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Furnished pursuant to the indentures governing the Second Priority Senior Secured Floating
Rate Notes due 2013 and 12 3/8% Senior Subordinated Notes due 2013
of Pregis Corporation.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006

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: N/A

Pregis Holding II Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
Incorporation or Organization)

20-3321581

(I.R.S. Employer Identification No.)

1900 West Field Court, Lake Forest, IL

(Address of principal executive offices)

60045

(Zip Code)

Registrant's telephone number, including area code: **(847) 482-2000**

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes [] No [X]

There were 149.0035 shares of the registrant's common stock, par value \$0.01 per share, issued and outstanding as of March 31, 2006.

PREGIS HOLDING II CORPORATION
QUARTERLY REPORT ON FORM 10-Q

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Item 1. Financial Statements

Pregis Holding II Corporation
Consolidated Balance Sheets
(dollars in thousands, except share and per share data)

| | <u>March 31, 2006</u> | <u>December 31, 2005</u> |
|--|-----------------------|--------------------------|
| | <u>(Unaudited)</u> | |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 43,360 | \$ 54,141 |
| Accounts receivable | | |
| Trade, net of allowances of \$6,058 and \$5,519, respectively | 131,151 | 120,678 |
| Other | 4,005 | 2,985 |
| Inventories | 92,938 | 89,298 |
| Deferred income taxes | 4,954 | 5,024 |
| Due from Pactiv | 22,672 | 22,677 |
| Prepayments and other current assets | 6,758 | 6,250 |
| Total current assets | <u>305,838</u> | <u>301,053</u> |
| Property, plant and equipment, net | 266,058 | 265,970 |
| Other assets | | |
| Goodwill | 133,427 | 140,834 |
| Intangible assets, net | 48,185 | 44,582 |
| Deferred financing costs | 12,788 | 13,427 |
| Other | 9,404 | 8,340 |
| Total other assets | <u>203,804</u> | <u>207,183</u> |
| Total assets | <u>\$ 775,700</u> | <u>\$ 774,206</u> |
| Liabilities and owner's equity | | |
| Current liabilities | | |
| Current portion of long-term debt | \$ 1,766 | \$ 1,783 |
| Accounts payable | 81,262 | 83,139 |
| Accrued taxes | 19,721 | 19,179 |
| Accrued payroll and benefits | 12,872 | 12,229 |
| Accrued interest | 10,463 | 8,075 |
| Other | 18,108 | 19,755 |
| Total current liabilities | <u>144,192</u> | <u>144,160</u> |
| Long-term debt | 436,599 | 432,353 |
| Deferred income taxes | 36,089 | 38,279 |
| Pension and related liabilities | 7,838 | 7,581 |
| Other | 6,755 | 7,005 |
| Owner's equity: | | |
| Common stock - \$0.01 par value; 1,000 shares authorized, 149.0035 shares issued and outstanding at March 31, 2006 and December 31, 2005 | - | - |
| Additional paid-in capital | 149,053 | 149,004 |
| Accumulated deficit | (5,327) | (3,409) |
| Accumulated other comprehensive income (loss) | 501 | (767) |
| Total owner's equity | <u>144,227</u> | <u>144,828</u> |
| Total liabilities and owner's equity | <u>\$ 775,700</u> | <u>\$ 774,206</u> |

The accompanying notes are an integral part of these financial statements.

Pregis Holding II Corporation
Consolidated and Combined Statements of Operations
(Unaudited)
(dollars in thousands)

| | <u>Successor</u> | <u>Predecessor</u> |
|--|-------------------------------------|--------------------|
| | <u>Three Months Ended March 31,</u> | |
| | <u>2006</u> | <u>2005</u> |
| Net sales | \$ 238,973 | \$ 218,961 |
| Operating costs and expenses: | | |
| Cost of sales, excluding depreciation and amortization | 188,617 | 176,037 |
| Selling, general and administrative | 30,089 | 28,789 |
| Depreciation and amortization | 12,636 | 8,297 |
| Restructuring income | - | (198) |
| Total operating costs and expenses | <u>231,342</u> | <u>212,925</u> |
| Operating income | 7,631 | 6,036 |
| Foreign exchange gain | (636) | (93) |
| Gain on sale of securities | - | (1,228) |
| Interest expense | 9,967 | 797 |
| Interest income | <u>(56)</u> | <u>(31)</u> |
| Income (loss) before income taxes | (1,644) | 6,591 |
| Income tax expense | <u>274</u> | <u>2,496</u> |
| Net income (loss) | <u>\$ (1,918)</u> | <u>\$ 4,095</u> |

The accompanying notes are an integral part of these financial statements.

Pregis Holding II Corporation
Consolidated and Combined Statements of Cash Flows
(Unaudited)
(dollars in thousands)

| | <u>Successor</u> | <u>Predecessor</u> |
|---|-------------------------------------|--------------------|
| | <u>Three Months Ended March 31,</u> | <u>March 31,</u> |
| | <u>2006</u> | <u>2005</u> |
| | | (Restated) |
| Operating activities | | |
| Net income (loss) | \$ (1,918) | \$ 4,095 |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 12,636 | 8,297 |
| Deferred income taxes | (1,634) | 763 |
| Unrealized foreign exchange gain | (653) | - |
| Amortization of deferred financing costs | 608 | - |
| Stock compensation expense | 49 | - |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | |
| Accounts receivable, net | (9,730) | (7,877) |
| Affiliate receivables / payables, net | - | (1,614) |
| Inventories | (2,654) | (6,160) |
| Prepayments and other current assets | (474) | 486 |
| Accounts payable | (2,210) | 11,901 |
| Accrued taxes | 147 | 1,435 |
| Accrued interest | 2,377 | (10) |
| Other current liabilities | (1,342) | (608) |
| Other | 142 | (87) |
| Cash (used in) provided by operating activities | <u>(4,656)</u> | <u>10,621</u> |
| Investing activities | | |
| Capital expenditures | (4,791) | (7,593) |
| Proceeds from sale of assets | 62 | 222 |
| Purchase price adjustment on acquisition of Pregis businesses | (1,751) | - |
| Other investing activities | - | (15) |
| Cash used in investing activities | <u>(6,480)</u> | <u>(7,386)</u> |
| Financing activities | | |
| Cash capital contributions | - | 2,664 |
| Repayment of long-term debt | (426) | - |
| Net decrease in short-term debt, affiliates | - | (2,769) |
| Other financing activities | 26 | (81) |
| Cash used in financing activities | <u>(400)</u> | <u>(186)</u> |
| Effect of exchange rate changes on cash and cash equivalents | <u>755</u> | <u>(709)</u> |
| Increase (decrease) in cash and cash equivalents | <u>(10,781)</u> | <u>2,340</u> |
| Cash and cash equivalents at beginning of period | <u>54,141</u> | <u>22,595</u> |
| Cash and cash equivalents at end of period | <u>\$ 43,360</u> | <u>\$ 24,935</u> |

The accompanying notes are an integral part of these financial statements.

Pregis Holding II Corporation
Notes to Unaudited Consolidated and Combined Financial Statements
(Amounts in thousands of U.S. dollars unless otherwise noted)

1. DESCRIPTION OF THE BUSINESS AND BASIS OF PRESENTATION

Description of the Business

On October 13, 2005, Pregis Corporation (“Pregis”), pursuant to a Stock Purchase Agreement (as amended, the “Stock Purchase Agreement”) with Pactiv Corporation (“Pactiv”) and certain of its affiliates, acquired the outstanding shares of capital stock of Pactiv’s subsidiaries comprising its global protective packaging and European specialty packaging businesses (the “Acquisition”). The purchase price for the Acquisition was \$559.3 million, including direct costs of the acquisition of \$15.7 million and pension plan funding of \$20.1 million.

Pregis Corporation, along with Pregis Holding II Corporation (“Pregis Holding II” or the “Company”) and Pregis Holding I Corporation (“Pregis Holding I”), were formed by AEA Investors LLC and its affiliates (the “Sponsors”) for the purpose of consummating the Acquisition. Pregis is an international manufacturer, marketer and supplier of protective packaging products and specialty packaging solutions, operating through two divisions: Global Protective Packaging and European Specialty Packaging.

The Global Protective Packaging division, which represents one reportable segment, manufactures, markets, sells and distributes protective-packaging products in both North America and Europe. Its protective mailers, air-encapsulated bubble products, sheet foam, engineered foam, inflatable airbag systems, honeycomb products and other protective packaging products are manufactured and sold for use in cushioning, void-fill, surface-protection, containment and blocking & bracing applications.

The European Specialty Packaging division is a European packaging business focused on the development, production, and marketing of specialty-packaging solutions principally to the food and healthcare markets. This division is represented by three businesses, each of which is a separate reportable segment: Flexibles, which produces barrier films and converted products for food, medical and non-food markets; Hospital Supplies, which manufactures and supplies customizable operating drape products, procedure packs, protection products, and sterilization packaging for the healthcare industry; and Rigid Packaging, a producer and re-seller of plastic-based rigid films and other packaging solutions principally serving the food and foodservice markets in the United Kingdom.

Basis of Presentation

Predecessor – The accompanying combined statements of operations and cash flows of the Company prior to the Acquisition include the combined financial statements of the businesses comprising the Global Protective Packaging and European Specialty Packaging divisions.

The combined financial statements of the Predecessor include allocations of certain Pactiv corporate expenses, including legal, human resources, payroll, accounting, employee benefits, real estate, insurance, information technology, telecommunications, treasury and other Pactiv corporate and infrastructure costs. The expense and cost allocations were determined on bases that were deemed reasonable by management in order to reflect the utilization of services provided or the benefit received by the Company during the periods presented. The combined financial information included herein does not necessarily reflect the results of operations or cash flows of the Company in the future or what would have been reflected had the Company operated as a separate, stand-alone entity during the periods presented. The income tax benefits

and provisions, related tax payments and deferred tax balances have been prepared as if the Company had operated as a stand-alone taxpayer for the periods presented.

Successor – The accompanying consolidated balance sheets as of March 31, 2006 and December 31, 2005, and statements of operations and cash flows for the three months ended March 31, 2006 include the accounts of Pregis Holding II Corporation and subsidiaries subsequent to the Acquisition.

The unaudited consolidated and combined financial statements included herein have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. Management believes these financial statements include all normal recurring adjustments considered necessary for a fair presentation of the financial position and results of operations of the Company. Operating results for the three months ended March 31, 2006 are not necessarily indicative of results that may be expected for the year ended December 31, 2006.

All significant intercompany balances and transactions have been eliminated in the consolidated and combined financial statements. Certain reclassifications have been made to the prior year data to conform to the current year presentation which had no effect on net earnings reported for any period.

Pregis Holding II is wholly owned by Pregis Holding I and has no operations other than its investment in Pregis. Therefore, the combined and consolidated results of Pregis Holding II reflect the financial position and operations of Pregis.

The consolidated financial statements of the Successor as of March 31, 2006 and December 31, 2005 and for the three months ended March 31, 2006 reflect the Acquisition under the purchase method of accounting, in accordance with the Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards (“SFAS”) No. 141, *Business Combinations*.

The following unaudited pro forma data summarizes the results of operations for the three months ended March 31, 2005 as if the Acquisition had occurred as of the beginning of this period.

| | Three months ended March 31, 2005 (unaudited) |
|------------------|--|
| Net sales | \$ 218,961 |
| Operating income | 2,306 |
| Net loss | (4,927) |

Pro forma adjustments include adjustments for purchase accounting adjustments, principally:

- (1) increase in depreciation and amortization expense of \$3.2 million resulting from the new fair value of property, plant and equipment and identified intangible assets (with finite lives),
- (2) increase in cost of goods sold of \$0.7 million related to the sale of inventory that had been revalued in purchase accounting, and
- (3) corresponding adjustments to income tax expense.

The pro forma results of operations also include adjustments for items directly related to the Acquisition and financing thereof, including:

- (1) elimination of excess pension cost of \$0.6 million, since certain under-funded U.K. pensions were fully funded in connection with the Acquisition,
- (2) addition of a management fee of \$0.4 million that will be paid to the Sponsors, pursuant to a management agreement,
- (3) increase in interest expense of \$9.2 million to reflect the Company's new capital structure, and
- (4) corresponding adjustments to income tax expense.

The pro forma information is not necessarily indicative of the results that actually would have been attained if the Acquisition had occurred as of the beginning of the period presented or that may be attained in the future.

The consolidated and combined financial statements included herein should be read in conjunction with the consolidated and combined financial statements and notes thereto included in the Annual Report furnished on Form 10-K for Pregis Holding II Corporation for the year ended December 31, 2005.

2. INVENTORIES

The major components of inventory were as follows:

| | March 31, 2006 | December 31, 2005 |
|------------------------------|---------------------------|------------------------------|
| Finished goods | \$ 47,267 | \$ 45,593 |
| Work-in-process | 14,880 | 14,219 |
| Raw materials | 27,158 | 25,861 |
| Other materials and supplies | 3,633 | 3,625 |
| | <u>\$ 92,938</u> | <u>\$ 89,298</u> |

3. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in goodwill for the three months ended March 31, 2006 were as follows:

| | Protective Packaging | Flexibles | Hospital Supplies | Rigid Packaging | Total |
|---|---------------------------------|------------------|------------------------------|----------------------------|-------------------|
| Goodwill as of January 1, 2006 | \$ 87,293 | \$ 20,765 | \$ 25,036 | \$ 7,740 | \$ 140,834 |
| Revised fair value of property, plant and equipment | - | (3,883) | - | - | (3,883) |
| Revised fair value of identifiable intangible assets | - | (4,201) | - | - | (4,201) |
| Adjustment to accrued liabilities | (639) | - | - | - | (639) |
| Adjustment to deferred taxes | (148) | (1,027) | - | - | (1,175) |
| Adjustment to acquisition price | 1,751 | - | - | - | 1,751 |
| Reallocation between segments | 675 | (675) | - | - | - |
| Foreign currency translation adjustment | (314) | 295 | 680 | 79 | 740 |
| Goodwill as of March 31, 2006 | <u>\$ 88,618</u> | <u>\$ 11,274</u> | <u>\$ 25,716</u> | <u>\$ 7,819</u> | <u>\$ 133,427</u> |

As of December 31, 2005, the Company based the fair value of its property, plant and equipment and acquired intangible assets on preliminary values obtained from independent appraisers. These appraisals

were finalized 2006, resulting in increases to the fair value of these assets totaling approximately \$8,084, which resulting in a corresponding reduction to goodwill. Additionally, the Stock Purchase Agreement provides for certain adjustments of the purchase price, including adjustments based on the closing working capital and indebtedness and cash levels (as defined in the Stock Purchase Agreement) of the Company at the date of the Acquisition. On February 13, 2006, the Company and Pactiv agreed to a \$1.8 million adjustment for excess cash held in the businesses at the closing date, net of a shortfall in capital spending by the businesses in comparison to their annual budgets. Such amount was paid to Pactiv and reflected as an increase to goodwill in the first quarter of 2006. The purchase price remains subject to the closing working capital adjustment, which the Company expects to finalize in the third quarter of 2006.

The following table reflects intangible assets and related amortization:

| | Average Life (Years) | March 31, 2006 | | December 31, 2005 | |
|--|----------------------------|--------------------|-----------------------------|--------------------|-----------------------------|
| | | Carrying Amount | Accumulated Amortization | Carrying Amount | Accumulated Amortization |
| Intangible assets subject to amortization: | | | | | |
| Customer relationships | 12 | \$ 39,248 | \$ 1,513 | \$ 34,835 | \$ 725 |
| Patents | 10 | 464 | 30 | 460 | 13 |
| Non-compete agreements | 2 | 2,629 | 543 | 2,629 | 252 |
| Software | 3 | 831 | 182 | 672 | 147 |
| Land use rights and other | 32 | 1,233 | 157 | 1,016 | 43 |
| Intangible assets not subject to amortization: | | | | | |
| Trademarks and trade names | | 6,205 | - | 6,150 | - |
| Total | | <u>\$ 50,610</u> | <u>\$ 2,425</u> | <u>\$ 45,762</u> | <u>\$ 1,180</u> |

Amortization expense related to intangible assets totaled \$903 and \$511 for the three months ended March 31, 2006 and 2005, respectively.

4. DEBT

The Company's long-term debt consists of the following:

| | March 31, 2006 | December 31, 2005 |
|--|-------------------|----------------------|
| Senior secured credit facilities: | | |
| Term B-1 facility, due October, 2012 | \$ 87,560 | \$ 87,780 |
| Term B-2 facility, due October, 2012 | 82,011 | 80,372 |
| Senior secured notes, due April, 2013 | 121,210 | 118,490 |
| Senior subordinated notes, due October, 2013, net of discount of \$2,672 and \$2,730 at March 31, 2006 and December 31, 2005 | 147,328 | 147,270 |
| Other | 256 | 224 |
| Total debt | <u>438,365</u> | <u>434,136</u> |
| Less: current portion | <u>(1,766)</u> | <u>(1,783)</u> |
| Long-term debt | <u>\$ 436,599</u> | <u>\$ 432,353</u> |

5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

In order to manage its interest rate risk and to achieve a targeted ratio of variable-rate versus fixed-rate debt, in November, 2005 the Company entered into an interest rate swap arrangement to swap a notional amount of 65.0 million euros from EURIOBOR-based floating rates to fixed rates over the period of January 2006 to January 2010. The swap arrangement was designated as a cash flow hedge. Changes in the fair value of this instrument are expected to be highly effective in offsetting the fluctuations in the floating interest rate and are recorded in other comprehensive income (OCI) until the underlying transaction is recorded. The accounting for the cash flow impact of the swap will be recorded as an adjustment to interest expense each period, starting with the initial settlement to be recorded in the second quarter of 2006. For the three months ended March 31, 2006, no amounts were reclassified from OCI to the income statement. At March 31, 2006, the fair value of this instrument was estimated to be an asset of \$718, based on quoted market prices, and is included in other assets.

The carrying values of other financial instruments included in current assets and current liabilities approximate fair values due to the short-term maturities of these instruments. The carrying value of amounts outstanding under the Company's senior secured credit facilities is considered to approximate fair value as interest rates vary, based on prevailing market rates. At March 31, 2006, the fair value of the Company's senior secured notes and senior subordinated notes was estimated to be \$124,846 and \$153,958, respectively, based on quoted market prices.

6. PENSION PLANS

The Company sponsors three defined benefit pension plans covering the majority of its employees located in the United Kingdom and the Netherlands, and three small defined benefit pension plans covering certain current or former employees of its German businesses.

The components of net periodic pension cost for the three months ended March 31, 2006 and 2005 were as follows:

| | <u>Successor</u> | <u>Predecessor</u> |
|--------------------------------------|-------------------------------------|--------------------|
| | <u>Three months ended March 31,</u> | |
| | <u>2006</u> | <u>2005</u> |
| Service cost of benefits earned | \$ 731 | \$ 980 |
| Interest cost on benefit obligations | 1,097 | 1,240 |
| Expected return on plan assets | (1,257) | (1,165) |
| SFAS No. 88 expense | - | (243) |
| Amortization of unrecognized: | | |
| Prior service cost | - | 24 |
| Net loss | - | 408 |
| Net periodic pension cost | <u>\$ 571</u> | <u>\$ 1,244</u> |

The Company's 2006 expected contributions to its defined benefit pension plans are not expected to be materially different from the amounts disclosed at December 31, 2005.

7. INCOME TAXES

For U.S. income tax purposes, the Predecessor's income or loss was included in Pactiv's consolidated federal income tax return. For periods subsequent to the Acquisition, the Company will file a consolidated federal income tax return with Pregis Holding I Corporation, its ultimate parent. The provision for income taxes in the Successor consolidated financial statements and the Predecessor combined financial statements reflects income taxes as if the businesses were stand-alone entities and filed separate income tax returns.

Reconciliation of the Company's effective income tax rate to the U.S. federal statutory rate is shown in the following table:

| | <u>Successor</u> | <u>Predecessor</u> |
|--|-------------------------------------|------------------------|
| | <u>Three Months Ended March 31,</u> | <u>Ended March 31,</u> |
| | <u>2006</u> | <u>2005</u> |
| U.S. federal income tax rate | (35.00)% | 35.00 % |
| Changes in income tax rate resulting from: | | |
| Foreign rate differential | (14.39) | (2.63) |
| State and local taxes on income, net of U.S. federal income tax benefit | (9.37) | 1.37 |
| Research and development credit | - | (0.44) |
| Valuation allowance | 70.47 | 3.58 |
| Other | 4.96 | 0.99 |
| Income tax expense | <u>16.67 %</u> | <u>37.87 %</u> |

8. RELATED PARTY TRANSACTIONS

As mentioned in Note 1, the Predecessor utilized various wholly-owned affiliates of Pactiv to provide administrative services and to finance operations. For the three months ended March 31, 2005, aggregate administrative fees and interest expense charged to the Company were \$5,510 and \$824, respectively.

In connection with the Acquisition, the Company entered into a management agreement with its Sponsors, who provide various advisory and consulting services. For the three months ended March 31, 2006, the Company recorded expense of \$454 related to this agreement.

The Company also has a short-term consulting agreement with James D. Morris, a member of its board of directors, and paid \$55 to Mr. Morris under this agreement for the three months ended March 31, 2006.

9. SEGMENT AND GEOGRAPHIC INFORMATION

The Company has four reportable segments, which are determined on the basis of the types of products produced by each segment. The Company's segments are as follows:

Protective Packaging – This segment manufactures, markets, sells and distributes protective packaging products in North America and Europe.

Flexibles – This segment produces customized barrier films and converted products for niche segments of the food, medical, and non-food markets in Europe and Egypt.

Hospital Supplies – This segment manufactures and supplies a full range of packaging products for the health care industry in Europe.

Rigid Packaging - This segment provides customized packaging products and solutions to the food and foodservice sectors in Europe.

Net sales by reportable segment were as follows:

| | <u>Successor</u> | <u>Predecessor</u> |
|----------------------|-------------------------------------|--------------------|
| | <u>Three Months Ended March 31,</u> | |
| | <u>2006</u> | <u>2005</u> |
| Protective Packaging | \$ 158,039 | \$ 142,145 |
| Flexibles | 46,041 | 39,056 |
| Hospital Supplies | 16,205 | 16,159 |
| Rigid Packaging | 20,195 | 23,098 |
| Eliminations | (1,507) | (1,497) |
| Net sales | <u>\$ 238,973</u> | <u>\$ 218,961</u> |

The Company evaluates the performance of its segments based on segment operating income, which may be adjusted for transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions may be excluded from the business segment results, they are included in reported consolidated earnings.

The following table presents operating income by reportable segment and reconciles the total segment operating income to income (loss) before income taxes:

| | <u>Successor</u> | <u>Predecessor</u> |
|-----------------------------------|-------------------------------------|--------------------|
| | <u>Three Months Ended March 31,</u> | |
| | <u>2006</u> | <u>2005</u> |
| Segment operating income (loss): | | |
| Protective Packaging | \$ 6,892 | \$ 3,747 |
| Flexibles | 3,402 | 707 |
| Hospital Supplies | 1,474 | 2,806 |
| Rigid Packaging | 236 | (1,224) |
| Total segment operating income | <u>12,004</u> | <u>6,036</u> |
| Unallocated expenses | (4,373) | - |
| Operating income | <u>7,631</u> | <u>6,036</u> |
| Other income | 636 | 1,321 |
| Interest expense | (9,967) | (797) |
| Interest income | 56 | 31 |
| Income (loss) before income taxes | <u>\$ (1,644)</u> | <u>\$ 6,591</u> |

Unallocated expenses represent the costs of support functions, including information technology, finance, human resources, legal and executive management. These expenses have not been allocated to the reporting segments for purposes of measuring their segment performance. For the period ended March 31, 2005, similar administrative fees totaling \$5,510 were charged directly to the businesses or allocated to the

businesses by Pactiv in connection with the preparation of stand-alone financial statements. However, such costs are not necessarily comparable to costs incurred by Pregis, now operating as an independent entity.

10. COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) and its components for the three months ended March 31, 2006 and 2005, were as follows:

| | <u>Successor</u> | <u>Predecessor</u> |
|---|-------------------------------------|--------------------|
| | <u>Three Months Ended March 31,</u> | |
| | <u>2006</u> | <u>2005</u> |
| Net income (loss) | \$ (1,918) | \$ 4,095 |
| Other comprehensive income (loss), net of income taxes: | | |
| Foreign currency translation adjustment | 481 | (16,730) |
| Net change in fair value of hedging instrument | 787 | - |
| Minimum pension liability adjustment | - | 501 |
| Comprehensive income (loss) | <u>\$ (650)</u> | <u>\$ (12,134)</u> |

11. STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*. SFAS 123R requires that all share-based payments to employees, including grants of employee stock options, be recognized in the financial statements based on their fair values. The Company adopted SFAS 123(R) on January 1, 2006 using the prospective transition method, which requires that nonpublic companies that had previously measured compensation cost under SFAS No. 123 using the minimum value method continue to account for equity awards outstanding at the date of adoption in the same manner as they had been accounted for prior to adoption. For all awards granted, modified or settled after the date of adoption, the Company will recognize compensation cost based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

In December 2005, Pregis Holding I Corporation, the Company's ultimate parent company, established the Pregis Holding I Corporation 2005 Stock Option Plan (the "Pregis Plan") to provide for the grant of nonqualified and incentive stock options to key employees, consultants and directors of the Company. During the quarter ended March 31, 2006, the Company granted 662.22 options to certain key employees, all of which were outstanding at quarter-end. As of March 31, 2006, the maximum number of shares available for award under the Pregis Plan is 1,655.45, including 884.96 options that were granted to certain key employees and directors prior to adoption of SFAS 123R. The options are subject to a five year vesting schedule; however, vesting may be accelerated at any time as determined by the committee administering the Pregis Plan. The options expire if not exercised within ten years of the date of grant. Additionally, vested options will generally terminate 45 days after termination of employment.

The Black-Scholes option-pricing model was used to estimate the fair value of option awards granted after adoption of SFAS No. 123R, using the following assumptions:

Three months ended
March 31, 2006

| | |
|---------------------------------|-------|
| Average life of options (years) | 5.0 |
| Volatility | 30.0% |
| Risk-free interest rate | 4.3% |
| Dividend yield | - |

Weighted-Average Expected Term. The Company does not have historical experience with respect to exercise behavior for its options. The expected term of the options granted was estimated to be equal to the vesting period of five years, which was considered to be a reasonable estimate in relation to exercise behavior experienced by similar private-equity owned entities.

Volatility. The Company is newly-formed and does not have publicly traded equity, so it does not have historical data regarding the volatility of its common stock. Therefore, the expected volatility used for 2006 is based on volatility of similar entities, referred to as “guideline” companies. In determining similarity, the Company considered industry, stage of life cycle, size and financial leverage.

Risk-Free Interest Rate. The risk-free interest rate is based on U.S. Treasury security yields for issues with a remaining term equal to the option’s expected life at the time of grant.

Dividend Yield. The dividend yield on the Company’s stock is assumed to be zero since the Company has not paid dividends and has no current plans to do so in the future.

Forfeitures. Based on our minimal historical experience of pre-vesting cancellations, the Company has assumed an annual forfeiture rate of 5% for its options. Under the true-up provisions of SFAS 123R, the Company will revise this estimate in subsequent periods if actual forfeitures differ from the above estimate.

The resulting fair value of \$1,018 for options granted in the first quarter of 2006 will be amortized to expense on a straight-line basis over the five year vesting period. For the three months ended March 31, 2006, the Company recognized compensation expense of \$49 for its option grants during the period. As of March 31, 2006, no options have vested under the Pregis Plan, and there was \$969 of unrecognized compensation costs related to the granted options. This cost is expected to be amortized over a weighted-average service period of approximately 4.9 years. The Company’s stock option activity for the three months ended March 31, 2006 under the Pregis Plan is as follows:

| | Outstanding Options | Weighted Average Exercise Price |
|--------------------------------|--------------------------------|--|
| Outstanding at January 1, 2006 | 885.0 | \$ 13,000.00 |
| Granted | 662.2 | 16,000.00 |
| Exercised | - | - |
| Forfeited | (21.5) | 13,000.00 |
| Outstanding at March 31, 2006 | <u>1,525.7</u> | <u>\$ 14,302.00</u> |

The following table summarizes information about all stock options issued under the Pregis Plan as of March 31, 2006:

| Options Outstanding | | | |
|----------------------------|---------------------------|--|--|
| Exercise Price | Number Outstanding | Weighted Average Remaining Life | Weighted Average Exercise Price |
| \$ 13,000.00 | 1,360.1 | 9.77 | \$ 13,000.00 |
| \$ 25,000.00 | 165.6 | 9.85 | \$ 25,000.00 |
| | <u>1,525.7</u> | | |

Certain of Pregis' employees also hold options to purchase shares of Pactiv common stock granted under the Pactiv Stock Option Plan. In connection with the Acquisition, any unvested options held by Pregis employees participating in the Pactiv Stock Option Plan became fully vested, and the Pregis employees were given one year from the date of the Acquisition in which to exercise the options. All outstanding options held by Pregis employees under this plan fully vested and became exercisable at the time of the Acquisition, and relevant expenses were allocated to Pregis in the Predecessor periods. Therefore, there is no subsequent expense to be borne by Pregis related to this plan. Any options that are exercised by Pregis employees related to this plan will be funded by Pactiv. If the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation under this plan in the prior-year period, its net income for the three months ended March 31, 2005 would have been reduced by \$359.

12. COMMITMENTS AND CONTINGENCIES

The Company is party to legal proceedings arising from its operations. Related reserves are recorded when it is probable that liabilities exist and where reasonable estimates of such liabilities can be made. While it is not possible to predict the outcome of any of these proceedings, the Company's management, based on its assessment of the facts and circumstances now known, does not believe that any of these proceedings, individually or in the aggregate, will have a material adverse effect on the Company's financial position. However, actual outcomes may be different than expected and could have a material effect on the company's results of operations or cash flows in a particular period.

The Company is subject to a variety of environmental and pollution-control laws and regulations in all jurisdictions in which it operates. Where it is probable that related liabilities exist and where reasonable estimates of such liabilities can be made, associated reserves are established. Estimated liabilities are subject to change as additional information becomes available regarding the magnitude of possible clean-up costs, the expense and effectiveness of alternative clean-up methods, and other possible liabilities associated with such situations. However, management believes that any additional costs that may be incurred as more information becomes available will not have a material adverse effect on the Company's financial position, although such costs could have a material effect on the Company's results of operations or cash flows in a particular period.

At March 31, 2006, the Company had \$6,717 of letters of credit outstanding under its senior credit facilities and other financing lines with local banks.

13. RECENT ACCOUNTING PRONOUNCEMENT

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. This Interpretation is effective as of January 1, 2007. The Company is currently evaluating the impact of FIN 48 on its financial statements.

14. RESTATEMENT

In the Predecessor periods, on a periodic basis Pactiv offset the intercompany balances between its North American-based businesses of the Predecessor and other Pactiv subsidiaries that would not otherwise be settled in cash. In such cases, these intercompany balances were transferred directly to equity to reflect their settlement, and in previously published Predecessor cash flow statements had been reflected within capital contributions, net. The previously published Predecessor cash flow statement for the three months ended March 31, 2005 has been restated herein, principally to remove the impact of non-cash capital contributions arising from this intercompany activity. The restatement, which did not affect the net changes in cash and cash equivalents, was as follows:

| | Three Months Ended March 31, 2005 | |
|--|--|-------------------------------|
| | As Restated | As Previously Reported |
| Cash provided by operating activities | \$ 10,621 | \$ 5,120 |
| Cash provided by (used in) financing activities | (186) | 5,315 |

15. SUPPLEMENTAL GUARANTOR CONDENSED FINANCIAL INFORMATION

In connection with the Acquisition, Pregis Holdings II (presented as Parent in the following tables of the Successor), through its wholly-owned subsidiary, Pregis Corporation (presented as Issuer in the following Successor tables), issued senior secured notes and senior subordinated notes. The senior notes are fully, unconditionally and jointly and severally guaranteed on a senior secured basis and the senior subordinated notes are fully, unconditionally and jointly and severally guaranteed on an unsecured senior subordinated basis, in each case, by Pregis Holdings II and substantially all existing and future wholly-owned domestic restricted subsidiaries of Pregis Corporation (collectively, the “Guarantors”). All other subsidiaries of Pregis Corporation, whether direct or indirect, do not guarantee the senior secured notes and senior subordinated notes (the “Non-Guarantors”). The Guarantors also unconditionally guarantee the Company’s borrowings under its senior secured credit facilities on a senior secured basis.

Additionally, the senior secured notes are secured on a second priority basis by liens on all of the collateral (subject to certain exceptions) securing Pregis Corporation’s new senior secured credit facilities. In the event that secured creditors exercise remedies with respect to Pregis and its guarantors’ pledged assets, the proceeds of the liquidation of those assets will first be applied to repay obligations secured by the first priority liens under the new senior secured credit facilities and any other first priority obligations.

The following Successor period condensed combining financial statements present the results of operations, financial position and cash flows of (1) the Parent, (2) the Issuer, (3) the Guarantors, (4) the Non-Guarantors, and (5) eliminations to arrive at the information for Pregis Holding II on a combined basis. Separate financial statements and other disclosures concerning the Guarantors are not presented because management does not believe such information is material to investors. Therefore, each of the Guarantors is combined in the presentation below. The information that follows for the Predecessor periods presents the combining information of the businesses comprising the Guarantors and Non-Guarantors.

Condensed Combining Balance Sheet
March 31, 2006

| | <u>Parent</u> | <u>Issuer</u> | <u>Guarantor Subsidiaries</u> | <u>Non-Guarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Combined</u> |
|--|-------------------|-------------------|-----------------------------------|---------------------------------------|---------------------|-------------------|
| Assets | | | | | | |
| Current assets | | | | | | |
| Cash and cash equivalents | \$ - | \$ 11 | \$ 10,584 | \$ 32,765 | \$ - | \$ 43,360 |
| Accounts receivable | | | | | | |
| Trade, net of allowances | - | - | 38,652 | 92,499 | - | 131,151 |
| Affiliates | - | 35,937 | 11,596 | 1,973 | (49,506) | - |
| Other | - | - | 996 | 3,009 | - | 4,005 |
| Inventories | - | - | 32,329 | 60,609 | - | 92,938 |
| Deferred income taxes | - | (2) | 3,844 | 1,112 | - | 4,954 |
| Due from Pactiv | - | - | 3,918 | 18,754 | - | 22,672 |
| Prepayments and other current assets | - | 2,116 | 1,839 | 2,803 | - | 6,758 |
| Total current assets | - | 38,062 | 103,758 | 213,524 | (49,506) | 305,838 |
| Investment in subsidiaries and intercompany balances | 144,227 | 552,327 | - | - | (696,554) | - |
| Property, plant and equipment, net | - | - | 97,765 | 168,293 | - | 266,058 |
| Other assets | | | | | | |
| Goodwill | - | - | 105,358 | 28,069 | - | 133,427 |
| Intangible assets, net | - | - | 22,842 | 25,343 | - | 48,185 |
| Deferred financing costs | - | 12,788 | - | - | - | 12,788 |
| Other | - | 718 | 221 | 8,465 | - | 9,404 |
| Total other assets | - | 13,506 | 128,421 | 61,877 | - | 203,804 |
| Total assets | \$ 144,227 | \$ 603,895 | \$ 329,944 | \$ 443,694 | \$ (746,060) | \$ 775,700 |
| Liabilities and owner's equity | | | | | | |
| Current liabilities | | | | | | |
| Current portion of long-term debt | \$ - | \$ 1,686 | \$ - | \$ 80 | \$ - | \$ 1,766 |
| Accounts payable | - | - | 20,901 | 60,361 | - | 81,262 |
| Accounts payable, affiliates | - | 8,610 | 30,213 | 10,683 | (49,506) | - |
| Accrued taxes | - | 886 | (258) | 19,093 | - | 19,721 |
| Accrued payroll and benefits | - | - | 4,319 | 8,553 | - | 12,872 |
| Accrued interest | - | 10,463 | - | - | - | 10,463 |
| Other | - | 875 | 7,536 | 9,697 | - | 18,108 |
| Total current liabilities | - | 22,520 | 62,711 | 108,467 | (49,506) | 144,192 |
| Long-term debt | - | 436,423 | - | 176 | - | 436,599 |
| Intercompany balances | - | - | 185,929 | 248,931 | (434,860) | - |
| Deferred income taxes | - | 715 | 22,982 | 12,392 | - | 36,089 |
| Other | - | 10 | 4,780 | 9,803 | - | 14,593 |
| Total owner's equity | 144,227 | 144,227 | 53,542 | 63,925 | (261,694) | 144,227 |
| Total liabilities and owner's equity | \$ 144,227 | \$ 603,895 | \$ 329,944 | \$ 443,694 | \$ (746,060) | \$ 775,700 |

Condensed Combining Balance Sheet
December 31, 2005

| | <u>Parent</u> | <u>Issuer</u> | <u>Guarantor Subsidiaries</u> | <u>Non-Guarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Combined</u> |
|---|-------------------|-------------------|-----------------------------------|---------------------------------------|---------------------|-------------------|
| Assets | | | | | | |
| Current assets | | | | | | |
| Cash and cash equivalents | \$ - | \$ 16,410 | \$ 10,814 | \$ 26,917 | \$ - | \$ 54,141 |
| Accounts receivable | | | | | | |
| Trade, net of allowances | - | - | 35,984 | 84,694 | - | 120,678 |
| Affiliates | - | 9,703 | 3,711 | 1,492 | (14,906) | - |
| Other | - | - | 481 | 2,504 | - | 2,985 |
| Inventories | - | - | 34,183 | 55,115 | - | 89,298 |
| Deferred income taxes | - | 197 | 3,844 | 983 | - | 5,024 |
| Due from Pactiv | - | - | 3,109 | 19,568 | - | 22,677 |
| Prepayments and other current assets | - | 2,026 | 1,724 | 2,500 | - | 6,250 |
| Total current assets | - | 28,336 | 93,850 | 193,773 | (14,906) | 301,053 |
| Investment in subsidiaries and intercompany balances | 144,828 | 548,654 | - | - | (693,482) | - |
| Property, plant and equipment, net | - | - | 101,018 | 164,952 | - | 265,970 |
| Other assets | | | | | | |
| Goodwill | - | - | 104,696 | 36,138 | - | 140,834 |
| Intangible assets, net | - | - | 23,440 | 21,142 | - | 44,582 |
| Deferred financing costs | - | 12,728 | 699 | - | - | 13,427 |
| Other | - | - | 219 | 8,121 | - | 8,340 |
| Total other assets | - | 12,728 | 129,054 | 65,401 | - | 207,183 |
| Total assets | \$ 144,828 | \$ 589,718 | \$ 323,922 | \$ 424,126 | \$ (708,388) | \$ 774,206 |
| Liabilities and owner's equity | | | | | | |
| Current liabilities | | | | | | |
| Current portion of long-term debt | \$ - | \$ 1,686 | \$ - | \$ 97 | \$ - | \$ 1,783 |
| Accounts payable | - | - | 31,559 | 51,580 | - | 83,139 |
| Accounts payable, affiliates | - | 502 | 7,945 | 6,459 | (14,906) | - |
| Accrued taxes | - | 886 | (827) | 19,120 | - | 19,179 |
| Accrued payroll and benefits | - | - | 3,788 | 8,441 | - | 12,229 |
| Accrued interest | - | 8,075 | - | - | - | 8,075 |
| Other | - | 1,148 | 8,642 | 9,965 | - | 19,755 |
| Total current liabilities | - | 12,297 | 51,107 | 95,662 | (14,906) | 144,160 |
| Long-term debt | - | 432,226 | - | 127 | - | 432,353 |
| Intercompany balances | - | - | 200,078 | 245,494 | (445,572) | - |
| Deferred income taxes | - | (168) | 25,597 | 12,850 | - | 38,279 |
| Pension and related liabilities | - | - | - | 7,581 | - | 7,581 |
| Other | - | 535 | 4,579 | 1,891 | - | 7,005 |
| Total owner's equity | 144,828 | 144,828 | 42,561 | 60,521 | (247,910) | 144,828 |
| Total liabilities and owner's equity | \$ 144,828 | \$ 589,718 | \$ 323,922 | \$ 424,126 | \$ (708,388) | \$ 774,206 |

Condensed Combining Statement of Operations
For the Three Months Ended March 31, 2006
(Successor)

| | <u>Parent</u> | <u>Issuer</u> | <u>Guarantor Subsidiaries</u> | <u>Non-Guarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Combined</u> |
|--|-------------------|-------------------|-----------------------------------|---------------------------------------|---------------------|-------------------|
| Net sales | \$ - | \$ - | \$ 89,581 | \$ 150,847 | \$ (1,455) | \$ 238,973 |
| Operating costs and expenses: | | | | | | |
| Cost of sales, excluding depreciation and amortization | - | - | 71,101 | 118,971 | (1,455) | 188,617 |
| Selling, general and administrative | - | 425 | 14,585 | 15,079 | - | 30,089 |
| Depreciation and amortization | - | - | 4,839 | 7,797 | - | 12,636 |
| Total operating costs and expenses | <u>-</u> | <u>425</u> | <u>90,525</u> | <u>141,847</u> | <u>(1,455)</u> | <u>231,342</u> |
| Operating income (loss) | - | (425) | (944) | 9,000 | - | 7,631 |
| Foreign exchange (gain) loss | - | (1,131) | 10 | 485 | - | (636) |
| Interest expense | - | (1,493) | 5,693 | 5,767 | - | 9,967 |
| Interest income | - | - | - | (56) | - | (56) |
| Equity in loss of subsidiaries | 1,918 | 3,299 | - | - | (5,217) | - |
| Income (loss) before income taxes | <u>(1,918)</u> | <u>(1,100)</u> | <u>(6,647)</u> | <u>2,804</u> | <u>5,217</u> | <u>(1,644)</u> |
| Income tax expense (benefit) | - | 818 | (2,076) | 1,532 | - | 274 |
| Net income (loss) | <u>\$ (1,918)</u> | <u>\$ (1,918)</u> | <u>\$ (4,571)</u> | <u>\$ 1,272</u> | <u>\$ 5,217</u> | <u>\$ (1,918)</u> |

Condensed Combining Statement of Operations
For the Three Months Ended March 31, 2005
(Predecessor)

| | <u>Guarantor Subsidiaries</u> | <u>Non-Guarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Combined</u> |
|--|-----------------------------------|---------------------------------------|---------------------|-----------------|
| Net sales | \$ 79,364 | \$ 140,762 | \$ (1,165) | \$ 218,961 |
| Operating costs and expenses: | | | | |
| Cost of sales, excluding depreciation and amortization | 62,112 | 115,090 | (1,165) | 176,037 |
| Selling, general and administrative | 11,921 | 16,868 | - | 28,789 |
| Depreciation and amortization | 2,991 | 5,306 | - | 8,297 |
| Restructuring income | 46 | (244) | - | (198) |
| Total operating costs and expenses | <u>77,070</u> | <u>137,020</u> | <u>(1,165)</u> | <u>212,925</u> |
| Operating income | 2,294 | 3,742 | - | 6,036 |
| Foreign exchange gain | - | (93) | - | (93) |
| Gain on sale of securities | - | (1,228) | - | (1,228) |
| Interest expense | (116) | 913 | - | 797 |
| Interest income | - | (31) | - | (31) |
| Income before income taxes | <u>2,410</u> | <u>4,181</u> | <u>-</u> | <u>6,591</u> |
| Income tax expense | 901 | 1,595 | - | 2,496 |
| Net income | <u>\$ 1,509</u> | <u>\$ 2,586</u> | <u>\$ -</u> | <u>\$ 4,095</u> |

Condensed Combining Statement of Cash Flows
For the Three Months Ended March 31, 2006
(Successor)

| | <u>Parent</u> | <u>Issuer</u> | <u>Guarantor Subsidiaries</u> | <u>Non-Guarantor Subsidiaries</u> | <u>Eliminations</u> | <u>Combined</u> |
|---|---------------|-----------------|-----------------------------------|---------------------------------------|---------------------|------------------|
| Operating activities | | | | | | |
| Net income | \$ (1,918) | \$ (1,918) | \$ (4,571) | \$ 1,272 | \$ 5,217 | \$ (1,918) |
| Non-cash adjustments | 1,918 | 3,642 | 2,171 | 8,492 | (5,217) | 11,006 |
| Changes in operating assets and liabilities, net of effects of acquisitions | - | (15,946) | 3,273 | (1,071) | - | (13,744) |
| Cash (used in) provided by operating activities | <u>-</u> | <u>(14,222)</u> | <u>873</u> | <u>8,693</u> | <u>-</u> | <u>(4,656)</u> |
| Investing activities | | | | | | |
| Capital expenditures | - | - | (1,103) | (3,688) | - | (4,791) |
| Acquisition of Pregis businesses | - | (1,751) | - | - | - | (1,751) |
| Proceeds from sale of assets | - | - | - | 62 | - | 62 |
| Cash used in investing activities | <u>-</u> | <u>(1,751)</u> | <u>(1,103)</u> | <u>(3,626)</u> | <u>-</u> | <u>(6,480)</u> |
| Financing activities | | | | | | |
| Repayment of long-term debt | - | (426) | - | - | - | (426) |
| Other financing activities | - | - | - | 26 | - | 26 |
| Cash (used in) provided by financing activities | <u>-</u> | <u>(426)</u> | <u>-</u> | <u>26</u> | <u>-</u> | <u>(400)</u> |
| Effect of exchange rate changes on cash and cash equivalents | - | - | - | 755 | - | 755 |
| Increase (decrease) in cash and cash equivalents | - | (16,399) | (230) | 5,848 | - | (10,781) |
| Cash and cash equivalents, beginning of period | - | 16,410 | 10,814 | 26,917 | - | 54,141 |
| Cash and cash equivalents, end of period | <u>\$ -</u> | <u>\$ 11</u> | <u>\$ 10,584</u> | <u>\$ 32,765</u> | <u>\$ -</u> | <u>\$ 43,360</u> |

Condensed Combining Statement of Cash Flows
For the Three Months Ended March 31, 2005
(Predecessor)

| | <u>Guarantor</u> <u>Subsidiaries</u> | <u>Non-Guarantor</u> <u>Subsidiaries</u> | <u>Eliminations</u> | <u>Combined</u> |
|---|---|---|---------------------|------------------|
| Operating activities | | | | |
| Net income | \$ 1,509 | \$ 2,586 | \$ - | \$ 4,095 |
| Non-cash adjustments | 3,733 | 5,327 | - | 9,060 |
| Changes in operating assets and liabilities, net of effects of acquisitions | <u>(1,550)</u> | <u>(984)</u> | <u>-</u> | <u>(2,534)</u> |
| Cash provided by operating activities | <u>3,692</u> | <u>6,929</u> | <u>-</u> | <u>10,621</u> |
| Investing activities | | | | |
| Capital expenditures | (3,837) | (3,756) | - | (7,593) |
| Proceeds from sale of assets | 14 | 208 | - | 222 |
| Other investing activities | <u>131</u> | <u>(146)</u> | <u>-</u> | <u>(15)</u> |
| Cash used in investing activities | <u>(3,692)</u> | <u>(3,694)</u> | <u>-</u> | <u>(7,386)</u> |
| Financing activities | | | | |
| Cash capital contributions | - | 2,664 | - | 2,664 |
| Net decrease in short-term debt, affiliate | - | (2,769) | - | (2,769) |
| Other financing activities | <u>-</u> | <u>(81)</u> | <u>-</u> | <u>(81)</u> |
| Cash used in financing activities | <u>-</u> | <u>(186)</u> | <u>-</u> | <u>(186)</u> |
| Effect of exchange rate changes on cash and cash equivalents | <u>-</u> | <u>(709)</u> | <u>-</u> | <u>(709)</u> |
| Increase in cash and cash equivalents | - | 2,340 | - | 2,340 |
| Cash and cash equivalents, beginning of period | <u>-</u> | <u>22,595</u> | <u>-</u> | <u>22,595</u> |
| Cash and cash equivalents, end of period | <u>\$ -</u> | <u>\$ 24,935</u> | <u>\$ -</u> | <u>\$ 24,935</u> |

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

This following discussion and analysis should be read in conjunction with the consolidated and combined financial statements and notes appearing elsewhere in this report and in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Cautionary Note Regarding Forward Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E in the Securities Exchange Act of 1934, as amended (the "Exchange Act"). You can generally identify forward-looking statements by our use of forward-looking terminology such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "might," "plan," "potential," "predict," "seek," "should," or "will," or the negative thereof or other variations thereon or comparable terminology. All forward looking statements, including, without limitation, management's examination of historical operating trends and data are based upon our current expectations and various assumptions. We have based these forward-looking statements on our current expectations, assumptions, estimates and projections. While we believe these expectations, assumptions, estimates and projections are reasonable, such forward-looking statements are only predictions and involve known and unknown risks and uncertainties, many of which are beyond our control. These and other important factors may cause our actual results, performance or achievements to differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements.

Some of the factors that could cause actual results to differ materially from those expressed or implied by the forward-looking statements include, among others:

- risks associated with our substantial indebtedness and debt service;
- risks associated with not having operated as a stand-alone entity prior to the Acquisition (as defined below) and the risk that our business could suffer if we fail to develop the systems and infrastructure necessary to support our business as a stand-alone entity;
- risks that we may not be able to accurately report our financial results or prevent fraud if we fail to achieve and maintain an effective system of internal controls;
- our inability to achieve anticipated cost savings and synergies following the Acquisition;
- increases in prices and availability of resin and other raw materials, our ability to pass increased costs on to our customers, and our ability to raise our prices generally with respect to our branded products;
- risks of increasing competition in our existing and future markets, including competition from new products introduced by competitors;
- our ability to meet future capital requirements;
- general economic or business conditions, nationally, regionally or in the individual markets in which we conduct business, may deteriorate and have an adverse impact on our business strategy, including, without limitation, factors relating to interest rates and gross domestic product levels;
- risks related to our acquisition or divestiture strategy;

- our ability to retain management;
- our ability to protect our intellectual property rights;
- changes in governmental laws and regulations, including environmental laws and regulations; and
- other risks and uncertainties, including those described in the “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 31, 2005.

Given these risks and uncertainties, you are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included in this report are made only as of the date hereof. We do not undertake and specifically decline any obligation to update any such statements or to publicly announce the results of any revisions to any of such statements to reflect future events or developments.

INTRODUCTION

We are an international manufacturer, marketer and supplier of protective packaging products and specialty packaging solutions. Our company operates through two divisions, corresponding to the type of products we provide:

- Global Protective Packaging manufactures, markets, sells and distributes protective packaging products in both North America and Europe. Global Protective Packaging’s protective mailers, air-encapsulated cushioning products, sheet foam, engineered foam, inflatable airbag systems, honeycomb products and other protective packaging products are used for cushioning, void-fill, surface protection, containment, and blocking and bracing. The Global Protective Packaging businesses comprise one reportable business segment.
- European Specialty Packaging is a European packaging business focused on the development, production and marketing of specialty packaging solutions principally to the food, medical and consumer products markets. European Specialty Packaging operates through three businesses, each representing a reportable segment:
 - *Flexibles*, which produces high value added customized converted barrier films and products for niche segments of the food, medical and consumer products markets;
 - *Hospital Supplies*, which manufactures and supplies a full range of customizable operating drape products, procedure packs, protection products and sterilization packaging for the health care industry; and
 - *Rigid Packaging*, which produces and resells plastic-based rigid films and thermoformed containers, primarily serving the food and foodservice sectors.

As discussed more fully in Note 1 to the unaudited financial statements, on October 13, 2005, Pregis acquired all of the outstanding shares of capital stock of Pactiv Corporation’s subsidiaries operating its global protective packaging and European specialty packaging businesses (the “Acquisition”). Therefore, the Company’s basis of accounting subsequent to the Acquisition differs from that prior to the Acquisition. Specifically, the substantial leverage put in place to fund the Acquisition has resulted in significantly higher interest expense, and the revaluation of the Company’s property, plant and equipment and identification of

intangible assets has resulted in higher depreciation and amortization expense than had been realized prior to the Acquisition.

RESULTS OF OPERATIONS

Three months ended March 31, 2006 compared to three months ended March 31, 2005

The following table illustrates the results of our operations for the three months ended March 31, 2006 and 2005 as a percentage of net sales:

| | <u>Successor</u> | | <u>Predecessor</u> |
|-------------------------------------|-------------------------------------|---|--------------------|
| | <u>Three Months Ended March 31,</u> | | |
| | <u>2006</u> | | <u>2005</u> |
| Net sales | 100.0 | % | 100.0 % |
| Operating costs and expenses: | | | |
| Cost of sales, excluding | | | |
| depreciation and amortization | 78.9 | | 80.4 |
| Gross margin | 21.1 | | 19.6 |
| Selling, general and administrative | 12.6 | | 13.1 |
| Depreciation and amortization | 5.3 | | 3.8 |
| Restructuring income | - | | (0.1) |
| Total operating costs and expenses | 96.8 | | 97.2 |
| Operating income | 3.2 | | 2.8 |
| Foreign exchange gain | (0.3) | | - |
| Gain on sale of securities | - | | (0.6) |
| Interest expense | 4.2 | | 0.4 |
| Interest income | - | | - |
| Income (loss) before income taxes | (0.7) | | 3.0 |
| Income tax expense | 0.1 | | 1.1 |
| Net income (loss) | (0.8) | % | 1.9 % |

Net Sales

Consolidated net sales for three months ended March 31, 2006 totaled \$239.0 million, representing growth of 9.1% compared to net sales of \$219.0 million in the comparable period of 2005. Excluding the unfavorable foreign currency impacts, due primarily to strengthening of the dollar in relation to the euro and British pound sterling, net sales would have increased by 15.3% in the 2006 period. The sales growth was driven by price increases (5.4%) implemented in response to increased raw material costs experienced in the second half of 2005, as well as volume improvement (9.9%). The volume improvement was attributable to customer growth, as well as increased resin resale volume, due to third party resin users seeking lower raw material costs.

Net Sales by Segment

| (dollars in millions) | <u>Successor</u> | | <u>Predecessor</u> | | <u>Change</u> | |
|-----------------------------|-------------------------------------|-----------------|--------------------|--------------|---------------|----------|
| | <u>Three Months Ended March 31,</u> | | | | <u>\$</u> | <u>%</u> |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | | |
| Net sales | | | | | | |
| Global Protective Packaging | \$ 158.0 | \$ 142.1 | \$ 15.9 | 11.2 % | | |
| Flexibles | 46.1 | 39.1 | 7.0 | 17.9 | | |
| Hospital Supplies | 16.2 | 16.2 | - | - | | |
| Rigid Packaging | 20.2 | 23.1 | (2.9) | (12.6) | | |
| Intersegment eliminations | (1.5) | (1.5) | - | - | | |
| | <u>\$ 239.0</u> | <u>\$ 219.0</u> | <u>\$ 20.0</u> | <u>9.1 %</u> | | |

Net sales of our protective packaging segment increased 11.2% for the three months ended March 31, 2006 compared to the same period of 2005. The improvement was driven by increased volume, as well as increased pricing implemented in response to escalating resin prices experienced in the latter half of 2005. The volume improvement was primarily generated by the European protective packaging businesses, including increased product volume and resin resale volume. Excluding the unfavorable foreign currency impact, the segment's net sales would have increased 15.3% in the 2006 period.

Net sales of our flexibles segment increased 17.9% for the three months ended March 31, 2006 compared to the same period of 2005. Increased volume, mainly due to additional resin resale volume, was the key factor in the sales growth, coupled with significant pricing improvement, which accounted for growth of approximately 11%. Excluding the unfavorable foreign currency impact, the segment's net sales would have increased 28.7% in the 2006 period.

Net sales of our hospital supplies segment for the three months ended March 31, 2006 were comparable to net sales for the same period of 2005. Excluding the unfavorable foreign currency impact, the segment's net sales would have increased 9.4% in the 2006 period. The growth was due to improved volume offset by competitive pricing reductions.

Net sales of our rigid packaging segment declined 12.6% for the three months ended March 31, 2006 compared to the same period of 2005, primarily due to reduced volume, as the segment lost a customer subsequent to the first quarter of 2005. Excluding the unfavorable foreign currency impact, the segment's net sales would have decreased only 5.8% in the 2006 period.

Gross Margin

Gross margin for the three months ended March 31, 2006 was \$50.4 million compared to \$43.0 million for the comparable period of 2005. Gross margin as a percent of net sales improved to 21.1% for the first three months of 2006, compared to 19.6% in the 2005 period. The increase was due primarily to improved margins, principally in the protective packaging and flexibles segments, which successfully implemented pricing increases in response to raw material cost increases experienced in the fourth quarter of 2005.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by \$1.3 million, or 4.5%, for the three months ended March 31, 2006 compared to the same period of 2005. The increase was primarily a result of costs

resulting from establishing a stand-alone infrastructure and other third-party costs as the Company transitions off of Pactiv's systems and infrastructure. Selling, general and administrative expenses of the reporting segments declined in the 2006 period, as the segments realized savings from cost reduction initiatives and reduced corporate overhead.

Depreciation and Amortization Expense

Depreciation and amortization expense increased \$4.3 million or 52.3% for the three months ended March 31, 2006 compared to the same period of 2005. The majority of the increase was due to the establishment of new fair values and useful lives of our tangible and intangible assets as a result of the Acquisition.

Operating Income

On a consolidated basis, our operating income increased \$1.6 million or 26.7% for the three months ended March 31, 2006 compared to the same period of 2005. The increase was driven by increased sales and improved gross margins, partially offset by higher selling, general and administrative and depreciation and amortization expenses, as noted above.

Operating Income by Segment

| (dollars in millions) | <u>Successor</u> | | <u>Predecessor</u> | | <u>Change</u> |
|--------------------------------|-------------------------------------|---------------|-------------------------------------|---------------|---------------|
| | <u>Three Months Ended March 31,</u> | | <u>Three Months Ended March 31,</u> | | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> | |
| Operating income (loss) | | | | | |
| Global Protective Packaging | \$ 6.9 | \$ 3.7 | \$ 6.9 | \$ 3.7 | \$ 3.2 |
| Flexibles | 3.4 | 0.7 | 3.4 | 0.7 | 2.7 |
| Hospital Supplies | 1.5 | 2.8 | 1.5 | 2.8 | (1.3) |
| Rigid Packaging | 0.2 | (1.2) | 0.2 | (1.2) | 1.4 |
| Unallocated expenses | (4.4) | - | (4.4) | - | (4.4) |
| | <u>\$ 7.6</u> | <u>\$ 6.0</u> | <u>\$ 7.6</u> | <u>\$ 6.0</u> | <u>\$ 1.6</u> |

Unallocated expenses for the three months ended March 31, 2006 represent the costs of support functions, including information technology, finance, human resources, legal and executive management. For the Predecessor period of 2005, similar costs were charged to the businesses by Pactiv or allocated to the businesses in connection with the preparation of stand-alone financial statements. However, such costs are not necessarily comparable to costs incurred by Pactiv operating as an independent entity.

The general increase in operating income was driven by volume and pricing improvements realized primarily in the global protective packaging segment and flexibles segment. Both the hospital supplies and rigid packaging segments continued to experience increased competition in their markets, which impacted both their pricing and volume for the period. However, in the three months ended March 31, 2006, the rigid packaging segment realized production efficiencies, which led to an increase in operating income of \$1.4 million, when compared to the 2005 period.

Other Non-Operating Expense (Income)

For the three months ended March 31, 2006, we generated an unrealized foreign exchange gain of approximately \$0.6 million, due to the revaluation of our euro-denominated third-party debt and

intercompany loans. The gain of \$0.1 million in the 2005 period was related to foreign exchange gains primarily generated by the strengthening of the Egyptian pound versus the euro. In the first quarter of 2005, our flexibles segment sold its shares in a German business, generating a gain of \$1.2 million.

As a result of the new debt structure put in place to the fund the Acquisition, our interest expense increased to \$10.0 million for the three months ended March 31, 2006 compared to \$0.8 million for the same period of 2005. Given our highly leveraged position, interest expense will continue to be significant in the future.

Income Tax Expense

Our effective tax rate for the three months ended March 31, 2006 was 16.7%. The rate varies from the U.S. federal statutory rate of 35% primarily due to foreign taxes provided at rates in excess of the 35% U.S. statutory rate, U.S. state and local income taxes, and the non-deductibility of losses generated by certain entities, thereby increasing the valuation allowance established against these losses.

Net Income (Loss)

Although net sales and gross margin improved, we generated a net loss of \$1.9 million in the three months ended March 31, 2006, compared to net income of \$4.1 million in the same period of 2005, primarily due to the increased depreciation and amortization and interest expense, as mentioned previously.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of liquidity are cash generated primarily from operating activities as well as from borrowings under our revolving credit facility. Prior to the Acquisition, the Company also obtained liquidity through borrowings from affiliates of Pactiv. Our principal uses of cash are operating expenses, capital expenditures and working capital needs and, since the Acquisition, debt service with respect to our senior secured credit facilities, senior secured notes and senior subordinated notes.

Operating Activities. For the three months ended March 31, 2006, cash used in operating activities was \$4.7 million, compared to cash provided by operating activities of \$10.6 million in the comparable period of 2005. During the 2006 period, we used cash to make interest payments of approximately \$7.4 million and to settle amounts due to Pactiv of approximately \$5.0 million, which had built up at year-end for payroll and other services provided by Pactiv in 2005. Additionally, December typically represents a low level of working capital investment for the Company, due to year-end factory shut-downs. Accordingly, we typically experience an increase in working capital through the first quarter as operations return to normal levels. Our working capital investment in the three months ended March 31, 2006 exceeded that in the comparable 2005 period, primarily due to the higher sales generated in the 2006 period.

Investing Activities. Cash used in investing activities was \$6.5 million for the three months ended March 31, 2006, which was comprised of capital spending of \$4.8 million, as well as a payment of \$1.8 million to Pactiv, representing additional purchase consideration per the terms of the Stock Purchase Agreement. Cash used in investing activities was \$7.4 million for the three months ended March 31, 2005, which was predominately due to investments in plant and equipment.

Financing Activities. Net cash used in financing activities totaled \$0.4 million for the three months ended March 31, 2006, which was mostly attributable to a net decrease in long-term debt borrowings. For the three months ended March 31, 2005, net cash used in financing activities totaled \$0.2 million, which

was mainly the net of cash contributions made by Pactiv to certain subsidiaries to enable them to settle affiliate borrowings.

Since the Acquisition, we have been highly leveraged. Our liquidity requirements are significant, primarily due to debt service requirements. Our primary source of liquidity will continue to be cash flows from operations, but we also have availability under a \$50 million revolving credit facility. At March 31, 2006, we had \$4.8 million in letters of credit issued under this facility; therefore, we had \$45.2 million of remaining availability. We had cash and cash equivalents of \$43.4 million at March 31, 2006.

The following discussion provides a description of our outstanding indebtedness at March 31, 2006:

Senior Secured Credit Facilities. In connection with the Acquisition on October 13, 2005, Pregis entered into senior secured credit facilities that provide for senior secured financing of up to approximately \$222.0 million, consisting of:

- A \$50.0 million revolving credit facility with a maturity of six years. The revolving credit facility is available in U.S. dollars, euros and/or pounds sterling.
- A \$88.0 million term loan B-1 facility with a maturity of seven years. The term loan B-1 facility is available in U.S. dollars and was drawn in full in connection with the consummation of the Acquisition.
- A 68 million euro (approximately \$84.0 million) term loan B-2 facility with a maturity of seven years. The term loan B-2 facility is available in Euros and was drawn in full in connection with the consummation of the Acquisition.

In addition, these senior secured credit facilities permit Pregis, subject to certain conditions including the receipt of commitments from lenders, to incur up to \$100.0 million (or a euro equivalent thereof) of additional term loans and to extend the maturity of Pregis's revolving credit facility. Proceeds of revolving loans and swingline loans may be used to provide financing for working capital and general corporate purposes.

The initial interest rate per annum applicable to the revolver under Pregis's senior secured credit facilities was equal to, at its option, an alternate base rate plus 1.00% per annum or LIBOR plus 2.00% per annum. Beginning in April 2006, the interest rates are adjusted in accordance with a pricing grid based on leverage ratios.

The term B-1 loan initial interest rate is equal to, at Pregis's option, an alternate base rate plus 1.25% per annum or LIBOR plus 2.25% per annum, and the term B-2 loan initial interest rate is EURIBOR plus 2.50% per annum.

In addition, Pregis pays the lenders 0.50% per annum on the unfunded commitments in respect of the revolving credit facility, payable quarterly in arrears and upon termination of the commitments. Beginning in April 2006, the facility fee is adjusted in accordance with a pricing grid based on leverage ratios.

The term loan B-1 facility matures at a rate of 1% per annum in equal quarterly installments during the first six years thereof, with the balance payable in equal quarterly installments during the seventh year thereof. The term loan B-2 facility matures at a rate of 1% per annum in equal quarterly installments during the first six years thereof, with the balance payable in equal quarterly installments during the seventh year thereof.

Subject to exceptions and, in the case of asset sale proceeds, reinvestment options, Pregis's senior secured credit facilities require mandatory prepayments of the loans from excess cash flows, asset sales and dispositions (including insurance and condemnation proceeds), issuances of debt and issuances of equity.

Pregis's senior secured credit facilities and related hedging arrangements are guaranteed by Pregis Holding II, the direct holding parent company of Pregis, and all of Pregis's current and future domestic subsidiaries and, if no material tax consequences would result, Pregis's future foreign subsidiaries and, subject to certain exceptions, are secured by a first priority security interest in substantially all of Pregis's and its current and future domestic subsidiaries' existing and future assets (subject to certain exceptions), and a first priority pledge of the capital stock of Pregis and the guarantor subsidiaries and an aggregate of 66% of the capital stock of Pregis's first-tier foreign subsidiary.

Pregis's senior secured credit facilities require that it comply on a quarterly basis with certain financial covenants, including a maximum leverage ratio and minimum cash interest coverage ratio. In addition, Pregis's senior secured credit facilities include negative covenants, subject to certain exceptions, that restrict or limit Pregis's ability and the ability of its subsidiaries to, among other things:

- incur, assume or permit to exist additional indebtedness, guaranty obligations or hedging arrangements,
- incur liens or agree to negative pledges in other agreements,
- engage in sale and leaseback transactions,
- make capital expenditures,
- make loans and investments,
- declare dividends, make payments or redeem or repurchase capital stock,
- in the case of subsidiaries, enter into agreements restricting dividends and distributions,
- engage in mergers, acquisitions and other business combinations,
- prepay, redeem or purchase certain indebtedness,
- amend or otherwise alter the terms of Pregis's organizational documents, Pregis's indebtedness and other material agreements,
- sell assets or engage in receivables securitization,
- transact with affiliates, and
- alter the business that Pregis conducts.

As of March 31, 2006, Pregis was in compliance with all covenants contained in its senior secured credit facilities.

In April 2006 the lenders under Pregis's senior secured credit facilities agreed to waive certain reporting covenants contained in the senior secured credit facilities. The waiver provided that Pregis must deliver its 2005 audited financial statements on or before May 31, 2006 and its unaudited financial results for the first quarter of 2006 within 50 days after the delivery of the 2005 audited financial statements. Pregis delivered its 2005 audited financial statements on May 31, 2006.

In May 2006 Pregis and the lenders under Pregis's senior secured credit facilities entered into a waiver and amendment to the senior secured credit facilities. The waiver provided that Pregis must deliver its unaudited financial results for the first quarter of 2006 on or before August 15, 2006, and its unaudited financial results for the second quarter of 2006 on or before September 30, 2006. In addition, the amendment increased the interest rate on the senior secured credit facilities by 0.25% during the following time periods: (1) from July 1, 2006 until the date financial statements for the first quarter of 2006 are delivered; and (2) from August 1, 2006 until the date financial results for the second quarter of 2006 are delivered. Pregis delivered its unaudited financial results for the first quarter of 2006 on August 15, 2006.

Senior Secured Floating Rate Notes and Senior Subordinated Notes. In connection with the Acquisition on October 13, 2005, Pregis issued €100.0 million aggregate principal amount of second priority senior secured floating rate notes due 2013 (the "senior secured notes") and \$150.0 million aggregate principal amount of 12³/₈% senior subordinated notes due 2013 (the "senior subordinated notes").

The senior secured notes mature on April 15, 2013. Interest accrues at a floating rate equal to EURIBOR plus 5.00% per year and is payable quarterly on January 15, April 15, July 15 and October 15 of each year, beginning on January 15, 2006. The senior secured notes are guaranteed on a senior secured basis by Pregis Holding II, Pregis's immediate parent, and each of Pregis's current and future domestic subsidiaries. Pregis may redeem some or all of the senior secured notes at any time prior to October 15, 2006 at a redemption price equal to par plus a make-whole premium. Pregis may redeem some or all of the notes on or after October 15, 2006 at redemption prices equal to 102% of their principal amount (in the 12 months beginning October 15, 2006), 101% of their principal amount (in the 12 months beginning October 15, 2007) and 100% of their principal amount (beginning October 15, 2008). Upon the occurrence of a change of control, Pregis will be required to make an offer to repurchase each holder's notes at a repurchase price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase.

The senior subordinated notes mature on October 15, 2013. Interest accrues at a rate of 12.375% and is payable semi-annually on April 15 and October 15 of each year, beginning on April 15, 2006. The notes are senior subordinated obligations and rank junior in right of payment to all of Pregis's senior indebtedness. The senior subordinated notes are guaranteed on a senior subordinated basis by Pregis Holding II and each of Pregis's current and future domestic subsidiaries. Pregis may redeem up to 35% of the senior subordinated notes at any time prior to October 15, 2008 with the net proceeds of certain equity offerings at a redemption price equal to 112.375% of their principal amount plus accrued interest. Pregis may redeem some or all of the senior subordinated notes at any time prior to October 15, 2009 at a redemption price equal to par plus a make-whole premium. Pregis may redeem some or all of the notes on or after October 15, 2009 at redemption prices equal to 106.188% of their principal amount (in the 12 months beginning October 15, 2009), 103.094% of their principal amount (in the 12 months beginning October 15, 2010) and 100% of their principal amount (beginning October 15, 2011).

The indentures governing the senior secured notes and the senior subordinated notes contain covenants that limit or prohibit Pregis's ability and the ability of its restricted subsidiaries, subject to certain exceptions, to incur additional indebtedness, pay dividends or make other equity distributions,

make investments, create liens, incur obligations that restrict the ability of Pregis's restricted subsidiaries to make dividends or other payments to Pregis, sell assets, engage in transactions with affiliates, create unrestricted subsidiaries, and merge or consolidate with other companies or sell substantially all of Pregis's assets. The indentures also contain reporting covenants regarding delivery of annual and quarterly financial information. The indenture governing the senior secured notes limits Pregis's ability to incur first priority secured debt to an amount which results in its secured debt leverage ratio being equal to 3:1, plus \$50 million, and prohibits it from incurring additional second priority secured debt other than by issuing additional senior secured notes. The indenture governing the senior secured notes also limits Pregis's ability to enter into sale and leaseback transactions. The indenture governing the senior subordinated notes prohibits Pregis from incurring debt that is senior to such notes and subordinate to any other debt. As of March 31, 2006, Pregis was in compliance with all covenants contained in the senior secured notes and senior subordinated notes. In August 2006, Pregis informed the trustee under the indentures that it could not deliver its quarterly financial statements for the second quarter of 2006 within the time periods required by the SEC rules.

In connection with issuing the notes, we entered into a registration rights agreement in which we agreed to file a registration statement which will permit us to offer to exchange the senior secured notes and the senior subordinated notes for new issues of identical debt securities registered under the Securities Act of 1933. We agreed to complete the exchange offer for the notes by July 9, 2006. We also agreed to provide a shelf registration statement to cover resales of the notes under certain circumstances. Given the delay in the completion of the audit of our 2005 financial statements, we have been unable to consummate the exchange offer by July 9, 2006. Therefore, since July 9, 2006, we have been paying penalty interest on the notes. Under the registration rights agreement, we are required to pay additional interest on the notes equal to 0.25% per year on the principal amount of notes for the first 90 days following any registration default, increasing by an additional 0.25% for each subsequent 90-day period, up to a maximum additional interest of 1.0% per year. Following the cure of all registration defaults, the accrual of additional interest will cease. We are using our best efforts to consummate the exchange offer and expect to do so as soon as practicable, subject to completion of the SEC's review.

The senior secured notes and senior subordinated notes are not listed on any national securities exchange in the United States. Application has been made to the Irish Stock Exchange for the outstanding senior secured notes to be admitted to the Official List and trading on its regulated market. However, there can be no assurance that the senior secured notes will become or remain listed.

Collateral for the Senior Secured Floating Rate Notes. The senior secured floating rate notes are secured by a second priority lien, subject to permitted liens, on all of the following assets owned by Pregis or the guarantors, to the extent such assets secure Pregis's senior secured credit facilities on a first priority basis (subject to certain exceptions):

- (1) substantially all of Pregis's and each guarantor's existing and future property and assets, including, without limitation, real estate, receivables, contracts, inventory, cash and cash accounts, equipment, documents, instruments, intellectual property, chattel paper, investment property, supporting obligations and general intangibles, with minor exceptions; and
- (2) all of the capital stock or other securities of Pregis's and each guarantor's existing or future direct or indirect domestic subsidiaries and 66% of the capital stock or other securities of Pregis's and each guarantor's existing or future direct foreign subsidiaries, but only to the extent that the inclusion of such capital stock or other securities will mean that the par value, book value as carried by us, or market value (whichever is greatest) of such capital stock or other securities of any subsidiary is not equal to or greater than 20% of the aggregate principal amount of the senior secured floating rate notes outstanding.

As of December 31, 2005, the capital stock of the following subsidiaries of Pregis constitute collateral for the senior secured floating rate notes:

| Name of Subsidiary | As of December 31, 2005 | | |
|--|---|--------------------------------|----------------------------------|
| | Amount of Collateral (Maximum of Book Value and Market Value) | Book Value of Capital Stock | Market Value of Capital Stock |
| Pregis (Luxembourg) Holding S.à.r.l. (66%) | \$23,700,000 | \$40,643,000 | \$40,789,000 |
| Pregis Innovative Packaging Inc. | \$23,700,000 | \$36,172,000 | \$37,900,000 |
| Hexacomb Corporation | \$8,500,000 | \$8,438,000 | \$8,500,000 |
| Pregis Management Corporation | \$100 | \$100 | \$100 |

As described above, under the collateral agreement, the capital stock pledged to the senior secured floating rate noteholders constitutes collateral only to the extent that the par value or market value or book value of the capital stock does not exceed 20% of the aggregate principal amount of the senior secured floating rate notes. This threshold is €20,000,000, or, at the December 31, 2005 exchange rate of euros to U.S. dollars of 0.8440, approximately \$23.7 million. As of December 31, 2005, the book value and the market value of the shares of capital stock of Pregis Innovative Packaging Inc. were approximately \$36.2 million and \$37.9 million, respectively, and the book value and the market value of 66% of the shares of capital stock of Pregis (Luxembourg) Holding S.à.r.l. were approximately \$40.6 million and \$40.8 million, respectively. Therefore, in accordance with the collateral agreement, the collateral pool for the senior secured floating rate notes includes approximately \$23.7 million with respect to the shares of capital stock of each of Pregis Innovative Packaging Inc. and Pregis (Luxembourg) Holding S.à.r.l. Since the book value and market value of the shares of capital stock of Pregis's other two domestic subsidiaries are less than the \$23.7 million threshold, they are not effected by the 20% clause of the collateral agreement.

The value of the collateral for the senior secured floating rate notes at any time will depend on market and other economic conditions, including the availability of suitable buyers for the collateral. As of December 31, 2005, the book value of the collateral for the senior secured floating rate notes totaled approximately \$532.4 million. The value of the collateral has not changed materially as of March 31, 2006.

Covenant Ratios contained in the Senior Secured Floating Rate Notes and Senior Subordinated Notes. The indentures governing the senior secured floating rate notes and senior subordinated notes contain two material covenants which utilize financial ratios. Non-compliance with these covenants could result in an event of default under the indentures and, under certain circumstances, a requirement to immediately repay all amounts outstanding under the notes and could trigger a cross-default under Pregis's senior secured credit facilities or other indebtedness we may incur in the future. First, Pregis is permitted to incur indebtedness under the indentures if the ratio of Consolidated Cash Flow to Fixed Charges on a pro forma basis (referred to in the indentures as the "Fixed Charge Coverage Ratio") is greater than 2:1 or, if the ratio is less, only if the indebtedness falls into specified debt baskets, including, for example, a credit agreement debt basket, an existing debt basket, a capital lease and purchase money debt basket, an intercompany debt basket, a permitted guarantee debt basket, a hedging debt basket, a receivables transaction debt basket and a general debt basket. In addition, under the senior secured floating rate notes indenture, Pregis is permitted to incur first priority secured debt only if the ratio of Secured Indebtedness to Consolidated Cash Flow on a pro forma basis (referred to in the senior secured floating rate notes indenture as the "Secured Indebtedness Leverage Ratio") is equal to or less than 3:1, plus \$50 million. Second, the restricted payment covenant provides that Pregis may declare certain

dividends, or repurchase equity securities, in certain circumstances only if Pregis's Fixed Charge Coverage Ratio is greater than 2:1.

As used in the calculation of the Fixed Charge Coverage Ratio and the Secured Indebtedness Leverage Ratio, Consolidated Cash Flow, commonly referred to as Adjusted EBITDA, is calculated by adding Consolidated Net Income, income taxes, interest expense, depreciation and amortization and other non-cash expenses, amounts paid pursuant to the management agreement with AEA Investors LLC, and the amount of any restructuring charge or reserve (including, without limitation, retention, severance, excess pension costs, contract termination costs and cost to consolidate facilities and relocate employees). In calculating the ratios, Consolidated Cash Flow is further adjusted by giving pro forma effect to acquisitions and dispositions that occurred in the prior four quarters, including certain cost savings and synergies expected to be obtained in the succeeding twelve months. In addition, the term Net Income is adjusted to exclude any gain or loss from the disposition of securities, and the term Consolidated Net Income is adjusted to exclude, among other things, the non-cash impact attributable to the application of the purchase method of accounting in accordance with GAAP and the cumulative effect of a change in accounting principles. While the determination of appropriate adjustments is subject to interpretation and requires judgment, we believe the adjustments listed below are in accordance with the covenants discussed above. The credit agreement governing our senior secured credit facilities calculates Adjusted EBITDA (referred to therein as "Consolidated EBITDA") in a similar manner.

The following table sets forth the Fixed Charge Coverage Ratio, Consolidated Cash Flow ("Adjusted EBITDA"), Fixed Charges, Secured Indebtedness Leverage Ratio and Secured Indebtedness as of and for the twelve months ended March 31, 2006:

| (unaudited) (dollars in thousands) | <u>Covenant Measure</u> | <u>Calculated at March 31, 2006</u> |
|---|-----------------------------|---|
| Fixed Charge Coverage Ratio (after giving pro forma effect to the Transactions) | Minimum of 2.0x | 2.3x |
| Secured Indebtedness Leverage Ratio | Maximum of 3.0x | 2.0x |
| Consolidated Cash Flow ("Adjusted EBITDA") | — | \$ 86,043 |
| Fixed Charges (after giving pro forma effect to the Transactions) | — | \$ 38,136 |
| Secured Indebtedness | — | \$ 169,827 |

Adjusted EBITDA is calculated under the indentures governing our senior secured floating rate notes and senior subordinated notes for the twelve months ended March 31, 2006 (represented by the combined Predecessor and Successor periods), as follows:

| (unaudited) (dollars in thousands) | Twelve months ended March 31, 2006 |
|---|---|
| Net loss of Pregis Corporation | \$ (17,731) |
| Interest expense, net | 21,561 |
| Income tax benefit | (2,152) |
| Depreciation and amortization | 40,481 |
| Goodwill impairment | 35,654 |
| EBITDA | <u>77,813</u> |
| Other non-cash charges (income): (1) | |
| Impact attributable to application of purchase accounting | 4,787 |
| Non-cash restructuring income | (156) |
| Non-cash stock based compensation expense | 49 |
| Unrealized foreign currency transaction losses, net | 61 |
| Net unusual or nonrecurring gains or losses: (2) | |
| Gain on sale of securities and other | 268 |
| Realized gain on foreign exchange forward contract | (5,441) |
| Executive management severance and recruiting expenses | 1,452 |
| Nonrecurring charges related to acquisitions and dispositions | 2,391 |
| Other adjustments: (3) | |
| Amounts paid pursuant to management agreement with Sponsor | 782 |
| Pro forma cost savings (4) | <u>4,037</u> |
| Adjusted EBITDA (“Consolidated Cash Flow”) | <u>\$ 86,043</u> |

- (1) Other non-cash charges (income) included as adjustments per our indenture covenants include (a) \$4.8 million of non-cash expense recorded to cost of sales in the twelve-month period due to the step-up of inventory under purchase accounting, (b) the credit for the net reversal of the remaining restructuring accrual which had been estimated for the 2004 restructuring program, (c) non-cash compensation expense arising from the grant of Company options, and (c) net unrealized foreign exchange currency transaction gains and losses.
- (2) As provided by our indentures, we took adjustments for unusual gains relating to the gain realized on the 2005 sale of our shares in Duales Systems Deutschland, a German recycling company, as well as the gain realized on the foreign exchange forward contract which settled favorably upon commencement of the Acquisition. Adjustment has also been made for severance expenses related to the separation of former executive management, as well as recruiting costs to locate the CEO and CFO replacements, as these were deemed to be nonrecurring in nature. The indentures also allow for adjustment of costs and expenses related to acquisition and disposition transactions.
- (3) Our indentures also require us to make adjustments for fees paid under the management agreement with AEA Investors LLC.
- (4) Our indentures also permit adjustments to net income on a pro forma basis for certain cost savings that we expect to achieve with respect to acquisitions or dispositions. Therefore, for the twelve month period presented, we have reflected pro forma cost savings of approximately \$1.3 million from fully funding two U.K. pension plans in connection with the Acquisition, as well as approximately \$2.7 million of incremental savings from operating on a stand-alone basis. In the Predecessor period of fiscal 2005, Pactiv charged us for legal, finance, human resources and other similar costs incurred to directly support our business operations. The pro forma adjustments

represent management's best estimate of the savings achievable in providing these support services on a stand-alone basis, as well as elimination of estimated intra-company gains and losses on historical intra-company sales with other Pactiv divisions. This activity is being conducted on an arm's length basis since the Acquisition. There can be no assurance that we will be able to achieve these pension or stand-alone savings.

Use of Non-GAAP Measures. EBITDA is defined as net income before interest expense (net of interest income), income tax expense, depreciation and amortization, and goodwill impairment. Adjusted EBITDA is defined as EBITDA adjusted to exclude the items described above. As mentioned previously, we have presented Adjusted EBITDA because it is a component in material covenants within our indentures (referred to therein as "Consolidated Cash Flow"). Also, we believe that EBITDA and Adjusted EBITDA are frequently used by securities analysts, investors and other interested parties in the evaluation of companies within our industry. We also believe that issuers of high yield securities present these figures because investors, analysts and rating agencies consider them useful in measuring the ability of issuers to meet debt service obligations. However, EBITDA and Adjusted EBITDA are not defined terms under GAAP and should not be considered as alternatives to operating income or net income as a measure of operating results or as an alternative to cash flows as a measure of liquidity.

Long-term Liquidity. Our primary future cash needs will consist of debt service and capital expenditures. We incur capital expenditures for the purpose of maintaining and replacing existing equipment and facilities, and from time to time, for facility expansion. We anticipate that the funds generated by our operations, as well as funds available under Pregis's senior secured credit facilities, will be sufficient to meet working capital requirements and to finance capital expenditures over the next twelve months. There can be no assurance, however, that our business will generate sufficient cash flow from operations, that anticipated net sales growth and operating improvements will be realized or that future borrowings will be available under Pregis's senior secured credit facilities in an amount sufficient to enable us to service our indebtedness or to fund our other liquidity needs. Our ability to meet our debt service obligations and other capital requirements, including capital expenditures, will depend upon our future performance which, in turn, will be subject to general economic, financial, business, competitive, legislative, regulatory and other conditions, many of which are beyond our control. Some other risks that could materially adversely affect our ability to meet our debt service obligations include, but are not limited to, risks related to increases in the cost of resin, our ability to protect our intellectual property, rising interest rates, a decline in the overall U.S. and European economies, weakening of our end markets, the loss of key personnel, our ability to continue to invest in equipment, and a decline in relations with our key distributors and dealers. In addition, any of the other items discussed in the "Risk Factors," included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 may also significantly impact our liquidity.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing its consolidated financial statements, the Company follows accounting principles generally accepted in the United States of America. The application of these principles requires significant judgments or an estimation process that can affect the results of operations, financial position and cash flows of the Company, as well as the related footnote disclosures. The Company continually reviews its accounting policies and financial information disclosures. There have been no material changes in policies or estimates since December 31, 2005, with the exception of the adoption of SFAS 123R, which did not have a significant impact on the Company's operating results.

Item 2. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company's exposures to market risk since December 31, 2005.

Item 3. Controls and Procedures

The registrant maintains disclosure controls and procedures, as defined in Rule 13a-15 under the Securities Exchange Act of 1934, as amended, that are intended to ensure that information required to be disclosed in the registrant's reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that the registrant's employees accumulate this information and communicate it to the registrant's management, including its Chief Executive Officer (its principal executive officer) and its Chief Financial Officer (its principal financial officer), as appropriate, to allow timely decisions regarding the required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily must apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by paragraph (b) of Rule 13a-15 under the Exchange Act, our management, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2005. Based on this evaluation, which included consideration of the material weaknesses described below, our management, including our Chief Executive Officer and our Chief Financial Officer, concluded that as of December 31, 2005, the Company's disclosure controls and procedures were not effective. In its reevaluation of the Company's disclosure controls and procedures as of March 31, 2006, the Chief Executive Officer and Chief Financial Officer noted certain incremental improvements. However, the Company has not yet completed its remediation of the material weaknesses noted.

In light of these material weaknesses, we performed additional analyses and other post-closing procedures to ensure that the consolidated and combined financial statements included within this Quarterly Report fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods presented.

As mentioned above, our evaluation of disclosure controls and procedures as of December 31, 2005 resulted in the identification of material weaknesses in our internal controls over financial reporting. The material weaknesses identified were as follows:

- We did not maintain effective controls over the preparation, review and presentation of financial information prepared in accordance with U.S. generally accepted accounting principles. Specifically, effective controls were not designed and in place to adequately prepare and review the consolidated and combined financial information. This control deficiency could result in misstatement in a number of our financial statement accounts, resulting in a material misstatement to our interim or annual financial statements that would not be prevented or detected.
- We did not maintain effective internal controls over the completeness and accuracy of the accounting for income taxes. Specifically, effective controls were not designed and in place to adequately review the tax provisions of all of the Company's subsidiaries, which resulted in adjustments to certain tax-related accounts. This weakness could result in a material misstatement of our current or deferred tax

balances or our tax expense accounts within our interim or annual financial statements that would not be prevented or detected.

Additionally, our evaluation of disclosure controls and procedures as of March 31, 2006 resulted in the identification of an additional material weakness in our internal controls, whereby certain account reconciliations were not effectively prepared in a timely manner. This weakness could result in misstatement in a number of our financial statement accounts, resulting in a material misstatement to our interim or annual financial statements that would not be prevented or detected.

We continue to believe these deficiencies were in part a result of insufficient staffing of our accounting and finance department. We believe we lacked sufficient depth of accounting knowledge, experience and training within certain of our businesses and our corporate accounting function, commensurate with the financial reporting requirements brought about by the Acquisition. Additionally, we believe we lacked sufficient knowledge and visibility to certain financial information prepared in the Predecessor period.

During the period covered by this report, the Company has taken steps to improve its control activities and procedures and continues to take further steps with regard to these matters. Specifically, we have recently hired additional accounting and finance staff with appropriate experience and technical knowledge, but continue to try to fill certain finance related positions. Additionally, we have engaged consultants to assist in formulating and documenting accounting processes, policies and procedures to adequately perform the income tax accounting and corporate consolidation processes.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are party to various lawsuits, legal proceedings and administrative actions arising out of the normal course of our business. While it is not possible to predict the outcome of any of these lawsuits, proceedings and actions, management, based on its assessment of the facts and circumstances now known, does not believe that any of these lawsuits, proceedings and actions, individually or in the aggregate, will have a material adverse effect on our financial position. However, actual outcomes may be different than expected and could have a material effect on our results of operations or cash flows in a particular period.

Item 1A. Risk Factors

There have been no material changes to the risk factors that were included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PREGIS HOLDING II CORPORATION

Date: September 5, 2006

By: /s/ Timothy J. Cunningham
Timothy J. Cunningham
Chief Financial Officer (principal financial
officer and principal accounting officer)
From May 1, 2006 to present

By: /s/ Kevin J. Corcoran
Kevin J. Corcoran
Chief Financial Officer (principal financial
officer and principal accounting officer)
From October 12, 2005 to April 30, 2006