ACCO BRANDS INVESTOR CALL
10.24.16

ACQUISITION OF ESSELTE & Q3 2016 EARNINGS CALL

Jennifer Rice, Vice President, Investor Relations:

Good morning. Welcome to our third quarter 2016 earnings conference call and discussion of today's announcement that we have reached an agreement to acquire Esselte. Joining us today are Boris Elisman, chairman and chief executive officer of ACCO Brands, and Neal Fenwick, executive vice president and chief financial officer.

Slides that accompany this call have been posted to the investor relations section of accobrands.com.

When speaking to quarterly results or the acquisition announcement we refer to adjusted results. Adjusted results exclude transaction costs, restructuring and other one-time and non-recurring charges and apply a normalized effective tax rate of 35%. Schedules of adjusted results and other non-GAAP financial measures and a reconciliation of these measures to the most directly comparable GAAP measures are in this morning's earnings release. Due to the inherent difficulty in forecasting and quantifying certain amounts, we do not reconcile our adjusted earnings per share guidance. For more information see this morning's press releases.

Forward-looking statements made during the call are based on certain risks and uncertainties, and our actual plans, actions and results could differ materially. Please refer to our press release and SEC filings for an explanation of certain of these risk factors and assumptions. Our forward-looking statements are made as of today's date and we assume no obligation to update them going forward.

Following our prepared remarks we will hold a Q&A session. Now, it is my pleasure to turn the call over to Boris Elisman.

Boris Elisman, Chairman and CEO, ACCO Brands Corporation:

Thank you, Jennifer, and good morning everyone. We have a lot of great news to talk about today.

Earlier this morning we announced that we've signed a definitive agreement to acquire Esselte in a transaction valued at $333 million. This is an exciting event for ACCO Brands. With $458M in incremental sales and $60M in adjusted EBITDA, the acquisition will expand our presence in the pan-European marketplace with improved scale and geographic reach, and add well-recognized brands such as Leitz, Esselte and Rapid to our portfolio.

Esselte has a rich heritage in the office products industry, and their attractive positions in stapling, bindery, desktop organization products, and Do-It-Yourself tools complement our existing European business. The Esselte team has done a terrific job growing European sales and improving profitability in a difficult economic environment, and we look forward to leveraging their commercial know-how and local manufacturing capabilities to benefit our combined business.

This is a financially compelling transaction. Even before realizing estimated synergies of $23 million, we expect the acquisition to be immediately accretive. We expect EPS accretion of 12 cents in the first 12 months, including 3 cents from synergies. We expect an additional 10 cents of accretion in years 2 and 3 from synergies. Our synergy estimates are based on our own experience of integrating and restructuring in Europe, and we will further refine our estimates post-completion.

Strategically, the acquisition will greatly enhance our ability to compete more effectively in Europe, and especially in continental Europe. We will nearly triple our European business to over $600M in sales, giving us greater scale and cost leverage to benefit customers, consumers and shareholders. The new ACCO Brands will be a European brand leader in a broad range of product categories, including binding, laminating, boards and easels, stapling and punch, and storage and organization products. We'll have the scale, expertise and financial capacity to invest in innovation and category management. Finally, this acquisition will diversify our customer base to make us less dependent on any one customer.

This transaction is very similar to the Mead acquisition we completed 4 ½ years ago and the Pelikan acquisition completed earlier this year. It adds scale, attractive brands, channel expansion, cost synergies, management talent and financial accretion. We're very excited about coming together with Esselte.

I'm also pleased to report that we had a great third quarter. Net sales increased 4%, largely driven by our acquisition of Pelikan Artline. Adjusted earnings per share were 29 cents compared to 28 cents in the prior year—driven by improved gross margin. For the first nine months of the year sales increased 2% including Pelikan. On a comparable basis, neutralizing for both the Pelikan acquisition and currency, sales for the nine months are flat. Reported earnings per share were down due to one-time items but adjusted earnings per share were up 7 cents to 55 cents per share. We are pleased with our performance so far this year, which reflects the solid execution of our business strategy.

A highlight of the quarter was our strong performance during back to school. Point of sales growth for school products in our US business was +7%, reflecting the strong sell-through of notebooks, backpacks, portfolios and locker accessories. We are happy with our growth in this consumer segment and believe our strong performance should bode well for increased placements next season.

We did see the expected channel destocking in North America this quarter by certain wholesalers as well as anticipated declines at traditional office superstores.

Our international business had strong results driven by Pelikan Artline. After adjusting for the acquisition and currency, International sales decreased 4% due to volume declines in certain markets. While the international macro environment remains challenging, we're pleased with our execution and excited about our prospects for the future as a result of the Pelikan and Esselte acquisitions.

Our computer products business demonstrated continued progress. The topline was even with the prior year, driven by desktop accessories. Computer Products operating margins continued to show expansion as a result of our focus on the more differentiated categories within that business.

Finally, turning to guidance: We are increasing our outlook for adjusted earnings per share and free cash flow. We now believe adjusted earnings per share will come in between 84 and 86 cents and we expect free cash flow of approximately $145 million. We continue to expect sales growth in the low-single digits.

Before turning it over to Neal to give you more details on the quarter and the Esselte transaction, I would like to wrap up by saying that for the last three years I've been sharing with you our strategies to increase shareholder value. These strategies include organic growth through product innovation, brand leadership and channel expansion. We have been successful at doing this – evidenced by our strong performance for the past three years and especially during back-to-school. They also include margin expansion through systemic productivity improvements, greater sales from higher value products, and de-levering. Finally they include smart uses of capital. We have generated significant cash flow which we have used to reduce debt, repurchase shares and for value-creating acquisitions that enable growth, improve customer relevance, strengthen consumer demand, or create scale and opportunity for synergies. Both Pelikan Artline and Esselte fit this profile.

Now I will turn it over to Neal…

Neal Fenwick, EVP and Chief Financial Officer, ACCO Brands Corporation:

Thank you, Boris, and good morning. First, let me say that I share Boris's enthusiasm for the strength of this combination with Esselte, both from a strategic perspective and a shareholder value perspective.

It is an immediately accretive acquisition that becomes even more accretive as we realize significant cost synergies. The purchase price of $333 million represents a 5.6x EBITDA multiple pre-synergies and a 4x multiple post synergies.

We expect to close the transaction in early 2017, with conditions to closing including approval by several European countries.

The transaction will be financed through a new Term Loan facility borrowed in Euros. We also plan to refinance our existing credit facility, both are contingent upon the deal closing. Our new proposed 5 year facility will consist of:

- A new $400 million multi-currency Revolving Credit Facility
- a new EUR 300.0 million Term Loan A, and
- a new AUD 80 million Term Loan A

In preparation for the acquisition we expect to use 2016 free cash flow to reduce debt. We began doing this in third quarter when we paid down our revolver and $78 million of our term loan. This, and the strong cash flow of the combined company, should allow us to keep our net leverage ratio at or below 3.0 throughout the purchase and integration periods.

Esselte's business generated net sales of $458 million in 2015, and adjusted EBITDA of $60 million. We expect EPS accretion for ACCO Brands of $0.12 per share after the first 12 months, including $0.03 of synergies. This $0.12 of accretion also fully loads the business with higher interest expense associated with funding the purchase as well as increased depreciation and amortization expense associated with purchase accounting. We expect an additional $0.10 of benefit from synergies, building over the second and third years.

We expect to incur transaction-related cash costs of approximately $55 million, which include costs associated with refinancing, legal and advisory fees, as well as costs associated with obtaining our synergies and integrating the two businesses. Approximately $11 million of these costs are expected to be incurred this year and have been accounted for in our free cash flow guidance.

ACCO Brands' cash flow generation with the Esselte acquisition is expected to significantly improve and facilitate accelerated de-leveraging of our balance sheet. We anticipate our pro forma adjusted net leverage ratio to be approximately 3.0x at closing and dropping well below 3.0x by the end of fiscal 2017. We expect greatly enhanced cash flow from the transaction – adding $20 million in the first 12 months growing to $55 million within 3 years after we realize synergy savings and reduce the cash costs associated with obtaining those synergies.

Now turning to the third quarter results, and beginning on page 4 of our slide deck:

Third quarter sales increased 4% to $431.1 million from $413.6 million in the prior-year quarter. The Pelikan Artline acquisition added 7% to sales. Foreign exchange had a slightly positive impact on sales. Underlying sales declined 3% as robust growth during back-to-school was offset by destocking at North American wholesalers and declines in the office superstore channel as well as in certain international markets. Operating income increased despite one-time and restructuring charges of $5.2 million. Adjusted operating income increased to $60.9 million from $54.8 million in the prior year as a result of the Pelikan acquisition and productivity improvements.

Net income decreased to $22.7 million, or $0.21 per share, compared to $32.6 million, or $0.30 per share, in the prior-year quarter. The decrease was substantially because of a $6 million reduction to the previously recognized gain from the revaluation to fair value of the company's previously held 50% equity investment in the Pelikan Artline joint venture. Adjusted net income increased to $32.0 million, or $0.29 per share, from $31.1 million, or $0.28 per share, in the prior-year quarter. The improvement was primarily driven by improved gross margin.

Turning to gross margin, reported gross margin increased 110 basis points and adjusted gross margin improved 120 basis points to 33.5%. The improvement was primarily driven by productivity initiatives and 40 basis points from Pelikan Artline.

SG&A expenses increased 11% in the quarter and as a percent of sales increased 120 basis points to 19.1%. Excluding $4.6 million of one-time items, adjusted SG&A increased 5% mainly due to the addition of Pelikan Artline. As a percentage of sales adjusted SG&A was 18.0% compared to 17.9% last year.

Turning to an overview of our segments for the quarter:

North America sales decreased 2%. Strong growth during back-to-school was offset by destocking at wholesalers and declines in the office superstore channel. North America operating income was roughly even with the prior year but margin improved 50 basis points to 17.8% as a result of cost savings and productivity improvements.

In our International segment, net sales increased 23%. The Pelikan Artline acquisition added 26%, or $28 million. Foreign exchange was positive, adding 1%. On a comparable basis, sales were down 4%. The underlying sales decrease was due to lower volume as a result of the ongoing recession in Brazil, channel destocking, most notably in Europe, and lost share with some customers.

International operating income increased due to the Pelikan Artline acquisition. Adjusted operating income increased 56%, or $6.3 million, and adjusted margin increased 290 basis points—primarily due to Pelikan Artline, which added $4.5 million to adjusted operating income.

As was the case last quarter, this $4.5 million of adjusted operating income resulted in only modest net income in the quarter. This is because the removal of the below-the-line JV income, which was previously accounted for using the equity method, and increased interest expense as a result of the transaction, mostly offset the operating income from Pelikan Artline.

Computer Products net sales were even with the prior year and Computer Products operating income increased $400 thousand to $3.1 million. On an adjusted basis, operating income increased $300 thousand and margin increased 100 basis points to 10.5% due to higher gross margin.

Turning now to our cash flow and balance sheet: We had strong cash generation -- $106 million in the quarter, and $100 million for the nine months. Cash generation was quite favorable compared to this point in our cycle last year, largely as a result of an improvement in working capital. Some of the improvement was timing driven, such as the build-up of cash at Pelikan Artline--which we didn't own last year--ahead of its working capital-intensive fourth-quarter back-to-school season. Because of slightly stronger year-to-date cash generation, we now expect free cash flow for the year could be in the range of approximately $145 million. This is inclusive of approximately $11 million of cash costs we expect to incur this year related to the Esselte acquisition.

As Boris noted we are also increasing our outlook for adjusted earnings per share, now expecting 84-to-86 cents. While our expectation for the fourth quarter has not changed since our last guidance, the increase for the year is primarily the result of two factors: 1) our year-to-date earnings per share number is now 1 cent higher as Q2 adjusted EPS becomes $0.26 instead of $0.25 now that we are able to adjust for $2 million of transaction costs that were previously reported in Q2. The second reason is because of the stronger bottom line performance in Q3.

That concludes our prepared remarks. Now Boris and I will be happy to take your questions… Operator?