

PACKAGING CORP OF AMERICA
Form 10-Q
November 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

or

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

For the transition period from to

Commission file number 1-15399

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

36-4277050
(I.R.S. Employer
Identification No.)

1955 West Field Court, Lake Forest, Illinois
(Address of Principal Executive Offices)

60045
(Zip Code)

Registrant's telephone number, including area code

(847) 482-3000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 31, 2017 the Registrant had outstanding 94,350,499 shares of common stock, par value \$0.01 per share.

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All reports we file with the Securities and Exchange Commission (SEC) are available free of charge via the Electronic Data Gathering Analysis and Retrieval (EDGAR) System on the SEC website at www.sec.gov. We also provide copies of our SEC filings at no charge upon request and make electronic copies of our reports available through our website at www.packagingcorp.com as soon as reasonably practicable after filing such material with the SEC.

PART I

FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Packaging Corporation of America

Consolidated Statements of Income and Comprehensive Income

(unaudited, dollars in millions, except per-share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Statements of Income:				
Net sales	\$1,640.1	\$1,484.0	\$4,760.6	\$4,302.4
Cost of sales	(1,242.8)	(1,154.5)	(3,660.1)	(3,353.8)
Gross profit	397.3	329.5	1,100.5	948.6
Selling, general, and administrative expenses	(130.2)	(116.9)	(388.9)	(346.0)
Other expense, net	(24.8)	(6.2)	(32.4)	(15.2)
Income from operations	242.3	206.4	679.2	587.4
Interest expense, net	(25.4)	(23.4)	(74.6)	(67.5)
Income before taxes	216.9	183.0	604.6	519.9
Provision for income taxes	(77.8)	(63.7)	(204.9)	(181.0)
Net income	\$139.1	\$119.3	\$399.7	\$338.9
Net income per common share:				
Basic	\$1.47	\$1.27	\$4.24	\$3.59
Diluted	\$1.47	\$1.26	\$4.23	\$3.58
Dividends declared per common share	\$0.63	\$0.63	\$1.89	\$1.73
Statements of Comprehensive Income:				
Net Income	\$139.1	\$119.3	\$399.7	\$338.9
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	0.1	—	(0.2)	—
Reclassification adjustments to cash flow hedges included in net income, net of tax of \$0.5 million, \$0.5 million, \$1.6 million, and \$1.6 million	0.9	0.9	2.6	2.6
Amortization of pension and postretirement plans actuarial loss and prior service cost, net of tax of \$1.2 million, \$1.0 million, \$3.7 million, and \$3.1 million	1.9	1.8	6.2	5.0
Changes in unfunded employee benefit obligation net of tax of \$2.0 million	—	—	—	3.1
Other comprehensive income	2.9	2.7	8.6	10.7
Comprehensive income	\$142.0	\$122.0	\$408.3	\$349.6

See accompanying condensed notes to unaudited quarterly consolidated financial statements.

Packaging Corporation of America

Consolidated Balance Sheets

(unaudited, dollars and shares in millions, except per-share data)

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 370.5	\$ 239.3
Accounts receivable, net of allowance for doubtful accounts and customer deductions of \$11.3 million and \$10.1 million as of September 30, 2017, and December 31, 2016, respectively	831.3	689.2
Inventories	736.6	723.6
Prepaid expenses and other current assets	43.4	30.3
Federal and state income taxes receivable	20.0	13.9
Total current assets	2,001.8	1,696.3
Property, plant, and equipment, net	2,881.6	2,895.7
Goodwill	732.1	737.9
Intangible assets, net	347.8	367.1
Other long-term assets	63.9	80.0
Total assets	\$ 6,027.2	\$ 5,777.0
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 156.5	\$ 25.8
Capital lease obligations	1.3	1.3
Accounts payable	379.5	323.8
Dividends payable	60.3	59.9
Accrued liabilities	207.8	201.2
Accrued interest	18.9	13.4
Total current liabilities	824.3	625.4
Long-term liabilities:		
Long-term debt	2,456.3	2,620.0
Capital lease obligations	19.3	20.3
Deferred income taxes	342.1	334.7
Compensation and benefits	322.8	357.2
Other long-term liabilities	68.2	59.6
Total long-term liabilities	3,208.7	3,391.8
Commitments and contingent liabilities		
Stockholders' equity:		
Common stock, par value \$0.01 per share, 300.0 million shares authorized, 94.4 million and 94.2 million shares issued as of September 30, 2017, and December 31, 2016, respectively	0.9	0.9
Additional paid in capital	466.1	451.4
Retained earnings	1,658.2	1,447.1
Accumulated other comprehensive loss	(131.0)	(139.6)

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Total stockholders' equity	1,994.2	1,759.8
Total liabilities and stockholders' equity	\$ 6,027.2	\$ 5,777.0

See accompanying condensed notes to unaudited quarterly consolidated financial statements.

Packaging Corporation of America

Consolidated Statements of Cash Flows

(unaudited, dollars in millions)

	Nine Months Ended September 30, 2017	2016
Cash Flows from Operating Activities:		
Net income	\$ 399.7	\$ 338.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization of intangibles	283.7	264.3
Amortization of deferred financing costs	6.0	5.8
Share-based compensation expense	15.4	15.0
Deferred income tax provision	1.6	6.5
Net loss on impairment of assets	13.5	—
Pension and post retirement benefits expense, net of contributions	(25.3)	(33.5)
Other, net	12.0	3.7
Changes in operating assets and liabilities:		
(Increase) decrease in assets —		
Accounts receivable	(142.2)	(36.0)
Inventories	(13.0)	4.1
Prepaid expenses and other current assets	(10.3)	(11.2)
Increase (decrease) in liabilities —		
Accounts payable	37.7	13.6

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Accrued liabilities	9.6	10.8
Federal and state income taxes payable / receivable	(5.1)	11.5
Net cash provided by operating activities	583.3	593.5
Cash Flows from Investing Activities:		
Additions to property, plant, and equipment	(226.2)	(188.1)
Acquisition of business, net of cash acquired	—	(385.6)
Additions to other long term assets	(6.9)	(9.4)
Proceeds from disposals	4.4	—
Other, net	1.1	0.4
Net cash used for investing activities	(227.6)	(582.7)
Cash Flows from Financing Activities:		
Repayments of debt and capital lease obligations	(35.6)	(30.7)
Proceeds from issuance of debt	—	385.0
Financing costs paid	—	(2.1)
Common stock dividends paid	(178.2)	(156.7)
Repurchases of common stock	—	(100.3)
Shares withheld to cover employee restricted stock taxes	(10.7)	(10.2)
Other, net	—	(0.2)
Net cash (used for) provided by financing activities	(224.5)	84.8
Net increase in cash and cash equivalents	131.2	95.6
Cash and cash equivalents, beginning of period	239.3	184.2
Cash and cash equivalents, end of period	\$ 370.5	\$ 279.8

See accompanying condensed notes to unaudited quarterly consolidated financial statements.

Condensed Notes to Unaudited Quarterly Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation

Packaging Corporation of America ("we," "us," "our," "PCA," or the "Company") was incorporated on January 25, 1999. In April 1999, PCA acquired the containerboard and corrugated packaging products business of Pactiv Corporation (Pactiv), formerly known as Tenneco Packaging, Inc., a wholly owned subsidiary of Tenneco Inc. We are a large diverse manufacturer of both packaging and paper products. We are headquartered in Lake Forest, Illinois and we operate primarily in the United States.

We report our business in three reportable segments: Packaging, Paper, and Corporate and Other. Our Packaging segment produces a wide variety of corrugated packaging products. The Paper segment manufactures and sells a range of white papers, including uncoated free sheet and coated one-side grades. During the third quarter of 2017, the Company announced that it will discontinue the production of uncoated free sheet and coated one-side grades at the Wallula, Washington mill in the second quarter of 2018 to begin the conversion of the No. 3 machine to a 400,000 ton-per-year virgin kraft linerboard machine. Corporate and Other includes support staff services and related assets and liabilities, transportation assets, and activity related to other ancillary support operations. For more information about our segments, see Note 16 Segment Information.

In these consolidated financial statements, certain amounts in prior periods' consolidated financial statements have been reclassified to conform with the current period presentation.

The consolidated financial statements of PCA as of September 30, 2017 and for the three and nine months ended September 30, 2017 and 2016 are unaudited but include all adjustments (consisting only of normal recurring adjustments) that management considers necessary for a fair presentation of such financial statements. The preparation of the consolidated financial statements involves the use of estimates and accruals. Actual results may vary from those estimates. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete audited financial statements. Operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016.

The consolidated financial statements include the accounts of PCA and its majority-owned subsidiaries after elimination of intercompany balances and transactions.

2. Acquisitions

TimBar Acquisition

On August 29, 2016, PCA acquired substantially all of the assets of TimBar Corporation ("TimBar"), a large independent corrugated products producer with six corrugated products production facilities, for a purchase price of \$385.6 million, net of cash acquired. We financed the acquisition with a new \$385.0 million five-year term loan facility. TimBar provides solutions to customers in the higher margin retail, industrial packaging and display and fulfillment markets with a focus on a multi-color graphics and technical innovation. TimBar's financial results are included in the Packaging segment from the date of acquisition.

The Company accounted for the TimBar acquisition using the acquisition method of accounting in accordance with ASC 805, Business Combinations. The total purchase price has been allocated to tangible and intangible assets acquired and liabilities assumed based on respective fair values, as follows (dollars in millions):

	12/31/16		Revised
	Allocation	Adjustments	Allocation
Goodwill	\$ 157.3	\$ (1.1)	\$ 156.2
Other intangible assets	94.4	-	94.4
Property, plant and equipment	95.3	-	95.3
Other net assets	38.6	-	38.6
Net assets acquired	\$ 385.6	\$ (1.1)	\$ 384.5

During the first quarter of 2017, we received \$1.1 million from the seller related to a working capital adjustment. We recorded the adjustment as a decrease to goodwill which lowered the purchase price to \$384.5 million.

Goodwill is calculated as the excess of the purchase price over the fair value of the net assets acquired. Among the factors that contributed to the recognition of goodwill were TimBar's commitment to continuous improvement and innovation in their operations, as well as the expected increases in PCA's containerboard integration levels. Goodwill is deductible for tax purposes.

Other intangible assets, primarily customer relationships, were assigned an estimated weighted average useful life of 14.2 years.

Property, plant and equipment were assigned estimated useful lives ranging from two to 24 years.

Columbus Container Acquisition

On November 30, 2016, PCA acquired substantially all of the assets of Columbus Container, Inc., an independent corrugated products producer with one production facility and five warehousing facilities, for a purchase price of \$99.7 million, net of cash acquired. We paid the purchase price with available cash on hand. Columbus Container, Inc. is a full-service provider of corrugated packaging products utilizing state-of-the-art technologies and design centers to provide customers a solution for nearly any packaging need. Columbus Container's financial results are included in the Packaging segment from the date of acquisition.

The Company accounted for the Columbus Container acquisition using the acquisition method of accounting in accordance with ASC 805, Business Combinations. The total purchase price has been preliminarily allocated to tangible and intangible assets acquired and liabilities assumed based on respective fair values, as follows (dollars in millions):

	12/31/16 Allocation	Adjustments	Revised Allocation
Goodwill	\$ 36.6	\$ (4.7)	\$ 31.9
Other intangible assets	26.3	6.0	32.3
Property, plant and equipment	27.2	1.0	28.2
Other net assets	9.6	(0.1)	9.5
Net assets acquired	\$ 99.7	\$ 2.2	\$ 101.9

During the third quarter of 2017, we increased the purchase price by \$2.2 million as a result of a working capital adjustment expected to be paid to the seller. We recorded the adjustment as a \$2.2 million increase to goodwill. The purchase price allocation above is preliminary and is subject to the finalization of working capital adjustments. Our current estimates and assumptions may change as more information becomes available.

Goodwill is calculated as the excess of the purchase price over the fair value of the net assets acquired. Among the factors that contributed to the recognition of goodwill were Columbus Container's commitment to continuous improvement and innovation in their operations, as well as the expected increases in PCA's containerboard integration levels. Goodwill is deductible for tax purposes.

Other intangible assets, primarily customer relationships, were assigned an estimated weighted average useful life of 14.1 years.

Property, plant and equipment were assigned estimated useful lives ranging from one to 32 years.

3. Earnings Per Share

The following table sets forth the computation of basic and diluted income per common share for the periods presented (dollars and shares in millions, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Numerator:	2017	2016	2017	2016
Net income	\$ 139.1	\$ 119.3	\$ 399.7	\$ 338.9

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Less: distributed and undistributed earnings allocated to

participating securities	(1.1)	(1.1)	(3.4)	(3.4)
Net income attributable to common shareholders	\$138.0	\$118.2	\$396.3	\$335.5
Denominator:				
Weighted average basic common shares outstanding	93.6	93.4	93.5	93.6
Effect of dilutive securities	0.2	0.2	0.2	0.1
Weighted average diluted common shares outstanding	93.8	93.6	93.7	93.7