PACKAGING CORP OF AMERICA
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2006

Or

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

For the transition period from to

Commission file number 1-15399

PACKAGING CORPORATION OF AMERICA

(Exact Name of Registrant as Specified in its Charter)

Delaware (State or other Jurisdiction of Incorporation or Organization)	**36-4277050** (IRS Employer Identification No.)
1900 West Field Court **Lake Forest, Illinois** (Address of Principal Executive Offices)	**60045** (Zip Code)

(847) 482-3000

(Registrant s telephone number, including area code)

Not Applicable

(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 x 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 x Accelerated filer o 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 x.

As of November 7, 2006, the Registrant had outstanding 104,511,956 shares of common stock, par value $0.01 per share.

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

Packaging Corporation of America
Condensed Consolidated Balance Sheets

	September 30, 2006 (unaudited)	December 31, 2005
(In thousands, except share and per share amounts)		
Assets		
Current assets:		
Cash and cash equivalents	$ 118,231	$ 112,669
Accounts and notes receivable, net of allowance for doubtful accounts and customer deductions of $6,467 and $5,404 as of September 30, 2006 and December 31, 2005, respectively	277,659	213,181
Inventories	200,637	191,828
Prepaid expenses and other current assets	10,005	6,836
Deferred income taxes	24,615	28,975
Total current assets	631,147	553,489
Property, plant and equipment, net	1,259,225	1,320,511
Goodwill	37,111	34,187
Other intangible assets, net of accumulated amortization of $4,614 and $3,837 as of September 30, 2006 and December 31, 2005, respectively	28,930	29,526
Other long-term assets	35,979	35,585
Total assets	$ 1,992,392	$ 1,973,298
Liabilities and shareholders equity		
Current liabilities:		
Short-term debt and current maturities of long-term debt	$ 119,146	$ 118,030
Accounts payable	126,883	124,851
Dividends payable	26,107	27,045
Accrued interest	5,469	12,774
Accrued federal and state income taxes	24,871	2,569
Accrued liabilities	93,633	86,825
Total current liabilities	396,109	372,094
Long-term liabilities:		
Long-term debt	567,686	577,173
Deferred income taxes	278,935	292,710
Other liabilities	50,904	49,901
Total long-term liabilities	897,525	919,784
Shareholders equity:		
Common stock, par value $.01 per share, 300,000,000 shares authorized, 104,461,876 shares and 103,686,284 shares issued as of September 30, 2006 and December 31, 2005, respectively	1,045	1,037
Additional paid in capital	425,291	418,621
Unearned compensation on restricted stock		(6,005)
Retained earnings	255,390	248,404
Accumulated other comprehensive income:		
Unrealized gain on derivatives, net	17,036	19,367
Cumulative foreign currency translation adjustment	(4)	(4)
Total accumulated other comprehensive income	17,032	19,363
Total shareholders equity	698,758	681,420
Total liabilities and shareholders equity	$ 1,992,392	$ 1,973,298

See notes to condensed consolidated financial statements.

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Packaging Corporation of America

Condensed Consolidated Statements of Operations

(unaudited)

	Three Months Ended September 30, 2006	2005
(In thousands, except per share amounts)		
Net sales	$ 575,041	$ 512,187
Cost of sales	(440,353)	(431,686)
Gross profit	134,688	80,501
Selling and administrative expenses	(40,944)	(38,056)
Corporate overhead	(14,031)	(12,315)
Other expense, net	(2,922)	(3,828)
Income from operations	76,791	26,302
Interest expense, net	(7,845)	(7,082)
Income before taxes	68,946	19,220
Provision for income taxes	(25,198)	(8,654)
Net income	$ 43,748	$ 10,566
Weighted average common shares outstanding:		
Basic	103,672	107,672
Diluted	104,583	108,311
Net income per common share:		
Basic	$ 0.42	$ 0.10
Diluted	$ 0.42	$ 0.10
Dividends declared per common share	$ 0.25	$ 0.25

See notes to condensed consolidated financial statements.

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Packaging Corporation of America

Condensed Consolidated Statements of Operations

(unaudited)

	Nine Months Ended September 30, 2006	2005
(In thousands, except per share amounts)		
Net sales	$ 1,633,992	$ 1,520,949
Cost of sales	(1,313,588)	(1,271,267)
Gross profit	320,404	249,682
Selling and administrative expenses	(118,161)	(110,802)
Corporate overhead	(37,577)	(36,667)
Joint venture dividend		14,032
Other expense, net	(7,586)	(8,131)
Income from operations	157,080	108,114
Interest expense, net	(24,105)	(21,152)
Income before taxes	132,975	86,962
Provision for income taxes	(47,995)	(36,017)
Net income	$ 84,980	$ 50,945
Weighted average common shares outstanding:		
Basic	103,484	107,372
Diluted	104,366	108,173
Net income per common share:		
Basic	$ 0.82	$ 0.47
Diluted	$ 0.81	$ 0.47
Dividends declared per common share	$ 0.75	$ 0.75

See notes to condensed consolidated financial statements.

Packaging Corporation of America

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Nine Months Ended September 30, 2006	2005
(In thousands)		
Cash Flows from Operating Activities:		
Net income	$ 84,980	$ 50,945
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	116,002	118,757
Amortization of financing costs	515	515
Amortization of treasury lock	(2,331)	(2,331)
Share-based compensation expense	4,576	1,146
Deferred income tax provision (benefit)	(9,415)	20,508
Loss on disposals of property, plant and equipment	3,639	5,211
Gain from joint venture dividend		(15,038)
Excess tax benefits from share-based compensation expense		5,113
Changes in operating assets and liabilities:		
Increase in assets		
Accounts receivable	(62,570)	(7,281)
Inventories	(8,217)	(5,966)
Prepaid expenses and other current assets	(3,169)	(2,821)
Increase (decrease) in liabilities		
Accounts payable	(291)	992
Accrued liabilities	21,545	(1,807)
Other, net	1,292	750
Net cash provided by operating activities	146,556	168,693
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(55,363)	(98,991)
Acquisition of businesses	(4,225)	(48,078)
Additions to other long term assets	(3,709)	(2,864)
Proceeds from disposals of property, plant and equipment	1,932	187
Joint venture dividend		15,038
Net cash used for investing activities	(61,365)	(134,708)
Cash Flows from Financing Activities:		
Payments on long-term debt	(9,060)	(161)
Common stock dividends paid	(78,945)	(69,840)
Proceeds from exercise of stock options	5,611	7,124
Excess tax benefits from share-based compensation expense	2,765	
Net cash used for financing activities	(79,629)	(62,877)
Net increase (decrease) in cash and cash equivalents	5,562	(28,892)
Cash and cash equivalents, beginning of period	112,669	213,321
Cash and cash equivalents, end of period	$ 118,231	$ 184,429

See notes to condensed consolidated financial statements.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements
(unaudited)
September 30, 2006

1. Basis of Presentation

The consolidated financial statements as of September 30, 2006 of Packaging Corporation of America (PCA or the Company) and for the three- and nine-month periods ended September 30, 2006 and 2005 are unaudited but include all adjustments (consisting only of normal recurring adjustments) that management considers necessary for a fair presentation of such financial statements. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with Article 10 of SEC Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. Operating results for the period ended September 30, 2006 are not necessarily indicative of the results that may be expected for the period ending December 31, 2006. These consolidated financial statements should be read in conjunction with PCA s Annual Report on Form 10-K for the year ended December 31, 2005.

2. Summary of Accounting Policies

Basis of Consolidation

The accompanying condensed consolidated financial statements of PCA include all majority-owned subsidiaries. All intercompany transactions have been eliminated. The Company has one joint venture that is accounted for under the equity method.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts in the financial statements and the accompanying notes. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes revenue as title to the products is transferred to customers. Shipping and handling billings to a customer are included in net sales. Shipping and handling costs are included in cost of sales. In addition, the Company offers volume rebates to some of its customers. The total cost of these programs is estimated and accrued as a reduction to net sales at the time of the respective sale.

Segment Information

PCA is engaged in one line of business: the integrated manufacture and sale of packaging materials, boxes and containers for industrial and consumer markets. No single customer accounts for more than 10% of total net sales.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

2. Summary of Accounting Policies (Continued)

Comprehensive Income

Comprehensive income is as follows:

	Three Months Ended September 30, 2006	2005
(In thousands)		
Net income	$ 43,748	$ 10,566
Other comprehensive income, net of tax:		
Amortization of treasury lock	(777)	(777)
Comprehensive income	$ 42,971	$ 9,789

	Nine Months Ended September 30, 2006	2005
(In thousands)		
Net income	$ 84,980	$ 50,945
Other comprehensive income, net of tax:		
Amortization of treasury lock	(2,331)	(2,331)
Foreign currency translation adjustment		2
Comprehensive income	$ 82,649	$ 48,616

Reclassifications

Prior year s financial statements have been reclassified where appropriate to conform with current year presentation.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires an employer that sponsors one or more single-employer defined benefit plans to (a) recognize the overfunded or underfunded status of a benefit plan in its statement of financial position, (b) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, Employers Accounting for Pensions, or SFAS No. 106, Employers Accounting for Postretirement Benefits Other than Pensions, (c) measure defined benefit plan assets and obligations as of the date of the employer s fiscal year-end, and (d) disclose in the notes to the financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. These requirements are effective for fiscal years ending after December 15, 2006, with the exception of the requirement to measure plan assets and obligations as of the employer s

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

2. Summary of Accounting Policies (Continued)

fiscal year-end. This requirement is effective for fiscal years ending after December 15, 2008. The Company expects to record an additional $40.0 million pension liability with a corresponding reduction in equity (accumulated other comprehensive income) at December 31, 2006. The Company is assessing the remaining provisions of SFAS No. 158 to determine the impact that the adoption of those provisions may have on its results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. This Statement is effective for fiscal years beginning after November 15, 2007. The Company is assessing SFAS No. 157 and has not yet determined the impact that the adoption of SFAS No. 157 will have on its results of operations

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) Topic 1N, Financial Statements Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company s financial position, results of operations or cash flows will only be impacted by SAB 108 if it has a prior year misstatement in its financial statements.

In September 2006, the FASB issued FASB Staff Position (FSP) No. AUG AIR-1, Accounting for Planned Major Maintenance Activities. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods and is effective for fiscal years beginning after December 15, 2006. The Company does not anticipate that the implementation of FSP No. AUG AIR-1 will have a material impact on its financial position, results of operations or cash flows.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109. FIN No. 48 provides guidance with respect to the recognition and measurement in the financial statements of uncertain tax positions taken or expected to be taken in a tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company is assessing FIN No. 48 and has not determined the impact that the adoption of FIN No. 48 will have on its results of operations.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and SFAS No. 3. The Statement requires that all voluntary changes in accounting principle be reported by retrospectively applying the principle to all prior periods that are

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

2. Summary of Accounting Policies (Continued)

presented in the financial statements. The Statement is effective for fiscal years beginning after December 15, 2005. The Company s financial position, results of operations or cash flows will only be impacted by SFAS No. 154 if it implements changes in accounting principles that are addressed by the standard or corrects accounting errors in future periods.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions. This Statement amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Under SFAS No. 153, if a nonmonetary exchange of similar productive assets meets a commercial-substance criterion and fair value is determinable, the transaction must be accounted for at fair value resulting in recognition of any gain or loss. SFAS No. 153 is effective for nonmonetary transactions in fiscal periods beginning after June 15, 2005. The adoption of this Statement on January 1, 2006 did not have an impact on the Company s financial position, results of operations or cash flows.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs. The Statement requires abnormal amounts of inventory costs related to idle capacity, freight, handling costs and spoilage be recognized as current period expenses. The Statement is effective for fiscal years beginning after June 15, 2005. The Company s policy has always been to account for inventory costs in a manner consistent with the provisions of this statement.

3. Earnings Per Share

The following table sets forth the computation of basic and diluted income per common share for the periods presented.

	Three Months Ended September 30,	
	2006	**2005**
(In thousands, except per share data)		
Numerator:		
Net income	$ 43,748	$ 10,566
Denominator:		
Basic common shares outstanding	103,672	107,672
Effect of dilutive securities:		
Stock options	718	553
Unvested restricted stock	193	86
Dilutive common shares outstanding	104,583	108,311
Basic income per common share	$ 0.42	$ 0.10
Diluted income per common share	$ 0.42	$ 0.10

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

3. Earnings Per Share (Continued)

	Nine Months Ended September 30, 2006	2005
(In thousands, except per share data)		
Numerator:		
Net income	$ 84,980	$ 50,945
Denominator:		
Basic common shares outstanding	103,484	107,372
Effect of dilutive securities:		
Stock options	722	729
Unvested restricted stock	160	72
Dilutive common shares outstanding	104,366	108,173
Basic income per common share	$ 0.82	$ 0.47
Diluted income per common share	$ 0.81	$ 0.47

4. Stock-Based Compensation

In October 1999, the Company adopted a long-term equity incentive plan which provides for grants of stock options, stock appreciation rights, restricted stock and performance awards to directors, officers and employees of PCA, as well as others who engage in services for PCA. Option awards granted to officers, employees and directors have contractual lives of seven or ten years. Options granted to officers and employees vest ratably over a three- or four-year period, whereas options granted to directors vest immediately. The plan, which will terminate on October 19, 2009, provides for the issuance of up to 4,400,000 shares of common stock. On May 4, 2005, the plan was amended to provide for the issuance of an additional 2,150,000 shares of common stock, or 6,550,000 shares in total. As of September 30, 2006, options or restricted stock for 5,406,746 shares have been granted. Forfeitures are added back to the pool of shares of common stock available to be granted at a future date.

Prior to January 1, 2006, the Company accounted for its equity incentive plan under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation. No stock option-based stock compensation cost was recognized in the Statement of Operations prior to January 1, 2006 as all stock options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment, using the modified-prospective-transition method. Under that transition method, stock compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

4. Stock-Based Compensation (Continued)

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company s income before income taxes for the three- and nine-month periods ended September 30, 2006, was $694,000 and $2,585,000 lower, respectively, and the Company s net income for the same periods was $423,000 and $1,575,000 lower, respectively, than if it had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for the three-month period ended September 30, 2006 were both $0.004 lower, and for the nine-month period ended September 30, 2006 were both $0.02 lower, than if the Company had continued to account for share-based compensation under APB No. 25.

Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits of deductions resulting from share-based payment arrangements as operating cash flows in the Statement of Cash Flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits from tax deductions in excess of the compensation cost recognized for those share awards (excess tax benefits) to be classified as financing cash flows. The excess tax benefit of $2,765,000 classified as a financing cash inflow for the nine months ended September 30, 2006 would have been classified as an operating cash inflow if the Company had not adopted SFAS No. 123(R).

As a result of adopting SFAS No 123(R), unearned compensation previously recorded in equity was reclassified against additional paid in capital on January 1, 2006. All stock-based compensation expense not recognized as of December 31, 2005 and compensation expense related to future grants of stock options and amortization of restricted stock will be recorded directly to additional paid in capital.

Compensation expense for both stock options and restricted stock recognized in the Statement of Operations for the three- and nine-month periods ended September 30, 2006 and 2005 was as follows:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
(In thousands)				
Stock options	$ (694)	$	$ (2,585)	$
Restricted stock	(829)	(608)	(1,991)	(1,146)
Impact on income before taxes	(1,523)	(608)	(4,576)	(1,146)
Income tax benefit	595	240	1,788	452
Impact on net income	$ (928)	$ (368)	$ (2,788)	$ (694)

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Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

4. Stock-Based Compensation (Continued)

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company s stock option plan for the three- and nine-month periods ended September 30, 2005:

(In thousands, except per share amounts)	**Three months ended Sept. 30, 2005**	**Nine months ended Sept. 30, 2005**
Net income as reported	$ 10,566	$ 50,945
Add: amortization of unearned compensation on restricted stock, net of tax	368	694
Less: stock-based compensation expense determined using fair value method, net of tax	(776)	(2,458)
Pro forma net income	$ 10,158	$ 49,181
Earnings per common share:		
Basic	$ 0.10	$ 0.47
Diluted	$ 0.10	$ 0.47
Pro forma earnings per common share:		
Basic	$ 0.09	$ 0.46
Diluted	$ 0.09	$ 0.45

Note that the above pro forma disclosure is provided for the three- and nine-month periods ended September 30, 2005 because employee stock options were not accounted for using the fair-value method during that period. When the Company presents its financial statements for 2006, it will present pro forma disclosures only for 2005 and 2004 because share-based payments will have been accounted for under SFAS No. 123(R) s fair value method for all of 2006.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

4. Stock-Based Compensation (Continued)

The Company uses the Black-Scholes-Merton option-pricing model to estimate the fair value of each option grant as of the date of grant. Expected volatilities are based on historical volatility of the Company s common stock. The expected life of the option is estimated using historical data pertaining to option exercises and employee terminations. Separate groups of employees that have similar historical exercise behavior are considered separately for estimating the expected life. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant. The estimated weighted-average fair values of and related assumptions for options granted were as follows:

	Nine Months Ended September 30, 2006	**2005**
Weighted-average fair value of options granted	$ 3.82	$ 3.72
Assumptions:		
Dividend yield	4.77 %	4.70 %
Expected volatility	25.49 %	27.15 %
Risk-free interest rate	5.14 %	3.77 %
Expected life of option (years)	5	5

A summary of the Company s stock option activity and related information follows:

	Options	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term (years)**	**Aggregate Intrinsic Value**
				(In thousands)
Outstanding at December 31, 2005	3,843,109	$ 16.57		
Granted	337,795	21.01		
Exercised	(527,902)	10.42		
Forfeited	(24,836)	22.01		
Outstanding at September 30, 2006	3,628,166	$ 17.81	5.7	$ 19,991
Vested or expected to vest at September 30, 2006	3,562,813	$ 17.75	5.7	$ 19,858
Exercisable at September 30, 2006	2,609,240	$ 16.37	5.3	$ 18,046

The total intrinsic value of options exercised during the three months ended September 30, 2006 and 2005 was $5,218,000 and $1,107,000, respectively, and during the nine months ended September 30, 2006 and 2005 was $6,506,000 and $13,059,000, respectively. As of September 30, 2006, there was $3,998,000 of total unrecognized compensation cost related to non-vested stock option awards granted under the Company s equity incentive plan. That cost is expected to be recognized over a weighted-average period of 1.9 years.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

4. Stock-Based Compensation (Continued)

During 2003, the Company began granting shares of restricted stock to certain of its employees and directors. Restricted stock awards granted to employees vest at the end of a three- or four-year period, whereas restricted stock awards granted to directors vest at the end of a six-month period. The fair value of restricted stock is determined based on the closing price of the Company s common stock on the grant date. The Company is recognizing compensation expense associated with restricted stock awards ratably over their vesting periods. A summary of the Company s restricted stock activity follows:

(dollars in thousands)	**2006** Shares	**2006** Fair Market Value at Date of Grant	**2005** Shares	**2005** Fair Market Value at Date of Grant
Restricted stock at January 1	387,030	$ 8,256	145,000	$ 3,063
Granted	251,550	5,301	250,755	5,403
Vested	(19,300)	(405)	(6,600)	(163)
Cancellations	(3,860)	(82)		
Restricted stock at September 30	615,420	$ 13,070	389,155	$ 8,303

As of September 30, 2006, there was $9,234,000 of total unrecognized compensation costs related to the above restricted stock awards. The Company expects to recognize the cost of these stock awards over a weighted-average period of 3.1 years.

5. Inventories

The components of inventories are as follows:

(In thousands)	**September 30, 2006 (unaudited)**	**December 31, 2005**
Raw materials	$ 87,987	$ 88,809
Work in process	6,136	5,119
Finished goods	63,925	61,994
Supplies and materials	82,430	76,197
Inventories at FIFO or average cost	240,478	232,119
Excess of FIFO or average over LIFO cost	(39,841)	(40,291)
Inventories, net	$ 200,637	$ 191,828

An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must necessarily be based on management s estimates of expected year-end inventory levels and costs. Because these are subject to many forces beyond management s control, interim results are subject to the final year-end LIFO inventory valuation.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
September 30, 2006

6. Goodwill and Other Intangible Assets

Goodwill

Changes in the carrying amount of goodwill for the period ended September 30, 2006 are as follows:

(In thousands)	
Balance at December 31, 2005	$ 34,187
Acquisition	2,858
Other	66
Balance at September 30, 2006	$ 37,111

Other Intangible Assets

The components of other intangible assets are as follows:

(Dollars in thousands)	Weighted Average Life	September 30, 2006 Gross Carrying Amount (unaudited)	Accumulated Amortization	December 31, 2005 Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization:					
Customer lists and relations	31 years	$ 17,441	$ 3,002	$ 17,660	$ 2,414
Covenants not to compete	7 years	2,142	1,612	1,742	1,423
		19,583	4,614	19,402	3,837
Intangible assets not subject to amortization:					
Intangible pension asset		13,961		13,961	
Total other intangible assets		$ 33,544	$ 4,614-	$ 33,363	$ 3,837

7. Employee Benefit Plans and Other Postretirement Benefits

For the three and nine months ended September 30, 2006 and 2005, net pension costs were comprised of the following:

(In thousands)	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Components of Net Pension Costs				
Service cost for benefits earned during the year	$ 4,573	$ 3,819	$ 13,719	$ 11,457
Interest cost on accumulated benefit obligation	1,118	673	3,354	2,019
Expected return on assets	(692)	(258)	(2,076)	(774)
Net amortization of unrecognized amounts	700	547	2,100	1,641
Net pension benefit costs	$ 5,699	$ 4,781	$ 17,097	$ 14,343

The Company makes pension plan contributions to the extent such contributions are mandatory, actuarially determined and tax deductible. The Company expects to contribute $22.3 million to the pension plans in 2006, of which $17.5 million has been contributed through September 30, 2006.

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7. Employee Benefit Plans and Other Postretirement Benefits (Continued)

For the three and nine months ended September 30, 2006 and 2005, net postretirement costs were comprised of the following:

(In thousands)	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Components of Net Postretirement Costs				
Service cost for benefits earned during the year	$ 236	$ 223	$ 708	$ 669
Interest cost on accumulated benefit obligation	147	146	441	438
Net amortization of unrecognized amounts	(52)	(44)	(156)	(132)
Net postretirement costs	$ 331	$ 325	$ 993	$ 975

8. Restructuring Charges and Other Severance

In August 2005, the Company announced that it would close a corrugated products plant by December 31, 2005. The charges related to this plant closing were recorded in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. In connection with the shutdown of the corrugated products plant, the Company recorded pre-tax restructuring charges of $1.7 million during the third and fourth quarters of 2005. On November 3, 2006, PCA sold the plant building for cash proceeds of $378,000.

In August 2006, the Company announced that it would close a corrugated products plant by the end of the third quarter of 2006. In connection with the closing of this plant, the Company sold the equipment and the building for $1.6 million in cash proceeds and recorded a pre-tax loss of $319,000. The Company also recorded $473,000 in severance and wrote off $174,000 of assets, primarily intangible assets. These costs are included in other expense, net in the statement of operations.

The following table presents an analysis of the 2006 activity related to these restructurings:

(In thousands)	Balance at December 31, 2005	Restructuring Charges	Non-Cash Charges	Cash Payments	Balance at Sept. 30, 2006
Severance and benefit costs	$ 497	$ 415	$	$ (471)	$ 441
Equipment disposal and other costs		376			