STANLEY WORKS
Form 10-K
February 27, 2007

The Stanley Works

10-K REPORT
FOR 2006

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

FORM 10-K

ANNUAL REPORT
PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 30, 2006

OR

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

For the transition period from __________________ to __________________

COMMISSION FILE 1-5224

THE STANLEY WORKS

(Exact Name Of Registrant As Specified In Its Charter)

Connecticut (State Or Other Jurisdiction Of Incorporation Or Organization)	06-0548860 (I.R.S. Employer Identification Number)
1000 Stanley Drive New Britain, Connecticut (Address Of Principal Executive Offices)	06053 (Zip Code)

860-225-5111

(Registrant's Telephone Number)

Securities Registered Pursuant To Section 12(b) Of The Act:

Title Of Each Class	Name Of Each Exchange On Which Registered
Common Stock-$2.50 Par Value per Share	New York Stock Exchange

Securities Registered Pursuant To Section 12(g) Of The Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

Yes X No ___

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes ___ No X

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 and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ___

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

Large accelerated filer X Accelerated filer ___ Non-accelerated filer ___

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes ___ No X

As of June 30, 2006, the aggregate market values of voting common equity held by non-affiliates of the registrant was $3,820,562,881 based on the New York Stock Exchange closing price for such shares on that date. On February 14, 2007, the registrant had 82,813,505 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed pursuant to Regulation 14A within 120 days after the end of the registrant's fiscal year are incorporated by reference in Part III of the Annual Report on Form 10-K.

FORM 10-K

PART I

ITEM 1. BUSINESS

1(a) GENERAL DEVELOPMENT OF BUSINESS

(i) General. The Stanley Works (''Stanley'' or the ''Company'') was founded in 1843 by Frederick T. Stanley and incorporated in 1852. Stanley is a worldwide producer of tools for professional, industrial and consumer use and security products. Stanley® is a brand recognized around the world for quality and value.

In 2006, Stanley had net sales of $4.0 billion from continuing operations and employed approximately 17,600 people worldwide. The Company's principal executive office is located at 1000 Stanley Drive, New Britain, Connecticut 06053 and its telephone number is (860) 225-5111.

(ii) Restructuring Activities. Information regarding the Company's restructuring activities is incorporated herein by reference to the material captioned ''Restructuring Activities'' in Item 7 and Note O Restructuring and Asset Impairments of the Notes to the Consolidated Financial Statements in Item 8.

1(b) FINANCIAL INFORMATION ABOUT SEGMENTS

Financial information regarding the Company's business segments is incorporated herein by reference to the material captioned ''Business Segment Results'' in Item 7 and Note P Business Segments and Geographic Areas of the Notes to the Consolidated Financial Statements in Item 8.

1(c) NARRATIVE DESCRIPTION OF BUSINESS

The Company's operations are classified into three business segments: Consumer Products, Industrial Tools and Security Solutions.

Consumer Products

The Consumer Products segment manufactures and markets hand tools, consumer mechanics tools, storage units and hardware. These products are sold to retailers (including home centers, mass merchants, hardware stores, and retail lumber yards) as well as through third party distributors.

Hand tools include measuring and leveling tools, planes, hammers, demolition tools, knives and blades, screwdrivers, saws, chisels, consumer tackers and staples, as well as electronic leveling and measuring devices. The Company markets its hand tools under the Stanley®, FatMax®, FatMax® Xtreme™, FatMax® XL™, Powerlock® and IntelliTools™ brands, as well as under certain retailers' private label brands.

Consumer mechanics tools include wrenches, sockets, metal tool boxes and cabinets which are marketed under the Stanley® and ZAG® brands, as well as under certain retailers' private label brands.

Storage units include plastic tool boxes and storage systems which are marketed under the Stanley® and ZAG® brands.

Hardware includes hinges, gate hardware, cabinet pulls, hooks, braces and shelf brackets which are marketed under the Stanley® and National® brands.

Industrial Tools

The Industrial Tools segment manufactures and markets: professional mechanics tools and storage systems; pneumatic tools and fasteners; plumbing, heating, air conditioning and roofing tools; hydraulic tools and accessories; assembly tools and systems; electronic leveling and measuring tools; and Stanley supply and services (specialty tools). These products are sold to customers and distributed primarily through third party distributors as well as through direct sales forces.

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Professional mechanics tools and storage include wrenches, sockets, electronic diagnostic tools, tool boxes and high-density industrial storage and retrieval systems. Professional mechanics tools are marketed under the Stanley®, Proto®, Facom®, USAG®, MAC®, Jensen®, Vidmar® and Blackhawk™ by Proto® brands.

Pneumatic tools and fasteners include Stanley®, Bostitch®, and Atro® fastening tools and fasteners (nails and staples) used for construction, remodeling, furniture making, pallet manufacturing and other applications involving the attachment of wooden materials.

Plumbing, heating, air conditioning and roofing tools include pipe wrenches, pliers, press fitting tools, and tubing cutters which are marketed under the Virax® brand.

Hydraulic tools and accessories include Stanley® hand-held hydraulic tools and accessories used by contractors, utilities, railroads and public works as well as LaBounty® mounted demolition hammers and compactors designed to work on skid steer loaders, mini-excavators, backhoes and large excavators.

Assembly tools and systems include electric and pneumatic assembly tools marketed under the Stanley® brand. These are high performance precision tools, controllers and systems for tightening threaded fasteners used chiefly by vehicle manufacturers.

Electronic leveling and measuring tools include laser and optical leveling and measuring devices and accessories utilized primarily by contractors, surveyors, engineers and other professionals and do-it-yourself individuals. These products are marketed under the CST®, David White® and Rolatape® brands.

Stanley supply and services distributes specialty tools for assembling, repairing and testing electronic equipment.

Security Solutions

The Security Solutions segment is a provider of access and security solutions primarily for retailers, educational and healthcare institutions, government, financial institutions, and commercial and industrial customers. The Company provides an extensive suite of mechanical and electronic security products and systems, and a variety of security services. The Company manufactures and markets automatic doors, door locking systems, commercial hardware and integrates security access control systems. Products in the Security Solutions segment include security integration systems, software, related installation, maintenance, and monitoring services, automatic doors, door closers, exit devices and locking mechanisms. Security products are marketed under the Stanley®, Blick®, Frisco Bay®, PAC®, ISR™, WanderGuard®, StanVision™, Sargent and Greenleaf® and BEST® brands and are sold primarily on a direct sales basis as well as, in certain instances, through third party distributors.

Competition

The Company competes on the basis of its reputation for product quality, its well-known brands, its commitment to customer service, strong customer relationships, the breadth of its product lines and its emphasis on product innovation.

The Company encounters active competition in all of its businesses from both larger and smaller companies that offer the same or similar products and services or that produce different products appropriate for the same uses. The Company has a large number of competitors; however, aside from a small number of competitors in the consumer hand tool and consumer hardware businesses who produce a range of products somewhat comparable to the Company's, the majority of its competitors compete only with respect to one or more individual products or product lines within a particular segment. Certain large customers offer private label brands (''house brands'') that compete across a wider spectrum of the Company's product offerings. The Company is one of the largest manufacturers of hand tools in the world, featuring a broader line of products than any other toolmaker. The Company is a significant manufacturer of pneumatic fastening tools and related fasteners to the construction, furniture and pallet industries as well as a leading manufacturer of hand-held hydraulic tools used for heavy construction, railroad, utilities and public works. The Company also believes that it is among the largest direct providers of access security integration services in North America.

Several of the Company's largest retail customers have elected to compete with the Company by developing house brands and sourcing products (generally from low cost countries).

Customers

A substantial portion of the Company's products are sold to home centers and mass merchants in the U.S. and Europe. In 2006, net sales to The Home Depot were 10% of the Company's consolidated sales from continuing operations. A consolidation of retailers both in North America and abroad has occurred over time. While this consolidation and the domestic and international expansion of these large retailers provide the Company with opportunities for growth, the increasing size and importance of individual customers creates a certain degree of exposure to potential volume loss. The loss of the customer referred to above, or the loss of certain of the other larger home centers or mass merchants as customers, could have a material adverse effect on the Company until either such customers were replaced or the Company made the necessary adjustments to compensate for the loss of business.

Despite the trend toward customer consolidation, the Company has been able to maintain a diversified customer base and has decreased the potential customer concentration risk over the past years, as sales from continuing operations in markets outside of the home center and mass merchant distribution channels have grown at a greater rate through a combination of efforts to broaden the customer base, primarily in the Security Solutions and Industrial Tools segments. In this regard, sales to the Company's largest customer as a percentage of the total Company's sales have decreased from 22% to 10% since 2002.

Raw Materials

The Company's products are manufactured of both ferrous and non-ferrous metals including, but not limited to steel, aluminum, zinc, brass, copper and nickel, as well as resin. Additionally, the Company uses other commodity based materials for components and packaging including, but not limited to, plastics, wood, and other corrugated products. The raw materials required are available from a number of sources at competitive prices and the Company has annual or quarterly spot contracts with many of its key suppliers. Certain commodity prices, particularly energy related and non-ferrous metals are expected to remain volatile in 2007, but the Company does not anticipate difficulties in obtaining supplies for any raw materials used in its production processes.

Backlog

Due to short order cycles and rapid inventory turnover in most of the Company's Consumer Products and Industrial Tools businesses, backlog is generally not considered a significant indicator of future performance. At February 3, 2007, the Company had approximately $347 million in unfilled orders compared with $274 million in unfilled orders at February 5, 2006. All of these orders are reasonably expected to be filled within the current fiscal year. Most customers place orders for immediate shipment and as a result, the Company produces primarily for inventory, rather than to fill specific orders.

Patents and Trademarks

No business segment is dependent, to any significant degree, on patents, licenses, franchises or concessions and the loss of these patents, licenses, franchises or concessions would not have a material adverse effect on any of the business segments. The Company owns numerous patents, none of which individually are material to the Company's operations as a whole. These patents expire at various times over the next 20 years. The Company holds licenses, franchises and concessions, none of which individually or in the aggregate are material to the Company's operations as a whole. These licenses, franchises and concessions vary in duration, but generally run from one to 20 years.

The Company has numerous trademarks that are used in its businesses worldwide. The STANLEY® and STANLEY in a notched rectangle design trademarks are material to all three business segments. These well-known trademarks enjoy a reputation for quality and value and are among the world's most trusted brand names. The Company's tagline, ''Make Something Great™'' is the centerpiece of the brand strategy for all segments. The Bostitch®, Besco, Powerlock®, Tape Rule Case Design (Powerlock), FatMax®, FatMax®Xtreme™, FatMax®XL™, LaBounty®, MAC®, Proto®, Jensen®,

Vidmar®, CST®, Zag®, Rolatape®, Blackhawk™ by Proto®, Atro®, National®, Facom®, Virax® and USAG® trademarks are also material to the Consumer Products and Industrial Tools segments. In the Security Solutions segment, the BEST®, Blick®, Frisco Bay®, PAC®, WanderGuard®, StanVision™, Safemasters®, Sargent and Greenleaf® and ISR™

trademarks are also material to this segment. The terms of these trademarks vary, typically, from 10 to 20 years, with most trademarks being renewable indefinitely for like terms.

Environmental Regulations

The Company is subject to various environmental laws and regulations in the U.S. and foreign countries where it has operations. Future laws and regulations are expected to be increasingly stringent and will likely increase the Company's expenditures related to environmental matters.

The Company is a party to a number of proceedings before federal and state regulatory agencies relating to environmental remediation. Additionally, the Company, along with many other companies, has been named as a potentially responsible party (''PRP'') in a number of administrative proceedings for the remediation of various waste sites, including fifteen active Superfund sites.

Current laws potentially impose joint and several liabilities upon each PRP. In assessing its potential liability at these sites, the Company has considered the following: whether responsibility is being disputed, the terms of existing agreements, experience at similar sites, and the Company's volumetric contribution at these sites.

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. The amount of liability recorded is based on an evaluation of currently available facts with respect to each individual site and includes such factors as existing technology, presently enacted laws and regulations, and prior experience in remediation of contaminated sites. The liabilities recorded do not take into account any claims for recoveries from insurance or third parties. As assessments and remediation progress at individual sites, the amounts recorded are reviewed periodically and adjusted to reflect additional technical and legal information that becomes available. As of December 30, 2006, the Company had reserves of approximately $31 million, for remediation activities associated with Company-owned properties as well as for Superfund sites, for losses that are probable and estimable.

The amount recorded for identified contingent liabilities is based on estimates. Amounts recorded are reviewed periodically and adjusted to reflect additional technical and legal information that becomes available. Actual costs to be incurred in future periods may vary from the estimates, given the inherent uncertainties in evaluating environmental exposures. Subject to the imprecision in estimating future environmental costs, the Company does not expect that any sum it may have to pay in connection with environmental matters in excess of the amounts recorded will have a materially adverse effect on its consolidated financial position, results of operations or liquidity.

Employees

At December 30, 2006, the Company had approximately 17,600 employees, nearly 8,200 of whom were employed in the U.S. Approximately 765 U.S. employees are covered by collective bargaining agreements negotiated with 13 different local labor unions who are, in turn, affiliated with approximately 6 different international labor unions. The majority of the Company's hourly-paid and weekly-paid employees outside the U.S. are not covered by collective bargaining agreements. The Company's labor agreements in the U.S. expire in 2007, 2008, 2009, 2010 and 2011. There have been no significant interruptions or curtailments of the Company's operations in recent years due to labor disputes. The Company believes that its relationship with its employees is good.

1(d) FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS

Financial information regarding the Company's geographic areas is incorporated herein by reference to Note P Business Segments and Geographic Areas of the Notes to the Consolidated Financial Statements in Item 8.

1(e) AVAILABLE INFORMATION

The Company's website is located at http://www.Stanleyworks.com. (This URL is intended to be an inactive textual reference only. It is not intended to be an active hyperlink to our website. The information on our website is not, and is not intended to be, part of this Form 10-K and is not incorporated into this report by reference.) Stanley makes its Forms 10-K, 10-Q, 8-K and amendments to each available free of charge on its website as soon as reasonably practicable after filing them with, or furnishing them to the U.S. Securities and Exchange Commission.

ITEM 1A. RISK FACTORS

The Company's business, operations and financial condition are subject to various risks and uncertainties. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Annual Report on Form 10-K, including those risks set forth under the heading entitled ''Cautionary Statements Under the Private Securities Litigation Reform Act of 1995'', and in other documents that the Company files with the U.S. Securities and Exchange Commission, before making any investment decision with respect to its securities. If any of the risks or uncertainties actually occur or develop, the Company's business, financial condition, results of operations and future growth prospects could change. Under these circumstances, the trading prices of the Company's securities could decline, and you could lose all or part of your investment in the Company's securities.

Large customer concentration and related customer inventory adjustments may negatively impact sales, results of operations and cash flows.

The Company has certain significant customers, particularly home centers and major retailers such as The Home Depot, Lowe's and Wal-Mart. The Home Depot individually accounted for 10% of the Company's consolidated net sales from continuing operations for the year ended December 30, 2006. The loss or material reduction of business from, or the lack of success of sales initiatives for the Company's products related to, any such significant customer could have a material adverse impact on the Company's results of operations and cash flows.

In addition, unanticipated inventory adjustments by such customers can have a negative impact on sales. For example, severe inventory adjustments taken by certain large North American home center customers in December 2005 negatively impacted sales by approximately $30 million versus normal levels. While the Company did not experience a significant impact from such customer inventory adjustments in late 2006, they may re-occur in the future.

Customer consolidation could have a material adverse effect on the Company's business.

A substantial portion of the Company's products in the Consumer Products and Industrial Tools segments are sold through home centers and mass merchant distribution channels. A consolidation of retailers in both North America and abroad has occurred over time and the increasing size and importance of individual customers creates risk of exposure to potential volume loss. The loss of certain larger home centers as customers would have a material adverse effect on the Company's business until either such customers were replaced or the Company made the necessary adjustments to compensate for the loss of business.

The Company's growth and repositioning strategies include acquisitions. The Company's recent acquisitions may not further its strategies and the Company may not be able to identify suitable future acquisition candidates.

In 2002, the Company embarked on a growth strategy to shift its business portfolio toward favored growth markets through acquisitions and divestitures, and thereby to reduce the risk associated with large customer concentrations. The strategy has been advanced over the last five years with the sales of the Company's residential entry door and home décor businesses, and the acquisition of a number of companies, including HSM Electronic Protection Services, Inc. (''HSM''), Facom S.A. (''Facom''), National Manufacturing Co. (''National''), Besco Pneumatic Corporation (''Besco''), Best Lock Corporation and its affiliates (''Best Access''), Chicago Steel Tape Co. and affiliates (''CST/Berger''), Blick plc (''Blick''), Frisco Bay Industries Ltd (''Frisco Bay''), ISR Solutions, Inc. (''ISR''), Security Group, Inc. (''Security Group'') a Precision Hardware, Inc. (''Precision'').

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Although the Company has extensive experience with acquisitions, there can be no assurance that recently acquired companies will be successfully integrated and effectively implement the Company's growth and repositioning strategy. If the Company successfully integrates the acquired companies and effectively implements its repositioning strategy, there can be no assurance that its resulting business segments will enjoy continued market acceptance or profitability.

In addition, there can be no assurance that the Company will be able to successfully identify suitable future acquisition candidates, negotiate appropriate terms, obtain the necessary financing, complete the transactions or successfully integrate the new company as necessary to continue its growth and repositioning strategies.

The Company's acquisitions may result in certain risks for its business and operations.

The Company has made a number of acquisitions in the past three years, including, but not limited to: HSM in January 2007, Besco in July 2006, Facom in January 2006, National in November 2005, Precision in May 2005, Security Group in January 2005, ISR in December 2004, Frisco Bay in March 2004, as well as CST/Berger and Blick in January 2004. The Company may make additional acquisitions in the future. Acquisitions involve a number of risks, including:

- the diversion of Company management's attention and other resources,
- the incurrence of unexpected liabilities, and
- the loss of key personnel and clients or customers of acquired companies.

Any intangible assets that the Company acquires may have a negative effect on its earnings and return on capital employed. In addition, the success of the Company's future acquisitions will depend in part on its ability to:

- combine operations,
- integrate departments, systems and procedures, and
- obtain cost savings and other efficiencies from the acquisitions.

Failure to effectively consummate or manage future acquisitions may adversely affect the Company's existing businesses and harm its operational results. The Company is still in the process of integrating the businesses and operations of Facom, National, Besco, HSM and other acquisitions with its existing businesses and operations. The Company cannot ensure that such integrations will be successfully completed, or that all of the planned synergies will be realized.

The Company may incur significant additional indebtedness, or issue additional equity securities, in connection with future acquisitions which may restrict the manner in which it conducts business. The potential issuance of such securities may limit the Company's ability to implement elements of its growth strategy and may have a dilutive effect on earnings.

As more fully described in Item 7 and Note I Long-Term Debt and Financing Arrangements of the Notes to the Consolidated Financial Statements in Item 8, the Company issued $450 million of Enhanced Trust Preferred Securities through its Trust subsidiary in 2005, the net proceeds of which were used to finance a portion of the acquisitions of Facom and National. In addition, the Company has a five year revolving credit agreement, enabling borrowings up to $550 million; this agreement includes provisions that allow designated subsidiaries to borrow up to $250 million in Euros and Pound Sterling, which may be available to, among other things, fund acquisitions.

On January 8, 2007 the Company entered into a new $500 million 364-day bridge facility which was utilized to partially finance the $545 million HSM acquisition on January 16, 2007. The Company intends to permanently refinance this bridge facility in 2007 with a combination of available cash, and the issuance of long-term debt and equity-linked securities.

The instruments and agreements governing certain of the Company's current indebtedness contain restrictive covenants that include, among other things:

- a limitation on creating liens on certain property of the Company and its subsidiaries;
- maintenance of specified financial ratios. Failure to maintain such ratios could result in limiting further access to liquidity and requiring the Company to pay all interest coupons on certain debt securities through the issuance of common stock before making further dividend payments on its common shares outstanding;
- a restriction on entering into certain sale-leaseback transactions; and
- customary events of default. If an event of default occurs and is continuing, the Company might be required to repay all amounts outstanding under the respective instrument or agreement.

Future new instruments and agreements governing indebtedness may impose other restrictive covenants. Such covenants could restrict the Company in the manner in which it conducts business and operations as well as in the pursuit of its growth and repositioning strategies.

The Company's brands are important assets of its businesses and violation of its trademark rights by imitators could negatively impact sales and brand reputation.

The Company's trademarks enjoy a reputation for quality and value and are important to its success and competitive position. Unauthorized imitation of its products or unauthorized use of its trademark rights may not only erode sales of the Company's products, but may also cause significant damage to its brand name and reputation, its ability to effectively represent the Company to its customers, contractors, suppliers, and/or licensees, as well as divert management time and attention. There can be no assurance that the Company's on-going effort to protect its brand and trademark rights will prevent all violations. In addition, the laws and enforcement mechanisms of some foreign countries may not allow the Company to protect its proprietary rights to the same extent as it is able to in the United States.

The Company has trademark licensing programs and licensees may not comply with product quality, manufacturing standards, marketing and other requirements.

The Company licenses certain of its trademarks to third parties for manufacturing, marketing, distribution and sale of various products. While it enters into comprehensive licensing agreements with its licensees covering product design, product quality, sourcing, manufacturing, marketing and other requirements, such licensees may not comply fully with those agreements. Non-compliance could include marketing products under the Company's brand names that do not meet its quality and other requirements or engaging in manufacturing practices that do not meet the Company's supplier code of conduct. These activities could harm brand equity, reputation and business.

Successful sales and marketing efforts depend on the Company's ability to recruit and retain qualified employees.

The success of the Company's efforts to grow its business depends on the contributions and abilities of key executives, its sales force and other personnel, including the ability of its sales force to adapt to any changes made in the sales organization and achieve adequate customer coverage. The Company must therefore continue to recruit, retain and motivate management, sales and other personnel sufficient to maintain its current business and support its projected growth. A shortage of these key employees might jeopardize the Company's ability to implement its growth strategy.

The Company faces active competition and if it does not compete effectively, its business may suffer.

The Company faces active competition and resulting pricing pressures. The Company's products compete on the basis of, among other things, its reputation for product quality, its well-known brands, price, innovation and customer service capabilities. The Company competes with both larger and smaller companies that offer the same or similar products and services or that produce different products appropriate for the same uses. These companies are often located in countries such as China,

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Taiwan and India where labor and other production costs are substantially lower than in the United States, Canada and Western Europe. Also, certain large customers offer private label brands that compete with some of the Company's product offerings as a lower-cost alternative. To remain profitable and defend market share, the Company must maintain a competitive cost structure, develop new products and services, respond to competitor innovations and enhance its existing products in a timely manner. The Company may not be able to compete effectively on all of these fronts and with all of its competitors, and the failure to do so could have a material adverse effect on its sales and profit margins.

The Stanley Fulfillment System (''SFS'') is a continuous operational improvement process applied to many aspects of the Company's business such as procurement, quality in manufacturing, maximizing customer fill rates, integrating acquisitions and other key businesses processes. In the event the Company is not successful in effectively applying the SFS disciplines to its key business processes its ability to compete and future earnings could be adversely affected.

In addition, the Company may have to reduce prices on its products and services, or make other concessions, to stay competitive and retain market share. The Company engages in restructuring actions, sometimes entailing shifts of production to low cost countries, as part of its efforts to maintain a competitive cost structure. If the Company does not execute restructuring actions well, its ability to meet customer demand may decline, or earnings may otherwise be adversely impacted; similarly if such efforts to reform the cost structure are delayed relative to competitors or other market factors the Company may lose market share and profits.

The Company's results of operations could be negatively impacted by inflation in the cost of raw materials, freight and energy.

The Company's products are manufactured of both ferrous and non-ferrous metals, including but not limited to steel, aluminum, zinc, brass, nickel and copper, as well as resin. Additionally, the Company uses other commodity based materials for components and packaging including, but not limited to: plastics, wood, and other corrugated products. As described in more detail in Item 7 hereto, the Company has been negatively impacted by commodity and freight inflation in recent years and it expects energy and certain commodity prices, particularly non-ferrous metals, to increase. If the Company is unable to mitigate these inflation increases through various customer pricing actions and cost reduction initiatives, its profitability may be adversely affected.

Ultimate income tax payments may differ from amounts currently recorded by the Company. Future tax law changes may materially increase the Company's prospective income tax expense.

The Company is subject to income taxation in the United States as well as numerous foreign jurisdictions. Judgment is required in determining the Company's worldwide income tax provision and accordingly there are many transactions and computations for which the final income tax determination is uncertain. The Company is routinely audited by income tax authorities in many tax jurisdictions. Although management believes the recorded tax estimates are reasonable, the ultimate outcome from any audit (or related litigation) could be materially different from amounts reflected in the Company's income tax provisions and accruals. Future settlements of income tax audits may have a material effect on earnings between the period of initial recognition of tax estimates in the financial statements and the point of ultimate tax audit settlement. Additionally, it is possible that future income tax legislation may be enacted that could have a material impact on the Company's worldwide income tax provision beginning with the period that such legislation becomes effective.

The Company's failure to continue to successfully manage, defend, litigate and accrue for claims and litigation could negatively impact its results of operations or cash flows.

As described in further detail in Items 1 and 3 and Note S Contingencies of the Notes to the Consolidated Financial Statements in Item 8, the Company becomes involved in various litigation matters arising out of the ordinary routine conduct of its business, including, from time to time, litigation relating to such items as commercial transactions, product liability, workers compensation, the Company's distributors, intellectual property claims, regulatory actions and environmental matters. There can be no assurance that the Company will be able to continue to successfully manage and

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defend such matters. In addition, given the inherent uncertainties in evaluating certain exposures, actual costs to be incurred in future periods may vary from the Company's estimates for such contingent liabilities.

The Company is exposed to market risk from changes in foreign currency exchange rate fluctuation which could negatively impact profitability.

Exposure to foreign currency risk results because the Company, through its global operations, enters into transactions and makes investments denominated in multiple currencies. The Company's predominant exposures are in European, Canadian and Asian currencies, including the Chinese Renminbi (''RMB''). In preparing its financial statements, for foreign operations with functional currencies other than the U.S. dollar, asset and liability accounts are translated at current exchange rates, and income and expenses are translated using weighted average exchange rates. With respect to the effects on translated earnings, if the U.S. dollar strengthens relative to local currencies, the Company's earnings could be negatively impacted. Although the Company utilizes risk management tools, including hedging, as it deems appropriate, to mitigate a portion of potential market fluctuations in foreign currencies, there can be no assurance that such measures will result in cost savings or that all market fluctuation exposure will be eliminated. The Company does not make a practice of hedging its non U.S. Dollar earnings.

In addition, on July 21, 2005, China announced it will let the RMB fluctuate within a very tight band (+/– .3% around weighted average prior day close) thereby effectively adopting a managed float and ending its decade-old valuation de facto peg to the U.S. dollar. The Company sources significant products from China and other Asian low cost countries for resale in other regions. To the extent the RMB or these other currencies appreciate with respect to the U.S. dollar, the Company may experience cost increases on such purchases. While the present 3% appreciation of the RMB should not generate material cost increases for RMB denominated purchases, further appreciation of this or other currencies utilized for procurement could adversely affect profitability. The Company may not be successful at implementing customer pricing or other actions in an effort to mitigate the related cost increases.

The Company's business is subject to risks associated with sourcing and manufacturing overseas.

The Company imports large quantities of finished goods, components and raw materials. Substantially all of its import operations are subject to customs requirements and to tariffs and quotas set by governments through mutual agreements or bilateral actions. In addition, the countries in which the Company's products and materials are manufactured or imported from may from time to time impose additional quotas, duties, tariffs or other restrictions on its imports or adversely modify existing restrictions. Imports are also subject to unpredictable foreign currency variation which may increase the Company's cost of goods sold. Adverse changes in these import costs and restrictions, or the Company's suppliers' failure to comply with customs regulations or similar laws, could harm the Company's business.

The Company's operations are also subject to the effects of international trade agreements and regulations such as the North American Free Trade Agreement, and the activities and regulations of the World Trade Organization. Although these trade agreements generally have positive effects on trade liberalization, sourcing flexibility and cost of goods by reducing or eliminating the duties and/or quotas assessed on products manufactured in a particular country, trade agreements can also impose requirements that adversely affect the Company's business, such as setting quotas on products that may be imported from a particular country into key markets such as the U.S. or the European Union.

The Company's ability to import products in a timely and cost-effective manner may also be affected by conditions at ports or issues that otherwise affect transportation and warehousing providers, such as port and shipping capacity, labor disputes, severe weather or increased homeland security requirements in the U.S. and other countries. These issues could delay importation of products or require the Company to locate alternative ports or warehousing providers to avoid disruption to customers. These alternatives may not be available on short notice or could result in higher transit costs, which could have an adverse impact on the Company's business and financial condition.

If the Company were required to write down all or part of its goodwill, indefinite-lived tradenames, or other definite-lived intangible assets, its net income and net worth could be materially adversely affected.

As a result of acquisitions, the Company has $1.1 billion of goodwill, $298 million of indefinite-lived tradenames, and $223 million of definite-lived intangible assets recorded on its Consolidated Balance Sheet at December 30, 2006. The Company is required to periodically, at least annually, determine if its goodwill or indefinite-lived tradenames have become impaired, in which case it would write down the impaired portion of the intangible asset. The definite-lived intangible assets, including customer relationships, are amortized over their estimated useful lives; such assets are also evaluated for impairment when appropriate. Impairment of intangible assets may be triggered by developments outside the Company's control, such as technological change, intensified competition or other matters causing a decline in expected future cash flows. If the Company were required to write down all or part of its goodwill, indefinite-lived tradenames, or other definite-lived intangible assets, its net income and net worth could be materially adversely affected.

If the investments in employee benefit plans do not perform as expected, the Company may have to contribute additional amounts to these plans, which would otherwise be available to cover operating and other expenses. Certain U.S. employee benefit plan expense is affected by the market value of the Company's common stock.

As described in further detail in Note M Employee Benefit Plans of the Notes to the Consolidated Financial Statements in Item 8, the Company sponsors pension and other post retirement defined benefit plans, as well as an Employee Stock Ownership Plan (''ESOP'') under which the primary U.S. defined contribution and 401(k) plans are funded. The Company's defined benefit plan assets are currently invested in equity securities, bonds and other fixed income securities, and money market instruments. The Company's funding policy is to contribute amounts determined annually on an actuarial basis to provide for current and future benefits in accordance with applicable law which require, among other things, that the Company make cash contributions to under funded pension plans. The Company expects to contribute approximately $13 million to its pension and other post retirement defined benefit plans in 2007.

There can be no assurance that the value of the plan assets, or the investment returns on those plan assets, will be sufficient in the future. It is therefore possible that the Company may be required to make significant additional cash contributions to the plans which would reduce the cash available for other business purposes, or that the Company will have to recognize a significant pension liability adjustment which would decrease the net assets of the Company.

Overall ESOP expense is affected by the market value of Stanley stock on the monthly dates when shares are released, among other factors. Net ESOP expense amounted to $2 million in each of the years 2006, 2005 and 2004. While the average market value of shares released increased from $43.20 in 2004 to $49.28 in 2006, other elements of ESOP expense, including a gradual reduction in the number of shares released annually from the trust, offset the favorable impact of the higher share price. ESOP expense could increase in the future if the market value of the Company's common stock declines.

The Company provides a 5% guaranteed rate of return on participant contributions made to the tax deferred 401(K) savings plan prior to July 1998 when all contributions were invested in Stanley common stock. The value of the shares purchased by participants prior to July 1998 along with the 5% cumulative guaranteed rate of return on Stanley common stock is known as an Investment Protection Account (''IPA''). Beginning in July 1998 the investment options for plan participant contributions were enhanced to include a variety of investment funds in addition to the Company's common stock, and there is no guaranteed rate of return to participants on any contributions made after that time. The IPA guarantee is included in the actuarial valuation of the ongoing U.S. pension plan. Payments related to the IPA guarantees, if they have any value, would be made to participants over a period of many years generally as they retire. In the event the market value of Stanley common stock declines below $43.59 (which is the stock price at which there was a settlement of this liability) additional costs may be triggered by the IPA benefit guarantee.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 30, 2006, the Company and its subsidiaries owned or leased material facilities (facilities over 50,000 square feet) for manufacturing, distribution and sales offices in 17 states and 13 foreign countries. The Company believes that its material facilities are suitable and adequate for its business.

Certain properties are utilized by more than one segment and in such cases the property is reported in the segment with highest usage. Material facilities owned by the Company and its subsidiaries follow:

Consumer Products

New Britain, Connecticut; Sterling and Rock Falls, Illinois; Cheraw, South Carolina; Pittsfield, Vermont; Richmond, Virginia; Smiths Falls, Coburg and Swift Current, Canada; Hellaby, England; Besancon Cedex, France; Puebla and Nueva Leon, Mexico; Xiaolan, Peoples Republic of China and Amphur Bangpakong, Thailand.

Industrial Tools

Phoenix, Arizona; Clinton, Connecticut; Shelbyville, Indiana; Dallas and Wichita Falls, Texas; Two Harbors, Minnesota; Columbus, Georgetown and Sabina, Ohio; Allentown, Pennsylvania; East Greenwich, Rhode Island; Pecky, Czech Republic; Arbois, Epernay, Ezy Sur Eure, Laissey, Morangis, Nevers, and Villeneuve Le Roi, France; Fano, Gemonio and Monvalle, Italy; Chihuahua, Mexico; Jiashan City, Lanfang and Xiaolan, Peoples Republic of China; Wroclaw, Poland and Taichung Hsien, Taiwan.

Security Solutions

Farmington, Connecticut; Indianapolis, Indiana; Nicholasville, Kentucky and Romulus, Michigan.

Material facilities leased by the Company and its subsidiaries follow:

Corporate Offices

New Britain, Connecticut.

Consumer Products

New Britain, Connecticut; Miramar, Florida; Kannapolis, North Carolina; Somerton, Australia; Mechelen, Belgium; Oakville and Smiths Falls, Canada; Northampton, England; Karmiel and Migdal, Israel.

Industrial Tools

Watseka, Illinois; Fishers, Indiana; Highland Heights and Westerville, Ohio; Milwaukie, Oregon; Zaventem, Belgium; Feuqieres En Vimeu and Morangis, France; Biassono and Figino Serenza, Italy.

Security Solutions

None

The aforementioned material facilities not being used by the Company include:

Consumer Products

Richmond, Virginia (owned); Swift Current, Canada (owned); one of the two properties located in Amphur Bangpakong, Thailand (owned).

Industrial Tools

Wichita Falls, Texas (owned); Villeneuve Le Roi, France (owned).

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Security Solutions

Romulus, Michigan (owned).

ITEM 3. LEGAL PROCEEDINGS

In the normal course of business, the Company is involved in various lawsuits and claims, including product liability, environmental and distributor claims, and administrative proceedings. The Company does not expect that the resolution of these matters will have a materially adverse effect on the Company's consolidated financial position, results of operations or liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted during the fourth quarter of 2006 to a vote of security holders.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is listed and traded on the New York Stock Exchange, Inc. (''NYSE'') under the abbreviated ticker symbol ''SWK'', and is a component of the Standard & Poor's (''S&P'') 500 Composite Stock Price

Index. The Company's high and low quarterly stock prices on the NYSE for the years ended December 30, 2006 and December 31, 2005 follow:

	2006			2005		
	High	Low	Dividend Per Common Share	High	Low	Dividend Per Common Share
QUARTER:						
First	$53.13	$47.00	$0.29	$49.14	$44.27	$0.28
Second	$54.59	$44.61	$0.29	$48.10	$41.51	$0.28
Third	$50.81	$41.60	$0.30	$51.75	$44.03	$0.29
Fourth	$53.48	$46.58	$0.30	$49.09	$43.31	$0.29
Total			$1.18			$1.14

As of February 14, 2007, there were 12,582 holders of record of the Company's common stock.

Information required by Item 201(d) of Regulation S-K concerning securities authorized for issuance under equity compensation plans can be found under Item 12 of this Annual Report on Form 10-K.

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 for the three months ended December 30, 2006:

2006	(a) Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number Of Shares Purchased As Part Of A Publicly Announced Plan or Program	Maximum Number Of Shares That May Yet Be Purchased Under The Plan or Program
October 2 – November 5	1,258	$ 49.85	—	—
November 6 – December 3	496	$ 50.58	—	—
December 4 – December 30	7,383	$ 50.95	—	—
	9,137	$ 50.77	—	—

(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.

ITEM 6. SELECTED FINANCIAL DATA

The Company made significant acquisitions during the five-year period presented below that affect comparability of results. Refer to Note F Acquisitions of the Notes to Consolidated Financial Statements in Item 8 for further information. Additionally, as detailed in prior year 10-K filings, the 2002 through 2004 results have been restated to remove the effects of discontinued operations, such that all years are comparable (in millions, except per share amounts):

	2006**	2005	2004	2003	2002
Continuing Operations:					
Net sales	$ 4,019	$ 3,285	$ 2,997	$ 2,485	$ 2,187
Net earnings	$ 291	$ 272	$ 237	$ 88	$ 155
Basic earnings per share:					
Continuing operations	$ 3.55	$ 3.26	$ 2.89	$ 1.05	$ 1.79
Discontinued operations	$ (0.01)	$ (0.03)	$ 1.58	$ 0.24	$ 0.35
Total basic earnings per share	$ 3.54	$ 3.23	$ 4.47	$ 1.28	$ 2.14
Diluted earnings per share:					
Continuing operations	$ 3.47	$ 3.18	$ 2.81	$ 1.04	$ 1.75
Discontinued operations	$ (0.01)	$ (0.02)	$ 1.54	$ 0.23	$ 0.34
Total diluted earnings per share	$ 3.46	$ 3.16	$ 4.36	$ 1.27	$ 2.10
Percent of net sales:					
Cost of sales	63.7%	64.0%	63.2%	65.8%	66.1%
Selling, general and administrative	23.8%	22.4%	23.1%	24.7%	22.9%
Interest, net	1.6%	1.0%	1.1%	1.1%	1.1%
Other, net	1.4%	1.5%	1.5%	1.6%	(0.4)%
Earnings before income taxes	9.1%	10.9%	10.8%	4.8%	10.2%
Net earnings	7.2%	8.3%	7.9%	3.5%	7.1%
Balance sheet data:					
Total assets*	$ 3,935	$ 3,545	$ 2,851	$ 2,424	$ 2,418
Long-term debt	$ 679	$ 895	$ 482	$ 514	$ 563
Shareowners' equity	$ 1,552	$ 1,445	$ 1,237	$ 885	$ 1,010
Ratios:					
Current ratio	1.3	2.1	1.7	1.6	1.8
Total debt to total capital	39.2%	42.4%	32.1%	43.2%	41.4%
Income tax rate — continuing operations	20.8%	24.1%	26.9%	25.5%	30.8%
Return on average equity — continuing operations	19.4%	20.3%	22.3%	9.3%	16.6%
Common stock data:					
Dividends per share	$ 1.18	$ 1.14	$ 1.08	$ 1.03	$ 0.99
Equity per share at year-end	$ 18.96	$ 17.24	$ 15.01	$ 10.88	$ 11.63
Market price per share — high	$ 54.59	$ 51.75	$ 49.33	$ 38.03	$ 52.00
Market price per share — low	$ 41.60	$ 41.51	$ 36.42	$ 20.84	$ 27.31
Average shares outstanding (in 000's):					
Basic	81,866	83,347	82,058	84,143	86,453
Diluted	83,704	85,406	84,244	84,839	88,246
Other information:					
Average number of employees	17,484	14,332	13,448	12,330	12,133
Shareowners of record at end of year	12,755	13,137	13,238	13,915	14,053

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*Item includes discontinued operations.

**Diluted earnings per share in 2006 reflects $0.07 of expense for stock options related to the adoption of SFAS 123R, ''Share-Based Payment''. Shareowners' equity as of December 30, 2006 decreased $61 million from the adoption of SFAS 158, ‘‘Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements NO. 87, 88, 106 an 132(R)’’. Refer to Note A Significant Accounting Policies of the Notes to Consolidated Financial Statements in Item 8 for further information.

ITEM 7. 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 and certain other sections of this Annual Report on Form 10-K contain statements reflecting the Company’s views about its future performance and 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.

BUSINESS OVERVIEW

The Company is a worldwide supplier of consumer products, industrial tools and security solutions for professional, commercial, industrial and consumer use. Its operations are classified into three business segments: Consumer Products, Industrial Tools and Security Solutions. The Consumer Products segment manufactures and markets hand tools, consumer mechanics tools, storage units and hardware. 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 Tools segment manufactures and markets professional mechanics and hand tools, pneumatic tools and fasteners, storage systems, plumbing, heating, air conditioning and roofing tools, hydraulic tools and accessories, assembly tools and systems, and electronic leveling and measuring tools. These products are sold to customers and distributed primarily through third party distributors as well as through direct sales forces. The Security Solutions 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 products and systems including automatic doors, door closers, access controls, exit devices, software and locking mechanisms, as well as a variety of security services, security integration, related installation and maintenance services.

For several years, the Company has focused on a profitable growth strategy and begun to transform itself from a mature 160 year old ‘‘American tool company’’, to an innovative, multi-national, diversified, industrial growth business. This strategy has included approximately $2 billion of acquisitions since the beginning of 2002, several key divestitures, the reduction of risk associated with certain large customer concentrations and increased brand investments. Additionally, the strategy reflects management's vision to build a growth platform in security while expanding the valuable branded tools and hardware platforms. Over the past several years, the Company has generated strong free cash flow and received substantial proceeds from divestitures that were utilized to invest in the transformation of the business portfolio.

Free cash flow, as defined in the following table, was $359 million in 2006, $294 million in 2005, and $317 million in 2004, considerably exceeding net earnings from continuing operations. The Company believes free cash flow is an important indicator of its liquidity, as well as its ability to fund future growth and provide a dividend to shareowners.

(Millions of Dollars)	2006	2005	2004
Net cash provided by operating activities	$ 439	$ 362	$ 372
Less: capital expenditures	(60)	(53)	(48)
Less: capitalized software	(20)	(15)	(7)
Free cash flow	$ 359	$ 294	$ 317

The Company strives to reinvest its free cash flow in high return businesses in order to generate strong return on assets and improve working capital efficiency. Significant areas of tactical emphasis related to execution of this strategy and its ability to generate free cash flow, as well as events impacting the Company's financial performance in 2006 and 2005, are discussed below.

CONTINUED GROWTH OF SECURITY SOLUTIONS BUSINESS

The Company further advanced its strategy of becoming a global market leader in the commercial security industry. Annual revenues of the Security Solutions segment have grown to $887 million, or 22% of 2006 sales, up from $105 million, or 5% of 2001 sales. Key events pertaining to the growth of this segment in the past two years include the following:

- The Company completed the acquisition of HSM Electronic Protection Services, Inc. (''HSM'') in January 2007 for approximately $545 million in cash. HSM, based near Chicago, Illinois, is a market leader in the security monitoring industry, and has annual revenues of approximately $200 million. HSM has a stable customer base, an extensive North American field network and the second largest market share in the U.S. commercial monitoring market. The acquisition will serve as a growth platform in the monitoring sector of the security industry. Management anticipates HSM will be neutral to 2007 earnings, increasing to 20 to 25 cents per diluted share earnings in 2009, with approximately $38 million of non-cash intangible asset amortization occurring in 2007 related to acquired contracts.
- During 2006, the Company completed three bolt-on acquisitions for a combined purchase price of $22 million. Automatic Entrances of Colorado, Inc. (''Automatic Entrances'') is a distributor that sells, installs and services automatic doors and gates in several western states in the U.S., and Automatic Doors Systems, Inc. (''Automatic Doors) is an automatic door distributor that operates in the southeastern U.S. Both of these acquisitions were integrated into the branch structure of the existing automatic doors business and increase its geographic scope. GDX

Technologies Ltd. (‘‘GDX’’) is a leading access control supplier in the United Kingdom that possesses strong technological product development capabilities. GDX complements the existing European security integration business.

- In January 2005, U.S. based Security Group, Inc. (‘‘Security Group’’) was acquired for approximately $50 million. Security Group is comprised of two primary operating companies: Sargent & Greenleaf, Inc. and The SafeMasters Co., Inc. Sargent & Greenleaf, Inc. is a manufacturer of medium and high security locks and locking systems for the financial, government and retail markets. The SafeMasters Co., Inc. is a North American access control provider offering a wide variety of physical security installation, maintenance and repair services, with emphasis on mechanical locking systems.
- In May 2005, the Company completed the acquisitions of Precision Hardware, Inc. (‘‘Precision’’) and Sielox Security Systems Pty Ltd (‘‘Sielox’’), for a combined purchase price of $48 million. Precision manufactures and distributes exit devices, door closers and security hardware in the United States and provides a complementary product offering to the Company’s existing mechanical access business. Australian-based Sielox specializes in the installation and servicing of electronic security systems for new construction projects.

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The above acquisitions complement the existing Security Solutions’ product offering, increase its scale and strengthen the value proposition offered to end user customers as industry dynamics favor multi-solution providers that offer ‘‘one-stop shopping’’ capabilities. The Company continues to focus on integrating the acquired businesses as it expands the suite of its security product and service offerings. In 2006 and 2005, various process improvement initiatives were initiated including integration of overlapping field service organizations and implementation of certain common back office systems. These integration efforts will continue for the next two years.

DRIVE FURTHER PROFITABLE GROWTH IN BRANDED TOOLS AND HARDWARE

While diversifying the business portfolio through expansion into Security Solutions is important, management also recognizes that the branded consumer products and industrial tools businesses are the foundations on which the Company was established and provide strong growth and cash flow generation prospects. While these businesses are strong and profitable today, management is committed to growing these businesses through innovative product development, brand support and relentless focus on global cost competitiveness in order to maintain vitality over the long term. Acquisition-related growth will also be pursued where appropriate. The following matters affected these businesses:

- The Company has rigorously focused on innovation in order to enhance its product development pipeline and reduce commercialization cycle time. In 2005, 350 new SKUs were successfully launched including the AntiVibe® Hammer, Quickslide® Knife and FatMax® Hacksaw. Innovation continued in 2006 with the successful launch of the largest new hand tools product introduction in the Company’s history. The FatMax® Xtreme™ product line commenced shipping at the end of March 2006 and was supplemented by a second phase roll-out initiated in September 2006, which included the initial launch of FatMax® XL™ in European markets.
- In January 2006, the Company completed the acquisition of Facom S.A. (‘‘Facom’’) for 407 million euros ($480 million) which was financed with a combination of cash on hand and debt

issuance. Facom, based in France, is a leading European manufacturer of hand and mechanics tools with annual revenues approximating $475 million. Facom designs, manufactures and markets the majority of its tool product offerings to professional automotive and industrial end users with its well-known industrial tool brands: Facom®, Virax® and USAG®. Facom operates primarily within the premium industrial and automotive tools sector in Europe, while the Company's pre-existing European customer base is focused mainly on the construction and D-I-Y (''do-it-yourself'') channels. As a result, the two businesses complement each other and benefit from joint efforts in areas such as product sourcing and procurement.

- On November 30, 2005, National Manufacturing Co. (''National'') was acquired for $174 million. National is a leading North American manufacturer and supplier of builders' hardware, marketing the majority of its products through the two-step cooperative channel to the builder trade. National serves over 25,000 outlets with manufacturing operations in the U.S., Canada and Mexico and has annual revenues of approximately $175 million.
- During 2006, the Company continued to focus on the integration of the recent Facom and National acquisitions with dedicated integration teams. Cost reduction actions for National resulted in the severance of 240 employees, rationalization of distribution processes and transitioning of certain manufacturing activities to Asia. The cost reduction actions and integration will continue throughout 2007. Facom is profitable and has experienced a long history of success in professional markets in Europe, especially in France and Italy. Nonetheless, many of its products are subject to competitive forces that will likely require a significant reformation of its cost structure and that of existing Stanley Europe. Management is committed to performing such a reformation in order to ensure the long-term competitiveness and preservation of the Facom and Stanley tool franchises in Europe. During 2006, the Company completed a consultation process with its European Works Council

regarding the reorganization of its Facom and Stanley hand tools activities in Europe (these ''Initiatives''). These initiatives will, among other things, implement growth strategies and reduce costs by rationalizing manufacturing, logistics, sales and support organizations. It will result in the severance of approximately 580 employees, the closure of two legacy Facom factories in France and four legacy Facom distribution centers located in the United Kingdom, Belgium, Germany and Switzerland. The Company estimates approximately $75 million in cash expenditures will be incurred for these Initiatives, the majority of which has been recorded in the Facom purchase price allocation. These Initiatives commenced during the latter half of 2006 and implementation will continue throughout 2007.

- In July 2006, the Company acquired approximately 67% of the outstanding shares of Besco Pneumatic Corporation (''Besco''), a leading manufacturer of pneumatic tools for $38 million in cash. Over the next five years, the Company will have the option to increase its ownership by an additional 15% to an ultimate ownership of 82%. Besco, which is headquartered in Taiwan and also has operations in China, possesses state-of-the-art research and development capabilities and efficient production facilities. Besco was one of Stanley fastening system's significant suppliers and approximately half of its 2005 sales of $38 million were to the Company. The acquisition is a key step in reducing the fastening systems business' existing cost structure and will facilitate the pursuit of business in emerging markets aided by Besco's brand strength in Asia.

CONTINUE TO INVEST IN THE STANLEY BRAND

The Stanley® brand is recognized as one of the world's great brands and is one of the Company's most valuable assets. Brand support was increased during 2006, 2005 and 2004, including television advertising campaigns associated with new product roll-outs, continued NASCAR racing sponsorships as well as more print and web-based advertising that generated approximately one billion brand impressions annually. These advertising and marketing campaigns yielded strong results as evidenced by various hand tools metrics during 2006: web traffic increase of 31%; sales lead increase of 9%; brand awareness increase of 30% and intent to buy increase of 30% versus 2005.

INSTITUTIONALIZE THE STANLEY FULFILLMENT SYSTEM

The Company continued to practice the operating disciplines specified by the Stanley Fulfillment System (''SFS''), which is a continuous operational improvement process committed to increasing customer and shareowner value. SFS's core disciplines consist of striving to achieve perfect quality, service excellence, optimal cost, and environmental health & safety. The Company applies SFS to many aspects of its business including procurement, maximizing customer fill rates, acquisition integration, and other key business processes. The SFS program helped to mitigate the impact of material price inflation that was experienced in recent years. In 2007, the Company plans to expand its efforts to leverage SFS across the enterprise with the intent of increasing working capital turns, decreasing cycle times, and increasing customer satisfaction.

Aside from the strategic commentary above, four other matters having a significant impact on the Company's results were inflation, currency exchange rate fluctuations, share repurchase and stock option expensing.

The Company has been negatively impacted by inflation, primarily commodity and freight, which has increased costs by approximately $85 million over the past two years. During this period, the Company has recovered approximately 68% of the cost increase through pricing actions, and largely offset the remainder through various cost reduction initiatives. The Company expects the negative impact of inflation during 2007 will be in the range of $60 — $65 million, and plans to recover more than two-thirds of this impact through pricing, and offset the remainder through productivity actions.

In recent years, the strengthening of foreign currencies had a favorable impact on the translation of foreign currency-denominated operating results into U.S. dollars. It is estimated that the favorable impact of foreign currency translation, including acquired companies, contributed $0.04 and $0.12 of

diluted earnings per share from continuing operations in 2005 and 2004, and had no effect on 2006 earnings per share. This impact was principally from the Canadian dollar and Asian currencies in 2005 and European currencies in 2004. Fluctuations in foreign currency exchange rates relative to the U.S. dollar may have a significant impact on future earnings, either positive or negative.

During 2006, the Company repurchased 4 million outstanding shares of its common stock for $200 million. This stock repurchase program was accretive to diluted earnings per share by approximately 13 cents in 2006. This was partially offset by the issuance of 2.1 million shares of common stock under various employee plans.

In 2006, the Company adopted Financial Accounting Standards Board Statement No. 123 (revised 2004), ''Share-Based Payment'' (''SFAS 123R''), which requires all share-based payments, including grants of employee stock options, to be recognized as an expense in the Consolidated Statement of Operations based on their fair values as they are earned by the employees under the vesting terms. Pursuant to the adoption of SFAS 123R, the Company recognized $9 million of non-cash, pre-tax stock option compensation expense in 2006, which negatively impacted diluted earnings per share by 7 cents compared to the corresponding 2005 period. Refer to Note A Significant Accounting Policies of the Notes to the Consolidated Financial Statements for further discussion of the adoption of SFAS 123R.

RESULTS OF OPERATIONS

Below is a summary of the Company's operating results at the consolidated level, followed by an overview of business segment performance. The terms ''organic'' and ''core'' are utilized to describe results aside from the significant impact of acquisitions and do not include their results of operations until they have reached their respective one year anniversary dates. This ensures appropriate comparability to operating results of prior periods.

Net Sales: Net sales from continuing operations were $4.019 billion in 2006, as compared to $3.285 billion in 2005, a 22% increase. Acquisitions contributed 21% or $689 million of the sales increase. Organic sales increased 1% driven by relatively consistent volume, pricing levels and foreign currency impact compared to the prior year. The organic increase was generated by share gains achieved in the consumer hand tools and automatic doors businesses offset by price and volume declines experienced in the fastening systems business. Favorable foreign currency translation in the Americas and Europe was partially offset by a negative impact from Asia.

Net sales from continuing operations were $3.285 billion in 2005, as compared to $2.997 billion in 2004, a 10% increase. Acquisitions contributed 6% or $167 million of the sales increase. Organic sales increased 4% driven by 2% volume growth, 1% favorable foreign currency and a 1% positive pricing impact. The organic volume growth was attributed to strong Consumer Products demand based on successful consumer hand tool and garage storage new product introductions, as well as increases in several Industrial Tools businesses, principally industrial mechanics tools, hydraulic tools, leveling / measuring tools and fastening systems. Favorable foreign currency translation in Canada and Asia increased net sales by 1%.

Gross Profit: The Company reported gross profit from continuing operations of $1.459 billion, or 36% of net sales, in 2006, compared to $1.181 billion, or 36% of net sales, in the prior year. The acquired businesses increased gross profit by $265 million. Included in the 2006 gross profit is the unfavorable impact of $22 million in non-cash inventory step-up charges related to the initial turnover of acquired inventory. Gross profit for 2006 was 37% of net sales excluding this non-recurring item, primarily due to the positive impact of the Facom acquisition. Core gross profit as a percentage of net sales was 36% in 2006, which was consistent with the prior year. The benefits of prior cost reduction actions, productivity improvements from the Stanley Fulfillment System, and pricing actions offset continued margin pressure from commodity and other inflation which resulted in approximately $48 million of additional costs, and a decline in fastening systems. The Company expects inflation to increase 2007 costs by approximately $60 – $65 million, which management plans to mitigate through various customer pricing actions and continued cost reduction and productivity initiatives. The fastening systems' gross profit decline reflected lower sales volumes, a result of weakening housing

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markets and price erosion, as well as a commitment to shed unprofitable business; gross profit in this business was further impacted by commodity cost inflation. Management launched an extensive cost reduction initiative with the objective to return fastening systems' to acceptable profitability over a two year period.

The Company reported gross profit from continuing operations of $1.181 billion, or 36% of net sales, in 2005, compared to $1.104 billion, or 37% of net sales, in the prior year. Acquisitions increased gross profit by $52 million. The remaining $25 million improvement was primarily attributed to the increase in organic sales volume and continued benefits of the Stanley Fulfillment System. As a percentage of sales, the year over year gross margin rate decline primarily stems from unfavorable mix and cost absorption in the fastening business, and to a lesser extent the impact of recently acquired businesses which possess lower gross margin percentages until integration synergies are realized. During 2005, there was carryover of commodity inflation from 2004 which resulted in approximately $40 million of additional costs that were mostly recovered through favorable pricing actions and cost reduction initiatives.

SG&A expenses: Selling, general and administrative expenses from continuing operations were $955 million, or 24% of net sales, in 2006, compared to $737 million, or 22% of net sales, in the prior year. The increase of $218 million primarily relates to acquired businesses that increased costs by $192 million, $11 million of increased non-cash stock compensation expense principally associated with the adoption of stock option expensing during 2006, and $11 million of increased brand support. Excluding acquisitions, SG&A as a percentage of sales increased slightly to 23% of net sales compared with 22% in 2005 due to the items described above, partially offset by benefits received from prior restructuring actions.

Selling, general and administrative expenses from continuing operations were $737 million, or 22% of net sales, in 2005, compared to $691 million, or 23% of net sales, in the prior year. The increase of $46 million mainly pertains to acquired businesses that increased costs by $34 million, and $14 million of increased brand support. Excluding acquisitions, SG&A as a percentage of sales decreased 50 basis points compared with 2004 levels despite the higher brand support expense due to sales volume leverage, lower Sarbanes-Oxley compliance costs and effective cost controls.

Interest and Other-net: Net interest expense from continuing operations in 2006 was $65 million, compared to $34 million in 2005. The increase was mainly due to the November 2005 issuance of $450 million in junior subordinated debt securities to fund acquisitions, and to a lesser extent increased commercial paper borrowings resulting primarily from the execution of the $200 million share repurchase program in the first half of 2006, along with higher applicable short-term interest rates. Interest expense will increase in 2007 due to borrowings associated with the January 2007 acquisition of HSM for $545 million; the earlier discussed net earnings expectations for HSM contemplate the interest costs related to financing the acquisition.

Net interest expense from continuing operations in 2005 was $34 million, consistent with 2004 levels. Interest expense was held fairly constant in a period of rising interest rates through the maintenance of overall lower debt levels during most of 2005 and application of effective hedging strategies.

Other-net from continuing operations represented $57 million of expense in 2006 compared to $48 million of expense in 2005. The increase was primarily driven by $9 million of higher intangible asset amortization expense associated with acquisition activity, a $4 million pension plan curtailment charge in the U.K., and a $5 million increase in foreign currency losses, partially offset by lower environmental expense and decreased losses on the sale of fixed assets.

Other-net from continuing operations represented $48 million of expense in 2005, an increase of $2 million over 2004. The slight increase was primarily driven by $6 million of higher intangible asset amortization associated with acquisition activity partially offset by lower foreign currency losses.

Income Taxes: The Company's effective income tax rate from continuing operations for 2006 was 21% as compared to 24% for 2005 and 27% for 2004.

The lower effective tax rate in the current year compared to 2005 is driven by the realization of credits against U.S. taxes and the inclusion of the European-based Facom acquisition. Additionally, substantial costs were incurred in 2005 for the repatriation of foreign earnings under the American Jobs Creation Act and such costs were not incurred in 2006. It is anticipated the 2007 effective tax rate will increase to within a 25% to 27% range, in part because certain credits affecting the 2006 and 2005 tax rate will not re-occur.

The decrease in the effective income tax rate in 2005 compared to 2004 reflects a higher proportion of taxable income in countries with lower statutory rates, as well as the recording of a $5 million tax benefit pertaining to the execution of tax planning strategies enabling the reduction of a previously provided valuation allowance on future utilization of certain prior year European net operating losses. Also, a $17 million tax benefit was recorded arising from the final settlement of various tax contingencies based on the resolution of income tax audits in 2005. In October 2004, the American Jobs Creation Act of 2004 (the ‘‘Act’’) was signed into law. The Act created a temporary incentive for U.S. corporations to repatriate foreign earnings by providing an 85 percent deduction for certain dividends received from controlled foreign corporations. During 2005, the Company repatriated $250 million in foreign earnings and recorded $16 million of tax expense pertaining to the repatriation.

Discontinued Operations: Net loss from discontinued operations of $1 million in 2006 primarily relates to the previous operating results and loss from the sale of the U.K. paint decorator tool business in March 2006. In 2005, the Company announced the planned sale of two small businesses: the U.K. paint decorator tool business and a small appliance hinge business. The operations of these two held for sale businesses, along with the resolution of tax and other matters associated with the 2004 divestitures, resulted in a net loss from discontinued operations of $2 million in 2005. Net earnings from discontinued operations were $130 million in 2004, reflecting a $95 million net gain on the March 2004 sale of the residential entry door business, a $24 million net gain on the December 2004 divestiture of the home décor business, a $4 million net loss on the sale of a small German paint roller business, as well as the operating results of these discontinued operations.

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 operating profit, which is defined as net sales minus cost of sales, SG&A and allocated corporate and common expenses; and operating profit as a percentage of net sales to assess the profitability of each segment. Segment operating profit excludes interest income, interest expense, other-net, intangible asset amortization expense, restructuring and asset impairments, and income tax expense. Refer to Note O Restructuring and Asset Impairments and Note G Goodwill and Other Intangible Assets of the Notes to the Consolidated Financial Statements for the amount of restructuring charges and asset impairments, and intangibles amortization expense, respectively, attributable to each segment. As discussed previously, the Company’s operations are classified into three business segments: Consumer Products, Industrial Tools, and Security Solutions.

Consumer Products:

(Millions of Dollars)	2006	2005	2004
Net sales from continuing operations	$ 1,329	$ 1,098	$ 1,043
Operating profit from continuing operations	$ 210	$ 185	$ 171
% of Net sales	15.8%	16.9%	16.4%

Net sales from continuing operations of Consumer Products increased 21% in 2006 compared to 2005. Of this increase, acquisitions, predominantly National, accounted for 18%, while organic volume and price rose 2% and 1%, respectively. Foreign currency did not significantly impact sales. The consumer hand tool business continued to achieve share gains from the strong performance of the new FatMax®Xtreme™ and FatMax®XL™ product lines which launched in the U.S. and European markets, representing the largest new hand tools product introduction in the Company's history. At the same time, the FatMax® range of product offerings delivered growth though continued premium innovation, distribution point expansion and related brand support. This favorable performance was partially offset by lower volumes in the consumer storage and mechanics tools businesses. The prior year sales

in the consumer storage business reflected higher volume from the initial launch of garage storage products. The 110 basis point decline in segment operating margin is primarily due to $8 million of non-cash inventory step-up amortization from acquisitions, the dilutive impact of National margins due to its legacy high-cost manufacturing structure which the Company continues to transition to low cost countries, increased brand support, and commodity cost inflation, partially offset by savings derived from price recovery initiatives and prior cost reduction actions.

Consumer Products' net sales from continuing operations in 2005 represented a 5% increase over 2004. Of this 5% increase, the November 2005 National acquisition contributed 1% while organic volume increased 3% driven by strength in the hand tools and consumer storage business associated with successful new product introductions. The effects of currency and pricing contributed equally to the remaining 1% increase. Solid organic sales growth was achieved despite an unanticipated inventory correction by certain large North American customers in December 2005 which negatively impacted sales by approximately $30 million versus normal levels. Operating margin improved 50 basis points primarily due to leverage associated with the increase in sales volume.

Industrial Tools:

(Millions of Dollars)	2006	2005	2004
Net sales from continuing operations	$ 1,803	$ 1,370	$ 1,293
Operating profit from continuing operations	$ 159	$ 136	$ 133
% of Net sales	8.8%	9.9%	10.3%

Industrial Tools' net sales increased 32% in 2006 compared to 2005, primarily driven by the Facom and Besco acquisitions, which increased sales by $452 million or 33%. Favorable pricing actions and favorable foreign currency collectively contributed 1%, and were more than offset by a core volume decline of 2%. The majority of this decrease was due to fastening systems organic sales declining 7% compared to the prior year stemming from weakness in the U.S. construction market and management's commitment to turn down unprofitable business. This decline more than offset strong results in the Mac Tools, Facom, hydraulic tools, industrial tools and storage businesses, as organic sales aside from fastening systems increased 3% in 2006 compared to the prior year. Mac Tools' continues to benefit from improved retention of its distributors based on management actions initiated early in the year. Industrial tools and storage and the hydraulic tools businesses obtained share gains from the success of new product introductions in the oil and mining industries as demand for such commodities remained strong during 2006. Operating profit as a percentage of net sales decreased by 110 basis points due to $13 million of non-cash inventory step-up amortization associated with the Facom acquisition, commodity inflation, supply chain inefficiencies in certain businesses due to increased backlog, and the sales volume decline and cost inefficiencies experienced by the U.S. fastening systems business, partially offset by the accretive impact of Facom. Management is committed to restoring the fastening systems business' long-term cost competitiveness by continuing the migration of production to Asia, reducing the overall SG&A and manufacturing footprint, as well as SKU rationalization. Additionally, the acquisition of Asian-based Besco and the opening of a new manufacturing facility in China during 2006 will strategically aid the fastening systems business' long term vitality.

Industrial Tools' net sales increased 6% in 2005 from 2004. The carryover effect from the 2004 CST/Berger and related 2005 acquisitions contributed nearly 1% of the sales increase. The 5% organic sales increase was comprised of 3% volume and 2% price. Sales volume rose on continued strong demand in the industrial mechanics tools, hydraulic tools, laser leveling tools, and storage businesses, and to a lesser extent fastening systems. These volume gains were partially offset by declines in the Mac Tools and assembly technologies businesses. Industrial mechanics tools' increase in volume was driven by share gains achieved from new product introductions and improved customer service. Hydraulic tools also benefited from new product introductions as well as higher product demand associated with the steel scrap market which was driven by the strong global demand for steel. Laser leveling tools continued to increase its market share in the U.S. and European professional markets due to new product offerings. Although demand began to slow during the latter half of 2005, fastening systems achieved moderate sales growth during 2005 based on demand from the U.S. construction and

industrial channels along with the success of innovative nail products. The storage business increase in volume was driven by the successful launch of a vertical lift module automated storage and retrieval system as well as strong demand experienced in the industrial, heavy truck, and automotive dealership markets. Assembly technologies was affected by weakness in the U.S. auto industry, as the ''Big 3'' automakers continued to reduce capital expenditures in conjunction with other cost reduction initiatives. Mac Tools sales fell due to a decline in the number of distributors in 2005 compared to 2004 as dealer attrition outpaced recruiting efforts. However, the average sales per Mac Tools' distributor was up 4% versus 2004 and operating margin improved slightly. Operating profit in 2005 was $136 million, or 9.9% of net sales, up slightly compared to $133 million, or 10.3% of net sales, in 2004. The 40 basis point decline in the operating margin rate, despite the sales volume increase, was primarily due to increased freight costs, as well as unfavorable mix and cost absorption in the fastening business where manufacturing volume was lower in 2005 compared to 2004 on improved inventory management.

Security Solutions:

(Millions of Dollars)	2006	2005	2004
Net sales from continuing operations	$ 887	$ 818	$ 662
Operating profit from continuing operations	$ 134	$ 124	$ 108
% of Net sales	15.1%	15.1%	16.3%

During 2006, Security Solutions' sales increased 8%. Acquisitions contributed 4%, organic sales volume 2%, pricing 1%, and currency 1%. The automatic doors business continued to grow its service revenue and achieved strong national account share gains driven by the favorable impact of new product introductions, new store openings and increased modernization of pre-existing stores. The mechanical access business benefited from new product introductions and its expanded ability to provide customers with virtually all of their varied mechanical product needs. In addition, the Security segment as a whole benefited from the growth and continued integration of its national service foot print. The 2006 operating margin as a percentage of net sales was consistent with 2005 as the favorable impact from prior cost reduction and integration actions were negated by commodity cost inflation and the dilutive impact of recently acquired companies until integration initiatives unfold.

Security Solutions' sales increased 24% in 2005. Excluding acquisitions, organic sales increased 2%. Sales volume and favorable foreign currency each represented 1% of the organic increase. The increase in organic volume was driven by the North American mechanical access and electronic security integration businesses, partially offset by declines in the North American automatic door and Blick U.K. security businesses. The strong sales volume achieved by the mechanical access business was driven by increased demand from its national accounts based on the continued ability to provide a diversified product offering to such customers, while the North American security integration business benefited from strong market conditions. The decline in Blick was attributable to overall softness in the U.K. economy, while the automatic doors business was negatively impacted by the non-recurrence of a major project upgrade at a large customer as compared with 2004. Acquisitions contributed $17 million of operating profit. The operating margin rate decrease is primarily attributed to unfavorable mix as a result of a higher proportion of electronic access sales as compared to mechanical access, as well as the impact of recent acquisitions as integration synergies were not yet fully achieved, and there was unfavorable impact from non-recurring inventory step-up costs in purchase accounting. However, the second half 2005 operating margin was 15.8% compared to 14.4% in the first half, reflecting the benefit of various cost reduction initiatives including headcount reductions at several of the businesses, progress in the integration of field service organizations and back office systems, and the continued roll-out of the Stanley Fulfillment System to recently acquired businesses.

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RESTRUCTURING ACTIVITIES

At December 30, 2006, the restructuring and asset impairment reserve balance was $63.1 million, which the Company expects to be fully expended by the end of 2007. Restructuring charges in 2007 are expected to increase to approximately $.20 per diluted share. A summary of the Company's restructuring reserve activity from December 31, 2005 to December 30, 2006 is as follows (in millions):

	12/31/05	Acquisition Impact	Net Additions	Usage	Currency	12/30/06
Acquisitions						
Severance	$ 2.2	$ 68.5	$ 0.4	$ (16.4)	$ —	$ 54.7
Facility Closure	—	2.7	—	(0.3)	—	2.4
Other	0.1	2.0	0.5	(1.1)	—	1.5
2006 Actions	—	—	11.9	(9.3)	—	2.6
Pre-2006 Actions	2.6	—	1.0	(1.8)	0.1	1.9
	$ 4.9	$ 73.2	$ 13.8	$ (28.9)	$ 0.1	$ 63.1

2006 Actions: During 2006, the Company initiated a cost reduction initiative in order to maintain its cost competitiveness and vitality. Severance charges of $11.9 million were recorded during the year relating to a reduction of 728 employees. Approximately $3.0 million of this charge pertained to the Consumer Products segment; $4.5 million to the Industrial Tools segment; and $4.4 million to the Security Solutions segment. Of these amounts, $9.3 million has been utilized to date, with $2.6 million of reserves remaining as of December 30, 2006. In addition to severance, $4.1 million for a U.K. pension plan curtailment was recorded in Other, net and $1.3 million of related consulting costs were recorded in SG&A.

Pre-2006 Actions: During 2005, the Company initiated a $5.7 million cost reduction in various businesses, of which $4.6 million was recorded in 2005 and $1.1 million was recorded during 2006. The action was comprised of the severance of 170 employees and the exit of a leased facility. Of this amount, $5.0 million has been utilized to date with $0.7 million of accrual remaining as of December 30, 2006. Approximately $4.3 million of this charge pertained to the Security Solutions segment; $0.9 million to the Industrial Tools segment; and $0.5 million to the Consumer Products segment. In addition, as of December 30, 2006, $1.2 million of reserves remain relating to pre-2005 actions.

Acquisition Related: During 2006, the Company completed a consultation process with its European Works Council regarding the reorganization of its Facom and Stanley hand tools activities in Europe (these ‘‘Initiatives’’). These Initiatives will, among other things, implement growth strategies and reduce costs by rationalizing manufacturing, logistics, sales and support organizations resulting in the severance of approximately 580 employees, the closure of two legacy Facom factories in France, as well as four legacy Facom distribution centers located in the United Kingdom, Belgium, Germany and Switzerland. The facility rationalization commenced recently with the severance of approximately 440 employees, closure of the two French factories and exit from the United Kingdom distribution center. The Company expects to complete these Initiatives during 2007. Cash expenditures to be incurred for these Initiatives are estimated at approximately $75 million, of which $59.4 million has been recorded to the Facom purchase price allocation and $0.7 million was reported as a 2006 restructuring charge. As of December 30, 2006, $6.6 million has been utilized to date, with $53.5 million accrual remaining. Also, $1.4 million of asset impairments were recorded to Cost of Sales relating to inventory rationalization associated with the plant shut downs.

In connection with its acquisition of National, the Company recorded $8.0 million in severance costs for 243 employees and $0.3 million for facility closure costs to the purchase price allocation, and $0.2 million was recorded as a restructuring charge. As of December 30, 2006, $5.8 million has been utilized with $2.7 million accrual remaining.

FINANCIAL CONDITION

Liquidity, Sources and Uses of Capital: The Company’s primary sources of liquidity are cash flows generated from operations and borrowings under various credit facilities.

Operating and Investing Activities: The Company has historically generated strong cash flows from operations. In 2006, cash flow from operations was $439 million compared to $362 million in 2005. The $77 million improvement in 2006 versus 2005 is mainly attributable to higher cash earnings on the strength of acquisitions, reflecting the removal of increased non-cash expenses in 2006 (particularly inventory step-up amortization associated with acquisitions, intangible asset amortization expense and stock-based compensation expense). Receivables, inventories and accounts payables generated $11 million higher cash inflows in 2006 compared with 2005 due to increased receivable sales. These favorable impacts were partially offset by cash outflows for restructuring activities which amounted to $29 million in 2006, an increase of $20 million over 2005. In 2005, operating cash flow totaled $362 million, down slightly from 2004.

Capital expenditures were $80 million in 2006, $68 million in 2005, and $55 million in 2004. The higher capital expenditures in 2006 were driven by upgrades of information systems, the incremental impact of normal capital spending incurred by recent acquisitions, and equipment purchases related to new product introductions. The increase in 2005 capital expenditures versus 2004 was due to new product introductions, information system upgrades and plant investments in China and Thailand. The Company expects future capital expenditures to increase approximately in proportion to its sales growth.

Free cash flow, as defined in the following table, was $359 million in 2006 and $294 million in 2005, considerably exceeding net earnings from continuing operations in a period of continued strong sales volume growth. The Company believes free cash flow is an important indicator of its liquidity, as well as its ability to fund future growth and provide a dividend to shareowners.

(Millions of Dollars)	2006	2005	2004
Net cash provided by operating activities	$ 439	$ 362	$ 372
Less: capital expenditures	(60)	(53)	(48)
Less: capitalized software	(20)	(15)	(7)
Free cash flow	$ 359	$ 294	$ 317

Based on its demonstrated ability to generate cash flow from operations as well as its strong balance sheet and credit position at December 30, 2006, the Company believes it has the financial flexibility to deploy capital to its shareholders' advantage through a combination of acquisitions, dividends, debt repayment, and potential future share repurchases.

In 2006, acquisition spending totaled $572 million, primarily related to Facom and Besco, and $20 million of debt repayments associated with the 2004 acquisition of Blick. 2005 acquisition spending amounted to $287 million principally for the National, Security Group, Sielox and Precision acquisitions discussed previously. As part of its portfolio diversification shift, in 2004 the Company received $205 million in net proceeds from sales of the residential entry door and home décor businesses, and disbursed $301 million for business acquisitions. In 2005, the $21 million of remaining taxes due on the gain from these business sales were paid. Pursuant to its profitable growth strategy, the Company will continue to assess its current business portfolio for disposition opportunities and make acquisitions in favored markets while minimizing the risk associated with large customer concentrations. The Company likely will complete additional 2007 acquisitions requiring funding of approximately $50 – $75 million, aside from HSM which was acquired for $545 million in January 2007.

During 2006, the Company entered into a sale-leaseback transaction of its corporate headquarters building. Under the terms of the transaction, the Company received $23 million in cash proceeds, reported in investing cash flows, and recorded a deferred gain of $11 million which will be amortized over the 15 year operating lease term. The cash proceeds were utilized to pay down short-term borrowings.

Financing Activities: The Company financed the HSM acquisition with proceeds from existing short term credit facilities and a new $500 million 364-day bridge facility entered into on January 8, 2007. The Company remains committed to its current credit ratings and intends to refinance this transaction with a combination of available cash, debt and equity-linked securities, which it believes will be consistent with maintaining those ratings. Management does not anticipate the need to issue common equity in the short term in order to achieve this objective. However, the above refinancing is expected to entail the issuance of common stock in the medium term.

Payments on long-term debt amounted to $4 million in 2006, $72 million in 2005 and $154 million in 2004. Payments in 2004 reflect the maturity of $120 million of debt on March 1, 2004. Net repayments of short-term borrowings in 2006 amounted to a cash outflow of $66 million as the Company paid down commercial paper utilizing a portion of the strong operating cash flows. Net short-term borrowings provided cash inflows of $103 million in 2005 and $20 million in 2004. The increase in 2005 was primarily attributed to commercial paper issued to fund the 2005 acquisitions aside from National.

In November 2005, the Company consummated a Section 144A offering, with registration rights, of $450 million of Enhanced Trust Preferred Securities (‘‘ETPS’’) through its unconsolidated trust subsidiary, The Stanley Works Capital Trust I (‘‘the Trust’’). Contemporaneously, the Company borrowed the proceeds of the ETPS offering from the Trust by issuing $450 million of junior subordinated debt securities payable to the Trust. The net proceeds were used to partially fund the acquisitions of National and Facom which closed on November 30, 2005 and January 1, 2006, respectively. These securities and underlying junior subordinated debt securities (collectively, the ‘‘securities’’) feature a 5 year fixed rate period ending December 1, 2010 and a floating rate period ending December 1, 2045. The fixed coupon was set at 5.902%. The obligations, tenor and terms of the ETPS mirror those of the junior subordinated debt securities. The securities can be redeemed by the Company on or after December 1, 2010 without penalty for early payment.

In 2005, the Company amended its long-term (multi-year) $400 million committed credit facility by increasing the facility size to $550 million and adding a multi currency sub-limit of $250 million available in Euros or Pound Sterling. This long-term credit facility matures in October 2009. In addition, the Company has short-term lines of credit with numerous foreign banks aggregating $251 million, of which $191 million was available at December 30, 2006. Short-term arrangements are reviewed annually for renewal. Aggregate credit lines amounted to $801 million. The $550 million committed credit facility is designated as a liquidity back-stop for the Company’s commercial paper program. As of December 30, 2006 there were no outstanding loans under this facility and the Company had $31 million of commercial paper outstanding. In addition to these lines of credit, the Company maintains a committed facility designed for the securitization of certain trade accounts receivable for purposes of additional liquidity. As of December 30, 2006, the Company’s maximum available funds under this arrangement were $87 million, of which $60 million was utilized.

In 2003, the Company filed a Shelf Registration in the amount of $900 million. At December 30, 2006, the Shelf Registration was unutilized. This filing represents a prospectus which, if accompanied by a prospectus supplement, would allow the Company to offer, issue and sell, together or separately, debt, equity and other securities.

The Company increased its cash dividend per common share to $1.18 in 2006. Dividends per common share increased 3.5% in 2006, 5.5% in 2005 and 4.9% in 2004.

In 2006, the Company completed a stock repurchase program whereby it repurchased 4 million outstanding shares of its common stock for $200 million. 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.

The Company’s debt to capital ratio was 39% at the end of 2006, 42% at the end of 2005 and 32% at the end of 2004. Reflecting the credit protection measures that are incorporated into the terms of the $450 million ETPS, the debt to capital ratio of the Company is more fairly represented by apportioning 50% of the ETPS issuance to equity when making the calculation. The resulting debt to

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capital ratio from this apportionment is 30% as of December 30, 2006. This adjustment is consistent with the treatment accorded these securities by the nationally recognized statistical ratings organizations that rate the Company's debt securities.

Contractual Obligations: The following summarizes the Company's significant contractual obligations and commitments that impact its liquidity:

Payments Due by Period

(Millions of Dollars)	Total	2007	2008 - 2009	2010 - 2011	Thereafter
Long-term debt	$ 910	$ 230	$ 20	$ 8	$ 652
Operating leases	111	29	38	21	23
Deferred compensation	40	5	10	12	13
Pension funding obligations[a]	17	17	—	—	—
Material purchase commitments	36	9	18	9	—
Outsourcing and other obligations	32	19	13	—	—
Total contractual cash obligations	$ 1,146	$ 309	$ 99	$ 50	$ 688

(a) The Company anticipates that funding of its pension and postretirement benefit plans in 2007 will approximate $17 million. That amount principally represents contributions either required by regulations or laws or, with respect to unfunded plans, necessary to fund current benefits. The Company has not presented estimated pension and postretirement funding in the table above beyond 2007 as funding can vary significantly from year to year based upon changes in the fair value of the plan assets, actuarial assumptions, or curtailment/settlement actions.

Aside from debt payments, for which there is no tax benefit associated with repayment of principal, payment of the above contractual obligations will typically generate a cash tax benefit such that the net cash outflow will be lower than the gross amounts indicated.

Other Commercial Commitments

Amounts of Commitments Expiration Per Period

(Millions of Dollars)	Total	2007	2008-2009	2010-2011	Thereafter
U.S. lines of credit	$ 550	$ —	$ 550	$ —	$ —
U.S. receivables securitization facility	87	87	—	—	—

International lines of credit	251	251	—	—	—