OWENS ILLINOIS INC /DE/
Form 10-Q
October 26, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended

September 30, 2016

or

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 1-9576

OWENS-ILLINOIS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	22-2781933 (IRS Employer Identification No.)

One Michael Owens Way, Perrysburg, Ohio (Address of principal executive offices)	43551 (Zip Code)

Registrant's telephone number, including area code: (567) 336-5000

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 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 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	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 Exchange Act). Yes No

The number of shares of common stock, par value $.01, of Owens-Illinois, Inc. outstanding as of September 30, 2016 was 162,196,998.

Part I — FINANCIAL INFORMATION

Item 1. Financial Statements.

The Condensed Consolidated Financial Statements of Owens-Illinois, Inc. (the “Company”) presented herein are unaudited but, in the opinion of management, reflect all adjustments necessary to present fairly such information for the periods and at the dates indicated. All adjustments are of a normal recurring nature. Because the following unaudited condensed consolidated financial statements have been prepared in accordance with Article 10 of Regulation S-X, they do not contain all information and footnotes normally contained in annual consolidated financial statements; accordingly, they should be read in conjunction with the Consolidated Financial Statements and notes thereto appearing in the Company’s Amendment No. 1 to the Annual Report on Form 10-K/A for the year ended December 31, 2015.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED RESULTS OF OPERATIONS

(Dollars in millions, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net sales	$ 1,712	$ 1,566	$ 5,060	$ 4,530
Cost of goods sold	(1,376)	(1,290)	(4,063)	(3,712)
Gross profit	336	276	997	818
Selling and administrative expense	(121)	(109)	(375)	(351)
Research, development and engineering expense	(16)	(15)	(48)	(46)
Interest expense, net	(66)	(67)	(199)	(188)
Equity earnings	15	17	44	46
Other income (expense), net	5	(44)	(24)	(59)
Earnings from continuing operations before income taxes	153	58	395	220
Provision for income taxes	(36)	(33)	(93)	(73)
Earnings from continuing operations	117	25	302	147
Loss from discontinued operations	(3)	(1)	(6)	(3)
Net earnings	114	24	296	144
Net earnings attributable to noncontrolling interests	(6)	(7)	(16)	(16)
Net earnings attributable to the Company	$ 108	$ 17	$ 280	$ 128
Amounts attributable to the Company:				
Earnings from continuing operations	$ 111	$ 18	$ 286	$ 131
Loss from discontinued operations	(3)	(1)	(6)	(3)
Net earnings	$ 108	$ 17	$ 280	$ 128
Basic earnings per share:				
Earnings from continuing operations	$ 0.68	$ 0.11	$ 1.76	$ 0.81
Loss from discontinued operations	(0.02)	(0.01)	(0.04)	(0.02)
Net earnings	$ 0.66	$ 0.10	$ 1.72	$ 0.79
Weighted averages shares outstanding (thousands)	162,080	160,730	161,744	161,284
Diluted earnings per share:				
Earnings from continuing operations	$ 0.68	$ 0.11	$ 1.75	$ 0.81
Loss from discontinued operations	(0.02)	(0.01)	(0.04)	(0.02)
Net earnings	$ 0.66	$ 0.10	$ 1.71	$ 0.79
Weighted average diluted shares outstanding (thousands)	163,204	161,612	162,607	162,264

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED COMPREHENSIVE INCOME

(Dollars in millions)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net earnings	$ 114	$ 24	$ 296	$ 144
Other comprehensive income (loss):				
Foreign currency translation adjustments	(79)	(265)	(93)	(499)
Pension and other postretirement benefit adjustments, net of tax	21	25	5	70
Change in fair value of derivative instruments, net of tax	(1)	(3)	5	(5)
Other comprehensive income (loss)	(59)	(243)	(83)	(434)
Total comprehensive income (loss)	55	(219)	213	(290)
Comprehensive (income) loss attributable to noncontrolling interests	(4)	1	(6)	
Comprehensive income (loss) attributable to the Company	$ 51	$ (218)	$ 207	$ (290)

See accompanying notes.

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OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in millions)

	September 30, 2016	December 31, 2015	September 30, 2015
Assets			
Current assets:			
Cash and cash equivalents	$ 294	$ 399	$ 270
Trade receivables, net of allowance of $32 million, $29 million, and $29 million at September 30, 2016, December 31, 2015 and September 30, 2015	857	562	753
Inventories	1,057	1,007	1,023
Prepaid expenses and other current assets	234	366	442
Total current assets	2,442	2,334	2,488
Property, plant and equipment, net	2,917	2,961	2,874
Goodwill	2,534	2,489	2,797
Intangibles, net	490	597	404
Other assets	1,114	1,040	991
Total assets	$ 9,497	$ 9,421	$ 9,554
Liabilities and Share Owners' Equity			
Current liabilities:			
Short-term loans and long-term debt due within one year	$ 262	$ 228	$ 250
Current portion of asbestos-related liabilities	130	130	143
Accounts payable	1,059	1,212	1,004
Other liabilities	582	552	527
Total current liabilities	2,033	2,122	1,924
Long-term debt	5,333	5,345	5,609
Asbestos-related liabilities	643	687	738
Other long-term liabilities	973	988	909
Share owners' equity	515	279	374
Total liabilities and share owners' equity	$ 9,497	$ 9,421	$ 9,554

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED CASH FLOWS

(Dollars in millions)

	Nine months ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net earnings	$ 296	$ 144
Loss from discontinued operations	6	3
Non-cash charges		
Depreciation and amortization	372	296
Pension expense	22	22
Restructuring, asset impairment and related charges	19	57
Cash payments		
Pension contributions	(15)	(13)
Asbestos-related payments	(45)	(58)
Cash paid for restructuring activities	(20)	(20)
Change in components of working capital	(320)	(326)
Other, net (a)	(89)	1
Cash provided by continuing operating activities	226	106
Cash utilized in discontinued operating activities	(6)	(3)
Total cash provided by operating activities	220	103
Cash flows from investing activities:		
Additions to property, plant and equipment	(310)	(299)
Acquisitions, net of cash acquired	(45)	(2,342)
Net cash proceeds related to sale of assets	57	1
Net foreign exchange derivative activity	16	2
Cash utilized in investing activities	(282)	(2,638)
Cash flows from financing activities:		
Changes in borrowings, net	(31)	2,522
Issuance of common stock	5	1
Treasury shares purchased		(100)
Distributions to noncontrolling interests	(10)	(13)
Payment of finance fees	(3)	(88)
Cash provided by (utilized in) financing activities	(39)	2,322
Effect of exchange rate fluctuations on cash	(4)	(29)
Decrease in cash	(105)	(242)
Cash at beginning of period	399	512
Cash at end of period	$ 294	$ 270

(a) Other, net includes other non-cash charges plus other changes in non-current assets and liabilities.

See accompanying notes.

OWENS-ILLINOIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Tabular data dollars in millions, except per share amounts

1. Segment Information

The Company has four reportable segments based on its geographic locations: Europe, North America, Latin America and Asia Pacific. These four segments are aligned with the Company's internal approach to managing, reporting, and evaluating performance of its global glass operations. Certain assets and activities not directly related to one of the regions or to glass manufacturing are reported with Retained corporate costs and other. These include licensing, equipment manufacturing, global engineering, and certain equity investments. Retained corporate costs and other also includes certain headquarters administrative and facilities costs and certain incentive compensation and other benefit plan costs that are global in nature and are not allocable to the reportable segments.

The Company's measure of profit for its reportable segments is segment operating profit, which consists of consolidated earnings from continuing operations before interest income, interest expense, and provision for income taxes and excludes amounts related to certain items that management considers not representative of ongoing operations as well as certain retained corporate costs. The Company's management uses segment operating profit, in combination with selected cash flow information, to evaluate performance and to allocate resources. Segment operating profit for reportable segments includes an allocation of some corporate expenses based on both a percentage of sales and direct billings based on the costs of specific services provided.

Financial information for the three and nine months ended September 30, 2016 and 2015 regarding the Company's reportable segments is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net sales:				
Europe	$ 586	$ 605	$ 1,795	$ 1,809
North America	578	520	1,709	1,520
Latin America	365	265	1,022	677
Asia Pacific	170	162	487	478
Reportable segment totals	1,699	1,552	5,013	4,484
Other	13	14	47	46
Net sales	$ 1,712	$ 1,566	$ 5,060	$ 4,530

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Segment operating profit:				
Europe	$ 64	$ 68	$ 192	$ 181
North America	79	61	247	214
Latin America	74	51	194	108
Asia Pacific	20	19	48	51
Reportable segment totals	237	199	681	554
Items excluded from segment operating profit:				
Retained corporate costs and other	(18)	(10)	(75)	(49)
Restructuring, asset impairment and other		(41)	(12)	(68)
Strategic transaction costs		(13)		(19)
Acquisition-related fair value inventory adjustments		(10)		(10)
Interest expense, net	(66)	(67)	(199)	(188)
Earnings from continuing operations before income taxes	$ 153	$ 58	$ 395	$ 220

Financial information regarding the Company's total assets is as follows:

	September 30, 2016	December 31, 2015	September 30, 2015
Total assets:			
Europe	$ 2,972	$ 2,902	$ 3,030
North America	2,536	2,500	2,028
Latin America	2,629	2,807	3,297
Asia Pacific	1,025	917	894
Reportable segment totals	9,162	9,126	9,249
Other	335	295	305
Consolidated totals	$ 9,497	$ 9,421	$ 9,554

2. Inventories

Major classes of inventory at September 30, 2016, December 31, 2015 and September 30, 2015 are as follows:

	September 30, 2016	December 31, 2015	September 30, 2015
Finished goods	$ 892	$ 858	$ 873
Raw materials	127	113	114
Operating supplies	38	36	36
	$ 1,057	$ 1,007	$ 1,023

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3. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets at September 30, 2016, December 31, 2015 and September 30, 2015 are as follows:

	September 30, 2016	December 31, 2015	September 30, 2015
Prepaid expenses	$ 61	$ 52	$ 50
Value added taxes	42	195	224
Other	131	119	168
	$ 234	$ 366	$ 442

In conjunction with the Vitro Acquisition in September of 2015, part of the total consideration paid by the Company included a value added tax receivable, which is included above as of December 31, 2015 and September 30, 2015. In the third quarter of 2016, approximately $127 million of this receivable was collected by the Company. The remaining $6 million of this receivable is expected to be refunded to the Company within the next twelve months.

4. Derivative Instruments

The Company has certain derivative assets and liabilities which consist of natural gas forwards and foreign exchange option and forward contracts. The Company uses an income approach to value these contracts. Natural gas forward rates and foreign exchange rates are the significant inputs into the valuation models. These inputs are observable in active markets over the terms of the instruments the Company holds, and accordingly, the Company classifies its derivative assets and liabilities as Level 2 in the hierarchy. The Company also evaluates counterparty risk in determining fair values.

Commodity Forward Contracts Designated as Cash Flow Hedges

In several regions, the Company enters into commodity forward contracts related to forecasted natural gas requirements, the objectives of which are to limit the effects of fluctuations in the future market price paid for natural gas and the related volatility in cash flows. In North America, the majority of its customer contracts contain provisions that pass the price of natural gas to its customers. In certain of these contracts, the customer has the option of fixing the natural gas price component for a specified period of time. To limit the effects of fluctuations in cash flows resulting from these customer contracts, the Company enters into commodity forward contracts related to forecasted natural gas requirements. In Asia Pacific, the Company implemented a hedging program in the first quarter of 2016, which included the execution of commodity forward contracts for certain contracted natural gas requirements. At September 30, 2016 and 2015, the Company had entered into commodity forward contracts covering approximately 12,400,000 MM BTUs and 6,300,000 MM BTUs, respectively.

The Company accounts for the above forward contracts as cash flow hedges at September 30, 2016 and recognizes them on the balance sheet at fair value. The effective portion of changes in the fair value of a derivative that is designated as, and meets the required criteria for, a cash flow hedge is recorded in the Accumulated Other Comprehensive Income component of share owners' equity ("OCI") and reclassified into earnings in the same period or periods during which the underlying hedged item affects earnings. An unrecognized gain of $2 million at September 30, 2016, an unrecognized loss of $4 million at December 31, 2015 and an unrecognized gain of $2 million at September 30 2015, respectively, related to the commodity forward contracts was included in Accumulated OCI, and will be reclassified into earnings in the period when the commodity forward contracts expire. Any material portion of the change in the fair value of a derivative designated as a cash flow hedge that is deemed to be ineffective is recognized in current earnings. The ineffectiveness related to these natural gas hedges for the three and nine months ended September 30, 2016 and 2015 was not material.

The effect of the commodity forward contracts on the results of operations for the three months ended September 30, 2016 and 2015 is as follows:

Amount of Gain (Loss) Recognized in OCI on Commodity Forward Contracts (Effective Portion)		Amount of Gain Reclassified from Accumulated OCI into Income (reported in cost of goods sold) (Effective Portion)	
2016	2015	2016	2015
$ (1)	$ 2	$ —	$ 4

The effect of the commodity forward contracts on the results of operations for the nine months ended September 30, 2016 and 2015 is as follows:

Amount of Gain Recognized in OCI on Commodity Forward Contracts (Effective Portion)		Amount of Gain Reclassified from Accumulated OCI into Income (reported in cost of goods sold) (Effective Portion)	
2016	2015	2016	2015
$ 2	$ 2	$ —	$ 6

Foreign Exchange Derivative Contracts and not Designated as Hedging Instruments

The Company may enter into short-term forward exchange or option agreements to purchase foreign currencies at set rates in the future. These agreements are used to limit exposure to fluctuations in foreign currency exchange rates for significant planned purchases of fixed assets or commodities that are denominated in currencies other than the subsidiaries' functional currency. The Company may also use foreign exchange agreements to offset the foreign currency risk for receivables and payables, including intercompany receivables, payables, and loans, not denominated in, or indexed to, their functional currencies. The Company records these short-term foreign exchange agreements on the balance sheet at fair value and changes in the fair value are recognized in current earnings.

At September 30, 2016 and 2015, the Company had outstanding foreign exchange and option agreements denominated in various currencies covering the equivalent of approximately $580 million and $600 million, respectively, related primarily to intercompany transactions and loans.

The effect of the foreign exchange derivative contracts on the results of operations for the three months ended September 30, 2016 and 2015 is as follows:

Location of Gain (Loss) Recognized in Income on	Amount of Gain (Loss) Recognized in Income on

Foreign Exchange Contracts	Foreign Exchange Contracts 2016	2015
Other expense	$ 4	$ (4)

The effect of the foreign exchange derivative contracts on the results of operations for the nine months ended September 30, 2016 and 2015 is as follows:

Location of Gain Recognized in Income on Foreign Exchange Contracts	Amount of Gain Recognized in Income on Foreign Exchange Contracts 2016	2015
Other expense	$ 6	$ 2

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Balance Sheet Classification

The Company records the fair values of derivative financial instruments on the balance sheet as follows:
(a) receivables if the instrument has a positive fair value and maturity within one year, (b) deposits, receivables, and other assets if the instrument has a positive fair value and maturity after one year, and (c) other accrued liabilities or other liabilities (current) if the instrument has a negative fair value and maturity within one year.

The following table shows the amount and classification (as noted above) of the Company's derivatives at September 30, 2016, December 31, 2015 and September 30, 2015:

	Balance Sheet Location	Fair Value September 30, 2016	December 31, 2015	September 30, 2015
Asset derivatives:				
Derivatives designated as hedging instruments:				
Commodity forwards contracts	a	$ 2	$ —	$ —
Derivatives not designated as hedging instruments:				
Foreign exchange derivative contracts	a	8	14	16
Total asset derivatives		$ 10	$ 14	$ 16
Liability derivatives:				
Derivatives designated as hedging instruments:				
Commodity forwards contracts	c	$ —	$ 3	$ 2
Derivatives not designated as hedging instruments:				
Foreign exchange derivative contracts	c	2	2	4
Total liability derivatives		$ 2	$ 5	$ 6

5. Restructuring Accruals

Selected information related to the restructuring accruals for the three months ended September 30, 2016 and 2015 is as follows:

	Asia Pacific Restructuring	Other Restructuring Actions	Total Restructuring
Balance at July 1, 2016	$ 6	$ 28	$ 34
Net cash paid, principally severance and related benefits	(1)	(2)	(3)
Other, including foreign exchange translation		(2)	(2)
Balance at September 30, 2016	$ 5	$ 24	$ 29

	European Asset Optimization	Asia Pacific Restructuring	Other Restructuring Actions	Total Restructuring
Balance at July 1, 2015	$ 11	$ 8	$ 33	$ 52
Charges			35	35
Write-down of assets to net realizable value			(19)	(19)
Net cash paid, principally severance and related benefits		(1)	(4)	(5)
Other, including foreign exchange translation			(1)	(1)
Balance at September 30, 2015	$ 11	$ 7	$ 44	$ 62

Selected information related to the restructuring accruals for the nine months ended September 30, 2016 and 2015 is as follows:

	Asia Pacific Restructuring	Other Restructuring Actions	Total Restructuring
Balance at January 1, 2016	$ 7	$ 36	$ 43
Charges	1	18	19
Write-down of assets to net realizable value		(7)	(7)
Net cash paid, principally severance and related benefits	(2)	(18)	(20)
Other, including foreign exchange translation	(1)	(5)	(6)
Balance at September 30, 2016	$ 5	$ 24	$ 29

	European Asset Optimization	Asia Pacific Restructuring	Other Restructuring Actions	Total Restructuring

Balance at January 1, 2015	$ 12	$ 12	$ 36	$ 60
Charges		5	52	57
Write-down of assets to net realizable value		(4)	(26)	(30)
Net cash paid, principally severance and related benefits		(5)	(15)	(20)
Other, including foreign exchange translation	(1)	(1)	(3)	(5)
Balance at September 30, 2015	$ 11	$ 7	$ 44	$ 62

The Company's decisions to curtail selected production capacity have resulted in write downs of certain long-lived assets to the extent their carrying amounts exceeded fair value or fair value less cost to sell. The Company classified the significant assumptions used to determine the fair value of the impaired assets, which was not material, as Level 3 in the fair value hierarchy as set forth in the general accounting principles for fair value measurements.

Asia Pacific Restructuring

During the nine months ended September 30, 2016, the Company recorded charges of $1 million. These charges primarily represented other exit costs as part of the Company's Asia Pacific Restructuring program.

During the three and nine months ended September 30, 2015, the Company recorded charges of $5 million. These charges primarily represented the write-down of assets as part of the Company's Asia Pacific Restructuring program.

The Company has recorded total cumulative charges of $221 million under this program.

Other Restructuring Actions

During the nine months ended September 30, 2016, the Company recorded charges of $18 million. These charges primarily represented employee costs, write-down of assets, and other exit costs of $14 million for a plant closure in the first quarter of 2016 in Latin America, $3 million related to a previous plant closure in North America and $1 million related to other restructuring actions.

During the three and nine months ended September 30, 2015, the Company recorded charges of $35 million and $52 million, respectively. For the nine months ended September 30, 2015, these charges primarily represented employee costs, write-down of assets, and other exit costs of $14 million for furnace closures in Latin America, $35 million of severance and other exit costs related to a plant closure in North America and $3 million related to other restructuring actions.

6. Pension Benefit Plans

The components of the net periodic pension cost for the three months ended September 30, 2016 and 2015 are as follows:

	U.S.		Non-U.S.	
	2016	2015	2016	2015
Service cost	$ 3	$ 6	$ 4	$ 5
Interest cost	23	24	12	15
Expected asset return	(37)	(42)	(19)	(23)
Amortization:				
Actuarial loss	16	17	5	5
Net periodic pension cost	$ 5	$ 5	$ 2	$ 2

The components of the net periodic pension cost for the nine months ended September 30, 2016 and 2015 are as follows:

	U.S.		Non-U.S.	
	2016	2015	2016	2015
Service cost	$ 11	$ 18	$ 13	$ 14
Interest cost	72	72	38	39
Expected asset return	(113)	(126)	(61)	(65)
Amortization:				
Actuarial loss	47	55	15	15
Net periodic pension cost	$ 17	$ 19	$ 5	$ 3

In March 2016, the Company remeasured the liability related to its hourly plan in the U.S. to reflect certain changes in future benefits. The remeasurement resulted in an increase to its pension liability of approximately $60 million and has been reflected in other comprehensive income.

7. Income Taxes

The Company performs a quarterly review of the annual effective tax rate and makes changes if necessary based on new information or events. The estimated annual effective tax rate is forecasted quarterly using actual historical information and forward-looking estimates. The estimated annual effective tax rate may fluctuate due to changes in forecasted annual operating income; changes in the forecasted mix of earnings by country; changes to the valuation allowance for deferred tax assets (such changes would be recorded discretely in the quarter in which they occur); changes to actual or forecasted permanent book to tax differences (non-deductible expenses); impacts from future tax settlements with state, federal or foreign tax authorities (such changes would be recorded discretely in the quarter in which they occur); or impacts from tax law changes. To the extent such changes impact deferred tax assets/liabilities, these changes would generally be recorded discretely in the quarter in which they occur. Additionally, the annual effective tax rate differs from the statutory U.S. Federal tax rate of 35% primarily because of valuation allowances in some jurisdictions and varying non-U.S. tax rates.

8. Debt

The following table summarizes the long-term debt of the Company:

	September 30, 2016	December 31, 2015	September 30, 2015
Secured Credit Agreement:			
Revolving Credit Facility:			
Revolving Loans	$ —	$ —	$ 220
Term Loans:			
Term Loan A	1,516	1,546	1,546
Term Loan A (€279 million at September 30, 2016)	303	301	309
Term Loan B	558	563	563
Senior Notes:			
6.75%, due 2020 (€500 million)	557	542	557
4.875%, due 2021 (€330 million)	367	357	367
5.00%, due 2022	495	494	494
5.875%, due 2023	681	680	679
5.375%, due 2025	296	296	296
6.375%, due 2025	294	293	293
Senior Debentures:			
7.80%, due 2018	250	250	250
Capital Leases	62	62	