PACKAGING CORP OF AMERICA
Form 10-Q
May 09, 2007

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 March 31, 2007

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	**36-4277050**
(State or other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
1900 West Field Court	
Lake Forest, Illinois	**60045**
(Address of Principal Executive Offices)	(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 May 7, 2007, the Registrant had outstanding 105,235,735 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

(In thousands, except share and per share amounts)	March 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 147,294	$ 161,837
Accounts and notes receivable, net of allowance for doubtful accounts and customer deductions of $5,968 and $6,463 as of March 31, 2007 and December 31, 2006, respectively	275,292	263,159
Inventories	200,438	195,946
Prepaid expenses and other current assets	14,687	6,473
Deferred income taxes	11,145	19,303
Total current assets	648,856	646,718
Property, plant and equipment, net	1,235,915	1,252,291
Goodwill	37,163	37,200
Other intangible assets, net of accumulated amortization of $5,150 and $4,872 as of March 31, 2007 and December 31, 2006, respectively	14,583	14,711
Other long-term assets	36,185	36,056
Total assets	$ 1,972,702	$ 1,986,976
Liabilities and stockholders equity		
Current liabilities:		
Short-term debt and current maturities of long-term debt	$ 119,150	$ 119,147
Accounts payable	125,934	119,397
Dividends payable	26,243	26,154
Accrued interest	5,467	12,870
Accrued federal and state income taxes	13,389	10,340
Accrued liabilities	71,524	98,490
Total current liabilities	361,707	386,398
Long-term liabilities:		
Long-term debt	567,851	567,770
Deferred income taxes	245,215	260,968
Pension and postretirement benefit plans	66,218	65,914
Other liabilities	22,073	14,155
Total long-term liabilities	901,357	908,807
Stockholders equity:		
Common stock, par value $.01 per share, 300,000,000 shares authorized, 104,973,070 shares and 104,611,181 shares issued as of March 31, 2007 and December 31, 2006, respectively	1,050	1,046
Additional paid in capital	437,639	429,508
Retained earnings	279,353	269,296
Accumulated other comprehensive income (loss):		
Unrealized gain on treasury lock, net	15,482	16,259
Unfunded employee benefit obligations, net	(23,883)	(24,335)
Cumulative foreign currency translation adjustment	(3)	(3)
Total accumulated other comprehensive income (loss)	(8,404)	(8,079)
Total stockholders equity	709,638	691,771
Total liabilities and stockholders equity	$ 1,972,702	$ 1,986,976

See notes to condensed consolidated financial statements.

Packaging Corporation of America
Condensed Consolidated Statements of Income
(unaudited)

(In thousands, except per share amounts)	**Three Months Ended March 31, 2007**	**2006 (Restated- See Note 2)**
Net sales	$ 559,159	$ 507,856
Cost of sales	(446,172)	(431,245)
Gross profit	112,987	76,611
Selling and administrative expenses	(41,951)	(37,701)
Corporate overhead	(12,896)	(11,179)
Other expense, net	(1,444)	(2,215)
Income from operations	56,696	25,516
Interest expense, net	(7,132)	(8,050)
Income before taxes	49,564	17,466
Provision for income taxes	(18,373)	(6,531)
Net income	$ 31,191	$ 10,935
Weighted average common shares outstanding:		
Basic	104,166	103,355
Diluted	105,065	104,238
Net income per common share:		
Basic	$ 0.30	$ 0.11
Diluted	$ 0.30	$ 0.10
Dividends declared per common share	$ 0.25	$ 0.25

See notes to condensed consolidated financial statements.

Packaging Corporation of America
Condensed Consolidated Statements of Cash Flows
(unaudited)

(In thousands)	Three Months Ended March 31, 2007	2006 (Restated- See Note 2)
Cash Flows from Operating Activities:		
Net income	$ 31,191	$ 10,935
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	37,595	38,360
Amortization of financing costs	172	172
Amortization of gain on treasury lock	(777)	(777)
Share-based compensation expense	1,520	1,357
Deferred income tax provision	4,318	1,734
Loss on disposals of property, plant and equipment	1,043	1,283
Excess tax benefits from share-based awards	247	48
Changes in operating assets and liabilities:		
(Increase) decrease in assets		
Accounts and notes receivable	(12,095)	(19,987)
Inventories	(4,492)	5,847
Prepaid expenses and other current assets	(8,214)	(7,170)
Increase (decrease) in liabilities		
Accounts payable	6,537	(9,003)
Accrued liabilities	(31,506)	(25,877)
Other, net	1,697	3,594
Net cash provided by operating activities	27,236	516
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(20,821)	(17,301)
Additions to other long term assets	(1,305)	(2,767)
Proceeds from disposals of property, plant and equipment	168	125
Other, net		(27)
Net cash used for investing activities	(21,958)	(19,970)
Cash Flows from Financing Activities:		
Payments on long-term debt	(36)	(8)
Common stock dividends paid	(26,154)	(27,045)
Proceeds from exercise of stock options	5,515	1,311
Excess tax benefits from share-based awards	854	382
Net cash used for financing activities	(19,821)	(25,360)
Net decrease in cash and cash equivalents	(14,543)	(44,814)
Cash and cash equivalents, beginning of period	161,837	112,669
Cash and cash equivalents, end of period	$ 147,294	$ 67,855

See notes to condensed consolidated financial statements.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements
(unaudited)
March 31, 2007

1. Basis of Presentation

The condensed consolidated financial statements as of March 31, 2007 and 2006 of Packaging Corporation of America (PCA or the Company) and for the three month periods then ended 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 March 31, 2007 are not necessarily indicative of the results that may be expected for the period ending December 31, 2007. These condensed consolidated financial statements should be read in conjunction with PCA s Annual Report on Form 10-K for the year ended December 31, 2006. The condensed consolidated financial statements as of March 31, 2006 have been restated for the adoption of FASB Staff Position (FSP) No. AUG AIR-1, Accounting for Planned Major Maintenance Activities. The Company adopted this FSP on January 1, 2007, which required prior year financial statements to be restated to account for the impact of this FSP as if it had been adopted on January 1, 2006. See Note 2, Summary of Accounting Policies Recent Accounting Pronouncements for additional information.

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 certain 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)
March 31, 2007

2. Summary of Accounting Policies (Continued)

Comprehensive Income

Comprehensive income is as follows:

	Three Months Ended March 31,	
(In thousands)	2007	2006
Net income	$ 31,191	$ 10,935
Other comprehensive income, net of tax:		
Amortization of unfunded employee benefit obligations	452	
Amortization of gain on treasury lock	(777)	(777)
Comprehensive income	$ 30,866	$ 10,158

Reclassifications

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

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendments to SFAS No. 115, Accounting for Certain Investments In Debt and Equity Securities, apply to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided that an entity also elects to apply the provisions of SFAS No. 157, Fair Value Measurements. The Company is assessing SFAS No. 159 and has not yet determined the impact that the adoption of SFAS No. 159 will have on its results of operations.

In September 2006, the FASB issued 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 plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, postretirement benefit plans) to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year end statement of financial position, and provide additional disclosures. These requirements were effective for fiscal years ending after December 15, 2006, with the exception of the requirement to measure plan assets and benefit obligations as of the plan sponsor s fiscal year-end. This requirement is effective for fiscal years ending after December 15, 2008. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158. The Company is assessing the remaining provision of SFAS No. 158 to determine the impact that the adoption of those provisions may have on its results of operations.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

2. Summary of Accounting Policies (Continued)

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 FASB issued 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. Prior to the adoption of this FSP, the Company determined its planned maintenance costs for the year and amortized these costs ratably throughout the year. On January 1, 2007, the Company began accounting for its planned major maintenance activities in accordance with FSP No. AUG AIR-1 using the deferral method. The implementation of FSP No. AUG AIR-1 will not have any impact on the Company s year end financial position or full year results of operations and cash flows as all maintenance costs incurred have been and continue to be expensed in the fiscal year in which the maintenance activity occurs. In accordance with FSP No. AUG AIR-1, the Company s financial position, results of operations and cash flows for each quarter of 2006 were adjusted to apply the FSP retrospectively. The following financial statement line items as of and for the three month period ended March 31, 2006 were adjusted as follows:

Statement of Income Three Months Ended 3/31/06 *(In thousands, except per share amounts)*	**As Originally Reported**	**As Adjusted**	**Effect of Change**
Cost of sales	$ (434,278)	$ (431,245)	$ 3,033
Gross profit	73,578	76,611	3,033
Income from operations	22,483	25,516	3,033
Income before taxes	14,433	17,466	3,033
Provision for income taxes	(5,446)	(6,531)	(1,085)
Net income	8,987	10,935	1,948
Net income per common share:			
Basic	$ 0.09	$ 0.11	$ 0.02
Diluted	$ 0.09	$ 0.10	$ 0.01

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Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

2. Summary of Accounting Policies (Continued)

Balance Sheet 3/31/06 *(In thousands)*	**As Originally Reported**	**As Adjusted**	**Effect of Change**
Prepaid expenses and other current assets	$ 11,615	$ 14,006	$ 2,391
Total current assets	521,608	523,999	2,391
Total assets	1,921,224	1,923,615	2,391
Accounts payable	116,490	115,848	(642)
Accrued federal and state income taxes	5,746	6,832	1,086
Total current liabilities	335,720	336,164	444
Retained earnings	231,449	233,397	1,948
Total stockholders equity	666,738	668,686	1,948
Total liabilities and stockholders equity	1,921,224	1,923,615	2,391

Statement of Cash Flows Three Months Ended 3/31/06 *(In thousands)*	**As Originally Reported**	**As Adjusted**	**Effect of Change**
Net income	$ 8,987	$ 10,935	$ 1,948
Prepaid expenses and other current assets	(4,779)	(7,170)	(2,391)
Accounts payable	(8,361)	(9,003)	(642)
Accrued liabilities	(26,962)	(25,877)	1,085

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, Accounting for Income Taxes, to create a single model to address accounting for uncertainty in tax positions. FIN No. 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, 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 adopted FIN No. 48 on January 1, 2007

As a result of the implementation of FIN No. 48, PCA recognized a $5.1 million decrease to reserves for uncertain tax positions and an increase to the beginning balance of retained earnings on the condensed consolidated balance sheet. After adoption on January 1, 2007, the Company had $9.1 million total gross unrecognized tax benefits. Of this total, $7.1 million (net of the federal benefit on state issues and interest) would impact its effective tax rate if recognized. At March 31, 2007, PCA had $7.5 million of unrecognized tax benefits.

PCA s continuing practice is to recognize interest and penalties related to uncertain tax positions in income tax expense. After adoption of FIN No. 48 on January 1, 2007, the Company had $0.6 million accrued for interest and no reserve for penalties. During the first quarter of 2007, PCA recorded $0.1 million for interest in its statement of operations, increasing the accrual for interest to $0.7 million at March 31, 2007.

PCA and its subsidiaries are subject to U.S. federal income taxes, as well as income taxes of multiple state and city jurisdictions. The federal income tax return for 2004 is currently under examination, and a federal examination of the tax year 2002 has been concluded. The tax years 2001 and 2003-2006 remain open to federal examination. In major state jurisdictions, tax years 2002-2006 remain open for examination.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

3. Earnings Per Share

The following table sets forth the computation of basic and diluted income per common share for the periods presented. Basic and diluted income per common share for the three months ended March 31, 2006 increased $0.02 and $0.01, respectively, due to the restatement of the Company s results of operations as a result of the adoption of FSP No. AUG AIR-1. See Note 2, Summary of Accounting Policies Recent Accounting Pronouncements for additional information.

(In thousands, except per share data)	**Three Months Ended March 31, 2007**	**2006**
Numerator:		
Net income	$ 31,191	$ 10,935
Denominator:		
Basic common shares outstanding	104,166	103,355
Effect of dilutive securities:		
Stock options	630	754
Unvested restricted stock	269	129
Dilutive common shares outstanding	105,065	104,238
Basic income per common share	$ 0.30	$ 0.11
Diluted income per common share	$ 0.30	$ 0.10

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 6,550,000 shares of common stock. As of March 31, 2007, options or restricted stock for 5,385,449 shares have been granted, net of forfeitures. Forfeitures are added back to the pool of shares of common stock available to be granted at a future date.

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

4. Stock-Based Compensation (Continued)

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 subsequent to January 1, 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). Compensation expense for both stock options and restricted stock recognized in the condensed consolidated statements of income for the three month periods ended March 31, 2007 and 2006 was as follows:

(In thousands)	**Three Months Ended March 31, 2007**	**2006**
Stock options	$ (690)	$ (787)
Restricted stock	(830)	(570)
Impact on income before taxes	(1,520)	(1,357)
Income tax benefit	592	530
Impact on net income	$ (928)	$ (827)

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. There were no option grants during the first quarter of 2007.

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, 2006	3,451,077	$ 17.96		
Exercised	(354,289)	15.57		
Forfeited	(1,133)	21.84		
Outstanding at March 31, 2007	3,095,655	$ 18.23	5.3	$ 19,092
Outstanding vested or expected to vest at March 31, 2007	3,056,600	$ 18.19	5.3	$ 18,971
Exercisable at March 31, 2007	2,096,848	$ 16.67	4.9	$ 16,203

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

4. Stock-Based Compensation (Continued)

The total intrinsic value of options exercised during the three months ended March 31, 2007 and 2006 was $3,204,000 and $843,000, respectively. As of March 31, 2007, there was $2,621,000 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 1.2 years.

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:

	2007		2006	
(dollars in thousands)	**Shares**	**Fair Market Value at Date of Grant**	**Shares**	**Fair Market Value at Date of Grant**
Restricted stock at January 1	610,380	$ 12,964	387,030	$ 8,256
Granted	8,000	196	12,000	280
Vested			(11,300)	(219)
Cancellations	(400)	(8)	(825)	(17)
Restricted stock at March 31	617,980	$ 13,152	386,905	$ 8,300

As of March 31, 2007, there was $7,687,000 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 2.3 years.

5. Inventories

The components of inventories are as follows:

(In thousands)	**March 31, 2007 (unaudited)**	**December 31, 2006**
Raw materials	$ 90,692	$ 87,243
Work in process	5,678	5,021
Finished goods	66,339	63,633
Supplies and materials	82,736	83,431
Inventories at FIFO or average cost	245,445	239,328
Excess of FIFO or average over LIFO cost	(45,007)	(43,382)
Inventories, net	$ 200,438	$ 195,946

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

5. Inventories (Continued)

An actual valuation of inventory under the LIFO method is 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.

6. Goodwill and Other Intangible Assets

Goodwill

Changes in the carrying amount of goodwill for the period ended March 31, 2007 are as follows:

(In thousands)	
Balance at December 31, 2006	$ 37,200
Other	(37)
Balance at March 31, 2007	$ 37,163

Other Intangible Assets

The components of other intangible assets are as follows:

		As of March 31, 2007		**As of December 31, 2006**	
(In thousands)	**Weighted Average Life**	**Gross Carrying Amount (unaudited)**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Customer lists and relations	31 years	$ 17,441	$ 3,410	$ 17,441	$ 3,205
Covenants not to compete	6 years	2,292	1,740	2,142	1,667
Total other intangible assets		$ 19,733	$ 5,150	$ 19,583	$ 4,872

7. Employee Benefit Plans and Other Postretirement Benefits

For the three months ended March 31, 2007 and 2006, net pension costs were comprised of the following:

	Three Months Ended March 31,	
(In thousands)	**2007**	**2006**
Components of Net Pension Costs		
Service cost for benefits earned during the year	$ 4,493	$ 4,573
Interest cost on accumulated benefit obligation	1,563	1,118
Expected return on assets	(1,190)	(692)
Net amortization of unrecognized amounts	808	700
Net pension costs	$ 5,674	$ 5,699

Packaging Corporation of America
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)
March 31, 2007

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

The Company makes pension plan contributions to the extent such contributions are mandatory, actuarially determined and tax deductible. The Company expects to contribute $23.2 million to the pension plans in 2007, of which $4.6 million has been contributed through March 31, 2007.

For the three months ended March 31, 2007 and 2006, net postretirement costs were comprised of the following:

	Three Months Ended March 31,	
(In thousands)	**2007**	**2006**
Components of Net Postretirement Costs		
Service cost for benefits earned during the year	$ 248	$ 236
Interest cost on accumulated benefit obligation	160	147
Net amortization of unrecognized amounts	(63)	(52)
Net postretirement costs	$ 345	$ 331

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 2005 and $325,000 during 2006. On November 3, 2006, PCA sold the building for cash proceeds of $378,000 and recorded a pre-tax gain 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 $454,000 in severance and wrote off $174,000 of assets, primarily intangible assets.

The following table presents an analysis of the 2007 activity related to the 2006 closure restructurings:

(In thousands)	**Severance and Benefit Costs**
Balance at January 1, 2007	$ 205
Restructuring charges	
Non-cash charges	2
Cash payments	(161)
Balance at March 31, 2007	$ 46

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

Packaging Corporation of America, or PCA, is the sixth largest producer of containerboard and corrugated products in the United States, based on production capacity. Approximately 80% of the containerboard tons produced at our mills are consumed in our corrugated products manufacturing plants. The remaining 20% is sold to domestic customers or the export market. Besides containerboard, we produce a wide variety of products ranging from basic corrugated shipping containers to specialized packaging such as wax-coated boxes for the agriculture industry. We also have multi-color printing capabilities to make high-impact graphics boxes and displays that offer our customers more attractive packaging. Our operating facilities and customers are located primarily in the United States.

In analyzing the operating performance of the company, we focus on the following factors that affect our business and are important to consider when reviewing our financial and operating results:

- corrugated products demand;
- corrugated products and containerboard pricing;
- containerboard inventories; and
- cost trends and volatility for our major costs, including wood and recycled fiber, purchased energy, labor and fringe benefits, and transportation costs.

The market for containerboard is generally subject to changes in the U.S. economy. Historically, supply and demand, as well as industry-wide inventory levels, has influenced prices of containerboard. In addition to U.S. shipments, approximately 10% of domestically produced containerboard has been exported for use in other countries.

Industry supply and demand trends remained in balance during the first quarter of 2007. Although industry shipments of corrugated products decreased 2.1% for the first three months of 2007 compared to the same period in 2006, industry containerboard inventory levels remained at historically low levels. Containerboard inventory at the end of the first quarter was the lowest March ending inventory in the past 25 years on a weeks of supply basis. As reported by industry publications, linerboard prices for the first quarter of 2007 averaged $50 per ton higher than last year s first quarter, reflecting the April 2006 $50 per ton price increase. Linerboard prices as published by industry publications did not change during the first quarter of 2007.

The cost to manufacture conta