Rock-Tenn CO
Form 10-Q
February 05, 2009
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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 December 31, 2008

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 1-12613

Rock-Tenn Company

(Exact Name of Registrant as Specified in Its Charter)

Georgia	**62-0342590**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

504 Thrasher Street, Norcross, Georgia	**30071**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s Telephone Number, Including Area Code: (770) 448-2193

N/A

(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Class	**Outstanding as of January 28, 2009**
Class A Common Stock, $0.01 par value	38,231,568

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PART I: FINANCIAL INFORMATION

Item 1. ***FINANCIAL STATEMENTS (UNAUDITED)***

ROCK-TENN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In Millions, Except Per Share Data)

	Three Months Ended December 31,	
	2008	2007
Net sales	$ 703.1	$ 596.3
Cost of goods sold	538.3	489.3
Gross profit	164.8	107.0
Selling, general and administrative expenses	81.5	65.2
Restructuring and other costs, net	6.5	3.0
Operating profit	76.8	38.8
Interest expense	(26.4)	(11.8)
Loss on extinguishment of debt	(2.4)	
Interest and other income (expense), net	0.4	(0.1)
Equity in loss of unconsolidated entities	(0.4)	(0.3)
Minority interest in income of consolidated subsidiaries	(0.7)	(0.9)
Income before income taxes	47.3	25.7
Income tax expense	(16.7)	(8.2)
Net income	$ 30.6	$ 17.5
Weighted average diluted shares outstanding	38.5	38.0
Basic earnings per share:		
Net income	$ 0.81	$ 0.47
Diluted earnings per share:		
Net income	$ 0.79	$ 0.46
Cash dividends paid per common share	$ 0.10	$ 0.10

See Accompanying Notes to Condensed Consolidated Financial Statements

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ROCK-TENN COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In Millions, Except Per Share Data)

	December 31, 2008	September 30, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 12.7	$ 52.8
Restricted cash and marketable debt securities		19.2
Accounts receivable (net of allowances of $11.5 and $9.0)	270.1	304.3
Inventories	292.3	283.0
Other current assets	49.4	49.2
Assets held for sale	0.7	0.7
Total current assets	625.2	709.2
Property, plant and equipment at cost:		
Land and buildings	394.0	398.3
Machinery and equipment	1,802.2	1,826.2
Transportation equipment	15.2	15.2
Leasehold improvements	5.7	7.6
	2,217.1	2,247.3
Less accumulated depreciation and amortization	(918.9)	(914.2)
Net property, plant and equipment	1,298.2	1,333.1
Goodwill	721.7	727.0
Intangibles, net	173.0	176.9
Investment in unconsolidated entities	25.7	29.4
Other assets	37.5	37.5
	$ 2,881.3	$ 3,013.1
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of debt	$ 191.5	$ 245.1
Accounts payable	205.1	241.5
Accrued compensation and benefits	68.1	95.2
Other current liabilities	69.4	65.9
Total current liabilities	534.1	647.7
Long-term debt due after one year	1,408.3	1,447.2
Hedge adjustments resulting from terminated fair value interest rate derivatives or swaps	6.1	6.6
Total long-term debt	1,414.4	1,453.8

Accrued pension and other long-term benefits	72.6	70.8
Deferred income taxes	153.3	153.3
Other long-term liabilities	52.5	29.4
Commitments and contingencies (Note 12)		
Minority interest	17.4	17.6
Shareholders equity:		
Preferred stock, $0.01 par value; 50,000,000 shares authorized; no shares outstanding		
Class A common stock, $0.01 par value; 175,000,000 shares authorized; 38,229,868 and 38,228,523 shares outstanding at December 31, 2008 and September 30, 2008, respectively	0.4	0.4
Capital in excess of par value	241.6	238.8
Retained earnings	448.5	421.7
Accumulated other comprehensive loss	(53.5)	(20.4)
Total shareholders equity	637.0	640.5
	$ 2,881.3	$ 3,013.1

See Accompanying Notes to Condensed Consolidated Financial Statements

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ROCK-TENN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In Millions)

	Three Months Ended December 31,	
	2008	2007
Operating activities:		
Net income	$ 30.6	$ 17.5
Items in income not affecting cash:		
Depreciation and amortization	37.9	25.8
Deferred income tax expense (benefit)	7.7	(2.7)
Share-based compensation expense	2.1	2.0
Gain on disposal of plant, equipment and other, net	(0.4)	(0.2)
Minority interest in income of consolidated subsidiaries	0.7	0.9
Equity in loss of unconsolidated entities	0.4	0.3
Payment on termination of cash flow interest rate hedges		(3.5)
Pension funding less (more) than expense	2.3	(0.9)
Impairment adjustments and other non-cash items	(0.7)	1.7
Change in operating assets and liabilities, net of acquisitions:		
Accounts receivable	29.4	18.1
Inventories	(13.8)	(2.0)
Other assets	(0.4)	(10.7)
Accounts payable	(33.7)	(14.4)
Income taxes payable	5.8	9.2
Accrued liabilities and other	(18.3)	(18.8)
Net cash provided by operating activities	49.6	22.3
Investing activities:		
Capital expenditures	(14.2)	(17.9)
Cash paid for purchase of business, net of cash received		(0.8)
Investment in unconsolidated entities	(0.5)	
Return of capital from unconsolidated entities	3.5	0.2
Proceeds from sale of property, plant and equipment	0.5	2.2
Net cash used for investing activities	(10.7)	(16.3)
Financing activities:		
Additions to revolving credit facilities	143.7	39.5
Repayments of revolving credit facilities	(41.8)	(17.7)
Additions to debt	74.0	10.0
Repayments of debt	(265.8)	(7.2)
Debt issuance costs	(0.4)	
Restricted cash and investments	19.2	
Issuances of common stock	0.7	0.6
Repayments to unconsolidated entity	(5.3)	(2.0)
Cash dividends paid to shareholders	(3.8)	(3.8)
Cash distributions paid to minority interest		(0.7)
Net cash (used for) provided by financing activities	(79.5)	18.7

Effect of exchange rate changes on cash and cash equivalents	0.5	
(Decrease) increase in cash and cash equivalents	(40.1)	24.7
Cash and cash equivalents at beginning of period	52.8	10.9
Cash and cash equivalents at end of period	$ 12.7	$ 35.6
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes, net of refunds	$ 2.3	$ 1.5
Interest, net of amounts capitalized	19.2	5.9

See Accompanying Notes to Condensed Consolidated Financial Statements

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ROCK-TENN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Month Period Ended December 31, 2008

(Unaudited)

The condensed consolidated financial statements include our accounts and the accounts of our partially-owned consolidated subsidiaries. Unless the context otherwise requires, ***we*** *,* ***us*** *,* ***our*** *,* ***RockTenn*** *and* ***the Company*** *refer to the business of Rock-Tenn Company, its wholly-ow subsidiaries and its partially-owned consolidated subsidiaries. Our references to the business of Rock-Tenn Company do not include entities that we do not consolidate but account for using the equity method.*

We are primarily a manufacturer of packaging products, recycled paperboard, containerboard, bleached paperboard and merchandising displays.

Note 1. Interim Financial Statements

Our independent public accounting firm has not audited our accompanying interim financial statements. We derived the condensed consolidated balance sheet at September 30, 2008 from the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2008 (the **Fiscal 2008 Form 10-K**). In the opinion of our management, the condensed consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair presentation of our results of operations for the three months ended December 31, 2008 and 2007, our financial position at December 31, 2008 and September 30, 2008, and our cash flows for the three months ended December 31, 2008 and 2007.

We have condensed or omitted certain notes and other information from the interim financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these interim statements should be read in conjunction with our Fiscal 2008 Form 10-K.

The results for the three months ended December 31, 2008 are not necessarily indicative of results that may be expected for the full year.

Note 2. New Accounting Standards

Recently Adopted Standards

We adopted Statement of Accounting Standards No. 157, *Fair Value Measurements* (**SFAS 157**) as of October 1, 2008, the beginning of our current fiscal year. See ***Note 10. Fair Value.***

Recently Issued Standards

In December 2007, the Financial Accounting Standards Board (**FASB**) issued SFAS No. 141 (revised 2007), *Business Combinations* (**SFAS 141(R)**). SFAS 141(R) expands the definition of a business combination and requires the fair value of the purchase price of an acquisition, including the issuance of equity securities, to be determined on the acquisition date. SFAS 141(R) also requires that all assets, liabilities, contingent considerations, and contingencies of an acquired business be recorded at fair value at the acquisition date. In addition, SFAS 141(R) requires that acquisition costs generally be expensed as incurred, restructuring costs generally be expensed in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period impact income tax expense. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008 (October 1, 2009 for us) with early adoption prohibited. We are currently evaluating the effect the implementation of SFAS 141(R) will have on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51* (**SFAS 160**). SFAS 160 changes the accounting and reporting for minority interests such that minority interests will be recharacterized as noncontrolling interests and will be required to be reported as a component of equity, requires that purchases or sales of subsidiaries equity interests that do not result in a change in control be accounted for as equity transactions and, upon a loss of control, requires the interest sold, as well as any interest retained, to be recorded at fair value with any gain or loss recognized in earnings. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008 (October 1, 2009 for us) with early adoption prohibited. We are currently evaluating the effect the implementation of SFAS 160 will have on our consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

In February 2008, the FASB issued FASB Staff Position 157-2, *Effective Date of FASB Statement No. 157* (**FSP 157-2**) that deferred the effective date of SFAS 157 until fiscal years beginning after November 15, 2008 (October 1, 2009 for us) for the application of SFAS 157 to all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). We are currently evaluating the effect the implementation of FSP 157-2 will have on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (**SFAS 161**). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 (January 1, 2009 for us). We expect to provide the related disclosures in our interim financial statements as of March 31, 2009.

Note 3. Comprehensive (Loss) Income

The following are the components of comprehensive (loss) income (in millions):

	Three Months Ended December 31,	
	2008	2007
Net income	$ 30.6	$ 17.5
Foreign currency translation adjustments	(19.7)	
Reclassification of net gain on cash flow hedges to earnings, net of tax	(0.1)	(0.3)
Net unrealized (loss) income on cash flow hedges, net of tax	(13.3)	0.1
Comprehensive (loss) income	$ (2.5)	$ 17.3

The change in other comprehensive income due to foreign currency translation was primarily due to the change in the Canadian/U.S. dollar exchange rates.

Note 4. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share (in millions, except per share data):

	Three Months Ended December 31,	
	2008	2007
Numerator:		
Net income	$ 30.6	$ 17.5
Denominator:		
Denominator for basic earnings per share weighted average shares	37.7	37.3
Effect of dilutive stock options and restricted stock awards	0.8	0.7
Denominator for diluted earnings per share weighted average shares and assumed conversions	38.5	38.0

Basic earnings per share:		
Net income per share basic	$ 0.81	$ 0.47
Diluted earnings per share:		
Net income per share diluted	$ 0.79	$ 0.46

Options to purchase 0.5 million and 0.3 million common shares were not included in computing diluted earnings per share in the three months ended December 31, 2008 and 2007, respectively, because the effect would have been antidilutive.

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Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Note 5. Acquisitions

Southern Container Acquisition

On March 5, 2008, we acquired the stock of Southern Container Corp. (**Southern Container**). We have included the results of Southern Container s operations in our financial statements in our Corrugated Packaging segment since the March 2, 2008 effective date. We made the acquisition in order to expand our corrugated packaging business with the Southern Container operations that we believe have the lowest system costs and the highest EBITDA margins of any major integrated corrugated company in North America.

The purchase price for the acquisition was $1,060.0 million, net of cash received of $54.0 million, including expenses. RockTenn and Southern Container made an election under section 338(h)(10) of the Internal Revenue Code of 1986, as amended (the **Code**) that increased RockTenn s tax basis in the acquired assets and is expected to result in a net present value benefit, subject to the completion of the final purchase price allocation, of approximately $150 million, net of an agreed upon payment included in the purchase price, for the election to the sellers of approximately $68.7 million paid to Southern Container s former stockholders in November 2008. In fiscal 2008, we incurred $26.8 million of debt issuance costs in connection with the transaction.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. We are in the process of analyzing the estimated values of assets and liabilities acquired and are obtaining third-party valuations of certain tangible and intangible assets, thus, the allocation of the purchase price is preliminary and subject to material revision.

Our preliminary allocation of purchase price as of March 2, 2008, follows (in millions):

Current assets, net of cash received	$ 135.0
Property, plant, and equipment	547.1
Goodwill	364.9
Intangible assets	120.7
Other long-term assets	15.8
Total assets acquired	1,183.5
Current portion of debt	116.9
Current liabilities	83.5
Long-term debt due after one year	126.3
Minority interest and other long-term liabilities	40.0
Total liabilities assumed	366.7
Net assets acquired	$ 816.8

We recorded estimated fair values for acquired assets and liabilities, including goodwill and intangibles. The intangibles are being amortized over estimated useful lives ranging generally from 11 to 40 years on a straight-line basis over a weighted average life of approximately 18 years, and 15 years for tax purposes. We recorded $72.9 million of customer relationship intangibles with a weighted average life of approximately 15 years, $18.4 million of trade names and trademarks with a weighted average life of approximately 39 years and $29.4 million for a steam supply contract with a weighted average life of approximately 11 years. None of the intangibles has significant residual value. A substantial portion of the goodwill is deductible for income tax purposes as a result of the Code section 338(h)(10) election.

The following unaudited pro forma information reflects our consolidated results of operations as if the Southern Container acquisition had taken place as of the beginning of the period presented. The unaudited pro forma information includes adjustments primarily for depreciation and

amortization based on the preliminary fair value of the acquired property, plant and equipment, acquired intangibles and interest expense on the acquisition financing debt. We have also added back the minority interest in the earnings of the Solvay mill subsidiary, since such interests were acquired by Southern Container prior to our acquisition; we have eliminated certain expenses that Southern Container historically incurred that the combined company does not expect to incur due to changes in employment and other contractual arrangements. The unaudited pro forma information in the table below for the three months ended December 31, 2007, is not necessarily indicative of the results of operations that we would have reported had the transaction actually occurred at the beginning of this period nor is it necessarily indicative of future results.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(In millions, except per share data)	
Net sales	$ 776.2
Net income	$ 29.1
Diluted earnings per common share	$ 0.77

Prior to the acquisition, Southern Container used a 52/53 week fiscal year and reported its results of operations in three 12-week periods and one 16-week period, with the 16-week period being the fourth period and ending on the last Saturday of the calendar year. The unaudited pro forma information above for the three months ended December 31, 2007 utilizes the condensed consolidated statements of income for RockTenn for the three months ended December 31, 2007 and the condensed consolidated statements of operations of Southern Container for the 16 weeks ended December 29, 2007.

Note 6. Restructuring and Other Costs, Net

Summary of Restructuring and Other Initiatives

We recorded pre-tax restructuring and other costs, net, of $6.5 million and $3.0 million for the three months ended December 31, 2008 and 2007, respectively. These amounts are not comparable since the timing and scope of the individual actions associated with a restructuring can vary. We discuss these charges in more detail below.

The following table presents a summary of restructuring and other charges, net, related to our active restructuring initiatives that we incurred during the three months ended December 31, 2008 and 2007, the cumulative recorded amount since we announced each initiative, and the total we expect to incur (in millions):

Summary of Restructuring and Other Costs (Income), Net

Segment	Period	Net Property, Plant and Equipment [1]	Severance and Other Employee Related Costs	Equipment and Inventory Relocation Costs	Facility Carrying Costs	Other Costs	Total
Consumer Packaging [a]	Current Qtr.	$ 0.1	$ 0.1	$ 0.4	$	$ 1.2	$ 1.8
	Prior Year Qtr.	1.9	1.1	0.1	0.1	0.1	3.3
	Cumulative	4.0	4.3	2.4	1.0	5.5	17.2
	Expected Total	4.0	4.3	2.4	1.0	5.5	17.2
Corrugated Packaging [b]	Current Qtr.			0.1			0.1
	Prior Year Qtr.						
	Cumulative	1.6	0.3	0.1		0.3	2.3
	Expected Total	1.6	0.3	0.4	0.2	0.4	2.9
Specialty Paperboard Products[c]	Current Qtr.						
	Prior Year Qtr.	(0.3)					(0.3)
	Cumulative	(0.2)	0.2	0.1	0.4	(0.1)	0.4
	Expected Total	(0.2)	0.2	0.1	0.4	(0.1)	0.4
Other[d]	Current Qtr.					4.6	4.6
	Prior Year Qtr.						

	Cumulative									14.2	14.2
	Expected Total									16.7	16.7
Total	Current Qtr.	$	0.1	$	0.1	$	0.5	$		$ 5.8	$ 6.5
	Prior Year Qtr.	$	1.6	$	1.1	$	0.1	$	0.1	$ 0.1	$ 3.0
	Cumulative	$	5.4	$	4.8	$	2.6	$	1.4	$ 19.9	$ 34.1
	Expected Total	$	5.4	$	4.8	$	2.9	$	1.6	$ 22.5	$ 37.2

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

(1) For this Note 6, we have defined **Net property, plant and equipment** as: property, plant and equipment impairment losses, subsequent adjustments to fair value for assets classified as held for sale, and subsequent (gains) or losses on sales of property, plant and equipment and related parts and supplies.

When we close a facility we recognize an impairment charge primarily to reduce the carrying value of equipment or other property to their estimated fair value or fair value less cost to sell, and record charges for severance and other employee related costs. Any subsequent change in fair value less cost to sell prior to disposition is recognized as identified; however, no gain is recognized in excess of the cumulative loss previously recorded. At the time of each announced closure, we generally expect to record future charges for equipment relocation, facility carrying costs, costs to terminate a lease or contract before the end of its term and other employee related costs. Expected future charges are reflected in the table above in the Expected Total lines until incurred.

(a) The Consumer Packaging segment charges primarily reflect the following folding carton plant closures recorded: Baltimore, Maryland (announced in fiscal 2008 and closed in fiscal 2009), Chicopee, Massachusetts (announced and closed in fiscal 2008), Stone Mountain, Georgia (announced and closed in fiscal 2007), and Kerman, California (announced and closed in fiscal 2006). Although specific circumstances vary, our strategy has generally been to consolidate our business into large well-equipped plants that operate at high utilization rates and take advantage of open capacity created by operational excellence initiatives. Therefore, we transfer a substantial portion of each plant s assets and production to our other folding carton plants. We believe these actions have allowed us to more effectively manage our business.

(b) The Corrugated Packaging segment charges primarily reflect the closure of our Greenville, South Carolina sheet plant (announced in fiscal 2008 and closed in fiscal 2009). We have transferred a substantial portion of Greenville s production to our other corrugated plants.

(c) The Specialty Paperboard Products segment income in fiscal 2008 primarily reflects the gain on sale of real estate relating to a previously closed facility.

(d) The expenses in the Other Costs column for the current quarter reflect Southern Container integration expenses of $2.4 million pre-tax and deferred compensation expense of $2.1 million pre-tax for key Southern Container employees. We expect to recognize a total of approximately $9 million of deferred compensation and retention bonus expense funded through a purchase price reduction from Southern Container s stockholders. We expect to expense the final $1.4 million of deferred compensation in the second quarter of fiscal 2009. Nearly all of these funds were escrowed and are primarily to be paid one year after the acquisition closing. Any of the funds forfeited by the employees, because they voluntarily terminate their employment prior to the first anniversary of the Southern Container acquisition, are payable to the former Southern Container stockholders.

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Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

The following table represents a summary of the restructuring accrual, which is primarily composed of accrued severance and other employee costs, and a reconciliation of the restructuring accrual to the line item **Restructuring and other costs, net** on our condensed consolidated statements of income for the three months ended December 31, 2008 and 2007 (in millions):

	2008	2007
Accrual at beginning of fiscal year	$ 3.4	$ 2.4
Additional accruals	1.0	1.1
Payments	(1.3)	(0.3)
Adjustments to accrual	0.4	
Accrual at December 31,	$ 3.5	$ 3.2

Reconciliation of accruals and charges to restructuring and other costs, net:

	2008	2007
Additional accruals and adjustments to accruals (see table above)	$ 1.4	$ 1.1
Integration expenses	1.9	
Deferred compensation expense	2.1	
Net property, plant and equipment	0.1	1.6
Severance and other employee costs	0.2	0.1
Equipment relocation	0.5	0.1
Facility carrying costs		0.1
Other	0.3	
Total restructuring and other costs, net	$ 6.5	$ 3.0

Note 7. Tax Provision

We recorded income tax expense of $16.7 million in the first quarter of fiscal 2009 compared to $8.2 million in the first quarter of last year. The first quarter of fiscal 2009 and 2008 effective rates were approximately 35.3% and 31.9%, respectively. In the first quarter of fiscal 2009 we recorded a $0.7 million tax benefit related to extension of the United States federal research credit, which was partially offset by $0.4 million deferred tax expense related to changes in state effective rates. The effective rate for the first quarter of fiscal 2008 was primarily impacted by a tax benefit of $1.1 million related to a tax rate reduction in Canada.

As of December 31, 2008, the gross amount of unrecognized tax benefits was approximately $13.7 million, exclusive of interest and penalties. Of this balance, if we were to prevail on all unrecognized tax benefits recorded, approximately $4.7 million would benefit the effective tax rate. We regularly evaluate, assess and adjust the related liabilities in light of changing facts and circumstances, which could cause the effective tax rate to fluctuate from period to period.

We recognize interest and penalties related to unrecognized tax benefits in income tax expense in the consolidated statements of income, which is consistent with the recognition of these items in prior reporting periods. As of December 31, 2008, we had a recorded liability of $2.2 million for the payment of interest and penalties related to the FIN 48 liability for unrecognized tax benefits.

We file federal, state and local income tax returns in the U.S. and various foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to fiscal 2001.

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Note 8. Inventories

We value substantially all of our U.S. inventories at the lower of cost or market, with cost determined on the last-in first-out (**LIFO**) inventory valuation method, which we believe generally results in a better matching of current costs and revenues than under the first-in first-out (**FIFO**) inventory valuation method. In periods of increasing costs, the LIFO method generally results in higher cost of goods sold than under the FIFO method. In periods of decreasing costs, the results are generally the opposite. Because LIFO is designed for annual determinations, it is possible to make an actual valuation of inventory under the LIFO method only at the end of each fiscal year based on the inventory levels and costs at that time. Accordingly, we base interim LIFO estimates on management s projection of expected year-end inventory levels and costs. We value all other inventories at the lower of cost or market, with cost determined using methods which approximate cost computed on a FIFO basis. These other inventories represent primarily foreign inventories and spare parts inventories. Inventories were as follows (in millions):

	December 31, 2008	September 30, 2008
Finished goods and work in process	$ 163.4	$ 163.3
Raw materials	125.6	113.4
Supplies and spare parts	49.6	49.9
Inventories at FIFO cost	338.6	326.6
LIFO reserve	(46.3)	(43.6)
Net inventories	$ 292.3	$ 283.0

Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)

Note 9. Debt

With the exception of certain items noted below, there were no significant changes in our debt characteristics during the three months ended December 31, 2008. For more information regarding certain of our debt characteristics, see ***Note 10. Debt*** of the Notes to Consolidated Financial Statements section of the Fiscal 2008 Form 10-K (**Debt Footnote on Form 10-K**).

The following were individual components of debt (in millions):

	December 31, 2008	September 30, 2008
8.20% secured notes due August 2011, net of unamortized discount of \$0.2 and \$0.2 [a]	\$ 249.8	\$ 249.8
Hedge adjustments resulting from terminated interest rate derivatives or swaps	4.7	5.1
	254.5	254.9
5.625% secured notes due March 2013, net of unamortized discount of \$0.1 and \$0.1 [a]	99.9	99.9
Hedge adjustments resulting from terminated interest rate derivatives or swaps	1.4	1.5
	101.3	101.4
9.25% unsecured notes due March 2016, net of unamortized discount of \$1.3 and \$1.3 [a]	198.7	198.7
Term loan facilities, net of unamortized discount of \$1.6 and \$1.7 [b]	746.9	747.3
Revolving credit and swing facilities [b]	132.4	33.5
Receivables-backed financing facility [c]	140.0	92.0
Cash payable to sellers [d]		110.7
Industrial development revenue bonds bearing interest at: variable rates - \$21.4 million at 3.59% at December 31, 2008, and \$29.0 million at 10.06% at September 30, 2008; fixed rates - \$120.9 million at 6.97% at September 30, 2008; due at various dates through October 2036 [e]	21.4	149.9
Other notes	10.7	10.5
Total Debt	1,605.9	1,698.9
Less current portion of debt	191.5	245.1
Long-term debt due after one year	\$ 1,414.4	\$ 1,453.8