Rock-Tenn CO
Form 10-Q
August 04, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2006

or

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

Commission File Number 0-23340
Rock-Tenn Company
(Exact Name of Registrant as Specified in Its Charter)

Georgia	**62-0342590**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
504 Thrasher Street, Norcross, Georgia	**30071**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code: **(770) 448-2193**
N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report.)

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 þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Class	Outstanding as of August 1, 2006
Class A Common Stock, $0.01 par value	36,791,446

ROCK-TENN COMPANY
INDEX

	Page
PART I FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Statements of Income for the three and nine months ended June 30, 2006 and 2005	1
Condensed Consolidated Balance Sheets at June 30, 2006 and September 30, 2005	2
Condensed Consolidated Statements of Cash Flows for the nine months ended June 30, 2006 and 2005	3
Notes to Condensed Consolidated Financial Statements	5
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3. Quantitative and Qualitative Disclosures About Market Risk	29
Item 4. Controls and Procedures	29
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	29
Item 6. Exhibits	29
Index to Exhibits	31
EX-31.1 SECTION 302 CERTIFICATION OF THE CEO	
EX-31.2 SECTION 302 CERTIFICATION OF THE CFO	
EX-32.1 SECTION 906 CERTIFICATION OF THE CEO & CFO	

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. ***FINANCIAL STATEMENTS (UNAUDITED)***

ROCK-TENN COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In Millions, Except Per Share Data)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Net sales	$ 548.3	$ 424.6	$ 1,568.4	$ 1,204.8
Cost of goods sold	456.3	352.7	1,327.6	1,019.5
Gross profit	92.0	71.9	240.8	185.3
Selling, general and administrative expenses	62.0	49.9	181.1	143.6
Restructuring and other costs, net	2.7	0.8	7.2	4.0
Operating profit	27.3	21.2	52.5	37.7
Interest expense	(14.3)	(9.1)	(42.1)	(22.3)
Interest and other income	0.6	0.3	1.2	0.4
Income (loss) from unconsolidated joint venture		(1.3)	1.4	(1.0)
Minority interest in income of consolidated subsidiaries	(1.6)	(1.4)	(4.7)	(3.0)
Income before income taxes	12.0	9.7	8.3	11.8
Income tax (expense) benefit	(1.0)	2.3	(1.1)	0.9
Net income	$ 11.0	$ 12.0	$ 7.2	$ 12.7
Weighted average diluted shares outstanding	36.9	35.9	36.6	35.9
Basic earnings per share:				
Net income	$ 0.30	$ 0.34	$ 0.20	$ 0.36
Diluted earnings per share:				
Net income	$ 0.30	$ 0.33	$ 0.20	$ 0.35
Cash dividends per common share	$ 0.09	$ 0.09	$ 0.27	$ 0.27

See Accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

ROCK-TENN COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In Millions, Except Per Share Data)

	June 30, 2006	September 30, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8.0	$ 26.8
Accounts receivable (net of allowances of $5.5 and $5.1)	222.3	199.5
Inventories	218.3	202.0
Other current assets	36.5	30.5
Assets held for sale	4.1	3.4
Total current assets	489.2	462.2
Property, plant and equipment at cost:		
Land and buildings	266.5	267.2
Machinery and equipment	1,301.9	1,287.5
Transportation equipment	10.7	10.5
Leasehold improvements	6.1	5.6
	1,585.2	1,570.8
Less accumulated depreciation and amortization	(727.2)	(685.8)
Net property, plant and equipment	858.0	885.0
Goodwill	355.1	350.9
Intangibles, net	62.5	68.0
Other assets	32.5	32.3
	$ 1,797.3	$ 1,798.4
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of debt	$ 111.3	$ 62.1
Accounts payable	159.0	116.4
Accrued compensation and benefits	58.8	50.9
Other current liabilities	58.5	49.8
Total current liabilities	387.6	279.2
Long-term debt due after one year	726.7	840.7

Hedge adjustments resulting from terminated fair value interest rate derivatives or swaps	10.9	12.3
Total long-term debt	737.6	853.0
Accrued pension	98.1	106.8
Deferred income taxes	82.3	83.0
Other long-term liabilities	4.5	3.6
Commitments and contingencies (Note 11)		
Minority interest	18.6	16.6
Shareholders equity:		
Preferred stock, $0.01 par value; 50,000,000 shares authorized; no shares outstanding		
Class A common stock, $0.01 par value; 175,000,000 shares authorized; 36,755,946 and 36,280,164 shares outstanding at June 30, 2006 and September 30, 2005, respectively	0.4	0.4
Capital in excess of par value	170.8	162.4
Retained earnings	323.1	326.0
Accumulated other comprehensive loss	(25.7)	(32.6)
Total shareholders equity	468.6	456.2
	$ 1,797.3	$ 1,798.4

See Accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

ROCK-TENN COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Millions)

	Nine Months Ended June 30, 2006	Nine Months Ended June 30, 2005
Operating activities:		
Net income	$ 7.2	$ 12.7
Items reconciling net income to cash provided by operating activities:		
Depreciation and amortization	77.8	57.5
Deferred income tax (benefit) expense	(1.8)	2.0
Income tax benefit of employee stock options		0.1
Share-based compensation expense	2.5	1.3
Gain on disposal of plant and equipment and other, net	(1.2)	(1.7)
Minority interest in income of consolidated subsidiaries	4.7	3.0
(Income) loss from unconsolidated joint venture	(1.4)	1.0
Proceeds from termination of cash flow interest rate hedges	14.5	
Pension funding (more) less than expense	(8.2)	4.5
Impairment adjustments and other non-cash items	2.6	(0.1)
Loss on foreign currency transactions	0.2	0.3
Change in operating assets and liabilities:		
Accounts receivable	(23.5)	20.3
Inventories	(13.5)	0.9
Other assets	(9.3)	(3.8)
Accounts payable	42.3	(2.2)
Income taxes payable	(2.3)	(5.7)
Accrued liabilities	14.8	8.6
Net cash provided by operating activities	105.4	98.7
Investing activities:		
Capital expenditures	(46.2)	(34.2)
Purchases of marketable securities		(195.3)
Maturities and sales of marketable securities		223.5
Cash paid for purchase of businesses, net of cash received	(7.8)	(554.0)
Proceeds from sale of property, plant and equipment	4.4	5.3
Net cash used for investing activities	(49.6)	(554.7)
Financing activities:		
Additions to revolving credit facilities	64.5	170.0
Repayments of revolving credit facilities	(161.5)	
Additions to debt	47.2	310.5
Repayments of debt	(17.1)	(9.8)
Payments on termination of fair value interest rate hedges		(4.3)

Debt issuance costs	(0.3)	(3.9)
Issuances of common stock	5.6	3.5
Excess tax benefits from share-based compensation	0.2	
Capital contributed to consolidated subsidiary from minority interest	2.1	
Cash dividends paid to shareholders	(9.9)	(9.7)
Cash distributions to minority interest	(4.8)	(1.9)
Net cash provided by (used for) financing activities	(74.0)	454.4
Effect of exchange rate changes on cash and cash equivalents	(0.6)	0.2
Decrease in cash and cash equivalents	(18.8)	(1.4)
Cash and cash equivalents at beginning of period	26.8	28.7
Cash and cash equivalents at end of period	$ 8.0	$ 27.3
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes, net of refunds	$ 5.4	$ 4.1
Interest, net of amounts capitalized	38.3	14.9

See Accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

Supplemental schedule of non-cash investing and financing activities:
The nine months ended June 30, 2006 includes two packaging segment acquisitions we funded and certain adjustments related to our GSPP Acquisition (as hereinafter defined) in fiscal 2005. Cash paid for the two fiscal 2006 acquisitions aggregated $7.7 million, which included an estimated $3.3 million of goodwill.
On June 6, 2005 we acquired from Gulf States Paper Corporation and certain of its related entities (**Gulf States**) substantially all of the assets of Gulf States Pulp and Paperboard and Paperboard Packaging (**GSPP**) operations and assumed certain of Gulf States related liabilities. We refer to this transaction collectively as the **GSPP Acquisition**. In the third quarter of fiscal 2005, we paid an aggregate purchase price of $553.9 million, which included an estimated $57.1 million of goodwill. The purchase price of the transaction was subject to adjustment based on the amount of working capital delivered to us as agreed with Gulf States. The amounts in the table below for the nine months ended June 30, 2005 also include working capital settlement and final appraisal adjustments for our Athens Corrugator acquisition in fiscal 2004.
In conjunction with these acquisitions, we assumed the following liabilities (in millions):

	Nine Months Ended June 30,	
	2006	2005
Fair value of assets acquired, including goodwill	$ 7.8	$ (588.9)
Cash paid	7.8	554.0
Liabilities assumed	$	$ 34.9

See Accompanying Notes to Condensed Consolidated Financial Statements

4

Table of Contents

ROCK-TENN COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Nine Month Periods Ended June 30, 2006
(Unaudited)

*Unless the context otherwise requires, **we, us, our** and **the Company** refer to the business of Rock-Tenn Company and its consolidated subsidiaries, including RTS Packaging, LLC, which we refer to as **RTS** and GSD Packaging, LLC , which we refer to as **GSD**. We own 65% of RTS and conduct our interior packaging products business through RTS. We own 60% of GSD and conduct some of our folding carton operations through GSD. These terms do not include Seven Hills Paperboard, LLC, which we refer to as **Seven Hills**. We own 49% of Seven Hills, a manufacturer of gypsum paperboard liner, which we do not consolidate for purposes of our financial statements. All references in the accompanying condensed consolidated financial statements and this Quarterly Report on Form 10-Q to aggregated data regarding sales price per ton and fiber, energy, chemical and freight costs with respect to our recycled paperboard mills excludes that data with respect to our Aurora, Illinois, recycled paperboard mill. We exclude that data because the Aurora operation sells only converted products. All other references herein to other operating data with respect to our recycled paperboard mills, including tons data and capacity utilization rates, include operating data from our Aurora recycled paperboard mill.*

Note 1. Interim Financial Statements

Our independent registered public accounting firm has not audited our accompanying condensed consolidated financial statements. We derived the condensed consolidated balance sheet at September 30, 2005 from the audited consolidated financial statements. In the opinion of our management, the condensed consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair presentation of our results of operations for the three and nine months ended June 30, 2006 and 2005, our financial position at June 30, 2006 and September 30, 2005, and our cash flows for the nine months ended June 30, 2006 and 2005.

We have condensed or omitted certain notes and other information from the interim financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these condensed consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended September 30, 2005 (the **Fiscal 2005 Form 10-K**).

The results for the three and nine months ended June 30, 2006 are not necessarily indicative of results that may be expected for the full year.

We have made certain reclassifications to prior year amounts to conform such amounts to the current year presentation.

During the third quarter of fiscal 2006 we recorded $1.8 million of pretax charges for items that related to prior periods. Most of the charges were due to losses at our merchandising display operations in Mexico. The charges were not material to any prior period.

Note 2. New Accounting Standards

Recently Adopted Standards

Statement of Financial Accounting Standards No. 151, *Inventory Costs an amendment of ARB No. 43, Chapter 4* issued in November 2004 was adopted by us on October 1, 2005 (**SFAS 151**). SFAS 151 requires us to recognize abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) as current-period charges and to base our allocation of fixed production overheads to the costs of conversion on the normal capacity of the production facilities. The adoption of SFAS 151 did not have a material effect on our condensed consolidated financial statements.

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* on October 1, 2005 (**SFAS 123(R)**), see ***Note 7. Share-Based Compensation.***

Table of Contents

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Recently Issued Standards

In July 2006, the Financial Accounting Standards Board released FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109* (**FIN 48**). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return (including a decision whether to file or not to file a return in a particular jurisdiction). Under FIN 48, the financial statements will reflect expected future tax consequences of such positions presuming the taxing authorities full knowledge of the position and all relevant facts, but without considering time values. FIN 48 substantially changes the applicable accounting model and is likely to cause greater volatility in income statements as more items are recognized discretely within income tax expense. FIN 48 also revises disclosure requirements and introduces a prescriptive, annual, tabular roll-forward of the unrecognized tax benefits. FIN 48 is effective as of the beginning of fiscal years that start after December 15, 2006 (October 1, 2007 for Rock-Tenn). Management is currently evaluating the impact that FIN 48 will have on our financial position and results of operations upon adoption.

Note 3. Comprehensive Income

The following are the components of comprehensive income (in millions):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Net income	$ 11.0	$ 12.0	$ 7.2	$ 12.7
Foreign currency translation adjustment	4.6	(1.8)	3.4	4.8
Unrealized gain on derivative instruments, net of tax	0.6		3.6	0.3
Comprehensive income	$ 16.2	$ 10.2	$ 14.2	$ 17.8

The change in other comprehensive income due to foreign currency translation was primarily due to the change in the Canadian/U.S. dollar exchange rates.

Note 4. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share (in millions, except per share data):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Numerator:				
Net income	$ 11.0	$ 12.0	$ 7.2	$ 12.7
Denominator:				
Denominator for basic earnings per share weighted average shares	36.2	35.5	36.0	35.4
Effect of dilutive stock options and restricted stock awards	0.7	0.4	0.6	0.5
Denominator for diluted earnings per share weighted average shares and assumed conversions	36.9	35.9	36.6	35.9
Basic earnings per share:				

Net income per share basic	$ 0.30	$ 0.34	$ 0.20	$ 0.36
Diluted earnings per share:				
Net income per share diluted	$ 0.30	$ 0.33	$ 0.20	$ 0.35

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Note 5. Acquisitions, Restructuring and Other Costs

Summary of Acquisitions

On February 27, 2006, our RTS subsidiary completed the acquisition of the partition business of Caraustar Industries, Inc. for an aggregate purchase price of $6.1 million. This acquisition by RTS was funded by capital contributions to RTS by us and our minority interest partner in proportion to our respective investments in RTS and was accounted for as a purchase of a business. We have included these operations in our condensed consolidated financial statements since that date. RTS made the acquisition in order to gain entrance into the specialty partition market which manufactures high quality die cut partitions. The acquisition included $2.4 million of goodwill. We expect the goodwill to be deductible for income tax purposes. The pro forma impact of the acquisition is not material to our financial results. The final allocation of the purchase price is subject to adjustment for the valuation of intangibles. Any adjustment will be immaterial.

On June 6, 2005, we acquired from Gulf States, substantially all of the assets of GSPP s operations and assumed certain of Gulf States related liabilities. We have included the results of GSPP s operations in our condensed consolidated financial statements since that date. The aggregate purchase price for the GSPP Acquisition was $552.4 million, net of cash received of $0.7 million, including expenses. The acquisition included $50.4 million of goodwill that we expect to be deductible for income tax purposes.

The following unaudited pro forma information reflects our consolidated results of operations as if the GSPP Acquisition had taken place on October 1, 2004. The pro forma information includes primarily adjustments for depreciation based on the estimated fair value of the property, plant and equipment we acquired, amortization of acquired intangibles and interest expense on the debt we incurred to finance the acquisition. The pro forma information is not necessarily indicative of the results of operations that we would have reported had the transaction actually occurred at the beginning of fiscal 2005 nor is it necessarily indicative of future results. Pro forma information in the table below is for the three and nine months ended June 30, 2005.

(In millions, except per share data)	Three Months Ended June 30, 2005	Nine Months Ended June 30, 2005
Net sales	$ 515.8	$ 1,546.5
Net income	$ 17.9	$ 25.2
Diluted earnings per common share	$ 0.50	$ 0.70

Summary of Restructuring and Other Initiatives

On March 17, 2006, we announced the closure of our Kerman, California folding carton plant. We transferred a substantial portion of the facility s assets and production to our other folding carton facilities. We recognized an impairment charge to reduce the carrying value of certain equipment to its estimated fair value, recorded a charge for severance and other employee related costs, recorded a liability for future lease payments when we ceased operations at the facility, and recorded a charge for the impairment of the customer relationship intangible asset.

On October 4, 2005, we announced the closure of our Marshville, North Carolina folding carton plant. We transferred the majority of the facility s production to our other folding carton facilities. We recognized an impairment charge in fiscal 2005 to reduce the carrying value of the equipment retired from service to its estimated fair value less cost to sell and have classified the facility and equipment as held for sale.

In the fourth quarter of fiscal 2005, we announced the closure of our Waco, Texas folding carton plant that we acquired as part of the GSPP Acquisition. We transferred the majority of the facility s production to other plants. We classified the land and building as held for sale and we recorded a liability of $1.5 million primarily for severance and other employee related costs as part of the purchase.

In the fourth quarter of fiscal 2004, we announced the closure of our Otsego, Michigan paperboard mill. We transferred approximately one third of the production of this facility to our remaining mills and recognized an impairment charge to reduce the carrying value of the facility and certain equipment to its estimated fair value.

Table of Contents

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Fiscal 2006

We recorded aggregate pre-tax restructuring and other costs of $2.7 million for the third quarter of fiscal 2006. We incurred pre-tax charges of $2.0 million at our Kerman facility primarily to record a $1.0 million liability for future lease payments when we ceased operations at the facility, and $0.7 million to record a charge for the impairment of the customer relationship intangible asset. These two charges are reflected in the Other column in the table that follows under the heading ***Summary of Restructuring and Other Charges.***

We recorded aggregate pre-tax restructuring and other costs of $7.2 million for the nine months ended June 30, 2006. We incurred pre-tax charges of $4.9 million at our Kerman facility primarily for equipment impairment, a charge for future lease payments when we ceased operations at the facility, a charge for the impairment of the customer relationship intangible asset, and severance and other employee costs. We incurred pre-tax charges of $0.7 million at our Marshville facility primarily for severance and other employee costs. We recorded additional pre-tax charges aggregating $1.6 million primarily for additional costs related to our Waco facility closure and GSPP transition costs.

The following table represents a summary of restructuring and other charges related to our active restructuring initiatives that we incurred during the current quarter, the current fiscal year, cumulatively since we announced the initiative, and the total we expect to incur (in millions):

Summary of Restructuring and Other Charges

Initiative and Segment	Period	Net Property, Plant and Equipment (a)	Severance and Other Employee Related Costs	Equipment and Inventory Relocation	Facility Carrying Costs	Other	Total
Otsego, Paperboard	Current Qtr.	$	$	$	$ 0.1	$	$ 0.1