$ 0.9 |
| Interest cost | 7.3 | 6.8 | 11.3 | 11.1 | 1.0 | 1.0 |
| Expected return on plan assets | (7.7) | (7.3) | (13.9) | (13.6) | | |
| Amortization of transition liability | | | 0.1 | 0.1 | | |
| Amortization of prior service cost/(credit) | 1.0 | | 0.1 | 0.1 | (0.2) | (0.1) |
| Amortization of net (gain) loss | 0.1 | 0.4 | 2.8 | 4.7 | (0.2) | (0.2) |
| Curtailment loss | | 1.1 | 0.9 | 0.3 | | |
| Net periodic benefit cost | \$ 2.7 | \$ 3.0 | \$ 4.7 | \$ 6.0 | \$ 1.4 | \$ 1.6 |

O. Fair Value Measurements

SFAS 157 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value. SFAS 157 requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs and significant value drivers are observable.

Level 3 Instruments that are valued using unobservable inputs.

The Company holds various derivative financial instruments that are employed to manage risks, including foreign currency and interest rate exposures. These financial instruments are carried at fair value and are included within the scope of SFAS 157. The Company determines the fair value of derivatives through the use of matrix or model pricing, which utilizes verifiable inputs such as market interest and currency rates. When determining the fair value of these financial instruments for which Level 1 evidence does not exist, the Company considers various factors including the following: exchange or market price quotations of similar instruments, time value and volatility factors, the Company's own credit rating and the credit rating of the counter-party.

The following table presents the fair value and the hierarchy levels, for financial assets and liabilities that are measured at fair value as of September 27, 2008 (in millions):

| Total Carrying Value at | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|------------------------------------|--|--|--|
|------------------------------------|--|--|--|

**September 27,
2008**

| | | | | | | |
|------------------------|----|------|----|----|------|----|
| Derivative assets | \$ | 30.6 | \$ | \$ | 30.6 | \$ |
| Derivative liabilities | \$ | 97.4 | \$ | \$ | 97.4 | \$ |

P. Discontinued Operations

On July 25, 2008, the Company sold its CST/berger laser leveling and measuring business, which was formerly in its CDIY segment, to Robert Bosch Tool Corporation for \$204 million in cash. CST/berger manufactures and distributes surveying accessories, as well as building and construction instruments primarily in the Americas and Europe. The sale resulted in an \$84.3 million after tax gain which was recorded during the third quarter of 2008. Goodwill disposed of in this divestiture amounted to \$26.9 million.

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During the second quarter of 2008, a small business (Facom Lista) in the industrial segment was sold. This sale resulted in a \$1.6 million gain, net of tax, which has been reported in discontinued operations. Goodwill disposed of in this divestiture amounted to \$0.9 million.

The Company has classified the assets and liabilities of a small business (Blick Alfia) in the security segment as held for sale. This business will be sold in the fourth quarter of 2008. The divestitures of these three businesses have been made pursuant to the Company's growth and portfolio diversification strategy.

In accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of operations of CST/berger and the two other small businesses for the periods presented have been reported as discontinued operations. The operating results of these entities are summarized as follows for the nine months ended September 27, 2008 and September 29, 2007 (in millions):

| | 2008 | 2007 |
|---------------------------------|-------------|-------------|
| Net sales | \$ 48.5 | \$ 76.4 |
| Pretax earnings from operations | 9.5 | 12.4 |
| Pretax gain on sale | 129.7 | |
| Pretax earnings | \$ 139.2 | \$ 12.4 |

The assets and liabilities of Blick Alfia are classified as held for sale in the Consolidated Balance Sheet at September 27, 2008. CST/berger and the two other small businesses have been classified as held for sale in the Consolidated Balance Sheets at December 29, 2007. The assets and liabilities of the businesses classified as held for sale as of September 27, 2008 and of December 29, 2007 are as follows (in millions):

| | 2008 | 2007 |
|--------------------------------------|-------------|-------------|
| Accounts receivable | \$ 1.8 | \$ 17.3 |
| Inventories | 1.1 | 10.9 |
| Other assets | 1.1 | 3.0 |
| Property, plant and equipment | 0.2 | 4.5 |
| Goodwill and other intangible assets | 0.0 | 46.0 |
| Total assets | \$ 4.2 | \$ 81.7 |
| Accounts payable | \$ 0.9 | \$ 9.0 |
| Accrued expenses | 1.5 | 8.6 |
| Other liabilities | 0.0 | 0.9 |
| Total liabilities | \$ 2.4 | \$ 18.5 |

Q. Subsequent Events

On September 29, 2008 the Company completed an offering of \$250 million aggregate principal amount of senior notes which are due in 2013. These notes bear a fixed coupon of 6.15% per annum. The Company will use the net proceeds from the offering to reduce borrowings under its existing commercial paper program and/or other short term obligations and for other general corporate purposes.

On October 1, 2008 the Company completed the acquisition of Générale de Protection (GdP) for \$166 million in cash. GdP, headquartered in Vitrolles, France, is a leading provider of audio and video security monitoring services, primarily for small and mid-sized businesses located in France and Belgium. Also, on October 1, 2008, the Company completed the purchase of Scan Modul for \$20 million in cash. Scan Modul, headquartered in Hillerod, Denmark, provides engineered healthcare storage equipment and services throughout Europe. The acquisition of Scan Modul expands the Company's healthcare storage technology offering provided by its existing InnerSpace business acquired in July 2007.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The financial and business analysis below provides information which the Company believes is relevant to an assessment and understanding of its consolidated financial position, results of operations and cash flows. This financial and business analysis should be read in conjunction with the consolidated financial statements and related notes.

The following discussion contains statements reflecting the Company's views about its future performance that constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which the Company operates and management's beliefs and assumptions. Any statements contained herein (including without limitation statements to the effect that The Stanley Works or its management believes, expects, anticipates, plans and similar expressions) that are not statements of historical fact should be considered forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. There are a number of important factors that could cause actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth, or incorporated by reference, below under the heading **Cautionary Statements**. The Company does not intend to update publicly any forward-looking statements whether as a result of new information, future events or otherwise.

OVERVIEW

The Company is a diversified worldwide supplier of tools and engineered solutions for professional, industrial, construction, and do-it-yourself (DIY) use, as well as engineered solutions and security solutions for industrial and commercial applications. Its operations are classified into three business segments: Construction & DIY (CDIY), Industrial and Security. The CDIY segment manufactures and markets hand tools, storage systems, and fasteners, as these products are principally utilized in construction and do-it-yourself projects. These products are sold primarily to professional end users and distributed through retailers (including home centers, mass merchants, hardware stores, and retail lumber yards). The Industrial segment manufactures and markets professional mechanics tools and storage systems, plumbing, heating, air conditioning and roofing tools, assembly tools and systems, hydraulic tools and specialty tools (Stanley supply and services). These products are sold to industrial customers and distributed primarily through third party distributors as well as direct sales forces. The Security segment is a provider of access and security solutions primarily for retailers, educational, financial and healthcare institutions, as well as commercial, governmental and industrial customers. The Company provides an extensive suite of mechanical and electronic security integration systems, software, related installation, maintenance, and a variety of security services including security monitoring services, electronic integration systems, software, related installation and maintenance services, automatic doors, door closers, exit devices, hardware and locking mechanisms.

For several years, the Company has pursued a diversification strategy to enable profitable growth. The strategy involves industry, geographic and customer diversification, as exemplified by the expansion of security solution product offerings, the growing proportion of sales outside the U.S., and the deliberate reduction of the Company's dependence on sales to U.S. home centers and mass merchants. Execution of this strategy has entailed approximately \$2.5 billion of acquisitions since the beginning of 2002, several divestitures, and increased brand investments. Additionally, the strategy reflects management's vision to build a growth platform in security while expanding the valuable branded tools platform. Over the past several years, the Company has generated strong free cash flow and received substantial proceeds from divestitures that enabled a transformation of the business portfolio. Refer to the **Business Overview** section of Management's Discussion and Analysis of Financial Condition and Results of

Operations in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2007 for additional strategic discussion.

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Key developments in 2008 pursuant to this diversification and profitable growth strategy include the following.

In July 2008, the Company completed the sale of the CST/berger laser leveling and measuring business for \$204 million in cash. The transaction generated a pre-tax book gain of \$128 million, and \$152 million in net after-tax cash proceeds. CST/berger had 2007 revenues of \$80 million. The Company also announced plans to exit several other small, non-strategic businesses with approximately \$50 million in annual revenues. As a result, CST/berger, along with two other small businesses, is reported in discontinued operations and prior periods have been recast for comparability.

On July 18, 2008, the Company completed the acquisitions of Sonitrol Corporation (Sonitrol), for \$281 million in cash, and Xmark Corporation (Xmark), for \$47 million in cash. Sonitrol, with annual revenue totaling approximately \$110 million, provides security monitoring services, access control and fire detection systems to commercial customers in North America via two monitoring centers and a national multi-channel distribution network. Sonitrol will complement the product offering of the pre-existing security integration and monitoring businesses, including HSM acquired in early 2007. Xmark, headquartered in Canada, markets and sells radio frequency identification (RFID)-based systems used to identify, locate and protect people and assets. Xmark annual revenues exceed \$30 million and it will enhance the Company's personal security business. Both acquisitions are reported in the Security segment.

On October 1, 2008 (in the fiscal fourth quarter), the Company completed the acquisition of Générale de Protection (GdP) for \$166 million (118 million euros) in cash. GdP, headquartered in Vitrolles, France, is a leading provider of audio and video security monitoring services, primarily for small and mid-sized businesses located in France and Belgium. GdP, with 2007 revenues totaling approximately \$87 million (64 million euros) represents Stanley's first significant expansion of its electronic security platform in continental Europe. GdP is expected to have no effect on 2008 earnings from continuing operations and have a modest accretive impact in 2009.

RESULTS OF OPERATIONS

Below is a summary of consolidated operating results for the three and nine months ending September 27, 2008, followed by an overview of performance by business segment. The terms *organic* and *core* are utilized to describe results aside from the impact of acquisitions during their initial 12 months of ownership. This ensures appropriate comparability to operating results in the prior period.

Net Sales: Net sales from continuing operations were \$1.120 billion in the third quarter of 2008 as compared to \$1.106 billion in the third quarter of 2007, representing an increase of \$14 million or 1%. Acquisitions, primarily Sonitrol and Xmark, contributed 3% of net sales. Foreign currency translation generated a 2% increase in sales, as most major currencies in all regions strengthened relative to the U.S. dollar compared to prior year, but weakened versus levels in the second quarter of 2008. Aside from acquisitions and currency, sales declined 4% attributable to a 7% unit volume decline which was offset partially by favorable pricing of 3%. Nearly 2% of the unit volume decline pertained to the previously disclosed loss of a major customer in the hardware business within the security segment (this impact will anniversary in the fourth quarter of 2008). Approximately half of the total unit volume decline occurred in the CDIY segment, as North America continued to be adversely impacted by the contraction in residential construction markets while demand in other regions, particularly Europe, further softened in the third quarter. The remaining unit volume decline was predominantly in the industrial segment, most significantly in the North American automotive repair business reflecting the deepening U.S. economic downturn. The European economy also weakened in the third quarter unfavorably affecting all of the Company's industrial segment businesses. This was partially offset by growth in the U.S. engineered storage and hydraulic tool businesses.

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Year-to-date net sales from continuing operations were \$3.348 billion in 2008, a \$108 million or 3% increase, versus \$3.240 billion for the first nine months of 2007. Acquisition growth contributed 2% of the increase, attributable to Sonitrol, Xmark, and several small security segment acquisitions. Foreign currency provided a 4% increase, pricing 3%, while volume decreased 5% compared to the prior year. The businesses contributing to the first nine months sales performance are mainly the same as those discussed above pertaining to the third quarter. However in the first six months of 2008, Europe achieved healthy growth which subsided in the third quarter.

Gross Profit: Gross profit from continuing operations was \$431 million, or 38.5% of net sales, in the third quarter of 2008, as compared with \$422 million of gross profit, or 38.1% of net sales, in the prior year. Acquisitions contributed \$19 million to gross profit. Core gross margin represented 38.1% of sales consistent with the prior year as the favorable impacts of customer price increases and productivity were offset primarily by cost inflation and lower unit volumes. The pace of energy and commodity cost inflation, particularly steel, which accelerated dramatically this summer, stabilized to some extent later in the third quarter. As a result, the Company's estimate of full year 2008 inflation remains at approximately \$150 million, which management plans to partially mitigate through various customer pricing actions that are expected to recover nearly 90% of this impact.

On a year-to-date basis, gross profit from continuing operations was \$1.279 billion, or 38.2% of net sales, in 2008, compared to \$1.230 billion, or 38.0% of net sales, for the corresponding 2007 period. The increase in gross profit was attributable to acquisitions, primarily Sonitrol and Xmark. The factors affecting the year-to-date performance are the same as those discussed pertaining to the third quarter. Successful execution of productivity projects and customer pricing increases collectively more than offset nearly \$100 million of year-to-date cost inflation.

SG&A expenses: Selling, general and administrative (SG&A) expenses from continuing operations, inclusive of the provision for doubtful accounts, were \$275 million, or 24.6% of net sales, in the third quarter of 2008, compared to \$252 million, or 22.8% of net sales, in the prior year. On a year-to-date basis, SG&A was \$833 million, or 24.9% of net sales, versus \$770 million, or 23.8% of net sales, in 2007. Acquisitions contributed \$11 million and \$22 million of the SG&A increase in the quarter, and year-to-date, respectively. The remaining increase in SG&A primarily reflects foreign currency impact, inflation and strategic investments in emerging markets, offset partially by cost reduction actions.

Interest and Other-net: Net interest expense from continuing operations in the third quarter of 2008 was \$18 million compared to \$20 million in 2007. The decrease is primarily due to repayment of \$150 million of debt that matured in November 2007 as well as increased interest income earned on higher foreign cash balances in the current year. Year-to-date net interest expense from continuing operations was \$55 million in 2008 compared to \$61 million over the first nine months of 2007. The reduction pertained to the same factors discussed in relation to the third quarter. Additionally, interest expense related to commercial paper declined as a result of lower borrowing costs in the current year.

Other-net expenses from continuing operations were \$29 million in the third quarter of 2008 versus \$25 million in 2007. Higher intangible asset amortization from the Sonitrol and Xmark acquisitions was the primary driver of this increase. Year-to-date other-net expenses from continuing operations were \$70 million in 2008, relatively consistent with \$68 million in 2007.

Income Taxes: The Company's effective income tax rate from continuing operations was 25.0% in the third quarter of this year, compared with 26.9% in the prior year's quarter. The year-to-date effective income tax rate from continuing operations was 25.9% in 2008 versus 26.4% in 2007. The lower effective tax rate in the current year is mainly attributable to a decrease in earnings in certain jurisdictions with higher tax rates.

Discontinued Operations: Net earnings from discontinued operations amounted to \$86 million for the third quarter of 2008, up from \$3 million in 2007, primarily due to the \$84 million after-tax gain realized on the sale of CST/berger. Net earnings from discontinued operations for the first nine months of 2008 totaled \$93 million versus \$8 million in the prior year. As discussed more fully in Note P,

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discontinued operations primarily reflects the operating results of the CST/berger business which was sold on July 25, 2008.

Business Segment Results

The Company's reportable segments are an aggregation of businesses that have similar products and services, among other factors. The Company utilizes segment profit, which is defined as net sales minus cost of sales and SG&A (aside from corporate overhead expense), and segment profit as a percentage of net sales to assess the profitability of each segment. Segment profit excludes the corporate overhead expense element of SG&A, interest income, interest expense, other-net (inclusive of intangible asset amortization expense), restructuring, and income tax expense. Corporate overhead is comprised of world headquarters facility expense, costs for the executive management team and for certain centralized functions that benefit the entire Company but are not directly attributable to the businesses, such as legal and corporate finance functions. The Company's operations are classified into three business segments: Construction & DIY, Industrial, and Security.

Security: Security sales from continuing operations increased 7% to \$395 million during the third quarter of 2008 from \$371 million in the corresponding 2007 period. Acquisitions, primarily Sonitrol and Xmark, contributed 10% of the sales increase. Pricing increased nearly 3%, while unit volume declined 6% attributable primarily to the previously disclosed loss of a major customer in the hardware business.

Year-to-date net sales from continuing operations were \$1.094 billion in 2008 as compared to \$1.057 billion in 2007, an increase of 4%. Acquisitions accounted for 5%; currency contributed 1%; pricing increased 2%; and volume declined 5%. In addition to the factors described in the analysis of the third quarter, segment sales in the first nine months reflected growth in convergent security, which benefited from strength in national accounts in the U.S., and robust sales in both Canada and Great Britain.

Security segment profit amounted to \$74 million, or 18.7% of net sales, for the third quarter of 2008 as compared with \$68 million, or 18.5% of net sales, in the prior year. On a year-to-date basis, segment profit was \$193 million, or 17.6% of net sales, in 2008 compared to \$181 million, or 17.1% of net sales, in the prior year period. The Sonitrol acquisition was accretive to the segment profit rate. The strong segment profit was further enabled by the successful reverse integration of the legacy systems integration business into HSM. Additionally, productivity and customer pricing benefits largely offset cost inflation and the hardware volume impact.

Industrial: Industrial sales of \$298 million in the third quarter of 2008 were flat with the prior year. Foreign currency translation provided a 4% increase, and favorable pricing 2%, which were offset by a 6% unit volume decrease. The North American automotive repair business was adversely affected by distributor attrition and the deteriorating U.S. economy. European sales volumes which had been positive in the first half of the year, declined in the third quarter as Facom and other businesses reflected the contraction of the European economy. These volume declines were partially offset by strong sales growth in U.S.-based engineered storage and to a lesser extent the hydraulic tools business. The sales growth in engineered storage was driven by government spending, particularly by army and navy bases, and also strength with commercial customers.

Year-to-date net sales from continuing operations were \$969 million in 2008, up 7% or \$61 million as compared to 2007. The InnerSpace acquisition contributed nearly 2% of the sales increase. Foreign currency generated a 6% favorable impact, customer pricing a 2% increase while organic unit volume declined 3%. The factors resulting in the Industrial segment's nine month performance are primarily the same as those discussed pertaining to the third quarter. However, in the first six months of 2008, Europe achieved healthy growth which subsided in the third quarter.

Industrial segment profit was \$40 million, or 13.5% of net sales, for the third quarter of 2008, compared to \$41 million, or 13.9% of net sales, in 2007. Industrial segment profit improved 50 basis points

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sequentially over the second quarter but declined 40 basis points versus the prior year. Year-to-date segment profit for the Industrial segment was \$133 million, or 13.7% of net sales, for 2008, flat compared with 2007 when it represented 14.6% of net sales. Customer pricing offset inflation in the third quarter; inflation had temporarily outpaced pricing in the first half. The segment profit rate was affected by volume declines as well as unfavorable product mix in both the hydraulic tools and Mac Tools businesses, partially offset by productivity improvements.

Construction & Do-It-Yourself (CDIY): CDIY sales of \$427 million during the third quarter of 2008 represented a 2% decrease from \$438 million in the third quarter of 2007. Unit volume declined 9%, and was partially offset by favorable pricing and foreign currency of 4% and 3% respectively. Volume was negatively impacted by the contraction in residential construction in both the Americas and Europe, as well as a decline in industrial markets served by fastening systems, reflecting increasingly weak macro-economic conditions. Fastening systems continued its planned shift toward more profitable business which resulted in additional volume pressure. Pervasive pricing actions were implemented in order to mitigate cost inflation across the entire segment.

Year-to-date net sales from continuing operations were \$1.284 billion in 2008 as compared to \$1.274 billion in 2007, an increase of 1%. Favorable foreign currency translation and pricing contributed 4% and 3% of the increase, respectively, while unit volume declined 6%. The most significant decrease was in North American markets due to the recessionary U.S. environment. Europe had essentially flat unit volume in the first half of 2008 but declined in the third quarter.

Segment profit was \$54 million for the third quarter of 2008, compared to \$72 million, representing 12.7% and 16.5% of net sales respectively. CDIY made progress on customer pricing actions and manufacturing productivity within the quarter, however cost inflation and lower sales volume pressures more than offset these benefits. On a year-to-date basis, segment profit was \$167 million, or 13.0% of net sales, compared to \$194 million, or 15.2% of net sales in 2007. The year-to-date performance reflects the same factors discussed relating to the third quarter in addition to spending to develop emerging markets.

Restructuring Charges and Asset Impairments

At September 27, 2008, the Company's restructuring reserve balance was \$25.4 million. This will be substantially expended during 2008, aside from approximately \$7 million pertaining to the Facom acquisition for which the timing of payments depends upon the actions of certain European governmental agencies. A summary of the Company's restructuring reserve activity from December 29, 2007 to September 27, 2008 is as follows (in millions):

| | 12/29/07 | Net Additions | Usage | Currency | 9/27/08 |
|-------------------------|----------|---------------|-----------|----------|---------|
| Acquisitions | | | | | |
| Severance | \$ 18.8 | \$ 0.8 | \$ (6.0) | \$ | \$ 13.6 |
| Facility Closure | 1.6 | 1.4 | (0.9) | | 2.1 |
| Other | 1.0 | | (0.4) | | 0.6 |
| 2008 Actions | | 25.0 | (15.1) | (0.8) | 9.1 |
| Pre-2008 Actions | 2.3 | | (2.3) | | |
| | \$ 23.7 | \$ 27.2 | \$ (24.7) | \$ (0.8) | \$ 25.4 |

2008 Actions: During the first nine months of 2008, the Company initiated cost reduction initiatives in order to maintain its cost competitiveness. Severance and related charges of \$20.0 million were recorded during the first nine months relating to the reduction of approximately 700 employees. In addition to severance, \$5.0 million was recorded for asset impairments primarily relating to the exit of a business. Approximately \$10.9 million of the total charges pertained to the Construction and DIY segment; \$6.2 million to the Industrial segment; and \$7.9 million to the Security segment. Of these

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amounts, \$15.1 million has been utilized to date, with \$9.1 million of reserves remaining as of September 27, 2008.

Pre-2008 Actions: During 2007, the Company initiated \$11.8 million of cost reduction actions in various businesses. These actions were comprised of the severance of 525 employees and the exit of a leased facility. This entire amount has been utilized as of September 27, 2008.

Acquisition Related: During the third quarter of 2008, \$2.0 million of reserves were established primarily relating to the Sonitrol acquisition. Of this amount, \$0.6 million was for severance of approximately 100 employees and \$1.4 million relates to the planned closure of 9 facilities. During 2007, \$3.0 million of reserves were established for HSM in purchase accounting. Of this amount, \$1.1 million was for severance of approximately 80 employees and \$1.9 million related to the closure of 13 branch facilities. As of September 27, 2008, \$2.1 million has been utilized, leaving \$0.9 million remaining. The Company also utilized \$6.7 million of restructuring reserves during the first nine months of 2008 established for various other current year and prior year acquisitions. As of September 27, 2008, \$16.3 million in accruals for restructuring remain, primarily relating to the Facom, HSM and Sonitrol acquisitions.

FINANCIAL CONDITION***Liquidity, Sources and Uses of Capital:***

Operating and Investing Activities: Cash flow from operations was \$166 million in the third quarter of 2008 compared to \$130 million in 2007. The increase primarily relates to strong working capital performance, partially offset by lower earnings aside from the gain on the sale of CST/berger. Year-to-date cash flow from operations was \$357 million compared to \$326 million in the prior year. The \$31 million year-to-date increase in cash flow from operations is mainly attributable to the same factors discussed pertaining to the third quarter along with lower restructuring payments in the current year.

Capital and software expenditures were \$28 million in the third quarter of 2008 versus \$12 million in 2007. On a year-to-date basis capital and software expenditures were \$82 million representing a \$27 million increase compared to the prior year. The increase primarily pertains to software investments as the Company is in the midst of North American systems implementations, along with physical security and other facility-related investments.

Free cash flow, as defined in the following table, was \$138 million in the third quarter of 2008 compared to \$118 million in the corresponding 2007 period. The Company believes free cash flow is an important measure of its liquidity, as well as its ability to fund future growth and provide a dividend to shareowners. Free cash flow does not include deductions for mandatory debt service, other borrowing activity, discretionary dividends on the Company's common stock and business acquisitions, among other items.

| (Millions of Dollars) | 2008 | 2007 |
|---|-------------|-------------|
| Net cash provided by operating activities | \$ 166 | \$ 130 |
| Less: capital and software expenditures | (28) | (12) |
| Free cash flow | \$ 138 | \$ 118 |

In the third quarter of 2008 the Company received \$163 million in cash from the sale of the CST/berger business, net of taxes paid and transaction costs. Approximately \$11 million in cash outflows for taxes due on the gain are expected to occur in the fourth quarter. On a year-to-date basis cash inflows from the sale of businesses were \$166 million

reflecting a small European divestiture in addition to CST/berger.

For the third quarter of 2008, acquisition spending totaled \$336 million mainly due to cash paid for the Sonitrol and Xmark acquisitions, compared to \$64 million in 2007, primarily for the InnerSpace

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acquisition. Acquisitions entailed a \$364 million cash outflow for the first three quarters of 2008 versus \$633 million in 2007, which reflected the January 2007 acquisition of the HSM security monitoring business.

Financing Activities:

There were no repurchases of common stock during the third quarter of 2008 or 2007. On a year-to-date basis, common stock repurchase activity was \$102 million (for 2.2 million shares) in 2008, down slightly from \$107 million (for 1.7 million shares) in 2007. The Company will continue to assess the possibility of repurchasing more of its outstanding common stock, based on a number of factors including the level of acquisition activity, the market price of the Company's common stock and the current financial condition of the Company.

Proceeds from the issuance of common stock during the third quarter of 2008 amounted to \$7 million, versus \$4 million in the prior year, which reflected higher levels of stock option exercises. Proceeds from the issuance of common stock and warrants totaled \$17 million for the first three quarters of 2008 and \$90 million for the corresponding 2007 period. The higher amount in 2007 is attributable to stock option exercises as well as \$19 million of proceeds from warrants sold in connection with the March, 2007 equity units offering to finance the HSM acquisition.

Net proceeds from short-term borrowings amounted to a cash outflow of \$32 million in the third quarter of 2008, compared with a \$13 million inflow in 2007. Net proceeds from short-term borrowings totaled \$141 million in the first nine months of 2008 versus \$146 million in 2007, with over \$100 million of proceeds in each year utilized to fund share repurchases. The remaining net short-term borrowings in 2008 pertained to acquisition funding and cash outflows for the termination of the U.S. receivable securitization facility. There were nominal long-term borrowings in 2008, while the \$530 million of proceeds for the year-to-date 2007 period represents the \$330 million in five-year convertible notes and \$200 million in three-year term notes issued to finance the HSM acquisition. The \$49 million outflow in the prior year for the bond hedge premium also pertained to the financing of the HSM acquisition.

Cash dividends on common stock totaled \$25 million for the third quarter of both 2008 and 2007. On a year-to-date basis the cash outflow for dividends was \$74 million in 2008, down slightly from \$75 million in the prior year as the higher dividend rate per share in the current period was more than offset by lower outstanding shares.

Debt to Capital Ratio

The Company's debt to capital ratio was 47% as of September 27, 2008. Reflecting the credit protection measures that are incorporated into the terms of the \$450 million Enhanced Trust Preferred Securities (ETPS) issued in 2005 and the equity characteristics of the \$330 million in Equity Units issued in 2007, the debt to capital ratio of the Company is more fairly represented by apportioning 50% of the ETPS issuance and 50-75% of the Equity Units issuance to equity when making the ratio calculation. The resulting debt to capital ratio from these apportionments is 33-36% as of September 27, 2008. The equity content adjustments to reported debt are consistent with the treatment accorded these securities by the nationally recognized statistical ratings organizations that rate the Company's debt securities, and accordingly the equity-content-adjusted debt to capital ratio is considered a relevant measure of its financial condition.

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The following table reconciles the debt to capital ratio computed with reported debt and equity to the same measure after the equity content adjustments attributed to the ETPS and Equity Unit securities:

| (Millions of Dollars) | Reported on Balance Sheet (GAAP) | ETPS 50% equity content adjustment | Equity Units | | As Adjusted for Equity | |
|-------------------------|---|---|--------------|-------|---------------------------|---------|
| | | | 50 | 75% | Content (non-GAAP) | |
| Debt | \$ 1,651 | (225) | (165) | (247) | \$1,261 | \$1,179 |
| Equity | \$ 1,871 | 225 | 165 | 247 | \$2,261 | \$2,343 |
| Capital (debt + equity) | \$ 3,522 | | | | \$3,522 | |
| Debt to capital ratio | 47% | | | | 36% | 33% |

As disclosed in Note Q Subsequent Events, on September 29, 2008 the Company completed an offering of \$250 million aggregate principal amount of senior notes which are due in 2013. These notes bear a fixed coupon of 6.15% per annum. The Company utilized the net proceeds from the offering to reduce borrowings under its existing commercial paper program and/or other short term obligations and for other general corporate purposes.

OTHER COMMERCIAL COMMITMENTS

On February 27, 2008, the Company amended its credit facility to provide for an increase and extension of its committed credit facility to \$800 million from \$550 million. In May 2008, the Company's commercial paper program was also increased to \$800 million. The credit facility continues to be designated as a liquidity back-stop for the Company's commercial paper program. The amended and restated facility expires in February 2013.

Additionally, as discussed in Note E, Accounts Receivable, the Company terminated its accounts receivable securitization facility.

OTHER MATTERS

Critical Accounting Estimates: There have been no significant changes in the Company's critical accounting estimates during 2008. Refer to the Other Matters section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2007 for a discussion of the Company's critical accounting estimates.

New Accounting Standards: Refer to Note B for a discussion of new accounting standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no significant change in the Company's exposure to market risk during the third quarter of 2008. For discussion of the Company's exposure to market risk, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, contained in the Company's Form 10-K for the year ended December 29, 2007.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of management, including the Company's Chairman and Chief Executive Officer and its Executive Vice President and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e)), as of September 27, 2008, as required by Rule 13a-15(b) of the Securities Exchange Act of 1934. Based upon that evaluation, the Company's Chairman and Chief Executive Officer and its Executive Vice President and Chief Financial Officer have concluded that, as of September 27, 2008, the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in its periodic Securities and Exchange Commission filings. There has been no

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change in the Company's internal controls that occurred during the third quarter of 2008 that have materially affected or are reasonably likely to materially affect the registrant's internal control over financial reporting.

**CAUTIONARY STATEMENT
Under the Private Securities Litigation Reform Act of 1995**

Certain statements contained in this Quarterly Report on Form 10-Q that are not historical, including, but not limited to, the statements regarding the Company's ability to: (i) limit the full year 2008 inflation impact to \$150 million and recover approximately 90% of this impact through various customer pricing actions; (ii) build a growth platform in security while expanding the branded tools platform; (iii) dispose of various legal proceedings without material adverse effect on the operations or financial condition of the Company; and (iv) limit costs associated with environmental remediation to a range of \$20 million to \$53 million, are forward looking statements and are based on current expectations.

These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. There are a number of risks, uncertainties and important factors that could cause actual results to differ materially from those indicated by such forward-looking statements. In addition to any such risks, uncertainties and other factors discussed elsewhere herein, the risks, uncertainties and other factors that could cause or contribute to actual results differing materially from those expressed or implied in the forward looking statements include, without limitation, those set forth under Item 1A Risk Factors in the Company's Annual Report on Form 10-K (together with any material changes thereto contained in subsequent filed Quarterly Reports on Form 10-Q); those contained in the Company's other filings with the Securities and Exchange Commission; and those set forth below.

The Company's ability to deliver the Results is dependent upon: (i) the success of the Company's efforts to expand its tools and security businesses; (ii) the Company's success at new product development and introduction and at identifying and developing new markets; (iii) the success of the Company's efforts to manage freight costs, steel and other commodity costs; (iv) the success of the Company's efforts to sustain or increase prices in order to, among other things, offset or mitigate the impact of steel, freight, non-ferrous commodity and other commodity costs and other inflation increases; (v) the Company's ability to reduce its costs, increase its prices, change the manufacturing location or find alternate sources for products made in China in order to (a) mitigate the impact of an increase in the VAT rate applicable to products the Company makes in China and (b) mitigate the impact of an anti-dumping tariff recently imposed on certain nails imported from China; (vi) the Company's ability to identify and effectively execute productivity improvements and cost reductions while minimizing any associated restructuring charges; and (vii) the Company's ability to negotiate satisfactory payment terms under which the Company buys and sells goods, services, materials and products.

The Company's ability to deliver the Results is also dependent upon: (i) the continued success of the Company's marketing and sales efforts; (ii) the success of recruiting programs and other efforts to maintain or expand overall Mac Tools truck count versus prior years; (iii) the ability of the Company to maintain or improve production rates in the Company's manufacturing facilities, respond to significant changes in product demand and fulfill demand for new and existing products; (iv) the ability to continue successfully managing and defending claims and litigation; (v) the success of the Company's efforts to mitigate any cost increases generated by, for example, continued increases in the cost of energy or significant Chinese Renminbi or other currency appreciation; and (vi) the geographic distribution of the Company's earnings.

The Company's ability to achieve the Results will also be affected by external factors. These external factors include: pricing pressure and other changes within competitive markets; the continued consolidation of customers particularly in consumer channels; inventory management pressures on the

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Company's customers; the impact the tightened credit markets may have on the Company's customers and suppliers; increasing competition; changes in trade, monetary, tax and fiscal policies and laws; inflation; currency exchange fluctuations; the impact of dollar/foreign currency exchange and interest rates on the competitiveness of products and the Company's debt program; the strength of the world economy; the extent to which North American and European markets associated with homebuilding and remodeling continue to deteriorate; and the impact of events that cause or may cause disruption in the Company's manufacturing, distribution and sales networks such as war, terrorist activities, political unrest and recessionary or expansive trends in the economies of the world in which the Company operates, including, but not limited to, the extent and duration of current recessionary trends in the global economy.

Unless required by applicable securities laws, the Company undertakes no obligation to publicly update or revise any forward looking statements to reflect events or circumstances that may arise after the date hereof. Readers are advised, however, to consult any further disclosures made on related subjects in the Company's reports filed with the Securities and Exchange Commission.

PART II OTHER INFORMATION**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors as disclosed in the Company's 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2008.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Issuer Purchases of Equity Securities**

The following table provides information about the Company's purchases of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act during the three months ended September 27, 2008:

| | (a) Total Number Of Shares Purchased | Average Price Paid Per Share | Total Number Of Shares Purchased As Part Of A Publicly Announced Program | Maximum Number Of Shares That May Yet Be Purchased Under The Program |
|---------------------------------|---|---------------------------------------|--|--|
| 2008 | | | | |
| June 29 - August 2 | 480 | \$ 44.89 | | |
| August 3 - August 30 | 84 | 47.24 | | |
| August 31 - September 27 | 564 | \$ 45.24 | | |

(a) The shares of common stock in this column were deemed surrendered to the Company by participants in various of the Company's benefit plans to satisfy the taxes related to the vesting or delivery of a combination of restricted

share units and long-term incentive shares under those plans.

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ITEM 6. EXHIBITS

- (4) Officers Certificate relating to 6.15% Notes due 2013 (incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K dated September 29, 2008).
- (11) Statement re computation of per share earnings (the information required to be presented in this exhibit appears in Note C to the Company's Condensed Consolidated Financial Statements set forth in this Quarterly Report on Form 10-Q).
- (31)(i)(a) Certification by Chief Executive Officer pursuant to Rule 13a-14(a)
- (i)(b) Certification by Chief Financial Officer pursuant to Rule 13a-14(a)
- (32)(i) Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (ii) Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE STANLEY WORKS

By:

/s/ James M. Loree

James M. Loree
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: November 3, 2008