Rock-Tenn CO
Form 10-Q
May 09, 2006

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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 March 31, 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 April 29, 2006
Class A Common Stock, $0.01 par value	36,594,293

ROCK-TENN COMPANY
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PART I: FINANCIAL INFORMATION

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

ROCK-TENN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In Millions, Except Per Share Data)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2006	2005	2006	2005
Net sales	$ 529.7	$ 394.4	$ 1,020.1	$ 780.2
Cost of goods sold	440.5	336.0	871.3	666.8
Gross profit	89.2	58.4	148.8	113.4
Selling, general and administrative expenses	62.0	47.9	119.1	93.7
Restructuring and other costs, net	3.5	2.7	4.5	3.2
Operating profit	23.7	7.8	25.2	16.5
Interest expense	(13.9)	(6.8)	(27.8)	(13.2)
Interest and other income (loss)	0.6	(0.1)	0.6	0.1
Income (loss) from unconsolidated joint venture	(0.2)	0.2	1.4	0.3
Minority interest in income of consolidated subsidiaries	(1.8)	(0.7)	(3.1)	(1.6)
Income (loss) before income taxes	8.4	0.4	(3.7)	2.1
Provision for income taxes	3.2	0.2	0.1	1.4
Net income (loss)	$ 5.2	$ 0.2	$ (3.8)	$ 0.7
Weighted average number of common and common equivalent shares outstanding	36.7	35.9	35.9	35.9
Basic earnings (loss) per share:				
Net income (loss)	$ 0.15	$ 0.01	$ (0.10)	$ 0.02
Diluted earnings (loss) per share:				
Net income (loss)	$ 0.14	$ 0.01	$ (0.10)	$ 0.02
Cash dividends per common share	$ 0.09	$ 0.09	$ 0.18	$ 0.18

See Accompanying Notes to Condensed Consolidated Financial Statements

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

	March 31, 2006	September 30, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8.1	$ 26.8
Accounts receivable (net of allowances of $5.1 and $5.1)	203.6	199.5
Inventories	208.5	202.0
Other current assets	42.2	30.5
Assets held for sale	5.0	3.4
Total current assets	467.4	462.2
Property, plant and equipment at cost:		
Land and buildings	265.9	267.2
Machinery and equipment	1,291.7	1,287.5
Transportation equipment	10.8	10.5
Leasehold improvements	5.6	5.6
	1,574.0	1,570.8
Less accumulated depreciation and amortization	(712.6)	(685.8)
Net property, plant and equipment	861.4	885.0
Goodwill	352.8	350.9
Intangibles, net	64.9	68.0
Other assets	36.5	32.3
	$ 1,783.0	$ 1,798.4
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of debt	$ 92.8	$ 62.1
Accounts payable	142.4	116.4
Accrued compensation and benefits	53.8	50.9
Other current liabilities	49.1	49.8
Total current liabilities	338.1	279.2
Long-term debt due after one year	761.9	840.7
Hedge adjustments resulting from terminated fair value interest rate derivatives or swaps	11.4	12.3
Total long-term debt, less current maturities	773.3	853.0
Accrued pension	106.2	106.8

Deferred income taxes	90.8	83.0
Other long-term liabilities	3.7	3.6
Commitments and contingencies (Note 12) Minority interest	18.9	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; 36,548,626 and 36,280,164 shares outstanding at March 31, 2006 and September 30, 2005, respectively	0.4	0.4
Capital in excess of par value	166.7	162.4
Retained earnings	315.7	326.0
Accumulated other comprehensive loss	(30.8)	(32.6)
Total shareholders equity	452.0	456.2
	$ 1,783.0	$ 1,798.4

See Accompanying Notes to Condensed Consolidated Financial Statements

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

	Six Months Ended March 31,	
	2006	2005
Operating activities:		
Net income (loss)	$ (3.8)	$ 0.7
Items reconciling net income (loss) to cash provided by operating activities:		
Depreciation and amortization	51.7	37.0
Deferred income taxes	7.3	(0.4)
Income tax benefit of employee stock options		0.1
Share-based compensation expense	1.5	0.7
Loss on disposal of plant and equipment and other, net	0.1	0.1
Minority interest in income of consolidated subsidiaries	3.1	1.6
Income from unconsolidated joint venture	(1.4)	(0.3)
Proceeds from termination of interest rate swaps	9.9	
Pension funding (more) less than expense	(0.3)	7.6
Impairment adjustments and other non-cash items	1.8	(0.1)
(Gain) loss on foreign currency transactions	(0.1)	0.4
Change in operating assets and liabilities:		
Accounts receivable	(5.6)	17.0
Inventories	(4.9)	(0.4)
Other assets	(7.2)	(4.3)
Accounts payable	26.0	(10.4)
Income taxes payable	(11.0)	(2.2)
Accrued liabilities	1.3	(10.5)
Net cash provided by operating activities	68.4	36.6
Investing activities:		
Capital expenditures	(27.1)	(22.4)
Purchases of marketable securities		(175.3)
Maturities and sales of marketable securities		172.3
Cash paid for purchase of businesses, net of cash received	(7.8)	(0.1)
Proceeds from sale of property, plant and equipment	0.8	2.5
Net cash used for investing activities	(34.1)	(23.0)
Financing activities:		
Additions to revolving credit facilities	60.5	
Repayments to revolving credit facilities	(126.4)	
Additions to debt	31.4	
Repayments of debt	(13.4)	(9.7)
Debt issuance costs	(0.3)	(0.1)
Issuances of common stock	2.9	2.8
Excess tax benefits from share-based compensation	0.1	

Capital contributed to consolidated subsidiary from minority interest	2.1	
Cash dividends paid to shareholders	(6.6)	(6.5)
Distribution to minority interest	(2.9)	(0.5)
Net cash used for financing activities	(52.6)	(14.0)
Effect of exchange rate changes on cash and cash equivalents	(0.4)	0.2
Decrease in cash and cash equivalents	(18.7)	(0.2)
Cash and cash equivalents at beginning of period	26.8	28.7
Cash and cash equivalents at end of period	$ 8.1	$ 28.5
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes, net of refunds	$ 4.0	$ 4.7
Interest, net of amounts capitalized	29.2	14.8

See Accompanying Notes to Condensed Consolidated Financial Statements

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Supplemental schedule of non-cash investing and financing activities:
In the second quarter of fiscal 2006, we funded two packaging segment acquisitions and recorded 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. The amounts in the table below for the six months ended March 31, 2005 include working capital settlement and final appraisal adjustments for our fiscal 2004 Athens Corrugator acquisition.
In conjunction with these acquisitions, we assumed the following liabilities (in millions):

	Six Months Ended March 31,	
	2006	2005
Fair value of assets acquired, including goodwill	$ 7.9	$ (0.2)
Cash paid	7.8	0.1
Liabilities assumed	$ 0.1	$ (0.3)

See Accompanying Notes to Condensed Consolidated Financial Statements

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ROCK-TENN COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Six Month Periods Ended March 31, 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, includes 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 six months ended March 31, 2006 and 2005, our financial position at March 31, 2006 and September 30, 2005, and our cash flows for the six months ended March 31, 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 six months ended March 31, 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.

Note 2. Summary of Significant Accounting Policies

For a discussion of our significant accounting policies, see ***Note 1. Description of Business and Summary of Significant Accounting Policies*** of the Notes to Consolidated Financial Statements section of our Fiscal 2005 Form 10-K. As of the date hereof, there have been no significant developments with respect to significant accounting policies since September 30, 2005.

Note 3. New Accounting 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, see ***Note 8. Share-Based Compensation*** .

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

Note 4. Comprehensive Income (Loss)

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2006	2005	2006	2005
Net income (loss)	$ 5.2	$ 0.2	$ (3.8)	$ 0.7
Foreign currency translation adjustment	(0.7)	(1.5)	(1.2)	6.6
Unrealized gain on derivative instruments, net of tax	1.4	0.1	3.0	0.3
Total other comprehensive income	0.7	(1.4)	1.8	6.9
Comprehensive income (loss)	$ 5.9	$ (1.2)	$ (2.0)	$ 7.6

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 and the repatriation of a portion of the capital invested in our Canadian operations in the first quarter of fiscal 2006 at an exchange rate of 1.174. The numbers that follow are the Canadian dollar equivalent of one U.S. dollar. The second quarter of fiscal 2006 was impacted as the exchange rate moved to 1.1681 at March 31, 2006 from 1.1628 at December 31, 2005. The second quarter of fiscal 2005 was impacted as the exchange rate moved to 1.2099 at March 31, 2005 from 1.1995 at December 31, 2004.

The six months ended March 31, 2006 was impacted as the exchange rate moved to 1.1681 at March 31, 2006 from 1.1624 at September 30, 2005. The six months ended March 31, 2005 was impacted as the exchange rate moved to 1.2099 at March 31, 2005 from 1.2614 at September 30, 2004.

Note 5. Earnings (Loss) per Share

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2006	2005	2006	2005
Numerator:				
Net income (loss)	$ 5.2	$ 0.2	$ (3.8)	$ 0.7
Denominator:				
Denominator for basic earnings (loss) per share weighted average shares	35.9	35.4	35.9	35.4
Effect of dilutive stock options and restricted stock awards	0.8	0.5		0.5
Denominator for diluted earnings (loss) per share weighted average shares and assumed conversions	36.7	35.9	35.9	35.9
Basic earnings (loss) per share:				
Net income (loss) per share basic	$ 0.15	$ 0.01	$ (0.10)	$ 0.02

Diluted earnings (loss) per share:				
Net income (loss) per share diluted	$ 0.14	$ 0.01	$ (0.10)	$ 0.02

Due to the net loss for the six months ended March 31, 2006, the assumed net exercise of stock options and restricted stock awards was excluded, as the effect would have been anti-dilutive. Options and restricted stock awards for 3.9 million and 0.5 million shares of common stock, respectively, were excluded because their effect was anti-dilutive. If we did not have a loss in the period, approximately 0.7 million shares of dilutive stock options and restricted stock awards would have been included in the denominator for the six months ended March 31, 2006.

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

Note 6. 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. The acquisition was funded by contributions from us and our minority interest partner in proportion to our respective investments and was accounted for as a purchase of a business. We have included these operations in our condensed consolidated financial statements since that date. We 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.

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** . We have included the results of GSPP s operations in our condensed consolidated financial statements since that date. 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 six months ended March 31, 2005.

(In millions, except per share data)	Three Months Ended March 31, 2005	Six Months Ended March 31, 2005
Net sales	$ 523.1	$ 1,031.2
Net income	$ 6.1	$ 7.9
Diluted earnings per common share	$ 0.17	$ 0.22

Summary of Restructuring and Other Initiatives

On March 17, 2006, we announced the closure of our Kerman, California folding carton plant. We expect to transfer the majority of the facility s 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.

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 for $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.

During the fourth quarter of fiscal 2003, we announced the closure of our Dallas, Texas, laminated paperboard products facility. We consolidated the operations of this plant into other existing facilities. We recognized an impairment charge to reduce the carrying value of the equipment retired from service to its estimated fair value less cost to sell. We have disposed of substantially all of this equipment and the facility is classified as held for sale.

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

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 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
Dallas,	Current Qtr.	$	$	$	$	$	$
Paperboard	Fiscal 2006				0.1		0.1
	Cumulative	0.1	0.2	0.1	0.3		0.7
	Expected	0.1	0.2	0.1	0.3		0.7
Otsego,	Current Qtr.				0.1		0.1
Paperboard	Fiscal 2006			0.1	0.1	(0.1)	0.1
	Cumulative	14.5	1.9	0.8	0.9	0.1	18.2
	Expected	14.5	1.9	0.9	1.1	0.1	18.5
Waco,	Current Qtr.			0.1	0.1		0.2
Packaging	Fiscal 2006			0.2	0.1		0.3
Products	Cumulative		0.2	0.5	0.1		0.8
	Expected		0.2	0.5	0.6	0.1	1.4
Marshville,	Current Qtr.		0.1	0.1			0.2
Packaging	Fiscal 2006		0.6	0.1			0.7
Products	Cumulative	2.5	0.6	0.1			3.2
	Expected	2.5	0.6	0.2	0.2	0.2	3.7
Kerman,	Current Qtr.	1.8	0.9			0.2	2.9
Packaging	Fiscal 2006	1.8	0.9			0.2	2.9
Products	Cumulative	1.8	0.9			0.2	2.9
	Expected	1.8	1.2	0.3	0.9	0.4	4.6
Other						0.1	0.1

	Current Qtr. Fiscal 2006					0.4	0.4
	Cumulative		0.1			0.5	0.6
	Expected		0.1			0.7	0.8
Totals	Current Qtr.	$ 1.8	$ 1.0	$ 0.2	$ 0.2	$ 0.3	$ 3.5
	Fiscal 2006	1.8	1.5	0.4	0.3	0.5	4.5
	Cumulative	18.9	3.9	1.5	1.3	0.8	26.4
	Expected	18.9	4.2	2.0	3.1	1.5	29.7

(a) *For purposes of the tables in this Note 6, we have defined* **Net property plant and equipment** as: property, plant and equipment impairment losses, and subsequent adjustments to fair value for assets classified as held for sale, subsequent (gains) or losses on sales of property, plant and equipment, and property, plant and equipment related parts and supplies.

Fiscal 2006

We recorded aggregate pre-tax restructuring and other costs of $3.5 million for the second quarter of fiscal 2006. We incurred pre-tax charges of $2.9 million at our Kerman facility primarily for equipment impairment and severance and other employee costs. We recorded additional pre-tax charges aggregating $0.6 million primarily for additional costs related to our Waco and Marshville facility closures.

We recorded aggregate pre-tax restructuring and other costs of $4.5 million for the six months ended March 31, 2006. We incurred pre-tax charges of $2.9 million at our Kerman facility primarily for equipment impairment and severance and other employee costs. We incurred pre-tax charges of $0.7 million at our Marshville facility primarily

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

for severance and other employee costs. We recorded additional pre-tax charges aggregating $0.9 million primarily for additional costs related to our Waco facility closure and GSPP transition costs.

The following table represents a summary of the restructuring accrual and a reconciliation of the accrual to the line item **Restructuring and other costs, net** on our condensed consolidated statements of operations for the six months ended March 31, 2006 (in millions):

	Reserve at September 30, 2005	Restructuring Charges	Payments	Adjustment to Accrual	Reserve at March 31, 2006
Severance and other employee costs	$ 1.6	$ 1.3	$ (0.8)	$	$ 2.1
Other	0.1	0.2		(0.1)	0.2
Total restructuring	$ 1.7	$ 1.5	$ (0.8)	$ (0.1)	$ 2.3
Adjustment to accrual (see table above)		(0.1)			
Net property, plant and equipment		1.8			
Severance and other employee costs		0.2			
Equipment and inventory relocation		0.4			
Facility carrying costs		0.3			
Other		0.4			
Total restructuring and other costs, net		$ 4.5			

The following table represents a summary of the restructuring accrual related to the costs to exit an activity of an acquired company. The reserves are for the Waco plant consolidation acquired as part of the GSPP Acquisition (in millions):

	Reserve at September 30, 2005	Restructuring Additions	Payments	Reserve at March 31, 2006
Severance and other employee costs	$ 1.5	$	$ (1.3)	$ 0.2

Fiscal 2005

We recorded aggregate pre-tax restructuring and other costs of $2.7 million for the second quarter of fiscal 2005. We incurred pre-tax charges of $1.3 million for the closure of our St. Paul, Minnesota, folding carton facility. The St. Paul charges consisted primarily of severance and other employee costs of $1.0 million, equipment removal and relocation of $0.2 million, and other costs of $0.1 million. The St. Paul union contract allows more senior folding carton employees from this facility to replace other union employees at our St. Paul mill. The replacement process requires 1-on-1 training for a specific period of time per position. As a result, we have included in the severance and other

employee costs $0.7 million of duplicate mill labor. At our Otsego, Michigan, specialty recycled paperboard mill, we incurred pre-tax charges of $0.7 million in connection with the closure. The charges consisted of facility carrying costs of $0.3 million, equipment removal and relocation costs of $0.2 million, and other costs of $0.2 million. During the quarter we recorded a charge of $0.6 million to expense previously capitalized patent defense costs associated with a patent from our former plastic packaging products division. This patent was not included in the sale of that division. In addition, we recorded a variety of charges on previously announced closings aggregating $0.1 million in the period. During the six months ended March 31, 2005, we recorded aggregate pre-tax restructuring and other costs of $3.2 million. We incurred pre-tax charges of $2.2 million for the previously announced closure of our St. Paul, Minnesota, folding carton facility. The St. Paul charges consisted of severance and other employee costs of $1.9 million, equipment removal and relocation of $0.2 million, and other costs of $0.1 million. Included in the severance and other employee costs was $0.8 million of duplicate mill labor, as discussed above. At our Otsego, Michigan, specialty recycled paperboard mill we incurred pre-tax charges of $1.1 million in connection with the closure. The charges consisted of facility carrying costs of $0.5 million, equipment removal and relocation costs of $0.4 million, and other costs of $0.2 million. During the six month period we recorded a charge of $0.6 million to expense previously capitalized patent defense costs associated with a patent from our former plastic packaging products division. During the first quarter of fiscal 2005, we received proceeds of $1.5 million from the sale of our Wright

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

City, Missouri, laminated paperboard converting facility and reduced the previously recorded impairment charge by $0.7 million to record the property at fair value less cost to sell.

The following table represents a summary of the restructuring accrual and a reconciliation of the accrual to the line item **Restructuring and other costs, net** on our condensed consolidated statements of operations for the six months ended March 31, 2005 (in millions):

	Reserve at September 30, 2004	Restructuring Charges	Payments	Adjustment to Accrual	Reserve at March 31, 2005
Severance and other employee costs	$ 1.0	$ 1.0	$ (1.7)	$ (0.2)	$ 0.1
Other	0.1				0.1
Total restructuring	$ 1.1	$ 1.0	$ (1.7)	$ (0.2)	$ 0.2
Adjustment to accrual (see table above)		(0.2)			
Severance and other employee costs		1.1			
Facility carrying costs		0.6			
Equipment and inventory relocation		0.6			
Net property, plant and equipment		(0.7)			
Other		0.8			
Total restructuring and other costs, net		$ 3.2			

Note 7. Tax Provision

The tax provision for the six months ended March 31, 2006 includes deferred income tax expense of $1.4 million from a tax law change in Quebec that we recorded in the first quarter of fiscal 2006. The tax provision for the six months ended March 31, 2005 is higher than normal due to an adjustment of $0.6 million that we recorded in the first quarter of fiscal 2005 related to the acquisition of the Athens corrugator. We originally recorded this adjustment as a reduction of tax expense in the year ended September 30, 2004.

Note 8. Share-Based Compensation

We maintain a share-based compensation plan which allows for the issuance of nonqualified stock options and restricted shares. We also maintain an employee stock purchase plan that provides for the issuance of shares to all of our eligible employees at a discounted price. Prior to fiscal 2006, we accounted for the plans under APB 25. Because all stock options granted had an exercise price equal to the market value of the stock on the date of the grant, no expense was recognized. The employee stock purchase plan was considered noncompensatory and no expense related to this plan was recognized. Expense related to the grant of restricted stock was recognized. Effective October 1, 2005, the Company adopted the fair value recognition provisions of SFAS 123(R). We chose the modified prospective method of adoption in which we recognize compensation expense for the portion of outstanding awards on the adoption date for which the requisite service period has not yet been rendered based on the grant-date fair value of those awards calculated under SFAS No. 123 and SFAS No. 148, for pro forma disclosures. Compensation expense in fiscal 2005 related to stock options and the employee stock purchase plan continues to be disclosed on a pro forma

basis only. In accordance with the modified prospective transition method, we eliminated the balance of Deferred Compensation displayed as a component of shareholders equity against additional paid-in capital for all periods presented. This item represented unrecognized compensation cost for restricted stock awards.

SFAS 123(R) requires that forfeitures be estimated over the vesting period of an award, rather than being recognized as a reduction of compensation expense when the forfeiture actually occurs. The only share-based compensation that was recognized in our financial statements prior to adoption of SFAS 123(R) was for grants of restricted stock. The cumulative effect of the use of the estimated forfeiture method for prior periods upon adoption of SFAS 123(R) related to the restricted shares was not material.

For the pro forma information we recognize compensation cost over the explicit service period (for retirement eligible employees, this included the period up to the date of actual retirement). Upon adoption of SFAS 123(R), we recognize compensation cost over a period to the date the employee first becomes eligible for retirement for awards granted or modified after the adoption of SFAS 123(R). Awards outstanding prior to the adoption of SFAS 123(R) will continue to be recognized over the explicit service period. If we followed the nonsubstantive vesting provisions

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

of SFAS 123(R) for retirement eligible employees, the impact on pro forma net income and pro forma diluted earnings per share would have been *de minimis*.

The following disclosure shows what our net income (loss) and earnings per share would have been using the fair value compensation model under SFAS 123(R) (in millions, except per share data):

	Three Months Ended March 31, 2005	Six Months Ended March 31, 2005
Net income, as reported	$ 0.2	$ 0.7
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	0.2	0.5
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(0.8)	(1.7)
Pro forma net loss	$ (0.4)	$ (0.5)
Earnings (loss) per share:		
Basic as reported	$ 0.01	$ 0.02
Basic pro forma	$ (0.01)	$ (0.02)
Diluted as reported	$ 0.01	$ 0.02
Diluted pro forma	$ (0.01)	$ (0.02)

We estimate, at the date of grant, the fair values for the options we granted using a Black-Scholes option pricing model. We use historical data to estimate option exercises and employee terminations in determining the expected term in years for stock options. Expected volatility is calculated based on the historical volatility of our stock. The risk-free interest rate is based on U.S. Treasury securities in effect at the date of the grant of the stock options. The dividend yield is calculated based on our historic annual dividend payments.

There were no stock options granted during the three and six months ended March 31, 2006 or for the first quarter of fiscal 2005. We applied the following weighted average assumptions to grants made during the three months ended March 31, 2005: expected term in years 7 years, expected volatility 43.4%, risk-free interest rate 3.9% and dividend yield 2.4%.

Stock Option Plans

Our 2004 Incentive Stock Plan allows for the granting of options to certain key employees for the purchase of a maximum of 2,000,000 shares of common stock plus the number of shares which would remain available for issuance under each preexisting plan if shares were issued on the effective date of this plan sufficient to satisfy grants then outstanding, plus the number of shares of common stock subject to grants under any preexisting plan which are outstanding on the effective date of this plan and which are forfeited or expire on or after such effective date. Our 2000 Incentive Stock Plan, approved in January 2001, allowed for the granting of options through January 2005 to certain key employees for the purchase of a maximum of 2,200,000 shares of common stock. Our 1993 Stock Option Plan allowed for the granting of options through November 2003 to certain key employees for the purchase of a maximum of 3,700,000 shares of common stock. Options that we granted under these plans vest in increments over a period of up to three years and have ten-year contractual terms.

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

The table below summarizes the changes in all stock options during the six months ended March 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in millions)
Outstanding at September 30, 2005	3,986,103	$ 13.90		
Granted				
Exercised	(78,333)	11.14		
Expired	(33,867)	16.68		
Forfeited	(2,000)	14.01		
Outstanding at March 31, 2006	**3,871,903**	**$ 13.93**	**5.5 years**	**$ 7.3**
Exercisable at March 31, 2006	**3,656,243**	**$ 13.92**	**5.4 years**	**$ 7.0**

Our results of operations for the three and six months ended March 31, 2006 includes $0.06 million and $0.1 million of compensation expense for stock options (net of approximately $0.04 million and $0.1 million of income taxes), respectively. The aggregate intrinsic value of options exercised during the three months ended March 31, 2006 and 2005 was $0.1 million and $0.005 million, respectively. The aggregate intrinsic value of options exercised during the six months ended March 31, 2006 and 2005 was $0.2 million and $0.3 million, respectively.

A summary of the status of our nonvested options as of March 31, 2006, and changes during the six months ended March 31, 2006, is presented below:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at September 30, 2005	246,999	$ 5.75
Granted		
Vested	(29,339)	5.97
Forfeited	(2,000)	5.71
Nonvested at March 31, 2006	**215,660**	**$ 5.72**

As of March 31, 2006, there was $0.1 million of total unrecognized compensation cost related to nonvested stock options; that cost is expected to be recognized over a period of 2 years. We amortize these costs using the accelerated attribution method.

SFAS 123(R) requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under prior guidance. Excess tax benefits of approximately $0.1 million were included in cash provided by financing activities for the six months ended March 31, 2006.

A summary of our unvested restricted stock awards as of September 30, 2005 and changes during the six months ended March 31, 2006 is presented below:

	Shares		Weighted Average Grant Date Fair Value
Unvested at September 30, 2005	508,831	$	13.55
Granted	18,000		13.95
Vested			
Forfeited			
Unvested at March 31, 2006	**526,831**	**$**	**13.56**

During the second quarter of fiscal 2006, 18,000 shares of restricted stock, which vest over one year, were granted to our non-employee directors. We will recognize a total of $0.3 million in compensation expense ($0.2 million and $0.1 million in fiscal 2006 and 2007, respectively) in connection with these shares. There was approximately $3.3 million of total unrecognized compensation cost related to unvested restricted shares as of March 31, 2006 that will be recognized over a weighted average remaining vesting period of 1.97 years. We have restricted shares outstanding granted in fiscal 2001, 2002, 2003, 2004, and 2005, each of which vests upon completion of required service in one third increments on the third, fourth and fifth anniversary of the grant date. The grants are subject to earlier vesting upon satisfaction of certain earnings improvement criteria specific to each award in one third increments on the first, second and third anniversary of the grant date. The measurement date for early vesting of all

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

of these grants is March 31 of the respective year. None of the early vesting periods for fiscal 2003, 2004, or 2005 grants have been satisfied.

Employee Stock Purchase Plan

Under the Amended and Restated 1993 Employee Stock Purchase Plan **(the Plan)**, shares of common stock are reserved for purchase by substantially all of our qualifying employees. In January 2004, our board of directors amended the Plan to allow for the purchase of an additional 1,000,000 shares, bringing the total authorized to a maximum of 3,320,000 shares of common stock. During the three and six months ended March 31, 2006, employees purchased approximately 87,000 and 172,000 shares under the Plan, respectively. We recognized $0.2 million and $0.3 million in expense relating to the Plan for the three and six months ended March 31, 2006, respectively. As of March 31, 2006, approximately 402,000 shares of common stock were available for purchase under the Plan.

Note 9. Inventories

We value substantially all of our U.S. inventories at the lower of cost or market, with cost determined on the last-in, first-out (**LIFO**) basis. We value all other inventories at the lower of cost or market and determine cost using methods that approximate cost computed on a first-in, first-out (**FIFO**) basis. Because LIFO is designed for annual determinations, it is possible to make an actual valuation of inventory under the LIFO method only at the end of each fiscal year based on the inventory levels and costs at that time. Accordingly, we base interim LIFO estimates on management s projection of expected year-end inventory levels and costs. Inventories were as follows (in millions):

	March 31, 2006	September 30, 2005
Finished goods and work in process	$ 129.7	$ 134.2
Raw materials	70.1	59.9
Supplies and spare parts	33.8	30.7
Inventories at FIFO cost	233.6	224.8
LIFO reserve	(25.1)	(22.8)
Net inventories	$ 208.5	$ 202.0

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

Note 10. Debt

The following were individual components of debt (in millions):

	March 31, 2006	September 30, 2005
Face value of 5.625% notes due March 2013, net of unamortized discount of $0.2 and $0.2	$ 99.8	$ 99.8
Hedge adjustments resulting from terminated interest rate derivatives or swaps	2.3	2.4
	102.1	102.2
Face value of 8.20% notes due August 2011, net of unamortized discount of $0.4 and $0.4	249.6	249.6
Hedge adjustments resulting from terminated interest rate derivatives or swaps	9.1	9.9
	258.7	259.5
Term debt [a]	250.0	250.0
Revolving credit facility [a]	150.0	216.0
Receivables-backed financing facility [b]	73.2	55.0
Industrial development revenue bonds, bearing interest at variable rates (4.98% at March 31, 2006, and 4.30% at September 30, 2005), due through October 2036	30.1	30.1
Other notes	2.0	2.3
	866.1	915.1
Less total current portion of debt	92.8	62.1
Long-term debt due after one year	$ 773.3	$ 853.0

The following were the aggregate components of debt (in millions):

	March 31, 2006	September 30, 2005
Face value of debt instruments, net of unamortized discounts	$ 854.7	$ 902.8
Hedge adjustments resulting from terminated interest rate derivatives or swaps	11.4	12.3
	$ 866.1	$ 915.1

For a discussion of certain of our debt characteristics, see ***Note 8. Debt*** of the Notes to Consolidated Financial Statements section of the Fiscal 2005 Form 10-K. Other than the items noted below, there have been no significant developments.

[a] The Senior Credit Facility includes

revolving credit, swing, and term loan facilities in the aggregate principal amount of $700 million. The Senior Credit Facility is pre-payable at any time and is scheduled to expire on June 6, 2010. At March 31, 2006, we had aggregate outstanding letters of credit under this facility of approximately $44 million. At March 31, 2006, due to the restrictive covenants on the revolving credit facility, maximum additional available borrowings under this facility were approximately $94 million. The applicable margin for determining the interest rate applicable to Base Rate Loans ranges from 0.000% to 0.750% of the aggregate borrowing availability based on the ratio of our

consolidated funded debt to EBITDA as defined in the credit agreement (**Credit Agreement EBITDA**). The applicable percentage for determining the facility commitment fee ranges from 0.175% to 0.400% of the aggregate borrowing availability based on the ratio of our consolidated funded debt to Credit Agreement EBITDA. At March 31, 2006, the applicable margin for determining the interest rate applicable to LIBOR Loans and the applicable margin for determining the interest rate applicable to Base Rate Loans were 1.75% and 0.75%, respectively. At September 30, 2005, the applicable margin for determining the interest rate applicable to

LIBOR Loans and the applicable margin for determining the interest rate applicable to Base Rate Loans were 1.50% and 0.50%, respectively. The facility commitment fee at March 31, 2006 and September 30, 2005 was 0.40% and 0.325% of the unused amount, respectively.

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

(b) On October 26, 2005, we increased the receivables-backed financing facility (**Receivables Facility**) from $75.0 to $100.0 million. The new facility is scheduled to expire on October 25, 2006. Borrowing availability under this facility is based on the eligible underlying receivables. At March 31, 2006, maximum available borrowings under this facility were approximately $75.8 million. The borrowing rate, which consists of the market rate for asset-backed commercial paper plus a utilization fee, was 5.01% as of March 31, 2006. The borrowing rate at September 30, 2005 was 4.10%.

Interest on our 8.20% notes due August 2011 is payable in arrears each February and August. Interest on our 5.625% notes due March 2013 is payable in arrears each September and March. Our August 2011 and March 2013 notes are unsecured facilities. The indenture related to these notes restricts us and our subsidiaries from incurring certain liens and entering into certain sale and leaseback transactions, subject to a number of exceptions. Three of our Canadian subsidiaries had revolving credit facilities with Canadian banks. The facilities provided borrowing availability of up to $10.0 million Canadian. At September 30, 2005, and at the time we terminated these facilities in December 2005, there were no amounts outstanding under these facilities.

Interest Rate Swaps

We are exposed to changes in interest rates as a result of our short-term and long-term debt. We use interest rate swap instruments to manage the interest rate characteristics of a portion of our outstanding debt. In June and September 2005, we entered into $350.0 million notional amount and $75.0 million notional amount of floating-to-fixed interest rate swaps, respectively, and designated them as cash flow hedges of a like amount of our floating rate debt. These swaps were terminated in February 2006. We realized net proceeds of $9.9 million upon termination. New swaps for identical notional amounts were entered into concurrently with the termination. Cash flows from terminated interest rate swaps are classified in the same category as the cash flows from the items being hedged. The amount of ineffectiveness recorded in the results of operations for the three and six month periods ended March 31, 2006 and 2005 was minimal. The fair value of our swaps was a deferred gain of $1.7 million at March 31, 2006.

Note 11. Retirement Plans

The following table represents a summary of the components of net pension cost (in millions):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2006	2005	2006	2005
Service cost	$ 2.4	$ 2.6	$ 4.7	$ 4.7
Interest cost	4.5	4.6	9.1	8.8
Expected return on plan assets	(4.9)	(4.9)	(9.9)	(9.6)
Amortization of prior service cost	0.1	0.2	0.1	0.1
Amortization of net loss	1.9	1.7	3.9	3.5
Pension curtailment income		(0.4)		(0.4)
Company defined benefit plan expense	4.0	3.8	7.9	7.1
Multi-employer plans for collective bargaining employees	0.2	0.1	0.3	0.2
Net pension cost	$ 4.2	$ 3.9	$ 8.2	$ 7.3