OWENS ILLINOIS INC /DE/
Form 10-Q
April 30, 2014

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, 2014

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 1-9576

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 x No o

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 o

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

The number of shares of common stock, par value $.01, of Owens-Illinois, Inc. outstanding as of March 31, 2014 was 165,074,114.

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 Annual Report on Form 10-K for the year ended December 31, 2013.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED RESULTS OF OPERATIONS

(Dollars in millions, except per share amounts)

	Three months ended March 31, 2014	2013
Net sales	$ 1,639	$ 1,641
Cost of goods sold	(1,318)	(1,322)
Gross profit	321	319
Selling and administrative expense	(133)	(129)
Research, development and engineering expense	(15)	(15)
Interest expense, net	(54)	(68)
Equity earnings	16	17
Other expense, net	(1)	(7)
Earnings from continuing operations before income taxes	134	117
Provision for income taxes	(27)	(33)
Earnings from continuing operations	107	84
Loss from discontinued operations	(1)	(10)
Net earnings	106	74
Net earnings attributable to noncontrolling interests	(5)	(5)
Net earnings attributable to the Company	$ 101	$ 69
Amounts attributable to the Company:		
Earnings from continuing operations	$ 102	$ 79
Loss from discontinued operations	(1)	(10)
Net earnings	$ 101	$ 69
Basic earnings per share:		
Earnings from continuing operations	$ 0.62	$ 0.48
Loss from discontinued operations	(0.01)	(0.06)
Net earnings	$ 0.61	$ 0.42
Weighted average shares outstanding (thousands)	164,760	164,069
Diluted earnings per share:		
Earnings from continuing operations	$ 0.62	$ 0.48
Loss from discontinued operations	(0.01)	(0.06)
Net earnings	$ 0.61	$ 0.42
Weighted average diluted shares outstanding (thousands)	166,165	165,501

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED COMPREHENSIVE INCOME

(Dollars in millions)

	Three months ended March 31, 2014	Three months ended March 31, 2013
Net earnings	$ 106	$ 74
Other comprehensive income:		
Foreign currency translation adjustments	32	(32)
Pension and other postretirement benefit adjustments, net of tax	23	45
Change in fair value of derivative instruments	1	4
Other comprehensive income	56	17
Total comprehensive income	162	91
Comprehensive income attributable to noncontrolling interests	(2)	(1)
Comprehensive income attributable to the Company	$ 160	$ 90

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in millions)

	March 31, 2014	December 31, 2013	March 31, 2013
Assets			
Current assets:			
Cash and cash equivalents	$ 201	$ 383	$ 359
Receivables	1,078	943	1,047
Inventories	1,204	1,117	1,178
Prepaid expenses	94	107	99
Total current assets	2,577	2,550	2,683
Property, plant and equipment, net	2,634	2,632	2,680
Goodwill	2,059	2,059	2,048
Other assets	1,218	1,178	1,106
Total assets	$ 8,488	$ 8,419	$ 8,517
Liabilities and Share Owners Equity			
Current liabilities:			
Short-term loans and long-term debt due within one year	$ 331	$ 322	$ 347
Current portion of asbestos-related liabilities	150	150	155
Accounts payable	1,074	1,144	904
Other liabilities	527	638	523
Total current liabilities	2,082	2,254	1,929
Long-term debt	3,371	3,245	3,550
Asbestos-related liabilities	283	298	289
Other long-term liabilities	992	1,019	1,594
Share owners equity	1,760	1,603	1,155
Total liabilities and share owners equity	$ 8,488	$ 8,419	$ 8,517

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED CASH FLOWS

(Dollars in millions)

	Three months ended March 31, 2014	2013
Cash flows from operating activities:		
Net earnings	$ 106	$ 74
Loss from discontinued operations	1	10
Non-cash charges		
Depreciation and amortization	111	107
Pension expense	15	26
Restructuring, asset impairment and related charges		10
Cash payments		
Pension contributions	(5)	(7)
Asbestos-related payments	(15)	(17)
Cash paid for restructuring activities	(21)	(34)
Change in components of working capital	(352)	(301)
Other, net (a)	(42)	(2)
Cash utilized in continuing operating activities	(202)	(134)
Cash utilized in discontinued operating activities	(1)	(2)
Total cash utilized in operating activities	(203)	(136)
Cash flows from investing activities:		
Additions to property, plant and equipment	(108)	(94)
Other, net	13	
Cash utilized in investing activities	(95)	(94)
Cash flows from financing activities:		
Changes in borrowings, net	136	160
Issuance of common stock	4	4
Distributions to noncontrolling interests	(19)	
Other, net	1	(5)
Cash provided by financing activities	122	159
Effect of exchange rate fluctuations on cash	(6)	(1)
Decrease in cash	(182)	(72)
Cash at beginning of period	383	431
Cash at end of period	$ 201	$ 359

(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, South 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 sales, global engineering, and non-glass 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 net sales and 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-month periods ended March 31, 2014 and 2013 regarding the Company s reportable segments is as follows:

	2014	2013
Net sales:		
Europe	$ 706	$ 650
North America	485	469
South America	239	269
Asia Pacific	203	247
Reportable segment totals	1,633	1,635
Other	6	6
Net sales	$ 1,639	$ 1,641

	2014	2013
Segment operating profit:		
Europe	$ 87	$ 59
North America	65	74
South America	41	53
Asia Pacific	25	40
Reportable segment totals	218	226
Items excluded from segment operating profit:		
Retained corporate costs and other	(30)	(31)
Restructuring, asset impairment and related charges		(10)
Interest expense, net	(54)	(68)
Earnings from continuing operations before income taxes	$ 134	$ 117

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

	March 31, 2014	December 31, 2013	March 31, 2013
Total assets:			
Europe	$ 3,585	$ 3,509	$ 3,263
North America	2,055	1,995	2,030
South America	1,453	1,467	1,638
Asia Pacific	1,142	1,150	1,294
Reportable segment totals	8,235	8,121	8,225
Other	253	298	292
Consolidated totals	$ 8,488	$ 8,419	$ 8,517

2. Receivables

Receivables consist of the following:

	March 31, 2014	December 31, 2013	March 31, 2013
Trade accounts receivable	$ 911	$ 757	$ 903
Less: allowances for doubtful accounts and discounts	39	39	41
Net trade receivables	872	718	862
Other receivables	206	225	185
	$ 1,078	$ 943	$ 1,047

The Company uses various factoring programs to sell certain receivables to financial institutions as part of managing its cash flows. The amount of receivables sold by the Company was $129 million, $192 million, and $116 million at March 31, 2014, December 31, 2013, and March 31, 2013, respectively. The Company has no continuing involvement with the sold receivables.

3. Inventories

Major classes of inventory are as follows:

	March 31, 2014	December 31, 2013	March 31, 2013
Finished goods	$ 1,037	$ 958	$ 1,014
Raw materials	121	113	124
Operating supplies	46	46	40
	$ 1,204	$ 1,117	$ 1,178

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 valuing 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 Futures Contracts Designated as Cash Flow Hedges

The significant majority of the Company s sales volume in North America is tied to customer contracts that contain provisions that pass the price of natural gas to the customer. In certain of these contracts, the customer has the option of fixing the natural gas price component for a specified period of time. When the customer exercises that option the Company enters into commodity futures contracts for the related natural gas requirements, in order to limit the effects of fluctuations in the future market price paid for natural gas and the related volatility in cash flows. At March 31, 2014 and 2013, the Company had entered into commodity futures contracts covering approximately 4,400,000 MM BTUs and 6,200,000 MM BTUs, respectively, primarily related to customer requests to lock the price of natural gas.

The Company accounts for these futures contracts as cash flow hedges 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 both March 31, 2014 and 2013 related to the commodity futures contracts was included in Accumulated OCI, and will be reclassified into earnings over the next twelve to twenty-four months. 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 months ended March 31, 2014 and 2013 was not material.

The effect of the commodity futures contracts on the results of operations for the three months ended March 31, 2014 and 2013 is as follows:

Amount of Gain Recognized in OCI on Commodity Futures Contracts (Effective Portion)		Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (reported in Cost of goods sold) (Effective Portion)	
2014	2013	2014	2013
$ 2	$ 3	$ 1	$ (1)

Forward Exchange Contracts not Designated as Hedging Instruments

The Company s subsidiaries 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. Subsidiaries may also use forward exchange agreements to offset the foreign currency risk for receivables and payables, including intercompany receivables and payables, not denominated in, or indexed to, their functional currencies. The Company records these short-term forward exchange agreements on the balance sheet at fair value and changes in the fair value are recognized in current earnings.

At March 31, 2014 and 2013, various subsidiaries of the Company had outstanding forward exchange and option agreements denominated in various currencies covering the equivalent of approximately $670 million and $900 million, respectively, related primarily to intercompany transactions and loans.

The effect of the forward exchange contracts on the results of operations for the three months ended March 31, 2014 and 2013 is as follows:

Location of Gain (Loss) Recognized in Income on Forward Exchange Contracts	Amount of Loss Recognized in Income on Forward Exchange Contracts	
	2014	2013
Other expense, net	$ (1)	$ (3)

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) other assets if the instrument has a positive fair value and maturity after one year, (c) other liabilities (current) if the instrument has a negative fair value and maturity within one year, and (d) other long-term liabilities if the instrument has a negative fair value and maturity after one year. The following table shows the amount and classification (as noted above) of the Company s derivatives:

	Balance Sheet Location	Fair Value March 31, 2014	Fair Value December 31, 2013	Fair Value March 31, 2013
Asset Derivatives:				
Derivatives designated as hedging instruments:				
Commodity futures contracts	a	$ 2	$ 1	$ 2
Derivatives not designated as hedging instruments:				
Foreign exchange contracts	a	4	3	3
Foreign exchange contracts	c	3		1
Total derivatives not designated as hedging instruments		7	3	4
Total asset derivatives		$ 9	$ 4	$ 6
Liability Derivatives:				
Derivatives not designated as hedging instruments:				
Foreign exchange contracts	c	$ 10	$ 7	$ 8
Total liability derivatives		$ 10	$ 7	$ 8

5. Restructuring Accruals

Selected information related to the restructuring accruals for the first three months of 2014 and 2013 is as follows:

	European Asset Optimization	Asia Pacific Restructuring	Other Restructuring Actions	Total Restructuring
Balance at January 1, 2014	$ 30	$ 20	$ 64	$ 114
Net cash paid, principally severance and related benefits	(2)	(4)	(15)	(21)
Other, including foreign exchange translation	(1)	(4)	(3)	(8)
Balance at March 31, 2014	$ 27	$ 12	$ 46	$ 85
Balance at January 1, 2013	$ 53	$ 6	$ 64	$ 123
First quarter 2013 charges	7	2	1	10
Write-down of assets to net realizable value	(2)			(2)
Net cash paid, principally severance and related benefits	(20)	(4)	(10)	(34)
Other, including foreign exchange translation	(1)		(1)	(2)
Balance at March 31, 2013	$ 37	$ 4	$ 54	$ 95

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.

6. Pension Benefit Plans

The components of the net periodic pension cost for the three months ended March 31, 2014 and 2013 are as follows:

	U.S.		Non-U.S.	
	2014	2013	2014	2013
Service cost	$ 6	$ 7	$ 7	$ 8
Interest cost	27	27	18	17
Expected asset return	(43)	(46)	(22)	(23)
Amortization:				
Actuarial loss	18	28	4	8
Net periodic pension cost	$ 8	$ 16	$ 7	$ 10

The U.S. pension expense excludes $8 million of special termination benefits that were recorded in discontinued operations in 2013.

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.

In the U.S., the Company has experienced cumulative losses in previous years and has recorded a valuation allowance against its deferred tax assets. The Company s U.S. operations are in a three-year cumulative income position, but this is not solely determinative of the need for a valuation allowance. The Company considered this factor and all other available positive and negative evidence and concluded that it is still more likely than not that the net deferred tax assets in the U.S. will not be realized, and accordingly continued to record a valuation allowance. The evidence considered included the magnitude of the current three-year cumulative income compared to historical losses, expected impact of tax planning strategies, interest rates, and the overall business environment. The Company continues to evaluate its cumulative income position and income trend as well as its future projections of sustained profitability and whether this profitability trend constitutes sufficient positive evidence to support a reversal of the valuation allowance (in full or in part). The amount of the valuation allowance recorded in the U.S. as of December 31, 2013 was $837 million.

8. Debt

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

	March 31, 2014	December 31, 2013	March 31, 2013
Secured Credit Agreement:			
Revolving Credit Facility:			
Revolving Loans	$ 150	$	$ 126
Term Loans:			
Term Loan A			53
Term Loan B	405	405	525
Term Loan C (81 million CAD at March 31, 2014)	74	76	100
Term Loan D (85 million at March 31, 2014)	116	117	158
Senior Notes:			
3.00%, Exchangeable, due 2015	621	617	647
7.375%, due 2016	594	593	591
6.75%, due 2020 (500 million)	688	690	641
4.875%, due 2021 (330 million)	454	455	423
Senior Debentures:			
7.80%, due 2018	250	250	250
Other	60	58	92
Total long-term debt	3,412	3,261	3,606
Less amounts due within one year	41	16	56
Long-term debt	$ 3,371	$ 3,245	$ 3,550