

3M CO
Form 10-Q
August 01, 2008
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008

Commission file number 1-3285

3M COMPANY

State of Incorporation: **Delaware**

I.R.S. Employer Identification No. **41-0417775**

Principal executive offices: **3M Center, St. Paul, Minnesota 55144**

Telephone number: **(651) 733-1110**

Edgar Filing: 3M CO - Form 10-Q

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Shares of common stock outstanding at June 30, 2008: 698,990,402.

This document (excluding exhibits) contains 50 pages.

The table of contents is set forth on page 2.

The exhibit index begins on page 47.

Table of Contents

3M COMPANY

Form 10-Q for the Quarterly Period Ended June 30, 2008

TABLE OF CONTENTS

| | PAGE |
|--------------------------------------------------------------------------------------------------------------|-------------|
| <u>PART I</u> | |
| <u>FINANCIAL INFORMATION</u> | |
| <u>ITEM 1. Financial Statements</u> | 3 |
| <u>Index to Financial Statements:</u> | |
| <u>Consolidated Statement of Income</u> | 3 |
| <u>Consolidated Balance Sheet</u> | 4 |
| <u>Consolidated Statement of Cash Flows</u> | 5 |
| <u>Notes to Consolidated Financial Statements</u> | |
| <u>Note 1. Basis of Presentation</u> | 6 |
| <u>Note 2. Acquisitions and Divestitures</u> | 8 |
| <u>Note 3. Goodwill and Intangible Assets</u> | 10 |
| <u>Note 4. Restructuring Actions and Other Exit Activities</u> | 11 |
| <u>Note 5. Supplemental Stockholders' Equity and Comprehensive Income Information</u> | 12 |
| <u>Note 6. Income Taxes</u> | 12 |
| <u>Note 7. Marketable Securities</u> | 13 |
| <u>Note 8. Pension and Postretirement Benefit Plans</u> | 15 |
| <u>Note 9. Derivatives and Other Financial Instruments</u> | 16 |
| <u>Note 10. Fair Value Measurements</u> | 16 |
| <u>Note 11. Commitments and Contingencies</u> | 19 |
| <u>Note 12. Management Stock Ownership Program (MSOP) and General Employees' Stock Purchase Plan (GESPP)</u> | 23 |
| <u>Note 13. Business Segments</u> | 26 |
| <u>Note 14. Review Report of Independent Registered Public Accounting Firm</u> | 27 |
| <u>Report of Independent Registered Public Accounting Firm</u> | 28 |
| <u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | |
| <u>Index to Management's Discussion and Analysis:</u> | |
| <u>Overview</u> | 29 |
| <u>Results of Operations</u> | 31 |
| <u>Performance by Business Segment</u> | 34 |
| <u>Financial Condition and Liquidity</u> | 41 |
| <u>Forward-Looking Statements</u> | 44 |
| <u>ITEM 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 45 |
| <u>ITEM 4. Controls and Procedures</u> | 45 |
| <u>PART II</u> | |
| <u>OTHER INFORMATION</u> | |
| <u>ITEM 1. Legal Proceedings</u> | 46 |
| <u>ITEM 1A. Risk Factors</u> | 46 |
| <u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 46 |
| <u>ITEM 3. Defaults Upon Senior Securities</u> | 46 |

Edgar Filing: 3M CO - Form 10-Q

| | | |
|----------------|------------------------------------------------------------|----|
| <u>ITEM 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | 47 |
| <u>ITEM 5.</u> | <u>Other Information</u> | 47 |
| <u>ITEM 6.</u> | <u>Exhibits</u> | 47 |

Table of Contents**3M COMPANY****FORM 10-Q**

For the Quarterly Period Ended June 30, 2008

PART I. Financial Information**Item 1. Financial Statements.****3M Company and Subsidiaries****Consolidated Statement of Income****(Unaudited)**

| (Millions, except per share amounts) | Three months ended June 30 | | Six months ended June 30 | |
|----------------------------------------------------|-------------------------------|----------|-----------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales | \$ 6,739 | \$ 6,142 | \$ 13,202 | \$ 12,079 |
| Operating expenses | | | | |
| Cost of sales | 3,510 | 3,175 | 6,846 | 6,197 |
| Selling, general and administrative expenses | 1,394 | 1,286 | 2,669 | 2,567 |
| Research, development and related expenses | 363 | 352 | 714 | 671 |
| (Gain)/loss on sale of businesses | 23 | (68) | 23 | (854) |
| Total | 5,290 | 4,745 | 10,252 | 8,581 |
| Operating income | 1,449 | 1,397 | 2,950 | 3,498 |
| Interest expense and income | | | | |
| Interest expense | 51 | 48 | 106 | 86 |
| Interest income | (18) | (29) | (48) | (57) |
| Total | 33 | 19 | 58 | 29 |
| Income before income taxes and minority interest | 1,416 | 1,378 | 2,892 | 3,469 |
| Provision for income taxes | 453 | 445 | 923 | 1,153 |
| Minority interest | 18 | 16 | 36 | 31 |
| Net income | \$ 945 | \$ 917 | \$ 1,933 | \$ 2,285 |
| Weighted average common shares outstanding basic | 702.1 | 718.4 | 704.3 | 723.9 |
| Earnings per share basic | \$ 1.35 | \$ 1.28 | \$ 2.74 | \$ 3.16 |
| Weighted average common shares outstanding diluted | 712.0 | 731.7 | 714.6 | 736.5 |
| Earnings per share diluted | \$ 1.33 | \$ 1.25 | \$ 2.70 | \$ 3.10 |
| Cash dividends paid per common share | \$ 0.50 | \$ 0.48 | \$ 1.00 | \$ 0.96 |

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Table of Contents**3M Company and Subsidiaries****Consolidated Balance Sheet****(Unaudited)**

| (Dollars in millions, except per share amount) | June 30 2008 | Dec. 31 2007 |
|---------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 1,547 | \$ 1,896 |
| Marketable securities - current | 455 | 579 |
| Accounts receivable - net | 3,943 | 3,362 |
| Inventories | | |
| Finished goods | 1,535 | 1,349 |
| Work in process | 989 | 880 |
| Raw materials and supplies | 651 | 623 |
| Total inventories | 3,175 | 2,852 |
| Other current assets | 1,419 | 1,149 |
| Total current assets | 10,539 | 9,838 |
| Marketable securities - non-current | 775 | 480 |
| Investments | 294 | 298 |
| Property, plant and equipment | 19,217 | 18,390 |
| Less: Accumulated depreciation | (12,298) | (11,808) |
| Property, plant and equipment - net | 6,919 | 6,582 |
| Goodwill | 5,536 | 4,589 |
| Intangible assets - net | 1,232 | 801 |
| Prepaid pension and postretirement benefits | 1,453 | 1,378 |
| Other assets | 610 | 728 |
| Total assets | \$ 27,358 | \$ 24,694 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Short-term borrowings and current portion of long-term debt | \$ 1,913 | \$ 901 |
| Accounts payable | 1,658 | 1,505 |
| Accrued payroll | 659 | 580 |
| Accrued income taxes | 643 | 543 |
| Other current liabilities | 2,114 | 1,833 |
| Total current liabilities | 6,987 | 5,362 |
| Long-term debt | 4,095 | 4,019 |
| Other liabilities | 3,741 | 3,566 |
| Total liabilities | \$ 14,823 | \$ 12,947 |
| Commitments and contingencies (Note 11) | | |
| Stockholders' equity | | |
| Common stock par value, \$.01 par value, 944,033,056 shares issued | 9 | 9 |
| Additional paid-in capital | 2,925 | 2,785 |
| Retained earnings | 21,437 | 20,316 |
| Treasury stock, at cost; 245,042,654 shares at June 30, 2008; 234,877,025 shares at Dec. 31, 2007 | (11,302) | (10,520) |
| Unearned compensation | (83) | (96) |

Edgar Filing: 3M CO - Form 10-Q

| | | | | |
|-----------------------------------------------|----|--------|----|--------|
| Accumulated other comprehensive income (loss) | | (451) | | (747) |
| Stockholders' equity - net | | 12,535 | | 11,747 |
| Total liabilities and stockholders' equity | \$ | 27,358 | \$ | 24,694 |

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Table of Contents**3M Company and Subsidiaries****Consolidated Statement of Cash Flows****(Unaudited)**

| (Dollars in millions) | Six months ended June 30 | |
|----------------------------------------------------------------------------------|-----------------------------|----------|
| | 2008 | 2007 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 1,933 | \$ 2,285 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 553 | 533 |
| Company pension and postretirement contributions | (95) | (114) |
| Company pension and postretirement expense | 52 | 128 |
| Stock-based compensation expense | 122 | 129 |
| Loss/(gain) from sale of businesses | 23 | (854) |
| Deferred income taxes | 19 | (232) |
| Excess tax benefits from stock-based compensation | (20) | (47) |
| Changes in assets and liabilities | | |
| Accounts receivable | (405) | (470) |
| Inventories | (171) | (139) |
| Accounts payable | 30 | 55 |
| Accrued income taxes | (15) | 259 |
| Product and other insurance receivables and claims | 129 | 112 |
| Other net | 85 | 39 |
| Net cash provided by operating activities | 2,240 | 1,684 |
| Cash Flows from Investing Activities | | |
| Purchases of property, plant and equipment (PP&E) | (632) | (652) |
| Proceeds from sale of PP&E and other assets | 6 | 27 |
| Acquisitions, net of cash acquired | (549) | (194) |
| Purchases of marketable securities and investments | (1,479) | (4,391) |
| Proceeds from sale of marketable securities and investments | 732 | 3,720 |
| Proceeds from maturities of marketable securities | 427 | 242 |
| Proceeds from sale of businesses | 85 | 897 |
| Other investing | (57) | |
| Net cash used in investing activities | (1,467) | (351) |
| Cash Flows from Financing Activities | | |
| Change in short-term debt net | 1,120 | (53) |
| Repayment of debt (maturities greater than 90 days) | (807) | (871) |
| Proceeds from debt (maturities greater than 90 days) | | 1,812 |
| Purchases of treasury stock | (1,082) | (2,199) |
| Reissuances of treasury stock | 217 | 483 |
| Dividends paid to stockholders | (704) | (696) |
| Distributions to minority interests | (12) | (10) |
| Excess tax benefits from stock-based compensation | 20 | 47 |
| Other net | 131 | (2) |
| Net cash used in financing activities | (1,117) | (1,489) |
| Effect of exchange rate changes on cash and cash equivalents | (5) | 57 |

Edgar Filing: 3M CO - Form 10-Q

| | | |
|------------------------------------------------------|----------|----------|
| Net increase (decrease) in cash and cash equivalents | (349) | (99) |
| Cash and cash equivalents at beginning of year | 1,896 | 1,447 |
| Cash and cash equivalents at end of period | \$ 1,547 | \$ 1,348 |

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Table of Contents

3M Company and Subsidiaries

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1. Basis of Presentation

The interim consolidated financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair statement of the Company's consolidated financial position, results of operations and cash flows for the periods presented. These adjustments consist of normal, recurring items. The results of operations for any interim period are not necessarily indicative of results for the full year. The interim consolidated financial statements and notes are presented as permitted by the requirements for Quarterly Reports on Form 10-Q.

As described in 3M's Current Report on Form 8-K dated May 19, 2008, (which updated 3M's 2007 Annual Report on Form 10-K) and 3M's Quarterly Report on Form 10-Q for the period ended March 31, 2008, during the first quarter of 2008 the Company reorganized its business segments (refer to Note 13). This Quarterly Report on Form 10-Q should be read in conjunction with the Company's consolidated financial statements and notes included in its Current Report on Form 8-K dated May 19, 2008.

Significant Accounting Policies

Earnings per share: The difference in the weighted average shares outstanding for calculating basic and diluted earnings per share is attributable to the dilution associated with the Company's stock-based compensation plans. Certain Management Stock Ownership Program (MSOP) options outstanding were not included in the computation of diluted earnings per share because they would not have had a dilutive effect (31.6 million average options for the three months ended June 30, 2008; 29.9 million average options for the six months ended June 30, 2008; 26.6 million average options for the three months ended June 30, 2007; 31.0 million average options for the six months ended June 30, 2007). The conditions for conversion related to the Company's Convertible Notes were not met (refer to 3M's Current Report on Form 8-K dated May 19, 2008, Note 10 to the Consolidated Financial Statements, for more detail). If the conditions for conversion are met, 3M may choose to pay in cash and/or common stock; however, if this occurs, the Company has the intent and ability to settle this debt security in cash. Accordingly, there was no impact on 3M's diluted earnings per share. The computations for basic and diluted earnings per share follow:

Earnings Per Share Computations

Three months ended
June 30

Six months ended
June 30

Edgar Filing: 3M CO - Form 10-Q

| (Amounts in millions, except per share amounts) | 2008 | 2007 | 2008 | 2007 |
|-----------------------------------------------------------------------|---------|---------|----------|----------|
| Numerator: | | | | |
| Net income | \$ 945 | \$ 917 | \$ 1,933 | \$ 2,285 |
| Denominator: | | | | |
| Denominator for weighted average common shares outstanding basic | 702.1 | 718.4 | 704.3 | 723.9 |
| Dilution associated with the Company's stock-based compensation plans | 9.9 | 13.3 | 10.3 | 12.6 |
| Denominator for weighted average common shares outstanding diluted | 712.0 | 731.7 | 714.6 | 736.5 |
| Earnings per share basic | \$ 1.35 | \$ 1.28 | \$ 2.74 | \$ 3.16 |
| Earnings per share diluted | 1.33 | 1.25 | 2.70 | 3.10 |

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. This statement applies under other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued Staff Positions (FSPs) No. 157-1 and No. 157-2, which, respectively, remove leasing transactions from the scope of SFAS No. 157 and defer its effective date for one year relative to certain nonfinancial assets and liabilities. As a result, the application of the definition of fair value and related disclosures of SFAS No. 157 (as impacted by these two FSPs) was effective for 3M beginning January 1, 2008 on a prospective basis with respect to fair value measurements of (a) nonfinancial assets and liabilities that

Table of Contents

are recognized or disclosed at fair value in the Company's financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. This adoption did not have a material impact on 3M's consolidated results of operations or financial condition. The remaining aspects of SFAS No. 157 for which the effective date was deferred under FSP No. 157-2 are currently being evaluated by the Company. Areas impacted by the deferral relate to nonfinancial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis. This deferral applies to such items as nonfinancial assets and liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods) or nonfinancial long-lived asset groups measured at fair value for an impairment assessment. The effects of these remaining aspects of SFAS No. 157 are to be applied by 3M to fair value measurements prospectively beginning January 1, 2009. The Company does not expect them to have a material impact on 3M's consolidated results of operations or financial condition. Refer to Note 10 for disclosures required by this new pronouncement.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity reports unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected are recognized in earnings as incurred and not deferred. SFAS No. 159 also established presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 was effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for 3M). At the effective date, an entity could elect the fair value option for eligible items that existed at that date. The entity was required to report the effect of the first remeasurement to fair value as a cumulative-effect adjustment to the opening balance of retained earnings. The Company did not elect the fair value option for eligible items that existed as of January 1, 2008.

In June 2007, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* that required nonrefundable advance payments made by the Company for future R&D activities to be capitalized and recognized as an expense as the goods or services are received by the Company. EITF Issue No. 07-3 was effective for 3M with respect to new arrangements entered into beginning January 1, 2008. The adoption of EITF Issue No. 07-3 did not have a material impact on 3M's consolidated results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which changes accounting for business acquisitions. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. For 3M, SFAS No. 141R is effective for business combinations and adjustments to an acquired entity's deferred tax asset and liability balances occurring after December 31, 2008. The Company is currently evaluating the future impacts and disclosures of this standard.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51, which establishes new standards governing the accounting for and reporting of noncontrolling interests (NCIs) in partially owned consolidated subsidiaries and the loss of control of subsidiaries. Certain provisions of this standard indicate, among other things, that NCIs (previously referred to as minority interests) be treated as a separate component of equity, not as a liability; that increases and decreases in the parent's ownership interest that leave control intact be treated as equity transactions, rather than as step acquisitions or dilution gains or losses; and that losses of a partially owned consolidated subsidiary be allocated to the NCI even when such allocation might result in a deficit balance. This standard also requires changes to certain presentation and disclosure requirements. For 3M, SFAS No. 160 is effective beginning January 1, 2009. The provisions of the standard are to be applied to all NCIs prospectively, except for the presentation and disclosure requirements, which are to be applied retrospectively to all periods presented. The Company is currently evaluating the future impacts and disclosures of this standard.

In December 2007, the FASB ratified the Emerging Issues Task Force consensus on EITF Issue No. 07-1, Accounting for Collaborative Arrangements that discusses how parties to a collaborative arrangement (which does not establish a legal entity within such arrangement) should account for various activities. The consensus

Table of Contents

indicates that costs incurred and revenues generated from transactions with third parties (i.e. parties outside of the collaborative arrangement) should be reported by the collaborators on the respective line items in their income statements pursuant to EITF Issue No. 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent. Additionally, the consensus provides that income statement characterization of payments between the participants in a collaborative arrangement should be based upon existing authoritative pronouncements; analogy to such pronouncements if not within their scope; or a reasonable, rational, and consistently applied accounting policy election. EITF Issue No. 07-1 is effective for 3M beginning January 1, 2009 and is to be applied retrospectively to all periods presented for collaborative arrangements existing as of the date of adoption. The Company is currently evaluating the impacts and disclosures of this standard, but would not expect EITF Issue No. 07-1 to have a material impact on 3M's consolidated results of operations or financial condition.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which will require increased disclosures about an entity's strategies and objectives for using derivative instruments; the location and amounts of derivative instruments in an entity's financial statements; how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities; and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. Certain disclosures will also be required with respect to derivative features that are credit-risk-related. SFAS No. 161 is effective for 3M beginning January 1, 2009 on a prospective basis. The Company does not expect this standard to have a material impact on 3M's consolidated results of operations or financial condition.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets, which amends the list of factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, Goodwill and Other Intangible Assets. The new guidance applies to (1) intangible assets that are acquired individually or with a group of other assets and (2) intangible assets acquired in both business combinations and asset acquisitions. Under FSP No. FAS 142-3, entities estimating the useful life of a recognized intangible asset must consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension. For 3M, this FSP will require certain additional disclosures beginning January 1, 2009 and application to useful life estimates prospectively for intangible assets acquired after December 31, 2008. The Company does not expect this standard to have a material impact on 3M's consolidated results of operations or financial condition.

In May 2008, the FASB issued FSP No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement). This FSP applies to convertible debt securities that, upon conversion by the holder, may be settled by the issuer fully or partially in cash (rather than settled fully in shares) and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that reflects the issuer's nonconvertible debt borrowing rate when related interest cost is recognized. This FSP is effective for 3M beginning January 1, 2009 with retrospective application to all periods presented. This standard impacts the Company's Convertible Notes (refer to 3M's Current Report on Form 8-K dated May 19, 2008, Note 10 to the Consolidated Financial Statements, for more detail), and will require that additional interest expense essentially equivalent to the portion of issuance proceeds retroactively allocated to the instrument's equity component be recognized over the period from the Convertible Notes' issuance in 2002 through late 2005 (the first date holders of these Notes had the ability to put them back to 3M). 3M is evaluating the impact of this standard and anticipates that its retrospective application will have no impact on results of operations for periods following 2005, but will result in an increase in opening additional paid in capital and a corresponding decrease in opening retained earnings, net of deferred tax impacts, on post-2005 consolidated balance sheets.

NOTE 2. Acquisitions and Divestitures

Divestitures:

Edgar Filing: 3M CO - Form 10-Q

In June 2008, 3M completed the sale of HighJump Software, a 3M Company, to Battery Ventures, a technology venture capital and private equity firm. 3M received proceeds of \$85 million for this transaction and recognized, net of assets sold, transaction and other costs, a pre-tax loss of \$23 million (recorded in the Safety, Security and Protection Services segment) in the second quarter of 2008.

Acquisitions:

During the six months ended June 30, 2008, 3M completed four business combinations. The purchase price paid for business combinations (net of cash acquired) and certain contingent consideration paid during the six months ended June 30, 2008 for previous acquisitions aggregated to \$549 million.

Table of Contents

The largest of these 2008 acquisitions was the April 2008 purchase of 100 percent of the outstanding shares of Aearo Holding Corp. (Safety, Security and Protection Services Business), the parent company of Aearo Technologies Inc. (hereafter referred to as Aearo), a manufacturer of personal protection and energy absorbing products, for approximately \$1.2 billion, inclusive of debt assumed, which was immediately paid off.

The three additional business combinations are summarized as follows:

(1) In March 2008, 3M (Industrial and Transportation Business) purchased certain assets of Hitech Polymers Inc., a manufacturer of specialty thermoplastic polymers and provider of toll thermoplastic compounding services based in Hebron, Kentucky.

(2) In April 2008, 3M (Health Care Business) purchased 100 percent of the outstanding shares of Les Entreprises Solumed Inc., a Quebec-based developer and marketer of leading-edge medical products designed to prevent infections in operating rooms and hospitals.

(3) In April 2008, 3M (Consumer and Office Business) purchased 100 percent of the outstanding shares of Kolors Kevarkian, S.A., a manufacturer of branded floor cleaning tools based in Argentina.

Purchased identifiable intangible assets for Aearo totaled \$485 million and will be amortized on a straight-line basis over a weighted-average life of 15 years (lives ranging from 3 to 19 years). Acquired patents for Aearo of \$11 million will be amortized over a weighted-average life of 11 years and other acquired intangibles of \$474 million, primarily customer relationships and tradenames, will be amortized over a weighted-average life of 15 years. Pro forma information related to the above acquisitions is not included because the impact on the Company's consolidated results of operations is not considered to be material. In-process research and development charges associated with these business combinations were not material.

The purchase price allocation for all 2008 business combinations, including Aearo, and certain other 2007 business combinations is considered preliminary. The impact on the consolidated balance sheet of the purchase price allocations related to acquisitions, including adjustments relative to other acquisitions within the allocation period, follow:

| Asset (Liability) (Millions) | Aearo Holding Corp. | Other Acquisitions | 2008 Total |
|-------------------------------------------------------------|---------------------------|-----------------------|---------------|
| Accounts receivable | \$ 76 | \$ 1 | \$ 77 |
| Inventory | 81 | 1 | 82 |
| Other current assets | 7 | 2 | 9 |
| Property, plant, and equipment net | 82 | 7 | 89 |
| Purchased intangible assets | 485 | 4 | 489 |
| Purchased goodwill | 887 | 16 | 903 |
| Accounts payable and other liabilities, net of other assets | (186) | (1) | (187) |
| Interest bearing debt | (684) | | (684) |
| Deferred tax asset/(liability) | (231) | 2 | (229) |

Edgar Filing: 3M CO - Form 10-Q

| | | | | | | |
|------------------------------------|----|-----|----|----|----|-----|
| Net assets acquired | \$ | 517 | \$ | 32 | \$ | 549 |
| Supplemental information: | | | | | | |
| Cash paid | \$ | 556 | \$ | 33 | \$ | 589 |
| Less: Cash acquired | | 39 | | 1 | | 40 |
| Cash paid, net of cash acquired | \$ | 517 | \$ | 32 | \$ | 549 |
| Non-cash (3M shares at fair value) | | | | | | |
| Net assets acquired | \$ | 517 | \$ | 32 | \$ | 549 |

In addition to business combinations, 3M periodically acquires certain tangible and/or intangible assets and purchases interests in certain enterprises that do not otherwise qualify for accounting as business combinations. These transactions are largely reflected as additional asset purchase and investment activity.

Table of ContentsSubsequent Events

On July 2, 2008, 3M (Health Care Business) announced that it completed its acquisition of IMTECH Corp., a manufacturer of dental implants and cone beam computed tomography (CBCT) scanning equipment for dental and medical radiology headquartered in Ardmore, Oklahoma.

NOTE 3. Goodwill and Intangible Assets

As discussed in Note 13, 3M made certain changes to its business segments effective in the first quarter of 2008, which resulted in no material changes to the goodwill balances by business segment. For those changes that resulted in reporting unit changes, the Company applied the relative fair value method to determine the impact to reporting units. SFAS No. 142 requires that goodwill be tested for impairment at least annually and when reporting units are changed. During the first quarter of 2008, the Company completed its assessment of any potential goodwill impairment under this new structure and determined that no impairment existed.

Purchased goodwill related to the four acquisitions which closed in the first six months of 2008 totaled \$904 million, \$2 million of which is deductible for tax purposes. The acquisition activity in the table below also includes the impacts of purchase accounting adjustments and contingent consideration for previously closed acquisitions. The amounts in the Translation and other column in the following table primarily relate to changes in foreign currency exchange rates, except for the \$77 million decrease in goodwill related to the sale of 3M's HighJump Software business (included in the Safety, Security and Protection Services business). The goodwill balance by business segment as of December 31, 2007 and June 30, 2008, follow:

Goodwill

| (Millions) | Dec. 31, 2007 Balance | Acquisition activity | Translation and other | June 30, 2008 Balance |
|------------------------------------------|-----------------------------|-------------------------|--------------------------|-----------------------------|
| Industrial and Transportation | \$ 1,524 | \$ (6) | \$ 35 | \$ 1,553 |
| Health Care | 839 | 17 | 40 | 896 |
| Display and Graphics | 894 | | (3) | 891 |
| Consumer and Office | 94 | 6 | 18 | 118 |
| Safety, Security and Protection Services | 611 | 886 | (76) | 1,421 |
| Electro and Communications | 627 | | 30 | 657 |
| Total Company | \$ 4,589 | \$ 903 | \$ 44 | \$ 5,536 |

Acquired Intangible Assets

Edgar Filing: 3M CO - Form 10-Q

For the six months ended June 30, 2008, acquired intangible asset activity through business combinations increased balances by \$489 million, while the sale of 3M's HighJump Software business reduced intangible asset balances by \$23 million. The carrying amount and accumulated amortization of acquired intangible assets as of June 30, 2008, and December 31, 2007, follow:

| (Millions) | June 30 2008 | Dec. 31 2007 |
|---------------------------------------------------------------------------------------------|-----------------|-----------------|
| Patents | \$ 459 | \$ 446 |
| Other amortizable intangible assets (primarily tradenames and customer related intangibles) | 1,245 | 801 |
| Non-amortizable intangible assets (tradenames) | 80 | 75 |
| Total gross carrying amount | \$ 1,784 | \$ 1,322 |
| Accumulated amortization - patents | (320) | (305) |
| Accumulated amortization - other | (232) | (216) |
| Total accumulated amortization | (552) | (521) |
| Total intangible assets - net | \$ 1,232 | \$ 801 |

Table of Contents

Amortization expense for acquired intangible assets for the three-month and six-month periods ended June 30, 2008 and 2007 follows:

| (Millions) | Three months ended June 30 | | Six months ended June 30 | |
|----------------------|-------------------------------|-------|-----------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Amortization expense | \$ 32 | \$ 21 | \$ 56 | \$ 42 |

The table below shows expected amortization expense for acquired intangible assets recorded as of June 30, 2008:

| (Millions) | Last 2 Quarters | 2009 | 2010 | 2011 | 2012 | After 2013 |
|----------------------|--------------------|--------|--------|--------|--------|---------------|
| | 2008 | | | | | |
| Amortization expense | \$ 65 | \$ 130 | \$ 115 | \$ 108 | \$ 102 | \$ 632 |

The expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, changes in foreign currency exchange rates, impairment of intangible assets, accelerated amortization of intangible assets and other events.

NOTE 4. Restructuring Actions and Other Exit Activities2006/2007 Restructuring Actions

During the fourth quarter of 2006 and the first six months of 2007, management approved and committed to undertake the following restructuring actions:

- **Pharmaceuticals business actions** – employee-related, asset impairment and other costs pertaining to the Company's exit of its branded pharmaceuticals operations in late 2006 and early 2007. These costs included severance and benefits for pharmaceuticals business employees who were not obtaining employment with the buyers of the pharmaceuticals business as well as impairment charges associated with certain assets not transferred to the buyers.
- **Overhead reduction actions** – employee-related costs for severance and benefits, costs associated with actions to reduce the Company's cost structure.

- Business-specific actions employee-related costs for severance and benefits, fixed and intangible asset impairments, certain contractual obligations, and expenses from the exit of certain product lines.

Actions with respect to the above activities were substantially completed in 2007 and additional charges and adjustments are not expected to be material.

The remaining accrued liability balances and cash payments in 2008 follow:

Restructuring Activity

| (Millions) | Accrued Liability Balances at Dec. 31, 2007 | Cash Payments in 2008 | Accrued Liability Balances at June 30, 2008 |
|--------------------------------------------|---------------------------------------------------|-----------------------------|---------------------------------------------------|
| Employee-Related Items and Benefits | | | |
| Pharmaceuticals business actions | \$ 5 | \$ (5) | |
| Overhead reduction actions | 10 | (7) | 3 |
| Business-specific actions | 5 | (4) | 1 |
| Total | \$ 20 | \$ (16) | 4 |

Other Exit Activities:

In the second quarter of 2008, the Company recorded pre-tax charges of \$19 million related to exit activities. These charges related to employee reductions at an Industrial and Transportation manufacturing facility located in the United Kingdom. These charges were recorded in cost of sales.

Table of Contents**NOTE 5. Supplemental Stockholders Equity and Comprehensive Income Information****Accumulated Other Comprehensive Income (Loss)**

| (Millions) | June 30, 2008 | Dec. 31, 2007 |
|-----------------------------------------------------------------|------------------|------------------|
| Cumulative translation net | \$ 971 | \$ 742 |
| Defined benefit pension and postretirement plans adjustment net | (1,408) | (1,453) |
| Debt and equity securities, unrealized gain (loss) net | (11) | (8) |
| Cash flow hedging instruments, unrealized gain (loss) net | (3) | (28) |
| Total accumulated other comprehensive income (loss) | \$ (451) | \$ (747) |

| (Millions) | Comprehensive Income | | | |
|---------------------------------------------------------------------------------|-------------------------------------|----------|-----------------------------------|----------|
| | Three-months ended June 30, 2008 | | Six-months ended June 30, 2007 | |
| Net income | \$ 945 | \$ 917 | \$ 1,933 | \$ 2,285 |
| Cumulative translation | (72) | 80 | 210 | 145 |
| Tax effect | (60) | (2) | 19 | 6 |
| Cumulative translation - net of tax | (132) | 78 | 229 | 151 |
| Defined benefit pension and postretirement plans adjustment | 19 | 48 | 68 | 96 |
| Tax effect | (5) | (18) | (23) | (32) |
| Defined benefit pension and postretirement plans adjustment - net of tax | 14 | 30 | 45 | 64 |
| Debt and equity securities, unrealized gain (loss) | (11) | 2 | (4) | 4 |
| Tax effect | 4 | | 1 | |
| Debt and equity securities, unrealized gain (loss) - net of tax | (7) | 2 | (3) | 4 |
| Cash flow hedging instruments, unrealized gain (loss) | 51 | (31) | 45 | (7) |
| Tax effect | (22) | 12 | (20) | 3 |
| Cash flow hedging instruments, unrealized gain (loss) - net of tax | 29 | (19) | 25 | (4) |
| Total net of tax | \$ 849 | \$ 1,008 | \$ 2,229 | \$ 2,500 |

Reclassification adjustments are made to avoid double counting in comprehensive income items that are also recorded as part of net income. As disclosed in Note 8, for the three and six-months ended June 30, 2008, \$19 million pre-tax (\$14 million after tax) and \$42 million pre-tax (\$29 million after tax), respectively, were reclassified to earnings from accumulated other comprehensive income to pension and postretirement expense in the income statement. These pension and postretirement expense amounts are shown in the table in Note 8 as amortization of transition (asset) obligation, amortization of prior service cost (benefit) and amortization of net actuarial (gain) loss. Reclassifications to earnings from accumulated other comprehensive income for debt and equity securities, which primarily include marketable securities, totaled approximately \$6 million pre-tax (\$4 million after tax) for the three and six-months ended June 30, 2008, as shown in the auction rate securities table in Note 10. Refer to Note 9 for a table that recaps cash flow hedging instruments reclassifications. No income tax provision has been made for the translation of foreign currency financial statements into U.S. dollars.

NOTE 6. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 1999. During the first six months of 2008, the Company paid IRS assessments related to tax and interest for the 2001 through 2004 tax years. The IRS's adjustments to the Company's tax positions including interest were fully reserved. As a result of these additional tax payments, the Company's unrecognized tax benefits were reduced by \$71 million for the first six months of 2008.

In addition to the U.S. federal examination, there is also limited audit activity in several U.S. state and foreign jurisdictions. Currently, the Company expects the liability for unrecognized tax benefits will change by an insignificant amount during the next 12 months.

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate as of December 31, 2007 and June 30, 2008, respectively, are \$334 million and \$256 million.

Table of Contents

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. At December 31, 2007 and June 30, 2008 respectively, accrued interest and penalties on a gross basis were \$69 million and \$38 million. Included in these interest and penalty amounts are interest and penalties related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

NOTE 7. Marketable Securities

The Company invests in agency securities, asset-backed securities, corporate notes securities, treasury securities and other securities. The following is a summary of amounts recorded on the Consolidated Balance Sheet for marketable securities (current and non-current) at June 30, 2008.

| (Millions) | June 30, 2008 |
|------------------------------------------|------------------|
| Agency securities | \$ 134 |
| Asset-backed securities: | |
| Automobile loans related | 83 |
| Other | 37 |
| Asset-backed securities total | 120 |
| Certificate of deposits | 93 |
| Corporate short-term notes securities | 86 |
| Other | 22 |
| Current marketable securities | \$ 455 |
| Treasury securities | \$ 256 |
| Agency securities | 244 |
| Corporate medium-term notes securities | 133 |
| Asset-backed securities: | |
| Automobile loans related | 51 |
| Credit cards related | 42 |
| Other | 39 |
| Asset-backed securities total | 132 |
| Auction rate securities | 10 |
| Non-current marketable securities | \$ 775 |
| Total marketable securities | \$ 1,230 |

Classification of marketable securities as current or non-current is dependent upon management's intended holding period, the security's maturity date and liquidity considerations based on market conditions. If management intends to hold the securities for longer than one year as of the balance sheet date, they are classified as non-current. At June 30, 2008, gross unrealized losses totaled approximately \$20 million, while gross unrealized gains were not material. Gross unrealized losses relate to auction rate securities, which are discussed further below, and fixed rate securities; primarily agency securities, treasury securities and corporate short-term note securities, which have experienced unrealized losses as interest rates have increased. Gross realized gains and losses on sales or maturities of marketable securities were not material for the first six months of 2008 and 2007. Cost of securities sold or reclassified use the first in, first out (FIFO) method. Since these marketable securities are

Edgar Filing: 3M CO - Form 10-Q

classified as available-for-sale securities, changes in fair value will flow through other comprehensive income, with amounts reclassified out of other comprehensive income into earnings upon sale or other-than-temporary impairment.

3M has a diversified marketable securities portfolio of \$1.230 billion as of June 30, 2008. Within this portfolio, current and long-term asset-backed securities (estimated fair value of \$252 million) are primarily comprised of interests in automobile loans and credit cards. At June 30, 2008, the asset-backed securities credit ratings were AAA or A-1+, except for one security with a fair value of \$9 million that had a BBB credit rating. 3M's marketable securities portfolio also includes auction rate securities (estimated fair value of \$10 million) that represent interests

Table of Contents

in investment grade credit default swaps. During the second half of 2007 and the first six months of 2008, these auction rate securities failed to auction due to sell orders exceeding buy orders. Liquidity for these auction-rate securities is typically provided by an auction process that resets the applicable interest rate at pre-determined intervals, usually every 7, 28, 35, or 90 days. The funds associated with failed auctions will not be accessible until a successful auction occurs or a buyer is found outside of the auction process. Based upon an analysis of temporary and other-than-temporary impairment factors, auction rate securities with an original par value of approximately \$34 million were written-down to an estimated fair value of \$16 million as of December 31, 2007 and subsequently written-down to an estimated fair value of \$11 million as of March 31, 2008 and an estimated fair value of \$10 million as of June 30, 2008. 3M recorded other-than-temporary impairment charges that reduced pre-tax income by approximately \$8 million in the fourth quarter of 2007, approximately \$1 million in the first quarter of 2008 and approximately \$8 million in the second quarter of 2008. There are \$7 million (pre-tax) of temporary impairments at June 30, 2008, which were recorded as unrealized losses within other comprehensive income. As of June 30, 2008, these investments in auction rate securities have been in a loss position for less than twelve months. These auction rate securities are classified as non-current marketable securities as of June 30, 2008 as indicated in the preceding table. Refer to Note 10 for a table that reconciles the beginning and ending balances of auction rate securities for 2008.

3M reviews impairments associated with the above in accordance with Emerging Issues Task Force (EITF) 03-1 and FSP SFAS 115-1 and 124-1, The Meaning of Other-Than-Temporary-Impairment and Its Application to Certain Investments, to determine the classification of the impairment as temporary or other-than-temporary. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders' equity. Such an unrealized loss does not reduce net income for the applicable accounting period because the loss is not viewed as other-than-temporary. The company believes that a portion of the impairment of its auction rate securities investments is temporary and a portion is other-than-temporary. The factors evaluated to differentiate between temporary and other-than-temporary include the projected future cash flows, credit ratings actions, and assessment of the credit quality of the underlying collateral.

The balances at June 30, 2008 for marketable securities by contractual maturity are shown below. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

| (Millions) | June 30, 2008 | |
|------------------------------------------|--------------------------|-------|
| Due in one year or less | \$ | 231 |
| Due after one year through three years | | 660 |
| Due after three years through five years | | 286 |
| Due after five years | | 53 |
| Total marketable securities | \$ | 1,230 |

Table of Contents**NOTE 8. Pension and Postretirement Benefit Plans**

Components of net periodic benefit cost and other supplemental information for the three months and six months ended June 30 follow:

Benefit Plan Information

| (Millions) | Three months ended June 30 | | | | | |
|------------------------------------------------------------------------------------------------------|-------------------------------------------------|-------|---------------|-------|----------------------------|-------|
| | Qualified and Non-qualified Pension Benefits | | | | Postretirement Benefits | |
| | United States | | International | | 2008 | 2007 |
| | 2008 | 2007 | 2008 | 2007 | | |
| Service cost | \$ 48 | \$ 48 | \$ 31 | \$ 30 | \$ 13 | \$ 14 |
| Interest cost | 149 | 142 | 66 | 55 | 25 | 26 |
| Expected return on plan assets | (222) | (210) | (80) | (70) | (26) | (26) |
| Amortization of transition (asset) obligation | | | 1 | 1 | | |
| Amortization of prior service cost (benefit) | 4 | 4 | (1) | (1) | (25) | (18) |
| Amortization of net actuarial (gain) loss | 14 | 31 | 10 | 13 | 16 | 18 |
| Net periodic benefit cost (benefit) | \$ (7) | \$ 15 | \$ 27 | \$ 28 | \$ 3 | \$ 14 |
| Settlements, curtailments and special termination benefits | 1 | 1 | | | | 13 |
| Net periodic benefit cost (benefit) after settlements, curtailments and special termination benefits | \$ (6) | \$ 16 | \$ 27 | \$ 28 | \$ 3 | \$ 27 |

Benefit Plan Information

| (Millions) | Six months ended June 30 | | | | | |
|------------------------------------------------------------------------------------------------------|-------------------------------------------------|-------|---------------|-------|----------------------------|-------|
| | Qualified and Non-qualified Pension Benefits | | | | Postretirement Benefits | |
| | United States | | International | | 2008 | 2007 |
| | 2008 | 2007 | 2008 | 2007 | | |
| Service cost | \$ 96 | \$ 96 | \$ 62 | \$ 60 | \$ 26 | \$ 28 |
| Interest cost | 298 | 284 | 132 | 110 | 51 | 52 |
| Expected return on plan assets | (444) | (420) | (160) | (140) | (52) | (52) |
| Amortization of transition (asset) obligation | | | 2 | 2 | | |
| Amortization of prior service cost (benefit) | 8 | 7 | (2) | (2) | (46) | (36) |
| Amortization of net actuarial (gain) loss | 28 | 63 | 20 | 26 | 32 | 36 |
| Net periodic benefit cost (benefit) | \$ (14) | \$ 30 | \$ 54 | \$ 56 | \$ 11 | \$ 28 |
| Settlements, curtailments and special termination benefits | 1 | 1 | | | | 13 |
| Net periodic benefit cost (benefit) after settlements, curtailments and special termination benefits | \$ (13) | \$ 31 | \$ 54 | \$ 56 | \$ 11 | \$ 41 |

Edgar Filing: 3M CO - Form 10-Q

During the first quarter of 2008, the Company made modifications to its U.S. postretirement benefits plan. The changes are effective beginning January 1, 2009, and allow current retired employees and employees who retire before January 1, 2013 the option to continue on the existing postretirement plans or elect the new plans. Current employees who retire after December 31, 2012, will receive a savings account benefits-based plan. As a result of the modification to the U.S. postretirement benefits plan, the Company remeasured its U.S. plans' assets and accumulated postretirement benefit obligation (APBO) as of March 31, 2008. The impact of the plan modifications reduced the APBO by \$148 million, which was partially offset by asset values being \$97 million lower than on December 31, 2007. Therefore, the accrued benefit cost liability recorded on the balance sheet as of March 31, 2008, was reduced by \$51 million. The remeasurement did not impact the postretirement expense for the quarter ended March 31, 2008, but reduces the expense for April 1 through December 31, 2008 by \$15 million.

For the six months ended June 30, 2008, contributions totaling \$94 million were made to the Company's U.S. and international pension plans and \$1 million to its postretirement plans. In 2008, the Company expects to contribute up to \$400 million to its U.S. and international pension plans. The Company does not have a required minimum pension contribution obligation for its U.S. plans in 2008. Therefore, the amount of the anticipated discretionary pension contribution could vary significantly depending on the U.S. plans' funding status as of the 2008 measurement date and the anticipated tax deductibility of the contribution. 3M's annual measurement date for

Table of Contents

pension and postretirement assets and liabilities is December 31 each year, which is also the date used for the related annual measurement assumptions.

NOTE 9. Derivatives and Other Financial Instruments

The Company uses interest rate swaps, currency swaps, and forward and option contracts to manage risks generally associated with foreign exchange rate, interest rate and commodity price fluctuations. For a more detailed discussion of the company's derivative instruments, refer to 3M's Current Report on Form 8-K dated May 19, 2008.

The Company enters into foreign exchange forward contracts, options and swaps to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies and certain intercompany financing transactions. These transactions are designated as cash flow hedges. Based on exchange rates at June 30, 2008, the Company expects to reclassify to earnings over the next 12 months a majority of the cash flow hedging instruments after-tax loss of \$3 million (with the impact offset by cash flows from underlying hedged items). Amounts recorded in accumulated other comprehensive income (loss) related to cash flow hedging instruments follow:

Cash Flow Hedging Instruments

| Net of Tax (Millions) | Three months ended June 30 | | Six months ended June 30 | |
|-------------------------------------------|-------------------------------|---------|-----------------------------|---------|
| | 2008 | 2007 | 2008 | 2007 |
| Beginning balance | \$ (32) | \$ (3) | \$ (28) | \$ (18) |
| Changes in fair value of derivatives | 31 | (21) | 11 | (11) |
| Reclassifications to earnings from equity | (2) | 2 | 14 | 7 |
| Total activity | 29 | (19) | 25 | (4) |
| Ending balance | \$ (3) | \$ (22) | \$ (3) | \$ (22) |

In the first half of 2008, the Company entered into a foreign currency forward contract with a notional amount of \$29 million that was designated as a partial hedge of the Company's net investment in its Chinese subsidiaries. This forward matures in December 2008.

NOTE 10. Fair Value Measurements

As discussed in Note 1, 3M adopted SFAS No. 157, Fair Value Measurements, (as impacted by FSP Nos. 157-1 and 157-2) effective January 1, 2008, with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company's financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities.

Under SFAS No. 157, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. SFAS No. 157 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available in the circumstances. The hierarchy is broken down into three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. Categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis:

At 3M, effective January 1, 2008, fair value under SFAS No. 157 (as impacted by FSP Nos. 157-1 and 157-2) principally applied to financial asset and liabilities such as available-for-sale marketable securities, available-for-sale investments (included as part of investments in the Consolidated Balance Sheet) and certain derivative instruments. Derivatives include cash flow hedges, interest rate swaps and most net investment hedges. These

Table of Contents

items were previously and will continue to be marked-to-market at each reporting period; however, the definition of fair value used for these mark-to-markets is now applied using SFAS No. 157. The information in the following paragraphs and tables primarily addresses matters relative to these financial assets and liabilities. Separately, there were no material fair value measurements with respect to nonfinancial assets or liabilities that are recognized or disclosed at fair value in the Company's financial statements on a recurring basis subsequent to the effective date of SFAS No. 157 (as impacted by FSP Nos. 157-1 and 157-2).

3M uses various valuation techniques, which are primarily based upon the market and income approaches, with respect to financial assets and liabilities. Following is a description of the valuation methodologies used for the respective financial assets and liabilities measured at fair value.

Available-for-sale marketable securities – except auction rate securities:

Marketable securities, except auction rate securities, are valued utilizing multiple sources, as the best individual price and the best source of information can change from one day to the next. Therefore, a weighted average price is used for these securities. Market prices are obtained for these securities from a variety of industry standard data providers, security master files from large financial institutions, and other third-party sources. These multiple prices are used as inputs into a distribution-curve-based algorithm to determine the daily fair value to be used. 3M classifies treasury securities as level 1, while all other marketable securities (excluding auction rate securities) are classified as level 2. Marketable securities are discussed further in Note 7.

Available-for-sale marketable securities – auction rate securities only:

As discussed in Note 7, auction rate securities held by 3M failed to auction during the second half of 2007 and first half of 2008. As a result, investments in auction rate securities are valued utilizing broker-dealer valuation models and third-party indicative bid levels in markets that are not active. 3M classifies these securities as level 3.

Available-for-sale investments:

Investments include equity securities that are traded in an active market. Closing stock prices are readily available from active markets and are used as being representative of fair value. 3M classifies these securities as level 1.

Certain derivative instruments:

Derivative assets and liabilities within the scope of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, are required to be recorded at fair value. The Company's derivatives that are impacted by SFAS No. 157 include foreign currency forward and option contracts, commodity price swaps, interest rate swaps, and net investment hedges where the hedging instrument is recorded at fair value. Net

Edgar Filing: 3M CO - Form 10-Q

investment hedges that use foreign currency denominated debt to hedge 3M's net investment are not impacted by SFAS No. 157 as the debt used as the hedging instrument is marked to a value with respect to changes in spot foreign currency exchange rates and not with respect to other factors that may impact fair value.

3M has determined that foreign currency forwards and commodity hedges will be considered level 1 measurements as these are traded in active markets which have identical asset or liabilities, while currency swaps, foreign exchange options, interest rate swaps and cross-currency interest rate swaps will be considered level 2. For level 2 derivatives, 3M uses inputs other than quoted prices that are observable for the asset. These inputs include foreign currency exchange rates, volatilities, and interest rates. The level 2 derivative positions are primarily valued using standard calculations/models that use as their basis readily observable market parameters. Industry standard data providers are 3M's primary source for forward and spot rate information for both interest rates and currency rates, with resulting valuations periodically validated through third-party or counterparty quotes and a net present value stream of cash flows model.

Edgar Filing: 3M CO - Form 10-Q

Table of Contents

The following table provides information by level for assets and liabilities that are measured at fair value, as defined by SFAS No. 157, on a recurring basis.

| (Millions) Description | Fair Value at June 30, 2008 | Level 1 | Fair Value Measurements Using Inputs Considered as | | Level 3 |
|------------------------------------------------------|--------------------------------------|---------|-------------------------------------------------------|--|---------|
| | | | Level 2 | | |
| Assets: | | | | | |
| Available-for-sale: | | | | | |
| Marketable securities except auction rate securities | \$ 1,220 | \$ 256 | \$ 964 | | \$ |
| Marketable securities - auction rate securities only | 10 | | | | 10 |
| Investments | 12 | 12 | | | |
| Derivative assets | 75 | 59 | 16 | | |
| Liabilities: | | | | | |
| Derivative liabilities | 115 | 52 | 63 | | |

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3).

| (Millions) Marketable securities auction rate securities only | Three months ended June 30, 2008 | Six months ended June 30, 2008 |
|--------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|--------------------------------------|
| Beginning balance | \$ 11 | \$ 16 |
| Total gains or losses: | | |
| Included in earnings | (2) | (3) |
| Included in other comprehensive income | 1 | (3) |
| Purchases, issuances, and settlements | | |
| Transfers in and/or out of Level 3 | | |
| Ending balance (June 30, 2008) | \$ 10 | \$ 10 |
| Additional losses included in earnings due to reclassifications from other comprehensive income for securities still held at June 30, 2008 | \$ (6) | \$ (6) |

In addition, the plan assets of 3M's pension and postretirement benefit plans are measured at fair value on a recurring basis (at least annually). During the quarter ended March 31, 2008, the Company remeasured the plan assets of its U.S. postretirement benefits plan in connection with a change in the benefits provided by this plan as discussed in Note 8.

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis:

During the six months ended June 30, 2008, the Company had no significant measurements of assets or liabilities at fair value (as defined in SFAS No. 157) on a nonrecurring basis subsequent to their initial recognition. As indicated in Note 1, the aspects of SFAS No. 157 for which the effective date for 3M was deferred under FSP No. 157-2 until January 1, 2009 relate to nonfinancial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis. This deferral applies to such items as nonfinancial assets and liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods) or nonfinancial

Edgar Filing: 3M CO - Form 10-Q

long-lived asset groups measured at fair value for an impairment assessment. During the six months ended June 30, 2008, such measurements of fair value impacted by the deferral under FSP No. 157-2 related primarily to the nonfinancial assets and liabilities with respect to the business combinations in 2008 as discussed in Note 2.

Table of Contents

NOTE 11. Commitments and Contingencies

Legal Proceedings:

The Company and some of its subsidiaries are involved in numerous claims and lawsuits, principally in the United States, and regulatory proceedings worldwide. These include various products liability (involving products that the Company now or formerly manufactured and sold), intellectual property, and commercial claims and lawsuits, including those brought under the antitrust laws, employment litigation and environmental proceedings. The following sections first describe the significant legal proceedings in which the Company is involved, and then describe the liabilities and associated insurance receivables the Company has accrued relating to its significant legal proceedings. Unless otherwise stated, the Company is vigorously defending all such litigation. Additional information can be found in Note 13 "Commitments and Contingencies" in the Company's Current Report on Form 8-K dated May 19, 2008, including information about the Company's process for establishing and disclosing accruals and insurance receivables.

Shareholder Derivative Litigation

As previously reported, in July 2007, a shareholder derivative lawsuit was filed in the U.S. District Court for the District of Delaware against the Company as nominal defendant and against each then current member of the Board of Directors and the officers named in the Summary Compensation Table of the 2007 Proxy Statement. The suit alleges that the Company's 2007 Proxy Statement contained false and misleading statements concerning the tax deductibility of compensation payable under the Executive Annual Incentive Plan ("Plan") and the standards for determining the amounts payable under the Plan. The lawsuit seeks a declaration voiding shareholder approval of the Plan, termination of the Plan, voiding the elections of directors, equitable accounting, and awarding costs, including attorneys' fees.

In May 2008, the Company and the individual defendants agreed to settle the litigation without admitting any liability or wrongdoing of any kind. The settlement agreement, which is subject to court approval, calls for the Compensation Committee of the Company's Board of Directors to adopt a resolution formally stating its interpretation of certain aspects of the Plan, and the Company to issue a press release to the same effect, and to pay up to \$600,000 in attorney's fees to the plaintiff's counsel. Upon receipt of the Court's scheduling order, the Company will notify all stockholders of the proposed settlement and its terms. Stockholders have a right to object to the terms of the settlement, and final consummation of the settlement must await the entry of the Court's final judgment approving the settlement.

Respirator Mask/Asbestos Litigation

As of June 30, 2008, the Company is a named defendant, with multiple co-defendants, in numerous lawsuits in various courts that purport to represent approximately 4,700 individual claimants, a significant reduction from the approximately 8,790 individual claimants with actions pending at March 31, 2008.

The vast majority of the lawsuits and claims resolved by and currently pending against the Company allege use of some of the Company's mask and respirator products and seek damages from the Company and other defendants for alleged personal injury from workplace exposures to

Edgar Filing: 3M CO - Form 10-Q

asbestos, silica, coal or other occupational dusts found in products manufactured by other defendants or generally in the workplace. A minority of claimants generally allege personal injury from occupational exposure to asbestos from products previously manufactured by the Company, which are often unspecified, as well as products manufactured by other defendants, or occasionally at Company premises.

Since approximately 2006, the Company has experienced a significant decline in the number of new claims filed annually by apparently unimpaired claimants. The Company attributes this decline to several factors, including certain changes enacted in several states in recent years of the law governing asbestos-related claims, and the highly-publicized decision in mid-2005 of the United States District Court for the Southern District of Texas that identified and criticized abuses by certain attorneys, doctors and x-ray screening companies on behalf of primarily unimpaired claimants, many of whom were recruited by plaintiffs' lawyers through mass chest x-ray screenings. The Company expects the filing of claims by unimpaired claimants in the future to continue at much lower levels than in the past. The Company believes that due to this change in the type and volume of incoming claims, it is likely that the number of claims alleging more serious injuries, including mesothelioma and other malignancies, while remaining relatively constant, will represent a greater percentage of total claims than in the past. The Company has demonstrated in past trial proceedings that its respiratory protection products are effective as claimed when used in the intended manner and in the intended circumstances. Consequently the Company believes that claimants are unable to establish that their medical conditions, even if significant, are attributable to the Company's respiratory protection products. Nonetheless the Company's litigation experience indicates that such claims are costlier to resolve than the claims of unimpaired persons, and it therefore anticipates an increase in the average cost of resolving pending and future

Table of Contents

claims on a per-claim basis than it experienced in prior periods when the vast majority of claims were asserted by the unimpaired.

Respirator Mask/Asbestos Litigation - Aearo Technologies

On April 1, 2008, a subsidiary of the Company purchased the stock of Aearo Holding Corp., the parent of Aearo Technologies (Aearo). Aearo manufactures and sells various products, including personal protection equipment, such as eye, ear, head, face, fall and respiratory protection products.

As of June 30, 2008, Aearo and/or other companies that previously owned and operated Aearo's respirator business (American Optical Corporation, Warner-Lambert LLC, AO Corp. and Cabot Corporation (Cabot)) are named defendants, with multiple co-defendants, including the Company, in numerous lawsuits in various courts in which plaintiffs allege use of mask and respirator products and seek damages from Aearo and other defendants for alleged personal injury from workplace exposures to asbestos, silica-related, or other occupational dusts found in products manufactured by other defendants or generally in the workplace.

As of June 30, 2008, the Company, through its newly acquired Aearo subsidiary, has recorded approximately \$8 million as an estimate of the probable liabilities, for product liabilities and defense costs related to current and future Aearo-related asbestos and silica-related claims. This amount is based upon the current allocation of the Aearo purchase price which, as indicated in Note 2, is considered preliminary. Responsibility for legal costs, as well as for settlements and judgments, is currently shared in an informal arrangement among Aearo, Cabot, American Optical Corporation and a subsidiary of Warner Lambert and their insurers (the Payor Group). Liability is allocated among the parties based on the number of years each company sold respiratory products under the AO Safety brand and/or owned the AO Safety Division of American Optical Corporation and the alleged years of exposure of the individual plaintiff. Aearo's share of the contingent liability is further limited by an agreement entered into between Aearo and Cabot on July 11, 1995. This agreement provides that, so long as Aearo pays to Cabot an annual fee of \$400,000, Cabot will retain responsibility and liability for, and indemnify Aearo against, asbestos and silica-related product liability claims for respirators manufactured prior to July 11, 1995. Since the date of manufacture for a particular respirator allegedly used in the past is often difficult to determine, the parties have applied the agreement to claims arising out of the use of respirators while exposed to asbestos or silica or products containing asbestos or silica prior to January 1, 1997. With these arrangements in place, Aearo's potential liability is limited to exposures alleged to have arisen from the use of respirators while exposed to asbestos, silica or other related long latency diseases on or after January 1, 1997.

To date, Aearo has elected to pay the annual fee. Aearo could potentially be exposed to additional claims for some part of the pre-July 11, 1995 period covered by its agreement with Cabot if Aearo elects to discontinue its participation in this arrangement, or if Cabot is no longer able to meet its obligations in these matters.

As discussed above, the current estimate of the cost of Aearo's share of existing and future respirator liability claims is preliminary. In addition, developments may occur that could affect the estimate of Aearo's liabilities. These developments include, but are not limited to: (i) significant changes in the number of future claims, (ii) significant changes in the average cost of resolving claims, (iii) significant changes in the legal costs of defending these claims, (iv) significant changes in the mix and nature of claims received, (v) trial and appellate outcomes, (vi) significant changes in the law and procedure applicable to these claims, (vii) significant changes in the liability allocation among the co-defendants, (viii) the financial viability of members of the Payor Group including exhaustion of available coverage limits, (ix) the outcome of the pending insurance coverage litigation among certain other members of the Payor Group and their respective insurers, and (x) a determination that the interpretation of the contractual obligations on which Aearo has estimated its share of liability is inaccurate. The Company cannot determine the impact of these potential developments on its current estimate of Aearo's share of liability for these existing and future claims. If any of the

developments described above were to occur, the actual amount of these liabilities for existing and future claims could be significantly larger than the reserved amount.

Employment Litigation

As previously reported, one current and one former employee of the Company filed a purported class action in the District Court of Ramsey County, Minnesota, in December 2004, seeking to represent a class of all current and certain former salaried employees employed by 3M in Minnesota below a certain salary grade who were age 46 or older at any time during the applicable period to be determined by the Court. The complaint alleges the plaintiffs suffered various forms of employment discrimination on the basis of age in violation of the Minnesota Human Rights Act and seeks injunctive relief, unspecified compensatory damages (which they seek to treble under the statute), including back and front pay, punitive damages (limited by statute to \$8,500 per claimant) and attorneys' fees. In January 2006, the plaintiffs filed a motion to join four additional named plaintiffs. This motion was unopposed by the Company and the four plaintiffs were joined in the case, although one claim has been dismissed following an individual settlement. The class certification hearing was held in December 2007. On April 11, 2008, the Court granted the plaintiffs' motion to certify the case as a class action and defined the class as all persons who were 46 or older when employed by 3M

Table of Contents

in Minnesota in a salaried exempt position below a certain salary grade at any time on or after May 10, 2003, and who did not sign a document on their last day of employment purporting to release claims arising out of their employment with 3M. No trial date or calendar of pretrial proceedings has been set at this time. On June 25, 2008, the Minnesota Court of Appeals granted the Company's petition for interlocutory review of the District Court's decision granting class certification in the case. While the appeal is pending, all other activity on the case is stayed.

A similar age discrimination purported class action was filed against the Company in November 2005 in the Superior Court of Essex County, New Jersey, on behalf of a class of New Jersey-based employees of the Company. The Company removed this case to the United States District Court for the District of New Jersey. On June 29, 2007, the attorneys for the plaintiff amended their complaint and dropped the class action allegations. The parties resolved this matter and in May 2008 the lawsuit was dismissed with prejudice.

In addition, three former employees filed age discrimination charges against the Company with the U.S. Equal Employment Opportunity Commission and the pertinent state agencies in Minnesota and California during 2005; two of these charges were amended in 2006. Such filings include allegations that the release of claims signed by certain former employees in the purported class defined in the charges is invalid for various reasons and assert age discrimination claims on behalf of certain current and former salaried employees in states other than Minnesota and New Jersey. In 2006, one current employee filed an age discrimination charge against the Company with the U.S. Equal Employment Opportunity Commission and the pertinent state agency in Missouri, asserting claims on behalf of a class of all current and certain former salaried employees who worked in Missouri and other states other than Minnesota and New Jersey. The same law firm represents the plaintiffs and claimants in each of these proceedings.

Environmental Matters and Litigation

The Company's operations are subject to environmental laws and regulations including those pertaining to air emissions, wastewater discharges, toxic substances, and the handling and disposal of solid and hazardous wastes enforceable by national, state, and local authorities around the world, and private parties in the United States and abroad. These laws and regulations provide, under certain circumstances, a basis for the remediation of contamination and for personal injury and property damage claims. The Company has incurred, and will continue to incur, costs and capital expenditures in complying with these laws and regulations, defending personal injury and property damage claims, and modifying its business operations in light of its environmental responsibilities. In its effort to satisfy its environmental responsibilities and comply with environmental laws and regulations, the Company has established, and periodically updates, policies relating to environmental standards of performance for its operations worldwide.

Remediation: Under certain environmental laws, including the United States Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state laws, the Company may be jointly and severally liable, typically with other companies, for the costs of environmental contamination at current or former facilities and at off-site locations. The Company has identified numerous locations, most of which are in the United States, at which it may have some liability. Please refer to the "Environmental remediation liabilities" in the table in the following section, *Accrued Liabilities and Insurance Receivables Related to Legal Proceedings*, for information on the amount of the reserve.

Regulatory Activities: As previously reported, the Company has been voluntarily cooperating with ongoing reviews by local, state, national (primarily the U.S. Environmental Protection Agency (EPA)), and international agencies of

possible environmental and health effects of perfluorooctanyl compounds (PFCs) (perfluorooctanoic acid or PFOA and perfluorooctane sulfonate or PFOS) and related compounds. As a result of its phase-out decision in May 2000, the Company no longer manufactures perfluorooctanyl compounds, except that a subsidiary recovers and recycles PFOA in Gendorf, Germany, for internal use in production processes and has agreed to a product stewardship initiative with the EPA to end its use of PFOA by 2015.

Regulatory activities concerning PFOA and/or PFOS continue in Europe and elsewhere, and before certain international bodies. These activities include gathering of exposure and use information, risk assessment, and consideration of regulatory approaches. In December 2006, the European Union adopted an amendment to the Marketing and Use Directive to limit use of PFOS. Member States were required to enact the Directive into national law by December 27, 2007 with an effective date of June 27, 2008.

As previously reported, the Minnesota Department of Health (MDH) detected low levels of another perfluorinated compound called perfluorobutanoic acid (PFBA) in municipal wells (and in private wells as announced by the MDH in June 2007) in six nearby communities (Woodbury, Cottage Grove, Newport, St. Paul Park, South St. Paul, and Hastings, all communities located southeast of St. Paul), some of which slightly exceeded the MDH s interim advisory level for PFBA of 1 part per billion (ppb). In February 2008, the MDH established a health-based value (HBV) for PFBA of 7 ppb based on a clearer understanding of PFBA through the results of three major studies and sampling more than 1,000 private wells. An HBV is the amount of a chemical in drinking water considered by the MDH staff to be safe for people to drink for a lifetime. As a result of this new HBV for PFBA, well advisories will no longer be required for

Table of Contents

certain wells in the Minnesota communities of Lake Elmo, Oakdale and Cottage Grove. Residents in the affected communities where the levels of PFBA in private wells exceed the HBV either have been provided water treatment systems or connected to a city water system. As part of legislation passed during the 2007 Minnesota legislative session directing the MDH to develop and implement a statewide Environmental Health Tracking and Biomonitoring program, the MDH announced in July 2008 that it will measure the amount of PFCs in the blood of 200 adults who live in the Minnesota communities of Oakdale, Lake Elmo and Cottage Grove.

The Company continues to work with the Minnesota Pollution Control Agency (MPCA) pursuant to the terms of the previously disclosed May 2007 Settlement Agreement and Consent Order to address the presence of perfluorinated compounds in the soil and groundwater at former disposal sites in Washington County Minnesota and at the Company's manufacturing facility at Cottage Grove Minnesota. Under this agreement, the Company's principal obligations include (i) evaluation of releases of perfluorinated compounds from these sites and propose response actions; (ii) providing alternative drinking water if and when an HBV or Health Risk Limit (HRL) (i.e., the amount of a chemical in drinking water determined by the MDH to be safe for people to drink for a lifetime) is exceeded for any perfluorinated compounds as a result of contamination from these sites; (iii) remediation of any source of PFBA and provide alternative drinking water if and when levels are found above an HBV or HRL; and (iv) sharing information with the MPCA about perfluorinated compounds.

The Company entered into a voluntary remedial action agreement with the Alabama Department of Environmental Management (ADEM) to address the presence of PFCs in the soil on the Company's manufacturing facility in Decatur, Alabama. For approximately twenty years, the Company incorporated wastewater treatment plant sludge containing PFCs in fields surrounding its Decatur facility pursuant to a permit issued by ADEM. After a review of the available options to address the presence of PFCs in the soil, ADEM agreed that the preferred remediation option is to use a multilayer cap over the former sludge incorporation areas on the manufacturing site with groundwater migration controls and treatment.

Please refer to the *Other environmental liabilities* in the table in the following section, *Accrued Liabilities and Insurance Receivables Related to Legal Proceedings* for information on the amount of the reserve established to implement the Settlement Agreement and Consent Order with the MPCA, the remedial action agreement with ADEM, and to address trace amounts of perfluorinated compounds in drinking water sources in the City of Oakdale and Lake Elmo, Minnesota, as well as presence in the soil and groundwater at the Company's manufacturing facilities in Decatur, Alabama, and Cottage Grove, Minnesota, and at two former disposal sites in Minnesota.

The Company cannot predict what regulatory actions arising from the foregoing proceedings and activities, if any, may be taken regarding such compounds or the consequences of any such actions.

Litigation: As previously reported, a former employee filed a purported class action lawsuit in 2002 in the Circuit Court of Morgan County, Alabama, involving perfluorooctanyl chemistry, alleging that the plaintiffs suffered fear, increased risk, subclinical injuries, and property damage from exposure to perfluorooctanyl chemistry at or near the Company's Decatur, Alabama, manufacturing facility. The Circuit Court in 2005 granted the Company's motion to dismiss the named plaintiff's personal injury-related claims on the basis that such claims are barred by the exclusivity provisions of the state's Workers Compensation Act. The plaintiffs' counsel filed an amended complaint in November 2006, limiting the case to property damage claims on behalf of a purported class of residents and property owners in the vicinity of the Decatur plant. Also in 2005, the judge in a second purported class action lawsuit (filed by three residents of Morgan County, Alabama, seeking unstated compensatory and punitive damages involving alleged damage to their property from emissions of perfluorooctanyl compounds from the Company's Decatur, Alabama, manufacturing facility that formerly manufactured those compounds) granted the Company's motion to abate the case, effectively

putting the case on hold pending the resolution of class certification issues in the action described above filed in the same court in 2002. Despite the stay, plaintiffs filed an amended complaint seeking damages for alleged personal injuries and property damage on behalf of the named plaintiffs and the members of a purported class. No further action in the case is expected unless and until the stay is lifted.

As previously reported, two residents of Washington County, Minnesota, filed in October 2004 a purported class action in the District Court of Washington County on behalf of Washington county residents who have allegedly suffered personal injuries and property damage from alleged emissions from the former perfluorooctanyl production facility at Cottage Grove, Minnesota, and from historic waste disposal sites in the vicinity of that facility. After the District Court granted the Company's motion to dismiss the claims for medical monitoring and public nuisance in April 2005, the plaintiffs filed an amended complaint adding additional allegations involving other perfluorinated compounds manufactured by the Company, alleging additional legal theories in support of their claims, adding four plaintiffs, and seeking relief based on alleged contamination of the City of Oakdale municipal water supply and certain private wells in the vicinity of Lake Elmo, Minnesota. In April 2006, the plaintiffs filed a second amended complaint adding two additional plaintiffs. The two original plaintiffs thereafter dismissed their claims against the Company. After a hearing on the plaintiffs' motion to certify the case as a class action at the end of March 2007,

Table of Contents

the Court on June 19, 2007 denied the plaintiffs' motion to certify the litigation as a class action. The trial of the individual cases is scheduled for the first half of 2009.

Accrued Liabilities and Insurance Receivables Related to Legal Proceedings

The following table shows the major categories of on-going litigation, environmental remediation and other environmental liabilities for which the Company has been able to estimate its probable liability and for which the Company has taken reserves and the related insurance receivables:

LIABILITY AND RECEIVABLE BALANCES

| (Millions) | June 30 2008 | Dec. 31 2007 |
|-------------------------------------------------|-----------------|-----------------|
| Breast implant liabilities | \$ 2 | \$ 1 |
| Breast implant insurance receivables | 15 | 64 |
| Respirator mask/asbestos liabilities | 112 | 121 |
| Respirator mask/asbestos insurance receivables | 214 | 332 |
| Environmental remediation liabilities | 36 | 37 |
| Environmental remediation insurance receivables | 15 | 15 |
| Other environmental liabilities | \$ 147 | \$ 147 |

For those significant pending legal proceedings that do not appear in the table and that are not the subject of pending settlement agreements, the Company has determined that liability is not probable or the amount of the liability is not estimable, or both, and the Company is unable to estimate the possible loss or range of loss at this time. The amounts in the preceding table with respect to environmental remediation represent the Company's best estimate of the liability. The Company does not believe that there is any single best estimate of the respirator mask/asbestos liability or the other environmental liabilities shown above, nor that it can reliably estimate the amount or range of amounts by which those liabilities may exceed the reserves the Company has established.

On January 5, 2007 the Company was served with a declaratory judgment action filed on behalf of two of its insurers (Continental Casualty and Continental Insurance Co. both part of the Continental Casualty Group) disclaiming coverage for respirator mask/asbestos claims. These insurers represent approximately \$14 million of the \$214 million insurance recovery receivable referenced in the above table. The action was filed in Hennepin County, Minnesota and names, in addition to the Company, over 60 of the Company's insurers. This action is similar in nature to an action filed in 1994 with respect to breast implant coverage, which ultimately resulted in the Minnesota Supreme Court's ruling of 2003 that was largely in the Company's favor. At the Company's request, the case was transferred to Ramsey County, over the objections of the insurers. The Minnesota Supreme Court heard oral argument of the insurers' appeal of that decision in March 2008 and ruled in May 2008 that the proper venue of that case is Ramsey County.

As a result of settlements reached with its insurers, the Company was paid \$104 million in the second quarter and the Company currently has agreements in place to receive another \$44 million in payments over the next four quarters in connection with the respirator mask/asbestos receivable.

NOTE 12. Management Stock Ownership Program (MSOP) and General Employees Stock Purchase Plan (GESPP)

In May 2008, shareholders approved 35 million shares for issuance under the 3M 2008 Long-Term Incentive Plan, which replaced and succeeded the 2005 MSOP, the 3M Performance Unit Plan, and the 1992 Directors Stock Ownership Program. Shares under this plan may be issued in the form of Incentive Stock Options, Nonqualified Stock Options, Progressive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Other Stock Awards, and Performance Units and Performance Shares. Awards denominated in shares of common stock other than options and Stock Appreciation Rights, per the 2008 Plan, will be counted against the 35 million share limit as 3.38 shares for every one share covered by such award. The remaining total MSOP shares available for grant under the 2008 Long Term Incentive Plan Program are 26,631,102 as of June 30, 2008. The Company issues options to eligible employees annually in May using the closing stock price on the grant date, which is the date of the Annual Stockholders Meeting. In addition to these annual grants, the Company makes other minor grants of stock options, restricted stock units and other stock-based grants.

Table of Contents

Effective with the May 2005 MSOP annual grant, the Company changed its vesting period from one to three years with the expiration date remaining at 10 years from date of grant. Beginning in 2007, the Company reduced the number of traditional stock options granted under the MSOP plan by reducing the number of employees eligible to receive annual grants and by shifting a portion of the annual grant away from traditional stock options primarily to restricted stock units. However, associated with the reduction in the number of eligible employees, the Company provided a one-time buyout grant of restricted stock units to the impacted employees. The income tax benefits shown in the following table can fluctuate by period due to the amount of Incentive Stock Options (ISO) exercised since the Company receives the ISO tax benefit upon exercise. The Company last granted ISO in 2002. Amounts recognized in the financial statements with respect to both the MSOP and GESPP (refer to Note 15 in 3M's Current Report on Form 8-K dated May 19, 2008) are as follows:

| (Millions, except per share amounts) | Three months ended June 30 | | Six months ended June 30 | |
|----------------------------------------------|-------------------------------|----------------|-----------------------------|-----------------|
| | 2008 | 2007 | 2008 | 2007 |
| Cost of sales | \$ 17 | \$ 18 | \$ 26 | \$ 26 |
| Selling, general and administrative expenses | 47 | 60 | 73 | 79 |
| Research, development and related expenses | 15 | 18 | 23 | 24 |
| Operating Income (Loss) | \$ (79) | \$ (96) | \$ (122) | \$ (129) |
| Income tax benefits | \$ 34 | \$ 44 | \$ 51 | \$ 57 |
| Net Income (Loss) | \$ (45) | \$ (52) | \$ (71) | \$ (72) |
| Earnings per share impact - diluted | \$ (0.06) | \$ (0.07) | \$ (0.10) | \$ (0.10) |

The following table summarizes MSOP stock option activity during the six months ended June 30, 2008:

| Stock Options | Number of Options | Exercise Price* | Remaining Contractual Life* (months) | Aggregate Intrinsic Value (millions) |
|----------------------|----------------------|--------------------|--------------------------------------------|--------------------------------------------|
| Under option | | | | |
| January 1 | 74,613,051 | \$ 70.50 | | |
| Granted | | | | |
| Annual | 5,239,660 | 77.22 | | |
| Progressive (Reload) | 74,867 | 80.02 | | |
| Other | 8,572 | 80.80 | | |
| Exercised | (3,368,366) | 49.25 | | |
| Canceled | (397,069) | 77.32 | | |
| June 30 | 76,170,715 | \$ 71.87 | 66 | \$ 389 |
| Options exercisable | | | | |
| June 30 | 63,659,712 | \$ 69.86 | 58 | \$ 389 |

*Weighted average

As of June 30, 2008, there was \$128 million of compensation expense that has yet to be recognized related to non-vested stock option based awards. This expense is expected to be recognized over the remaining vesting period with a weighted-average life of 1.9 years. The total intrinsic values of stock options exercised during the six-month periods ended June 30, 2008 and 2007, was \$100 million and \$244 million, respectively. Cash received from options exercised was \$166 million and \$443 million for the six months ended June 30, 2008 and 2007,

Edgar Filing: 3M CO - Form 10-Q

respectively. The Company's actual tax benefits realized for the tax deductions related to the exercise of employee stock options were \$28 million and \$71 million for the six months ended June 30, 2008 and 2007, respectively. Capitalized stock-based compensation amounts were not material at June 30, 2008.

Table of Contents

For annual stock options, the weighted average fair value at the date of grant was calculated using the Black-Scholes option-pricing model and the assumptions that follow.

| Stock Option Assumptions | Annual | | |
|--------------------------|----------|----------|----------|
| | 2008 | 2007 | 2006 |
| Exercise price | \$ 77.22 | \$ 84.79 | \$ 87.23 |
| Risk-free interest rate | 3.1% | 4.6% | 5.0% |
| Dividend yield | 2.0% | 2.1% | 2.0% |
| Expected volatility | 21.7% | 20.0% | 20.0% |
| Expected life (months) | 70 | 69 | 69 |
| Black-Scholes fair value | \$ 15.28 | \$ 18.12 | \$ 19.81 |

Expected volatility is a statistical measure of the amount by which a stock price is expected to fluctuate during a period. For the 2008, 2007 and 2006 annual grant date, the Company estimated the expected volatility based upon the average of the most recent one year volatility, the median of the term of the expected life rolling volatility, the median of the most recent term of the expected life volatility of 3M stock, and the implied volatility on the grant date. The expected term assumption is based on the weighted average of historical grants.

As previously mentioned, beginning with the May 2007 MSOP Annual Grant, the Company expanded its utilization of restricted stock units. Restricted stock unit grants do not accrue dividends during the vesting period and vest at the end of three years. The one-time buyout restricted stock unit grant in 2007 vests at the end of five years. The following table summarizes MSOP restricted stock and restricted stock unit activity during the six months ended June 30, 2008:

| Restricted Stock and Restricted Stock Units | Number of Awards | Grant Date Fair Value* |
|---------------------------------------------|------------------|------------------------|
| Nonvested balance | | |
| As of January 1 | 2,001,581 | \$ 77.63 |
| Granted | | |
| Annual | 924,045 | 77.23 |
| Other | 116,578 | 78.33 |
| Vested | (35,845) | 75.59 |
| Forfeited | (24,039) | 64.91 |
| As of June 30 | 2,982,320 | \$ 77.66 |

*Weighted average

As of June 30, 2008, there was \$132 million of compensation expense that has yet to be recognized related to non-vested restricted stock and restricted stock units. This expense is expected to be recognized over the remaining vesting period with a weighted-average life of 2.8 years. The total fair value of restricted stock and restricted stock units that vested during the six-month periods ended June 30, 2008 and 2007 was not material.

In addition, the Company issues cash settled Restricted Stock Units and Stock Appreciation Rights in certain countries. These grants do not result in the issuance of Common Stock and are considered immaterial by the Company.

Table of Contents**NOTE 13. Business Segments**

Effective in the first quarter of 2008, 3M made certain changes to its business segments in its continuing effort to drive growth by aligning businesses around markets and customers. The most significant of these changes are summarized as follows:

- 3M's Display and Graphics segment created the Projection Systems Department by combining Visual Systems, 3M Precision Optics Inc. and the Company's mobile display technology. The new department will focus on bringing 3M technology to the projection market, providing customers with a centralized resource dedicated to developing differentiated solutions. Visual Systems (previously in the Electro and Communications segment) serves the world's office and education markets with overhead projectors and transparency films, as well as equipment and materials for electronic and multimedia presentations. 3M Precision Optics Inc. and the Company's mobile display technology were previously part of the Optical Systems Division within the Display and Graphics segment.
- 3M's Touch Systems business (previously in the Display and Graphics segment), which includes touch screens and touch monitors, was transferred to the Electro and Communications segment. Touch Systems brings synergistic technologies and strong alignment with 3M's electronics divisions and markets.
- Certain adhesives and tapes in the Industrial Adhesives and Tapes business (Industrial and Transportation segment) were transferred to the Consumer and Office segment, primarily related to the Stationery Products business and Construction and Home Improvement business.

3M's businesses are organized, managed and internally grouped into segments based on differences in products, technologies and services. 3M continues to manage its operations in six operating business segments: Industrial and Transportation; Health Care; Display and Graphics; Consumer and Office; Safety, Security and Protection Services; and Electro and Communications. 3M's six business segments bring together common or related 3M technologies, enhancing the development of innovative products and services and providing for efficient sharing of business resources. These segments have worldwide responsibility for virtually all 3M product lines. 3M is not dependent on any single product or market. Transactions among reportable segments are recorded at cost. 3M is an integrated enterprise characterized by substantial intersegment cooperation, cost allocations and inventory transfers. Therefore, management does not represent that these segments, if operated independently, would report the operating income information shown.

The financial information presented herein reflects the impact of all of the preceding segment structure changes for all periods presented.

| Business Segment Information (Millions) | Three months ended June 30 | | Six months ended June 30 | |
|--------------------------------------------|-------------------------------|----------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| NET SALES | | | | |
| Industrial and Transportation | \$ 2,081 | \$ 1,802 | \$ 4,168 | \$ 3,585 |
| Health Care | 1,118 | 988 | 2,195 | 1,950 |
| Display and Graphics | 846 | 1,005 | 1,717 | 1,931 |
| Consumer and Office | 899 | 834 | 1,737 | 1,651 |

Edgar Filing: 3M CO - Form 10-Q

| | | | | |
|------------------------------------------|-----------------|----------|------------------|-----------|
| Safety, Security and Protection Services | 1,040 | 799 | 1,899 | 1,557 |
| Electro and Communications | 748 | 693 | 1,473 | 1,357 |
| Corporate and Unallocated | 7 | 21 | 13 | 48 |
| Total Company | \$ 6,739 | \$ 6,142 | \$ 13,202 | \$ 12,079 |

OPERATING INCOME

| | | | | |
|------------------------------------------|-----------------|----------|-----------------|----------|
| Industrial and Transportation | \$ 406 | \$ 358 | \$ 878 | \$ 768 |
| Health Care | 310 | 279 | 631 | 1,341 |
| Display and Graphics | 184 | 350 | 371 | 646 |
| Consumer and Office | 179 | 165 | 345 | 343 |
| Safety, Security and Protection Services | 197 | 140 | 401 | 321 |
| Electro and Communications | 151 | 135 | 297 | 245 |
| Corporate and Unallocated | 22 | (30) | 27 | (166) |
| Total Company | \$ 1,449 | \$ 1,397 | \$ 2,950 | \$ 3,498 |

Table of Contents

The following items impacted operating income for the three months and six months ended June 30, 2008. In June 2008, 3M completed the sale of HighJump Software and recognized a pre-tax loss of \$23 million (recorded in the Safety, Security and Protection Services segment). The Company also recorded pre-tax charges of \$19 million in the second quarter of 2008 related to exit activities. These charges related to employee reductions at an Industrial and Transportation manufacturing facility located in the United Kingdom. These items are discussed in more detail in Note 2 (Acquisitions and Divestitures) and Note 4 (Restructuring Actions and Other Exit Activities), respectively.

The following items impacted operating income for the three months ended June 30, 2007. In the second quarter of 2007, the gain on sale of 3M's Opticom Priority Control Systems and Canoga Traffic Detection businesses (\$68 million operating income gain recorded in Display and Graphics) was partially offset by restructuring expenses (\$33 million expense recorded in various business segments) and increases in environmental liabilities (\$13 million expense recorded in Corporate and Unallocated).

In addition to the preceding, the following first quarter 2007 items impacted operating income results for the six months ended June 30, 2007. The sale of 3M's global branded pharmaceuticals business resulted in a pre-tax gain on sale of \$786 million. This gain was recorded in the Pharmaceuticals business within the Health Care segment, consistent with where the 2006 gain on sale of other portions of the business was recorded. The Health Care segment included a net pre-tax gain of \$7 million, which primarily related to adjustments to restructuring costs that were recorded in the fourth quarter of 2006. The Electro and Communications segment includes a pre-tax restructuring charge of \$19 million, primarily related to asset impairment charges. There was also a \$121 million increase in environmental liabilities (reflected in Corporate and Unallocated).

Corporate and unallocated operating income includes a variety of miscellaneous items, such as corporate investment gains and losses, certain derivative gains and losses, insurance-related gains and losses, certain litigation and environmental expenses, corporate restructuring charges and certain under- or over-absorbed costs that the company may choose not to allocate directly to its business segments. Because this category includes a variety of miscellaneous items, it is subject to fluctuation on a quarterly and annual basis.

NOTE 14. Review Report of Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, has performed reviews of the unaudited interim consolidated financial statements included herein, and their review report thereon accompanies this filing. Pursuant to Rule 436(c) of the Securities Act of 1933 ("Act") their report on these reviews should not be considered a "report" within the meaning of Sections 7 and 11 of the Act and the independent registered public accounting firm liability under Section 11 does not extend to it.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Edgar Filing: 3M CO - Form 10-Q

To the Stockholders and Board of Directors of 3M Company:

We have reviewed the accompanying consolidated balance sheet of 3M Company and its subsidiaries as of June 30, 2008 and the related consolidated statements of income for the three-month and six-month periods ended June 30, 2008 and 2007, and of cash flows for the six-month periods ended June 30, 2008 and 2007. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2007, and the related consolidated statements of income, of changes in stockholders' equity and comprehensive income, and of cash flows for the year then ended (not presented herein), and in our report dated February 11, 2008, except with respect to our opinion on the consolidated financial statements insofar as it relates to the effects of the changes in the segments and geographic areas discussed in Notes 16 and 17 as to which the date is May 19, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2007, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Minneapolis, Minnesota

July 31, 2008

Table of Contents

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

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is designed to provide a reader of 3M's financial statements with a narrative from the perspective of management. 3M's MD&A is presented in five sections:

- Overview
- Results of Operations
- Performance by Business Segment
- Financial Condition and Liquidity
- Forward-Looking Statements

OVERVIEW

3M is a diversified global manufacturer, technology innovator and marketer of a wide variety of products and services. 3M manages its operations in six operating business segments: Industrial and Transportation, Health Care, Display and Graphics, Consumer and Office, Safety, Security and Protection Services, and Electro and Communications.

As discussed in Note 13 to the Consolidated Financial Statements, effective in the first quarter of 2008, 3M made certain changes to its business segments. The financial information presented herein reflects the impact of these business segment changes for all periods presented.

For the three months ended June 30, 2008, sales increased 9.7 percent compared to the same period last year, as the strength of 3M's portfolio and international presence helped generate good sales and earnings growth. Operating income margins were maintained at high levels in all six business segments, resulting in a total 3M operating income margin of 21.5 percent. 3M continues to invest in research and development, additional sales presence, a more efficient supply chain and in acquisitions, as evidenced by the April 1, 2008 acquisition of Aearo Holding Corp. (hereafter referred to as Aearo), the parent company of Aearo Technologies Inc., a global leader in the personal protection industry.

Second quarter 2008 included a loss on the sale of HighJump Software and charges for exit activities, which combined penalized net income by \$46 million, or \$0.06 per diluted share, while second quarter 2007 included gains, partially offset by restructuring and environmental charges, which on a net basis benefited net income by \$18 million, or \$0.02 per diluted share. Including these items, 3M reported net sales of \$6.739 billion and net income of \$945 million, or \$1.33 per diluted share, for the three months ended June 30, 2008, compared to reported net sales of \$6.142 billion and net income of \$917 million, or \$1.25 per diluted share, for the three months ended June 30, 2007. Refer to Note A at the end of this overview section for more detail on these 2008 and 2007 items.

3M's product and geographical diversification enabled the Company to post good second-quarter and first-half 2008 results, despite the weak U.S. economy, challenges in the Optical Systems business within the Display and Graphics business segment, and record commodity prices. The second-quarter and first six months of 2008 were impacted by four principal factors:

- Strong sales and operating income performance in five of its six business segments (all except Display and Graphics)
- Ongoing tough U.S. economy, particularly in retail, automotive OEM and residential housing
- Strong international performance, with international representing nearly two-thirds of 3M's worldwide sales
- Continued slowing of, and margin compression in, the Optical Systems business when compared to 2007, which primarily impacted sales and operating income performance in the Asia Pacific region

Concerning Optical Systems, in July 2008, management approved and committed to undertake actions to more closely align its cost structure with the current demand in segments of the optical film LCD market. 3M will eliminate approximately 300 jobs in Optical Systems, in the U.S. and internationally. This will include positions in SG&A, manufacturing, research and development and other functions. 3M is improving manufacturing efficiency by consolidating several converting sites in the Asia region. 3M's former film converting plant in Poland will be transformed into a multi-use multi-divisional facility for other 3M businesses.

Table of Contents

The following table summarizes sales and operating income results by business segment.

| (Millions) | Three months ended June 30 | | | | % change | |
|------------------------------------------|----------------------------|--------------|-----------|--------------|-----------|--------------|
| | 2008 | | 2007 | | Net Sales | Oper. Income |
| | Net Sales | Oper. Income | Net Sales | Oper. Income | | |
| Industrial and Transportation | \$ 2,081 | \$ 406 | \$ 1,802 | \$ 358 | 15.5% | 13.1% |
| Health Care | 1,118 | 310 | 988 | 279 | 13.1% | 10.7% |
| Display and Graphics | 846 | 184 | 1,005 | 350 | (15.9)% | (47.5)% |
| Consumer and Office | 899 | 179 | 834 | 165 | 7.8% | 9.1% |
| Safety, Security and Protection Services | 1,040 | 197 | 799 | 140 | 30.2% | 40.7% |
| Electro and Communications | 748 | 151 | 693 | 135 | 7.9% | 11.4% |
| Corporate and Unallocated | 7 | 22 | 21 | (30) | | |
| Total Company | \$ 6,739 | \$ 1,449 | \$ 6,142 | \$ 1,397 | 9.7% | 3.7% |

Worldwide total sales growth was 9.7 percent. Local-currency sales growth (which includes volume, selling price and acquisition impacts, but excludes divestiture and translation impacts) was 4.6 percent for the second quarter of 2008, including 4.1 percentage points from acquisitions. Local-currency sales increased 25.6 percent in Safety, Security and Protection Services (including 19.8 percentage points from acquisitions), 8.7 percent in Industrial and Transportation (including 4.2 percentage points from acquisitions), 7.7 percent in Health Care (including 1.1 percentage points from acquisitions), 3.5 percent in Consumer and Office (including 0.7 percentage points from acquisitions) and 2.2 percent in Electro and Communications (including 0.4 percentage points from acquisitions). Local-currency sales declined 18.8 percent in Display and Graphics.

Worldwide sales growth was broad-based, with five of six segments experiencing strong sales and operating income growth in the second quarter. Security and Protection Services sales growth was led by acquisitions, primarily Aearo, along with organic growth in personal protection, window films, cleaning solutions for commercial buildings and corrosion protection products, with geographic area sales growth led by Europe, the U.S. and Latin America. Industrial and Transportation had broad-based sales growth across the portfolio, with strong sales growth in all businesses and major geographic areas. Health Care sales growth was strongest in orthodontics, dental and medical, with positive sales growth in all major geographies. Sales in Consumer and Office were led by international sales growth in Europe and Asia Pacific, but were negatively impacted by the weakness in U.S. office mass retail channels. Electro and Communications sales growth was led by electrical markets, electronic materials and communications markets, with sales growth geographically led by Asia Pacific and Europe. 3M continued to experience declines in the flexible circuits business where a number of product solutions are going end-of-life. Within Display and Graphics, positive sales growth in Commercial Graphics and Traffic Safety Systems was more than offset by lower sales in Optical Systems, which were down 36 percent year-on-year. As a result, sales for Display and Graphics were down 15.9 percent in the second quarter of 2008. The challenges in Optical Systems are likely to persist throughout 2008 and early 2009 as price and attachment rate pressure remains intense in segments of the LCD market and OEMs aggressively pursue cost reductions from their component suppliers, including 3M. Refer to the Performance by Business Segment section for a more detailed discussion of the results of the respective segments.

Geographically, Latin America and Canada led local-currency sales growth (including acquisitions) in the second quarter of 2008, with a combined increase of 16.4 percent, followed by the United States with a 6.6 percent increase and Europe with a 6.4 percent increase. Local-currency sales in Asia Pacific declined 4.2 percent. Asia Pacific was negatively impacted by Optical Systems sales, which were down 36 percent in that region. Excluding Optical Systems, Asia Pacific sales increased 10 percent on a local-currency basis. Of the local-currency sales growth, acquisitions contributed 4.7 percent to the combined Latin America and Canada, 6.5 percent to the United States, 3.7 percent to Europe, and 1.0 percent to Asia Pacific. Foreign currency translation positively impacted international sales by 8.6 percent, as the U.S. dollar weakened in aggregate against many currencies in these geographic areas. Foreign currency translation positively impacted Latin America and Canada by 9.8 percent, Europe by 11.8 percent and Asia Pacific by 5.1 percent.

Operating income margins for the three months ended June 30, 2008 were 21.5 percent, compared to 22.7 percent in the second quarter of 2007. Operating income margins in the second quarter of 2008 were negatively impacted by 0.6 percentage points from the loss on sale of HighJump Software and charges for exit activities. Operating income margins in the second quarter of 2007 were positively impacted by the gain on sale of businesses, net of restructuring expenses and increases in environmental liabilities, which contributed 0.3 percentage points of the 22.7 percent operating income margin.

Table of Contents

3M generated \$2.240 billion of operating cash flows for the six months ended June 30, 2008, an increase of \$556 million compared to the six months ended June 30, 2007. Refer to the section entitled "Cash Flows from Operating Activities" later in the MD&A for a discussion of items impacting cash flows. For the six months ended June 30, 2008, the Company utilized \$1.786 billion of cash to repurchase 3M common stock and pay dividends. In February 2007, 3M's Board of Directors authorized a two-year share repurchase of up to \$7.0 billion for the period from February 12, 2007 to February 28, 2009. As of June 30, 2008, approximately \$3.0 billion remained available for repurchase. In February 2008, 3M's Board also authorized a dividend increase of 4.2 percent for 2008, marking the 50th consecutive year of dividend increases for 3M. 3M's debt to total capital ratio (total capital defined as debt plus equity) as of June 30, 2008 was 32 percent. 3M has an AA credit rating, with a stable outlook, from Standard & Poor's and an Aa1 credit rating, with a negative outlook, from Moody's Investors Service. The Company has sufficient access to capital markets to meet currently anticipated growth and acquisition investment funding needs.

(Note A).

In June 2008, 3M completed the sale of HighJump Software and recognized a loss (\$23 million pre-tax, \$32 million after-tax) in the second quarter of 2008. In the second quarter of 2008, the Company also recorded charges (\$19 million pre-tax, \$14 million after-tax) related to employee reductions at an Industrial and Transportation manufacturing facility located in the United Kingdom. Combined, these items penalized second quarter 2008 operating income by \$42 million and net income by \$46 million, or \$0.06 per diluted share. These items are discussed in more detail in Note 2 (Acquisitions and Divestitures) and Note 4 (Restructuring Actions and Other Exit Activities).

In 2007, 3M completed and recorded gains from the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses in the second quarter and from the sale of its global branded pharmaceuticals business in Europe in the first quarter. Both the first and second quarter 2007 gain on sale of businesses were partially offset by restructuring expenses and increases in environmental liabilities. These items benefited second quarter 2007 operating income by \$22 million and net income by \$18 million, or \$0.02 per diluted share, and benefited first six months 2007 operating income by \$675 million and net income by \$440 million, or \$0.60 per diluted share. Second quarter 2007 included net benefits from gains related to the sale of businesses (\$68 million pre-tax, \$47 million after-tax), which were partially offset by restructuring actions (\$33 million pre-tax, \$21 million after-tax) and increases in environmental liabilities (\$13 million pre-tax, \$8 million after-tax). First six months 2007 included net benefits from gains related to the sale of businesses (\$854 million pre-tax, \$553 million after-tax), which were partially offset by restructuring actions (\$45 million pre-tax, \$30 million after-tax) and increases in environmental liabilities (\$134 million pre-tax, \$83 million after-tax).

RESULTS OF OPERATIONS

Percent change information compares the second quarter and first six months of 2008 with the same period last year, unless otherwise indicated.

Net Sales:

Edgar Filing: 3M CO - Form 10-Q

| | Three months ended June 30, 2008 | | | Six months ended June 30, 2008 | | |
|---------------------------------|-------------------------------------|----------|-----------|-----------------------------------|----------|-----------|
| | U.S. | Intl. | Worldwide | U.S. | Intl. | Worldwide |
| Net sales (millions) | \$ 2,425 | \$ 4,314 | \$ 6,739 | \$ 4,651 | \$ 8,551 | \$ 13,202 |
| % of worldwide sales | 36.0% | 64.0% | | 35.2% | 64.8% | |
| Components of net sales change: | | | | | | |
| Volume organic | (1.9)% | 1.8% | 0.4% | (2.2)% | 2.7% | 0.9% |
| Price | 2.0 | (1.1) | 0.1 | 1.8 | (1.2) | (0.1) |
| Organic local-currency sales | 0.1 | 0.7 | 0.5 | (0.4) | 1.5 | 0.8 |
| Volume acquisitions | 6.5 | 2.7 | 4.1 | 4.8 | 1.8 | 2.9 |
| Local-currency sales | 6.6 | 3.4 | 4.6 | 4.4 | 3.3 | 3.7 |
| Divestitures | (0.6) | (0.1) | (0.3) | (0.5) | | (0.2) |
| Translation | | 8.6 | 5.4 | | 9.2 | 5.8 |
| Total sales change | 6.0% | 11.9% | 9.7% | 3.9% | 12.5% | 9.3% |

In the second quarter of 2008, worldwide sales grew 9.7 percent in U.S. dollar terms, with international up 11.9 percent and the U.S. up 6.0 percent. Worldwide, local-currency sales growth was 4.6 percent, comprised of organic local-currency volume growth of 0.4 percent, selling price increases of 0.1 percent, and acquisitions growth of 4.1 percent, primarily Aearo. Foreign currency translation added 5.4 percent to second-quarter 2008 sales.

Table of Contents

Excluding the impact of the optical business, local-currency sales increased 8.1 percent as organic volumes increased 2.5 percent, selling prices increased 1.1 percent, and acquired volume was up 4.5 percent. Worldwide, local currency sales growth was led by the Industrial and Transportation, Health Care and Safety, Security and Protection Services businesses.

In the United States, local-currency sales improved 6.6 percent when compared to last year's second-quarter. Due to the slow economic conditions, especially in the retail, housing and automotive OEM markets, organic volumes declined 1.9 percent, while acquisitions added 6.5 percent and selling price increases added 2.0 percent. All businesses delivered U.S. price increases as 3M tries to offset the continued high price of commodities. 3M experienced U.S. sales growth in, Safety, Security and Protection Services, Industrial and Transportation, Health Care and Consumer and Office, while sales declined in Electro and Communications and Display and Graphics.

International sales on a local-currency basis increased 3.4 percent in the second quarter. Organic volumes increased 1.8 percent with five of six businesses (all except Display and Graphics) posting positive organic volume growth. Selling prices declined 1.1 percent, including a 12 percent price decline in optical. Acquisitions added 2.7 percent to international local-currency growth in the quarter. Excluding optical, international local-currency sales growth was 9.1 percent, including 5.5 percent from organic volume growth, 3.1 percent from acquisitions and 0.5 percent from selling prices. International local-currency sales growth was led by Latin America at 21 percent, followed by Canada at 7 percent, and Europe at 6 percent. Local-currency sales declined 4 percent in Asia Pacific due to a 37 percent local-currency decline in optical. Excluding optical, Asia Pacific sales in local-currencies increased 10 percent over the same quarter last year. Foreign currency translation increased second-quarter international sales by 8.6 percent. Refer to the Performance by Business Segment section for additional discussion of sales change by segment and the preceding Overview section for discussion of sales growth by geographic area.

Operating Expenses:

| (Percent of net sales) | Three months ended | | | Six months ended | | |
|----------------------------------------------|--------------------|-----------------|--------|------------------|-----------------|--------|
| | 2008 | June 30 2007 | Change | 2008 | June 30 2007 | Change |
| Cost of sales | 52.1% | 51.8% | 0.3% | 51.9% | 51.2% | 0.7% |
| Selling, general and administrative expenses | 20.7 | 20.9 | (0.2) | 20.2 | 21.3 | (1.1) |
| Research, development and related expenses | 5.4 | 5.7 | (0.3) | 5.4 | 5.6 | (0.2) |
| (Gain)/loss on sale of businesses | 0.3 | (1.1) | 1.4 | 0.2 | (7.1) | 7.3 |
| Operating income | 21.5% | 22.7% | (1.2)% | 22.3% | 29.0% | (6.7)% |

Cost of sales as a percent of net sales increased 0.3 percentage points in the second quarter and 0.7 percentage points in the first six months compared to the same periods in 2007. The increase in cost of sales for both the second quarter and first six months was primarily attributable to the impact of Optical Systems. The remainder of 3M's broad-based portfolio performed as expected, with impacts from selling price increases, along with process improvements and cost reductions, helping to offset higher raw material costs. Raw material costs in the second quarter increased approximately 3 to 4 percent year-on-year. In 2008, charges of \$19 million related to employee reductions at an Industrial and Transportation manufacturing facility located in the United Kingdom penalized cost of sales as a percent of net sales by approximately 0.3 percentage points in the second quarter and 0.2 percentage points for the first six months of 2008. In 2007, restructuring expenses, primarily related to the phase-out of operations at the Company's New Jersey roofing granule facility in the second quarter and charges related to the Company's decision to close a facility in Wisconsin in the first quarter, penalized cost of sales as a percent of net sales by approximately 0.6 percentage points in the second quarter and 0.3 percentage points for the first six months of 2007.

Selling, general and administrative (SG&A) expenses as a percent of net sales decreased 0.2 percentage points in the second quarter and 1.1 percentage points in the first six months compared to the same periods in 2007. These decreases are driven by environmental and restructuring expenses in 2007 which did not repeat in 2008. In the second quarter of 2007, an increase in environmental liabilities (\$13 million) and SG&A restructuring expenses (\$3 million) increased SG&A as a percent of net sales by 0.2 percentage points. The first quarter of 2007 includes a \$121 million increase in environmental liabilities and \$7 million in SG&A restructuring expenses, which when combined with second quarter items, increased first-half 2007 SG&A by 1.2 percentage points.

Research, development and related expenses as a percent of net sales decreased 0.3 percentage points in the second quarter and 0.2 percentage points in the first six months compared to the same periods in 2007. R&D and related costs in dollars increased approximately 6 percent in the first six months of 2008 as the Company continued to aggressively invest in future technologies and growth opportunities.

Table of Contents

The (gain)/loss on sale of businesses as a percent of net sales decreased by 1.4 percentage points in the second quarter and 7.3 percentage points in the first six months compared to the same periods in 2007. In June 2008, 3M completed the sale of HighJump Software and recognized a pre-tax loss of \$23 million in the second quarter of 2008. 3M completed and recorded gains from the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses (pre-tax gain of \$68 million) in the second quarter of 2007 and from the sale of its global branded pharmaceuticals business in Europe (pre-tax gain of \$786 million) in the first quarter of 2007.

Operating Income:

3M uses operating income as one of its primary business segment performance measurement tools. Operating income margins were 22.3 percent in the first six months of 2008, a decrease from 29.0% in the first six months of 2007. Operating income margins in 2008 were negatively impacted by 0.4 percentage points from the loss on sale of HighJump Software and charges for exit activities. Operating income margins in 2007 were positively impacted by the gain on sale, net of restructuring expenses and increases in environmental liabilities, which contributed 5.6 percentage points of the 29.0 percent operating income margin.

Interest Expense and Income:

| (Millions) | Three months ended June 30 | | Six months ended June 30 | |
|------------------|-------------------------------|-------|-----------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Interest expense | \$ 51 | \$ 48 | \$ 106 | \$ 86 |
| Interest income | (18) | (29) | (48) | (57) |
| Total | \$ 33 | \$ 19 | \$ 58 | \$ 29 |

Interest expense increased for the second quarter and first six months of 2008 when compared to the same periods in 2007, primarily related to higher average U.S. and international long-term debt balances and higher long-term debt interest rates in the U.S., which were partially offset by lower short-term debt balances and interest rates. Interest income was lower in the second quarter and first six months of 2008, due to other-than-temporary impairments related to auction rate securities investments (Note 7) and lower interest rates, which were partially offset by higher average cash, cash equivalent and marketable securities balances.

Provision for Income Taxes:

| (Percent of pre-tax income) | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------|-------------------------------|-------|-----------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Effective tax rate | 32.0% | 32.3% | 31.9% | 33.2% |

The tax rate for both the second quarter and first six months of 2008 decreased when compared to the same periods in 2007, primarily due to lower international tax rates and adjustments to income tax reserves. These tax rate benefits were partially offset by the combination of the divestiture of HighJump Software and charges for exit activities in the second quarter of 2008. 3M's tax basis in HighJump Software was significantly lower than its book value, primarily related to the treatment of acquired goodwill, which negatively impacted the tax rate. Refer to

Note 6 for further discussion of income taxes.

Minority Interest:

| (Millions) | Three months ended June 30 | | Six months ended June 30 | |
|-------------------|-------------------------------|-------|-----------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Minority Interest | \$ 18 | \$ 16 | \$ 36 | \$ 31 |

Minority interest expense eliminates the income or loss attributable to non-3M ownership interests in 3M consolidated entities. 3M's most significant consolidated entity with non-3M ownership interests is Sumitomo 3M Limited (3M owns 75 percent of Sumitomo 3M Limited). The increase for the second quarter and first six months of 2008 primarily related to Sumitomo 3M Limited.

Table of Contents***Currency Effects:***

3M estimates that year-on-year currency effects, including hedging impacts, increased net income by approximately \$60 million for the for the three months ended June 30, 2008 and increased net income by approximately \$110 million for the six months ended June 30, 2008. This estimate includes the effect of translating profits from local currencies into U.S. dollars; the impact of currency fluctuations on the transfer of goods between 3M operations in the United States and abroad; and transaction gains and losses, including derivative instruments designed to reduce foreign currency exchange rate risks. However, this estimate does not reflect the higher commodity prices 3M is currently experiencing related to dollar-denominated commodities, which would mute this impact somewhat. 3M estimates that year-on-year derivative and other transaction gains and losses had a minimal impact on net income for the three months ended June 30, 2008 and decreased net income by approximately \$15 million for the six months ended June 30, 2008.

New Accounting Pronouncements:

Information regarding new accounting pronouncements is included in Note 1 to the Consolidated Financial Statements.

PERFORMANCE BY BUSINESS SEGMENT

As discussed in Note 13 to the Consolidated Financial Statements, effective in the first quarter of 2008, 3M made certain changes to its business segments. Segment information for all periods presented has been reclassified to reflect the new segment structure.

Information related to 3M's business segments for the second quarter and first six months of both 2008 and 2007 is presented in the tables that follow. Local-currency sales (which includes both organic and acquisition volume impacts plus price impacts) are provided for each segment. The divestiture impact, if any, translation impact and total sales change are also provided for each segment.

Industrial and Transportation Business:

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|----------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 2,081 | \$ 1,802 | \$ 4,168 | \$ 3,585 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | 8.7% | 5.6% | 9.1% | 4.8% |
| Translation | 6.8 | 2.9 | 7.2 | 2.8 |
| Total sales change | 15.5% | 8.5% | 16.3% | 7.6% |
| Operating income (millions) | \$ 406 | \$ 358 | \$ 878 | \$ 768 |
| Percent change | 13.1% | 12.2% | 14.2% | 10.0% |

Edgar Filing: 3M CO - Form 10-Q

| | | | | |
|------------------|--------------|-------|--------------|-------|
| Percent of sales | 19.5% | 19.9% | 21.1% | 21.4% |
|------------------|--------------|-------|--------------|-------|

The Industrial and Transportation segment serves a broad range of markets, such as appliance, paper and packaging, food and beverage, and automotive OEM and aftermarket (auto body shops). Industrial and Transportation products include tapes, a wide variety of coated and non-woven abrasives, adhesives, specialty materials, filtration products, closure systems for personal hygiene products, and components and products that are used in the manufacture, repair and maintenance of automotive, marine, aircraft and specialty vehicles.

Second quarter of 2008:

The Industrial and Transportation segment had broad-based sales growth across the portfolio, with sales up 15.5 percent to \$2.1 billion. Sales growth was led by the industrial adhesives and tapes business, followed by automotive aftermarket, abrasives and closure systems for personal hygiene products. The automotive OEM market also experienced solid sales growth, led by international. Local currency sales increased 8.7 percent, including 4.2 percent from acquisitions.

All geographic regions saw sales growth in the quarter, including the U.S. Strong market penetration continued in emerging economies, especially BRICP (Brazil, Russia, India, China, Poland) countries, where the business drove strong organic local-currency growth. Elsewhere around the globe, 3M experienced strong growth in Europe, Asia Pacific and Latin America. Some of the products driving growth in the second quarter were abrasives used in autobody shops; laminating adhesives providing attachment solutions in industrial applications; closure systems for personal hygiene products; and packaging, masking and specialty tapes.

Table of Contents

In the second quarter of 2008, the Company recorded pre-tax charges of \$19 million related to exit activities. These charges related to employee reductions at an Industrial and Transportation manufacturing facility located in the United Kingdom. Operating income for the second quarter of 2007 included \$2 million in restructuring expenses. These items negatively impacted second quarter 2008 operating income growth by 5 percentage points.

First six months of 2008:

Year-to-date sales were up 16.3 percent, with operating income up 14.2 percent, as operating margins held steady in excess of 21 percent, helped by strong operational discipline. Like the second quarter, first six months sales growth was led by industrial adhesives and tapes, automotive aftermarket and abrasives, in addition to solid growth in the automotive OEM market and closure systems for personal hygiene products. Operating income growth was negatively impacted by 2.1 percentage points due to the exit activities and restructuring actions included in the preceding second quarter discussion.

Industrial and Transportation continues to invest in innovative new products along with complementary gap fill acquisitions. In July 2008, 3M announced that it had entered into an agreement to acquire EMFI S.A. and SAPO S.A., manufacturers of polyurethane-based structural adhesives and sealants, headquartered in Haguenau, France. Industrial and Transportation expects continued emerging market penetration, particularly in the BRICP countries, and is also driving 3M technologies and solutions into the oil and gas market to meet the needs of major energy customers.

Health Care Business:

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|--------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 1,118 | \$ 988 | \$ 2,195 | \$ 1,950 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | 7.7% | 19.5% | 6.7% | 19.9% |
| Divestitures | (0.1) | (24.2) | (0.1) | (24.5) |
| Translation | 5.5 | 3.6 | 5.9 | 3.8 |
| Total sales change | 13.1% | (1.1)% | 12.5% | (0.8)% |
| Operating income (millions) | \$ 310 | \$ 279 | \$ 631 | \$ 1,341 |
| Percent change | 10.7% | 7.3% | N/A | N/A |
| Percent of sales | 27.7% | 28.3% | 28.8% | N/A |

The Health Care segment serves markets that include medical clinics and hospitals, pharmaceuticals, dental and orthodontic practitioners, and health information systems. Products and services provided to these and other markets include medical and surgical supplies, skin health and infection prevention products, drug delivery systems, dental and orthodontic products, health information systems and microbiology solutions. The global branded pharmaceuticals business was sold in December 2006 and January 2007.

Second quarter of 2008:

Health Care continued its excellent performance thus far in 2008 with broad-based sales growth of 13.1 percent. Local currency growth was 7.7 percent, including acquisition growth of 1.1 percent. Three divisions drove solid sales growth in the quarter – namely orthodontics, dental, and medical. Orthodontics and dental, or 3M’s oral care business, showed outstanding strength and led the way. The U.S. market had good sales growth, while international sales growth was outstanding, as all regions outside the U.S. drove solid increases in both sales and operating income. Some of the products that drove sales include advanced wound care and surgical tapes, dental restorative materials and equipment for crown and bridge procedures and self-ligating brackets for orthodontics.

3M’s dental business closed a deal in July 2008 for IMTEC Corp., a manufacturer of dental implants and scanning equipment primarily known for their mini dental implants, which general dentists can administer. 3M also marked the first sales of the chair-side oral scanner, a digital impression system that enables the motion capture of accurate and precise dental impressions. In orthodontics, 3M continued to deliver strong results, and a deal to acquire the German sister-company of U.S.-based Lingualcare Inc. was announced, expanding 3M’s offering for digital orthodontic products into Europe and Asia and helping to meet the surging demand for this invisible orthodontic solution.

Table of Contents

In the medical business, 3M closed the Les Entreprises Solumed Inc. acquisition, further solidifying 3M's position as a provider of leading-edge medical products designed to prevent infections. Also, 3M was awarded top honors by the International Association for Food Protection for its contributions to food safety technology.

Operating income rose nearly 11 percent, to \$310 million. Operating income in the second quarter of 2007 includes an operating income gain of \$2 million, primarily related to adjustments to restructuring costs incurred in the fourth quarter of 2006.

First six months of 2008:

Year-to-date, sales have increased 12.5 percent, with operating income margins at 28.8 percent. Like the second quarter, orthodontics, dental, and medical have driven the strong sales growth.

In addition to the preceding second quarter 2007 gain related to restructuring costs, the combination of the following first quarter 2007 items positively impacted first six months 2007 Health Care operating income by \$793 million. In January 2007 the Company sold its branded pharmaceuticals business in the Europe region. The operating income gain related to this sale, which is included in Health Care, totaled \$786 million. In addition, a net pre-tax gain of \$7 million was recorded, which primarily related to adjustments to restructuring costs incurred in the fourth quarter of 2006.

3M believes the disaggregated information that follows for 3M Health Care's remaining businesses (without pharmaceuticals) and for pharmaceuticals on a stand-alone basis is useful.

Health Care Business without Pharmaceuticals:

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|--------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 1,118 | \$ 988 | \$ 2,195 | \$ 1,950 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | 7.7% | 19.5% | 6.7% | 19.9% |
| Divestitures | (0.1) | | (0.1) | |
| Translation | 5.5 | 3.6 | 5.9 | 3.8 |
| Total sales change | 13.1% | 23.1% | 12.5% | 23.7% |
| Operating income (millions) | \$ 310 | \$ 277 | \$ 631 | \$ 541 |
| Percent change | 11.8% | 32.0% | 16.6% | 20.7% |
| Percent of sales | 27.7% | 28.0% | 28.8% | 27.7% |

The following discussion provides information on 3M Health Care's remaining businesses (without pharmaceuticals).

Second quarter of 2008:

Refer to the preceding section entitled *Health Care Business* for a discussion of sales change. Second quarter operating income in Health Care (without pharmaceuticals) increased 11.8 percent to \$310 million with margins of 27.7 percent.

First six months of 2008:

Refer to the preceding section entitled *Health Care Business* for a discussion of sales change. Operating income increased more than 15 percent, while operating margins increased to 28.8 percent. Operating income in the first six months of 2007 included \$5 million in restructuring expenses, primarily severance and related benefits.

Pharmaceuticals Business:

| | Three months ended June 30 | | Six months ended June 30 | | | |
|-----------------------------|-------------------------------|------|-----------------------------|------|----|-----|
| | 2008 | 2007 | 2008 | 2007 | | |
| Operating income (millions) | \$ | \$ | 2 | \$ | \$ | 800 |

Operating income in the second quarter of 2007 includes a net operating income gain of \$2 million, primarily related to adjustments to restructuring costs incurred in the fourth quarter of 2006. In addition to the preceding

Table of Contents

item, the combination of the following first quarter 2007 items positively impacted first six months 2007 Health Care operating income by \$798 million. In early January 2007 the Company sold its branded pharmaceuticals business in Europe. The operating income gain related to this sale, which is included in pharmaceuticals, totaled \$786 million. In addition, a net pre-tax restructuring gain of \$12 million was recorded, which primarily related to adjustments to restructuring costs incurred in the fourth quarter of 2006.

Display and Graphics Business:

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|----------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 846 | \$ 1,005 | \$ 1,717 | \$ 1,931 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | (18.8)% | 9.5% | (14.1)% | 4.7% |
| Divestitures | (0.6) | | (0.7) | |
| Translation | 3.5 | 1.4 | 3.7 | 1.3 |
| Total sales change | (15.9)% | 10.9% | (11.1)% | 6.0% |
| Operating income (millions) | \$ 184 | \$ 350 | \$ 371 | \$ 646 |
| Percent change | (47.5)% | 46.5% | (42.6)% | 21.1% |
| Percent of sales | 21.7% | 34.8% | 21.6% | 33.4% |

The Display and Graphics segment serves markets that include electronic display, traffic safety and commercial graphics. This segment includes optical film solutions for electronic displays; computer screen filters; reflective sheeting for transportation safety; commercial graphics systems; and projection systems, including mobile display technology and visual systems products. The optical film business provides films that serve numerous market segments of the electronic display industry. 3M provides distinct products for five market segments, including products for: 1) LCD computer monitors 2) LCD televisions 3) handheld devices such as cellular phones 4) notebook PCs and 5) automotive displays.

Second quarter of 2008:

During the second quarter, 3M saw sales growth in both Commercial Graphics and Traffic Safety Systems. Overall, second quarter sales for Display and Graphics were down nearly 16 percent with operating income down 47.5 percent, with 11.7 percentage points of this reduction due to net gains recorded in 2007 that did not repeat in 2008 (reference discussion at the end of this second quarter section). The remaining impact was driven by the sales and operating income declines of 36 and 54 percent, respectively, in the Optical Systems Division. Operating margins in Display and Graphics improved slightly sequentially to 21.7 percent as 3M continues to right size the business and execute on manufacturing improvements. Excluding the Optical Systems Division and divestiture impacts, the remaining Display and Graphics businesses sales increased 5.3 percent and operating income was flat.

Display and Graphics saw the effects of slow U.S.-driven markets for Traffic Safety Solutions and Commercial Graphics. Highway construction and commercial graphics for the trucking industry have both slowed, resulting in sequentially slowing sales during the course of the second quarter in the U.S. for both businesses. Despite the headwinds in the U.S., good performance in these businesses internationally was led by Europe, Latin America and Asia Pacific.

Edgar Filing: 3M CO - Form 10-Q

In the Optical Systems Division, market forces continue to drive the transition in LCD TV s. The LCD TV film business has continued to face pricing and attachment rate pressures as customers move to lower-cost design solutions based on lower brightness and color specifications, therefore eliminating 3M film in many LCD TV sets. As a result, year-on-year film sales into LCD TV s has declined 66 percent with operating income down nearly 80 percent. While this transition is certainly difficult, 3M believes that by the end of 2008 or early 2009 it will be through much of this transition as the balance of 3M film sales into handhelds, notebooks and monitors remains relatively steady.

3M s Mobile Projection Technology, an ultra compact, LED-based projection engine for personal devices, is now in production. 3M is continuing to see interest in this new technology across a range of personal electronics options, including cell phones, laptop computers and PDAs.

In June 2007, 3M completed the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses and recognized an operating income gain of \$68 million in the Display and Graphics segment in the

Table of Contents

second quarter of 2007. In addition, Display and Graphics recorded restructuring-related expenses of \$4 million in the second quarter of 2007. Operating income in the second quarter of 2007 includes this aggregate net operating income benefit of \$64 million, which contributed 6.3 percentage points of the 34.8 percent operating income margin.

First six months of 2008:

For the first six months, Display and Graphics sales have decreased 11.1 percent. Operating income declined 42.6 percent, with the preceding net aggregate benefit of \$64 million in 2007 contributing 6.3 percentage points of this 42.6 percent operating income decline when comparing the first six months of 2008 to the same period in 2007. This net benefit also contributed 3.3 percentage points of the 33.4 percent operating income margin for the first six months of 2007.

Consumer and Office Business:

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|--------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 899 | \$ 834 | \$ 1,737 | \$ 1,651 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | 3.5% | 6.2% | 0.5% | 7.1% |
| Translation | 4.3 | 2.0 | 4.7 | 1.9 |
| Total sales change | 7.8% | 8.2% | 5.2% | 9.0% |
| Operating income (millions) | \$ 179 | \$ 165 | \$ 345 | \$ 343 |
| Percent change | 9.1% | 21.1% | 0.8% | 19.4% |
| Percent of sales | 20.0% | 19.8% | 19.9% | 20.8% |

The Consumer and Office segment serves markets that include consumer retail, office retail, home improvement, building maintenance and other markets. Products in this segment include office supply products, stationery products, construction and home improvement products, home care products, protective material products and consumer health care products.

Second quarter of 2008:

The Consumer and Office business saw improvement from the first quarter, with sales increasing year-on-year by 7.8 percent in the second quarter. Local currency sales were up 3.5 percent, including 0.7 percent from acquisitions. Operating income was up 9.1 percent, with operating income margins of 20 percent.

Consumer and Office experienced positive growth in all divisions, with do-it-yourself (construction and home improvement products) and home care leading the way. Overall sales growth was tempered by weakness in the office mass retail channel in the U.S. Geographically, 3M's

Edgar Filing: 3M CO - Form 10-Q

international subsidiaries drove growth again this quarter, with sales growth in all regions led by Europe and Asia Pacific.

Through expanded distribution, brand presence and merchandising programs, 3M's Consumer and Office business drove outstanding growth of its Filtrete air filtration products for residential HVAC systems. In Home Care, 3M recently launched the Scotch-Brite Ultra Nail Saver cleaning sponge and Scotch Fur Fighter pet hair remover. 3M also launched its Nexcare cold-sore treatment product, leveraging its experience in manufacturing products focused on skin wellness to provide consumers with lasting, permanent relief from cold-sores. Other products driving growth in the second quarter were Ultrathon insect repellent, Scotchbrite scouring products, along with Command mounting and fastening products.

First six months of 2008:

Year-to-date sales increased 5.2 percent and operating income increased nearly one percent, which 3M believes is an outstanding result in the current business climate. As in the second quarter, sales growth was led by do-it-yourself and home care.

Going forward, 3M expects sales growth in the Consumer and Office segment to continue to be led by international operations as U.S. growth will remain uncertain over the near term due to challenging economic conditions.

Table of Contents*Safety, Security and Protection Services Business:*

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|--------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 1,040 | \$ 799 | \$ 1,899 | \$ 1,557 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | 25.6% | 16.7% | 16.2% | 15.9% |
| Divestitures | (1.2) | | (0.6) | |
| Translation | 5.8 | 4.0 | 6.4 | 3.8 |
| Total sales change | 30.2% | 20.7% | 22.0% | 19.7% |
| Operating income (millions) | \$ 197 | \$ 140 | \$ 401 | \$ 321 |
| Percent change | 40.7% | 0.9% | 24.7% | 8.3% |
| Percent of sales | 19.0% | 17.5% | 21.1% | 20.6% |

The Safety, Security and Protection Services segment serves a broad range of markets that increase the safety, security and productivity of workers, facilities and systems. Major product offerings include personal protection products, safety and security products (including border and civil security solutions), energy control products, cleaning and protection products for commercial establishments, roofing granules for asphalt shingles, and supply chain execution software solutions. As discussed below, 3M completed the sale of its HighJump Software business, which provided supply chain execution software solutions, in the second quarter of 2008.

Second quarter of 2008:

Led by acquisitions, primarily Aearo, along with organic growth in personal protection, window films, cleaning solutions for commercial buildings and corrosion protection products, Safety, Security and Protection Services delivered sales of \$1 billion, up 30.2 percent from last year. Growth in local currency was 25.6 percent, including 19.8 percent from acquisitions. Acquired growth was primarily from Aearo, an Indianapolis-based, but global manufacturer of personal protection and energy absorbing products that added hearing protection and fall protection lines to 3M's existing full-line of respiratory products. Geographic sales were strong across the globe, led by Europe, the U.S. and Latin America.

In personal protection, 3M continues to see strong demand for its maintenance free and elastomeric respirators as well as reflective materials. With the Aearo acquisition, 3M now offers a more complete personal protection solution that spans the industrial, military and construction markets. 3M's Speedglas auto-darkening filters and helmet product development team has been awarded Business Week's gold IDEA award for design excellence.

In building and commercial services, 3M saw strong demand for its floor maintenance products, due to an increase in commercial construction in many parts of the world. Also, 3M has continued to see steady growth in its corrosion protection products, where pipe coating solutions extend the life of both the underground and above ground pipelines.

Edgar Filing: 3M CO - Form 10-Q

In the track and trace business, 3M refined its strategic direction for the tracking of high value assets, asset utilization, and safety and security applications. In connection with these strategy refinements, 3M announced and completed the sale of its HighJump Software business and recognized a pre-tax loss of \$23 million in the second quarter of 2008.

In the second quarter of 2007, 3M recorded a restructuring charge of \$29 million related to the phase-out of operations at its New Jersey roofing granule facility. This included fixed asset impairments and employee-related restructuring liabilities. The combination of these items contributed 10.7 percentage points of the reported 40.7 percent operating income growth. Included in these operating income results is approximately \$20 million of one-time Aearo acquisition related costs, which negatively impacted second quarter and year-to-date operating margins by almost two percent and one percent, respectively.

First six months of 2008:

Year-to-date sales increased 22 percent. As in the second quarter, sales growth was led by acquisitions, primarily Aearo, along with organic growth in personal protection, window films, cleaning solutions for commercial buildings and corrosion protection products. The sale of business and restructuring charge discussed in the preceding paragraph contributed 3.7 percentage points of the reported 24.7 percent operating income growth. Operating income margins are in excess of 21 percent for the first six months of 2008, including the 2008 charge related to the sale of HighJump Software.

Table of Contents*Electro and Communications Business:*

| | Three months ended June 30 | | Six months ended June 30 | |
|-----------------------------------|-------------------------------|--------|-----------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales (millions) | \$ 748 | \$ 693 | \$ 1,473 | \$ 1,357 |
| Sales change analysis: | | | | |
| Local currency (volume and price) | 2.2% | 0.4% | 2.7% | 0.2% |
| Translation | 5.7 | 2.1 | 5.8 | 2.2 |
| Total sales change | 7.9% | 2.5% | 8.5% | 2.4% |
| Operating income (millions) | \$ 151 | \$ 135 | \$ 297 | \$ 245 |
| Percent change | 11.4% | 19.2% | 21.3% | 6.0% |
| Percent of sales | 20.1% | 19.5% | 20.1% | 18.0% |

The Electro and Communications segment serves the electrical, electronics and communications industries, including electrical utilities; electrical construction, maintenance and repair; OEM electrical and electronics; computers and peripherals; consumer electronics; telecommunications central office, outside plant and enterprise; as well as aerospace, military, automotive and medical markets; with products that enable the efficient transmission of electrical power and speed the delivery of information and ideas. Products include electronic and interconnect solutions, micro interconnect systems, high-performance fluids, high-temperature and display tapes, telecommunications products, electrical products, and touch screens and touch monitors. 3M's Aluminum Conductor Composite Reinforced, or ACCR product, allows energy suppliers to transmit more than two times the capacity without the risks and delays of major construction projects.

Second quarter of 2008:

Sales for the quarter increased nearly 8 percent versus the same quarter last year. Operating income rose 11.4 percent, driven by outstanding cost discipline that produced margins of 20.1 percent. Sales in local currency increased 2.2 percent, mostly from organic growth. 3M continued to see weakness in end-of-life flexible circuit applications for inkjet printers, which adversely affected Electro and Communications sales by 1 percent and operating income by nearly 3 percent.

Overall, Electro and Communications saw strong growth in three of its businesses: Electrical Markets, Electronic Markets Materials and Communications Markets. Sales growth was led by strong growth in Asia Pacific and Europe. Some of the products driving growth in the second quarter were outside plant and central office equipment used in the telecommunications industry, insulating, protecting and sensing products used in electrical applications, and electrical and powergrid solutions used in the energy and electric power industry.

First six months of 2008:

Year-to-date, sales have increased 8.5 percent, with operating income up 21.3 percent and operating income margins exceeding 20 percent. Operating income for the first six months of 2007 included \$19 million in first quarter 2007 restructuring expenses, primarily for asset impairment charges related to the Company's decision to close a facility in Wisconsin, which contributed 8.8 percentage points of the reported 21.3 percent operating income growth when comparing the first half of 2008 to the first half of 2007.

Table of Contents**FINANCIAL CONDITION AND LIQUIDITY**

The Company generates significant ongoing cash flow. On April 1, 2008, 3M (Safety, Security and Protection Services Business) completed its acquisition of 100 percent of the outstanding shares of Aearo a global leader in the personal protection industry that manufactures and markets personal protection and energy absorbing products for approximately \$1.2 billion, inclusive of debt assumed, which was immediately paid off.

The Company's net debt position is as follows:

| (Millions) | June 30 2008 | Dec. 31 2007 |
|-----------------------------------------------------------|-----------------|-----------------|
| Total Debt | \$ 6,008 | \$ 4,920 |
| Less: Cash and cash equivalents and marketable securities | 2,777 | 2,955 |
| Net Debt | \$ 3,231 | \$ 1,965 |

Cash, cash equivalents and marketable securities at June 30, 2008 totaled approximately \$2.8 billion, helped by strong cash flow generation. 3M believes that it has access to ample capital to fund expected investments, including capital expenditures. The Company has sufficient access to capital markets to meet currently anticipated growth and acquisition investment funding needs. The Company does not utilize derivative instruments linked to the Company's stock. However, the Company does have contingently convertible debt that, if conditions for conversion are met, is convertible into shares of 3M common stock (refer to Note 10 in 3M's Current Report on Form 8-K dated May 19, 2008, which updated 3M's 2007 Annual Report on Form 10-K).

The Company's financial condition and liquidity are strong. Various assets and liabilities, including cash and short-term debt, can fluctuate significantly from month to month depending on short-term liquidity needs. Working capital (defined as current assets minus current liabilities) totaled \$3.552 billion at June 30, 2008, compared with \$4.476 billion at December 31, 2007. Working capital was lower primarily due to increases in short-term debt and decreases in cash, cash equivalents and marketable securities, which were partially offset by increases in receivables and inventories.

The Company has an AA credit rating, with a stable outlook, from Standard & Poor's and an Aa1 credit rating, with a negative outlook, from Moody's Investors Service. Under 3M's \$1.5-billion five-year credit facility agreement, the Company is required to maintain its EBITDA to Interest Ratio as of the end of each fiscal quarter at not less than 3.0 to 1. This is calculated (as defined in the agreement) as the ratio of consolidated total EBITDA for the four consecutive quarters then ended to total interest expense on all funded debt for the same period. At June 30, 2008, this ratio was approximately 3.0 to 1.

The Company has a well-known seasoned issuer shelf registration statement, effective February 24, 2006, to register an indeterminate amount of debt or equity securities for future sales. The Company intends to use the proceeds from future securities sales off this shelf for general corporate purposes. In connection with this shelf registration, in June 2007 the Company established a medium-term notes program through which up to \$3 billion of medium-term notes may be offered. This program has a remaining capacity of \$2.5 billion as of June 30, 2008.

Edgar Filing: 3M CO - Form 10-Q

The Company uses various working capital measures that place emphasis and focus on certain working capital assets and liabilities. These measures are not defined under U.S. generally accepted accounting principles and may not be computed the same as similarly titled measures used by other companies. One of the primary working capital measures 3M uses is a combined index, which includes accounts receivable, inventory and accounts payable. This combined index is defined as quarterly net sales multiplied by four, divided by certain components of working capital, which for this calculation is defined as ending net accounts receivable plus inventory less accounts payable. This index measured 4.9 at June 30, 2008, similar to the 5.0 index at June 30, 2007, but down from 5.3 at December 31, 2007. Receivables increased \$581 million, or 17.3 percent, compared with December 31, 2007, with higher June 2008 sales compared to December 2007 sales contributing to this increase. In addition, foreign currency translation increased accounts receivable by \$113 million compared with December 31, 2007, as the U.S. dollar weakened in aggregate against many currencies. Inventories increased \$323 million, or 11.3 percent, compared with December 31, 2007, with \$70 million of this increase related to foreign currency translation. Accounts payable increased \$153 million compared with December 31, 2007, with \$35 million of this increase related to foreign currency translation.

Cash flows from operating, investing and financing activities are provided in the tables that follow. Individual amounts in the Consolidated Statement of Cash Flows exclude the effects of acquisitions, divestitures and exchange rate

Table of Contents

impacts, which are presented separately in the cash flows. Thus, the amounts presented in the following operating, investing and financing activities tables reflect changes in balances from period to period adjusted for these effects.

Cash Flows from Operating Activities:

| (Millions) | Six months ended | |
|----------------------------------------------------|------------------|-----------------|
| | 2008 | June 30 2007 |
| Net income | \$ 1,933 | \$ 2,285 |
| Depreciation and amortization | 553 | 533 |
| Company pension contributions | (94) | (113) |
| Company postretirement contributions | (1) | (1) |
| Company pension expense | 41 | 87 |
| Company postretirement expense | 11 | 41 |
| Stock-based compensation expense | 122 | 129 |
| Loss/(gain) from sale of businesses | 23 | (854) |
| Income taxes (deferred and accrued income taxes) | 4 | 27 |
| Excess tax benefits from stock-based compensation | (20) | (47) |
| Accounts receivable | (405) | (470) |
| Inventories | (171) | (139) |
| Accounts payable | 30 | 55 |
| Product and other insurance receivables and claims | 129 | 112 |
| Other net | 85 | 39 |
| Net cash provided by operating activities | \$ 2,240 | \$ 1,684 |

Cash flows from operating activities can fluctuate significantly from period to period, as pension funding decisions, tax timing differences and other items can significantly impact cash flows. In addition, higher June 2008 sales compared to December 2007 negatively impacts working capital, especially accounts receivable. In the first six months of 2008, cash flows provided by operating activities increased by \$556 million compared to the first six months of 2007. Net income decreased \$352 million when compared to the first six months of 2007, impacted by the combined after-tax impact of the gain on sale of the branded pharmaceuticals business in Europe and the sale of 3M's Opticom Priority Control Systems and Canoga Traffic Detection businesses, net of restructuring expenses and an increase in environmental liabilities, which increased net income by \$440 million in the first six months of 2007. Since the pharmaceuticals gain is included in and increased net income in 2007, the pre-tax gain from the sale of the pharmaceuticals business of must be subtracted, as shown above, to properly reflect operating cash flows. The cash proceeds from sale of the pharmaceuticals business are shown as part of cash from investing activities; however, when the related taxes are paid they are required to be shown as part of cash provided by operating activities. Thus, operating cash flows for the first six months of 2007 were penalized due to cash income tax payments of approximately \$500 million in the first half of 2007 that related to the sale of portions of the global branded pharmaceuticals business. Non-pharmaceutical related cash income tax payments in the first half of 2008 were approximately \$300 million higher than in the first half of 2007 due to normal timing differences in tax payments, negatively impacting cash flows.

Table of Contents**Cash Flows from Investing Activities:**

| (Millions) | Six months ended | |
|-----------------------------------------------------------------------------------------------|------------------|-----------------|
| | 2008 | June 30 2007 |
| Purchases of property, plant and equipment (PP&E) | \$ (632) | \$ (652) |
| Proceeds from sale of PP&E and other assets | 6 | 27 |
| Acquisitions, net of cash acquired | (549) | (194) |
| Proceeds from sale of businesses | 85 | 897 |
| Purchases and proceeds from sale or maturities of marketable securities and investments - net | (320) | (429) |
| Other investing activities | (57) | |
| Net cash used in investing activities | \$ (1,467) | \$ (351) |

Investments in property, plant and equipment enable growth in diverse markets, helping to meet product demand and increasing manufacturing efficiency. Capital expenditures were \$632 million in the first six months of 2008, a decrease of \$20 million compared to the first six months of 2007. The Company expects capital expenditures to total approximately \$1.3 to \$1.4 billion for total year 2008, compared with \$1.422 billion in 2007.

In March 2008, 3M entered into a sale-leaseback relative to an administrative location in Italy. 3M anticipates leasing back the facility through late 2009 at which time a new location will be utilized. Because only a small portion of the proceeds was received through June 2008 coupled with required deferral of a portion of the gain from the sale over the leaseback period, no material gain has been recorded through June 2008. The remaining proceeds, which are secured by a bank guarantee, are expected to be received in September 2008, which will result in a pre-tax gain of approximately 29 million Euros in the third quarter of 2008.

Refer to Note 2 in this Quarterly Report on Form 10-Q for information on 2008 acquisitions and divestitures. The Company received \$85 million in proceeds from the sale of HighJump Software in the second quarter of 2008. 3M received \$817 million in proceeds from the sale of the pharmaceuticals business in Europe in the first quarter of 2007 and \$80 million from the sale of 3M's Opticom Priority Control Systems and Canoga Traffic Detection businesses in the second quarter of 2007. The Company is actively considering additional acquisitions, investments and strategic alliances, and from time to time may also divest certain businesses.

In the Consolidated Statement of Cash Flows, purchases of marketable securities and investments, and proceeds from sale or maturities of marketable securities and investments are primarily attributable to asset-backed securities and other marketable securities, which are classified as available-for-sale. Interest rate risk and credit risk related to the underlying collateral may impact the value of investments in asset-backed securities, while factors such as general conditions in the overall credit market and the nature of the underlying collateral may affect the liquidity of investments in asset-backed securities. The coupon interest rate for asset-backed securities are either fixed rate or floating rate. Floating rate coupons reset monthly or quarterly based upon the corresponding monthly or quarterly LIBOR rate. Each individual floating rate security has a coupon based upon the respective LIBOR rate +/- an amount reflective of the credit risk of the issuer and the underlying collateral. Terms of the reset are unique to individual securities. Fixed rate coupons are established at the time the security is issued and are based upon a spread to a related maturity treasury bond. The spread against the treasury bond is reflective of the credit risk of the issuer and the underlying collateral on the original issue date. 3M does not currently expect risk related to its holdings in asset-backed securities to materially impact its financial condition or liquidity. Refer to Note 7 for more details about 3M's diversified marketable securities portfolio, which totaled \$1.230 billion as of June 30, 2008.

Table of Contents**Cash Flows from Financing Activities:**

| (Millions) | Six months ended | |
|------------------------------------------------------|------------------|------------|
| | June 30 | |
| | 2008 | 2007 |
| Change in short-term debt net | \$ 1,120 | \$ (53) |
| Repayment of debt (maturities greater than 90 days) | (807) | (871) |
| Proceeds from debt (maturities greater than 90 days) | | 1,812 |
| Total cash change in debt | \$ 313 | \$ 888 |
| Purchases of treasury stock | (1,082) | (2,199) |
| Reissuances of treasury stock | 217 | 483 |
| Dividends paid to stockholders | (704) | (696) |
| Distributions to minority interests and other net | 139 | 35 |
| Net cash used in financing activities | \$ (1,117) | \$ (1,489) |

Total debt at June 30, 2008, was \$6.008 billion, up from \$4.920 billion at December 31, 2007. In the first six months of 2008, the increase in short-term debt is primarily related to commercial paper activity. Repayment of debt primarily represents debt acquired upon the acquisition of Aeero that was immediately repaid. Total debt was 32 percent of total capital (total capital is defined as debt plus equity), compared with 30 percent at year-end 2007. The Company's purchases of treasury stock totaled \$1.082 billion in the first six months of 2008, a decrease compared to the high purchase level in the first half of 2007 when the Company bought back \$2.199 billion in shares.

Repurchases of common stock are made to support the Company's stock-based employee compensation plans and for other corporate purposes. In February 2007, 3M's Board of Directors approved a two-year share repurchase authorization of up to \$7.0 billion for the period from February 12, 2007 to February 28, 2009. As of June 30, 2008, the Company has \$3.0 billion remaining under this authorization, which the Company does not currently expect to fully utilize by February 28, 2009. Refer to the table titled "Issuer Purchases of Equity Securities" in Part II, Item 2, for more information.

In February 2008, the Board of Directors increased the quarterly dividend on 3M common stock by 4.2 percent to 50 cents per share, equivalent to an annual dividend of \$2.00 per share. This marked the 50th consecutive year of dividend increases. Other cash flows from financing activities include distributions to minority interests, excess tax benefits from stock-based compensation, changes in cash overdraft balances, and principal payments for capital leases.

Contractual Obligations Update:

During the first quarter of 2008, the Company amended an existing unconditional agreement to purchase raw materials from a third-party supplier. The amendment, which runs through December 31, 2011, requires 3M purchases of these raw materials to aggregate \$133 million over the two-year period 2010 and 2011. The contractual obligation table shown in 3M's 2007 Annual Report on Form 10-K already reflected the previous commitment that is continuing for years 2008 and 2009, but did not reflect this new commitment for years 2010 and 2011. The purchase obligation amounts do not represent the entire anticipated purchases by 3M during the contract period, but represent only those items for which the Company is contractually obligated.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations in Part I, Item 2, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The Company may also make forward-looking statements in other reports filed with the Securities and Exchange Commission, in materials delivered to stockholders and in press releases. In addition, the Company's representatives may from time to time make oral forward-looking statements.

Forward-looking statements relate to future events and typically address the Company's expected future business and financial performance. Words such as plan, expect, aim, believe, project, target, anticipate, intend, estimate, will, should, could and other words having similar meaning, typically identify such forward-looking statements. In particular, these include statements about: (1) worldwide economic conditions; (2) competitive conditions and customer preferences; (3) foreign currency exchange rates and fluctuations in those rates; (4) the timing and acceptance of new product offerings; (5) the availability and cost of purchased

Table of Contents

components, compounds, raw materials and energy (including oil and natural gas and their derivatives) due to shortages, increased demand or supply interruptions (including those caused by natural and other disasters and other events); (6) the impact of acquisitions, strategic alliances, divestitures, and other unusual events resulting from portfolio management actions and other evolving business strategies, and possible organizational restructuring; (7) expected productivity improvements; and (8) legal proceedings. The Company assumes no obligation to update or revise any forward-looking statements.

Forward-looking statements are based on certain assumptions and expectations of future events and trends that are subject to risks and uncertainties. Actual future results and trends may differ materially from historical results or those reflected in any such forward-looking statements depending on a variety of factors. Discussion of these factors is incorporated by reference from Part II, Item 1A, Risk Factors, of this document and from Part I, Item 1A, Risk Factors, of 3M's Current Report on Form 8-K dated May 19, 2008, and should be considered an integral part of Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

In the context of Item 3, market risk refers to the risk of loss arising from adverse changes in financial and derivative instrument market rates and prices, such as fluctuations in interest rates and currency exchange rates. For a discussion of sensitivity analysis related to these types of market risks, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in 3M's Current Report on Form 8-K dated May 19, 2008. The Company believes that there have been no material changes in these market risks since year-end 2007.

Item 4. Controls and Procedures.

a. The Company carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in the Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective.

b. There was no change in the Company's internal control over financial reporting that occurred during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

3M COMPANY

FORM 10-Q

For the Quarterly Period Ended June 30, 2008

PART II. Other Information

Item 1. Legal Proceedings.

Discussion of legal matters is incorporated by reference from Part I, Item 1, Note 11, "Commitments and Contingencies", of this document, and should be considered an integral part of Part II, Item 1, "Legal Proceedings".

Item 1A. Risk Factors.

The most significant risk factors applicable to the Company are described in Part I, Item 1A "Risk Factors" of 3M's Current Report on Form 8-K dated May 19, 2008. There have been no material changes from the risk factors previously disclosed in 3M's Current Report on Form 8-K dated May 19, 2008.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**(e) Issuer Purchases of Equity Securities**

Repurchases of common stock are made to support the Company's stock-based employee compensation plans and for other corporate purposes. In February 2007, 3M's Board of Directors authorized a two-year share repurchase of up to \$7 billion for the period from February 12, 2007 to February 28, 2009.

Issuer Purchases of Equity

Securities (registered pursuant to

Section 12 of the Exchange Act)

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs (Millions) |
|----------------------------------|--------------------------------------------------|------------------------------------|-------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|
| January 1-31, 2008 | 1,876,312 | \$ 78.23 | 1,871,200 | \$ 4,002 |
| February 1-29, 2008 | 2,281,560 | \$ 79.37 | 2,201,400 | \$ 3,828 |
| March 1-31, 2008 | 2,153,150 | \$ 78.28 | 2,126,600 | \$ 3,662 |
| Total January 1 - March 31, 2008 | 6,311,022 | \$ 78.66 | 6,199,200 | \$ 3,662 |
| April 1-30, 2008 | 2,148,930 | \$ 78.82 | 2,103,100 | \$ 3,496 |
| May 1-31, 2008 | 2,436,300 | \$ 77.12 | 2,368,400 | \$ 3,313 |
| June 1-30, 2008 | 3,591,969 | \$ 73.42 | 3,586,500 | \$ 3,050 |

Edgar Filing: 3M CO - Form 10-Q

| | | | | | | | |
|-----------------|---------------|------------|----|-------|------------|----|--------------|
| Total April 1 | June 30, 2008 | 8,177,199 | \$ | 75.94 | 8,058,000 | \$ | 3,050 |
| Total January 1 | June 30, 2008 | 14,488,221 | \$ | 77.13 | 14,257,200 | \$ | 3,050 |

(1) The total number of shares purchased includes: (i) shares purchased under the Board's authorizations described above, and (ii) shares purchased in connection with the exercise of stock options (which combined totaled 5,112 shares in January 2008, 80,160 shares in February 2008, 26,550 shares in March 2008, 45,830 shares in April 2008, 67,900 shares in May 2008 and 5,469 shares in June 2008).

Item 3. Defaults Upon Senior Securities. No matters require disclosure.

Table of Contents

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

The stockholders of the Company voted on three items at the Annual Meeting of Stockholders held on May 13, 2008:

1. The election of directors
2. The ratification of the appointment of PricewaterhouseCoopers LLP as the Company's Independent Registered Public Accounting Firm
3. The proposal to approve the Long-Term Incentive Plan

The nominees for directors were elected based upon the following votes:

| Nominee | Votes For | Votes Withheld |
|--------------------|-------------|----------------|
| Linda G. Alvarado | 557,780,522 | 35,985,400 |
| George W. Buckley | 562,833,300 | 30,932,623 |
| Vance D. Coffman | 568,065,596 | 25,700,327 |
| Michael L. Eskew | 569,741,790 | 24,024,133 |
| W. James Farrell | 569,030,987 | 24,734,935 |
| Herbert L. Henkel | 566,637,712 | 27,128,211 |
| Edward M. Liddy | 561,906,655 | 31,859,267 |
| Robert S. Morrison | 568,608,780 | 25,157,143 |
| Aulana L. Peters | 564,488,425 | 29,277,497 |
| Robert J. Ulrich | 569,913,186 | 23,852,736 |

The ratification of the appointment of PricewaterhouseCoopers LLP, an independent registered public accounting firm, to audit the consolidated financial statements of the company and its subsidiaries for the year 2008, received the following votes:

| | |
|-----------------|-------------|
| For | 575,564,193 |
| Against | 6,153,034 |
| Abstain | 12,048,694 |
| Broker Non-Vote | 0 |

The proposal to approve the Long-Term Incentive Plan received the following votes:

| | |
|---------|-------------|
| For | 389,339,911 |
| Against | 83,006,141 |

| | |
|-----------------|-------------|
| Abstain | 15,028,679 |
| Broker Non-Vote | 106,391,191 |

Item 5. Other Information.

As stated in our Form 8-K dated July 23, 2008, 3M announced the appointment of David W. Meline as 3M's Vice President, Corporate Controller, effective September 1, 2008. In this position, Mr. Meline will also serve as the chief accounting officer of the Company.

Item 6. Exhibits.

Exhibits. These exhibits are either incorporated by reference into this report or filed with this report as indicated below. Exhibit numbers 10.1 through 10.28 are management contracts or compensatory plans or arrangements.

Index to Exhibits:

(3) Articles of Incorporation and bylaws

- (3.1) Certificate of incorporation, as amended as of May 11, 2007, is incorporated by reference from our Form 8-K dated May 14, 2007.
- (3.2) Bylaws, as amended as of February 11, 2008, is incorporated by reference from our Form 8-K dated February 11, 2008.

(4) Instruments defining the rights of security holders, including indentures:

- (4.1) Indenture, dated as of November 17, 2000, between 3M and Citibank, N.A., with respect to 3M's senior debt securities, is incorporated by reference from our Form 8-K dated December 7, 2000.

Edgar Filing: 3M CO - Form 10-Q

Table of Contents

- (4.2) Indenture, dated as of November 21, 2002, between 3M and Citibank, N.A., with respect to Liquid Yield Option Notes zero coupon senior debt securities, is incorporated by reference from Registration No. 333-103234 on Form S-3 filed on February 14, 2003.
- (4.3) First Supplemental Indenture, dated as of November 16, 2005, to Indenture between 3M and Citibank, N.A., with respect to Liquid Yield Option Notes zero coupon senior debt securities, is incorporated by reference from our 8-K dated November 17, 2005.
- (4.4) Except as set forth in the preceding Exhibits 4.1, 4.2 and 4.3, the instruments defining the rights of holders of long-term debt securities of 3M have been omitted. We agree to furnish to the SEC, upon request, a copy of such instruments with respect to issuances of long-term debt of 3M.

- (10) Material contracts and management compensation plans and arrangements:
 - (10.1) 3M 2008 Long-Term Incentive Plan is incorporated by reference from our Form 8-K dated May 13, 2008.
 - (10.2) Form of Agreement for Stock Option Grants to Executive Officers under 3M 2008 Long-Term Incentive Plan is incorporated by reference from our Form 8-K dated May 13, 2008.
 - (10.3) 3M 2005 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 2005 Annual Meeting of Stockholders.
 - (10.4) 3M 2002 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 2002 Annual Meeting of Stockholders.
 - (10.5) 3M 1997 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 1997 Annual Meeting of Stockholders.
 - (10.6) 3M 1992 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 1992 Annual Meeting of Stockholders.
 - (10.7) Form of award agreement for non-qualified stock options granted under the 2005 Management Stock Ownership Program, is incorporated by reference from our Form 8-K dated May 16, 2005.
 - (10.8) Form of award agreement for non-qualified stock options granted under the 2002 Management Stock Ownership Program, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
 - (10.9) 3M 1997 General Employees Stock Purchase Plan, as amended through November 8, 2004, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
 - (10.10) 3M VIP (Voluntary Investment Plan) Plus is incorporated by reference from Registration Statement No. 333-73192 on Form S-8, filed on November 13, 2001.
 - (10.11) 3M Deferred Compensation Plan, as amended through February 2008, is incorporated by reference from our Form 8-K dated February 14, 2008.
 - (10.12) 3M Executive Annual Incentive Plan is incorporated by reference from our Form 8-K dated May 14, 2007.
 - (10.13) Form of Agreement for Performance Unit or Share Awards to Executive Officers during 2008 under 3M Performance Unit Plan is incorporated by reference from our Form 8-K dated May 8, 2008.
 - (10.14) 3M Performance Unit Plan, as amended through February 11, 2007, is incorporated by reference from our Form 8-K dated May 14, 2007.
 - (10.15) Description of changes to Non-Employee Director Compensation and Stock Ownership Guidelines dated as of August 13, 2007 is incorporated by reference from our Form 10-Q for the quarter ended September 30, 2007.
 - (10.16) Description of changes to 3M Compensation Plan for Non-Employee Directors is incorporated by reference from our Form 8-K dated August 8, 2005.
 - (10.17) 3M Compensation Plan for Non-Employee Directors, as amended, through November 8, 2004, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
 - (10.18) 3M 1992 Directors Stock Ownership Program, as amended through November 8, 2004, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
 - (10.19) 3M Executive Life Insurance Plan, as amended, is incorporated by reference from our Form 10-K for the year ended December 31, 2003.
 - (10.20) Summary of Personal Financial Planning Services for 3M Executives is incorporated by reference from our Form 10-K for the year ended December 31, 2003.
 - (10.21) 3M policy on reimbursement of incentive payments is incorporated by reference from our Form 10-K for the year ended December 31, 2006.

Edgar Filing: 3M CO - Form 10-Q

- (10.22) Employment agreement dated as of December 6, 2005, between 3M and George W. Buckley is incorporated by reference from our Form 8-K dated December 9, 2005.
- (10.23) Amendment, dated August 14, 2006, to employment agreement between 3M and George W. Buckley is incorporated by reference from our Form 10-Q for the quarter ended September 30, 2006.
- (10.24) Description of compensation plan for Robert S. Morrison is incorporated by reference from our Form 8-K dated August 8, 2005.

Table of Contents

| | |
|---------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (10.25) | Employment agreement dated as of January 23, 2002, between 3M and Patrick D. Campbell is incorporated by reference from our Form 10-K for the year ended December 31, 2001. |
| (10.26) | Employment agreement dated as of November 19, 2002, between 3M and Richard F. Ziegler is incorporated by reference from our Form 10-K for the year ended December 31, 2002. |
| (10.27) | Letter agreement dated as of March 14, 2007, between 3M and Richard F. Ziegler is incorporated by reference from our 8-K dated March 19, 2007. |
| (10.28) | Appointment and Compensatory arrangements between 3M and David W. Meline are incorporated by reference from our Form 8-K dated July 23, 2008. |
| (10.29) | Five-year credit agreement as of April 30, 2007, is incorporated by reference from our Form 8-K dated May 3, 2007. |

Filed electronically herewith:

| | |
|--------|------------------------------------------------------------------------------------------------------------------------------------------|
| (12) | Calculation of ratio of earnings to fixed charges. |
| (15) | A letter from the Company's independent registered public accounting firm regarding unaudited interim consolidated financial statements. |
| (31.1) | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. |
| (31.2) | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. |
| (32.1) | Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. |
| (32.2) | Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. |

Table of Contents

SIGNATURES

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

3M COMPANY

(Registrant)

Date: August 1, 2008

By /s/ Patrick D. Campbel
Patrick D. Campbell,
Senior Vice President and Chief Financial Officer

(Mr. Campbell is the Principal Financial Officer and has
been duly authorized to sign on behalf of the Registrant.)