MAGNETEK INC
Form 10-Q
February 11, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended: January 2, 2005

OR

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

For the transition period from

Commission file number 1-10233

MAGNETEK, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-3917584**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

10900 Wilshire Blvd., Suite 850

Los Angeles, California 90024

(Address of principal executive offices)

(Zip Code)

(310) 208-1980

(Registrant s telephone number, including area code)

(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 ý No o

Indicate by check mark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Exchange Act.

Yes ý No o

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of Registrant s Common Stock, as of January 28, 2005, was 28,542,650 shares.

2005 MAGNETEK FORM 10-Q

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands, except per share data)

(unaudited)

	Three Months (13 Weeks) Ended			
	January 2, 2005		December 28, 2003	
Net sales	$	64,026	$	58,091
Cost of sales		48,102		45,188
Gross profit		15,924		12,903
Research and development		3,877		3,285
Selling, general and administrative		12,311		13,255
Loss from operations		(264)		(3,637)
Interest expense		334		411
Other income		(1,300)		
Income (loss) before provision for income taxes		702		(4,048)
Provision for income taxes		140		
Net income (loss)	$	562	$	(4,048)
Earnings (loss) per common share				
Basic and diluted:				
Net income (loss)	$	0.02	$	(0.15)

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands, except per share data)

(unaudited)

	Six Months Ended	
	(27 Weeks) January 2, 2005	**(26 Weeks) December 28, 2003**
Net sales	$ 133,204	$ 108,526
Cost of sales	100,342	85,277
Gross profit	32,862	23,249
Research and development	7,571	6,128
Selling, general and administrative	24,016	23,725
Income (loss) from operations	1,275	(6,604)
Interest expense	698	1,083
Other income	(1,300)	
Income (loss) before provision for income taxes	1,877	(7,687)
Provision for income taxes	375	
Net income (loss)	$ 1,502	$ (7,687)
Earnings (loss) per common share		
Basic and diluted:		
Net income (loss)	$ 0.05	$ (0.30)

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands)

	January 2, 2005 (unaudited)	June 27, 2004 (audited)
ASSETS		
Current assets:		
Cash	$ 4,054	$ 2,318
Accounts receivable, net	62,965	57,608
Inventories	54,414	51,432
Prepaid expenses and other	6,112	9,027
Total current assets	127,545	120,385
Property, plant and equipment	139,265	123,036
Less-accumulated depreciation and amortization	105,176	90,918
Property, plant and equipment, net	34,089	32,118
Goodwill	65,362	63,828
Prepaid pension	56,809	57,523
Other assets	13,906	14,293
Total Assets	$ 297,711	$ 288,147
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 36,102	$ 41,181
Accrued liabilities	9,861	11,551
Current portion of long-term debt	2,123	1,997
Total current liabilities	48,086	54,729
Long-term debt, net of current portion	21,082	16,129
Pension benefit obligations	88,889	88,889
Other long-term obligations	8,792	7,552
Deferred income taxes	8,911	8,326
Stockholders equity		
Common stock	285	285
Paid in capital in excess of par value	127,928	127,692
Retained earnings	70,990	69,488
Accumulated other comprehensive loss	(77,252)	(84,943)
Total stockholders equity	121,951	112,522
Total Liabilities and Stockholders Equity	$ 297,711	$ 288,147

See accompanying notes

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MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

(unaudited)

	Six Months Ended	
	(27 Weeks) January 2, 2005	**(26 Weeks) December 28, 2003**
Cash flows from operating activities:		
Net income (loss)	$ 1,502	$ (7,687)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,897	5,041
Tax refund proceeds, net	3,332	
Changes in operating assets and liabilities	(9,331)	607
Total adjustments	(1,102)	5,648
Net cash provided by (used in) operating activities	400	(2,039)
Cash flows from investing activities:		
Proceeds from sale of businesses		1,250
Capital expenditures	(3,938)	(2,506)
Net cash used in investing activities	(3,938)	(1,256)
Cash flow from financing activities:		
Proceeds from issuance of common stock	236	18,768
Borrowings (repayments) under line-of-credit agreements	6,391	(14,428)
Principal payments under capital lease obligations	(40)	(207)
Borrowings under (repayment of) long term notes	(1,272)	756
Increase in deferred financing costs	(41)	(516)
Net cash provided by financing activities	5,274	4,373
Net increase in cash	$ 1,736	$ 1,078
Cash at the beginning of the period	2,318	1,680
Cash at the end of the period	$ 4,054	$ 2,758

See accompanying notes

MAGNETEK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JANUARY 2, 2005

(Amounts in thousands, except per share data)

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company s Form 10-K for the year ended June 27, 2004 filed with the Securities and Exchange Commission. In the Company s opinion, these unaudited statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position of the Company as of January 2, 2005, and the results of its operations and its cash flows for the three-month and six-month periods ended January 2, 2005 and December 28, 2003. Results for the three-months and six-months ended January 2, 2005 are not necessarily indicative of results that may be experienced for the full fiscal year.

The Company uses a fifty-two, fifty-three week fiscal year ending on the Sunday nearest to June 30. Fiscal quarters are the thirteen- or fourteen-week periods ending on the Sunday nearest September 30, December 31, March 31 and June 30. The three-month periods ended January 2, 2005 and December 28, 2003 (the Company s second fiscal quarter) each contained thirteen weeks; the six-month periods ended January 2, 2005 and December 28, 2003 contained twenty-seven and twenty-six weeks, respectively.

2. Summary of Significant Accounting Policies

Principles of Consolidation The condensed consolidated financial statements include the accounts of Magnetek, Inc. and its subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated.

Use of Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas requiring management estimates include the following key financial areas:

Accounts Receivable

Accounts receivable represent receivables from customers in the ordinary course of business. The Company is subject to losses from uncollectible receivables in excess of its allowances. The Company maintains allowances for doubtful accounts for estimated losses from customers inability to make required payments. In order to estimate the appropriate level of this allowance, the Company analyzes historical bad debts, customer concentrations, current customer creditworthiness, current economic trends and changes in customer payment patterns. If the financial conditions of the Company s customers were to deteriorate and to impair their ability to make payments, additional allowances may be required in future periods. The Company s management believes that all appropriate allowances have been provided.

Inventories

The Company s inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method, including material, labor and factory overhead. Inventory on hand may exceed future demand either because the product is obsolete, or the amount on hand is more than can be used to meet future needs. The Company identifies potentially obsolete and excess inventory by evaluating overall inventory levels. In assessing the ultimate realization of inventories, the Company is required to make judgments as to future demand requirements and compare those with the current or committed inventory levels. If future demand requirements are less favorable than those projected by management, additional inventory write-downs may be required.

Reserves for Contingencies

The Company periodically records the estimated impacts of various conditions, situations or circumstances involving uncertain outcomes. The accounting for such events is prescribed under Statement of Financial Accounting Standard (SFAS) No. 5, Accounting for Contingencies. SFAS No. 5 defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

SFAS No. 5 does not permit the accrual of gain contingencies under any circumstances. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that the loss has been incurred, given the likelihood of uncertain events; and (2) that the amount of the loss can be reasonably estimated.

The accrual of a contingency involves considerable judgment on the part of management. The Company uses its internal expertise, and outside experts, as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

Income Taxes

The Company uses the liability method to account for income taxes. The preparation of consolidated financial statements involves estimating the Company s current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheets. An assessment of the recoverability of the deferred tax assets is made, and a valuation allowance is established based upon this assessment.

The Company does not record deferred taxes on domestic pretax income or losses, due to (1) the availability of net operating loss (NOL) carryforwards that have been fully reserved through valuation allowances for pretax income, and (2) uncertainty surrounding the timing of realizing NOL carryforwards generated in the current period in future periods.

Federal income taxes are not provided currently on undistributed earnings of foreign subsidiaries since the Company presently intends to reinvest any earnings overseas indefinitely.

Pension Benefits

The valuation of the Company s pension plan requires the use of assumptions and estimates to develop actuarial valuations of expenses and assets/liabilities. These assumptions include discount rates, investment returns and mortality rates. Changes in assumptions and future investments returns could potentially have a material impact on the Company s expenses and related funding requirements.

Revenue Recognition The Company s policy is to recognize revenue when the earnings process is complete. The criteria used in making this determination are persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Sales are recorded net of returns and allowances, which are estimated using historical data, at the time of sale.

Revenue is recognized upon shipment, except in those cases where product is shipped to customers with consignment stock agreements, wherein revenue is recognized when the customer removes the product from consignment stock. With the exception of consignment stock, terms of shipment are FOB shipping point, and payment is not contingent upon resale or any other matter other than passage of time. As a result, title to goods passes upon shipment. Amounts billed to customers for shipping costs are reflected in net sales; shipping costs are reflected in cost of sales.

Sales to distributors are recorded with appropriate reserves for future returns in accordance with SFAS No. 48, Revenue Recognition When Right of Return Exists , and generally do not include future installation obligations or acceptance requirements.

Property, Plant and Equipment Additions and improvements are capitalized at cost, whereas expenditures for maintenance and repair are charged to expense as incurred. Depreciation is provided over the estimated useful lives of the respective assets (ranging from three to forty years) principally using the straight-line method.

Goodwill In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, the Company reviews the carrying value of goodwill at least annually, and more frequently if indicators of potential impairment arise, using discounted future cash flow analyses as prescribed in SFAS No. 142.

Deferred Financing Costs Costs incurred to obtain financing are deferred and included in other assets in the condensed consolidated balance sheets. Deferred financing costs are amortized over the term of the financing facility, and related amortization expenses are included in interest expense in the condensed consolidated statements of operations.

Earnings per Share In accordance with SFAS No. 128, Earnings per Share , basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporate the incremental shares issuable upon the assumed exercise of stock options as if all exercises had occurred at the beginning of the fiscal period.

Stock-Based Compensation The Company has elected to continue to use the intrinsic-value method of accounting as prescribed by Accounting Principles Board (APB) No. 25 Accounting for Stock Issued to Employees in accounting for stock based awards to employees. Under APB 25, the Company recognizes no compensation expense with respect to such awards when the exercise price is equal to or greater than the market price at the date of grant. Accordingly, no stock-based employee compensation cost is reflected in reported results of operations for all periods presented. The Company adopted the interim disclosure provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of FASB Statement no. 123 .

The following table illustrates the pro forma effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation , to stock-based employee compensation:

	Three Months Ended		Six Months Ended	
	January 2, 2005	December 28, 2003	January 2, 2005	December 28, 2003
Net income (loss)	$ 562	$ (4,048)	$ 1,502	$ (7,687)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(1,160)	(1,149)	(2,384)	(2,290)
Pro forma net loss	$ (598)	$ (5,197)	$ (882)	$ (9,977)
Earnings (loss) per share as reported:				
Basic and diluted	$ 0.02	$ (0.15)	$ 0.05	$ (0.30)
Pro forma loss per share:				
Basic and diluted	$ (0.02)	$ (0.19)	$ (0.03)	$ (0.39)

Recent Accounting Pronouncement On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment , which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees , and amends SFAS No. 95, Statement of Cash Flows . Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Adoption of SFAS No. 123(R) is required as of the first interim or annual reporting period that begins after June 15, 2005. The Company will adopt the provisions of SFAS No. 123(R) as required in our first quarter of fiscal year 2006.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date.

2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company plans to adopt SFAS No. 123(R) using the modified-prospective method.

As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using APB No. 25 s intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123(R) s fair value method will have an impact on our result of operations, although it will have no impact on our overall financial position. The impact of adoption of SFAS No. 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income (loss) and earnings (loss) per share in the table above under Stock-Based Compensation. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. To the extent these tax deductions are recognized, this requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

Derivative Financial Instruments The Company has occasionally used derivative financial instruments to reduce financial market risks. These instruments are used to hedge foreign currency and interest rate market exposures. The Company does not use derivative financial instruments for speculative or trading purposes. The Company accounts for derivative instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and SFAS No. 149, Amendment of Statement 133 on Derivatives and Hedging . These statements require that an entity recognize all derivatives as either assets or liabilities in the statement of financial position, measured at fair value, and that hedge accounting be applied when certain conditions are met. The Company had no derivative financial instruments at January 2, 2005.

Foreign Currency Translation - The Company s foreign entities accounts are measured using local currency as the functional currency. Assets and liabilities are translated at the exchange rate in effect at year-end. Revenues and expenses are translated at the rates of exchange prevailing during the year. Unrealized translation gains and losses arising from differences in exchange rates from period to period are included as a component of accumulated other comprehensive loss in stockholders equity. The Company does not hold large cash balances in foreign currencies, therefore the effect of exchange rate changes on these balances is not material to the consolidated statement of cash flows.

Reclassifications Certain prior year balances were reclassified to conform to the current year presentation.

3. Inventories

Inventories at January 2, 2005 and June 27, 2004 consist of the following:

	January 2, 2005	June 27, 2004
Raw materials and stock parts	$ 32,476	$ 29,237
Work-in-process	13,384	13,498

Finished goods		8,554		8,697
	$	54,414	$	51,432

4. Commitments and Contingencies

The Company is a party to several product liability lawsuits associated with discontinued business operations that have been sold. As part of the sales transactions, the Company agreed for a limited time to defend and indemnify the purchasers of the discontinued business operations against certain product liability claims. The last remaining contractual indemnification obligation of that type terminated on December 14, 2003; however, the Company remains obligated to continue defending and indemnifying valid claims made prior to the applicable termination date for each such obligation. The Company is also a named party in two product liability lawsuits related to the Telemotive Industrial Controls business acquired in December 2002, although insurance has accepted the Company s tender of the defense of those claims and it is expected that the policies in effect for the Telemotive Industrial Controls business prior to the sale will cover the losses, if any, and that the Company will be indemnified by the selling shareholders for any uninsured losses. The few remaining product liability cases related to discontinued business operations are being aggressively defended by the Company, and management believes that its insurers will bear all liability, if any, that exceeds applicable deductibles, and that none of these proceedings individually or in the aggregate will have a material adverse effect on the Company s results of operations or financial position.

The Company has been named, along with numerous other defendants, in asbestos-related lawsuits associated with business operations previously acquired by the Company, but which are no longer owned. None of the businesses produced or sold asbestos-containing products during the Company s ownership and the Company believes it has no liability for such claims. The Company is either contractually indemnified against liability for asbestos-related claims or believes that the claims may be covered by policies of insurance in effect prior to the Company s purchase of the businesses. While the outcome of these asbestos-related lawsuits and the availability of coverage cannot be predicted with certainty, claims against the Company have not historically been aggressively pursued by plaintiff s counsel in the past and the Company has routinely been dismissed from such cases prior to trial. In certain jurisdictions, the Company has successfully obtained dismissal early in the proceedings. The Company does not believe the asbestos-related lawsuits, individually or in the aggregate, will have a material adverse effect on its financial position or results of operations.

In April 1998, Ole K. Nilssen filed a lawsuit in the U.S. District Court for the Northern District of Illinois alleging infringement by the Company of seven of his patents pertaining to electronic ballast technology, and seeking unspecified damages and injunctive relief to preclude the Company from making, using or selling products allegedly infringing his patents. The Company denied that its products infringed any valid patent and filed a response asserting affirmative defenses, as well as a counterclaim for a judicial declaration that its products do not infringe the patents asserted by Mr. Nilssen and also that the asserted patents are invalid. In June 2001, the Company sold its lighting business to Universal Lighting Technologies, Inc. (ULT), and agreed to provide a limited indemnification against certain claims of infringement that Mr. Nilssen might allege against ULT. In April 2003, Mr. Nilssen s lawsuit and the counterclaims were dismissed with prejudice and both parties agreed to submit limited issues in dispute to binding arbitration before an arbitrator with a relevant technical background. Arbitration commenced on November 8, 2004 and a decision is expected prior to the end of fiscal year 2005. The Company presented what it believes are strong defenses at arbitration; however, an unfavorable decision could have a material adverse effect on the Company s financial position and results of operations.

In February 2003, Mr. Nilssen filed a lawsuit in the U.S. District Court for the Northern District of Illinois alleging infringement by ULT of twenty-nine of his patents pertaining to electronic ballast technology, and seeking unspecified damages and injunctive relief to preclude ULT from making, using or selling products allegedly infringing his patents. ULT made a claim for indemnification, which the Company accepted, subject to the limitations set forth in the purchase and sale agreement. The case is now pending in the U.S. District Court for the Middle District of Tennessee following the Company s successful motion to remove the case to a more appropriate forum. As in the case against Magnetek, the Company denies that the products for which it has an indemnification obligation to ULT infringe any valid patent and has filed a response on behalf of ULT asserting affirmative defenses, as well as a counterclaim for a judicial declaration that the products do not infringe Mr. Nilssen s patents and that the patents are invalid. The Company will continue to aggressively defend the claims against ULT that are subject to defense and indemnification and believes its defenses against the indemnifiable claims are strong; however, an unfavorable decision could have a material adverse effect on the Company s financial position and results of operations.

From time to time, the Company discovered the existence of hazardous substances at certain facilities associated with previously owned businesses and responded as necessary to bring the facilities into compliance with applicable laws and regulations. Upon sale of the businesses, the Company agreed, in some cases, to indemnify the buyers against environmental claims associated with the divested operations, subject to various conditions and limitations. Remediation activities, including those related to the Company s indemnification obligations, did not involve material expenditures during the second quarter of fiscal 2005 and are not expected to involve material expenditures during the third quarter of fiscal of 2005.

The Company has also been identified by the United States Environmental Protection Agency and certain state agencies as a potentially responsible party for cleanup costs associated with alleged past waste disposal practices at several previously owned facilities and offsite locations. Its remediation activities as a potentially responsible party were not material in the second quarter of fiscal 2005 and are not expected to be material during the third quarter of fiscal 2005. Although the materiality of future expenditures for environmental activities may be affected by the level and type of contamination, the extent and nature of cleanup activities required by governmental authorities, the nature of the Company s alleged connection to the contaminated sites, the number and financial resources of other potentially responsible parties, the availability of indemnification rights against third parties and the identification of additional contaminated sites, the Company s estimated share of liability, if any, for environmental remediation, including its indemnification obligations, is not expected to be material.

Prior to the Company s purchase of Century Electric, Inc. (Century Electric) in 1986, Century Electric acquired a business from Gould Inc. (Gould) in May 1983 that included a leasehold interest in a fractional horsepower electric motor manufacturing facility located in McMinnville, Tennessee. Gould agreed to indemnify Century Electric from and

against liabilities and expenses arising out of the handling and cleanup of certain waste materials, including but not limited to cleaning up any polychlorinated biphenyls (PCBs) at the McMinnville facility (the 1983 Indemnity). The presence of PCBs and other substances, including solvents, in the soil and in the groundwater underlying the facility and in certain offsite soil, sediment and biota samples has been identified. The McMinnville plant is listed as a Tennessee Inactive Hazardous Waste Substance Site and plant employees were notified of the presence of contaminants at the facility. Gould has completed an interim remedial excavation and disposal of onsite soil containing PCBs and a preliminary investigation and cleanup of certain onsite and offsite contamination. The Company believes the cost of further investigation and remediation (including ancillary costs) are covered by the 1983 Indemnity. The Company sold its leasehold interest in the McMinnville plant in August 1999 and while the Company believes that Gould will continue to perform substantially under its indemnity obligations, Gould s substantial failure to perform such obligations could have a material adverse effect on the Company s financial position, cash flows or results of operations.

In 1986, the Company acquired the stock of Universal Manufacturing Company (Universal) from a predecessor of Fruit of the Loom (FOL), and the predecessor agreed to indemnify the Company against certain environmental liabilities arising from pre-acquisition activities at a facility in Bridgeport, Connecticut. Environmental liabilities covered by the indemnification agreement include completion of additional cleanup activities, if any, at the Bridgeport facility (sold in connection with the sale of the transformer business in June 2001) and defense and indemnification against liability for potential response costs related to offsite disposal locations. FOL, the successor to Universal, filed a petition for Reorganization under Chapter 11 of the Bankruptcy Code in 1999 and the Company filed a proof of claim in the proceeding for obligations related to the environmental indemnification agreement. The Company believes that FOL had substantially completed the clean-up obligations required by the indemnification agreement prior to the bankruptcy filing. In November 2001, the Company and FOL entered into an agreement involving the allocation of certain potential tax deductions and Magnetek withdrew its claims in the bankruptcy proceeding. FOL s obligation to the state of Connecticut was not discharged in the reorganization proceeding. FOL s inability to satisfy its remaining obligations related to the Bridgeport facility and any offsite disposal locations, or the discovery of additional environmental contamination at the Bridgeport facility could have a material adverse effect on the Company s financial position or results of operations.

5. Comprehensive Income (Loss)

For the three- and six-month periods ended January 2, 2005 and December 28, 2003, comprehensive income (loss) consisted of the following:

	Three Months Ended		Six Months Ended	
	January 2, 2005	**December 28, 2003**	**January 2, 2005**	**December 28, 2003**
Net income (loss)	$ 562	$ (4,048)	$ 1,502	$ (7,687)
Currency translation adjustment	5,816	4,295	7,691	5,387
Comprehensive income (loss)	$ 6,378	$ 247	$ 9,193	$ (2,300)

6. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three- and six-month periods ended January 2, 2005 and December 28, 2003:

	Three Months Ended		Six Months Ended	
	January 2, 2005	December 28, 2003	January 2, 2005	December 28, 2003
Numerator:				
Net income (loss)	$ 562	(4,048)	$ 1,502	(7,687)
Denominator:				
Weighted average shares used to compute basic earnings (loss) per share	28,520	27,618	28,511	25,709
Add dilutive effect of stock options outstanding	758		761	
Weighted average shares used to compute diluted earnings (loss) per share	29,278	27,618	29,272	25,709
Net income (loss) per share:				
Basic	$ 0.02	$ (0.15)	$ 0.05	$ (0.30)
Diluted	$ 0.02	$ (0.15)	$ 0.05	$ (0.30)

The dilutive effect of stock options outstanding at December 28, 2003 was not included in the calculation of dilutive loss per share for the three-month and six-month periods ended December 28, 2003. The Company had a net loss for those periods, and as a result, inclusion of the dilutive effect of stock options would have had an anti-dilutive impact

7. Warranties

The Company offers warranties for certain products that it manufactures, with the warranty term generally ranging from one to two years. Warranty reserves are established for costs expected to be incurred after the sale and delivery of products under warranty, based mainly on known product failures and historical experience. Actual repair costs incurred for products under warranty are charged against the established reserve balance as incurred. Changes in the warranty reserve were as follows:

	Six Months Ended	
	January 2, 2005	December 28, 2003
Balance, beginning of fiscal year	$ 254	$ 503
Additions charged to earnings for product warranties	363	31
Use of reserve for warranty obligations	(288)	(51)
Decrease to pre-existing warranties		(75)
Balance, end of period	$ 329	$

		0.0	$0.5	$0.0
Interest cost	0.9	0.8	0.9	0.9
Expected return on plan assets	(1.3)	(0.9)	(1.3)	(0.9)
Amortization of net loss	0.1	0.0	—	—
Net periodic benefit cost (credit)	$ 0.2	$ (0.1)	$0.1	$0.0

(in millions)	Six Months Ended June 30, 2016 U.S.	Canada	Six Months Ended June 30, 2015 U.S.	Canada
Components of net periodic benefit cost (credit):				
Service cost	$0.9	$ 0.1	$0.9	$ 0.1
Interest cost	1.8	1.6	1.7	1.7
Expected return on plan assets	(2.6)	(1.8)	(2.7)	(1.8)
Amortization of net loss	0.1	0.1	—	—
Net periodic benefit cost (credit)	$0.2	$ 0.0	$(0.1)	$ 0.0

7. FAIR VALUE MEASUREMENTS

At June 30, 2016 and December 31, 2015, the carrying amounts of cash, receivables, payables and other components of other current assets and other current liabilities approximate their fair value due to the short maturity of these items. Borrowings under the ABL Facility are at variable market interest rates (Level 2 data), and accordingly, the carrying amount approximates fair value.

At the time of the Merger, the Company recorded a $59.4 million contingent liability associated with the Tax Receivable Agreement ("TRA") at fair value using a discounted cash flow model that reflected management's expectations about probability of payment. The fair value of the TRA is a Level 3 measurement which relied upon both Level 2 data (publicly observable data such as market interest rates) and Level 3 data (internal data such as the Company’s projected revenues, taxable income and assumptions about the utilization of Unisource’s net operating losses, attributable to taxable periods prior to the Merger, by the Company). The contingent liability is remeasured at fair value at each reporting period with the change in fair value recognized in other expense (income), net in the Company’s Condensed Consolidated Statements of Income. At June 30, 2016, the Company remeasured the contingent liability using a discount rate of 4.4%.

The following table provides a reconciliation of the beginning and ending balance of the contingent liability for the three and six months ended June 30, 2016:

(in millions)	Contingent Liability
Balance at December 31, 2015	$ 63.0
Change in fair value adjustment recorded in other expense (income), net	1.8
Balance at March 31, 2016	64.8
Change in fair value adjustment recorded in other expense (income), net	2.0
Balance at June 30, 2016	$ 66.8

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There have been no transfers between the fair value measurement levels for the three and six months ended June 30, 2016. The Company recognizes transfers between the fair value measurement levels at the end of the reporting period.

8. EARNINGS PER SHARE

Basic earnings per share ("EPS") for Veritiv common stock is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS is similarly calculated, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued, except where the inclusion of such common shares would have an antidilutive impact.

A summary of the numerators and denominators used in the basic and diluted EPS calculation is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions, except per share data)	2016	2015	2016	2015
Numerator:				
Net income	$7.9	$4.3	$11.2	$2.1
Denominator:				
Weighted average number of shares outstanding – basic and diluted	16.00	16.00	16.00	16.00
Earnings per share:				
Basic and diluted earnings per share	$0.49	$0.27	$0.70	$0.13
Antidilutive stock-based awards excluded from computation of diluted EPS	0.20	0.06	0.20	0.06
Performance stock-based awards excluded from computation of diluted EPS because performance conditions had not been met	0.34	0.24	0.34	0.24

9. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table provides the components of accumulated other comprehensive loss ("AOCL") at June 30, 2016 (amounts are shown net of their related income tax effect, if any):

(in millions)	Foreign currency translation adjustments	Retirement liabilities	Interest rate swap	AOCL
Balance at December 31, 2015	$ (27.1)	$ (7.4)	$ (0.5)	$ (35.0)
Unrealized net gains (losses) arising during the year	3.8	—	(0.3)	3.5
Amounts reclassified from AOCL	—	0.1	—	0.1
Net current period other comprehensive income (loss)	3.8	0.1	(0.3)	3.6
Balance at March 31, 2016	(23.3)	(7.3)	(0.8)	(31.4)
Unrealized net losses arising during the year	(1.6)	—	0.0	(1.6)
Amounts reclassified from AOCL	—	0.1	—	0.1
Net current period other comprehensive income (loss)	(1.6)	0.1	—	(1.5)
Balance at June 30, 2016	$ (24.9)	$ (7.2)	$ (0.8)	$ (32.9)

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The following table provides the components of AOCL at June 30, 2015 (amounts are shown net of their related income tax effect, if any):

(in millions)	Foreign currency translation adjustments	Retirement liabilities	AOCL
Balance at December 31, 2014	$ (14.7)	$ (7.4)	$(22.1)
Unrealized net losses arising during the year	(6.6)	—	(6.6)
Net current period other comprehensive loss	(6.6)	—	(6.6)
Balance at March 31, 2015	(21.3)	(7.4)	(28.7)
Unrealized net gains arising during the year	0.1	—	0.1
Net current period other comprehensive income	0.1	—	0.1
Balance at June 30, 2015	$ (21.2)	$ (7.4)	$(28.6)

10. COMMITMENTS AND CONTINGENCIES

Legal Proceedings

From time to time, the Company is involved in various lawsuits, claims, and regulatory and administrative proceedings arising out of its business relating to general commercial and contractual matters, governmental regulations, intellectual property rights, labor and employment matters, tax and other actions.

Although the ultimate outcome of any legal proceeding or investigation cannot be predicted with certainty, based on present information, including the Company's assessment of the merits of the particular claim, the Company does not expect that any asserted or unasserted legal claims or proceedings, individually or in the aggregate, will have a material adverse effect on its cash flow, results of operations or financial condition.

Escheat Audit

During 2013, Unisource was notified by the State of Delaware that it intended to examine the books and records of Unisource to determine compliance with Delaware escheat laws. Since that date, seven other states have joined with Delaware in the audit process, which is conducted by an outside firm on behalf of the states and covers the period from 1986 to present. The Company has been informed that similar audits have generally taken four years or more to complete. The Company has determined that the ultimate outcome of this audit cannot be reasonably estimated at this time. Any claims or liabilities resulting from these audits could have a material impact on the Company’s financial condition, results of operations and cash flows.

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11. SEGMENT INFORMATION

The following tables present net sales, Adjusted EBITDA (earnings before interest, income taxes, depreciation and amortization, restructuring charges (income), stock-based compensation expense, LIFO (income) expense, non-restructuring severance charges, integration expenses, fair value adjustments on the contingent liability associated with the TRA and certain other adjustments) and certain other measures for each of the reportable segments and total operations for the periods presented:

(in millions)	Print	Publishing	Packaging	Facility Solutions	Corporate & Other	Total
Three Months Ended June 30, 2016						
Net sales	$751.7	$ 252.5	$ 704.8	$ 322.0	$ 29.8	$2,060.8
Adjusted EBITDA	19.7	5.9	59.2	13.9	(48.6)	50.1
Depreciation and amortization	3.2	0.8	3.1	1.5	5.0	13.6
Restructuring charges (income)	(0.6)	—	0.1	0.2	—	(0.3)
Three Months Ended June 30, 2015						
Net sales	812.5	294.4	699.6	324.5	28.3	2,159.3
Adjusted EBITDA	18.4	7.4	51.8	10.6	(47.5)	40.7
Depreciation and amortization	3.4	1.0	4.0	2.1	4.8	15.3
Restructuring charges	0.8	—	0.5	0.4	0.5	2.2
Six Months Ended June 30, 2016						
Net sales	1,510.8	514.8	1,376.3	623.0	55.7	4,080.6
Adjusted EBITDA	35.7	9.9	105.9	21.4	(87.9)	85.0
Depreciation and amortization	6.4	1.7	6.1	3.0	9.9	27.1
Restructuring charges	0.3	—	0.4	0.5	0.2	1.4
Six Months Ended June 30, 2015						
Net sales	1,633.2	603.9	1,374.8	633.6	51.7	4,297.2
Adjusted EBITDA	33.9	13.8	97.5	17.5	(93.6)	69.1
Depreciation and amortization	6.8	1.6	7.8	3.9	8.7	28.8
Restructuring charges	1.6	—	1.4	1.3	1.3	5.6

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The table below presents a reconciliation of income before income taxes as reflected in the Condensed Consolidated Statements of Income to total Adjusted EBITDA:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2016	2015	2016	2015
Income before income taxes	$14.1	$10.8	$21.6	$8.7
Interest expense, net	6.4	6.4	12.9	12.8
Depreciation and amortization	13.6	15.3	27.1	28.8
Restructuring charges (income)	(0.3)	2.2	1.4	5.6
Stock-based compensation	3.1	0.9	5.1	1.9
LIFO (income) expense	2.2	(4.8)	(3.1)	(10.0)
Non-restructuring severance charges	1.4	1.0	2.2	1.4
Integration expenses	6.1	10.3	12.3	20.3
Fair value adjustments on TRA contingent liability	2.0	(1.7)	3.8	(0.4)
Other	1.5	0.3	1.7	—
Adjusted EBITDA	$50.1	$40.7	$85.0	$69.1

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements contained in this report regarding the Company’s future operating results, performance, business plans, prospects, guidance and any other statements not constituting historical fact are "forward-looking statements" subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Where possible, the words "believe," "expect," "anticipate," "intend," "should," "will," "would," "planned," "estimated," "potential," "goal," "outlook," "may," "predicts," "could," or the negative of such terms, or other comparable expressions, as they relate to the Company or its business, have been used to identify such forward-looking statements. All forward-looking statements reflect only the Company’s current beliefs and assumptions with respect to future operating results, performance, business plans, prospects, guidance and other matters, and are based on information currently available to the Company. Accordingly, the statements are subject to significant risks, uncertainties and contingencies, which could cause the Company’s actual operating results, performance, business plans or prospects to differ materially from those expressed in, or implied by, these statements.

Factors that could cause actual results to differ materially from current expectations include risks and other factors described under "Risk Factors" in our Annual Report on Form 10-K and elsewhere in the Company’s publicly available reports filed with the Securities and Exchange Commission ("SEC"), which contain a discussion of various factors that may affect the Company’s business or financial results. Such risks and other factors, which in some instances are beyond the Company’s control, include: the industry-wide decline in demand for paper and related products; increased competition from existing and non-traditional sources; adverse developments in general business and economic conditions as well as conditions in the global capital and credit markets; foreign currency fluctuations; our ability to collect trade receivables from customers to whom we extend credit; our ability to attract, train and retain highly qualified employees; the effects of work stoppages, union negotiations and union disputes; loss of significant customers; changes in business conditions in our international operations; procurement and other risks in obtaining packaging, paper and facility products from suppliers for resale to our customers; changes in prices for raw materials; fuel cost increases; inclement weather, anti-terrorism measures and other disruptions to the transportation network; our dependence on a variety of IT and telecommunications systems and the Internet; reliance on third-party vendors for various services; cyber-security risks; costs to comply with laws, rules and regulations, including environmental, health and safety laws, and to satisfy any liability or obligation imposed under such laws; regulatory changes and judicial rulings impacting our business; adverse results from litigation, governmental investigations or audits, or tax-related proceedings or audits; our inability to renew existing leases on acceptable terms, negotiate rent decreases or concessions and identify affordable real estate; our ability to adequately protect material intellectual property and other proprietary rights, or to defend successfully against intellectual property infringement claims by third parties; our pension and health care costs and participation in multi-employer plans; increasing interest rates; our ability to generate sufficient cash to service debt; our ability to comply with the covenants contained in our debt agreements; our ability to refinance or restructure our debt on reasonable terms and conditions as might be necessary from time to time; changes in accounting standards and methodologies; our ability to realize the anticipated synergies, cost savings and growth opportunities from the merger transaction, our ability to integrate the xpedx business with the Unisource business, and the possibility of incurring expenditures in excess of those currently budgeted in connection with the integration; and other events of which we are presently unaware or currently deem immaterial that may result in unexpected adverse operating results.

For a more detailed discussion of these factors, see the information under the heading "Risk Factors" in our Annual Report on Form 10-K and in other filings made with the SEC. Forward-looking statements are made only as of the date hereof, and the Company undertakes no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In addition, historical information should not be considered as an indicator of future performance.

The following discussion of the Company's results of operations for the three and six months ended June 30, 2016 should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto, included elsewhere in this report.

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Executive Overview

Business Overview

Veritiv Corporation ("Veritiv" or the "Company") is a leading North American business-to-business distributor of print, publishing, packaging and facility solutions. Additionally, Veritiv provides logistics and supply chain management solutions to its customers. Veritiv was established in 2014, following the merger of International Paper Company's xpedx distribution solutions business and UWW Holdings, Inc., the parent company of Unisource Worldwide, Inc. The Company operates from approximately 180 distribution centers primarily throughout the U.S., Canada and Mexico.

Veritiv's business is organized under four reportable segments: Print, Publishing, Packaging and Facility Solutions. This segment structure is consistent with the way the Chief Operating Decision Maker, who is Veritiv's Chief Executive Officer, makes operating decisions and manages the growth and profitability of the Company's business. The Company also has a Corporate & Other category, which includes certain assets and costs not primarily attributable to any of the reportable segments, as well as the Veritiv logistics solutions business, which provides transportation and warehousing solutions. The following summary describes the products and services offered in each of the reportable segments:

- Print – The Print segment sells and distributes commercial printing, writing, copying, digital, wide format and specialty paper products, graphics consumables and graphics equipment primarily in the U.S., Canada and Mexico. This segment also includes customized paper conversion services of commercial printing paper for distribution to document centers and form printers. Veritiv's broad geographic platform of operations coupled with the breadth of paper and graphics products, including exclusive private brand offerings, provides a foundation to service national, regional and local customers across North America.

- Publishing – The Publishing segment sells and distributes coated and uncoated commercial printing papers to publishers, retailers, converters, printers and specialty businesses for use in magazines, catalogs, books, directories, gaming, couponing, retail inserts and direct mail. This segment also provides print management, procurement and supply chain management solutions to simplify paper and print procurement processes for Veritiv's customers.

- Packaging – The Packaging segment provides standard as well as custom and comprehensive packaging solutions for customers based in North America and in key global markets. The business is strategically focused on higher growth industries including light industrial/general manufacturing, food production, fulfillment and internet retail, as well as niche verticals based on geographical and functional expertise. Veritiv's packaging professionals create customer value through supply chain solutions, structural and graphic packaging design and engineering, automation, workflow and equipment services, contract packaging, and kitting and fulfillment.

- Facility Solutions – The Facility Solutions segment sources and sells cleaning, break-room and other supplies such as towels, tissues, wipers and dispensers, can liners, commercial cleaning chemicals, soaps and sanitizers, sanitary maintenance supplies and equipment, safety and hazard supplies, and shampoos and amenities primarily in the U.S., Canada and Mexico. Through this segment, Veritiv manages a world class network of leading suppliers in most facilities solutions categories. Additionally, the Company offers total cost of ownership solutions with re-merchandising, budgeting and compliance reporting, inventory management, and a sales-force trained to bring leading vertical expertise to the major North American geographies.

Seasonality

The Company's operating results are subject to seasonal influences. Historically, the highest consolidated net sales, net income and consequently Adjusted EBITDA, as defined below, occur during the third quarter while the lowest consolidated net sales, net income and consequently Adjusted EBITDA occur during the first quarter. Within the Print and Publishing segments, seasonality is driven by increased magazine advertising page counts, retail inserts, catalogs and direct mail primarily due to back-to-school, political election and holiday-related advertising and promotions in the second half of the year. The Packaging segment net sales tend to increase each quarter throughout the year, and net sales for the first quarter are typically less than net sales for the fourth quarter of the preceding year. Production schedules for non-durable goods that buildup to the holidays and peak in the fourth quarter drive this seasonal net sales pattern. Net sales for the Facility Solutions segment tend to be highest during the second quarter due to increased summer demand in the away-from-home resort, cruise and hospitality markets and second highest during the third quarter due to back-to-school demand.

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Results of Operations, Including Business Segments

The following discussion compares the consolidated operating results of Veritiv for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Increase (Decrease)		Six Months Ended June 30,		Increase (Decrease)	
(in millions)	2016	2015	$	%	2016	2015	$	%
Net sales	$2,060.8	$2,159.3	$(98.5)	(5)%	$4,080.6	$4,297.2	$(216.6)	(5)%
Cost of products sold (exclusive of depreciation and amortization shown separately below)	1,687.9	1,768.3	(80.4)	(5)%	3,342.4	3,530.2	(187.8)	(5)%
Distribution expenses	121.7	129.5	(7.8)	(6)%	249.2	260.2	(11.0)	(4)%
Selling and administrative expenses	207.7	218.0	(10.3)	(5)%	408.6	428.6	(20.0)	(5)%
Depreciation and amortization	13.6	15.3	(1.7)	(11)%	27.1	28.8	(1.7)	(6)%
Integration expenses	6.1	10.3	(4.2)	(41)%	12.3	20.3	(8.0)	(39)%
Restructuring charges (income)	(0.3)	2.2	(2.5)	(114)%	1.4	5.6	(4.2)	(75)%
Operating income	24.1	15.7	8.4	54%	39.6	23.5	16.1	69%
Interest expense, net	6.4	6.4	—	—%	12.9	12.8	0.1	1%
Other expense (income), net	3.6	(1.5)	5.1	*	5.1	2.0	3.1	155%
Income before income taxes	14.1	10.8	3.3	31%	21.6	8.7	12.9	*
Income tax expense	6.2	6.5	(0.3)	(5)%	10.4	6.6	3.8	58%
Net income	$7.9	$4.3	$3.6	84%	$11.2	$2.1	$9.1	*

* - not meaningful

Net Sales

For the three and six months ended June 30, 2016, net sales declined primarily due to declines in the Print, Publishing and Facility Solutions segments. See the “Segment Results” section for additional discussion.

Cost of Products Sold

For the three and six months ended June 30, 2016, the decrease in cost of products sold was primarily due to declines in sales as previously discussed. See the “Segment Results” section for additional discussion.

Distribution Expenses

For the three months ended June 30, 2016, distribution expenses declined primarily due to (i) a $3.9 million decrease in labor costs, primarily attributable to a decrease in temporary labor due to lower sales volume, (ii) a $3.4 million decrease in transportation expenses, primarily due to lower diesel prices which resulted in reductions in direct fuel spend and third-party freight and (iii) a $1.2 million decrease in facilities expenses due to warehouse consolidations. For the six months ended June 30, 2016, distribution expenses declined primarily due to decreases of (i) $5.8 million in labor costs, (ii) $3.6 million in facilities expenses and (iii) $3.3 million in transportation expenses.

Selling and Administrative Expenses

For the three months ended June 30, 2016, selling and administrative expenses declined primarily due to (i) a $2.8 million decrease in health and welfare expenses due to lower medical expenses, (ii) a $2.3 million decrease in bad debt expense due to favorable collection experience, (iii) a $1.7 million decrease in travel and entertainment expenses, (iv) a $1.1 million reduction in incentive compensation and (v) a $1.1 million decrease in commissions expense due to lower sales volume.

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For the six months ended June 30, 2016, selling and administrative expenses declined primarily due to decreases of (i) $8.4 million in bad debt expense, (ii) $4.0 million in incentive compensation expense, (iii) $3.2 million in health and welfare expense and (iv) $1.9 million in commissions. In addition, expenses were further reduced as the Company recognized a $3.2 million rebate from a pharmaceutical benefits management provider covering the years 2014 and 2015. The rebate had been deferred while a finalized contract was negotiated with the provider.

Depreciation and Amortization Expenses

For the three and six months ended June 30, 2016, depreciation and amortization expense declined when compared to the three and six months ended June 30, 2015, primarily due to $1.1 million and $2.2 million, respectively, of amortization for intangible assets acquired in the Merger that were fully amortized in the prior year.

Integration Expenses
See Note 2, Integration and Restructuring Charges, to the Condensed Consolidated Financial Statements for additional information related to the Company's integration efforts.
Restructuring Charges (Income)
For the three months ended June 30, 2016, restructuring expenses declined primarily due to (i) a $2.7 million gain on the sale of a closed facility and (ii) a $1.0 million decrease in relocation expenses.

For the six months ended June 30, 2016, restructuring expenses declined primarily due to (i) a $2.7 million gain on the sale of a closed facility and (ii) a $2.2 million decrease in relocation expense.

See Note 2, Integration and Restructuring Charges, to the Condensed Consolidated Financial Statements for additional information related to the Company's restructuring efforts. The Company may continue to record restructuring charges in the future as restructuring activities progress.

Interest Expense, Net
For the three months ended June 30, 2016, interest expense was unchanged from the prior year.

For the six months ended June 30, 2016, interest expense rose due to a $0.3 million increase in expense related to the ABL Facility. The increase was due to a $1.5 million increase from higher LIBOR-based borrowing rates that was offset by a $1.2 million decline from a lower average daily loan balance.

Effective Tax Rate
Veritiv's effective tax rate was 44.0% and 60.2% for the three months ended June 30, 2016 and 2015, respectively. Veritiv's effective tax rate was 48.1% and 75.9% for the six months ended June 30, 2016 and 2015, respectively. The difference between the Company’s effective tax rate and the U.S. statutory tax rate of 35.0% is principally related to the non-recognition of tax benefits on certain losses, non-deductible expenses, and state income taxes (net of federal benefit). The historic volatility of the Company's effective tax rate has been primarily due to both the low level of pre-tax income as well as variations in the Company's income (loss) by jurisdiction. Over time and with higher pre-tax income, the Company estimates its effective tax rate will trend toward approximately 40%. However, the effective tax rate may vary significantly due to potential fluctuations in the amount and source, including both foreign and domestic, of pre-tax income and changes in amounts of non-deductible expenses and other items that could impact the effective tax rate.
Segment Results
Adjusted EBITDA (earnings before interest, income taxes, depreciation and amortization, restructuring charges (income), stock-based compensation expense, LIFO (income) expense, non-restructuring severance charges, integration expenses, fair value adjustments on the contingent liability associated with the Tax Receivable Agreement

("TRA") and certain other adjustments) is the primary financial performance measure Veritiv uses to manage its segments, monitor its results of operations, measure its compliance with the covenants under the ABL Facility (as defined in the Notes to the Condensed Consolidated Financial Statements) and incentivize its management. This common metric is intended to align shareholders, debt holders and management.

Veritiv uses Adjusted EBITDA because Veritiv believes investors commonly use Adjusted EBITDA as a key financial metric for valuing companies. In addition, the credit agreement governing the ABL Facility permits the Company to exclude these and other charges in calculating Consolidated EBITDA, as defined in the ABL Facility.

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Adjusted EBITDA has limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of Veritiv's results as reported under U.S. generally accepted accounting principles ("U.S. GAAP"). For example, Adjusted EBITDA:

- does not reflect the Company's income tax expenses or the cash requirements to pay its taxes; and
- although depreciation and amortization charges are non-cash charges, it does not reflect that the assets being depreciated and amortized will often have to be replaced in the future, and the foregoing metrics do not reflect any cash requirements for such replacements.

Other companies in the industry may calculate Adjusted EBITDA differently than Veritiv does, limiting its usefulness as a comparative measure. Veritiv compensates for these limitations by relying both on the Company's U.S. GAAP results and by using Adjusted EBITDA for supplemental purposes. Additionally, Adjusted EBITDA is not an alternative measure of financial performance under U.S. GAAP and therefore should be considered in conjunction with net income and other performance measures such as operating income and not as an alternative to such U.S. GAAP measures.

Due to the shared nature of the distribution network, distribution expenses are not a specific charge to each segment, but are instead allocated to each segment based primarily on operational metrics that correlate with changes in volume. Accordingly, distribution expenses allocated to each segment are highly interdependent on the results of other segments. Lower volume in any segment that is not offset by a reduction in distribution expenses can result in the other segments absorbing a larger share of distribution expenses. Conversely, higher volume in any segment can result in the other segments absorbing a smaller share of distribution expenses. The impact of this at the segment level is that the changes in distribution expense trends may not correspond with volume trends within a particular segment.

The Company sells thousands of products. In the Print, Packaging and Facility Solutions segments, Veritiv is unable to compute the impact of changes in sales volume based on changes in sales of each individual product. Rather, the Company assumes that the margin stays constant and estimates the volume impact based on changes in cost of products sold as a proxy for the change in sales volume. After any other significant sales variances are identified, the remaining sales variance is attributed to price/mix.

The Company approximates foreign currency effects by applying the foreign currency exchange rate for the prior period to the local currency results for the current period.

The Company believes that the decline in demand for paper and related products is due to the widespread use of electronic media and permanent product substitution, more e-commerce, less print advertising, fewer catalogs and a reduced volume of direct mail, among other factors. This trend is expected to continue and will place continued pressure on the Company's revenues and profit margins and make it more difficult to maintain or grow Adjusted EBITDA within the Print and Publishing segments.

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Included in the following table are net sales and Adjusted EBITDA for each of the reportable segments reconciled to the combined totals:

(in millions)	Print	Publishing	Packaging	Facility Solutions	Corporate & Other	Total
Three Months Ended June 30, 2016						
Net sales	$751.7	$252.5	$704.8	$322.0	$29.8	$2,060.8
Adjusted EBITDA	$19.7	$5.9	$59.2	$13.9	$(48.6)	$50.1
Adjusted EBITDA as a % of net sales	2.6%	2.3%	8.4%	4.3%	*	2.4%
Three Months Ended June 30, 2015						
Net sales	$812.5	$294.4	$699.6	$324.5	$28.3	$2,159.3
Adjusted EBITDA	$18.4	$7.4	$51.8	$10.6	$(47.5)	$40.7
Adjusted EBITDA as a % of net sales	2.3%	2.5%	7.4%	3.3%	*	1.9%
Six Months Ended June 30, 2016						
Net sales	$1,510.8	$514.8	$1,376.3	$623.0	$55.7	$4,080.6
Adjusted EBITDA	$35.7	$9.9	$105.9	$21.4	$(87.9)	$85.0
Adjusted EBITDA as a % of net sales	2.4%	1.9%	7.7%	3.4%	*	2.1%
Six Months Ended June 30, 2015						
Net sales	$1,633.2	$603.9	$1,374.8	$633.6	$51.7	$4,297.2
Adjusted EBITDA	$33.9	$13.8	$97.5	$17.5	$(93.6)	$69.1
Adjusted EBITDA as a % of net sales	2.1%	2.3%	7.1%	2.8%	*	1.6%

* - not meaningful

The table below provides a reconciliation of Veritiv's net income determined in accordance with U.S. GAAP to Adjusted EBITDA for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2016	2015	2016	2015
Net income	$7.9	$4.3	$11.2	$2.1
Interest expense, net	6.4	6.4	12.9	12.8
Income tax expense	6.2	6.5	10.4	6.6
Depreciation and amortization	13.6	15.3	27.1	28.8
EBITDA	34.1	32.5	61.6	50.3
Restructuring charges (income)	(0.3)	2.2	1.4	5.6
Stock-based compensation	3.1	0.9	5.1	1.9
LIFO (income) expense	2.2	(4.8)	(3.1)	(10.0)
Non-restructuring severance charges	1.4	1.0	2.2	1.4
Integration expenses	6.1	10.3	12.3	20.3
Fair value adjustments on TRA contingent liability	2.0	(1.7)	3.8	(0.4)
Other	1.5	0.3	1.7	—
Adjusted EBITDA	$50.1	$40.7	$85.0	$69.1
Net sales	$2,060.8	$2,159.3	$4,080.6	$4,297.2
Adjusted EBITDA as a % of net sales	2.4%	1.9%	2.1%	1.6%

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Print

The table below presents selected data with respect to the Print segment:

(in millions)	Three Months Ended June 30, 2016	2015	2016 vs. 2015 Increase (Decrease) %	Six Months Ended June 30, 2016	2015	2016 vs. 2015 Increase (Decrease) %
Net sales	$751.7	$812.5	(7.5)%	$1,510.8	$1,633.2	(7.5)%
Adjusted EBITDA	$19.7	$18.4	7.1 %	$35.7	$33.9	5.3 %
Adjusted EBITDA as a % of net sales	2.6 %	2.3 %		2.4 %	2.1 %	

The table below presents the components of the net sales change compared to the prior year:

(in millions)	Increase (Decrease) Three Months Ended June 30, 2016 vs. 2015	Six Months Ended June 30, 2016 vs. 2015
Volume	$(59.7)	$(119.2)
Foreign currency	(2.9)	(8.5)
Price/Mix	1.8	5.3
Total change	$(60.8)	$(122.4)

Comparison of the Three Months Ended June 30, 2016 and June 30, 2015

The net sales decrease was primarily attributable to the continued erosion in sales volume from the secular decline in the paper industry.

The Adjusted EBITDA increase was primarily due to (i) a $4.7 million decrease in labor costs due to a $1.9 million decline in supply chain wage and temporary worker expense reductions because of lower sales volume and a $1.5 million decrease in incentive compensation, (ii) a $1.4 million decrease in bad debt expense due to favorable collections experience, (iii) a $1.0 million increase attributed to cost of products sold decreasing faster than net sales primarily due to improved sourcing, (iv) a $0.7 million decrease in commission expense due to the reduction in sales volume, (v) a $0.6 million decrease in transportation expenses primarily due to lower diesel prices, (vi) a $0.5 million decrease in travel and entertainment expenses and (vii) a $0.3 million decrease in equipment rental expense. These improvements were partially offset by an $8.6 million reduction from the decline in sales volume.

Comparison of the Six Months Ended June 30, 2016 and June 30, 2015

The net sales decrease was primarily attributable to the continued erosion in sales volume from the secular decline in the paper industry as well as strategic customer choices made in the prior year.

The Adjusted EBITDA increase was primarily due to (i) a $7.4 million decrease in labor costs that was primarily due to a $3.3 million decline in supply chain wage and temporary worker expense reductions and a $2.1 million reduction in incentive compensation expenses, (ii) a $4.5 million decrease in bad debt expense, (iii) a $3.1 million increase attributed to cost of products sold decreasing faster than net sales primarily due to improved sourcing, (iv) a $1.4 million decrease in commission expense, (v) a $1.3 million decrease in transportation expenses due to a decrease in fuel spend and (vi) a $0.8 million decrease in equipment rental expense. These improvements were partially offset by a $17.1 million reduction from the decline in sales volume.

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Publishing

The table below presents selected data with respect to the Publishing segment:

(in millions)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	2016 vs. 2015 Increase (Decrease) %	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015	2016 vs. 2015 Increase (Decrease) %
Net sales	$252.5	$294.4	(14.2)%	$514.8	$603.9	(14.8)%
Adjusted EBITDA	$5.9	$7.4	(20.3)%	$9.9	$13.8	(28.3)%
Adjusted EBITDA as a % of net sales	2.3 %	2.5 %		1.9 %	2.3 %	

The table below presents the components of the net sales change compared to the prior year:

(in millions)	Increase (Decrease) Three Months Ended June 30, 2016 vs. 2015	Six Months Ended June 30, 2016 vs. 2015
Volume	$(32.6)	$(77.5)
Foreign currency	—	(0.1)
Price/Mix	(9.3)	(11.5)
Total change	$(41.9)	$(89.1)

Comparison of the Three Months Ended June 30, 2016 and June 30, 2015

Approximately $21.3 million of the decrease in net sales was attributable to the loss of two customers. The remaining decrease was primarily attributable to the continued erosion in sales volume from the secular decline in the paper industry and unfavorable changes in price/mix.

The Adjusted EBITDA decrease was primarily due to a $2.0 million decrease due to lower sales volume, which was partially offset by a $0.7 million decrease in commission expense attributable to lower sales volumes.

Comparison of the Six Months Ended June 30, 2016 and June 30, 2015

Approximately $50.4 million of the decrease in net sales was attributable to the loss of five customers. The remaining decrease was primarily attributable to the continued erosion in sales volume from the secular decline in the paper industry and unfavorable changes in price/mix.

The Adjusted EBITDA decrease was primarily due to (i) a $4.8 million decrease due to lower sales volume and (ii) a $2.3 million decrease attributed to cost of products sold decreasing less than net sales. These declines were partially offset by (i) a $1.7 million decrease in commission expense and (ii) a $1.4 million decrease in bad debt expense due to favorable collections experience.

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Packaging

The table below presents selected data with respect to the Packaging segment:

(in millions)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	2016 vs. 2015 Increase (Decrease) %	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015	2016 vs. 2015 Increase (Decrease) %
Net sales	$704.8	$699.6	0.7 %	$1,376.3	$1,374.8	0.1 %
Adjusted EBITDA	$59.2	$51.8	14.3 %	$105.9	$97.5	8.6 %
Adjusted EBITDA as a % of net sales	8.4 %	7.4 %		7.7 %	7.1 %	

The table below presents the components of the net sales change compared to the prior year:

(in millions)	Increase (Decrease) Three Months Ended June 30, 2016 vs. 2015	Increase (Decrease) Six Months Ended June 30, 2016 vs. 2015
Volume	$11.8	$ 12.5
Foreign currency	(5.8)	(14.1)
Price/Mix	(0.8)	3.1
Total change	$5.2	$ 1.5

Comparison of the Three Months Ended June 30, 2016 and June 30, 2015

The net sales increase was primarily attributable to growth in operations in Canada and Mexico.

The Adjusted EBITDA increase was primarily due to (i) a $3.1 million improvement attributed to cost of products sold increasing at a slower rate than net sales due to improved sourcing, (ii) a $2.8 million improvement from increased sales volume and (iii) a $1.3 million decrease in labor costs primarily due to a decrease in incentive compensation costs.

Comparison of the Six Months Ended June 30, 2016 and June 30, 2015

The net sales increase was primarily attributable to growth in operations in Canada and Mexico.

The Adjusted EBITDA increase was primarily due to (i) a $7.5 million improvement attributed to cost of products sold increasing at a slower rate than net sales due to improved sourcing and (ii) a $2.9 improvement from increased sales volume.

Facility Solutions

The table below presents selected data with respect to the Facility Solutions segment:

(in millions)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	2016 vs. 2015 Increase (Decrease) %	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015	2016 vs. 2015 Increase (Decrease) %
Net sales	$322.0	$324.5	(0.8)%	$623.0	$633.6	(1.7)%
Adjusted EBITDA	$13.9	$10.6	31.1 %	$21.4	$17.5	22.3 %
Adjusted EBITDA as a % of net sales	4.3 %	3.3 %		3.4 %	2.8 %	

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The table below presents the components of the net sales change compared to the prior year:

	Increase (Decrease)	
(in millions)	Three Months Ended June 30, 2016 vs. 2015	Six Months Ended June 30, 2016 vs. 2015
Volume	$5.9	$2.7
Foreign currency	(3.2)	(9.1)
Price/Mix	(5.2)	(4.2)
Total change	$(2.5)	$(10.6)

Comparison of the Three Months Ended June 30, 2016 and June 30, 2015

The net sales decrease was primarily attributable to the impact of changes in foreign currency exchange rates, partially offset by growth in the segment's Canadian operations.

The Adjusted EBITDA improvement was primarily due to (i) $1.7 million decrease in labor costs primarily due to a $0.8 million decrease in incentive compensation and a $0.6 million decrease in supply chain temporary labor expenses, (ii) a $1.3 million increase in sales volume, (iii) a $0.7 million decrease in transportation expenses due to lower diesel prices which resulted in reductions in direct fuel spend and third party freight and (iv) a $0.6 million decrease in bad debt expense due to favorable collections experience. These improvements were partially offset by a $1.5 million decrease from cost of products sold declining at a slower rate than net sales.

Comparison of the Six Months Ended June 30, 2016 and June 30, 2015

The net sales decrease was primarily attributable to the impact of changes in foreign currency exchange rates, partially offset by growth in the segment's Canadian operations.

The Adjusted EBITDA improvement was primarily due to (i) a $1.6 million decrease in labor costs due to a $0.8 million decrease in incentive compensation and a $0.6 million decrease in supply chain temporary labor expenses, (ii) a $1.1 million decrease in bad debt expense due to favorable collections experience and (iii) a $0.6 million decrease in commissions due to lower sales volume.

Corporate & Other

Comparison of the Three Months Ended June 30, 2016 and June 30, 2015

Revenue increased $1.5 million, or 5.3%, due to continued growth in freight brokerage services.

The Adjusted EBITDA decline was primarily due to a $2.0 million increase in labor costs due to higher incentive compensation expense and continued investment in personnel to grow the freight brokerage business.

Comparison of the Six Months Ended June 30, 2016 and June 30, 2015

Revenue increased $4.0 million, or 7.7%, due to continued growth in freight brokerage services.

The Adjusted EBITDA improvement was primarily due to (i) a $2.8 million decrease in labor costs resulting from the previously mentioned pharmaceutical benefits management provider rebate and (ii) a $2.1 million decrease in foreign exchange losses.

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Liquidity and Capital Resources

The cash requirements of the Company are provided by cash flows from operations and borrowings under the ABL Facility. The following table sets forth a summary of cash flows:

	Six Months Ended June 30,	
(in millions)	2016	2015
Net cash provided by (used for):		
Operating activities	$122.8	$124.4
Investing activities	(12.9)	(22.4)
Financing activities	(118.4)	(80.8)

Operating Activities

Net cash provided by operating activities decreased by $1.6 million compared to the prior year. The decrease was due to a $6.3 million decrease in operating assets and liabilities which more than offset the increase in net income adjusted for non-cash items. The changes in operating activities are impacted by the timing of working capital payments.

Investing Activities

Net cash used for investing activities decreased by $9.5 million compared to the prior year due to lower capital expenditures and increased proceeds from asset sales.

Financing Activities

Net cash used for financing activities increased by $37.6 million compared to the prior year primarily due to higher net repayments on the ABL Facility. The decline in net cash used for investing activities allowed Veritiv to use more cash to repay the ABL Facility.

Funding and Liquidity Strategy

Availability under the ABL Facility is determined based upon a monthly borrowing base calculation which includes eligible customer receivables and inventory, less outstanding borrowings, letters of credit and certain designated reserves. As of June 30, 2016, the available additional borrowing capacity under the ABL Facility was approximately $451.3 million.

Veritiv's ability to fund its capital needs will depend on its ongoing ability to generate cash from operations, borrowings under the ABL Facility and funds received from capital market offerings. If Veritiv's cash flows from operating activities are lower than expected, the Company may need to borrow under the ABL Facility, incur additional debt or issue additional equity. Although management believes that the arrangements currently in place will permit Veritiv to finance its operations on acceptable terms and conditions, the Company’s access to, and the availability of, financing on acceptable terms and conditions in the future will be impacted by many factors, including (i) the liquidity of the overall capital markets and (ii) the current state of the economy.

The ABL Facility has a springing minimum fixed charge coverage ratio of at least 1.00 to 1.00 on a trailing four-quarter basis, which will be tested only when specified availability is less than the limits outlined under the ABL Facility. At June 30, 2016, the above test was not applicable and is not expected to be applicable in 2016.

Veritiv's management expects that the Company's primary future cash needs will be for working capital, capital expenditures, contractual commitments and strategic investments. Additionally, management expects that cash provided by operating activities and available capacity under the ABL Facility will provide sufficient funds to operate the business and meet other liquidity needs.

Off-Balance Sheet Arrangements

Veritiv does not have any off-balance sheet arrangements as of June 30, 2016, other than operating lease obligations and the letters of credit under the ABL Facility. The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on its financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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Contractual Obligations

There have been no material changes to the Company's contractual obligations from those disclosed in Veritiv's Annual Report on Form 10-K for the year ended December 31, 2015.

Critical Accounting Policies and Estimates

There have been no material changes to the Company's critical accounting policies and estimates from those disclosed in Veritiv's Annual Report on Form 10-K for the year ended December 31, 2015.

Recently Issued Accounting Standards

See Note 1, Business and Summary of Significant Accounting Policies, to the Condensed Consolidated Financial Statements for information regarding recently issued accounting standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from the information provided in Item 7A "Quantitative and Qualitative Disclosures about Market Risk" of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company’s management has carried out an evaluation, with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended. Based upon such evaluation, management has concluded that the Company’s disclosure controls and procedures were effective as of June 30, 2016.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended June 30, 2016 that has materially affected, or is likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 10, Commitments and Contingencies, to the Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 6. EXHIBITS

See Exhibit Index.

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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.

VERITIV CORPORATION
(Registrant)

Date: August 9, 2016 By: /s/ Stephen J. Smith
Name: Stephen J. Smith
Title: Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: August 9, 2016 By: /s/ W. Forrest Bell
Name: W. Forrest Bell
Title: Chief Accounting Officer
(Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit No.	Description
3.1	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Veritiv Corporation dated May 12, 2016 incorporated by reference from Exhibit 3.1 to the Registrant’s Form 8-K filed on May 13, 2016.
10.1*	Form of Director Deferred Share Unit Award Agreement (Stock-Settled Award).
31.1*	Rule 13a-14(a) Certification of the Chief Executive Officer.
31.2*	Rule 13a-14(a) Certification of the Chief Financial Officer.
32.1*	Section 1350 Certification of the Chief Executive Officer.
32.2*	Section 1350 Certification of the Chief Financial Officer.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

* Filed herewith