Veritiv Corp
Form 10-Q
May 10, 2016

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

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016

OR

q 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 001-36479

VERITIV CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	46-3234977
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1000 Abernathy Road NE	
Building 400, Suite 1700	
Atlanta, Georgia	30328
(Address of principal executive offices)	(Zip code)

(770) 391-8200
(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 ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer¨		Accelerated filer	x
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company¨	

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

The number of shares outstanding of the registrant's common stock as of May 6, 2016 was 16,000,753.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

VERITIV CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data, unaudited)

	Three Months Ended March 31,	
	2016	2015
Net sales (including sales to related party of $9.0 and $9.0, respectively)	$2,019.8	$2,137.9
Cost of products sold (including purchases from related party of $56.3 and $69.5, respectively) (exclusive of depreciation and amortization shown separately below)	1,654.5	1,761.9
Distribution expenses	127.5	130.7
Selling and administrative expenses	200.9	210.6
Depreciation and amortization	13.5	13.5
Integration expenses	6.2	10.0
Restructuring charges	1.7	3.4
Operating income	15.5	7.8
Interest expense, net	6.5	6.4
Other expense, net	1.5	3.5
Income (loss) before income taxes	7.5	(2.1)
Income tax expense	4.2	0.1
Net income (loss)	$3.3	$(2.2)
Earnings (loss) per share:		
Basic and diluted earnings (loss) per share	$0.21	$(0.14)
Weighted average shares outstanding:		
Basic and diluted	16.00	16.00

See accompanying Notes to Condensed Consolidated Financial Statements.

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VERITIV CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in millions, unaudited)

	Three Months Ended March 31,	
	2016	2015
Net income (loss)	$3.3	$(2.2)
Other comprehensive income (loss):		
Foreign currency translation adjustments	3.8	(6.6)
Change in fair value of cash flow hedge, net of $0.1 tax for 2016	(0.3)	—
Pension liability adjustments, net of $0.1 tax for 2016	0.1	—
Other comprehensive income (loss)	3.6	(6.6)
Total comprehensive income (loss)	$6.9	$(8.8)

See accompanying Notes to Condensed Consolidated Financial Statements.

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VERITIV CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in millions, except par value, unaudited)

	March 31, 2016	December 31, 2015
Assets		
Current assets:		
Cash	$47.7	$54.4
Accounts receivable, less allowances of $33.3 and $33.3, respectively	985.8	1,037.5
Related party receivable	4.5	3.9
Inventories	728.4	720.6
Other current assets	118.1	108.8
Total current assets	1,884.5	1,925.2
Property and equipment, net	359.3	363.7
Goodwill	50.2	50.2
Other intangibles, net	29.3	30.2
Deferred income tax assets	70.8	73.3
Other non-current assets	33.1	34.3
Total assets	$2,427.2	$2,476.9
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$590.6	$565.1
Related party payable	10.7	10.7
Accrued payroll and benefits	104.8	120.5
Other accrued liabilities	89.6	100.4
Current maturities of long-term debt	2.6	2.8
Financing obligations to related party, current portion	14.9	14.7
Total current liabilities	813.2	814.2
Long-term debt, net of current maturities	749.0	800.5
Financing obligations to related party, less current portion	194.7	197.8
Defined benefit pension obligations	28.8	28.7
Other non-current liabilities	102.5	105.6
Total liabilities	1,888.2	1,946.8
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Preferred stock, $0.01 par value, 10.0 million shares authorized, none issued	—	—
Common stock, $0.01 par value, 100.0 million shares authorized, 16.0 million shares issued and outstanding	0.2	0.2
Additional paid-in capital	568.2	566.2
Accumulated earnings (deficit)	2.0	(1.3)
Accumulated other comprehensive loss	(31.4)	(35.0)
Total shareholders' equity	539.0	530.1
Total liabilities and shareholders' equity	$2,427.2	$2,476.9

See accompanying Notes to Condensed Consolidated Financial Statements.

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VERITIV CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions, unaudited)

	Three Months Ended March 31,	
Operating Activities	2016	2015
Net income (loss)	$3.3	$(2.2)
Depreciation and amortization	13.5	13.5
Amortization of deferred financing fees	1.1	1.1
Net losses (gains) on sales of property and equipment	0.2	(0.2)
Long-lived asset impairment charges	0.4	—
Provision for allowance for doubtful accounts	(2.3)	3.8
Deferred income tax provision (benefit)	2.6	(0.3)
Stock-based compensation	2.0	1.0
Other non-cash items, net	2.1	0.5
Changes in operating assets and liabilities		
Accounts receivable and related party receivable	58.5	41.0
Inventories	(2.8)	(21.7)
Accounts payable and related party payable	37.6	72.0
Accrued payroll and benefits	(20.7)	(9.3)
Other	(21.0)	(6.9)
Net cash provided by operating activities	74.5	92.3
Investing Activities		
Property and equipment additions	(8.9)	(9.7)
Proceeds from asset sales	1.0	0.2
Net cash used for investing activities	(7.9)	(9.5)
Financing Activities		
Change in book overdrafts	(15.4)	(11.9)
Borrowings of long-term debt	1,122.0	1,121.8
Repayments of long-term debt	(1,175.9)	(1,181.0)
Payments under equipment capital lease obligations	(1.0)	(1.0)
Payments under financing obligations to related party	(3.6)	(3.4)
Net cash used for financing activities	(73.9)	(75.5)
Effect of exchange rate changes on cash	0.6	(1.4)
Net change in cash	(6.7)	5.9
Cash at beginning of period	54.4	57.6
Cash at end of period	$47.7	$63.5
Supplemental Cash Flow Information		
Cash paid for income taxes, net of refunds	$0.6	$0.7
Cash paid for interest	5.2	5.2

See accompanying Notes to Condensed Consolidated Financial Statements.

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Veritiv Corporation ("Veritiv" or the "Company") is a 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 ("xpedx") and UWW Holdings, Inc. ("UWWH"), the parent company of Unisource Worldwide, Inc. ("Unisource") (the "Merger"). The Company operates from approximately 180 distribution centers primarily throughout the U.S., Canada and Mexico.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for a complete set of annual audited financial statements.

The accompanying unaudited financial information should be read in conjunction with the Consolidated and Combined Financial Statements and Notes contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") for the year ended December 31, 2015. In the opinion of management, all adjustments (consisting of normal recurring accruals and other adjustments) considered necessary for a fair presentation have been included. The operating results for the interim periods are not necessarily indicative of results for the full year.

All significant intercompany transactions between Veritiv's businesses have been eliminated.

Following the Merger, certain corporate and other related functions continued to be provided by International Paper under a transition services agreement. During the three months ended March 31, 2015, the Company recognized $5.6 million in selling and administrative expenses related to this agreement. As of December 31, 2015, all of the functions originally provided by International Paper under this agreement have been fully transitioned to the Company.

Use of Estimates

The preparation of unaudited financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenue and expenses, and certain financial statement disclosures. Estimates and assumptions are used for, but not limited to, revenue recognition, accounts receivable valuation, inventory valuation, employee benefit plans, income tax contingency accruals and valuation allowances and goodwill and other intangible asset valuations. Although these estimates are based on management's knowledge of current events and actions it may undertake in the future, actual results may ultimately differ from these estimates and assumptions. Estimates are revised as additional information becomes available.

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Recently Issued Accounting Standards

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers	The standard will replace existing revenue recognition standards and significantly expand the disclosure requirements for revenue arrangements. It may be adopted either retrospectively or on a modified retrospective basis to new contracts and existing contracts with remaining performance obligations as of the effective date.	January 1, 2018; early adoption date is no earlier than December 15, 2016	The Company is currently evaluating the alternative methods of adoption (full retrospective or modified retrospective), and the effect on its Consolidated Financial Statements and related disclosures. The Company plans to adopt this ASU on January 1, 2018.
ASU 2015-11, Simplifying the Measurement of Inventory	The standard requires companies to measure inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. This ASU will not apply to inventories measured by either the last-in first-out method or retail inventory method.	January 1, 2017	The Company is currently evaluating the impact the ASU may have on its first-in first-out based inventory, which is approximately 13% of the Company's inventory balance as of March 31, 2016. The Company plans to adopt this ASU on January 1, 2017.
ASU 2016-02, Leases (Topic 842)	The standard requires lessees to put most leases on their balance sheet, but recognize expenses in their statement of operations in a manner similar to current accounting guidance. The new guidance also eliminates the current guidance related to real estate specific provisions.	January 1, 2019; early adoption is permitted	The Company is currently evaluating the impact the ASU will have on its Consolidated Financial Statements and related disclosures. The Company plans to adopt this ASU on January 1, 2019.
ASU 2016-09, Compensation-Stock Compensation (Topic 718)	The standard is issued as part of the Financial Accounting Standards Board's simplification initiative. The areas for simplification involve several aspects of the accounting for share-based payment transactions, including income tax consequences, award classification as either equity or liabilities, and classification on the statement of cash flows.	January 1, 2017; early adoption is permitted	The Company adopted this ASU on January 1, 2016. The adoption did not materially impact the financial statements or related disclosures.

2. INTEGRATION AND RESTRUCTURING CHARGES

Integration Charges

The Company currently expects integration and restructuring charges associated with achieving anticipated cost savings and other synergies from the Merger to be approximately $225.0 million through 2017, including approximately $55.0 million for capital expenditures, primarily consisting of information technology infrastructure, systems integration and planning, but excluding approximately $27.0 million of merger-related expenses. Through March 31, 2016, the Company has incurred approximately $150.0 million, including approximately $45.0 million for capital expenditures.

During the three months ended March 31, 2016 and 2015, Veritiv incurred costs to integrate the combined businesses of xpedx and Unisource. Integration expenses include professional services and project management fees, internally dedicated integration management resources, retention compensation, information technology conversion costs, rebranding costs and other costs to integrate the combined businesses of xpedx and Unisource.

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The following table summarizes the components of integration expenses:

(in millions)	Three Months Ended March 31, 2016	2015
Integration management	$1.8	$—
Retention compensation	1.1	3.4
Information technology conversion costs	1.1	2.1
Rebranding	0.7	0.8
Legal, consulting and other professional fees	0.5	2.9
Other	1.0	0.8
Total integration expenses	$6.2	$10.0

Veritiv Restructuring Plan

As part of the Spin-off and Merger, the Company is executing on a multi-year restructuring program of its North American operations intended to integrate the legacy xpedx and Unisource operations, generate cost savings and capture synergies across the combined company. The restructuring plan includes initiatives to: (i) consolidate warehouse facilities in overlapping markets, (ii) improve the efficiency of the delivery network, (iii) consolidate customer service centers, (iv) reorganize the field sales and operations functions and (v) restructure the corporate general and administrative functions. As part of its restructuring efforts, the Company continues to evaluate its operations outside of North America to identify additional cost saving opportunities. The Company has elected to restructure certain of its operations in specific countries, which included staff reductions, lease terminations, and facility closures.

The Company recorded restructuring charges of $1.7 million and $3.4 million during the three months ended March 31, 2016 and 2015, respectively, related to these company-wide initiatives. See Note 11, Segment Information, for the impact these charges had on the Company's reportable segments. Other direct costs reported in the table below include facility closing costs and other incidental costs associated with the development, communication, administration and implementation of these initiatives.

The following is a summary of the Company's restructuring activity for the three months ended March 31, 2016:

(in millions)	Severance and Related Costs	Other Direct Costs	Non-Cash Items	Total
Balance at December 31, 2015	$ 1.7	$ 0.4	$ —	$2.1
Costs incurred	0.7	0.3	0.7	1.7
Payments	(0.9)	(0.4)	—	(1.3)
Other adjustments	—	—	(0.7)	(0.7)
Balance at March 31, 2016	$ 1.5	$ 0.3	$ —	$1.8

The following is a summary of the Company's restructuring activity for the three months ended March 31, 2015:

(in millions)	Severance and Related Costs	Other Direct Costs	Total
Balance at December 31, 2014	$ 3.7	$ 0.2	$3.9

Costs incurred	1.9	1.5	3.4
Payments	(2.7)	(0.4)	(3.1)
Balance at March 31, 2015	$ 2.9	$ 1.3	$4.2

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3. DEBT

The Company's long-term debt obligations were as follows:

(in millions)	March 31, 2016	December 31, 2015
Asset-Based Lending Facility (the "ABL Facility")	$744.7	$ 795.5
Equipment capital lease obligations [1]	6.9	7.8
Total debt	751.6	803.3
Less: current portion of long-term debt	(2.6)	(2.8)
Long-term debt, net of current maturities	$749.0	$ 800.5

[1] Equipment capital lease obligations include $0.7 million related to the Toronto build-to-suit arrangement for the three months ended March 31, 2016 and for the year ended December 31, 2015.

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 March 31, 2016, the available additional borrowing capacity under the ABL Facility was approximately $444.5 million.

4. INCOME TAXES

The Company’s provision for income taxes for the three months ended March 31, 2016 and 2015 is based on the estimated annual effective tax rate, plus any discrete items.

The following table presents the provision for income taxes and the effective tax rates for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
(in millions)	2016	2015
Income (loss) before income taxes	$7.5	$(2.1)
Income tax expense	$4.2	$0.1
Effective tax rate	56.0 %	(4.8)%

The difference between the Company’s effective tax rate for the three months ended March 31, 2016 and 2015 and the U.S. statutory tax rate of 35.0% primarily relates to the non-recognition of tax benefits on certain losses, non-deductible expenses, and state income taxes (net of federal income tax benefit). The effective tax rate may vary significantly due to potential changes in the amount and mix of pre-tax book income and changes in amounts of non-deductible expenses and other items.

5. RELATED PARTY TRANSACTIONS

Transactions with Georgia-Pacific

Veritiv purchases certain inventory items from, and sells certain inventory items to, Georgia-Pacific in the normal course of business. As a result of the Merger and private placement, Georgia-Pacific, as joint owner of the sole stockholder of UWWH, is a related party. The following tables summarize the financial impact of those related party transactions with Georgia-Pacific:

(in millions)	Three Months Ended March 31, 2016	2015
Sales to Georgia-Pacific, reflected in net sales	$9.0	$9.0
Purchases of inventory from Georgia-Pacific, recognized in cost of products sold	$56.3	$69.5

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(in millions)	March 31, 2016	December 31, 2015
Inventories purchased from Georgia-Pacific that remained on Veritiv's balance sheet	$ 24.9	$ 25.2
Related party payable to Georgia-Pacific	$ 10.7	$ 10.7
Related party receivable from Georgia-Pacific	$ 4.5	$ 3.9

6. DEFINED BENEFIT PLANS

In conjunction with the Merger, Veritiv assumed responsibility for Unisource's defined benefit plans and Supplemental Executive Retirement Plans in the U.S. and Canada. Net periodic benefit cost (credit) associated with these plans is summarized below:

	Three Months Ended March 31, 2016		Three Months Ended March 31, 2015	
(in millions)	U.S.	Canada	U.S.	Canada
Components of net periodic benefit cost (credit):				
Service cost	$0.4	$ 0.1	$0.4	$ 0.1
Interest cost	0.9	0.8	0.8	0.8
Expected return on plan assets	(1.3)	(0.9)	(1.4)	(0.9)
Amortization of net loss	—	0.1	—	—
Net periodic benefit cost (credit)	$0.0	$ 0.1	$(0.2)	$ 0.0

7. FAIR VALUE MEASUREMENTS

At March 31, 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, 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 at fair value using a discounted cash flow model that reflected management's expectations about probability of payment. The fair value of the Tax Receivable Agreement 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 Operations. At March 31, 2016, the Company remeasured the contingent liability using a discount rate of 4.9%.

The following table provides a reconciliation of the beginning and ending balance of the contingent liability for the three months ended March 31, 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

There have been no transfers between the fair value measurement levels for the three months ended March 31, 2016. The Company recognizes transfers between the fair value measurement levels at the end of the reporting period.

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

(in millions)	Three Months Ended March 31, 2016	2015
Numerator:		
Net income (loss)	$3.3	$(2.2)
Denominator:		
Weighted average number of shares outstanding – basic and diluted	16.00	16.00
Antidilutive stock-based awards excluded from computation of diluted EPS	0.15	0.06
Performance stock-based awards excluded from computation of diluted EPS because performance conditions had not been met	0.53	0.25

9. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table provides the components of accumulated other comprehensive loss ("AOCL") at March 31, 2016 and for the period ended (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)

The following table provides the components of AOCL at March 31, 2015 and for the period ended (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)

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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 two to four years 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.

11. SEGMENT INFORMATION

The following tables present net sales, Adjusted EBITDA (earnings before interest, income taxes, depreciation and amortization, restructuring charges, stock-based compensation expense, LIFO income, non-restructuring severance charges, integration expenses, fair value adjustments on the contingent liability associated with the Tax Receivable Agreement ("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 March 31, 2016						
Net sales	$759.1	$				