

RR Donnelley & Sons Co
Form 10-Q
July 30, 2014

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 June 30, 2014

OR

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

Commission File Number 1-4694

R.R. DONNELLEY & SONS COMPANY

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-1004130
(I.R.S. Employer
Identification No.)

111 South Wacker Drive,
Chicago, Illinois
(Address of principal executive offices)

60606
(Zip code)

(312) 326-8000

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer

Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 25, 2014, 199.8 million shares of common stock were outstanding.

R.R. DONNELLEY & SONS COMPANY

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

(UNAUDITED)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	\$288.9	\$1,028.4
Receivables, less allowances for doubtful accounts of \$45.4 in 2014 (2013 - \$44.8)	2,083.3	1,832.3
Inventories (Note 3)	586.4	501.2
Prepaid expenses and other current assets	244.3	199.7
Total current assets	3,202.9	3,561.6
Property, plant and equipment-net (Note 4)	1,650.0	1,430.1
Goodwill (Note 5)	1,736.6	1,436.3
Other intangible assets-net (Note 5)	481.4	315.9
Deferred income taxes	86.7	118.8
Other noncurrent assets	389.3	375.5
Total assets	\$7,546.9	\$7,238.2
LIABILITIES		
Accounts payable	\$1,124.5	\$1,143.0
Accrued liabilities	817.5	814.8
Short-term and current portion of long-term debt (Note 14)	406.4	270.9
Total current liabilities	2,348.4	2,228.7
Long-term debt (Note 14)	3,428.9	3,587.0
Pension liabilities	198.8	245.2
Other postretirement benefits plan liabilities	179.0	174.1
Other noncurrent liabilities	477.0	349.5
Total liabilities	6,632.1	6,584.5
Commitments and Contingencies (Note 13)		
EQUITY (Note 9)		
RR Donnelley shareholders' equity		
Preferred stock, \$1.00 par value		
Authorized: 2.0 shares; Issued: None	—	—
Common stock, \$1.25 par value		
Authorized: 500.0 shares;		
Issued: 259.0 shares in 2014 (2013 - 243.0 shares)	323.7	303.7
Additional paid-in-capital	3,032.8	2,802.4
Accumulated deficit	(536.9)	(473.4)

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Accumulated other comprehensive loss	(485.8)	(488.1)
Treasury stock, at cost, 59.2 shares in 2014 (2013 - 61.2 shares)	(1,439.4)	(1,512.8)
Total RR Donnelley shareholders' equity	894.4	631.8
Noncontrolling interests	20.4	21.9
Total equity	914.8	653.7
Total liabilities and equity	\$7,546.9	\$7,238.2

(See Notes to Condensed Consolidated Financial Statements)

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

(UNAUDITED)

	Three Months		Six Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
Products net sales	\$2,440.7	\$2,135.0	\$4,666.4	\$4,264.7
Services net sales	461.8	436.6	909.9	845.4
Total net sales	2,902.5	2,571.6	5,576.3	5,110.1
Products cost of sales (exclusive of depreciation and amortization)	1,882.8	1,641.7	3,628.7	3,310.0
Services cost of sales (exclusive of depreciation and amortization)	357.5	331.7	712.2	643.6
Total cost of sales	2,240.3	1,973.4	4,340.9	3,953.6
Products gross profit	557.9	493.3	1,037.7	954.7
Services gross profit	104.3	104.9	197.7	201.8
Total gross profit	662.2	598.2	1,235.4	1,156.5
Selling, general and administrative expenses (exclusive of depreciation and amortization)	339.3	294.2	655.8	576.4
Restructuring, impairment and other charges-net (Note 6)	22.8	19.8	68.0	42.5
Depreciation and amortization	121.9	111.0	237.4	224.6
Income from operations	178.2	173.2	274.2	313.0
Interest expense-net	70.8	65.5	141.8	128.3
Investment and other expense-net	2.3	6.0	6.9	9.5
Loss on debt extinguishment	—	—	77.1	35.6
Earnings before income taxes	105.1	101.7	48.4	139.6
Income tax expense	39.5	35.2	16.0	47.8
Net earnings	65.6	66.5	32.4	91.8
Less: Income (loss) attributable to noncontrolling interests	0.9	1.1	(3.3)	(0.7)
Net earnings attributable to RR Donnelley common shareholders	\$64.7	\$65.4	\$35.7	\$92.5
Net earnings per share attributable to RR Donnelley common shareholders (Note 10):				
Basic net earnings per share	\$0.32	\$0.36	\$0.18	\$0.51
Diluted net earnings per share	\$0.32	\$0.36	\$0.18	\$0.51
Dividends declared per common share	\$0.26	\$0.26	\$0.52	\$0.52
Weighted average number of common shares outstanding:				
Basic	200.2	182.0	196.7	181.6
Diluted	201.4	183.2	198.2	183.1

(See Notes to Condensed Consolidated Financial Statements)

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net earnings	\$65.6	\$66.5	\$32.4	\$91.8
Other comprehensive income (loss), net of tax (Note 11):				
Translation adjustments	8.7	(25.8)	(0.3)	(18.7)
Adjustment for net periodic pension and other postretirement benefits plan cost	1.4	4.8	2.3	3.9
Change in fair value of derivatives	0.1	—	0.1	0.1
Other comprehensive income (loss)	10.2	(21.0)	2.1	(14.7)
Comprehensive income	75.8	45.5	34.5	77.1
Less: comprehensive income (loss) attributable to noncontrolling interests	0.8	1.2	(3.5)	(0.6)
Comprehensive income attributable to RR Donnelley common shareholders	\$75.0	\$44.3	\$38.0	\$77.7

(See Notes to Condensed Consolidated Financial Statements)

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(UNAUDITED)

	Six Months Ended June 30,	
	2014	2013
OPERATING ACTIVITIES		
Net earnings	\$32.4	\$91.8
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Impairment charges	9.7	7.8
Depreciation and amortization	237.4	224.6
Provision for doubtful accounts receivable	7.7	4.7
Share-based compensation	9.9	11.1
Deferred income taxes	(10.7)	(11.3)
Changes in uncertain tax positions	(1.5)	4.3
Loss (gain) on investments and other assets – net	(1.3)	3.3
Loss related to Venezuela currency remeasurement – net	18.6	3.2
Loss on debt extinguishment	77.1	35.6
Net pension and other postretirement benefits plan income	(23.6)	(9.3)
Gain on bargain purchase	(10.5)	—
Other	21.4	14.1
Changes in operating assets and liabilities - net of acquisitions:		
Accounts receivable - net	(37.7)	45.6
Inventories	2.6	12.7
Prepaid expenses and other current assets	(19.2)	(6.1)
Accounts payable	(130.9)	(236.9)
Income taxes payable and receivable	(12.5)	(9.4)
Accrued liabilities and other	(71.7)	(113.2)
Pension and other postretirement benefits plan contributions	(27.5)	(14.7)
Net cash provided by operating activities	69.7	57.9
INVESTING ACTIVITIES		
Capital expenditures	(106.3)	(84.3)
Acquisitions of businesses, net of cash acquired	(376.2)	0.3
Disposition of business	2.3	—
Proceeds from sale of investments and other assets	9.6	2.2
Other investing activities	(1.1)	3.2
Net cash used in investing activities	(471.7)	(78.6)
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	400.0	447.8
Net change in short-term debt	3.4	2.4
Payments of current maturities and long-term debt	(811.0)	(386.8)
Net proceeds from credit facility borrowings	193.0	—
Debt issuance costs	(7.2)	(8.2)
Dividends paid	(99.2)	(94.0)

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Other financing activities	(0.8)	(6.1)
Net cash used in financing activities	(321.8)	(44.9)
Effect of exchange rate on cash and cash equivalents	(15.7)	(10.7)
Net decrease in cash and cash equivalents	(739.5)	(76.3)
Cash and cash equivalents at beginning of year	1,028.4	430.7
Cash and cash equivalents at end of period	\$288.9	\$354.4

Supplemental non-cash disclosure:

Issuances of 17.0 million shares of RR Donnelley stock for acquisitions of businesses	\$319.0	\$—
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(See Notes to Condensed Consolidated Financial Statements)

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(in millions, except per share data, unless otherwise indicated)

1. Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements include the accounts of R.R. Donnelley & Sons Company and its subsidiaries (the “Company” or “RR Donnelley”) and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These unaudited condensed consolidated interim financial statements reflect all normal and recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim periods and should be read in conjunction with the consolidated financial statements and the related notes thereto included in the Company’s latest Annual Report on Form 10-K and Form 10-K/A for the year ended December 31, 2013 filed with the SEC on February 26, 2014 and February 27, 2014, respectively. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2014. All significant intercompany transactions have been eliminated in consolidation. These unaudited condensed consolidated interim financial statements include estimates and assumptions of management that affect the amounts reported in the condensed consolidated financial statements. Actual results could differ from these estimates.

2. Acquisitions and Dispositions

On March 25, 2014, the Company acquired substantially all of the North American operations of Esselte Corporation (“Esselte”), a developer and manufacturer of nationally branded and private label office and stationery products. The acquisition, combined with the Company’s existing products, created a more competitive and efficient office products supplier capable of supplying enhanced offerings across the combined customer base. The purchase price for Esselte included \$78.2 million in cash, 1.0 million shares of RR Donnelley common stock and a \$2.8 million payable related to the settlement of net working capital, or a total transaction value of \$99.3 million based on the Company’s closing share price on March 24, 2014. Esselte’s operations are included in the Variable Print segment.

On March 10, 2014, the Company acquired the assets of MultiCorpora R&D Inc. and MultiCorpora International Inc. (together “MultiCorpora”) for approximately \$6.1 million. MultiCorpora is an international provider of translation technology solutions. The acquisition of MultiCorpora expanded the capabilities of the Company’s translation services offering which supports clients’ multi-lingual communications. MultiCorpora’s operations are included in the Strategic Services segment.

On January 31, 2014, the Company acquired Consolidated Graphics, Inc. (“Consolidated Graphics”), a provider of digital and commercial printing, fulfillment services, print management and proprietary Internet-based technology solutions, with operations in North America, Europe and Asia. The acquisition enhanced the Company’s ability to provide integrated communications solutions for its customers. The purchase price for Consolidated Graphics was \$359.9 million in cash and 16.0 million shares of RR Donnelley common stock, or a total transaction value of \$660.6 million based on the Company’s closing share price on January 30, 2014, plus the assumption of Consolidated Graphics’ debt of \$118.4 million. Immediately following the acquisition, the Company repaid substantially all of the

debt assumed. Consolidated Graphics' operations are primarily included in the Variable Print segment. In the second quarter of 2014, Consolidated Graphics' operations in the Czech Republic and Japan were moved from the Variable Print segment to the Europe and Asia reporting units, respectively, within the International segment to reflect corresponding changes in the management reporting structure of the organization.

On February 7, 2014, the Company sold the assets and liabilities of Office Tiger Global Real Estate Service Inc. ("GRES"), its commercial and residential real estate advisory services, for net proceeds of \$2.3 million and a loss of \$0.7 million, which was recognized in net investment and other expense in the Consolidated Statements of Operations. The operations of the GRES business were included in the International segment.

For the three and six months ended June 30, 2014, the Company recorded \$0.5 million and \$8.2 million of acquisition-related expenses, respectively, associated with acquisitions completed or contemplated, within selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

The Esselte, MultiCorpora and Consolidated Graphics acquisitions were recorded by allocating the cost of the acquisitions to the assets acquired, including other intangible assets, based on their estimated fair values at the applicable acquisition date. The excess of the cost of the acquisitions over the net amounts assigned to the fair value of the assets acquired was recorded as goodwill. The goodwill associated with these acquisitions is primarily attributable to the synergies expected to arise as a result of the acquisitions.

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(in millions, except per share data, unless otherwise indicated)

For Esselte, the fair value of the identifiable net assets acquired of approximately \$109.8 million exceeded the purchase price of \$99.3 million, resulting in a bargain purchase gain of \$10.5 million for the six months ended June 30, 2014, which was recorded in net investment and other expense. A \$6.1 million reduction in this gain, primarily due to a change in estimate of certain tax attributes and working capital adjustments, was recognized as a loss during the three months ended June 30, 2014 as a result of finalizing the purchase price allocation. The gain on the bargain purchase was primarily attributable to the Company’s ability to utilize certain tax operating losses.

The tax deductible goodwill related to the Consolidated Graphics, Esselte and MultiCorpora acquisitions was \$74.1 million.

Based on the valuations, the final purchase price allocations for these acquisitions were as follows:

Accounts receivable	\$241.4
Inventories	89.6
Prepaid expenses and other current assets	16.3
Property, plant and equipment	335.0
Other intangible assets	204.9
Other noncurrent assets	11.9
Goodwill	300.2
Accounts payable and accrued liabilities	(217.4)
Other noncurrent liabilities	(57.5)
Deferred taxes-net	(97.5)
Total purchase price-net of cash acquired	826.9
Less: debt assumed	118.4
Less: value of common stock issued	319.0
Less: gain on bargain purchase	10.5
Less: amount due for net working capital settlement	2.8
Net cash paid	\$376.2

The fair values of other intangible assets, technology and goodwill associated with the acquisitions of Esselte, MultiCorpora and Consolidated Graphics were determined to be Level 3 under the fair value hierarchy. The following table presents the fair value, valuation techniques and related unobservable inputs for these Level 3 measurements:

	Fair Value	Valuation Technique	Unobservable Input	Range
Customer relationships	\$178.1	Excess earnings	Discount rate	

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		Attrition rate	17.0%
			-
			21.0%
			5.0% -
			9.5%
Trade names	26.5	Relief-from-royalty method	19.0%
		Discount rate	0.5% -
		Royalty rate (after-tax)	1.5%
Technology	1.1	Excess earnings	Discount rate 17.0%

The fair values of property, plant and equipment associated with the Consolidated Graphics, Esselte, and MultiCorpora acquisitions were determined to be Level 3 under the fair value hierarchy. Property, plant and equipment values were estimated using either the cost or market approach, if a secondhand market existed.

2013 Disposition

During the fourth quarter of 2013, the Company sold the assets and liabilities of R.R. Donnelley SAS (“MRM France”), its direct mail business located in Cosne sur Loire, France, for a loss of \$17.9 million, which was recognized in net investment and other expense in the Consolidated Statements of Operations. The loss included cash incentive payments due to the purchaser of \$18.8 million, of which \$12.0 million was paid as of June 30, 2014 with the remaining balance to be paid by January 2015. The operations of the MRM France business were included in the International segment.

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(in millions, except per share data, unless otherwise indicated)

For the three and six months ended June 30, 2013, the Company recorded \$0.1 million and \$1.1 million of acquisition-related expenses, respectively, associated with acquisitions contemplated within selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

Pro forma results

The following unaudited pro forma financial information for the three and six months ended June 30, 2014 and 2013 presents the combined results of operations of the Company and the 2014 acquisitions described above, as if the acquisitions had occurred at January 1, 2013.

The unaudited pro forma financial information is not intended to represent or be indicative of the Company’s consolidated results of operations or financial condition that would have been reported had these acquisitions been completed as of the beginning of the periods presented and should not be taken as indicative of the Company’s future consolidated results of operations or financial condition. Pro forma adjustments are tax-effected at the applicable statutory tax rates.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net sales	\$2,902.5	\$2,887.8	\$5,729.1	\$5,746.4
Net earnings attributable to RR Donnelley common shareholders	76.5	57.9	58.8	66.6
Net earnings per share attributable to RR Donnelley common shareholders:				
Basic	\$0.38	\$0.29	\$0.29	\$0.34
Diluted	\$0.38	\$0.29	\$0.29	\$0.33

The unaudited pro forma financial information includes amortization of purchased intangibles of \$20.4 million and \$40.9 million for the three and six months ended June 30, 2014, respectively and \$21.3 million and \$42.8 million for the three and six months ended June 30, 2013, respectively. The unaudited pro forma financial information includes restructuring, impairment and other charges from operations of \$17.8 million and \$47.9 million for the three and six months ended June 30, 2014, respectively and \$25.8 million and \$64.8 million for the three and six months ended June 30, 2013, respectively.

Additionally, the pro forma adjustments affecting net earnings attributable to RR Donnelley common shareholders for the three and six months ended June 30, 2014 and 2013 were as follows:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Depreciation and amortization of purchased assets, pre-tax	\$1.8	\$(2.6)	\$1.6	\$(4.5)
Acquisition-related expenses, pre-tax	0.3	0.1	18.9	(16.5)
Restructuring, impairment and other charges, pre-tax	5.0	(5.0)	22.1	(21.2)
Inventory fair value adjustments, pre-tax	2.2	—	14.3	(14.3)
Other pro forma adjustments, pre-tax	6.1	(8.5)	(4.5)	1.4
Income taxes	(3.5)	(0.5)	(13.7)	17.9

R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES (“RR DONNELLEY”)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(in millions, except per share data, unless otherwise indicated)

3. Inventories

The components of the Company’s inventories, net of excess and obsolescence reserves for raw materials and finished goods, at June 30, 2014 and December 31, 2013 were as follows:

	June 30, 2014	December 31, 2013
Raw materials and manufacturing supplies	\$270.7	\$ 212.6
Work in process	183.2	145.2
Finished goods	224.8	235.4
LIFO reserve	(92.3)	(92.0)
Total	\$586.4	\$ 501.2

4. Property, Plant and Equipment

The components of the Company’s property, plant and equipment at June 30, 2014 and December 31, 2013 were as follows:

	June 30, 2014	December 31, 2013
Land	\$119.3	\$94.3
Buildings	1,238.7	1,160.6
Machinery and equipment	6,255.0	6,024.0
	7,613.0	7,278.9
Accumulated depreciation	(5,963.0)	(5,848.8)
Total	\$1,650.0	\$1,430.1

During the three and six months ended June 30, 2014, depreciation expense was \$91.4 million and \$179.3 million, respectively. During the three and six months ended June 30, 2013 depreciation expense was \$86.4 million and \$174.9 million, respectively.

Assets Held for Sale

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Primarily as a result of restructuring actions, certain facilities and equipment are considered held for sale. The net book value of assets held for sale was \$20.9 million and \$18.5 million at June 30, 2014 and December 31, 2013, respectively. These assets were included in other current assets in the Condensed Consolidated Balance Sheets at June 30, 2014 and December 31, 2013 at the lower of their historical net book value or their estimated fair value, less estimated costs to sell.

5. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill by segment for the six months ended June 30, 2014 were as follows:

	Publishing and Retail Services	Variable Print	Strategic Services	International	Total
Net book value as of December 31, 2013					
Goodwill	\$ 688.0	\$ 1,638.6	\$ 1,005.4	\$ 1,275.9	\$ 4,607.9
Accumulated impairment losses	(669.9)	(1,105.2)	(243.5)	(1,153.0)	(3,171.6)
Total	18.1	533.4	761.9	122.9	1,436.3
Acquisitions	—	276.2	3.5	20.5	300.2
Foreign exchange and other adjustments	—	0.6	0.2	(0.7)	0.1
Net book value at June 30, 2014					
Goodwill	688.0	1,915.4	1,009.8	1,309.0	4,922.2
Accumulated impairment losses	(669.9)	(1,105.2)			